Evolving Standards on Stabilization:

New norms, practical insights and emerging risks

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IGF INTERGOVERNMENTAL FORUM on Mining, Minerals, Metals and Sustainable Development

Secretariat hosted by IISD

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Speakers

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Introduction

Speaker: Alexandra Readhead

Stabilization clauses – what are we talking about….

What are they?

A provision in a contract between a company and a government, or in the domestic law of the host state, where the government commits not to change all or some of the law applicable to the company for a set period of time.

Why are they used?

Investors:

- Reduce risk
- Enhance bankability
- Rent seeking / opportunism

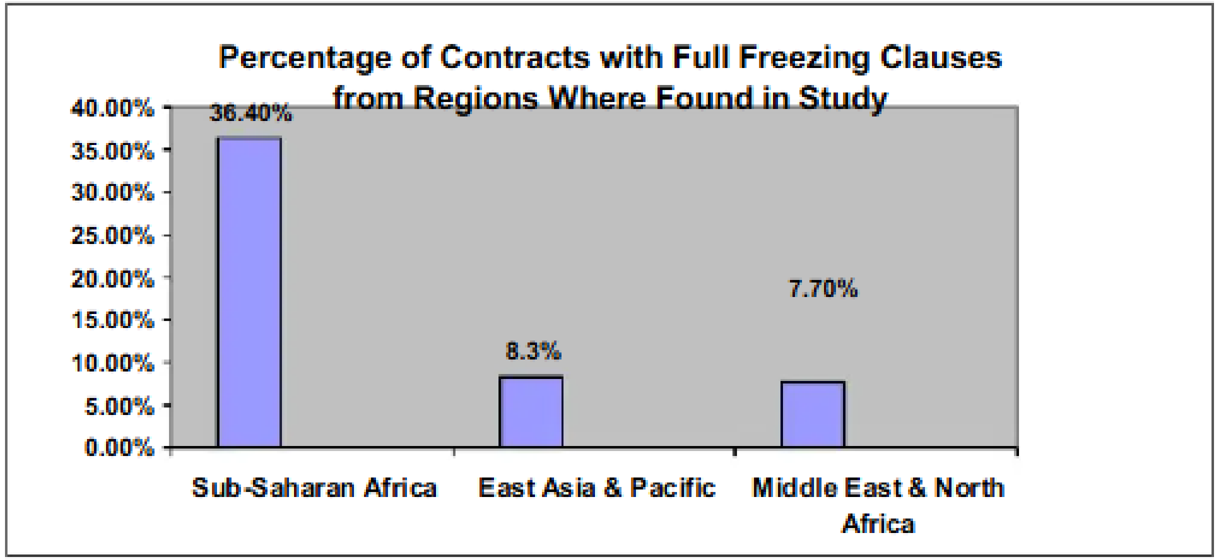
Governments

- Attract foreign direct investment (FDI)
- Demand from industry / info asymmetry

….and why does it matter?

Developing countries – most in need of legal advances – are disproportionately affected

Figure 6.2: Percentage of Contracts with Full Freezing Clauses, by Region*



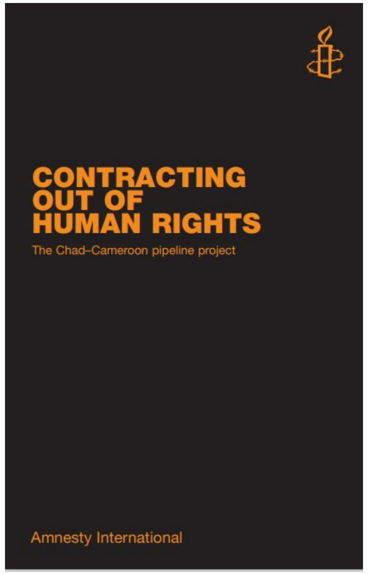
*No full freezing clauses for South Asia; Eastern Europe, Southern Europe and Central Asia or OECD countries.
Source: *Author.*

Source: IFC study (2009)

Tanzania slaps Acacia Mining with $190b tax bill

TUESDAY, JULY 25, 2017 — UPDATED ON JULY 28, 2020 • 2 min read

President John Pombe Magufuli has been on his crusade that mining companies that have been working in Tanzania have been ripping off the country, mainly by under-declaring the true worth of what they take out of the country. PHOTO | FILE



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Rio Tinto offers $472m to settle Mongolian mine tax dispute

Against this background of controversy, a new standard on stabilization emerges

Historical approaches:

Scope	Freezing	Economic Equilibrium	None
Fiscal	✓	✓	✓
Non-fiscal	✓	✓	✓

OECD Guiding Principles – a **new normative framework:**

Scope	Freezing	Economic Equilibrium	None	Revenue certainty
Fiscal	✗	✓ but limited	✓	✓
Non-fiscal	✗	✗	✓	N/A

From Principles to Practice: Implementing the *OECD Guiding Principles VII and VIII*

Speaker: Howard Mann


IGF INTERGOVERNMENTAL FORUM on Mining, Minerals, Metals and Sustainable Development

Evolving Standards on Stabilization

A practical guide to the Organisation for Economic Co-operation and Development's Guiding Principles on Durable Extractive Contracts, Principles VII and VIII

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IGF's Guidance on Stabilization

- **We track** the evolution of global norms and standards on stabilization clauses
- **We break down** OECD Guiding Principles VII and VIII on non-fiscal and fiscal stabilization
- **We provide model legal language** to implement the principles in <u>domestic law</u> and <u>contracts</u>

Foundational Principle

An investment contract between an investor and host state should be consistent with and comply with the domestic law of the host state and applicable international laws

- ✓ The contract should not take legal precedence over domestic law
- ✓ Investors should not seek exemptions or alterations from domestic law that are not permitted in the law (as per OECD Guidelines for Multinational Enterprises)
- ✓ Domestic laws should be clear and transparent on what exemptions or alterations the government can negotiate

Non-fiscal Stabilization

OECD Principle VII		IGF Suggested Provision
There should be no stabilization of non-fiscal laws & regulations.	→	Drafting Principle 1: The Government shall **not agree to any provisions** in any contract or other form of agreement **that limits the application of any applicable law or regulation in force from time to time**, including any laws, regulations, or treaties **relating to non-fiscal matters**, or any amendment, addition, or new judicial interpretation of any applicable law in force from time to time.

Non-Fiscal Stabilization – treatment of costs

OECD Principle VII	IGF Suggested Provision
For investors, all costs of compliance with changes in laws should be deductible as operational expenses, not capital costs.	Drafting Principle 2: Costs incurred by an investor that are attributable to compliance with changes to non-fiscal laws and are exclusively related to the project's operations, shall be **treated as deductible operational costs** in the year they are incurred for purposes of tax deductibility and cost recovery in production-sharing contracts.

Non-fiscal Stabilization – safe harbour

OECD Principle VII	**IGF Suggested Provision**
New laws and regulations must be bona fide, non-discriminatory and non-arbitrary. Laws that implement treaties, international standards or best practices are presumed to be safe. Changes in non-fiscal laws should not be directly or indirectly expropriatory.	Drafting Principle 3: (a) Safe harbour clause: The Government shall not adopt measures that are arbitrary or discriminatory against the Company. **Without prejudice to other measures designed to pursue legitimate public interest objectives**, bona fide non-fiscal changes in law that are consistent with relevant internationally recognised standards and best practices shall not be regarded as arbitrary or discriminatory**.**

Fiscal Stabilization

OECD Principle VIII: **Rejects presumption that investors require fiscal stabilization in all cases or that governments should provide it in all cases**

- ✓ **However**, recognizes that in some cases there may be a commercial need for fiscal stabilization
- ✓ In such cases, stabilization, if given by the government, should be tailored to the **commercial needs.**

Highlighted IGF Suggested Provisions

OECD Principle VIII	IGF Suggested Provision
Fiscal stabilization should be based on proof of commercial need.	Drafting Principle 4: The terms of fiscal stabilization shall be based on **sufficient information demonstrating commercial and investment-related need** by the Company*, **consistent with criteria set out in this law** **~** Step 1: Investor provides information Step 2,3: Government reviews & assesses costs v benefits Step 4,5: Decision is made and published

Highlighted IGF Suggested Provisions

OECD Principle VIII	IGF Suggested Provision
General obligation to be truthful.	<u>Drafting Principle 5:</u> The validity of the terms of fiscal stabilization **depends on accurate information about the project and its financing**, which the Company should freely disclose to the government, and **should remain confidential** between the Investor and the involved government officials.

Fiscal Stabilization

OECD Principle VIII: When given, stabilization should be:

Tailored in scope, not comprehensive to all taxes for full period

- Types of taxes: E.g., Royalties, profit taxes, withholding taxes, capital gains
- Duration: E.g., External financing period, anticipated project cost recovery period, fixed date from beginning of commercial production

Highlighted IGF Suggested Provisions

OECD Principle VIII	IGF Suggested Provision
Fiscal stabilisation provisions can be limited in scope: international tax treaties are a special case.	Drafting Principle 1: Any **international tax treaties** that are included in whole or in part within the permitted exceptions to fiscal laws expressly set out in this law may be stabilized **on the condition that they remain in force as between the treaty parties during the stabilized period**. Notwithstanding the above, any amendment to an international tax treaty shall be applied by the Government and Company, as amended and in force from time to time.

Highlighted IGF Suggested Provisions

OECD Principle VIII	IGF Suggested Provision
The terms of the fiscal stabilization cannot be transferred, extended, or renewed.	Drafting Principle 6: The terms of the fiscal stabilization are specific to the project and the Company and **cannot be transferred, extended, or renewed**, unless otherwise provided in this law, and subject to government approval, and during the original stabilization period and for its duration.

Fiscal Stabilization

OECD Principle VIII: Other side of the coin: Revenue Certainty for Governments

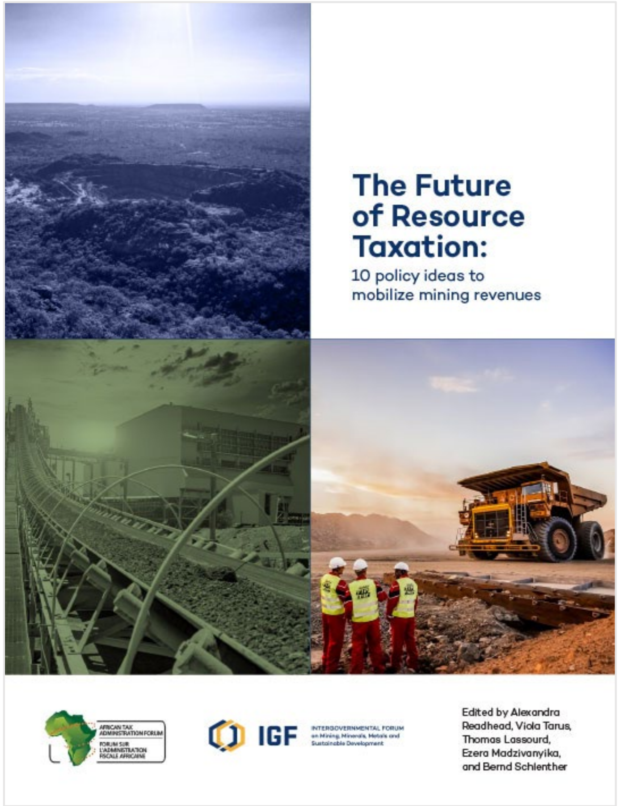
- ✓ Recognizes obligation on investors to pay their taxes owed, and rights of government to enforce the tax laws
- ✓ Governments retain the right to respond to structural or operational changes made by the investor that create tax avoidance or tax evasion by investor
- ✓ Exclusion from stabilization
- ✓ Limited here to internationally recognized tax practices

Highlighted IGF Suggested Provisions

OECD Principle VIII	IGF Suggested Provision
The company is obligated to pay all taxes.	Drafting Principle 7: Where the Company has **altered its structure or operations** or otherwise **taken steps to materially reduce its tax liabilities** through tax avoidance, base erosion, or profit shifting practices, the **Government retains the right**, notwithstanding any provisions above, **to protect the revenue base against such Company actions by implementing changes to its laws or tax administration policies** and practices, providing such changes are consistent with internationally recognized tax practices.

Implementing our Approach

- ✓ Review all legal sources of stabilisation for consistency
- ✓ Assess commercial need for fiscal stabilization
  - Role of project modelling
  - Obligation of investor to provide actual true projections
- ✓ Consider alternatives: flexible, responsive fiscal regimes
- ✓ Accessible, systematic consultation mechanism
- ✓ Ensure transparency



Discussion

THANK YOU

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