**Human Rights-Compatible International Investment Agreements**

*Virtual Consultation for Asia and the Pacific, 14 June 2021*

**Submission on Stabilization Clauses, developing countries and Human Rights**

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21 June 2021

**Summary**

In addition to investor protections in international investment agreements (IIAs), broad legal rights may be granted to foreign investors through ‘stabilization clauses’ in investment project contracts with host states. The clauses may enable foreign investors to claim compensation, through international arbitration (ISDS), from host states for the effects of new human rights measures. The Virtual Consultation should extend its inquiry to cover these clauses, as reformed IIAs will not protect human rights and related policy space adequately where project contracts continue to contain these clauses.

**About stabilization clauses**

Stabilization clauses are intended to protect the stability (profitability) of long-term, capital-intensive, foreign investments against subsequent, non-commercial changes to the investment environment.[[2]](#footnote-2) Developing countries may agree to stabilization clauses in project contracts with foreign investors in the belief that the clauses encourage inward foreign investment (for which claim there is no sound evidence) or because they have little effective choice, given that some lenders and political risk insurers have insisted upon their presence for projects in developing countries.

While earlier stabilization clauses involving developing host states addressed the risk of nationalization, later clauses ‘have evolved into diverse and sophisticated tools to manage non-commercial risk associated with the investment project.’[[3]](#footnote-3) Stability might be incorporated into the conditions of a foreign investment project through an IIA, a stand-alone stability agreement, a special treaty or legislation but is most commonly incorporated through a stabilization clause in the private project contract between a foreign investor and a host state.[[4]](#footnote-4) Through the clauses, a host state gives a foreign investor what is essentially a guarantee relating to regulatory or fiscal changes which would adversely affect the profitability of all or part of the investment.

Stabilization clauses have been broken down into three types: freezing clauses (which may be full or limited in their scope); economic equilibrium clauses (which also may be full or limited); and clauses which are hybrids of these two types. Freezing clauses are the most restrictive type of stabilization clause for host states, rendering new laws inapplicable to an investment. They aim to *freeze* the law of the host state at the time the contract is entered in to, potentially including human rights or related law, with respect to the foreign investment project. The least restrictive for host states of the types of stabilisation clause are limited economic equilibrium clauses. It is important to note that broadly framed change-in-law stabilization clauses may be expressed to include not only changes made through legislative measures but also those made through executive action (regulations) and judicial decisions,[[5]](#footnote-5) changes in host state policy and changes brought about by the host state’s entering a new international treaty.

Importantly, ‘umbrella clauses’ exist in many IIAs and have been interpreted to give investors the right to take a claimed violation of a stabilization clause in a project contract to ISDS arbitration, as though the clause were a term of the IIA itself.[[6]](#footnote-6)

**Stabilization clauses and human rights**

In 2009, a research project was conducted by Andrea Shemburg for the International Finance Corporation and the United Nations Special Representative of the Secretary-General on Business and Human Rights. The project was to examine whether stabilization clauses may affect a host state’s action to implement its international human rights obligations.[[7]](#footnote-7) Shemberg explains in the Abstract that the study,

examined whether stabilization clauses can limit the application of new social and environmental regulations to investment activities over the life of the investment, or to obtain compensation from host states for the costs of compliance with such new laws. This study used social and environmental laws (such as nondiscrimination, health and safety, labor and employment rights, and the protection of the environment and cultural heritage) as a surrogate for human rights obligations, because [these laws] are some of the more easily identifiable legislative areas that can both protect rights and impact investors.

The Shemberg study, together with a study in Africa by Frank (both discussed below), provides concrete evidence that stabilization clauses with non-OECD and African host states have been drafted in ways which may insulate foreign investors from having to implement new environmental and social laws or may provide foreign investors with the rights and avenues for claiming compensation for compliance with such laws.

**The scope and extent of stabilization clauses**

Not enough is known about the extent and scope of stabilization clauses, largely because the terms of project contracts are typically confidential and arbitrations of disputes between host states and foreign investors are not ordinarily fully reported. However, two recent studies have shed important light on the subject.

The Shemberg study analysed stabilization clauses in 76 contracts and 12 contract models across a number of industries and most regions.[[8]](#footnote-8) The study differentiated between project contracts with OECD and non-OECD host states, rather than between developed and developing states. Shemberg found that stabilization clauses in project contracts (and other sources) with non-OECD host states were common. She also found that the more broadly framed and onerous types of stabilization clause were included far more frequently and widely with non-OECD than with OECD states, although the sample included only a small number of contracts and models with OECD host states (13 of the 88).

Shemberg reports that practitioners interviewed during the study expressed the view that modern investment project contracts generally do not contain freezing clauses, yet her research demonstrates that, on the contrary, they are still very much in use. Equally significantly, the study found that even where the least restrictive of the types of stabilisation clause used with non-OECD host states, their terms were more burdensome than for project contracts involving OECD hosts states.[[9]](#footnote-9)

The more recent study by Frank, investigating stabilization clauses in project contracts with African host states, confirmed that ‘full freezing clauses and full economic equilibrium clauses constitute the bulk of the stabilization clauses currently in use’ in Africa and that ‘the stringent nature of these full stabilization clauses gives investors extensive bargaining powers’.[[10]](#footnote-10) However, Frank also found a remarkable lack of uniformity among stabilization clauses in Africa and that some African states have been pushing back strongly. For example, the more resource-rich African states have been pressing for ‘double edged’ stabilization clauses, in which a change in law which improves the financial position of an investor will trigger an adjustment to the contract in favour of the host state.[[11]](#footnote-11)

Taken together, the Shemberg and Frank studies provide concrete evidence that stabilization clauses are indeed present in current investment project contracts with developing country host states and that the stabilization clauses included in project contracts with non-OECD and African countries tend to be of the more restrictive and more onerous type for host states.

**The legal effects of stabilization clauses**

Stabilization clauses may take investor protection far beyond the level available ordinarily under investment treaties. Investor protections in investment treaties are typically framed in relatively broad terms which at least allow for conflicting purposes (investors’ interests and the public interest) to be reconciled, even if arbitral tribunals have been inconsistent in their approaches to this. Stabilization clauses are more specific in their terms and more restrictive of host states, and may even enjoy the legal status of exceptions to the general presumption of the state’s right to regulate in a non-discriminatory manner for a public purpose.[[12]](#footnote-12) Traditionally, tribunals have accepted the legal validity and effects of stabilization clauses, and later tribunals have not disturbed this.[[13]](#footnote-13)

As mentioned earlier, many investment agreements contain umbrella clauses. Allowing access to the ISDS procedure to address violation of a stabilization clause in a project contract reinforces its legal value.[[14]](#footnote-14) However, there is considerable diversity in the interpretation by arbitral tribunals of umbrella clauses and in the wording of the clauses,[[15]](#footnote-15) but this does not prevent the risk of enforcement of a stabilization clause having a powerfully deterring effect on a host state considering human rights measures. The deterrent effect will be magnified by the size of compensation awards which have been made by some tribunals or claimed by investors threatening to initiate ISDS proceedings.

**Suggested steps to protect human rights policy space**

Some steps have been suggested for reducing the risk that stabilization clauses will act to prevent, or throw a ‘regulatory chill’ over, stronger human rights measures in developing countries. One focuses on ISDS and on developing explicit provisions for forthcoming multilateral, regional and plurilateral treaties to address the regulatory chill thrown by ISDS, including over human rights action. Another is for states to terminate their bilateral investment treaties which contain ISDS provisions.[[16]](#footnote-16) There are precedents for developing countries making this change, including by South Africa, Bolivia, India and Indonesia. The particular benefit of this change is that it would have the effect of removing ISDS as an avenue not only for claims under investment agreements but also for claims under stabilization clauses in relevant project contracts.[[17]](#footnote-17) ClientEarth recommends that a multilateral mechanism be developed through UNCITRAL to allow for a coordinated withdrawal from investment agreements or, at least, from consent to ISDS.[[18]](#footnote-18)

A further step, which directly addresses the problem of historical stabilization clauses, is for developing country host states to seek to renegotiate the terms of their project contracts with foreign investors. The renegotiation could perhaps be undertaken on a regional basis, for strength in numbers.

In the meantime, more information needs to be gathered about the ISDS risks posed by stabilization clauses in project contracts (or in other instruments), particularly for human rights in developing country host states. Despite the valuable information from the two studies mentioned, the full extent, nature and scope of stabilization clauses applying to host developing countries are simply not known at present. Gathering the necessary information will require greater transparency by host states as to the terms on which they have agreed to such projects.

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2. S Frank, ‘Stabilization clauses in long-term investment contracts in the energy sector in Africa’ in K Miles (ed), Research Handbook on Environment and Investment Law (Edward Elgar 2019) 351. [↑](#footnote-ref-2)
3. L Cotula, ‘Reconciling Regulatory Stability and Evolution of Environmental Standards in Investment Contracts: Towards a Rethink of Stabilization Clauses’ (2008) 1(2) Journal of World Energy Law and Business 160. [↑](#footnote-ref-3)
4. Ibid. [↑](#footnote-ref-4)
5. See, for example, *Duke Energy International Peru Investments No. 1 v. Peru*, ICSID Case No. ARB/03/28, 25 Jul. 2008. [↑](#footnote-ref-5)
6. UN Committee on Trade and Development (UNCTAD), ‘Mapping of IIA Clauses’, Figure 10 (Investment Policy Hub) <https://investmentpolicy.unctad.org/pages/1031/mapping-of-iia-clauses>. Note that umbrella clauses occur less commonly in ‘new generation’ investment agreements. [↑](#footnote-ref-6)
7. A Shemberg, Stabilization Clauses and Human Rights: A Research Project Conducted for the IFC and the United Nations Special Representative of the Secretary-General on Business and Human Rights (United Nations Office of the High Commissioner for Human Rights, 2008). [↑](#footnote-ref-7)
8. Ibid., 5. [↑](#footnote-ref-8)
9. Note that the non-OECD countries referred to in the Shemberg study may not all have been low- or middle-income developing countries. [↑](#footnote-ref-9)
10. Frank, note 2, 356. [↑](#footnote-ref-10)
11. Ibid 362. [↑](#footnote-ref-11)
12. See *Methanex v. United States of America*. [↑](#footnote-ref-12)
13. Cotula, note 3, 160, 162-163. [↑](#footnote-ref-13)
14. See *El Paso Energy International Company v. The Argentine Republic*, ICSID Case No. ARB/03/15, 27 Apr. 2006; *CMS Gas v. Argentina*, especially para 302. Treaty status will only be conferred where the wording of the umbrella clause is sufficiently specific. [↑](#footnote-ref-14)
15. Some clauses, for example, require a particular kind or level of impact on an investment to trigger their operation. [↑](#footnote-ref-15)
16. UNCTAD, UNCTAD’s Reform Package for the International Investment Regime (UNCTAD, 2018) 27. UNCTAD notes that ‘African countries are actively engaged in IIA reform at the regional level through parallel negotiations of, and amendments to, various “new generation” international investment instruments. These include, among others, the Pan-African Investment Code, Phase II of the Tripartite FTA between the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC) and the Southern African Development Community (SADC), the Continental Free Trade Area, the COMESA Common Investment Area and the SADC Finance and Investment Protocol’: 27. [↑](#footnote-ref-16)
17. However, ‘survival clauses’ in investment agreements may keep investor protections in place for many years following termination. See, for example, the India-Netherlands BIT 1995, terminated by India in 2016 but with protections for existing investors nevertheless continuing until 2031: *Agreement between the Republic of India and the Kingdom of the Netherlands for the promotion and protection of investments 1995*, Article 16(1). [↑](#footnote-ref-17)
18. ClientEarth, Potential Solutions for Phase 3: Aligning the Objectives of UNCITRAL Working Group III with States’ International Obligations to Combat Climate Change, Submission to UNCITRAL Working Group III, 2019 6. [↑](#footnote-ref-18)