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Stabilization and the Impact of Changing Patterns of Energy Investment

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More than a decade of investor-state tension in which states sought to rebalance arrangements with international investors in the light of rising commodity prices is now a matter of history in the energy industry[2]. Some of the disputes that resulted from that fractious period continue in arbitration or litigation proceedings, and plenty of new disputes have emerged since, but those that had their roots in actions by states seeking what they saw as a *fairer* deal with investors benefiting from high rents are increasingly rare on the time-lagged landscape of investment disputes.

During this period the interplay between investors and states took on at least one new feature that continues to play a role in the very different investment context of today. What we might call a *diversification* of both investors and states became evident, with an influx of new states aspiring to market their wares to international energy investors, especially in oil and gas. Their novelty lies not in their statehood but rather as new entrants in the competition for investment capital characteristic of states with actual or prospective reserves of petroleum. Many have rapidly evolving economies after a period of prolonged conflict, meaning that guarantees offered are particularly vulnerable to a review in the near to medium term. Indeed, a number of them have been willing to commence that process of review even before production of the resource has commenced.

At the same time, the kind of offer held out by such states has been particularly attractive to a new kind of energy investor: either private equity investors on the one hand, or small, exploration-focussed companies on the other, neither being likely to be motivated by the decades-long view of an investment typically associated with an IOC. For them, stability guarantees are no less important but they serve a different purpose, and are linked to an exit strategy in the foreseeable future. This combination of players – new market entrants - and their rather unconventionally short-term approaches to the stability of long term contractual arrangements have raised questions about the adequacy of traditional

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[2] Parts of this paper have been presented variously at the AIPN International Petroleum Summit, Houston, May 2017 and the Volterra Fietta Energy Lecture Series, London, June 2017. I am grateful to the participants at these events for the comments I received and for the invitations to address these gatherings.

guarantees of contract stability. Yet it has attracted little attention in the writings on energy disputes. In this paper, I want to revisit this twin feature of recent and current energy investment and consider its significance for the notion of stabilisation in long-term petroleum contracts[3].

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In its first two issues, the *Journal of World Energy Law and Business* published several articles on investment protection in the context of efforts by states to change contract terms, focussing on the role of stabilisation clauses[4]. Much of this early discussion reviewed both the existing arbitral awards and scholarly debate from an earlier period for a contemporary audience, noting the different kinds of stabilisation clause that were commonly used and how tribunals had or might interpret them. At roughly the same time, the AIPN commissioned and published two research reports on this subject[5]. Both of them noted the expansion of investment treaties and particularly the doctrine of Fair and Equitable Treatment and the notion of legitimate circumstances. Would this generation of investment treaty protections lend support to contract stability? The salience of this burst of scholarly activity and research lay in rather dramatic circumstances: a resurgence of state demands for renegotiation and adaptation from a striking diversity of states, a phenomenon sometimes characterised at the time as 'resource nationalism'.

Implicit in much of this writing there was a sense that energy investment had changed in important ways since the last wave of scholarly interest in contract stability in the 1990s. Most obviously, there was a shift from the 'petroleum-centric' character of energy investment that was evident in the seminal arbitral awards of the 1980s. Energy investment had to take into account the large-scale investment in other forms of energy such as wind and solar power. That trend continues robustly today. Whether the shift has had significant implications for the development of legal doctrine is not yet clear, and awaits further jurisprudential development. *As an indicator of change, it may also miss the point*. The

[3] The paper does not attempt to engage with the general debates about the merits or otherwise of stabilisation mechanisms in relation to state sovereignty, or to produce another classification of types of clause in long-term energy agreements. Literature on this subject continued to grow during this period: for example, …

[4] The articles by Piero Bernardini, Stabilization and Adaptation in Oil and Gas Investments 1(1) JWELB (2008) 98 and Lorenzo Cotula, Reconciling Regulatory Stability and Evolution of Environmental Standards in Investment Contracts: Towards a Rethink of Stabilization Clauses 1(2) JWELB (2008), are examples of this. Note too, F Alexander, Comment on Articles by Piero Bernardini, Loenzo Cotula and AFM Maniruzzaman, 2(3) JWELB (2009) 243-258. At roughly the same time, other articles and monographs appearing on this subject included: Abdullah Al Faruque, Renegotiation and Adaptation of Petroleum Contracts: The Quest for Equilibrium and Stability, 9(2) Journal of World Investment and Trade (2008) 113; Peter Cameron, International Energy Investment Law (OUP, New York, 2010); Mustafa Erkan, International Energy Investment Law: Stability Through Contractual Clauses (Kluwer Law International, Alphen aan den Rijn, 2011), Charles Leben, The Advancement of International Law (Portland, Hart, 2010), and United Nations/International Finance Corporation (the Ruggie Report), Stabilization Clauses and Human Rights (2008): http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p_StabilizationClausesandHumanRights/$FILE/Stabilization + Paper.pdf.

[5] P Cameron, Stabilisation in Investment Contracts and Change of Rules by Host Countries: Tools for Oil & Gas Investors", (2006); M Maniruzzaman, The Pursuit of Stability in Energy Investment Contracts: A Critical Appraisal of the Emerging Trends (2009). Both are available on the AIPN website: www.aipn.org.

patterns of energy investment have also changed over this period though the arrival of a significant number of new players both as investors and as states, leading to greater diversity among the key players. More explicitly, there was a sense of anticipation that some of the familiar forms of contract stability – particularly the so-called renegotiation or balancing form of contract clause - were likely to be subjected to scrutiny by arbitral tribunals, rendering fresh insights into their legal character.

On the investor side, the new players were not new in absolute terms but rather in their numbers and profile. They came in the form of 'first movers', small exploration-focussed companies that have a large appetite for risk, and are typically keen to monetise success at an early stage, and private equity vehicles that also tend to have a time-horizon that is much shorter than that of the traditional internationally operating oil and gas company. Their business model has implications for the kind of time-frame and basic assumptions usually associated with petroleum agreements. For example, the timing of a potential income stream for an oil company under a production sharing contract is post-production through cost oil and profit oil. At this time, the host state will benefit through its combination of royalty, tax and production oil. However, these new investors may envisage an exit *before* production and indeed development, even in the event of – and because of - a commercial exploration success.

The former group – the 'first movers' - have always played an important role in opening up new areas of oil and gas activity around the world. However, during the period of the long boom they came into their own as a highly visible class of investor, unfamiliar but particularly welcome for many of the newer governments entering the sector with prospective but unproven resources to offer. Ten years on, in a very different investment climate, such investors have been joined by private equity investors to become important drivers of energy investment. This is evident in the North Sea as it matures as a petroleum province, as well as in West Africa, and other areas[6]. It has long been a feature of the North American domestic market.

Just as apparent, ten years ago, was the mushrooming of states that had policies of investment promotion directed at the international oil and gas industry[7]. Generally, those policies included the offer of long-term contract stability. Some indication of the scale of this expansion can be gleaned from the various reports produced over the last decade by

[6] Privately held companies including ones backed by private equity have become more prominent in the mergers and acquisitions market since the oil price collapse but they were already growing in importance prior to this as the IOCs cut back on acquisitions (putting value over volume; retrenching to North America; focussing on tight oil) and NOCs slowed down their overseas expansion, particularly among Chinese companies. In terms of upstream M&A deals privately owned companies increased their share from 11% in 2012 to 26% in 2017 (Wood Mackenzie statistics supplied to author)..

[7] According to one source, at the high point of the commodity price boom, there were 81 countries with economies dependent on oil, gas and mining and almost 80 per cent of them had below global average levels of per capita income: McKinsey Global Institute (2013), Reverse the Curse: Maximizing the potential of resource-driven economies, McKinsey & Company. 'Resource-driven countries' are defined in this study as those economies where the oil, gas and mineral sectors play a dominant role, using three criteria: (1) resources account for more than 20 per cent of exports; (2) resources generate more than 20 per cent of fiscal revenue; or (3) resource rents are more than 10 per cent of economic output.

the International Monetary Fund's Fiscal Affairs Department[8]. Following requests from governments for assistance in building up this economic sector[9], there was a step-change in the number of country missions by IMF specialist staff to give advice to governments on the fiscal policies most likely to attract international investment in what was increasingly referred to as the extractives sector (oil, gas and mining)[10].

On the crest of a wave of high prices and an apparently limitless appetite for risk by investors, a new generation of states joined or made it known they wished to join the club of petroleum and mineral producers[11]. These new arrivals had different and diverse origins: some states emerged from armed conflicts and were hungry for reconstruction and growth; others had shaken off political ideologies that constrained policy choices and stifled initiative. Compared to their predecessors, the *prospective resource-rich states*, as the IMF called them, were more open, pluralistic and confident societies. At least 35 per cent of them were low-income or lower-middle income countries[12]. Many of them were in Africa.

It is this feature of the energy investment landscape – on the one hand, a group of states seeking foreign investment for the first time and on the other, international investors with shorter-term horizons than the typical IOC – that spurs this article's reflections on stabilisation. At the same time, a customary caveat needs to be entered. For an analysis of how legal doctrine is evolving, stabilisation remains an elusive topic since only a few new awards touch upon it[13], while others that are known – by this author for example - to have

[8] For example: Fiscal regimes for Extractive Industries—Design and Implementation: http://www.imf.org/external/np/pp/eng/2012/081512.pdf; Macroeconomic Policy Frameworks for Resource-Rich Developing Countries: http://www.imf.org/external/np/pp/eng/2012/082412.pdf; Macroeconomic Policy Frameworks for Resource-Rich Developing Countries--Background Paper 1: http://www.imf.org/external/np/pp/eng/2012/082412a.pdf ; Macroeconomic Policy Frameworks for Resource-Rich Developing Countries--Analytic Frameworks and Applications: http://www.imf.org/external/np/pp/eng/2012/082412b.pdf; also, reflecting on this period in a constructive vein is 'The Commodities Roller Coaster: A Fiscal Framework for Uncertain Times, IMF Fiscal Monitor, October 2015: http://www.elibrary.imf.org/view/IMF089/22829-9781513570709/22829-9781513570709/22829-9781513570709.xml?redirect=true.

[9] No less than one third of the membership of the International Monetary Fund (IMF) comprises 'resource-rich' countries, dependent on EI revenues for their future prosperity (IMF (2012), 'Fiscal Regimes for Extractive Industries: Design and Implementation, Washington D.C., p.6).

[10] For a comprehensive review of the legal, regulatory and contractual issues arising in this sector, from a development perspective, see Peter Cameron and Michael Stanley (2017), Oil, Gas and Mining: A Sourcebook for the Extractive Sector, World Bank, Washington DC.

[11] The IMF listed among 'prospective natural resource-exporting developing countries the following: Afghanistan, Central African Republic, Ghana, Guatemala, Kyrgyz Republic, Lao PDR, Madagascar, Mozambique, Sao Tome e Principe, Sierra Leone, Tanzania and Togo (IMF, 2012, Macroeconomic Policy Frameworks for Resource Rich Developing Countries, Appendix 1, 47).

[12] Oxford Policy Management (2013), drawing on UNCTAD statistical data: http://unctadstat.unctad.org

[13] For example: *Paushok*, note 21 above, para. 302, p. 67: "*…foreign investors are acutely aware that significant modification of taxation levels represents a serious risk, especially when investing in a country at an early stage of economic and institutional development. In many instances, they will obtain the appropriate guarantees in that regard in the form of, for example, stability agreements which limit or prohibit the possibility of tax increases*"; *AES Summit Generation Limited v. Republic of Hungary*, Award, ICSID Case No. ARB/07/22, 23 September 2010, at para. 9.3.31: in the context of a transitional economy, "*the Tribunal observes that no specific commitments were made by Hungary that could limit its sovereign right to change its law (such as a stability clause) or that could legitimately have made the investor believe that no change in the law would occur*"; *Suez, Sociedad General de Aguas de Barcelona S.A. v. Argentina*, ICSID Case No. ARB/03/17,

considered it directly remain unpublished. Still other cases, in which there has been a stabilisation issue, have ended in a settlement between the parties before any award was made[14]. The sample of available cases – and the existence of thousands of original contracts that are inaccessible due to commercial confidentiality - is always very far from representative and requires caution in interpretation.

The customary narratives behind stabilisation instruments and justifications for having them also need to be treated with caution. Disputes involving prospective petroleum producing states are likely to differ from those typically arising from the context of *established* petroleum production, such as those involving Venezuela or Ecuador, or Algeria. This will not come as a surprise to in-house counsel or practitioners but may well do so for the kind of arbitrator typically presiding over energy disputes between states and investors. Rarely a specialist, he or she will tend to be versed in the 'multinationals versus host states' narrative classically set out by the Harvard political scientist Raymond Vernon many years ago. The investor sees an opportunity and agrees on terms with the host government. It then takes a risk, relying on geological knowledge and economic modelling, and then, if successful, it expands its operation (or sells part or all of its investment), taking on a substantial commitment in the host country. The balance of negotiating power then shifts to the host government which may or more likely its successor may then claim the initial terms were unfair and will seek a revision, or worse (for the investor) expropriation the asset. This 'obsolescing bargain' scenario is still relevant in the energy (or more precisely the extractives sector: oil, gas and mining, where the risk-reward relationship is sharp), and is commonly referred to in the standard studies of international investment law, such as that of Dolzer and Schreuer[15]. It is conventionally offered as a main reason why international investors typically seek guarantees of long-term contract stability.

Decision on Liability, 30 July 2010, at para. 214, p. 79: "*It was largely because of the country's history of instability that the Claimants required the incorporation of the specific clauses on extraordinary tariff adjustment reviews*" (to create stability); see also: *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v The Republic of Estonia*, ICSID Case No. ARB/99/2 Award, 25 June 2001, at para. 348: "*…the Tribunal considers it imperative to recall the particular context in which the dispute arose, namely, that of a renascent independent state coming rapidly to grips with the reality of modern financial, commercial and banking practices and the emergence of state institutions responsible for overseeing and regulating areas of activity perhaps previously unknown. This is the context in which Claimants knowingly chose to invest in an Estonian financial institution, EIB*".

[14] A recent example is the agreement reached by Algeria and Total in 2017 to drop claims against each other which were being heard by tribunals in Geneva. Total and Repsol, its partner, launched the arbitration in May 2016 under a PSC, seeking reimbursement of US$400 million paid to Algeria under a tax on 'exceptional profits'. This tax was implemented in 2007 at a midway point in the resources boom when oil had risen to US$30 a barrel. The claim presumably involved breach of a stabilisation clause. Sonatrach (the NOC) filed a counter-claim alleging that Total and Repsol had failed to operate the gas field in accordance with applicable environmental laws and had extracted more gas from the field than was permitted by the geological models agreed when the contract was signed, endangering the preservation of the field. Sonatrach and its partner, Partex, commenced a second arbitration and sought a contractual penalty of US$100 million. The settlements included a new contractual framework for the gas project, development of a new project and continuation of an existing project: 'Algeria's Sonatrach, Repsol, Sign Pact to Consolidate Ties – State Media, https://oglinks.news/article/391cd9/repsol-sign-pact-to-consolidate-ties-media.

[15] R Dolzer and C Schreuer, Principles of International Investment Law (second edn, 201…).

The last few years have demonstrated that this classical scenario of risk now forms only one part of a more complex picture in energy investment. Moreover, the subsequent shift to a new, less favourable phase in international investment carries with it another, familiar risk that tends to impact on stabilisation mechanisms: like a pendulum effect, in a downturn states will tend to offer terms to attract foreign investors to their territory that they have cause to regret at a later stage, but which are locked in with a stabilisation clause or similar mechanism. If investor caution continues to lead to investment becoming more focussed on 'short-cycle' projects – such as expanding existing projects or narrowing the geographical scope to the western hemisphere, governments elsewhere will have to think again about what they have to offer in the competition for scarce capital if they are to link energy investment to domestic growth and related benefits. Africa in particular – with often very little infrastructure in place and limited human capacity, but growing demographics, will be competing with other regions and also within Africa countries will be competing with each other to attract the few companies interested in new country entry. Of course, there will be some countries which have no need to offer stabilisation clauses to attract investment even in these conditions. Brazil is one example that comes to mind, as well as most countries in the western hemisphere.

This pendulum swing in investment policies is far from unfamiliar in the international energy industry. It has provoked comment from observers in the past. For example, a report on human rights and stabilization produced by Harvard Professor John Ruggie contained the following statement: "Investors and lawyers (including those representing states and investors) observe that states sometimes accept sweeping stabilization clauses, along with other terms that appear to tilt the project in favour of the investor, as a way of securing a large investment project and enticing further investment in the country"[16]. Writing during an earlier downturn in the investment cycle, Thomas Waelde noted: "(p)romises not to alter given legislative regimes (for investment) have therefore re-emerged, in the most extensive form ever seen, as an important tool of foreign investment promotion policy"[17].

Thus, States will offer generous terms to potential investors in certain circumstances: when they need to attract foreign investment where there is none; to attract 'first movers' in the hope of discovering oil; when their neighbours offer stabilization; and in low oil price periods to overcome foreign investors' reluctance to invest capital that is in short supply. As the economic rent for many host states goes down and appears likely to stay down for some time, the risk of this over-compensation grows, leading ultimately to demands for renegotiation and often to disputes. States with resources that are marginal or not yet proven are likely to be prime candidates for such practices in investment promotion.

In this context, as part of its offer to international investors, the typical mechanism for guaranteeing contract stability to investors – the stabilisation clause in one of its forms or as a hybrid - can be a useful way of giving a government a competitive edge in this competition for capital, particularly over a neighbouring country. The inclusion of a stabilisation clause

[16] Stabilization Clauses and Human Rights: a research project conducted for IFC and the United Nations Special Representative of the Secretary-General on Business and Haman Rights (2009), p.5.

[17] T Waelde and George N'Di, Stabilising International Investment Commitments (1996) 31 Texas Intl LJ 215 at 218.

might just be sufficient to conclude a deal with a company that has an appetite for risk. Yet experience gained from the last upturn in the investment cycle showed that some of these 'pendulum' risks have acquired new characteristics as a result of the *diversification* of states and investors, set out above. In the next part of this paper, two instances of this will be examined: change of law, and early exit by the investor.

* * *

If one sought analogies for the kind of circumstances in which prospective petroleum producing states might have disputes with investors that involved a stabilisation element, these are available. In a number of recent awards, the tribunal has underscored the significance for the investor of securing a stabilisation clause to protect its investment in a fast-moving economic and social setting. Tribunals have had to examine legal arrangements agreed with governments that are engaged in sweeping changes in the national economy. An example of this is *Parkerings v Lithuania*[18] where the tribunal asked the investor: what stability did you expect when you invested in a country emerging from a state planned economy and why did you not seek or insist on a stabilisation clause? This was a state structure that was still evolving and its various branches could be expected to display some lack of cohesiveness at least in an early stage. It concluded:

> 'By deciding to invest notwithstanding this possible instability, the Claimant took the *business risk* to be faced with changes of laws possibly or even likely to be detrimental to its investments'[19].

Another illustration of the importance of having a stabilization clause and the penalty for not obtaining one was provided in the *Pauschok* case[20], where the tribunal stated:

> ... Foreign investors are acutely aware that significant modification of taxation levels represents a serious risk, especially when investing in a country at an early stage of economic and institutional development. In many instances, they will obtain the appropriate guarantees in that regard in the form of, for example, stability agreements which limit or prohibit the possibility of tax increases. As a matter of fact, GEM attempted, although without success, to obtain such an agreement in 2001, a few years after Claimants' initial investment and, in 2002, Vostokneftegaz- a company controlled by Claimants- did secure a stability agreement on a certain number of taxes. In the absence of such a stability agreement in favor of GEM, Claimants have not succeeded in establishing that they had legitimate expectations that they would not be exposed to significant tax increases in the future.

These awards underline the importance of a stabilisation clause in a dynamic setting. In addition to rapid economic change, the prospective petroleum producing states present

[18] *Parkerings Companiet AS v Lithuania, Award,* ICSID Case No ARB/05/8, IIC 302 (2007) 14 August 2007. See also *Alex Genin, Eastern Credit Limited, Inc. and A.S.Baltoil v The Republic of Estonia*, ICSID Case No ARB/99/2: http://italaw.com/cases/documents/486.

[19] Paras 335-336: "*…legislative changes, far from being unpredictable, were in fact to be regarded as likely. As any businessman would, the Claimant was aware of the risk that changes of laws would probably occur after the conclusion of the Agreement…By deciding to invest notwithstanding this possible instability, the Claimant took the business risk to be faced with changes of laws possibly or even likely to be detrimental to its investment. The Claimant could (and with hindsight should) have sought to protect its legitimate expectations by introducing into the investment agreement a stabilisation clause or some other provision protecting it against unexpected and unwelcome changes.*"

[20] Sergei Pauschok, CISC Golden East Company, CJSC Vostokneftegaz Company v The Republic of Mongolia, Award on Jurisdiction and Liability, 28 April 2011 (UNCITRAL), para.302.

some additional risks to the unwary investor. The prevalence of decades-old mining codes, inadequate or absent hydrocarbons laws and a history of taking a patchwork approach to the conclusion of agreements with investors has often left a legacy of provisions open to misinterpretation, and confusion. The complex implications of large new developments, notably in oil and gas but also in for example, minerals such as iron ore, are creating unfamiliar challenges for governments in some of these low-income countries, testing the adequacy of their legal frameworks and institutional capacity. For those states that have recently joined or which are about to join the club of resource-rich economies, there is an often an urgent need for legal reform, particularly in areas where the tax administration is still being built up.

A. Change of Law Risk

In relation to stability, the change of law risk presents special challenges for investors in the category of states I have described as the prospective petroleum producers. In recent years, the evolving and incomplete character of the local tax regimes has contributed to investor-state disputes in at least three African states, despite the existence of stabilisation clauses in the petroleum agreements made with foreign investors: Ghana, Mozambique and Uganda. Nor is the African continent alone in this respect[21]. The kind of stability arrangements in which change of law provisions are found is described in the literature variously as adjustment, adaptation, renegotiation, equilibrium, or balancing clauses[22].

A change in law provision will usually try to address up to three issues: what is the action that has triggered the change; why is the change problematic; are the parties aware of what is alleged to have been changed and its significance for the original bargain?

With respect to the first, some stabilisation clauses define the ‘law’ that has changed to include different kinds of legal instruments and in some cases to include ‘interpretation’ of the law. The need for this explanation is to identify the specific origin of the problem. Second, it is also necessary to explain why the change in any legal instrument (or interpretation) should be a problem at all. In brief, the answer is that the change has effects that undermine the economic bargain struck between the investor and the state in the original contract. This linkage is crucial since it points to a question about the character of the effects of the change in law. The third issue is how to ensure that both parties are aware that communication of a change in law within the terms of the stability arrangement has occurred prior to discussion or negotiation about the next steps. All of the above predate any formal step to commence arbitral proceedings. In practice, it is commonly required that

[21] Some Latin American examples are considered below. I am excluding from this category of prospective petroleum producing states the kind of country that has just achieved statehood and is evolving its legal regime for the first time. Very few countries fall into this category.

[22] Although ‘renegotiation’ is commonly used in the literature, it is potentially misleading. An automatic adjustment following a triggering event can hardly be described as a ‘renegotiation’, nor is ‘renegotiation’ necessarily linked to a disruption in the balance of the commercial bargain originally struck. In my own extended treatment of this subject, I use the generic term of ‘balancing’ for this kind of clause: International Energy Investment Law: the Pursuit of Stability, Oxford University Press (2010), 74-80.

the parties should take some initial step to discuss or mutually determine what the issue is prior to either or both parties taking any formal action.

Essentially, a scheme of linked actions is typically established by the parties to make a 'change of law' trigger effective. The host government guarantees stability to the investor but does not fetter its sovereign capacity to make new laws, including laws that may affect the stabilised investment. If such laws are adopted, wording will typically be adopted in the investment agreement to ensure that the laws (1) fall within the definition of instrument that can catalyse change, and (2) that such change 'materially' or 'negatively' affects the terms of that agreement. Prior to such a change in law acting as a trigger to activate the protection scheme for the investment, the parties will need to establish some communication about this issue not only with a view to resolving it but at a more basic level to identify what the issue is. If they cannot agree on this and/or a solution, the investment agreement will typically provide for a formal process of dispute resolution to commence.

As an example of a change of law provision (and many are possible), Article 30 of a Tanzanian Production Sharing Contract addresses *Change in Legislation* in the following manner:

> If at any time or from time to time there should be *a change in legislation or regulations* which materially affects the commercial and fiscal benefits afforded by 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 (my italics).[23]

The italicised wording makes it clear that a "change in law," defined here as "a change in legislation or regulations", is required and the parties are required to commence discussions with a view to restoring the original benefits in the contract. The possibility of an amicable solution is encouraged. Interestingly, this model contract provision differs from at least one actual PSC in Tanzania which this author has seen, which defines 'change in law' to include "reinterpretation, change in application, change in interpretation or modification".

The triggering event will usually be a change in the law that materially affects the interests of a party or parties to the contract, and typically that will be the foreign investor. The question remains: what constitutes a change in law?

Some investment agreements define the category of law widely to encompass as many legal instruments as possible, while others are narrower in scope. In the 2006 edition of the Energy Charter Treaty Host Government Agreement, interpretation and administrative application are treated as part of 'change of law'. In particular, Article 37[24] provides as follows:

> "(c) Any interpretation or application, by the courts, executive or legislative authorities, or administrative or regulatory bodies, of any of the [host state]".

[23] Article 30: Change in Legislation, Tanzania Model Production Sharing Contract of November 2004, in *Barrows Basic Oil Laws and Concession Contracts*, Supplement 161 – Series on South & Central Africa.

[24] *Article 37 (1) and (4) (available at: http://www.encharter.org/fileadmin/user_upload/document/ma-en.pdf*).

As the explanatory notes state: "[the Model Agreements] have been developed by the Energy Charter Secretariat with the support of the Legal Advisory Task Force (LATF), which currently consists of over 40 senior legal experts from 23 leading energy companies and international law firms." These Model Agreements are "designed, revised and updated in due time in order to reflect the most recent accepted practices within their field of concern." They were designed to have an influence on a regional grouping of around 50 countries. Furthermore, the notes state that the "Models have been structured with the aim of striking a reasonable balance between the obligations of a state wishing to attract essential and/or competitive investment and the rights of private investors prepared to invest. The underlying idea is therefore a sustainable allocation of risk and the equitable distribution of the overall benefits between public and/or private parties engaged in the project."

The model provision in the Energy Charter Treaty provides some persuasive evidence of the intended scope of 'change of law' provisions in stabilisation clauses as a matter of investment practice and what we might infer to be the modern approach to drafting such provisions.

On this view, an investor is not expected to forecast how existing laws might be interpreted or applied in the future by domestic courts and administrative agencies of the host state, nor should it be expected to forecast which policies future governments would adopt should there be changes in the economic situation. Thus, in *Saluka v. Czech Republic* the tribunal held that whatever the scope of the claimant's due diligence may have been, "it could not possibly lead to a reliable forecast as to which policies future governments would adopt should an aggravation of the (nation's 'banks') bad debt problem occur"; as such, the claimant "cannot be said to have assumed the risk of being treated differently when the Czech Government in fact decided to step in with financial assistance"[25].

Yet, from the host state's point of view, it may consider it has good reason to avoid stabilisation clauses that include changes in interpretation and administrative application as changes in law, on the ground that to do so is to accept 'nebulous concepts' which would open them up to abusive challenges. This gives further support to a restrictive construction of such clauses

In an ICSID arbitral award, *Burlington v Ecuador*[26], the tribunal examined the meaning of a change defined in the contract:

> In the event of a modification to the tax system or the creation or elimination of new taxes not foreseen in this Contract or of the employment contribution, in force at the time of the execution of this Contract and as set out in this Clause, which have an impact on the economics of this Contract, a correction factor will be included in the production sharing percentages to absorb the impact of the increase or decrease in the tax or in the employment contribution burden[27].

In *Burlington*, the Ecuadorian president submitted a bill to Congress proposing to increase state participation in so-called 'extraordinary profits'[28]. The Ecuadorian Congress approved the Bill

[25] Saluka Investments B.V. v. Czech Republic, UNCITRAL, Partial Award, 17 March 2006, para. 332.

[26] *Burlington v. Ecuador*, (ICSID Case No. ARB/08/5) decision on Liability, 14 December 2012, paras. 316-335.

[27] Id. at para 317.

[28] Id. at para 29.

and enacted Law 42, amending the Hydrocarbons Law[29]. The Constitutional Court of Ecuador then ruled that Law 42 did not modify the PSCs[30]. In arbitration, Ecuador argued that Law 42 did not modify the PSCs because it dealt only with oil prices[31]. The tribunal, however, held that a 'modification to the tax system' had occurred through the enactment and application of Law 42.

In another case involving Law 42 in Ecuador, *EnCana Corporation v Ecuador*[32], the contract provisions referred to 'Tax Regime Amendment' as the triggering change, to the extent that they affected the economy of the contract. The case turned on Value Added Tax ("VAT") which was not expressly referred to in the investment agreement in the list of taxes that were to be subject to stabilization. The tribunal held that the stability clauses in the various agreements applied in case of amendment to the tax regime *but also to its interpretation* (my italics). At the time that the agreements became effective, VAT refunds were allowable. In the tribunal's view, subsequent developments produced a modification to the tax regime or to its interpretation as compared to the situation when the agreements became effective. There was a settled practice of interpretation by the tax regime (and evidence to support this), which was contradicted by the legal measure subsequently introduced.

By the time the dispute arose in *EnCana Corp*., there had been "numerous amendments and modifications made to the tax regime in general and the VAT regime in particular during the relevant period.[33]"24 This context was important in EnCana Corp. The tribunal could identify an established interpretation of the law that had been adhered to previously by the tax authority, noting that in this case it was one from which the tax authority then departed. If a change in law is to be based merely upon a change in interpretation of the law, the tribunal is unlikely to depend upon the assertion of a change in law by an aggrieved claimant and ignore the sovereign entirely; instead it is likely to seek to base the deviation by the tax authority upon some objective criteria. In the EnCana Corp. case it was able to identify that deviation.

In the above cases, the measure introduced as a change in law had draconian effects on the investors concerned. However, not only was the change in law held to be expropriatory in effect, but Ecuador was also criticised for failing to provide any clarity about its meaning and extent, and for making changes inconsistent with established practice as well as law.

On the basis of the foregoing analysis, it would appear that if an investor were able to prove that an established interpretation existed, an inconsistent interpretation could be classified as a change in law. For investors in the prospective petroleum states, however, this is likely to be a challenge. Most likely the structure and content of government in many of such countries is still evolving, with sound administrative practices not yet in place, especially with respect to its petroleum or energy regime. Few of these countries will start with a clean slate in terms of relevant laws, with a legacy of laws and regulations from decades earlier perhaps. Further, few governments will – at least initially - have a fully-fledged, detailed petroleum legal regime in place until the geology justifies it. It is hard to see how such reticence in the use of scarce public funds can be deemed unwise. So, the government is often giving the

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[29] *Id*. at para 30.

[30] *Id*. at para 145.

[31] *Id.*

[32] *EnCana Corporation v Republic of Ecuador*, LCIA Case No. UN 3481, UNCITRAL, Award, 2006.

[33] Id. at para 41.

guarantees at a time when its regime is at an early stage of development when it is still heavily influenced by past circumstances when public policy was overwhelmingly focussed on achieving other objectives. A subsequent pattern of state behaviour along the classical Vernon model, sketched out above, the 'obsolescing bargain risk', may indeed occur, but it is much more likely that such actions will reflect attempts by the host state to introduce order into its petroleum regime after the geology has proved the worth of such a task.

Ideally, a change in law as a triggering event for a stabilisation clause would include a change in the interpretation or administrative application of law. This is clearly supported by the conclusions reached by the diverse parties associated with the Energy Charter Model Agreements referred to above. Each of these situations – a new law, a regulation or an interpretation of a law or regulation - may give rise to a substantial adverse change to the position of the investor in terms of the expected economic benefits. In other words, from an investment and economic perspective, there is no reason to distinguish between a change in law or a change in its interpretation or a change in its administrative application[34].

Any interpretation or construction of a stabilisation clause should be in alignment with its practical purpose in the absence of clear language seeking to restrict its scope. In other words, taking a very literal approach to the construction of a stabilisation clause – if interpretation is not expressly mentioned in the contract itself, it is not to be inferred that the parties have agreed on it - would give host governments the ability to severely dilute the protection by adopting particular interpretations or administrative practice. If a host government wishes to achieve this outcome however, it would require specific and clear language to that effect so that the investor is made aware of the fact that the stabilisation clause will not provide the protection that the investor would otherwise expect.

In summary, if the language is construed in such a way as to allow the government to circumvent the stabilisation clause, then this is likely to particularly unacceptable in the circumstances of the prospective petroleum producers because it contradicts the purpose of such a clause in the overall agreement. If its scope is only limited to legislative changes, a government could adopt other measures to make it worthless. If interpretation were not to be included, it would be easy for the state to go around the 'change in law' provision and undermine stabilisation. A narrow construction is likely to prove fatal. Given the rapidly evolving structure of the domestic administration and courts at the time the investor enters into a PSA, a failure to include interpretation and application of law which has the force and effect of law would undermine the purpose of a stabilisation clause: the host state would be allowed to give with one hand and subsequently take with the other[35]. It is all the more important that the stabilisation clause should operate to provide the protection ordinarily to be expected.

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[34] One of the few cases to examine stabilisation clauses in the past decade is *Duke Energy International v Peru* (ICSID Case No. ARB/03/28, Award, 18 August 2008). Changes in tax law were treated as extending far beyond formal enactment of law to both issues of interpretation and administrative application because otherwise a government could extract itself from decisions and claim that it has not changed the law: paras 222-223. A breach of the tax burden stabilization commitment may occur, the tribunal held, even "in absence of proof [...] of a stable interpretation or application" (where insufficient time does not allow for the development of a stable interpretation or application). A caveat here is that the provision refers to 'stability of the tax regime' and not expressly to a change in law, but one could argue that such stability presupposes that a change is possible even if a change is not specified.

[35] Consider in this respect the following statement by the sole arbitrator in *Yury Bogdanov v. Republic of Moldova, Arbitration No. V* (114/2009), pursuant to the Rules of the Arbitration Institute of The Stockholm

B. Applicability of Stabilization Clauses to an Early Exit

At the outset, it was noted how a growing category of investors could raise problematic issues in relation to the long-term character of stabilisation clauses. Initially, the investor will emphasise to the host government the importance of long-term stability if the exploration risk is to be taken on. However, the fact is that many companies with successful exploration will want to sell all or part of their interest. This circulation of capital is something that established petroleum producers are familiar with, and ought prima facie to present no problems if the state's consent is required to the sale or transfer.

The difficulties arise when (1) the domestic regime in place is not yet fully evolved or not yet at a level of development that meets the requirements of a sound petroleum legal and fiscal regime, and (2) the potential gain from an early exit is substantial and not amenable to a state share. These were evident in several cases that arose during the boom years, and affected several of the prospective petroleum producing states, mainly African ones. The issue concerning stabilisation is whether or not such a clause is limited to protecting the economic balance of an ongoing project (for example, in the face of a disruption to its equilibrium caused by a change of law) or it extends to all of the benefits of the project. If the latter, then in the absence of capital gains taxation, the investor should be protected from any changes in law relating to exit taxation.

A number of disputes have emerged as a result of gains made by investors through the sale of interests to other investors after making a significant hydrocarbons or minerals discovery. Even if we may not yet be able to access awards from such cases[36], some initial reflections on this recent development may assist in identifying what, if anything is actually new about it.

In a seminal publication from the International Monetary Fund (IMF) on taxation in the petroleum and mining industries[37], Jack Calder includes the treatment of capital gains on disposal of licence interests in a list of issues he identifies as *problematic* for states. Capital gains is particularly challenging (and frustrating) for the host state because the gains can be realised far outside the jurisdiction in which the reserves are located. This can "add numerous complications and uncertainties to resource taxation"[38]. At about the same time, a separate publication for an NGO argued for clearer rules in future petroleum agreements concerning asset transfers and capital gains taxation[39]. Although the focus of these analyses

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Chamber of Commerce, Award, 30 March 2010: "It is further not reasonable to construe the stabilisation clauses in Law 625/1995 and Law 440/2001 so narrowly that they would leave it open to the Republic of Moldova to change the customs regime at will as long as so was done by legislation other than these two particular Laws. To so construe the clauses would make them void of any real meaning" (at para 84).

[36] Comments on recent or pending cases are therefore limited to materials that are in the public domain.

[37] The Taxation of Petroleum and Minerals: Principles, Problems and Practice, Routledge/IMF, 2010, edited by P Daniel, M Keen and C McPherson (Daniel et al).

[38] Daniel et al, p.328.

[39] Keith Myers, 'Selling Oil Assets in Uganda and Ghana – a Taxing Problem', Revenue Watch Institute, 2010.

is on specific fiscal instruments, it is not difficult to detect some of the broader concerns about investor-state practices such as the 'fairness' of stabilisation clauses or alleged imbalances in the international dispute settlement regime.

As every oil and gas lawyer knows, license or concession interests often change hands; they may be sold from one investor to another, subject to various government approvals. The reasons may differ widely, and often include a need to fund additional exploration work in the contract area. Provided they are located within a clear legal framework, these transactions can serve a very useful function for all parties. If commercial logic persuades a company that its interests are better served by relinquishing its interest in a concession or contract, it may sell it to another party, always taking care that the obligations already given to the host state are going to be taken over by the successor company. If a state has granted rights to a small company with an appetite for risk which then makes a major discovery, the state may well heave a sigh of relief if the company proposes to sell the interest on to a much larger company with access to the capital and management skills required to develop the discovery and related infrastructure. Even prior to making an investment, these small companies (sometimes called 'first movers' in the petroleum industry) will be looking to make their reward through transfers or sales of their interest to the larger 'independents' or 'majors' with the financial and technical muscle to exploit the discovery. The transaction may involve the sale of shares in companies that hold mineral rights, rather than a sale of the rights themselves.

Such companies are often part of a complex web of cross-border ownership chains. So, if there is a capital gain involved, it may be made by a non-resident and be protected by a tax treaty. Of course, if there is a limited or no market for the purchase of such an interest, following an oil price fall and retrenchment by the larger companies, such companies face the full costs of taking an exploration success forward.

Where a sale has been arranged in a robust market, as existed until recently, a large part of the premium, or capital gain, that the investor achieves on such sales (which may be substantial) is rent[40]. Nevertheless, depending on the legislation and regulations in place, the investor may be able to structure the sale so that taxation is limited (for example, by transferring interests upstream rather than by a sale of in-country assets when the tax rules are incomplete or unclear). The premiums observed in the last few years have exceeded expectations considerably as a result of dramatically increased prices for petroleum and minerals, and have understandably encouraged re-examination of their fiscal treatment.[41] Much media coverage was given to the way the issue has arisen in Ghana, Mozambique and Uganda some years ago in both the hydrocarbons and mining sectors[42]. The main issues arising centre on these questions: should these gains be taxed, and if so, who should or who can tax the gain?

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[40] This subject is discussed at greater length in 'Oil, Gas and Mining: the Extractive Industries Source Book, by Peter Cameron and Michael Stanley (The World Bank, 2017).

[41] Nahkle, C. (2007). *Do High Oil Prices Justify an Increase in Taxation in a Mature Oil Province? The Case of the UK Continental Shelf.* Surrey: Surrey Energy Economics Centre (SEEC).

[42] Following negotiations between the state and the investors concerned, most of the hydrocarbons E&P assignments in Mozambique were taxed. The petroleum law has been amended to ensure this is addressed for future cases of this kind.

Capital Gains Taxation (CGT) has become more important to host governments and more controversial for at least two reasons. First, for a number of years capital gains became much higher due to price increases (but this can be expected to reverse with price falls). Second, CGT is extensively addressed in *developed* countries and (usually) the basic principle is that capital gains are taxable. In contrast, in many resource-rich countries outside the OECD area, CGT is either not addressed at all or the tax rules contain so many loopholes that an international oil or mining company can easily find ways of mitigating CGT (although this is changing as loopholes are identified and actions are taken to close them). In addition, tax treaty-shopping strategies using tax havens are often used by such companies when dealing with developing countries to (among other reasons) obtain exemption from CGT.

This is the origin of recent increased interest by governments in such transactions with a significant capital gain and in the possibility of taxing them. In Central and East Africa alone, three governments elected to review their CGT rules (Congo, Kenya, Tanzania) and another, South Africa, was called upon to do so by an influential policy institute within the governing party (South Africa))[43]. *Previously, there appears to have been no practice of levying tax on such transactions.* The shift in policy preference has therefore encountered an absence of legal power in existing arrangements, and ones on which investors have made their calculations to date. An example of the recent evolution in policy in Africa is evident from Mozambique. In a takeover by the mining company, Rio Tinto, of a project in the country, no CGT was paid. This triggered significant popular unrest and as a result the law was changed but not retrospectively and was enforced in relation to similar changes in the hydrocarbons sector[44].

Already any arbitrator or counsel will see the existence of some familiar elements. Parties conduct their commercial affairs on the basis of existing laws and contracts that turn out to

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[43] Bloomberg News, 22 January 2014: 'Congo Oil Law May Impose 40% Tax, Allow Drilling in Gorilla Park' [Parliament is debating an oil code that may impose a 40 per cent CGT, allow drilling in national parks and force current title holders to renegotiate their deals]; Mail & Guardian, 19 June 2013: 'Kenya dismisses concern over capital gains tax' [Kenya tries to allay investors' concerns over a planned review of CGT, pointing out that it is too early to state which asset classes will be affected]; The Zambesia, 20 December 2013: Tanzania says to demand $258 mln tax on Ophir gas deal [Tanzania will levy a CGT of at least $258 million on the proposed $1.3 billion asset sale of Ophir Energy's natural gas fields to a unit of Singapore's Temasek Holdings, according to its energy minister]; and in South Africa a report by the ANC Policy Institute, State Intervention in the Minerals Sector, March 2012, contained a section entitled 'Exploration Right Speculators', and stated: "In order to discourage mineral right speculators we must introduce an exploration (prospecting) right transfer capital gains tax of 50%, payable if the right is on-sold or the company changes hands before mining commences. This will encourage genuine mineral property developers rather than speculators ("flippers")"; page 34.

[44] The independent Columbia Center on Sustainable Investment described the pattern of events as follows: "Rio Tinto purchased all of the shares in Riversdale Mining Limited (an Australian company) on the Australian Stock Exchange, for around US$4 billion. Riversdale Mining Limited had a subsidiary, Riversdale Energy (Mauritius) Limited (a company registered in Mauritius) which owned the local company, Riversdale Mozambique Limitada (RML). RML held the rights to the coal projects in Mozambique. Through its takeover, Rio Tinto indirectly acquired the rights to the Mozambique coal projects. The value of Riversdale Mining Limited was due to its rights in the Mozambique coal projects. Mozambique is in the process of amending its laws so as to capture transactions such as this in the future": 'Capturing the benefits of a transfer of mineral rights – scenarios to capture by contract/legislation/regulation and issues to consider (see the Scenario 1 Example) http://ccsi.columbia.edu/files/2013/11/CGT__note_-_May_18.pdf (last visited 22 February 2015).

be poorly drafted from a public interest point of view (in failing to capture a gain that has some ultimate link to the resource in the ground which they own). Controversy only develops once the investor has committed resources, accepted a risk and in the case where a significant discovery has been made, has found a buyer willing to pay a premium price for the commercial interest.

Some elements of this may be less familiar. At an IMF Workshop on 'Resources without Borders: International Issues in Fiscal Regimes for Extractive Industries'[45], there was a discussion of this topic among governments and international experts. A main concern was how the two worlds of international tax and national fiscal regimes for hydrocarbons and mining are increasingly intersecting, with issues arising that do not have easy solutions and impact upon the design of international assistance to governments. The taxation of gains attributable to domestic resources and its relationship to the operations of international resource companies was thought to be a major issue. Globalisation continues to open up fresh avenues for international companies to structure investments to minimise their tax burden, and government responses need to evolve further.

For some states, such as those in the OECD area, capital gains tax is imposed using different schemes provided for in the general tax law. This has long since been a settled matter, but even in these cases, practice is not uniform. For example, in Norway the gain is not taxed but instead an administrative process will ensure that the transaction has no negative impact on the long-term revenues to the state (the gain is usually re-invested in Norway)[46]. For countries that are new to hydrocarbons or minerals discoveries, the tax rules applicable to assignments may be ones they have scarcely thought about, focusing rather on what to do to ensure that the basic exploration takes place, and on how to tax any resulting production.

Contract and investment treaty terms may also overlook the issue or else treat it in terms that are unclear. In some cases, individual contract terms may be clear but in a way that current policy in the countries concerned could hardly deem satisfactory. For example, in Kenya, a PSC concluded in 1989 with a consortium comprising Total, Amoco, Marathon and Texaco oil companies, contained the following provision on Assignment. Article 35.2 states that the "Contractor may assign *free of any tax* to a person other than an Affiliate part or all of its rights and obligations under this Contract with the consent of the Minister, which consent shall not be unreasonably withheld…"[47] (my italics). In a PSA concluded between the Angolan National Oil Company and Agip in the same era, Article XXI on Assignment stated that any assignment made pursuant to the provisions of the Article "shall be free of

[45] Washington DC, 21-22 May 2012: published in book form in 2017 as 'International Taxation and the Extractive Industries' edited by Philip Daniel, Michael Keen, Artur Swistak and Victor Thuronyi, Routledge, London and New York. Notably, chapter 7 on Taxing Gains on Transfer of Interest is by Lee Burns, Honore LeLeuch and Emil M Sunley.

[46] Norway was one of the first countries to publish a detailed regulation on assignments and how they would be taxed. This approach was followed by the UK and Australia.

[47] Production Sharing Contract of 1989 between Total/Amoco/Marathon/Texaco and Government (Block 1), Barrows Basic Oil Laws and Concession Contracts, South and Central Africa Series, Supplement 124, p. 1.

any transfer or related taxes, charges or fees"[48]. Indeed, sub-Saharan African countries were not alone in this approach. A contract between Egypt and Amoco in 1989 contained a provision on assignment at Article XX which stated that "(a)ny assignment made pursuant to the provisions of this Agreement shall be free of any transfer or related taxes, charges or fees".[49]

As a further illustration of how open-ended the debate is on this subject, I note a passage from an unpublished but recent report commissioned by the African Petroleum Producers Association (APPA)[50]. The Consultant noted the lack of action taken by APPA member states in this area (at the time) in spite of its growing importance, largely because host states' attitudes appeared to be in flux. After an extensive international comparison of government actions, it cautions:

> "The state's right to consent to, and control, and possibly exercise rights of first refusal on a change of ownership by the investor, including a change of control, is one of the areas where the approach of many states has been changing in recent years. Kazakhstan, Indonesia, Libya and Nigeria are all taking a new look at the related issues and making changes to their procedures. The Consultant recommends that Member States consider whether the provisions of their petroleum regimes adequately address the concerns that can arise on a change of ownership or control; based on our review [of APPA members' legislation and knowledge of their practices], it is the Consultant's view that many Member States will want to consider altering their approach in light of the changing attitudes of other states in this area."

This underlines the general point that this is an area where practice in design and enforcement are still evolving. As the IMF has repeatedly noted, tax administrations in developing countries face particular challenges:

> It is obvious that resource taxation presents a challenge to administrative capacity, especially in developing countries, many of which struggle with routine functions, let alone technical and professional functions. The huge imbalance in expertise between taxpayers and tax administrators makes effective fiscal control difficult.[51]

[48] Petroleum Exploration and Production Sharing Agreement dated 22 March 1982 between Angolan National Oil Company (SONANGOL) & Agip S.p.A. in the Block One Area, Barrows Basic Oil Laws and Concession Contracts, South and Central Africa Series, Supplement 119, p.1.

[49] Amoco Concession Agreement dated 18 July 1989 between Egypt, the Egyptian General Petroleum Corporation (EGPC) and Amoco Egypt Oil Company (Sallum Area, Western Desert), Barrows Basic Oil Laws and Concession Contracts, North Africa Series, Supplement 95, p.17.

[50] 2011: unpublished (copy held by author of this article).

[51] J. Calder, 'Resource Tax Administration: Functions, Procedures and Institutions', in P. Daniel, M. Keen and C. McPherson (eds), *The Taxation of Petroleum and Minerals: Principles, Problems and Practice*(Routledge,London, 2010) 340 at p.361.

The improvement of taxation has been described as "a key aspect of state-building" since taxation is "a defining feature of state power"[52]. Several studies have argued that tax reform is an investment that is central to the wider institutional development of a country[53]. However, if this appears to be a context in which developing states are at risk of being 'victims' of internationally operating investors, it should be emphasized that the tax administrations of such states can be positively impacted upon by the actions of developed states and trends in their taxation policies. Cooperation among tax authorities has in fact been increasing in recent years[54].

The overall context is one in which governments in developed countries have been taking the lead in addressing potential abuses by internationally operating companies in taxation. The influence upon developing countries can be expected to be considerable, particularly in the natural resources sector.

The recent experiences of large capital gains in the extractives sector of developing countries also raise policy and ethical questions for the host state: why should such profits not be taxable in such countries when they are taxed in most OECD countries? Is it *fair* to exempt them from CGT? It would be very surprising if the newer producing countries and prospective petroleum producers did not place this subject on their reform 'to do' list.

Although no evidence has been presented here of a 'trend', there is some support for the proposition that CGT is indeed being reformed as part of the catch-up legislation being introduced by the prospective resource-rich states. Major drivers are likely to be that the transaction gains can be very significant and that they may be realised as part of a corporate strategy of seeking to take the benefit at an early stage, prior to development and production of the deposit. Both of them are likely to raise questions on the government side as to whether the tax regime is a fair one. However, another factor is the increased transparency in the accounts of listed petroleum companies on the taxation of assets. This latter point is likely to become ever-more important, as the amount of realized capital gains for a specific transaction, and the fact of whether they are taxed and where, will be matters of public record. If the host country chooses not to tax the gain made by the seller, and any sensible government official or advisor will think hard before taking or recommending a retrospective measure, this kind of public information may well generate a serious political issue for the government concerned. A prudent government will seek to ensure that any revisions do not trigger negative perceptions about the stability of its investment climate.

[52] IMF Fiscal Affairs Department Staff Paper, 'Revenue Mobilization in Developing Countries', 8 March 2011, p.8.

[53] OECD (2008), 'Governance, Taxation and Accountability: Issues and Practice', Development Assistance Committee Guidelines and Reference Series; also discussed with reference to the UK Department for International Development experiences in M. Everest-Phillips, 'Business Tax as State-building in Developing Countries: applying governance principles in private sector development', International Journal of Regulation and Governance, vol. 8 (2), 123-154; http://www.itdweb.org/documents/Philips_IJRG_Dcmbr_2K8.pdf.

[54] For example, see OECD, 'Addressing Base Erosion and Profit Shifting', a report issued on 12 February 2012 on multinationals' tax strategies and aimed at the development of an action plan with cooperation from governments in tackling base erosion of the corporate tax systems. This builds upon earlier work by the OECD in this area. The challenges are probably most evident in the field of transfer pricing.

The significance of the above context for our understanding of the scope of a stabilisation clause is surely that the rapidly changing landscape of international taxation in the extractive industries requires governments to ensure that their laws are up-to-date in protecting the national revenue base, and explicit in requiring gains such as CGT to be captured in the event of an early exit[55]. Where there is no such provision, the risk to the government is that a belated attempt to introduce one will trigger a claim that the exit tax breaches the terms of the contract's stabilisation clause. Obviously, the success or otherwise of that action (or threat to initiate it by the investor) will depend upon the legal fact pattern, the contract provision, and so on in the particular circumstances. With respect to first mover companies who are (as the state is usually aware) likely to exit once the exploration phase has been successful and prior to development (as a result of their business model and/or resource constraints), for exit not to be included within the scope of such clauses would severely dilute their utility to these companies. Their initial evaluation of the project will inevitably include any applicable exit taxes given the likelihood of their selling their interest at the point in time that commercially viable reserves have been discovered. Where no attempt has been made in law to capture any potential gain on exit, the basis is being laid down for a possible future dispute. Clearly, practice on this in the far past has been overtaken by events linked to the processes of globalisation.

C. Conclusions

Much writing on stabilisation mechanisms tends toward classificatory schemes, producing typologies that are more or less useful in grasping the diversity of such instruments that characterises the world of practice. Some more recent work, noting the absence of such mechanisms from the operational practices of a fairly large group of petroleum producing countries, has underlined the pitfalls of such mechanisms for sovereign states. There remain only a limited number of arbitral awards addressing this subject that scholars are able to reference and comment upon.

What this paper has tried to do is to draw upon the experience of the relatively recent long boom in oil and gas prices, as well as a range of sources that include extra-legal ones, to explore – even if in a provisional and tentative way – how certain trends in energy investment that emerged in fairly robust form during this period had implications for our thinking about such mechanisms. It is well known that the bête noire of investors – the possibility that a host state would expropriate a hard-won commercial success and therefore needed legal protection for the foreign investor – has given way to a more complex constellation of threats, from indirect expropriation to revocation of permits or contractual forms. In the past decade, this has become yet more complex. But it remains one in which states and investors must proceed as partners with a focus on shared value.

How such trends will develop during a period in which international capital flows have declined is a subject that has to be left to others. There are also other trends concerning stabilisation that have not been considered here – such as the growing impact of

[55] It could be as straightforward a provision as this: "Any transfer or assignment of interest shall attract capital gains tax in accordance with the law."

environmental, health and safety costs, an area often seen as a legitimate carve-out from the scope of stabilisation mechanisms. Nonetheless, in spite of its limited scope it is hoped that this paper invites a reconsideration of the more traditional assumptions about the use and purpose of long term legal protections for investment in an international context that is increasingly short-term in its focus.