

**A CRITICAL EXAMINATION OF KEY ISSUES AND CHALLENGES IN
STABILIZATION AND RENEGOTIATION CLAUSES IN EXPLORATION AND
PRODUCTION AGREEMENT IN NIGERIA**

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ABSTRACT: *A source of legal dispute and disagreement between International Oil Companies (IOCs) and the host government has always been the question of contractual continuity in exploration and production agreements (EPAs). While the IOCs are concerned with stability and predictability over the duration of their oil field exploration, host governments prefer more flexible contractual arrangements where the EPAs can achieve the most favorable returns. Over the years, various contractual clauses and provisions have been explored by the contracting parties in order to compromise conflicting interests, and two of these clauses are stabilization and renegotiation clauses. It is on this premise that the aim of this paper is to analyze the implementation and legal implications of stabilization and renegotiation clauses in the petroleum sector, especially as a means of guaranteeing contractual protection. It defines related issues and reflects on issues resulting from the use of these clauses in directing the relationship between the parties. A great deal has been based on stabilization and re-negotiation clauses, their importance in protecting investors, and the preservation of EPA stability. This paper argues that the much needed efficacy and stability that it purports to provide has not been accomplished by both clauses. Rather, in long-term oil negotiations, they could have potentially done more harm than good and failed to promote productivity and stability. In addition, the paper indicates that renegotiation provisions are a better option and way of preserving stability and efficiency in EPAs, given that the equilibrium of the initial agreement is likely to be disturbed by uncertainty and unexpected future events. As such, this paper will focus on the benefits of renegotiation clauses in the present forms of EPAs and will make a case for renegotiation clauses and establish that for efficiency, maintenance of good relations and preserving the contract in present times, renegotiation clauses serve a far better purpose for both the IOCs and Host government, and that renegotiation should be acknowledged as an integral feature of the foreign investment process*

KEYWORDS: critical examination, issues and challenges, stabilization, renegotiation, clauses, exploration, production, agreement, Nigeria

INTRODUCTION

Ownership of Natural Resources often lies with the State, and considering that their development is a matter of importance for economies of the countries concerned, the State plays a major role, as a regulator or an operator¹. For several decades, long term contracts have been used by investors and host countries² in developing these resources, for the Investor, the main objective is to repatriate capital and obtain a return commensurate with, among other things, the magnitude of its investment and risk³. While for the host country the core goal is to obtain its agreed share of revenue from the project, related developments, and secure benefits such as industrial spin-off and job creation⁴. Both parties try to create an agreement which meets and satisfies not only their interest but that of the public, a number of exploration and production agreements (EPAs) exist between investors and the host country (HC) which includes concessions, production sharing agreements, joint ventures and service contracts⁵. These agreements are characterized by long durations spanning over twenty to thirty years, large capital investment and high risk of operation in the industry making them prone to geological, economic, political, fiscal and commercial risk which may not be recognized at the of signing the agreement⁶. Such risks can make the contract partially impracticable or from a commercial or financial standpoint less viable to one or both parties and lead to a complete destruction of the contract and possibly the contractual relationship⁷. Thus stability mechanisms in legal, contractual and economic forms are necessary to check these risks in petroleum contracts especially in developing countries⁸. Such mechanisms include stabilization and renegotiation clauses which most governments and investors welcome their inclusion in contracts to stabilize and protect their interest against risk and uncertainties associated with the industry especially in developing countries⁹.

¹ Peter D. Cameron, *International Energy Law: The Pursuit of Stability*. (Oxford University Press, Oxford 2010) (hereafter Cameron 2010)1.01

² For the purpose of this paper, the terms Investor, foreign investor, international oil company (IOC) will be used interchangeably.

³ Cameron 2010, 3

⁴ Cameron 2010, 3

⁵ Cameron 2010, 36.

⁶ K. P.Berger, ‘Renegotiation and adaptation of International Investment Contracts: The role of contract Drafters and Arbitrators’ (2004) 2:4 Oil, Gas & Energy Law Intelligence. www.ogel.org.(hereafter Klaus) Accessed 30thOctober 2020. (hereafter Berger)1; Kolo, Abba and TW Walde, ‘ Renegotiation and adaptation clauses in International Investment Projects: Applicable Legal Principles and industry Practices’ (2003) 1(2) OGEL,(hereafter Walde 2003) 1-48.,Jose Macedo, ‘ From tradition to modernity: The case of stabilization and renegotiation clauses’, (hereafter Macedo) www.dundee.ac.uk/cepmlp/car/html/gateway/filesphp?=-cepmlp-car14-25. Accessed 10th November 2020.

⁷Walde 2003 1-48.

⁸ A. Al Faruque, ‘Typologies, Efficacy and political Economy of Stabilisation clauses: A critical Appraisal’ (2007) 5:4 Oil, Gas & Energy Law Intelligence. www.ogel.org(hereafter Faruque 2007)1

⁹Faruque 2; Walde 2003 1

Stabilization clauses are intended as a safe guard against any unilateral termination or modification of the contract by either party, particularly the Host government; it serves *strictosensu* to safeguard the investor against any Legislative Act which may be adverse to the agreement¹⁰. A renegotiation clause on the other hand, is a clause in an agreement which ensures the right of either party to the agreement to secure the renegotiation of certain provisions in the agreement¹¹, in the light of new circumstances that may occur and threaten the success of such contracts, renegotiation clauses give the parties to the contract the opportunity to renegotiate the terms and maintain economic equilibrium¹².

A lot of focus has been on stabilization clauses, its relevance in protecting investors, and maintaining stability in EPAs. This paper argues that stabilization clauses have not achieved the much needed efficiency¹³ and stability it purports to provide, rather they may have actually done more harm than good and failed in aiding efficiency¹⁴ and stability in long term petroleum agreements and suggest that renegotiation clauses are a better option and way of maintaining stability and efficiency in EPAs, considering that change and unforeseen future occurrences are bound to occur upsetting the balance of the initial agreement. This paper will focus on the benefits of renegotiation clauses in international exploration and production agreements, it will make a case for renegotiation clauses and establish that for efficiency, maintenance of good relations and preserving the contract in present times, renegotiation clauses serve a far better purpose for both the International Oil Companies (IOCs) and Host government, and that renegotiation should be acknowledged as an integral feature of the foreign investment process.¹⁵

Nature of Exploration and Production Agreements

A Host country (HC) such as Nigeria seeking to develop its oil resources must determine the structure in which it intends to foster their exploration and exploitation¹⁶. Three main types of EPA's exist that are open to a HC and International oil companies (IOCs); the production sharing agreement, risk service contracts and concessions¹⁷. The joint venture agreement is another type

¹⁰AFMManiruzzam ' Some reflections on stabilization techniques in the international petroleum, gas and mineral agreements' (2005), 4, I.E.L.T.R, 96

¹¹www.eurofound.europa.eu/emire.Denmark/renegotiation

¹²Walde 2003, 2-3

¹³ For the purpose of this paper, the word efficiency means producing the desired or satisfactory result ie achieving the actual purpose it is meant to achieve. Oxford students dictionary (2nded 1988)202, efficiency also means working productively with minimum wasted effort or expense, Concise Oxford English Dictionary (11thed 2008) 456-457.

¹⁴This paper aims to show that stabilization clauses have not achieved their desired result, and that they have created waste through breach leading to arbitration and break down of relations.

¹⁵S.K.B. Asante, 'Stability of contractual relations in the transnational investment process' (1979) 28 ICLQ 413,

¹⁶Atsegbua Lawrence, ' Acquisition of Oil Rights Under Contractual Joint Ventures in Nigeria' (1993) 37 (1) Journal of African Law10

¹⁷ Cameron 2010 1.73; YinkaOmorogbe, *Oil and Gas Law in Nigeria* (Malthouse press, Lagos 2001) (hereafter, Omorogbe)38

which is used but rarely as the basic agreement between an oil company and the HC¹⁸. A summary of these agreements are highlighted below to facilitate a better understanding of these agreements

Concessions

This model is also known as the tax or royalty or license¹⁹ model²⁰. This was the earliest type of petroleum agreement between the IOC's and the Host government (HC) whereby the oil company received the exclusive right to explore for petroleum and if found to produce, market, and transport the oil and gas²¹. This right grants the licensee ownership of the oil produced and the right to dispose of it usually with an obligation to supply the local market²². Companies compete by offering bids and the successful bidder pays the bidding price and signing bonus which are kept by the state whether or not oil is found, but if commercial production occurs, the HC gains revenue based on the quantity of production and the price at which the product is sold²³. This model has little or no financial risk for the host country as the financial burden of development, including costs of exploration are borne by the oil company²⁴. This model gives the investor security with regards to rights in the ground and is used in countries like Norway, Thailand, Morocco, Australia and the UK and is compatible with technology transfer and training programmes²⁵, and could be exclusive (the granter can be precluded from offering further licenses in respect of the same geographical area) or non-exclusive²⁶. The concession or license model suffers from a nomenclature problem as it is associated with a period in the history of petroleum operations when the host government conceded rights to its resources to a foreign oil company for long periods and under conditions that would no longer be deemed acceptable²⁷. A negative feature is the ownership of petroleum it gave the oil companies which could be seen as an affront to the sovereignty of a

¹⁸PCR Lima, 'Possible changes in the Legal framework of the Brazillian Oil Industry' (2009) 7 I.E.L.R., 252-255. (hereafter Lima) 252

¹⁹Taverne defined a license as an administrative authorization issued by the government acting on behalf of the state exercising the latter's sovereign powers over natural resources. Taverne, Bernard, '*Petroleum Industry and Governments: A study of the Involvement of Industry and Governments in the production and Use of Petroleum.* (2nd ed.) (Kluwer Law International 2008) (hereafter Taverne 2008)5.1

²⁰Cameron 2010, 1.84.

²¹Omorogbe, 39

²² Cameron 2010,1.84. and Taverne, Bernard, '*Petroleum Industry and Governments: An Introduction to Petroleum Regulation, Economics and Government Policies*' 5.2.1

²³ Lima 253.

²⁴ Lima 253.

²⁵ Cameron 2010, 1.84

²⁶ Greg Gordon, 'Petroleum Licensing' in Greg Gordon and John Paterson (ed) *Oil and Gas Law: Current Practice and Emerging Trends* (Dundee University Press 2007, Dundee) 3.4;Taverne 2008, 116.

²⁷ Cameron 2010, 1.85; the traditional concessions covered large areas of land, transferred title to the investor and contained no obligation on the investor to explore or produce oil.

state²⁸. A number of countries especially the developing countries have made a complete or partial switch and moved from concessions to production sharing agreements²⁹.

Production Sharing Agreements (PSAs)

A production sharing agreement is a contractual arrangement made between a foreign oil company (contractor) and a designated state enterprise (state party), authorizing the contractor to conduct petroleum exploration and exploitation within a certain area (contract area) in accordance with the agreement³⁰. PSAs are among the most common type of contractual arrangements for exploration and development of petroleum³¹. Under a PSA the state as the owner of mineral resources engages the IOC to provide technical and financial services for exploration and development operations³². The state is traditionally represented by its government or agencies such as the national oil company (NOC)³³. Title to oil and gas remains vested in the HC or it's NOC while the IOC operates as a contractor which fulfills work obligations at its sole risk and expense, bringing its expertise which the HC lacks and in return, obtains a right to recovery of costs from the petroleum produced and a share of the production or profit oil if commercial production is established³⁴. Under PSAs, the HC has the option to participate in different aspects of the exploration and development process³⁵. The relationship between the HC and the FOC is governed by contract and exploration activities are carried out on a compensation basis with the IOC being paid with a portion of the oil produced if commercial discovery is made (this is the production sharing) subject to removal of cost oil³⁶ and the remainder, the profit oil is shared between the HC and the IOC³⁷.

²⁸ Cameron 2010, 1.86

²⁹ Countries like Nigeria, Malaysia, Abu Dhabi, Egypt, Indonesia and some developed countries like Russia and China introduced the PSA. Taverne Bernard, 'Production Sharing Agreements in Principle and Practice' in M.R. David (editor), *Upstream Oil and Gas Agreements* (Sweet and Maxwell, London 1996) (hereafter, Taverne 1996)48

³⁰Taverne, Bernard, 'Production Sharing Agreements in Principle and practice' in M.R. David (editor), *Upstream Oil and Gas Agreements* (Sweet and Maxwell 1996) 44, (hereafter Taverne 1996).

PSA's were first introduced in Indonesia in 1966

³¹ Kirsten Bindemann, 'Production Sharing Agreement: An Economic analysis' Oxford Institute for Energy Studies, WPM, October 1999 (hereafter Bindemann)1; Cameron 2010,1.76.

³²Bindemann 1

³³ Countries like Nigeria, Libya, Malaysia and Indonesia operate with their national oil companies. Taverne 1996, 62,63,67. Cameron 2010, 1.76

³⁴ Cameron 2010, para 1.75; Bindemannpg 1; Rudolf Dolzer and Christopher Schreuer, *Principles of International Investment Law* (Oxford University Press 2008)(hereafter Dolzer and Schreuer)7373. And the state owns the installations and equipments.

³⁵Bindemannpg 1; Taverne 1996, 45. Countries like Nigeria through its NOC participates in PSAs with FOCs like Shell, Mobil and Chevron.

³⁶ Which is the portion of the oil produced that goes towards the compensation of the FOC's expenditure; Anthony Jennings, 'Government agreements and JOAs, in Anthony Jennings (ed) *Oil and Gas Production Contracts* (1sted) (Thomson Reuters Ltd, London 2008)(hereafter Jennings)1-003

³⁷ The income of the HC is still liable to tax; Atsegbua, 14; Cameron 1.90

Joint Ventures

Joint ventures (JVs) are generally agreed to be alliance between two or more companies or individuals for the purpose of conducting a profit motivated business³⁸. In the petroleum industry JVs are common due to the fact that start-up costs and project risk are enormous particularly when new infrastructure is required³⁹. Projects involving the exploration and development of oil and gas commonly involve the creation of a joint venture between partners which could be individuals, corporate entities or government agencies⁴⁰. The starting point for the commercial activities of a JV will be the grant of rights by the government⁴¹. From the 1970's it became common for host states to participate in their oil industries, not just as regulators but as full- fledged partners in the enterprise this is found in most countries of the world with the notable exceptions of United states and Great Britain⁴². The JV is governed by other agreements which co-exist with the foundational contract that defines the relationship of the parties and sets out their respective interest in the contract⁴³. JVs are a useful vehicle between developed countries with a market economy and other countries seeking to develop a market economy, a major advantage of a JV is its use for large intergovernmental projects which cannot be funded by one country alone⁴⁴. However, JVs require painstaking negotiations over extended periods of time to ensure that all matters are thoughtfully addressed; risks, costs and liability must be shared⁴⁵. Due to these difficulties JVs are less commonly used as the basic agreement between an oil company and a HC⁴⁶.

Service contracts (SC)

Under the SC the HC grants only contractual not propriety rights to the IOC to conduct petroleum exploration for a fee or an agreed share of the production⁴⁷. SC are perceived as minimizing the foreign investor's role and impact in the host country.⁴⁸ Under the SC, the IOC provides the HC

³⁸ Stephen Sayer, 'Negotiating and structuring International Joint Venture Agreements' in the CEPMLP web journal vol 5 available at: <http://www.dundee.ac.uk/cepmlp/journal/html/vol5/article5-1.html>. (hereafter Sayer)1.1

³⁹Sayer 1.2

⁴⁰ John Wilkinson, *Introduction to Oil & Gas Joint Ventures Vol 1* Oil Fields Publications Ltd (hereafter Wilkinson) 39

⁴¹ Wilkinson 39.

⁴²Omorogbe, 45; Countries like Nigeria have, through the NNPC entered into contractual JVs with IOC'S like Shell, Chevron, Agip and Exxon Mobil, www.nnpcgroup.com/NNPCBusiness/UpstreamVentures.aspx.

⁴³Omorogbe, 45.

⁴⁴Sayer 1.2.

⁴⁵ Lima 254; JVs have led to disappointments and placed burdens on meeting cash calls on the HC which it has not always met.

⁴⁶ Lima 254.

⁴⁷ Jennings 1-022; Paul Cesar 254.SC first came into existence in the late 1960's between HC's and IOC's desiring to gain access to relatively assured supplies of crude oil. Under the SC, the HC hires the services of the IOC which assumes the legal status of a contractor, the IOC is not a concession holder or partner but merely a hired agent, Atsegbua 19.

⁴⁸ This view is not shared by many, because especially in a risk service agreement, all risk and investment are placed on the IOC which provides the capital for exploration and production and unless oil is found in commercial quantity, the IOC will not be re-imbursed for the expenses it has incurred in its unsuccessful search. Wolfgang Peter, Jean-

with technical services and information relating to the development of the petroleum resources; SC can be pure service contracts (where the HC pays a pre-agreed fee to the IOC for performing a service) or risk service contracts (where the IOC is responsible for capital cost and where exploration is successful the HC pays a fee based on a share of production)⁴⁹. This fee is usually based on a percentage of the remaining revenue which is subject to taxes, SC are similar to PSC but differ mainly in the mechanism for recovery of costs and the remuneration of the contractor⁵⁰. In both types of SC the oil company does not acquire exploration or production title nor does it acquire ownership to the petroleum produced at any stage of the production⁵¹. The attraction of foreign investors to SC are limited to locations of certain prospectively reducing the risk of exploration, Proven undeveloped fields in developing countries are candidates for such contracts especially where the HC lacks the capital and technical expertise to develop the resources. However, the arguments against SC lie in the incentive they offer⁵².

Though the above agreements may vary in their details and operation they must establish two key issues: division of profit between the government and the IOCs, and treatment of cost⁵³. In employing any type, the HC should consider factors like; energy security, involvement in the decision making process, acquisition of knowledge and expertise. Local involvement⁵⁴, revenue maximization and maintaining a balance between a reasonable depletion rate of its natural resources and the need to generate funds for economic development. The HC should also ensure protection of its environment and the health and safety of its citizens by making sure that the IOCs effect minimal damage and where such is the case, there should be provision for restoration⁵⁵. Finally the petroleum activities of a HC should not be contrary to the states policies. Profit maximization, long term access to petroleum resources, growth and expansion should be foremost in the IOC's objective.

STABILIZATION CLAUSES (SCs)

Quentin de Kuyper, Benedict de Candolle, *Arbitration and Renegotiation of International Investment agreements* (Kluwer Law international, Netherland 1995) (hereafter Wolfgang) 22; Atsegbua 20.

⁴⁹ Pure service contracts are rare; Paul Cesar 254; Jennings 1-022; Cameron 2010, 1.91.

⁵⁰ Daniel Johnston, *International Exploration Economics, Risk, and Contract analysis* (Pennwell Corporations, Oklahoma, USA, 2003) 41; Atsegbua 20.

⁵¹ The IOC is simply engaged as an agent to the host state and is paid a fee in cash or kind from the oil produced, in consideration for services rendered. Paul Cesar 254. A key feature of SC is the method of payment in oil, Cameron 2010, 1.91.

⁵² They encourage IOC's to seek high cost operations based on poor development plans as their operations are more profitable if lower recovery rate is achieved than a maximum one and can also lead to windfall gains for the investor where payment is in oil and vulnerable to volatile prices, Cameron 2010, 1.91 and 1.92.

⁵³ Lima 252.

⁵⁴ Like employment and training for its citizens.

⁵⁵ With high fines to act as a deterrent for non-compliance, Jenik Radon, 'The ABCs of Petroleum Contracts: License-Concessions Agreements, Joint Ventures, and Production-sharing Agreements' in Svetlana Tsalik and Anya Schiffrin (eds) *Covering Oil: A Reporters Guide to Energy Development*, (New York: Open Society Institute, 2005) 77-78.

SCs date as far back as the period between World War I and II when American companies included them in concessionary agreements because of Latin American nationalizations⁵⁶. SCs are contractual device developed in response to the IOC's concern for stability and protection in investment contracts, they are a form of governmental guarantee in a petroleum contracts providing that the terms negotiated under the contract between the HC and the IOC will not be unilaterally altered or terminated by the HC through promulgation of legislation or regulation⁵⁷. Their use can be understood when viewed in the light of the inherent risk⁵⁸ IOCs are exposed to when they invest in foreign countries (especially unstable countries). As a result, foreign investors demand a legal guarantee as a form of collateral against such risk and the HC willing not only to attract foreign investment but also show its seriousness to respect its commitment to the IOCs in lieu of such risk consent to the inclusion of SCs in such agreements⁵⁹.

At the dawn of the 21st Century, SCs are becoming an essential legal tool in the management of political risk which far from having disappeared has extended even to areas formerly viewed as stable⁶⁰. The reason not farfetched being that Investors are unlikely to insist on stabilization guarantees from a developed country as the concern over political risk in these countries is minute⁶¹.

SCs serve the following purposes;

(a) SC serve as a form of protection against political risk to a foreign investor⁶², the primary function of a SC is to protect foreign Investors from subsequent changes in the law of the host state

⁵⁶T.A.Q. Al -Emadi, 'Stabilisation Clauses in International Joint Venture Agreements' (2010) 3, I.E.L.R. 54. (hereafter Al-Emadi)

⁵⁷ By agreeing to a SC the HC accepts that the exercise of its legislative and administrative powers will not have the effect of modifying the contractual conditions agreed with the investor to the investor's detriment, Bernadini 2008, 100. SC have also been defined as a contract language which freezes the provision of a national system of law chosen as the law of the contract as of the date of the contract in order to prevent the application to the contract of any future alterations of the system, R.D Bishop, 'International arbitration of petroleum disputes: The development of a lexpetrolea' (1998) Y.C.A 1159.

⁵⁸ Risk such as expropriation and nationalization (whether direct or indirect) in oil producing states resulting in IOCs losing their investment in such countries, in George Joffe et al, 'Expropriation of Oil and gas Investments: historical, legal and economic perspectives in a new age of resource nationalism' (2009) 2(1) JWELB 1-8.

⁵⁹A.F.M. Maniruzzaman, 'Some reflections on stabilization techniques in international petroleum, gas and mineral agreements' (2005) 4 I.E.L.T.R, 96. (hereafter Maniruzzaman 2005)

⁶⁰ Bertrand Montembault, 'The stabilization of state contracts using the example of oil contracts: the return of the gods of Olympia?' (2003) I.B.L.J 595.

⁶¹ And even where such request are made they are unlikely to be granted; Waelde and Ndi, 'Stabilizing international investment commitments: International law versus contract interpretation' (1996) T.I.L.J 222 (hereafter waelde 1996) 31

⁶² Political risk is the risk that the laws of a country will unexpectedly change to the detriment of the investor after the investor has invested huge capital in the country, thereby reducing the value of its investment examples of political risk are; tax increase, increase in import or export duties, nationalization and expropriation of investors assets. P.E Comeaux and S.N Kinsella, 'Reducing political risk in developing countries: bilateral investment treaties,

which may result in a direct taking, such as nationalization or expropriation, or indirect taking of the property of the Investors⁶³. SC serve as a major risk management function Given that international law may not sufficiently protect foreign investors from a State's unilateral change of law.⁶⁴

(b) SCs provide predictability and certainty to exploration and production agreements⁶⁵ which is considered a core element of any legal system for its efficacy⁶⁶. The law applicable to a long term contract like a petroleum contract is vital in determining the rights and position of the parties and also the eliminating uncertainty as to what the law will be and how it will affect the contract⁶⁷.

(c) SCs encourage and promote foreign direct investment⁶⁸ The HC's interest in agreeing to a stabilization clause stems from the need to encourage foreign investment, the presence of a SC clause in an Exploration and production agreement (EPA) can function as a psychological boost to give the IOC's confidence with respect to the risk and duration of EPAs⁶⁹. For the HC, given the fact that huge capital is required to start such projects and most developing states lack the resources or technology to undertake such projects it shows a commitment on their part to preserve the original contract⁷⁰.

(d) SCs function as a form of indemnity for the IOC against any loss suffered by the IOC resulting from any action or omission on the part of the HC government, this creates a legitimate expectation for the benefit of the IOC that has to be reflected in whatever form of compensation when the agreement is frustrated⁷¹.

(e) SCs serve as risk allocation clauses, it is a way for the parties to allocate between them the risk inherent in long term transactions⁷². Most contracts come with risk which both parties should be willing to bear but the risk inherent in exploration and production contracts in developing countries exceed the level of acceptable risk hence the need for stabilization mechanisms in such agreements⁷³.

stabilization clauses, and MIGA and OPIC investment insurance' (1994) 16 N Y L Sch J Int'l Comp Law,(hereafter Kinsella)1

⁶³ Abdullah Faruque, 'Validity and efficacy of stabilization clauses: Legal protection vs. functional Value (2006) 23(4) J.I.A (hereafter Faruque 2006) 321

⁶⁴Faruque 2006 321; Nwokolo 15

⁶⁵Faruque 2006, 322

⁶⁶Faruque 2007, 13

⁶⁷Faruque 2006 322.

⁶⁸Nwokolo 14, Faruque 2006, 322.

⁶⁹Faruque 2006 322-323; risk involve geological and commercial risk; waelde 1996

⁷⁰ Jose Macedo, 'From tradition to modernity: not necessarily an evolution-the case of stabilization and renegotiation clauses' CEPMLP Dundee. www.dundee.ac.uk/cepmlp/gateway/files.php?file=cepmlp-car14-25. Accessed 14th November 2020

⁷¹A.F.M. Maniruzzaman, 'Damages for breach of stabilization clauses in International Investment Law: where do we stand today?' (2007) 11(12) I.E.L.T.R 246-247

⁷²Bernardini 2008, 98; Cameron 2010, 2.49

⁷³Bernardini 2008, 98-99. But the question still remains if SC achieve this purpose in reality.

SCs are necessary in Petroleum projects which require significant investment⁷⁴ as Lenders view stabilization clauses as an essential to the bankability of an investment project, they see SCs as a way to ensure that the HS will not enact laws to eliminate or damage the commercial viability of an investment project or take other actions to make loan repayments more difficult⁷⁵. SCs complement the guarantee financiers often require from investors.

SCs have been categorized into different forms but for the purpose of this paper the ‘*freezing clause*’, ‘*economicequilibrium clause*’ and the ‘*intangibility clause*’ which affects the legislative powers of a State is the focus.

The *freezing clause* attempts to freeze the law of the HS by providing that the governing law of the contract shall be that of the HS at the time the contract was executed, thereby preventing the application of subsequent changes in the HS’s laws to the contract⁷⁶. Such a clause is intended to protect the Investor against legislative risk by limiting the legislative competence of the HS with regard to the contractual relationship between the parties⁷⁷.

The *intangibility clause* provides that the HC may not unilaterally modify or terminate the contract without the mutual consent of both parties, it is aimed at achieving a compromise in the event that a change of law affects the terms of the contract⁷⁸. An intangibility clause can be seen in the concession contract between Liamco and Libya;

The government of Libya, the commission and the appropriate provincial authorities will take all steps necessary to ensure that the company enjoys all the rights conferred by this concession. The contractual rights expressly created by this concession shall not be altered except by mutual consent of the parties⁷⁹.

⁷⁴J.Mloncle and D.PPollez, ‘Stabilisation clauses in Investment Contracts’ (2009) 3 I.B.L.J, 268 ; C.P. Thorpe, *Fundamentals of upstream Petroleum Agreements* (2008) (C.P.Thorpe Ltd, EastbourneUk) 8-10.

⁷⁵ Andrea Shermberg, ‘Stabilization clauses and human rights: A research project conducted for IFC and the United Nations special representative to the secretary general on business and human rights, March 11, 2008 (hereafter Shermberg)

[www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p_StabilizationClausesandHumanRights/\\$FILE/Stabilization+pa.pdf](http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p_StabilizationClausesandHumanRights/$FILE/Stabilization+pa.pdf) accessed 15th November 2020.

⁷⁶ In other words, the agreement prevails over the over the contrary or inconsistent legislation of the state, this type is also referred to as the ‘strictosensu clause’, A.F.M. Maniruzzaman, ‘The pursuit of Stability in International energy investment contracts: A critical appraisal of the emerging trends’ (2008) 1(2) J.W.E.L.B, 123(hereafter Maniruzzaman 2008) C.T Curtis, ‘The legal security of economic development agreements’ (1988) 29 H.I.L.J 346 (hereafter Curtis) ; M.T.B. Coale, ‘Stabilization clauses in international petroleum transactions’ (2001-2002) 30 Denv. J. Int’l L. &pol’y, 223 (hereafter Coale)

⁷⁷Maniruzzaman 2005, 97. ⁷⁷ For an example of freezing clause see, Mineral Development agreement between The Government of The Republic of Liberia, China_Union(Hong Kong) Mining Co, Ltd and China_Union Investment (Liberia) Bong Mines Co. Ltd. http://www.emansion.gov.lr/doc/china_union_gol_mineral_agreement.pdf14.4,29.1.

⁷⁸Curtis 346; A.DNwokolo, ‘Is there a Legal and functional value for the stabilization clause in International Petroleum Agreements?’, www.dundee.ac.uk/cepmlp/car/htmlcar8-article27.pdf accessed 23 November 2010, 6-7;(hereafter Nwokolo,) Coale 223.

⁷⁹ Libyan American Oil Company (LIAMCO) v. Government of the Libyan Arab Republic, Award of 12 April 1977, (1981)20 ILM 1

The *economic equilibrium clause* is a modern form of stabilization clause which seeks to maintain the profitability of the contract where the terms of the contract are altered, it allows for change of laws to affect the contract while providing for the IOC to be compensated by the HC for any loss suffered due to such change⁸⁰.

Irrespective of the type of SC used, the aim in the words of El Chiati, is;

Behind the great diversity of stabilization clauses lies a one and sole objective: to preclude the application to an agreement of any subsequent legislative (statutory) or administrative (regulatory) act issued by the government or the administration that modifies the legal situation of the investor⁸¹

RENEGOTIATION CLAUSES

Renegotiation clauses (RCs) are provisions in contracts that upon the happening of certain event/events require the parties to return to the bargaining table and renegotiate the terms of their agreements⁸². Bernadini is of the view that RCs are an alternative to SC and this preference to Nwete, is hinged on the allowance RCs give the contracting parties to accommodate fundamental changes within the existing framework of the contract⁸³. RCs rest on the principle of *clausula rebus sic stantibus*, and have gained acceptance as a means of achieving stability and flexibility in long-term international commercial contracts, particularly EPA's involving the HC and IOC's⁸⁴. EPA's are characterized by lengthy time duration, high cost and large scale investments⁸⁵, which may or may not yield commercial find to justify the investment coupled with uncertainty due to technological and political risk to vagaries of international oil prices⁸⁶. The above creates the need for some form of guarantee and stability in the contract most especially for the Investor as against the HC's need for a flexible and amenable contract to enable it exercise its regulatory and sovereign powers over its natural resources⁸⁷.

A principal function of long-term transactions is to facilitate trade between the parties who must make relationship specific investments because once investments have been sunk and parties become locked in, the agreement must be governed by the provisions of the contract⁸⁸. Parties cannot foresee all the vagaries of the future though lawyers may try to "play God"⁸⁹ by freezing

⁸⁰ They stabilize the economic equilibrium of the contract rather than the regulatory framework. Lorenzo Cotula, 'Reconciling regulatory stability and evolution of environmental standards in investment contracts: Towards a rethink of stabilization clauses' (2008) 1(2) J.W.E.L.B 161.

⁸¹A.Z.EChiati, Protection of Investment in the context of Petroleum Agreements (1987) Recueil des cours 204(IV) 115; Curtis 347.

⁸²J.YGotanda 'Renegotiation and Adaptation clauses in International Investment Contracts, revisited' (2003) 36 V.J.T.N.L 1462. (hereafter Gotanda)

⁸³Bernadini 101; Bede Nwete, 'To what extent can renegotiation clauses achieve stability and flexibility in petroleum development contracts?' (2006) 2 I.E.L.T.R (hereafter Nwete) 56 ;Dolzer and Schreuer 77.

⁸⁴Nwete 56.

⁸⁵Kolo and Waelde 1.

⁸⁶Nwete 56; Macedo4 ;Klaus 1-2; Coale 219.

⁸⁷Nwete 56.

⁸⁸Hart 755.

⁸⁹Waelde 1996, 220.

the contract, RCs provide a certain degree of flexibility which allows the parties to adjust the contract to new circumstances that were not envisaged at the time of making the contract⁹⁰.

RCs can preserve long term business relationships by reducing the likelihood of disputes which can terminate the contract relationship and result in the inability of parties to work together on current and future projects⁹¹.

RCs offer the parties an early opportunity to settle differences that have the tendency to engender disputes, to Nwete it is a first step dispute resolution mechanism which offers the parties a better consensual opportunity to maintain the benefits of the contractual relationships by adapting the contractual document to their needs⁹².

RCs offer a middle ground between the flexibility needs of the HC and the stability needs of the Investor, They allow the HC to exercise its regulatory and sovereign powers by making laws or taking other steps that can affect the petroleum development of the contract while providing the Investor with an opportunity to renegotiate the contract with a view to maintaining the financial premises and economies of the project⁹³.

RCs salvage potentially frustrated contracts especially for the IOC's due to asset specificity⁹⁴, Where there is no provision for renegotiation in good faith and the HC decides to frustrate the contract, the IOC cannot turn to another supplier this can render the investment of the IOC worthless in the face of such frustration or termination.

RCs offer the parties an opportunity to complete an otherwise incomplete contract⁹⁵ by acting as the mechanism for revising the terms of the contract and enabling the parties to allocate unanticipated risk⁹⁶ and share profits emanating from large discoveries, increase in oil prices and improvement in technology which reduces cost of production⁹⁷.

⁹⁰JeswaldSalacuse, 'Renegotiating international business transactions: The continuing struggle of life against form' (2001) 35 Int'l Lawyer,(hereafter Salacuse 2001)1513 ; Cameron 2010 2.61

⁹¹Salacuse 2001, 1514; Gotanda. This can occur where one party in the absence of a renegotiation clause refuses to negotiate even when the current situation is onerous on one party, if the disadvantaged party is the state, it could result in termination and the state may refuse future dealings which such a company.

⁹²Nwete 60; Kolo and Waelde 2.

⁹³For the HC, a RC allows it to make new laws with respect to its environment, human rights and this flexibility allows economic development for the state. Salacuse 2001 1515;Nwete 60; Shermberg; Cotula 2008.

⁹⁴ The reason behind asset specificity is that once investments have been made, the parties are locked into the transaction the IOC's cannot turn to alternative sources of supply and obtain the item (petroleum resources) which belong to the state as only the HC can grant access to such resources. O.E Williamson, 'The economics of organization: The transaction cost approach' (Nov 1981) 87(3) Am. J. Soc. 555. [www.jstor.org/stable /2778934](http://www.jstor.org/stable/2778934) accessed 10th November 2020.

⁹⁵ Hart 755; Daniel Johnston, *International petroleum fiscal systems and production sharing contracts* (1994 Pennwell Corporation) Oklahoma USA) 173.

⁹⁶ Risk such as geological, price, regulatory and political risk which may negatively impact on the project, Nwete 60.

⁹⁷ This profit could be termed windfall profits emanating from the above, where there is no provision for renegotiation and such boom occurs, a HC may not wanting to nationalize the assets of the IOC may introduce windfall taxes.

RCs attract foreign direct investment. The inclusion of a RC in an agreement indicates the HC's commitment to encourage investment, providing an attractive economic climate, improving economic and social development.

RCs offer the IOC's protection against unilateral revocation or modification of the contract by the HC, under a RC the state binds itself to renegotiate the agreement in case of supervening circumstances instead of revoking or altering the terms⁹⁸. It protects the IOC by not establishing a fixed legal situation but making the contractual framework flexible and dynamic throughout the duration of the contract in case the HC changes the economic circumstances by sovereign acts⁹⁹.

ISSUES AND CHALLENGES ASSOCIATED WITH STABILIZATION AND RENEGOTIATION CLAUSES

Issues with Stabilization Clauses

UNGA resolution No. 1803 (XVIII) not only recognizes the rights of peoples and nations to permanent sovereignty over their natural wealth and resources, it further declares that nationalization and expropriation can be implemented on the grounds of public utility, security or national interest, subject to appropriate compensation¹⁰⁰. Commentators are of the view that SC are a limitation on a states' sovereignty which fetters the power of a HC to make new laws and that it is contrary to public international law¹⁰¹. Arbitrations like *Aramco* and *Agip* reflect the view that a state exercises its sovereignty when it binds itself with clauses in an investment agreement¹⁰². Authors are of the view that insertion of SC in exploration and production agreements (EPA's) are more likely to affect the amount of damages awarded or the certainty that damages will be awarded¹⁰³.

A school of thought is of the view that SC are an infringement on state duties and Investors responsibilities towards human rights, according to this school SC can make foreign investors immune from bonafide social and environmental laws that come into force after the effective date of the agreement¹⁰⁴. They argue that the negative effect of SC are exacerbated in developing

(China in 2006 imposed a special upstream tax levy on oil companies at rates between 20 – 40% linked to oil prices in respect of 40 dollars per barrel, Algeria in 2006 promulgated regulations imposing windfall tax on production values exceeding 30 US dollars per barrel. Nwete 60; Marketwatch.com and Businesswire.com 2007 cited in Chekol 10.

⁹⁸Z.AAlqurashi, 'Renegotiation of international petroleum agreements' (2005) 22(4) J.I.A 267.

⁹⁹ Klaus 1361.

¹⁰⁰UNGA Resolution 1803 (XVIII) 14 December, 1962.

¹⁰¹T.B Hansen. 'Legal effect given stabilization clauses in economic development agreements' (1987-1988) 28 V.J.I.L1028.

¹⁰² Saudi Arabia v. Arabian American Oil Company (1958) 27 ILR 168; *Agip v. Popular Republic of Congo* (1982) 21 ILM 735.

¹⁰³ Kinsella 25; See Maniruzzaman 2007, 246.

¹⁰⁴Shermberg 10

countries where rapid legislative development and implementation is needed rather than obstacles to the implementation of the new laws¹⁰⁵.

Human rights groups have voiced concerns that SC in the Baku-tbilisi-ceyhan (BTC) and the Chad-Cameroon pipeline project hinders the rights of HC's to meet their international human rights obligations and limit the application of new laws protecting human rights¹⁰⁶.

SC hampers social development, most developing countries entered into EPA's with Investors at a time when their regulatory systems were weak and with the inclusion of SC in such agreements these countries are unable to promulgate new laws in furtherance of development¹⁰⁷. This is also seen where the HC is required to compensate the Investor for compliance with new social or environmental laws; this creates a financial disincentive for the HC and can hinder the application of dynamic social and environmental standards over the life of a long term project¹⁰⁸.

SC can also hamper economic development; they cement a state's weak economic position at the time of signing the contract¹⁰⁹ and constrain a HC's ability to review the terms of existing EPA's to benefit from unexpected windfall profits so despite the rise in oil prices which may not have been foreseeable at the time of the contract, SC tie the hands of HC's from reviewing such terms¹¹⁰.

¹⁰⁵Shermberg 10

¹⁰⁶ They are grave concerns that the agreement between (BP) the pipeline consortium leader and the Turkish government creates a huge disincentive for Turkey to protect human rights because Turkey has agreed to pay compensation if pipeline construction or operation is disturbed. Amnesty international warns that this could mean 40-60 years of serious risk to human rights of those who protest. The SC in the Chad Cameroon project also infringes on International Human rights. For detailed reports see, Amnesty International, Human Rights on the line: The Baku-Tbilisi-Ceyhan pipeline project (report) May 20, 2003. www.amnesty.org.uk/news/details.asp?NewsID=14542 accessed 3rd November 2020; Amnesty International, Contracting out of Human rights: The Chad-Cameroon pipeline project. (report) September 2005. POL 34/12/2005. www.amnesty.org/en/library/assets/POL34/012/2005/en/76f5b921-d4bf-11dd-8a23-d58a49cod652/pol340122005en.pdf.

¹⁰⁷ Amnesty International, Nigeria: Petroleum, pollution and poverty in the Niger Delta (report) June 2009 (Amnesty International publications, London, United Kingdom) 10

¹⁰⁸Shermberg 10; This can apply to areas of employment law, like reduced hours of work, increase in minimum wage which can impact on the IOC's project cost. Where the HC has to compensate the IOC's for applying such laws or where the IOC's refuse to apply the laws due to SC, the willingness of the HC to enforce such laws can be diminished due to stabilization clauses.

¹⁰⁹ J. Radon, 'Kazakhstan's PSA Challenge: Sanctity of Contracts Vs. Stabilization', (2010) 8(2) O.G.E.L 3.

¹¹⁰T.WWaelde, 'Renegotiating acquired rights in the oil and gas industries: Industry and political cycle meet the rule of law' (2008) 1(1) J.W.E.L.B. 55.

SC can create distortions in legal policy and hamper sustainable development, because HC's will be trying to create ways to foster sustainable development goals that are less costly for on-going investment projects even if these policies are less effective in fostering sustainable development¹¹¹. Cameron identifies the *Obsolescing bargaining*¹¹² theory as a major reason for instability in long term petroleum agreements and investors use SC to secure their investments in such agreements¹¹³. The issue with regards to stabilization clauses is not a question of its validity when freely inserted in an agreement because it has been established that they are valid and binding under international law¹¹⁴, though not a guarantee against nationalization or expropriations¹¹⁵. In the Libyan expropriation cases of *BP Exploration, Topco and Liamco*¹¹⁶ The Libyan revolutionary government nationalized the entire interest of *BP* and part interest of *TOPCO AND LIAMCO* initially, when *Topco* and *Liamco* commenced arbitration the remaining of their interest were also nationalized despite the inclusion of SC in the concessions¹¹⁷. Though the awards in the above cases were favourable to the companies, it doesn't change the fact that the Libyan government still disregarded the SC and went ahead to nationalize the interest of the foreign companies. In more recent cases like;

*Aguaytia Energy, LLC (AEL) v. Republic of Peru*¹¹⁸ and *Duke Energy International Peru Investments No 1, Ltd v. Republic of Peru*¹¹⁹ The SC in both cases though held to be valid did not stop the Peruvian government from acting contrary to the SC which was the reason for the case. In the first case AEL claimed that Peru breached the *conite* agreement by taking actions inconsistent with the stability of AEL's right to non-discrimination and applied favourable conditions to other state held companies, while in Duke's case the Peruvian government was in breach of the SC freezing the tax regime¹²⁰.

¹¹¹ Lorenzo Cotula, 'Regulatory takings, stabilization clauses and sustainable development' (OECD, Global forum on VII on international Investment)(27-28 March 2008)12-13 www.oecd.org/dataoecd/45/8/40311122.pdf(hereafter Cotula 2008)

¹¹² This is a cycle whereby after the bulk of investment has been made by the investor, the allocation of risks shifts rapidly from the HC to the Investor. Negotiating leverage shifts during the life cycle of the project, factors like change of government, discovery in commercial quantity and commencement of production) may influence the original agreement and force a revision of the terms under grounds of being obsolete. See Cameron 2010, 1.03-1.06.

¹¹³ Cameron 2010, 1.06; A.A. Chekol, 'Stabilization clauses in petroleum development agreements examining their adequacy' CEPMLP Dundee, www.dundee.ac.uk/cepmlp/gateway/files.php?file=cepmlp_car13_51, 6.

¹¹⁴ Chiati 161; *Saudi Arabia v. Arabian American Oil Company (Aramco)* 1963 27. I.L.R, *Texaco Overseas oil Petroleum Company/California Asiatic Oil Company v. Government of the Libyan Arab Republic (Topco)* 1978 17 I.L.M.

¹¹⁵ Chiati 162

¹¹⁶ *BP Exploration Company (Libya) Ltd. v. Government of the Libyan Arab Republic* 53, I.L.R; *Topco* (supra); *Liamco* supra n.80.

¹¹⁷ For more details see *BP*,s case (supra); *TOPCO*(supra) *LIAMCO*(supra)

¹¹⁸ For more details see ICSID case No. Arb/06/13 pg 41-43 and 53-54. (Award dated 11 December 2008).

¹¹⁹ For more details see ICSID case No. Arb/03/28 227(Award dated August 18 2008)

¹²⁰ *AEL v. Republic of Peru* (supra); *Duke Energy* (supra)

The Russian example of, *Hulley Enterprise Ltd (Cyprus) v. The Russian Federation*¹²¹ The claimants alleged in their notices of arbitration and statement of claim that the respondent expropriated and failed to protect the claimants' investments¹²².

One trend is clear and constant from the above mentioned cases, The HC all breached the agreements despite the presence of SC in the agreements. While SC may be valid, they cannot in reality prevent a HC from exercising its inalienable right to legislate¹²³.

However, Authors are of the view that the presence of a stabilization clause in an EPA increases the likelihood that compensation will be awarded the IOC¹²⁴. Curtis suggests restitution in the light of violation of an SC, however arbitrators will not order specific performance of an EPA even if it contains a SC of respect for the sovereignty of a state and inability to enforce such an Award¹²⁵. Nwaokoro is of the view that stabilization clauses create a false sense of security for the IOC's when faced with adverse governmental measures that purport to alter the fiscal regime governing international EPA's¹²⁶. He further stresses that stabilization clauses in itself provides no more than a psychological comfort as a wronged IOC must litigate in the HC where the courts or arbitrators are unlikely to order specific performance of an agreement even if it contains a stabilization clause¹²⁷.

Where countries do not want to out rightly expropriate or nationalize foreign investment they engage in what is called *creeping expropriation*¹²⁸, example Venezuela's introduction of a new hydrocarbon law in 2001 with measures taken to regulate the petroleum industry¹²⁹. In 2007 the president of the Republic announced that all projects that had been operating outside the framework of the 2001 hydrocarbons law would be nationalized, Venezuela radicalized the nationalization by forcing six major oil companies to renegotiate their agreements with respect to

¹²¹http://encharter.org/fileadmin/user_upload/document/Hulley_interim_award.pdf Accessed 4th November 2020) 2

¹²²Hulley Enterprise case (supra). Although there may not be a SC *strict sensu*, but the energy charter treaty by (part III, Art 10) was supposed to create a protection for these Investors but the Russian Government still went ahead to expropriate the assets concerned. Energy Charter Treaty, www.ena.it/pdfai/Treaty.pdf

¹²³Faruque 2006, 329; *Pakerings v. Lithuania* ICSID case No ARB/05/8, 332.

¹²⁴Kinsella 30; Bernadini 2008, 101; Note that compensation may not be payable when the HC exercises its legislative powers in a bonafide and non-discriminatory manner, see *Saluka v. Czech Republic* <http://www.pac-cpa.org/upload/files/SAL.CZ%20partial%20Award%20170306.pdf> accessed 24th October 2020

¹²⁵ Curtis 365; Kinsella points that the award for restitution granted in the Texaco case (n. 114) cited above is an exception, which has not been followed in subsequent arbitrations and even the award for restitution in the Texaco case proved difficult to enforce in the face of strong opposition by the HC. Rather a violation of a SC is more likely to affect the amount of damages to be awarded. Nwaokoro 101, El-Chiati 165, Kinsella 25; Cotula 2008, 165-166.

¹²⁶Nwaokoro 103.

¹²⁷Nwaokoro 101, Chiati 165,

¹²⁸Statitization: measures by a state to take over an entire industry. D.E. Vielleville and B.S. Vasani, 'Sovereignty over natural resources versus rights under Investment contracts: Which one prevails?' (2008) 5(2) T.D.M (hereafter Vielleville) 2.

¹²⁹*Mobil Corporation and others v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/27 (June 2010) 7.

four heavy oil projects in the Orinico basin¹³⁰. Some of the oil companies accepted the forced terms while others like Mobil initiated arbitration proceedings against Venezuela.

The achievement or the ability of stabilization clauses to ensure stability or efficiency in EPAs should be measured during times when they are most needed and the record on that from the above examples show minimal success if any¹³¹.

Drawbacks with Renegotiation Clauses

RCs have been viewed as increasing transaction cost and diverting the Investors resources and attention from what he does best (exploiting natural resources), this view is not absolute as RCs salvage potentially frustrated contracts especially where the terms are unduly onerous to one party¹³². However, the cost of the onerous performance of the contract, termination by the HC, loss of investment due to asset specificity for the IOC, litigation or arbitration may eventually be higher than the cost of renegotiation and supposed time wasted.

Another concern is that RCs may inject uncertainty undermining the stability of the contract, by inviting spurious claims for renegotiation¹³³. This problem, Nwete suggest, can be addressed by; Inserting a time limit within which the renegotiation must produce results and failing which a dispute must be declared and the parties are to submit to arbitration.... none of the parties may want to go to arbitration bearing in mind that a dispute must be declared at the end of the time limit and the tribunal may adapt the contract contrary to their intentions¹³⁴.

Where the parties decide to submit to arbitration the issue of whether failure to agree amounts to a dispute arises because without a ‘*dispute*’, the tribunal may not exercise jurisdiction and where it does it may be unable to decree an enforceable award¹³⁵. It was decided that “*An obligation to negotiate is not an obligation to agree*”¹³⁶ as a result no *real or legal dispute* may exist between the parties. This may pose a problem because the existence of a dispute is a prerequisite for arbitration under the ICSID and the UNCITRAL model law¹³⁷. However one party’s violation of the requirement of good faith in renegotiation of the contract giving rise a legal right of the

¹³⁰Vielleville 2

¹³¹ A.A Chekol n. 113

¹³²Berger 1; Nwete 61; Macedo 12.

¹³³Gotanda 1463; Kolo and Waelde 24

¹³⁴Nwete 62.

¹³⁵Emmanuel Gaillard and John Savage (eds) Fouchard, Gaillard, Goldman on *International commercial arbitration* (1999 Kluwer Law International, Netherlands) 24, 27-29.

¹³⁶*Kuwait v. American Independent Oil Company* (Aminoil) (1982) 21 ILM 1004.

¹³⁷ICSID requires the existence of a legal dispute for proceedings to commence Art 25(1). Delaume is of the view that disputes involving renegotiating the agreement or certain of its terms will normally fall outside the scope of the convention, George Delaume, ‘ICSID arbitration proceedings: Practical aspects’ (1985) 5 *pace Law Review* 567-68; UNCITRAL model law Art 7(1); Gotanda 1463.

aggrieved party to enforce it should qualify as a legal dispute within the jurisdiction of the ICSID¹³⁸.

Another drawback is where the RC provides little guidance to the arbitrator on modifying the terms of the contract, the result could be an award contrary to what the parties envisaged¹³⁹. This can be checked by limiting the role of the arbitrator to the purpose of the RC clause¹⁴⁰.

Reasons like changed economic conditions can render an entire agreement inequitable. The fiscal impositions in the Shell/Ghana onshore petroleum prospecting and production agreement were virtually nullified by the energy crisis in 1973 and the entire agreement had to be renegotiated¹⁴¹. More liberal agreements between the same IOCs and neighbouring nations can necessitate renegotiation and in such instances a sort of more favoured nation clause comes into play, Nigeria invoked this principle when the IOC's renegotiated their contracts with the Arab states¹⁴². A new government more ideologically committed to control of strategic sectors in the country's economy may result in renegotiation for equity participation in the IOC or obsolescence of the technical formula for determining a rate can trigger renegotiation¹⁴³.

In 2008, the NNPC voiced that Nigeria intends to renegotiate its 1993 and 2000 production contract to win more favourable terms for the nation, the 2000 MOU with oil companies' guarantees a profit of \$2.50 a barrel and a lower tax rate of 65.75% was equally guaranteed by the 2000 MOU which differs from that under the profit tax Act of 85%¹⁴⁴. These incentives have capped the upside from such contracts. The Nigerian move to renegotiate reinforces a global trend of oil exporting countries demanding better terms to reflect surging oil prices¹⁴⁵. The argument of the Nigerian government is that majority of these contracts were signed when oil prices were close to \$20 per barrel and the cost of exploring in frontier areas deep offshore was high and distinct terms for gas

¹³⁸AFMManiruzzaman, 'International Energy Contracts and Cross-Border Pipeline Projects: Stabilization, Renegotiation and Economic Balancing in changed circumstances-some recent trends' (2006) 4(4) OGEL, 9

¹³⁹Gotanda 1466.

¹⁴⁰ This reduces the risk of the arbitrator re-writing the contract contrary to the parties' intentions and ensuring that the economic or financial equilibrium of the original contract is maintained with the interest of both parties represented.

¹⁴¹ Asante 412, After this experience shell was persuaded to accept a renegotiation clause to the effect that the terms of the agreement will be reviewed if the fundamental bases of the agreement changed, having regard to the world market price in the petroleum industry.

¹⁴² Asante 412.

¹⁴³Asante 412-413

¹⁴⁴ Business Monitor International, Oil and Gas Insight, February 2008.www.oilandgasInsight.com/file.51787/Nigeria-begins-oil-contract-renegotiation.html

¹⁴⁵ Mathew Green, 'Nigeria warns on oil contracts' Financial Times (22nd January 2008) www.ft.com/cms/s/0/6502d52e-c875-11dc-94a-0000779fd2ac.html#axzz1vTuMVGRT. Accessed 17th November 2020.

exploration was not factored into the contract¹⁴⁶. Idornigie is of the view that the move to renegotiate is justified as the current terms of the PSC do not adjust to project profitability.

Significant changes in the assumption underlying the original contract which fundamentally affected the original expectations of the parties with respect to profit/returns from the operation mounted pressure for renegotiation¹⁴⁷, in most of the above cases. Experience shows that the HC will renegotiate the contract whether or not the agreement or governing law provides for such renegotiation¹⁴⁸ this leaves little doubt as to the inevitability of RCs in EPAs.

RECOMMENDATION

In using RCs to achieve stability and efficiency in EPAs parties should pay particular attention to certain key issues; The scope and foreseeability of the events that trigger renegotiation, Does the applicable law recognize the ability of the arbitrator to adapt the terms of the contract in the event that the parties are unable to reach an agreement through renegotiation and the criteria to be used by the arbitral tribunal in adapting the contract¹⁴⁹.

The events that trigger renegotiation should be defined to reduce frequent calls which can create unpredictability but not be too specific to preclude parties from relying on it where vital, hence RCs should not be deemed fit for all purpose but should address changes like price fluctuation and marginal discovery else it will not achieve efficiency. This reduces the ability of the parties to seek for renegotiation on flimsy grounds yet enhancing flexibility¹⁵⁰.

The parties should ensure that the arbitrator has powers to adapt the contract under the applicable law but the arbitrator's role should be limited to adjudicating the disputes arising from the agreement and not reviewing the contractual arrangement so that the award does not defeat the purpose of the RC.

The factors that trigger renegotiation should not be within the control of any party and should be based on events that could not reasonably have been taken into account at the time of concluding the contract¹⁵¹.

CONCLUSION

Although both the hardship¹⁵² concept can in theory provide a starting point for renegotiation of the contract in changed circumstances this is rarely the case as a HC will be precluded from

¹⁴⁶Declining exploration cost is also a key driver in oil contract renegotiations, IdornigieOboarenegbe, 'What is the justification for the proposed renegotiation of deep off-shore production sharing contracts in Nigeria' (2008) 6 I.E.L.R 196

¹⁴⁷Qurashi 265

¹⁴⁸Qurashi 265

¹⁴⁹Gotanda 1472

¹⁵⁰Nwete 60

¹⁵¹ The test of reasonableness should be objective.

¹⁵² The UNIDRIOT principle in Art 6.2(2) defines hardship as events upon the occurrence of which the economic equilibrium of the contract is fundamentally altered due to increase in cost of performance or diminished returns in the value of performance.

invoking this principle where the event is brought about by itself¹⁵³, even where the contract is concluded by its NOC for reasons of piercing the corporate veil¹⁵⁴. The IOC's likewise will rarely achieve renegotiation of the contract on invoking this principle making renegotiation of the contract difficult in the absence of a renegotiation clause. Where the performance of the contracts become too unfavourable, HCs will mostly call for renegotiations¹⁵⁵ or force renegotiation where the IOC's are unwilling. Hence it is in the interest of both parties to include RCs in the agreement for better performance of the contract as the continuity and efficiency of the contract depends on renegotiation. This is particularly so where the project and parties depend on continued performance of both sides to maintain an advantageous project and their relationship¹⁵⁶.

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¹⁵³E.g. Legislation

¹⁵⁴ The NOCs are regarded as an integral component of the state which is responsible for change of conditions in the HC, Berger 5.

¹⁵⁵E.g. the Indonesian government is looking to renegotiate its outdated oil and gas contracts that were signed before the Indonesian oil and gas law took effect in 2004, 'Indonesia to renegotiate contracts' (21st July 2011) Upstream online.com, www.upstreamonline.com/live/article268458.ece?mobile=&lots=SITE. Accessed 17th November 2020.

¹⁵⁶Kolo 29.

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