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Legal Status of Stabilisation Clauses vis-à-vis Legislative Actions: The Implications in the Current and Future Investment in the Petroleum Industry in Tanzania

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Abstract:

Stabilisation clauses are one of the key protection tools for investors in the petroleum industry. The clauses protect investors from unilateral Government legislative action of changing the agreed terms of the agreement. The clauses are useful in attracting foreign capital investment as through the Government commitments, investors get confidence in their projects. The confidence extends to bankers. Most of Tanzania's Production Sharing Agreements (PSAs) contain stabilisation clauses.

The Natural Wealth and Resources Contract (Review and Re-negotiation of Unconscionable Terms) Act, 2017, declares unconscionable all existing PSAs with stabilisation clauses. Those provisions in the PSAs are in danger of being expunged in case investors are unwilling or re-negotiation fails with the Government. Expunging a term of the PSA amounts to a unilateral amendment of the agreement by the Government, which is contrary to its commitment guaranteed through stabilisation and renegotiation clauses that require mutual consent. This amounts to a fundamental breach of an agreement that entitles the innocent party (an investor) to damages since the breach of stabilisation clauses constitutes a violation of international law.

Stabilisation clauses are regarded as tools for attracting investment in the petroleum industry. By removing stabilisation clauses, the Government has opted to remove one of the key attractions to investments in the petroleum industry in Tanzania. Hence, the future investment in the petroleum Industry in Tanzania is shaken. Stabilisation clauses are key for the bankability of petroleum projects.

Keywords: *Petroleum Industry, Production Sharing Agreement and Stabilisation Clauses.*

1. Introduction

The United Republic of Tanzania has been exploring petroleum since the 1950s. Several multinational petroleum companies have conducted exploration operations

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in different onshore and offshore sedimentary basins.[1] Exploring and developing petroleum is a capital-intensive venture with long-term investment exposed to various political, economic, regulatory and price volatility risks.[2] In undertaking the exploration and development of petroleum in Tanzania, two contractual systems have been used: the concessionary system (a tax and royalty system) and Production Sharing Agreements (hereinafter referred to as PSA.[3] A concession agreement is an agreement between a Government and a company that grants that company the exclusive right to explore for, develop, produce, transport and market petroleum resources at its own risk and expense within a fixed area for a specific time.[4]

Under the concessionary system, two companies (British Petroleum (BP) and Shell International Oil Company) were jointly awarded a concession covering the onshore coastal basins and the islands of Zanzibar, Pemba, and Mafia.[5] PSA system is a contractual arrangement between a Government or a National Oil Company (NOC) and an investor or International Oil Company (IOC) to explore and produce hydrocarbons for a specific period within a contract area.[6] The system started in Tanzania after establishing TPDC under Government Notice No. 140 of 1969, which is applicable to date. The Government of the United Republic of Tanzania, TPDC and Azienda Generale Italiana Petroli (AGIP) signed the first PSA in 1969.

Since 1952 when exploration activities started, there have been numerous legislative reforms governing the petroleum industry in Tanzania, focusing on ensuring the Government captures the economic rent. Most of the existing PSAs in Tanzania contains stabilisation clauses to protect and attract investments in the petroleum industry. Stabilisation clauses may take different forms; freezing stabilisation clauses and modern stabilisation clauses[7]. Part two will provide elaboration of the genesis, meaning and types of stabilisation clauses. The article will focus on the reforms with unilateral measures the Government undertook in 2017.

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[1] Abdallah Katunzi, Marius Siebert, and Friedrich-Ebert-Stiftung, Tanzania Oil and Gas Almanac: A Reference Guide (Friedrich-Ebert-Stiftung and OpenOil 2015) 12.

[2] Tade Oyewunmi, 'Stabilisation and Renegotiation Clauses in Production Sharing Contracts: Examining the Problems and Key Issues' (2011) 9 Oil, Gas & Energy Law Intelligence 1, 3.

[3] Muhammed Mazeel, Petroleum Fiscal Systems and Contracts (Diplomica Verlag 2010) 1 <http://site.ebrary.com/id/10489503> accessed 21 March 2020.

[4] Philip Daniel, Michael Keen and Charles P McPherson (eds), The Taxation of Petroleum and Minerals: Principles, Problems and Practice (Routledge/International Monetary Fund 2010) 111.

[5]"TPDC | Welcome..."https://tpdc.co.tz/upstream.php> accessed 21 March 2020.

[6] Kirsten Bindemann, Production-Sharing Agreements: An Economic Analysis (Oxford Inst for Energy Studies 1999) 1.

[7] Mario Mansour, Carole Nakhle, and Oxford Institute for Energy Studies, Fiscal Stabilization in Oil and Gas Contracts: Evidence and Implications (2016) 14–15.

The article evaluates the legislative reforms with unilateral effects of amending existing petroleum contracts (PSAs) with the protection mechanisms of stabilisation clauses. The analysis will base on the meaning, categories, rationale and legal status of stabilisation clauses, legislative actions with unilateral measures and their implications in the petroleum industry's current and future investments, and concluding remarks at the end.

2. Meaning, Genesis, and Categories of Stabilisation Clauses in Petroleum Agreements

(i) Meaning of Stabilisation Clauses

Stabilisation clauses are clauses in an investment contract concluded between a host government and a foreign investor or in a domestic law that provides an undertaking that the Government will respect and maintain the agreed terms for a specific project period.[8] Cameroon defines stabilisation clauses as "all of the mechanisms, contractual or otherwise, which aim to preserve over the life of the contract the benefit of specific economic and legal conditions which the parties considered appropriate at the time they entered into the contract."[9] The maintenance of the contractual relationship aims to curb subsequent government legislative or administrative measures that may have the effect of annulling or changing the agreed terms in a contract.[10] Various techniques are used to stabilise the contractual relationship, including contractual stabilisation clauses, the special law for a project, and international law to govern the contract and dispute settlement.[11]

(ii) Genesis of Stabilisation Clauses

Stabilisation clauses were introduced by American companies in Latin America between the two world wars when investors experienced nationalisation challenges by host governments of their concession, especially after reaching a sound stage of reaping profit or production.[12] The 1925 Concession Agreement between the British company Lena Goldfield and the Soviet Union that required the Soviet Government "not to make any alteration in the agreement by Order, Decree, or other unilateral

[8] Jola Gjuzi, Stabilization Clauses in International Investment Law: A Sustainable Development Approach (Springer Berlin Heidelberg 2018) 11.
[9] Peter D Cameron, International Energy Investment Law: The Pursuit of Stability (Oxford University Press 2010) 73.
[10] AFM Maniruzzaman, 'The Pursuit of Stability in International Energy Investment Contracts: A Critical Appraisal of the Emerging Trends' (2008) 1 The Journal of World Energy Law & Business 119, 120.
[11] ibid 120–124.
[12] Gjuzi (n 8) 14–15.

act, or at all except with Lena's consent" is regarded as the first stabilisation contractual clause.[13] The trend of contractual stabilisation increased in the mid-twentieth century in investment contracts. Sornarajah illustrated that stabilisation clauses were considered an essential contractual tool to protect investors who were the weak party against the host government, which had the legislative power to change the agreed terms in the contracts.[14] Hence, "It was in the interests of the foreign corporation to neutralise this power. The stabilisation clauses were introduced into the agreement to effect this."[15]

(iii) Categories of Stabilisation Clauses

Stabilisation clauses may broadly be categorised mainly into three levels: classic stabilisation, intangible, and modern stabilisation.

(a) Classic Stabilisation Clauses

Classic stabilisation clause is invariably referred to as a freezing stabilisation clause or incorporation clause or stabilisation clause in *stricto sensu* operate to ensure that the law applicable to a particular contract or project shall be the host government's prevailing law during the contracting period.[16] It is a more traditional approach that freezes the laws of the host state obtained on the day of the agreement to apply for the whole duration of the contract.[17] Such a clause prohibits the host state from changing its laws and, in a sense, 'handcuffs' the host state's exercise of its sovereign rights to change its laws.[18] Such a clause restricts changes made after the effective date to be applied in the investment contract.[19] A freezing clause may sometimes freeze only certain aspects of the host country's laws, such as fiscal regime, like freezing only royalty and permit for the whole contract period.[20] Other freezing stabilisation clauses freeze all laws applicable to a petroleum contract.[21] The freezing effect extends to court decisions having the force of law delivered after the effective date.[22] Further, the stabilisation clause *stricto*

[13] ibid 15.
[14] Sornarajah M, *The International Law on Foreign Investment* (Cambridge University Press 2010) 281 <https://doi.org/10.1017/CBO9780511841439> accessed 22 March 2020.
[15] ibid.
[16] Gjuzi (n 8) 38.
[17] Abdullah Faruque, 'Validity and Efficacy of Stabilisation Clauses: Legal Protection vs. Functional Value' (2006) 23 Journal of International Abitration 317, 319.
[18] Cameron, *International Energy Investment Law* (n 9) 70.
[19] Ibid.
[20] Article 12 of the Bolivia Model Production Sharing Agreement, 1997.
[21] Maniruzzaman, 'The Pursuit of Stability in International Energy Investment Contracts: A Critical Appraisal of the Emerging Trends' (n 10) 121.
[22] ibid.

sensu may be crafted to prioritise the contract over the newly enacted law in a sense that when there is a conflict between the law and the agreement, the latter shall prevail.[23]

For several reasons, most states and even investors have been shifting away from freezing stabilisation clauses to other forms of stabilisation like modern stabilisation clauses. The clause lacks the flexibility to address future events as it is rigid and static. In case of unforeseen future circumstances, it will inevitably cause tension between the parties (State and investor). Emerging human rights and environmental issues, for example, would require a State to adapt its laws to such changes. It is anticipated that stringent international environmental standards will likely emerge in the future. For a state to comply with those standards, it must take regulatory measures to ensure domestic laws comply with the newly imposed standards.[24] Due to the rigidness of the freezing stabilisation clause, that compliance will amount to breaching the contract and may frustrate the entire contract. Lack of flexibility on the freezing stabilisation clause also poses more problems regarding the taxation regime. The rigidness in the tax regime may affect both a host state and an investor if, for example, the oil prices are higher or lower without adjustment; the contractual provision cannot rescue the situation, which may stifle the economic expectation.[25] Most states prefer flexibility to stability and will use their sovereignty to achieve it.[26]

Frequent use of freezing stabilisation clauses on different investors over time poses administrative complexity as each investor will be subject to the law at the time of the agreement.[27]For instance, in the taxation regime, the problem will arise in determining the applicable fiscal rule for each contract based on different rates as amended or redrafted several times, and there is likely to be no one in the tax administration who remembers the fine points of the tax laws that applied 20 years

[23] Faruque (n 17) 319; Gjuzi (n 8) 40.
[24] Lorenzo Cotula, 'Reconciling Regulatory Stability and Evolution of Environmental Standards in Investment Contracts: Towards a Rethink of Stabilization Clauses' (2008) 1 The Journal of World Energy Law & Business 158, 168.
[25] Peter D Cameron, 'Stabilisation in Investment Contracts and Changes of Rules in Host Countries: Tools for Oil and Gas Investors' (Association of International Petroleum Negotiators (AIPN) 2006) 14.
[26] Bernahard Maier, 'How Has International Law Dealt with the Tension Between Sovereignty Over Natural Resources and Investor Interests in the Energy Sector? Is There a Balance?' (2010) 4 International Energy Law Review 1.
[27] Gehne Katja and Romulo Brillo, 'Stabilisation Clauses in International Investment Law: Beyond Balancing and Fair and Equitable Treatment' (NCCR Trade Regulation 2014) 2013/46 6 <http://www.nccr trade.org/fileadmin/user_upload/nccr-trade.ch/wp2/Stab_clauses_final_final.pdf> accessed on 22th May 2021.

ago. Hence, this poses a significant challenge for developing countries due to the scarcity of electronic tracking systems and governance problems.[28]

Freezing stabilisation clauses infringe a state's legislative sovereignty. This will cause problems when an unforeseen event occurs, and the host state wishes to respond by a regulatory measure which will affect the agreement. Hence, freezing clauses do not guarantee investor protection when the State exercises its sovereign powers for the public interest.[29] In the case of *Marvin Roy Feldman Karpa v the United Mexican States,* the tribunal held that '…governments must be free to act in the broader public interest through the protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like.'[30]

Claims that present parliament cannot bind future parliament; in the sense that laws passed by current parliament cannot be frozen as future parliament can do and undo.[31] Studies have indicated that states take unilateral actions notwithstanding a freezing stabilisation clause, provided it acts without discrimination and in good faith.[32] Therefore, foreign investors are not protected under these circumstances, and the Government cannot limit the powers of the parliament. International law recognises the sovereign right of the State to change its laws.[33] Under international law, a state has the sovereign power to change its laws, which cannot be fettered by mere stipulations in the contract.[34] This has led IOCs to favour economic balancing provisions as they have favourable remedies to freezing clauses in case of unilateral actions by a State. The latter only entitles the IOCs to lump-sum damages, which is not generally the expectation when investing in the project.[35]

(b) Intangible Stabilisation Clauses

The intangible clause provides that an agreement cannot be modified or annulled except by mutual consent of the contracting parties.[36] The clause aims at protecting

[28] ibid.
[29] ibid.
[30] Paragraph 37 of the case of *Marvin Roy Feldman Karpa v United Mexican States* (2002) ICSID Case No. ARB (AF)/99/1.
[31] Cameron, *International Energy Investment Law* (n 9) 63.
[32] Faruque (n 17) 325.
[33] Cameron, *International Energy Investment Law* (n 9) 110.
[34] ibid 101.
[35] Maniruzzaman, 'The Pursuit of Stability in International Energy Investment Contracts: A Critical Appraisal of the Emerging Trends' (n 10) 126.
[36] Faruque (n 17) 319.

the contract from host government measures unless mutual consent of the parties is obtained.[37] Intangibility clauses do not bar the host state from enacting the laws but seek to prevent unilateral amendments to the contract.[38] It means the Government is free to enact the laws, but the other party must accept its application to the contract or project if it has some negative impacts.

The intangible clause is prevalent in almost all PSAs in Tanzania. In PSAs, the clause has been crafted as follows; "This Agreement shall not be amended or modified in any respect except by the mutual consent in writing of the parties hereto."[39] The modification of the PSA contrary to the spirit of the intangible stabilisation clauses prevalent will amount to the fundamental breaching of the PSAs, hence triggering the claims for damages. Jola Gjuzi believes that both the intangibility clause and stabilisation clause *stricto sensu* are freezing clauses due to their nature of freezing the host state's laws or contracts.[40] This is because even intangibility clauses require the other party's consent (investor) for the enacted law to apply to the contract.

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[37] Gjuzi (n 8) 43.

[38] Faruque (n 17) 319.

[39] Article 29(b) of the Production Sharing Agreement for Kilosa-Kilombero Area between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Swala Oil and Gas (Tanzania) Limited signed on 20th February 2012; Article 27 of the Production Sharing Agreement for Nyuni East SongoSongo Area between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Ndovu Resources Limited signed on 25th March 1999; Article 27 of the Production Sharing Agreement between the Government of the United Republic of Tanzania, TPDC and Artumas Group and Partners (Gas) Limited (currently operated by Maurel & Prom) dated 18th May 2004; Article 28 of the Production Sharing Agreement for Mnazibay North between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Hydrotanz Limited signed on 29th May 2008; Article 29 of the Production Sharing Agreement for South Lake Tanganyika between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Beach Petroleum (Tanzania) Limited signed on 23rd June 2010; Article 28 of the Production Sharing Agreement for Malagarasi Basin between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Motherland Industries Ltd Mumbai India signed on 2010; Article 30 of the Production Sharing Agreement for Rukwa Area between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Heritage Rukwa (TZ) Limited signed on 27th October 2011; Article 30 of the Production Sharing Agreement for Kyela Basi between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Heritage Rukwa (TZ) Limited signed on 24th January 2012; Article 29 of the Production Sharing Agreement for Pangani Area between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Swala Oil and Gas (Tanzania) Limited signed on 20th February 2012 and Article 29 of the Production Sharing Agreement for Kilosa-Kilombero Area between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Swala Oil and Gas (Tanzania) Limited signed on 20th February 2012.

[40] Gjuzi (n 8) 45.

(c) Modern Stabilisation Clauses

The modern stabilisation clause is also referred to as the economic balancing provision or economic stabilisation clause. In this type of stabilisation clause, "the state's exercise of sovereign authority is not contractually barred, rather the provision counterbalances such action that the economic equilibrium of the contract as of the effective date of the contract will be maintained during the lifetime of the contract."[41] It requires the host state not to enact any legislation that adversely affects the project's costs. Economic balancing must be taken to restore parties to economic equilibrium if it affects .[42] The clauses provide mechanisms for automatic amendment or an avenue for renegotiating contractual terms when unforeseen events with adverse economic effects occur. [43]The renegotiation nature helps maintain the contract's benefit for both parties,[44] hence not infringing the State's legislative sovereignty.[45]

The economic stabilisation clause is a more flexible device, representing a compromise between the State's exercise of legislative, administrative and regulatory power and the viability and continuation through adjustment of the contractual relationship and by provision of compensation.[46] This stability attracts foreign investors as their primary objective of economic benefits is guaranteed, and on the other hand, the State's economic interest is also taken into account.[47] Most countries have favoured the economic stabilisation clauses, and this trend can be evidenced by many current model PSA worldwide.[48]

According to Maniruzzaman, three types of economic stabilisation clauses can be found in most international petroleum contracts; Stipulated Economic Balancing (SEB), Non-specified Economic Balancing (NSEB) and Negotiated Economic Balancing (NEB).[49] SEB provides an automatic modification of the agreement in a

[41] Maniruzzaman, 'The Pursuit of Stability in International Energy Investment Contracts: A Critical Appraisal of the Emerging Trends' (n 10) 124.
[42] Faruque (n 17) 320.
[43] Klaus Peter Berger, 'Renegotiation and Adaptation of International Investment Contracts: The Role of Contract Drafters and Arbitrators' (2003) 36 Vanderbilt Journal of Transitional Law 1347, 1350.
[44] Abba Kolo and Thomas W Walde, 'Renegotiation and Contract Adaptation in International Investment Projects: Applicable Legal Principles and Industry Practices' (2000) 1 Journal of World Investment 6.
[45] Faruque (n 17) 321.
[46] ibid 332.
[47] Maniruzzaman, 'The Pursuit of Stability in International Energy Investment Contracts: A Critical Appraisal of the Emerging Trends' (n 10) 126.
[48] ibid 127–128.
[49] ibid 125.

way stipulated in that agreement.[50] The contract stipulates an automatic adjustment mechanism of the terms or the method of attaining the contract's economic balance.[51] A good example of SEB is the Ecuadorian Model Production Sharing Contract, which provides a mechanism or a formula of adjustment where tax increases or decreases.[52] While providing for automatic modification, NEB does not provide the mechanism of such modification, nor does it require the mutual consent of the contracting parties for such modification.[53] The clause creates uncertainty for the parties regarding the readjustment mechanism applicable when there is a change in the law or regulatory matter due to its open-ended approach.[54] The Joint Development and Production Sharing Contract for the Azeri and Chirag Fields provides for automatic adjustment of the contract on any present or future changes in the law by indemnification by SOCAR. Still, it does not specify or stipulate the method the mode.[55]As the name depicts, NEB requires the parties to meet and negotiate the modification to retain the economic balance of the investment contract when a triggering event (change in law or administrative or regulatory changes) happens.[56] According to Jola Gjuzi, the negotiation requirement provides a parting zone of the economic stabilisation clause from the classic stabilisation, which freezes the laws without providing an avenue for renegotiation.[57]

In Tanzania, most signed and existing PSAs contain the NEB clause. There is a mixture of classic stabilisation clauses and NEB in these clauses. In this scenario, NEB becomes the dominant character as it is the one that provides the output after the occurrence of legislative changes, which adversely affects the PSA. These PSAs pinpoint the law that governs it. Where any changes materially or adversely affect the commercial and fiscal benefits, the Parties must mutually agree to restore the

[50] ibid.
[51] Gjuzi (n 8) 46.
[52] ibid.
[53] Maniruzzaman, 'The Pursuit of Stability in International Energy Investment Contracts: A Critical Appraisal of the Emerging Trends' (n 10) 126.
[54] Gjuzi (n 8) 47.
[55] Article 23 (2) of the Agreement on the Joint Development and Production Sharing for the Azeri and Chirag Fields and The Deep Water Portion of the Gunashli Field in the Azerbaijan Sector of the Caspian Sea between the State Oil Company of the Azerbaijan Republic, Amoco Caspian Sea Petroleum Limited, Bp Exploration (Caspian Sea) Limited, Delta Nimir Khazar Limited, Den Norske Stats Oljeselskap A.S, Lukoil Joint Stock Company, Mcdermott Azerbaijan, Inc., Pennzoil Caspian Corporation, Ramco Hazar Energy Limited, Turkiye Petrolleri A.O., Unocal Khazar, Ltd dated 20th September 1994.
[56] Gjuzi (n 8) 47; Maniruzzaman, 'The Pursuit of Stability in International Energy Investment Contracts: A Critical Appraisal of the Emerging Trends' (n 10) 126.
[57] Gjuzi (n 8) 48.

benefits. [58] Other PSAs provide further requirements or guidance by requiring the parties to refer the matter for arbitration where the negotiation fails. [59] It leaves it to the arbitral tribunal to decide the commercial and fiscal benefits to be restored to the agreement.

3. Rationale for Stabilisation Clauses

The rationale for stabilisation can be viewed from the State and investor perspectives. The various States have used stabilisation clauses to attract foreign investors to invest in their countries, and investors have been confident with this guarantee of protection from the host countries. Stabilisation clauses are being used by most host countries, especially developing countries, to attract foreign investment.[60] The clauses give confidence to investors by providing the guarantee that the Government will honour the terms of the contract.[61] According to Peter Cameron, the confidence extends to bankers of these IOCs.[62]

Predictability and certainty of the long-term natural resources contracts are also one of the main reasons for the inclusion of stabilisation clauses.[63] Predictability and certainty are crucial in petroleum contracts considering they are long-term contracts with capital intensive investment and hence susceptible to various risks like political, economic, regulatory, geological and administrative[64]. Including a stabilisation clause means the Government and an investor agree to the contract's legal regime, and any alteration must be agreed upon mutually. The clause bind the Government to respect the agreements for the project lifetime, as it was emphasised in the case of *Liberian Eastern Timber Corporation v Government of*

[58] Article 27 of the Production Sharing Agreement for Kilosa-Kilombero Area between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Swala Oil and Gas (Tanzania) Limited signed on 20th February 2012. The same clause can be found in various PSAs including Article 29 of the Production Sharing Agreement between Heritage Rukwa (Tanzania) Limited, the Government of the United Republic of Tanzania and TPDC signed on 27th October 2011; Article 30 of the PSA between Ophir Tanzania (Block 1) Limited, the Government of the United Republic of Tanzania and TPDC signed 29th October 2005; Article 27 of the PSA between Swala Oil and Gas (Tanzania) Limited, the Government of the United Republic of Tanzania and TPDC signed 20th February 2012; Article 30 of the PSA between Ophir Tanzania (Block 4) Limited, the Government of the United Republic of Tanzania and TPDC signed 19th June 2006.

[59] Article 30 of the Production Sharing Agreement for Block 2 between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Statoil Tanzania SA signed on 18th April 2007.

[60] Faruque (n 17) 322.

[61] ibid 323.

[62] Cameron, 'Stabilisation in Investment Contracts and Changes of Rules in Host Countries: Tools for Oil and Gas Investors' (n 25) 12.

[63] Faruque (n 17) 322.

[64] Gjuzi (n 8) 22; Cameron, 'Stabilisation in Investment Contracts and Changes of Rules in Host Countries: Tools for Oil and Gas Investors' (n 25) 12.

Republic of Liberia where the tribunal held that "..a Stabilization Clause is commonly found in long term development contracts and, ...is meant to avoid the arbitrary actions of the contracting Government. This clause must be respected, especially in this type of agreement. Otherwise, the contracting State may easily avoid its contractual obligations by legislation".[65] This protection against unilateral measures by the Government creates predictability and certainty.

The internationalisation of petroleum contracts is viewed as the main target of stabilisation clauses.[66] The government's commitment not to interfere with or modify the agreement by its sovereign power is a fundamental criterion of internationalisation.[67] This implies in case of dispute. The arbitral tribunal may not confine itself to the host state's laws but also the international rules.[68] The arbitral tribunals have ruled stabilisation to internationalise contracts. In *Texaco v the Libyan Arab Republic*, the tribunal ruled that stabilisation clauses internationalise the contract in the following wording:

> ...Hence, the insertion, as in the present case, of so-called stabilization clause: these clauses tend to remove all or part of an agreement from the internal law and to provide for its correlative submission to sui generis rules as stated in the Aramco award, or to a system which is properly an international law system...[69]

The tribunal will rely on international law in determining the dispute where the petroleum agreement contains a stabilisation clause. The genesis of the internationalisation of contracts emanates from the case of *sapphire International Petroleum Limited v. National Iranian Oil Company* which provided that stabilisation clauses give a contract a quasi-international character that releases it from the sovereignty of a particular legal regime.[70]

4. Legal Status of Stabilisation Clauses under International Regime

The position of stabilisation clauses will be explained based on various writings and arbitral tribunal decisions. In its generality, stabilisation clauses are

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[65] *Liberian Eastern Timber Corporation v Government of Republic of Liberia, 26 I.L.M 647 666-667.*
[66] Ernest Enobun, 'Host Governments' Legislative Acts and Unilateral Review of State Contracts in Spite of Stabilization Clauses: A Sovereign Right or Sovereign Wrong?' (2009) 7 Oil, Gas & Energy Law Intelligence 1, 10.
[67] Ivar Alvik, *Contracting with Sovereignty: State Contracts and International Arbitration* (Portland, Or : Hart Pub 2011) 220.
[68] Enobun (n 66) 10–11.
[69] Paragraph 45 of the case of *Texaco v Libyan Arab Republic, 17 I.L.M 3 (1978).*
[70] Part IV (B) (b) 2 of *sapphire International Petroleum Limited v. National Iranian Oil Company,* 35 I.L.R (1967).

considered binding under international law. The focus will be on contractual stabilisation clauses and not legislative stabilisation. Legislative stabilisation clauses are out of the scope of this article. In a nutshell, legislative stabilisation is provided in the national law of a host government where a certain law is enacted for a specific project.[71]

Stabilisation clauses are valid under international law as they are concluded by mutual consent of the parties.[72] Stabilisation clauses are valid regardless of the invocation of the principle of PSNR, which has assumed the status of jus cogens since the State's freedom of contract remains integral. The State uses its prerogative power to execute petroleum contracts, and the principle of estoppel requires the State not to repudiate the undertakings voluntarily made.[73]

Another argument for the bindingness nature of stabilisation clauses can be viewed from the angle of the principle of *pacta sunt servanda*, which requires contractual undertakings to be respected by the parties. This find supports in the arbitral decision of the *Texaco case*, where the tribunal has the following to say:

> No international jurisdiction has ever had the least doubt as to the existence, in international law, of the rule *pacta sunt servanda*: it has been affirmed vigorously both in t*he Aramco* award in 1958 and in the *Sapphire* award in 1963. On [sic] can read, indeed, in the *Sapphire award,* that 'it is a fundamental principle of law, which is constantly being proclaimed by international Courts, that contractual undertakings must be respected. The rule "pacta sunt servanda" is the basis of every contractual relationship'. This tribunal cannot but reaffirm this in its turn by stating that the maxim *pacta sunt servanda* should be viewed as a fundamental principle of international law.[74]

The tribunal views *pacta sunt servanda* as the fundamental principle of international law and must be adhered to. It means, stabilisation clauses being a commitment provided in petroleum contracts, have full force under international law, the derogation of which amounts to an unlawful breach of the said contracts.

There have been arguments that stabilisation with the effect of freezing the applicable law is regarded invalid under international law by many writers as it

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[71] Gjuzi (n 8) 184–185; Maniruzzaman, 'The Pursuit of Stability in International Energy Investment Contracts: A Critical Appraisal of the Emerging Trends' (n 10) 120.
[72] Faruque (n 17) 323.
[73] ibid
[74] Paragraph 51 of the case of *Texaco v Libyan Arab Republic*, *Liamco v Libya* and *Kuwait v Aminoil, 17 I.L.M 3 (1978).*

attempts to fetter the State's public power.[75] The argument emanates from the principle of sovereignty over natural resources, that is, a *jus cogens* that does not permit derogation.[76] This aims to justify the lawfulness of unilateral amendment or modification of an agreement, but it does not exonerate the host government from paying adequate compensation. The arguments find no support from various arbitral tribunal decisions, which prove that the stabilisation clause cannot be declared invalid merely based on the State's sovereignty.[77] In the landmark case of *Texaco*, the tribunal indicated the discretional power of the State to enter into an international commitment. It held that 'the result is that a State cannot invoke its sovereignty to disregard commitment freely undertaken through the exercise of this same sovereignty, and cannot through measures belonging to its internal order make null and void the rights of the contracting party which has performed its various obligations under the contract.'[78] The tribunal delivered that verdict after considering the requirements provided in the UNGA Resolution 1803 on the principle of PSNR dated 14th December 1962, which requires a state to observe agreements entered freely in good faith.[79]

In the case of *Texaco*, the tribunal went further to expound on the validity and efficacy of the freezing stabilisation clause provided in the Libyan Concession. It provided that:

> Such a provision, the effect of which is to stabilize the position of the contracting party, does not, in principle, impair the sovereignty of the Libyan State. Not only has the Libyan State freely undertaken commitments but also the fact that this clause stabilizes the petroleum legislation and regulations as of the date of the execution of the agreements **does not affect in principle the legislative and regulatory sovereignty of Libya. Libya reserves all its prerogatives to issue laws and regulations** in the field of petroleum activities in respect of nationals or foreign persons with which it has not undertaken such commitment…Any changes which may result from the adoption of new laws and regulations must, to affect the contract parties, be agreed to by them. this is so not

[75] Thomas W Waelde and George Ndi, 'Stabilising International Investment Commitments: International Law Versus Contract Interpretation' (1996) 1 Oil, Gas & Energy Law Intelligence 1, 18.
[76] Thomas J Pate, 'Evaluating Stabilization Clauses in Venezuela's Strategic Association Agreements for Heavy-Crude Extraction in the Orinoco Belt: The Return of a Forgotten Contractual Risk Reduction Mechanism for the Petroleum Industry' (2009) 40 Inter-American Law Review 347, 351; Faruque (n 17) 323.
[77] Faruque (n 17) 324.
[7878] Paragraph 68 of the case of *Texaco v Libyan Arab Republic*, *Liamco v Libya* and *Kuwait v Aminoil,* 17 I.L.M 3 (1978).
[79] Ibid.

> because the sovereignty of Libya would be reduced, but simply by reason of the fact that Libya has, **through an exercise of its sovereignty, undertaken commitments under an international agreement, which, for its duration, is the law common to the parties.**[80] (emphasis added).

The tribunal ruling shows that the sovereignty of the State is not affected by a merely contractual commitment. The commitment prevails since it was made by a State using its same sovereignty.

Freedom of contracting by the State is through its sovereign power; hence, a State cannot disregard the commitment in the contract claiming to infringe its sovereign authority. In *AGIP S.p.A. v. People's Republic of the Congo*, the tribunal held that 'stabilisation clauses freely accepted by the Government do not affect the principle of its sovereignty legislative and regulatory powers and that, in the present case, changes in the legislative and regulatory arrangements stipulated in the agreement simply cannot be invoked against the other contracting party.'[81] The validity of stabilisation clauses under international law further finds support also in the case of *Saudi Arabia v Arabian American Oil Company (Aramco)*, the tribunal ruled that a State, through its sovereignty, poses a legal power to grant rights in an agreement and forbids itself from withdrawing before the end of the agreement, Nothing can prevent a State from binding itself in that manner.[82]

In the award of *Libyan American Oil Company (LIAMCO) v. the Government of the Libyan Arab Republic*, the tribunal reaffirmed the legally binding nature of stabilisation and intangibility clauses. The stabilisation clauses are consistent with the sanctity of the contract principle recognised under municipal and international law and the non-retrospective application of the laws.[83] In the case of *Liberian Eastern Timber Corporation (LETCO) v. the Republic of Liberia* the tribunal appreciated the usefulness of stabilisation clauses and their status under international law in the following wording:

> This clause, commonly referred to as a "Stabilization Clause", is commonly found in long-term development contracts and as is the case with notification procedures of the Concession Agreement, is meant to avoid the arbitrary actions of the contracting Government. This clause must be respected, especially in this type of agreement. Otherwise, the

[80] [80] Paragraph 71 of the case of *Texaco v Libyan Arab Republic*, *Liamco v Libya* and *Kuwait v Aminoil,* 17 I.L.M 3 (1978).
[81] *AGIP S.p.A. v. People's Republic of the Congo,* ICSID Case No. ARB/77/1, 21 I.L.M 726 (1982).
[82] Saudi Arabia v Arabian American Oil Company (Aramco), 27 ILR 167 (1963) referred in Waelde and Ndi (n 75) 19.
[83] Paragraphs 113 and 114 of the case of *Libyan American Oil Company (LIAMCO) v. the Government of the Libyan Arab Republic,* 17 ILM 3 (1978).

> contracting State may easily avoid its contractual obligations by legislation. [84]

The tribunal cements the necessity of stabilisation clauses in prohibiting arbitrary actions of the Government through legislative measures. The host governments must respect the clauses, and the power of the State to regulate natural resources is subject to contractual commitments freely entered.

5. Legal Status of Stabilisation Clauses in Tanzania Petroleum Industry

The regime in Tanzania has tremendously changed the treatment of stabilisation clauses. Stabilisation clauses in Tanzania face a dilemma after enacting the Natural Wealth and Resources Contracts (Review and Re-negotiation of Unconscionable Terms) Act (the Unconscionable Act).[85] The Act creates the dilemma by declaring an agreement unconscionable that restricts the powers of a sovereign. The Act provides as follows;

6(2) Terms of the arrangement or agreement shall be deemed to be unconscionable and treated as such if they contain any provision or requirement that:

> (a) aim at restricting the right of the State to exercise full permanent sovereignty over its wealth, natural resources and economic activity
>
> (b) are restricting the right of the State to exercise authority over foreign investment within the country and in accordance with the laws of Tanzania[86]

The provision declares the terms of an agreement that restrict the sovereign power of the Government in exercising authority over foreign investments to be unconscionable. Stabilisation clauses tend to limit the sovereign government's power to enact laws that affect the petroleum agreements. Abdallah Faruque cemented that the role of stabilisation clauses is to prevent legislative intervention in the already negotiated agreement.[87] In essence, stabilisation clauses restrict or prohibit the Government from using its legislative power to enact laws that will affect the project.

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[84] *Liberian Eastern Timber Corporation (LETCO) v. Republic of Liberia,* ICSID Case No. ARB/83/2, 26 ILM 647 (1987).
[85] The Natural Wealth and Resources Contracts (Review and Re-negotiation of Unconscionable Terms) Act, Cap. 450 R.E. 2019
[86] Section 6(2) (a) and (b) of the Natural Wealth and Resources Contracts (Review and Re-negotiation of Unconscionable Terms) Act, Cap. 450 R.E. 2019.
[87] Faruque (n 17) 318.

Under the requirement of the Unconscionable Act, all existing PSAs with stabilisation clauses are in danger of being expunged in case investors are unwilling to change the same. Expunging a term of the PSA amounts to a unilateral amendment of the agreement by the Government, which is contrary to its commitment guaranteed through stabilisation and re-negotiation clauses that require mutual consent. This amounts to a fundamental breach of an agreement that entitles the innocent party (an investor) to damages since the breach of stabilisation clauses constitutes an international law violation.[88] The breach of contract by the unilateral amendment of contracts may amount to expropriation. The annulment of a particular vital clause in an agreement may be considered confiscation, as was ruled in the *Jalapa Railroad and Power Co v Mexico (US v Mexico)* case.[89] The Government annulled an agreement by using legislation, and hence "In the words of the tribunal, the government had, therefore 'stepped out of the role of contracting party and sought to escape vital obligations under its contract by exercising its superior governmental power".[90] In this sense, the Government cannot escape liability guaranteed in the contracts through legislative power. Doing so, the Government may be considered to have expropriated an investor's project.

Forcing re-negotiation or unilateral amendments was implemented in Venezuela Way back in 2007, when the Government forced six Western major oil companies to agree with a 60 per cent control in the four Orinoco projects. Some of the oil companies agreed with the Government, but others, like Exxon-Mobil, initiated arbitration proceedings against the Government of Venezuela and PDVSA.[91]

Petroleum agreements require stability, considering their long-term nature coupled with political risks in developing countries, including Tanzania. In future petroleum agreements, stabilisation clauses can no longer be included; otherwise, the same will be illegal. This may impact future investments in Tanzania, considering more explorations are required.

[88] Jean Ho, *State Responsibility for Breaches of Investment Contracts* (Cambridge University Press 2018) 192.
[89] Alvik (n 67) 170.
[90] Ibid.
[91] Juan Carlos Boue', 'Enforcing Pacta Sunt Servanda? Conoco-Phillips and Exxon-Mobil Versus the Bolivarian Republic of Venezuela' 5 Journal of International Dispute Settlement 438, 438.

6. What Stands for the Current Petroleum Agreements in the Petroleum Industry

The existing petroleum agreements contain stabilisation clauses that are considered unconscionable and can be expunged under the current legal regime. By unilateral amendments of contracts contrary to the stabilisation clauses, the Government may be condemned with damages under an international tribunal. In most cases, international arbitral tribunals assess damages differently on stabilisation contracts by awarding high damages. The reasoning is that stabilisation clauses create a legitimate expectation for an investor for the whole contract period. The breach of stabilisation clause usually indicates the violation of the legitimate expectation and may constitute expropriation.[92]

The existence of stabilisation clauses in a petroleum agreement is considered one of the key elements used by tribunals in assessing damages for an investor.[93] A host state's breach of stabilisation clauses entitles a foreign investor to higher compensation for denying his contractual rights guaranteed for the whole project life cycle.[94] In *American Independent Oil Company v. the Government of the State of Kuwait,* the tribunal held that stabilisation clauses create a legitimate expectation that must be considered in computing damages.[95]

Through the Unconscionable Act, the Government of Tanzania may find itself on the verge of being condemned with damages as these laws infringe the already signed PSAs. The Unconscionable Act applies retrospectively as it allows the National Assembly to review terms of the arrangements or agreements on natural wealth and resources made before the Act's coming into force.[96] The Act also has an overriding effect over any other law governing natural wealth and resources administration and management.[97]Hence, the PSAs with stabilisation clauses are unconscionable, and the respective term is on the verge of being expunged and ceases to have an effect.[98] The law is very clear on this aspect. It states that "Where the Government has served notice of intention to renegotiate the arrangement or agreement in terms of section 6 and the other party fails to agree to renegotiate the

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[92] Alvik (n 67) 157.
[93] AFM Maniruzzaman, 'Damages for Breach of Stabilisation Clauses in International Investment Law: Where Do We Stand Today?' [2007] International Energy Law and Taxation Review 246, 246.
[94] Ho (n 88) 194; M Sornarajah, 'Compensation for Expropriation: The Emergence of New Standards' 13 Journal of World Trade 108, 114–115.
[95] Paragraph 159 of the *American Independent Oil Company v. the Government of the State of Kuwait,* 21 ILM 976 (1982).
[96] Section 5 (3) of the Natural Wealth and Resources Contracts (Review and Re-negotiation of Unconscionable Terms) Act, Cap. 450 R.E. 2019.
[97] ibib section 7 (2).
[98] ibid section 7 (1).

unconscionable terms or no agreement is reached with regards to the unconscionable terms, such terms shall cease to have effect to the extent of unconscionable terms and shall, by operation of this Act, be treated as having been expunged."[99]The provision clearly shows that the re-negotiation proposed by the Act is a mandatory one. The other party in the agreement (investor) is forced to agree to the Government's proposed amendments. Refusing to agree to the penalty is to expunge the term from the agreement. This is a unilateral amendment of the agreement by the Government and breached the agreement, which entitles the investor to damages.

The Unconscionable Act provides for the requirement of expunging the terms in the contract which have been declared unconscionable. However, the Act does not provide what will be the new term in that contract after the unconscionable term has been expunged. By being silent, the law means the proposal offered by the Government for re-negotiation will stand and be the applicable term in the contract. The practical difficulty of implementing the changes comes into play. Will that mean the Government will be redrafting the PSA by removing all the ascertained unconscionable terms where the re-negotiation fails. This is the government's unilateral amendment of the PSA and a fundamental breach of the PSA.

One investor has terminated the PSA and instituted proceedings in the International Chamber of Commerce (ICC) against the Government of the United Republic of Tanzania and TPDC, claiming that the two laws (the Unconscionable Act and the Permanent Sovereignty Act) outlaw their rights guaranteed in the PSA. [100] The law contradicts the requirements of the PSA, which provides for mutual consent to the amendment of the PSA by the parties. According to an investor, the Unconscionable At created uncertainty on their investment and unilaterally removed the rights agreed in the PSA. The case is still pending at the ICC as the parties strive to reach an amicable settlement of the matter outside the tribunal.

7. Future Investment in the Petroleum Industry in Tanzania after the Legal Reforms

The petroleum industry's investment ischaracterised by long-term contracts that require large capital with a high risk of sunk costs.[101] Further, petroleum exploration, development and production require an investor to commit substantial

[99] ibid.
[100] A case was filed in the ICC on 7th June 2019. The case is still pending; hence cannot be disclosed as the proceedings under ICC are confidential unless otherwise agreed by the parties.
[101] Daniel, Keen and McPherson (n 4) 14.

technical know-how.[102] The huge capital investments and technical requirements dictate the use of investors' funds rather than Government budgetary funds. No government in the world will use its revenue to explore petroleum, bearing the risk it carries. Due to this, foreign capital investors will demand stability in their contractual terms.

The requirement of extensive capital coupled with the commitment of technical know-how in exploiting petroleum dictates the protection of the investment. Due to this huge investment with multiple risks, ICOs will demand Host Government protection of their investments. According to Hansen, since developing countries require foreign capital to develop their petroleum resources, foreign investors will demand assurances of their investments from Host Governments that there will be no legislative changes that may alter the terms of the agreement.[103] Hence, stability attracts and gives confidence to investors to invest in petroleum ventures.

The removal of stabilisation clauses in Tanzania started in 2008. The Government of Tanzania removed the requirement of having stabilisation clauses in the Model Production Sharing Agreement (MPSA) 2008, which was provided in the MPSA 2004. The Government intention of removing stability continued in the MPSA 2013. It should be noted that even after removing stabilisation clauses in the MPSA, still, all PSAs signed after the MPSA 2008 contained stabilisation clauses.[104] The inclusion of stabilisation clauses in signed PSAs showed the bargaining power of investors was high, and the Government agreed as a means of attracting investments in the petroleum industry. Further, the exclusion of stabilisation clauses was only done in MPSAs, which are mere guidelines used in negotiations by the Government Negotiation Team (GNT).

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[102] Timothy B Hansen, 'The Legal Effect Given Stabilization Clauses in Economic Development Agreements' (1987) 28 Virginia Journal of International Law 1015, 1015.

[103] ibid.

[104] Refer Article 29 of the Production Sharing Agreement for Rukwa Area between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Heritage Rukwa (TZ) Limited signed on 27th October 2011 which provided that the PSA was negotiated with due regard to the Petroleum (Exploration and Production) Act of 1980 and any legislative changes which affect the commercial and fiscal terms agreed should entitle parties to mutually agree on the amendments to restore the benefits eroded by that law. The same stability has been provided in Article 27 of the Production Sharing Agreement for Kilosa-Kilombero Area between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Swala Oil and Gas (Tanzania) Limited signed on 20th February 2012; Article 31 of the Production Sharing Agreement for Nyuni Area between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Ndovu Resources Limited signed on 27th October 2011; Article 30 of the Production Sharing Agreement for Malagarasi Basin between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Motherland Industries Limited Mumbai India signed on 2010 and Article 32 of the Production Sharing Agreement for Block 8 between the Government of the United Republic of Tanzania, Tanzania Petroleum Development Corporation and Petrobras Tanzania Limited signed on 2011.

Currently, the exclusion of stabilisation clause is provided in the law, the Unconscionable Act, which declares unconscionable all terms in an agreement that restricts the State's sovereign power.[105] This means the Government intends to do away with stabilisation clauses. The declaration of unconscionability of stabilisation clauses applies retrospectively to existing PSAs and upcoming PSAs. Future PSAs cannot have an opportunity of including stabilisation clauses since doing so will be illegal. Stabilisation clauses are regarded as tools for attracting investment in the petroleum industry.[106] By removing stabilisation clauses, the Government has opted to remove one of the key attractions to investments in the petroleum industry in Tanzania. Hence, the future investment in the petroleum industry in Tanzania is shaken. Stabilisation clauses are key for the bankability of petroleum projects.[107]

It should be noted that certainty and predictability is a critical parameter considered by investors in petroleum projects. Unilateral amendments of contracts by legislative measures create uncertainty in the petroleum industry. The uncertainty created by the Unconscionable Act affects future investments in the petroleum industry in Tanzania. By allowing unilateral amendments to a signed agreement, the law creates an uncertain environment for an investor to commit billions of dollars to exploring and developing petroleum projects.[108] A prudent investor may not agree to sign a long-term agreement subject to various risks which are fully subjected to Government discretion in its modification. An agreement of such nature cannot even secure bankers' loans due to the high risk created by the law.[109]

Tanzania is still a frontier that requires more exploration of petroleum. To date, approximately forty-two per cent (42%) covering 226,648 square kilometres out of the 534,000 square kilometres of the total sedimentary basins have been granted exploration licences for oil and gas in Tanzania.[110] This means most sedimentary basins are yet to be explored and need investors. Also, despite several efforts to conduct exploration activities from the 1950s, Tanzania has not yet discovered oil; hence, more explorations are required. But the uncertainties created by the

[105] Section 6 (2) (i) and (ii) of the Natural Wealth and Resources Contracts (Review and Re-Negotiation of Unconscionable Terms) Act, Cap 450 R.E. 2019.
[106] Hansen (n 102) 1016.
[107] Gjuzi (n 8) 29.
[108] Section 7 of the Natural Wealth and Resources Contracts (Review and Re-Negotiation of Unconscionable Terms) Act, Cap 450 R.E. 2019
[109] Gjuzi (n 8) 29.
[110] The Tanzania Natural Gas Utilization Master Plan (NGUMP), 2014, 112.

Unconscionable Act may hamper the investment activities in the petroleum industry.

8. Conclusion

Stabilisation clauses are one of the key protection tools for investors in the petroleum industry. The clauses protect investors from unilateral Government legislative action changing the agreed terms of the agreement. Further, the clauses are useful in attracting foreign capital investment as through the Government commitments, investors get confidence in their projects. The confidence extends to bankers. It is recommended that the Government of Tanzania should not remove stabilisation clauses from PSAs. This means that the Unconscionable Act should be amended to remove the prohibition of using stabilisation clauses in petroleum contracts. The attraction of investors in the petroleum industry in Tanzania is crucial, considering that fifty-eight per cent (58%) covering 534,000 square kilometres of the sedimentary basin is unexplored and requires foreign investors to undertake explorations.

Unilateral amendments of contractual terms through legislative means create uncertainty and unnecessary disputes. For existing PSAs, unilateral amendment breaches the agreements and may lead to expropriation. The Government may be condemned with punitive damages since investors have legitimate expectations of their projects. Future investment in the petroleum industry will be affected due to the uncertainty created by the unilateral amendments of the PSAs. It is recommended that the three provisions of the Natural Wealth and Resources Contracts (Review and Re-negotiation of Unconscionable Terms) Act of 2017 be amended. Section 4(3) allows retrospective application of the law to PSAs made before its enactment affects the substantive rights of IOCs, which brings unnecessary disputes with the Government. Also, section 6 provides unconscionable terms that are too wide subject to different interpretations and create uncertainty in agreements. The last provision is section 7, which allows for expunging terms declared unconscionable by the National Assembly. This provision is dangerous and undermines the commitments offered by the Government in existing PSAs that it will honour the terms, and any amendment must be through mutual agreement.