The Relationship Between Losing Sovereignty and Stabilization Clause in an Investment Agreement

Introduction

This is a Brief on the above. I will commence with a discussion on sovereignty, stabilization clause in an investment agreement and an explanation of the relationship between the two in the context of losing sovereignty.

Sovereignty

Normally, a state is deemed to possess independence and 'sovereignty' over its subjects and its affairs and within its territorial limits. When it is stated that a state is independent, this has some attributes – a number of rights, powers, and privileges at international law. There are also duties and obligations. A state enjoys sovereign immunity (state immunity). The rule of jurisdictional immunity of foreign states and foreign heads of states has two aspects of significance:

a) An immunity as to process of the court;
b) An immunity with respect to property belonging to the foreign state or foreign sovereign.

Thus, the courts would not by their process 'implead' a foreign state or foreign sovereign against its will. Several principles have been suggested as the basis of this immunity:[1]

i) *Par in parem non habet imperium* (equals do not have authority over one another) - one sovereign power cannot exercise jurisdiction over another sovereign power, but only over inferiors;

[1] JG Starke, Introduction to International Law (9th edn, Butterworths) 95, 202-203

ii) Reciprocity or comity;
iii) The fact that in general the judgment of a municipal court cannot be enforced practically against a foreign state;
iv) The merits of a dispute involving the transactions or policy of a foreign government ought not be canvassed in the domestic courts of another country.[2]

Under customary international law, immunity was absolute but it is generally now restrictive depending on the nature of the transaction – pure sovereign act (*jure imperii*) and commercial transactions (*jure gestionis*): *Trendtex v CBN.*[3]

Waiver of Immunity

Sovereign immunity of a state entity may be waived. A state entity may waive its immunity by:

- prior written agreement
- instituting proceedings without claiming immunity
- submitting to jurisdiction as a defendant in a suit intervening in or taking any steps in any suit (other than for the purpose of claiming immunity)

As a General Counsel at the Bureau of Public Enterprises (BPE), our practice was not to waive immunity unless expressly authorised by Government. However, whether it is waived or not, state practice is that very few states now claim absolute immunity in a commercial transaction.

In the Facebook post, I saw Article 8(1) purportedly from the contract with the Export-Import Bank of China. This clause provides thus:

[2] ibid
[3] (1977) QB 529

The borrower hereby irrevocably waives any immunity on the ground of immunity or otherwise for itself or its property in connection with any arbitration proceeding pursuant to Article 8(5) thereof with the enforcement of any arbitral award pursuant thereto, except for the military and diplomatic assets.

I have not seen Article 8(5) of the Contract. I suppose it will be the dispute resolution clause. Generally, international investment contracts contain waiver of immunity clauses. In practice, waiver is sought twice - to commence the action and another to enforce an award. I think that this clause is too wide as it contains both. Similarly, such clauses are usually qualified by words like 'to the extent permitted by the applicable law' – in this case, Nigerian law. In China, they virtually practice absolute immunity. They will not accept a similar clause in China and they have claimed immunity over commercial transactions. Some examples of Chinese state-owned companies that have claimed sovereign immunity in foreign lawsuits are the Aviation Industry Corporation of China (AVIC) and China National Building Material. These two Chinese companies had the backing of the Chinese Government.

Stabilization Clause in an Investment Contract

In investment contracts, investors are wary about changes in law that are outside their control and changes in the dynamics of their business. Clearly, such changes can adversely affect the contract or modify the rights and obligations of the investor. With the consent of the host government and the investor, a stabilization clause is usually inserted to mitigate or manage the political risks connected with the project. There are two general clauses – freezing clauses and economic equilibrium clause. There can be a hybrid.

i) **Freezing Clauses** – such clauses usually provide that for the term of the project, for example, a concession of 30 years, the applicable domestic laws, rules and regulations affecting the project as at the date of the contract are frozen. In other words, all the laws, rules and regulations passed after that date will not apply to the investor or the project unless the investor agrees.

ii) **Economic Equilibrium Clauses** – any changes affecting the investor and project after the date of the contract will not apply to the investor unless the host state agrees to indemnify the investor and modify the contract. This is to ensure that economic equilibrium is maintained.

iii) **Hybrid Clauses** – a combination of i) and ii) – foreign investor not automatically exempted from the application of the new law and other changes but may be granted exemptions or compensation.

I was a party-appointed arbitrator in the dispute between NNPC and Shell in respect of a Production Sharing Contract (PSC) of 1993 that contains a stabilization clause. Clause 19.2 of the PSC provides in part thus:

> **In the event that any enactment or a change in the laws or regulation of Nigeria or any rules, procedures, guidelines, instructions, directives, or policies, pertaining to the Contract introduced by any Government department or Government parastatals or agencies occurs subsequent to the Effective Date of this Contract which materially and adversely affects the rights and obligations or the economic benefits of the Contractor, the Parties shall use their best efforts to**

agree to such modifications to this Contract as will compensate for the effect of such changes. . .

This is a hybrid clause. The Arbitral Tribunal agreed that the changes introduced by the FGN were material enough to warrant the modification of the PSC.

The Relationship Between Waiver of Sovereignty and Stabilization Clause

One major challenge of investment contracts with such clauses is that they restrict the legislative and regulatory powers of the host state. They affect the independence and sovereignty of a state. Local investors always feel that foreign investors are unnecessarily protected by such clauses as the host government cannot enforce laws, rules and regulations elsewhere in the country. International human rights organisations are concerned with the effect of such clauses on human rights. Above all, nationals are concerned that foreign investors are either exempted from the application of new laws or compensated if the laws affect their economic fortunes.

My advice always is that contracts should be properly negotiated, taking into account the interest of the general public, including foreign investors. In the particular case of the Chinese contract, I would recommend that it should be re-negotiated to ensure that the waiver is consistent with Nigerian law (in the event that Nigerian law is the governing law of the contract otherwise with reference to Nigerian law).

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30 July, 2020.