

**CAN STABILIZATION CLAUSES PROVIDE A
SUITABLE PROTECTION FOR THE MINING
INVESTMENTS IN RELATION TO
ENVIRONMENTAL REGULATORY CHANGES?**

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ABSTRACT

The protection of the environment through national regulations may seriously affect the economics of a mining investment, inclusively producing a regulatory taking. This dissertation explores whether some form of stabilization clause may be appropriate and effective to protect the mining investments against the referred to risk, concluding that some formulas of contractual stabilization may be used as suitable protections in favour of the mining investors.

ABBREVIATIONS

AMINOIL	:	American Independent Oil Company.
BIT	:	Bilateral Investment Treaties.
CIDH	:	Inter-American Court of Human Rights.
CONACAMI	:	General Coordination of Communities Affected by Mining Activities.
ECT	:	Energy Charter Treaty.
EPI	:	Environmental Performance Index.
F&ET	:	Fair and equitable treatment.
GRZ	:	Government of the Republic of Zambia.
ICSID	:	International Centre for Settlement of Investment Disputes.
MIGA	:	Multilateral Investment Guarantee Agency.
MIT	:	Multilateral Investment Treaties.
MTBE	:	Methyl tertiary-butyl ether.
NAFTA	:	North American Free Trade Agreement.
NGO	:	Non-Governmental Organization.
OECD	:	Organization for Economic Co-operation and Development.
PAMA	:	Programme for the adjustment and environmental stewardship.
S.A.R.	:	Syrian Arab Republic.
SOCAR	:	State Oil Company of Azerbaijan Republic.
UN	:	United Nations.
UNCTAD	:	United Nations Conference on Trade and Development.
US	:	United States of America.
WHO	:	World Health Organization.

INTRODUCTION

The global increment of environmental awareness has produced a major change in the way that mining operations are carried out.

Nowadays, governments have the responsibility to protect the environment, among others by issuing an effective environmental regulatory framework; while mining companies are subject to a new set of environmental obligations, having to invest in new procedures and technologies that allow them to minimize and control the environmental impacts of their activities.

Despite the undeniable importance of environmental protection, the implementation of new environmental regulations has considerably increased political risk affecting the stability and predictability of the mining investments. In the present, mining companies are concerned because of the effects that the administrative decisions and regulations issued by the host government in relation to the environment, may produce on their cash flows or inclusively on the continuance of their mining operations. In the same sense, governments - principally of developing countries - may also be concerned that the strictness of their national environmental regulations might scare away mining investors. In addition, the population, local and international NGOs, international institutions and most developed countries, among other stakeholders; are constantly keeping an eye on the environmental performance of both of the mentioned parties, and could also exercise pressures or initiate procedures aiming to enhance the level of environmental protection.

For these reasons, mining companies require new mechanisms of protection against environmental regulatory risk, which have to contemplate special considerations related to the protection of the environment. With regard, this dissertation aims to determine whether some type of stabilization clause may be a suitable safeguard for mining investors in relation to the environmental regulatory changes.

As a caveat, it must be said that this matter and most of the principles and concepts involved are complex and subject to different views in the doctrine and arbitral practice, as explored during the paper.

This dissertation is structured as follows: the first section explores the implications of the recognition of a right to certain environmental quality and related regulations, with special attention to the potential occurrence of an environmental taking; the second section explains the principal mechanisms of investment protection which could be implemented to reduce or manage the political risk of the host countries, analyzing in particular the stabilization clauses contained in state agreements; the third part contains examples of stabilization clauses used in the practice by mining companies to establish different degrees of stabilization over domestic environmental regulations; the fourth section explains the considerations that in opinion of this dissertation must be taken into account for a suitable protection of the mining investments in relation to the environmental regulatory changes, and concludes whether some types of the stabilization clause can be qualified as providing such suitable protection; and the final section draft some final conclusions.

CAN STABILIZATION CLAUSES PROVIDE A SUITABLE PROTECTION FOR THE MINING INVESTMENTS IN RELATION TO ENVIRONMENTAL REGULATORY CHANGES?

1. ENVIRONMENTAL REGULATORY CHANGES AND THE MINING INVESTMENTS.

The increase of the environmental global awareness over the past decades, has posed new challenges and risks for the governments and mining investors. This section aims to describe some of the principal issues related to national environmental regulations and the economical impacts that the development of these regulations may produce on mining investments.

1.1. Right to certain environmental quality.

The importance of the protection of the environment was firstly stressed internationally by the United Nations Conference on the Human Environment (Stockholm 1972). The Declaration on the Human Environment, issued within this Conference, proclaimed that:

“Principle 1.- Man has the fundamental right to freedom, equality and adequate conditions of life, in an environment of a quality that permits a life of dignity and well-being, and he bears a solemn responsibility to protect and improve the environment for present and future generations.”¹

The principles, recommendations and other environmental-related provisions contained in this instrument have given the basis for the actual development of international and national environmental regulations².

¹ Declaration of the United Nations Conference on the Human Environment, principle 1 (1972), also in: <www.unep.org/Documents.Multilingual/Default.asp?DocumentID=97&ArticleID=1503> (last visited, January 31st 2008).

² Shelton, Dinah, *The Links between International Human Rights Guarantees and Environmental Protection*, (University of Chicago, 2004), p. 1, also in: <<http://internationalstudies.uchicago.edu/environmentalrights/shelton.pdf>> (last visited, January 14th 2008).

The above quoted formula also exemplifies a first approach to the recognition of the right of environmental protection, considering it as a means, mechanism or pre-condition for the enjoyment of the rights to life and health and other internationally recognized human rights³. Subsequent national and international instruments have used the same formula.

The modern approach on the subject, acknowledges the right to an environment of a specific quality as being an independent and fundamental human right, through formulas that recognize the right to a “healthy”, “safe”, “secure”, “clean” or “ecologically balanced” environment⁴. As examples of this second view can be mentioned the San Salvador Protocol, which establishes that “everyone shall have the right to live in a healthy environment and to have access to basic public services”⁵, and the African Charter on Human and People’ rights, which states that “all peoples shall have the right to a satisfactory environment favourable to their development”⁶.

National legislations have generally recognized this right, either as a means to achieve other fundamental rights or as a fundamental right itself, as confirmed by the World Conservation Union which has recently identified the existence of over 100 constitutions in the world that guarantee the right to a clean and healthy environment or the obligation of the State to prevent the environmental harm⁷.

Legal implications of the recognition of this right

The recognition of this right to certain quality of the environment, contained in national or international instruments, is not only lyrical and presents practical

³ Shelton, Op. cit. 2, p. 1.

⁴ Shelton, Op. cit. 2, p. 2.

⁵ Additional Protocol to the American Convention on Human Rights in the Area of Economic, Social and Cultural Rights, article 11, (San Salvador 1988), also in: <<http://www1.umn.edu/humanrts/oasinstr/zoas10pe.htm>> (last visited, January 29th 2008).

⁶ African [Banjul] Charter on Human and Peoples' Rights, article 24, (adopted 1981), also in: <www1.umn.edu/humanrts/instr/z1afchar.htm> (last visited, January 30th 2008).

⁷ IUCN, *Human Rights and Environment: Overlapping Issues*, (IUCN Environmental Law Centre, undated), p. 11, , also in: <www.iucn.org/themes/law/pdffdocuments/DEV14_HR%20and%20Env%20NEW%20VERSION_MSM.pdf> (last visited, January 31st 2008).

implications as these rights can be enforced through national or international courts.

Regarding national courts, stands out the much-commented US Alien Tort Claims Act that grants the US district courts with “original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the united states”, and which have been invoked in important mining-related cases in the last three decades⁸.

In the case of international courts, the Inter-American Court of Human Rights (for its Spanish acronym: CIDH), is growing in importance dealing with conflicts concerning the enforcement of this right against governments and mining companies, e.g. this institution is currently in charge of solving the claim of the NGO CONACAMI against Peru for several contraventions of human rights of the peasant community of the *Comunidad San Mateo de Huanchor*, because of the environmental impacts produced by an abandoned mining tailing dam⁹, and have also ordered said government to implement precautionary measures to protect the population of the city of *La Oroya* from the pollution of an adjacent mining operations¹⁰.

1.2. Contents and development of the environmental regulations

This sub-section describes the impacts of mining on the environment, and provides an overview of the main reasons that shape the particular national environmental legislations and makes them evolve over time.

⁸ Malone, Linda, Defending the environment: Civil Society Strategies to enforce international environmental law, (Washington, DC, USA: Island press, 2006), p. 258.

⁹ University of Minnesota, *Comunidad de San Mateo de Huanchor v. Peru*, Case 504/03, Inform No. 69/04, Inter-Am. C.H.R., OEA/Ser.L/V/II.122 Doc. 5 rev. 1 en 527 (2004), also in: <www1.umn.edu/humanrts/cases/S69-04.html> (last visited, January 24th 2008).

¹⁰ Business and Human Rights Resource Centre Human Rights Body Calls on Peru to Protect Citizens from Contamination by American-owned Smelter, (September 2005) <http://www.business-humanrights.org/Links/Repository/272744/link_page_view> (last visited February 26th 2008).

Mining impacts on the environment

The mining industry produces highly disruptive effects on the environment¹¹. These impacts are produced mainly in the stages of exploration, development, exploitation and processing, and their intensity depends on the stage of mining operation; as mining impacts increase as operations advance from the first to the last of the mentioned stages¹². The main mining impacts on the environment are briefly referred to in Box N° 1.

Box N° 1: Main environmental impacts of the mining activities.

Among the impacts of the mining activities stands out: (a) acid mine drainage¹³ produced by surface and underground mining works intersecting water tables¹⁴ or generated by the contact of water bodies with mining tailings or waste rock dumps¹⁵, and (b) discharge of “process water” in the later stages of the mining processing stage, which is returned to the water bodies containing chemical products and other contaminants (like mercury and cyanide)¹⁶. Other impacts worth mentioning are the erosion caused by physically unstable mining waste, the desertification produced by the clearance of vegetation and topsoil in the surface mining operations, other threats to ecosystems and biological diversity¹⁷, and the intensive use of water and other natural resources.

The impacts of the mining activities on the environment can be produced either by current mining operations or by environmental mining legacies¹⁸.

¹¹ Roderick G., Eggert, *Mining, the Environment, and Public Policy in Mining*, in Roderick G. Eggert, Ed., Mining and the Environment (Washington: Resources for the Future, 1994), p. 1-3.

¹² Walde, T.W., Environmental Policies towards Mining in Developing Countries, (CPMLP Professional Paper N° PP3, 1992), p. 3.

¹³ Which can be defined as “the inorganic chemical water pollution resulting from the oxidation of sulphide-containing minerals”, see: UNEP, Environmental Aspects of Selected Non-ferrous Metals (Cu, Ni, Pb, Zn, Au) ore mining. A Technical Guide, (United Nations Publication, 1991), p.43.

¹⁴ UNEP, Op. cit. 13, p. 27.

¹⁵ Walde, T.W., Op. cit. 12, p. 4.

¹⁶ Otto, J., Effective Environmental Mining Legislation for Developing Countries, (Seminar Paper SP12, Zambia, 1992), p. 8.

¹⁷ MMSD, *Breaking New Ground, Chapter 10: Mining Minerals and the Environment*. (2002) <www.ied.org/mmsd/mmsd_pdfs/finalreport_10.pdf> (last visited, February 14th 2008)

¹⁸ Also called, historical mining liabilities, abandoned or orphan mines (or mining operations).

In the case of current mining operations, the responsible is in principle¹⁹ able to be identified and in application of the Polluter Pays principle²⁰ to be held responsible for the effects of its activities. In order to avoid the miner to simply “walk away” from the mining operation without executing a proper closure and rehabilitation of the area; the government is likely to request guarantees that assure the proper closure of the mine at the end of its useful life. These assurances can be given by forms of cash or equivalents (irrevocable letters of credit, certificates of deposit, government bonds and trust funds), surety bonds (obligations for the eventual performance of the closure obligations in case of the miner’s breach), and corporate self-guarantees²¹.

Regarding abandoned mining operations the problem is far more complex, considering that these environmental mining liabilities were generated by mining and smelting operations that occurred over the past decades, centuries or millennia, and that continue producing negative effects on the environment, in many ways far more troubling than those produced by current operations²², and consequently the responsible could be unidentifiable or could not bear anymore the closure obligations because of insolvency or bankruptcy²³.

National environmental legislations

In order to deal with the environmental impacts and in compliance with their obligations emanated from the right to certain environmental quality, each country has produced a different set of environmental regulations some of which are specific to mining activities, while others are general and applies to more than one

¹⁹ In occasions the identification of the responsible parties may be complex, for example in the case of artisanal and informal miners.

²⁰ World Bank, *It is not over until it is over: mine closure around the world*, International Finance Corporation, (2002), p. 9, also in: <<http://siteresources.worldbank.org/INTOGMC/Resources/notoverwhenover.pdf>>, (last visited December 5th 2007).

²¹ Bastida, L., *Interfaces between international standards, national legislations and corporate self-regulation regarding mine closure: the experience of Argentina, Bolivia and Chile*, thesis for the Master of Laws in Mineral Law and Policy, CEPMLP-Dundee University, (March 2005), p. 21.

²² See MMSD, Op. cit. 17, Chapter 10.

²³ Boyd, J., *Bonding requirements for coal and hard-rock mines in the US*, in Bastida, E., (et. al.) (eds.), International and Comparative Mineral Law and Policy (Netherlands: Kluwer Law International, 2005), p. 729.

economic sector. In a broad sense, which is considered for the purposes of this dissertation, environmental regulations comprise any laws, regulations, decrees and standards, *ad hoc* agreements with individual mining investors, administrative guidelines, policy statements, and industry's self-regulation; adopted to protect the environment²⁴.

Among the main factors that decide the variety of national approaches to environmental protection, can be mentioned:

- The disparate interest of governments on the protection of the environment or their ability to contradict environmental groups of pressure. For example, China presents a poor environmental performance albeit being a major world power²⁵. It has also been noted that the present globalize world has produced a “race to the bottom” in environmental standards, considering that the states relax the protection of the environment to attract more investments or maintain domestic investments in the country²⁶.
- The influence and pressure of national or international environmental organizations, and in the specific case of the developing countries, of more developed countries²⁷.
- The special regulatory considerations derived from particular national circumstances. For example, the existence of widely spread small-scale, artisanal or informal mining operations (mainly found in developing countries) or the participation of governments in the mining business determining sometimes the lessening of the environmental regulation and control mechanisms.

²⁴ Otto, James M., Regulatory approaches to Mining and the Environment in Developing Nations: examples from Africa, (Seminar Paper #SP 13, CEPMLP, 1992), p. 10-13.

²⁵ As can be verified by the EPI environmental performance ranking China, ranks 94 of 133 countries studied. See Yale and Columbia Universities, *Pilot 2006 Environmental Performance Index (EPI)*, <http://www.yale.edu/epi/2006EPI_Report_Full.pdf> (last visited July 15th 2007).

²⁶ World Bank Briefing Papers, *Is Globalization causing a Race to the Bottom in Environmental Standards?*, <www1.worldbank.org/economicpolicy/globalization/documents/AssessingGlobalizationP4.pdf> (last visited February 27th 2008)

²⁷ As explained by T. W. Wälde, Op. cit. 12, p.23; and Wälde, Thomas and Ndi, George, *Stabilizing International Investment Commitment: International Law Versus Contract Interpretation*, in Texas International Law Journal, Vol. 31. (1994), p. 231.

- It is also possible to observe a major gap in the quality of the environmental regulation and performance level regarding the protection of the environment between developing and developed countries²⁸, which is considered to be originated on the lack of necessary human, economical resources, and required technologies to enhance its degree of protection, or the existence of considerable levels of corruption²⁹.

As states have developed particular environmental legislations, international institutions have also issued their own environmental guidelines, instruments, standards, etc. principally to be considered as a model for the countries. Among others can be mentioned the World Bank Group's Pollution Prevention and Abatement Handbook³⁰ or the WHO's Guidelines for Drinking-Water Quality, which includes standards for the quantity of mining elements or substances in the drinking water.³¹

Development of environmental legislation

In spite of being distinct and showing different degrees of performance, national environmental regulations share a very important characteristic: they cannot be static. Governments require modifying their mining environmental regulations from time to time, generally to tighten them (nevertheless it could also be to relax them)³², considering the following main drivers:

- a. the change of the scientific understanding of the effects of these activities or the development of improved technologies to minimize them,

²⁸ Warhurst, Alyson, *The Limitations of Environmental Regulation in Mining*, in Mining and the Environment p. 139-145. (Roderick G. Eggert, Ed; Washington: Resources for the Future, 1994).

²⁹ Wälde, T.W., Op. cit. 12, p. 34.

³⁰ IFC World Bank Group, *Pollution Prevention and Abatement Handbook*, (July, 1998) <www.ifc.org/ifcext/enviro.nsf/Content/PPAH> (last visited February 25th 2008).

³¹ WHO, *Guidelines for Drinking-Water Quality* (1993) <www.lenntech.com/WHO's-drinking-water-standards.htm> (last visited February 25th 2008).

³² Reid T., Collin, *Regulation in a Changing World: Review and Revision of Environmental Permits*, p.2. Article based on a paper delivered at the Law and the Environment 2006 Conference at University College Cork. (April, 2006).

- b. the emergence of new international standards,
- c. the change in the damaging effects of a particular activity and the consequent development of new alternatives to deal with them,
- d. the change of perceptions, attitudes and interests of the society, or
- e. the change of economic and political priorities³³.

As can be noted, the reasons for the change of environmental regulations can be basically technical or ideological.

Strictness v. uncertainty of the environmental changes

To conclude this sub-section, it is important to notice that mining investors are not as much concerned of the strictness of an environmental regulation, as they are of these rules being unpredictable³⁴.

In proof of this assertion, Table N° 1 compares the top ten countries in relation to the (domestic and foreign) expenditure on mining exploration during the year 2006, with their environmental performance according to the last Environmental Performance Index (EPI); which appears to demonstrate that the environmental rigorousness of the legislation of a country does not seem to be a strong deterrent for the attraction of a country of investment in greenfield mining projects, considering that at least the five more explored countries are positioned within the upper third in the EPI.

³³ Reid T., Collin, Op. cit. 32, p. 2-3; and Wälde, Thomas and Ndi, George, Op. cit. 27, p. 231.

³⁴ Verhoosel G., *Foreign Investment and Environmental Regulatory Change In Developing And Transition Economies: How To Reconcile The Tension For The Benefit Of Technology Transfer*, in: CEPMLP Journal Vol. 1- article1-1, <<http://www.dundee.ac.uk/cepmlp/journal/html/Vol1/article1-1.html>> (last visited January 12th 2008).

Table N° 1: Comparison between the top ten countries recipient of mining exploration expenditure in the 2006 and its position on the EPI.

Country	Position in the Exploration Expenditure 2007 ³⁵	Position in the EPI 2008 ³⁶ (Universe 149 countries)
Canada	1	12
Australia	2	46
United States	3	39
Mexico	4	47
Russia	5	28
Peru	5	59
South Africa	6	97
Brazil	6	34
Mongolia	6	100

1.3. Effects of environmental regulatory changes on mining investments

This sub-section explores the negative economic effects that environmental regulatory changes may (and not always) produce on mining investments, giving special importance to the potential occurrence of a regulatory taking.

Negative effects of environmental regulatory change on investments:

Mining companies invest in a country with the obvious expectation of making profits³⁷. These expectations can be affected by actions of the government encompassed in the broad concept of political risk, which is the fear that governments may unilaterally alter the rules of investments injuring the investor's interests³⁸. This risk is likely to increase as the project develops³⁹. The most

³⁵ MEG; World Exploration Trends. A Special Report from Metals Economics Group for the PDAC International Convention 2007, (Metals Economics Group, Nova Scotia, 2007), p. 4. See: <www.commodities-now.com/content/research/includes/assets/ExploTrendsExecSummary.pdf> (last visited February 2nd 2008).

³⁶ Yale and Columbia Universities; Op. cit. 25.

³⁷ Crowson, Phillip., Inside Mining, (Mining Journal Books Ltd., London, 1998), p. 3.

³⁸ Cordes, John and Otto, James, The Regulation of Mineral Enterprises: A Global Perspective on Economics, Law and Policy, (Colorado: Rocky Mountain Mineral Law Foundation, 2002), p. 5-1.

feared manifestations of political risk are the fiscal and the (non-fiscal) environmental regulatory changes⁴⁰.

As explained in the previous section, governments face the need to tighten their environmental regulations from time to time, while the resulting environmental regulatory changes may (or may not) affect economically a mining investment.

The following is a list of the typical environmental regulatory changes that are likely to affect economically a mining investment:

- a. Setting up new obligations to be complied by mining companies. For example, the imposition of environmental taxes or other kind of environment-related payments, the requirement of new environmental studies or standards, the obligation to constitute financial guarantees as an assurance of their compliance with certain environmental provisions (commonly applied to the final and post-closure mine closure stages), etc.
- b. Establishing new liabilities for mining companies, for example the closure and rehabilitation of abandoned mines within the area of their mining rights, irrespective of the participation of the affected mining company in their production.
- c. Establishing additional procedural requirements, like the extension of the procedural times, the inclusion of new requirements in environmental procedures, the appointment of additional authorities to be consulted or to decide in environmental matters, or the requirement of new licenses, permits or others.
- d. Issuing new laws limiting or determining the way of carrying on mining operations, like the obligation to use a specific technology or inputs for the mining processes.

³⁹ Curtis, Christopher T, *The Legal Security of Economic Development Agreements*, (Harvard International Law Journal, Vol. 29, N. 2, Spring 1988), p. 320.

⁴⁰ Wälde T. W., Stabilizing International Investment Commitments: International Law versus Contract Interpretation, (PP13, Dundee, CEPMLP, 1994), p. 19.

- e. Banning or limiting mining operations in certain areas of the country, like the common higher restrictions or even prohibitions applied to mining operations executed on environmental protected or urban areas.
- f. Banning or limiting the use of minerals as inputs of products, for example, the case of the growing asbestos ban.

As examples can be briefly mentioned the Fraser Island Case in Australia (1976) in which an administrative decision to withhold export permits based on environmental concerns blocked the access of mining companies to export markets destroying the investment's value⁴¹; the standing ICSID arbitration between Glamis Gold Co. and the United States, in which Glamis claims the expropriation of its mining investment (and others contraventions), through regulations requiring the grading and backfilling of mining operations neighboring Native American sacred lands⁴²; as well as the cases of indirect expropriation summarized in Box N° 2.

Indirect expropriation and regulatory taking

An expropriation implies the government taking of the property of foreign mining investors within the host country⁴³. With regard, it is important to notice that the right to expropriate of the government is recognized under the principle of sovereignty, and is considered a lawful measure under international law, provided that: (i) is carried out for a public purpose, (ii) is not discriminatory against a particular investor, (iii) is executed respecting the due process, and (iv) is compensated⁴⁴.

⁴¹ Pritchard, R., *Safeguards for Foreign Investment in Mining*, in International and Comparative Mineral Law and Policy (Netherlands: Kluwer Law International, Bastida, Wälde and Warden-Fernández (eds.), 2005), p. 81.

⁴² US Department of State, *Glamis Gold Ltd. V. US*, in: <<http://www.state.gov/s/l/c10986.htm>> (last visited 28th February 2008).

⁴³ Kinsella, N. Stephan and Rubins, Noah D., International Investment, Political Risk, and Dispute Resolution: A Practitioner's Guide (Oceana Publications, September 2005), p. 6.

⁴⁴ Cotula, L., *Stabilisation clauses and evolution of environmental standards in foreign investment contracts*, (Yearbook of International Environmental Law, OUP, forthcoming), p. 4; in the same sense see, Cameron, Peter D., Stabilisation in Investment Contracts and Changes of Rules in Host Countries: Tools for Oil & Gas Investors Final Report, (AIPN, 2006), p. 13-14 See:

Box N° 2: Examples of arbitration procedures which discussed the occurrence of regulatory taking through environmental regulation.

The following are some of the most commented arbitration procedures in the doctrine, related to damages

- a. *Metalclad v. the United Mexican States*.- *Metalclad* claimed that Mexico took a measure “tantamount to an expropriation” regarding a landfill this company operated in Mexican territory, by: (i) refusing to grant a construction permit, and (ii) issuing an Ecological Decree creating a Natural Area for the protection of rare cactus over the area of the landfill. The Tribunal considered that through these measures Mexico had indirectly expropriated *Metalclad’s* investment without paying any compensation⁴⁵.
- b. *Tecmed v. The United Mexican States*: Tecmed claimed that Mexico had expropriated a hazardous waste disposal site that this company operated in Mexican territory, by: (i) the refusal of the Mexican environmental authorities to renew its license to operate, due to local public protests, and more importantly (ii) the issuance of regulation prohibiting disposing hazardous waste within 25 kilometers of any city of more than 100,000 people, which totally prevented the operation of the waste disposal, due to its closeness to the city of *Hermosillo* (8 km.). The Tribunal considered that the investment, benefits and profits were fully and irrevocably destroyed and determined that being the taking of the investor’s property executed due to public protests, the measures taken by the Mexican government were neither justified nor proportional to the public purpose presumably protected⁴⁶.
- c. *Methanex v. United States*: *Methanex* suffered losses caused by the State of California’s ban on the sale and use of the gasoline additive that this company commercialized known as “MTBE” (methyl tertiary-butyl ether) and claimed that the California ban caused the taking of a substantial portion of its investments. The Tribunal concluded that the ban was a lawful regulation and not an expropriation.⁴⁷

Expropriations can be directly or indirectly executed. Direct expropriation (like confiscations and nationalizations) involves in general the taking of the investor’s property by a measure of the government directly targeted on that purpose. An indirect expropriation occurs when a measure that is not targeted in principle to deprive the investor of his property rights, ultimately produces that effect⁴⁸. The latter type of expropriation can also be generated by a government measure that is

http://lba.legis.state.ak.us/sga/doc_log/2006-07-05_aipn_stabilization-cameron_final.pdf (last visited February 20th 2008).

⁴⁵ *Metalclad Corporation v. the United Mexican States*, see *infra* note 50.

⁴⁶ Kinsella, N. S. and Rubins, N. D; Op. cit. 43, p. 210-211.

⁴⁷ *Methanex v. United States*, Final Award of the Tribunal on Jurisdiction and Merits. Part IV – Chapter D - Page 7. See award in: <<http://www.state.gov/documents/organization/51052.pdf>> (last visited January 24th 2008).

⁴⁸ The Doctrine of Indirect Expropriation in Light of the Practice of the Iran-United States Claims Tribunal by Veijo Heiskanen, in *Transnational Dispute Management*, Vol. 3, issue 5, 2006, p. 3.

actually a disguised form of expropriation⁴⁹. Regarding the extent of this concept, the ICSID Tribunal in *Metalclad Corporation v. United Mexican States* have noted that this term comprises the terms creeping, *de facto* expropriation or measures tantamount to expropriation, to which commentators refer to usually without a clear or unequivocal definition⁵⁰. The broad concept of indirect expropriation includes the notion of regulatory takings.

A regulatory taking occurs when a sole or progressive set of regulatory changes produce an effect equivalent to expropriation⁵¹. In contrast, the *bona fide* regulatory measures of the government are considered to be within the policy powers of the government, and hence do not require to be accompanied by the payment of compensation⁵². Hence, the main difference between a regulatory taking and a valid environmental regulation is that the former needs to be compensated, while the latter does not require such payment.

Effects doctrine and the threshold level of compensation

An obvious first question to answer in relation to the environmental regulatory taking is to determine when a regulatory measure or a group of them can be considered as constituting an expropriation.

A common view appears to be the application of the “effects” doctrine⁵³, which focuses in the magnitude of the negative effects of the government’s measures on the property of the investor, regardless of the government’s reasons or intentions. Under this view, the fact that a regulatory taking was supported on environmental issues or not is irrelevant, and the only analysis that matters is the consequences of the measure (or measures) to determine whether compensation should be paid. This doctrine was originated in the Iran – US Claims Tribunal that in the *Phillips* case decided that “liability to compensate for the expropriation of alien property

⁴⁹ *Ibid.*

⁵⁰ *Metalclad Corporation v. the United Mexican States*, paragraph 114, (ICSID 2000). <<http://icsid.worldbank.org/ICSID/FrontServlet>> (last visited February 4th 2008).

⁵¹ Cotula, Op. cit. 44, p. 30.

⁵² Cotula, Op cit. 44, p. 6.

⁵³ As explained by Kinsella, N. S. and Rubins, N. D., Op. cit. 43, p. 206-207.

does not depend on proof that the expropriation was intentional”⁵⁴. Under the same Tribunal, the *Tippetts* case supported that “the intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact”⁵⁵.

Another relevant arbitration related to the environment, despite being referred to a direct expropriation, is the case of *Compañía del Desarrollo de Santa Elena S.A. v. The Republic of Costa Rica*, in which deciding the compensation to be paid by Costa Rica for the taking of a terrain of *Santa Elena* to extend a national park, the Tribunal - applying the “effects doctrine” – considered that “expropriatory environmental measures no matter how laudable and beneficial to society as a whole are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state’s obligation to pay compensation remains”⁵⁶[emphasis added].

The “effects” doctrine rises the difficult of determining where to draw the line dividing what may be considered as a valid environmental regulatory measure, and what might be qualified as a regulatory taking or indirect expropriation⁵⁷. With regard, there is no doubt that the actions of a government that destroy the total value of the investor’s property (understood broadly as any right, interest or asset) shall be considered as expropriatory, whereas those in which most of investment value remains cannot be considered as such. The problem is then to determine where to consider the threshold on the cases in between.

In order to set the threshold level of interference for a government measure to be considered as an expropriation, the arbitration tribunals have usually relied on the

⁵⁴ Ibid, p. 206.

⁵⁵ OECD: Directorate for Financial and Enterprise Affairs, “*Indirect Expropriation*” and the “*right to regulate*” in the international investment law. Working Paper on International Investment Number 2004/4, p. 15 <<http://www.oecd.org/dataoecd/22/54/33776546.pdf>> (last visited January 30th 2008).

⁵⁶ See award in <http://www.worldbank.org/icsid/cases/santaelena_award.pdf> (last visited July 10th 2007).

⁵⁷ OECD, Op. cit. 55, p. 3.

Metalclad award framed in the NAFTA Convention (see Box N° 2), which established that:

“Thus, expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.”⁵⁸ [emphasis added]

A more restrictive interpretation of the term “tantamount to expropriation” was given by the also NAFTA *Pope & Talbot Inc. v. the Government of Canada* arbitration, concerning the limitation to the access of the lumber export of a Canadian company to the US market, in which the Tribunal decided that an expropriation had not occurred under NAFTA article 1110, due to the lack of “substantial deprivation” of the property rights that prevented the investor of the “use, enjoy, or dispose of the property”⁵⁹. As can be noted, this ruling provides a more restrictive formula than the *Metalclad*’s reasonably-to-be-expected economic benefit.

Finally, it is valid to say that the “effects” doctrine’s threshold presents a lack of consistency in the arbitral practice as can be observed by contrasting the decision in the *CMS Gas Transmission Company v. Argentine Republic*, where the Tribunal didn’t considered that an expropriation had taken place despite it was found that the investment had lost the 98.5% of its value; with the *CME v. Czech Republic* award, in which the Tribunal did considered that the actions of the government had destroyed completely the value of the investment albeit the final assessed loss of the investor’s property value was of 87 %⁶⁰.

⁵⁸ *Metalclad Corporation v. the United Mexican States*, Op. cit. 50, para. 103.

⁵⁹ Quoted by Cotula, Op. cit. 44, p. 9.

⁶⁰ As explained by Kinsella, N. S., and Rubins, N.D., Op. cit. 43, p. 207-209.

Purpose and proportionality of the measures

A contrary view to the “effects” doctrine has been taken by a number of Tribunals that went beyond the sole analysis of the effects of the measure on the value or viability of the investment and studied the causes and even proportionality of the measures to determine whether compensation must be paid⁶¹.

For example, in the case of *Tecmed v. The United Mexican States* (see Box N° 2) the Tribunal determined that Mexico’s measure destroyed the economic and commercial operations of the company, but (against the application of the “effects” doctrine) the arbitrators continued its analysis to determine whether this measure was justified and proportional under the state’s policy powers and the public interest under protection, concluding that “deprivation or neutralization of the economic or commercial value of the Claimant’s investment” had to be weighted against “a serious urgent situation, crisis, need or social emergency” to determine whether it occurred an expropriation⁶².

The arbitration between *Methanex Corporation* and the United States of America (see Box N° 2), based again on the NAFTA, constitutes another example of this view. In this case, Tribunal considered again the environmental purpose of the measures of the government but established an exception concluding that:

“But as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alia, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.”⁶³ [emphasis added]

⁶¹ OECD, Op. cit. 55, p. 22.

⁶² Kinsella, N. S., and Rubins, N. D., Op. cit. 43, p. 210-211.

⁶³ See award (2005) in <<http://www.state.gov/documents/organization/51052.pdf>> (last visited July 10th 2007)., para. 15 of the section referred to NAFTA Art. 1110.

Considering the above grounds, the Tribunal decided that under the NAFTA “the California ban was a lawful regulation and not an expropriation”⁶⁴.

Some international instruments also require looking into the reasons of the regulatory measures to determine whether or not an expropriation has taken place, establishing an exception in the case of environmental regulatory measures. It is noteworthy that in none of the reviewed instruments these exceptions are absolute, considering that all of them contemplate the obligation to compensate for new environmental regulations only under “rare circumstances” or when they were designed “to have a confiscatory effect”.

Box N° 3: International instruments limiting the possibility of environmental regulation to be considered as regulatory takings.

Some treaties and other international instruments have expressly considered that in principle government actions sustained in “public safety” or “policy powers”⁶⁵- like the protection of the environment - cannot be considered as expropriatory, and hence, no compensation is due to be paid. For example:

- The US BIT model of 2004⁶⁶ establishes that “except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.”⁶⁷.
- The Canadian BIT model, also include as caveat that only in “rare circumstances” the non-discriminatory measures, designed to protect the environment and other public purposes, are deemed to be considered as indirect expropriations. As example of these “rare circumstances”, the Canadian model refer to the case in which “a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith”⁶⁸.
- The MIGA Model Contract of Guarantee for Non-Shareholder Loans establishes that “no measure shall constitute an Expropriation (...) if it constitutes a bona fide, non-discriminatory measure of general application that governments normally take for the purpose of regulating economic activity, ensuring public safety, raising revenues or protecting the environment, unless the measure is designed by the Host Government to have a confiscatory effect.”⁶⁹ [emphasis added]

⁶⁴ *Ibid*, see para. 7 of the decision referred to NAFTA Art.1110.

⁶⁵ Kinsella, N. S., and Rubins, N. D., Op. cit. 43, p. 204.

⁶⁶ U.S. Bit model (2004), see in <http://www.ustr.gov/assets/Trade_Sectors/Investment/Model_BIT/asset_upload_file847_6897.pdf> (last visited December 8th 2007).

⁶⁷ *Ibid*, Section 4 (b).

⁶⁸ See UNCTAD, Investor-State Disputes Arising from Investment Treaties: a review, p. 60 (New York-Geneva, 2005), in: <http://www.unctad.org/en/docs/iteit20054_en.pdf> (last visited February 3rd 2008).

⁶⁹ MIGA Model Contract of Guarantee for Non-Shareholder Loans (fourth revision April 2007), Art. 4, 4.2 (Expropriation: Covered Risk), in <www.miga.org/documents/disclosure/Contract%20of%20Guarantee%20for%20Non-Shareholder%20Loans.pdf> (last visited January 13th 2008)

Proposed criteria to identify a regulatory taking

As can be verified by the above arbitral jurisprudence, there are no clear rules on how to determine if a indirect expropriation or regulatory measure has taken place and appears to be always a need for a case-by-case approach⁷⁰, paying special attention to the wording of the treaty⁷¹. This position is considered as being provided by the AMINOIL case, which determined that the interpretation of a stabilization clause, must be done taking into account all the different and surrounding factors and circumstances⁷².

Notwithstanding, a test appears to be emerging as a trend to determine whether a regulatory taking has occurred, based on the arbitral jurisprudence and treaties provisions. According to this test, the following three elements have to be considered to determine whether a regulatory measure is expropriatory: (i) the economic impact of the government interference, especially if it causes the investor's property rights to be useless, (ii) the character of the government interference, particularly the compliance of the requirements of public purpose, non-discrimination and due process, and (iii) the contravention of the legitimate expectations of the investors, which is explained later by this paper⁷³.

Also an OECD paper suggests to analyze the "normality" of the measures as criteria to determine whether a regulatory taking has been produced, in the sense that it is not "normal" for the governments to regulate contradicting previous commitments undertaken with the investor, ignoring the due process, using regulatory changes for hidden objectives, nor considering themselves as judge and party in determining whether a compensation shall be paid.⁷⁴

⁷⁰ OECD Indirect expropriation: is the right to regulate in risk? <<http://www.oecd.org/dataoecd/5/52/36055332.pdf>> (last visited January 30th 2008), p. 1; and OECD, Op. cit. 55, p. 3.

⁷¹ OECD, Op. cit. 55, p. 22.

⁷² Maniruzzaman, A.F.M., Stabilization in Investment Contracts and Change of Rules by Host Countries: Tools for Oil and Gas Investors, Association of International Petroleum Negotiators, (First Draft of AIPN Research Project 2005-06), p.88, available in: <http://lba.legis.state.ak.us/sga/doc_log/2006-03-15_aipn_stabilization-maniruzzaman_first_draft.pdf> (last visited July 11th 2007).

⁷³ OECD, Op. cit. 55, p. 6; Cotula, Op. cit. 44, p. 19.

⁷⁴ OECD, Op. cit. 70, p. 6.

2. STABILITY AND THE PROTECTION OF INVESTMENTS.

As explained in the previous section, mining investors can be economically affected by the changes of environmental legislation, which is one of the most feared manifestations of political risk of the country. This section briefly describes the main mechanisms to protect investors against this risk, and in particular the stabilization clauses incorporated in state agreements.

2.1. Mechanisms of investment protection against political risk.

There are some safeguards that protect the mining investors in different degrees against the political risk, and hence facilitate their decision to invest in a country. Among the main ones, can be mentioned:

- a. The multilateral or bilateral investment protection treaties (respectively MIT and BIT), which are agreements entered into between countries with the primarily objective to protect and promote investments. In the eyes of the investors, the participation of a country in a treaty or treaties which apply to protect their investments is traduced as “quality”, whereas the non-participation in these instruments signals “danger” and discourages the decision to invest⁷⁵. Some of the most common contents of the investment treaties are: (i) the emphasis on public policy’s concerns, specially in relation to public health, protection of the environment and national security, (ii) reference to compensation to be paid in case of expropriation, and (iii) the inclusion of standards such as the “fair and equitable treatment” or “umbrella clauses”, which grants some degree of stabilization as is explained later in this paper.⁷⁶ It is noteworthy that most of these treaties do not deal explicitly with regulatory takings⁷⁷.

⁷⁵ Pritchard, R., Op. cit. 41, p. 85.

⁷⁶ UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking*, (UN 2007), p. xi-xii, in <http://www.unctad.org/en/docs/iteiia20065_en.pdf> (last visited February 8th 2008); UNCTAD, Op. cit. 68, p. 19.

⁷⁷ UNCTAD, Op. cit. 76, p. xii.

Some of the most well-known multilateral investment treaties are the NAFTA - entered into Mexico, United States and Canada - that has been the basis for some of the principal arbitration decisions regarding the effects of environmental regulation on the economics of the investments, and the Energy Charter Treaty (ECT), which is the only treaty targeted specifically in the energy sector and which have been signed by over 50 countries⁷⁸. Regarding the BITs and according to UNCTAD, as of 2006 more than 2,500 of these instruments were standing worldwide⁷⁹.

- b. Guarantees embodied in the Constitution or other national legislation, which are adopted by host governments in their domestic legislation. For example, constitutional guarantees against nationalization without compensation, or investment codes granting principally fiscal guarantees. As evident, their main shortcoming is that being embodied in the national legislation; the guarantees are finally exposed to the political instability of the host country, diminishing its safeguarding effect over time.
- c. The political risk insurance, which is a mechanism of protection that allows the investor to transfer the risk to a third party in exchange of a payment. Albeit its benefits, this safeguard can only be obtained through the payment of an exorbitant price⁸⁰. The most known political risk insurance is the one provided by the Multilateral Investment Guarantee Agency – MIGA of the World Bank; which, among others, covers the investor’s risk of expropriation of his investment through discriminatory administrative or legislative actions of the national or sub-national levels of government⁸¹.

⁷⁸ Energy Charter, *Members and Observers*, <<http://www.encharter.org/index.php?id=61&L=title%3DGo>> (last visited February 11th 2008).

⁷⁹ UNCTAD, *Analysis of Bilateral Investment Treaties Finds Growth in Agreements, new areas of focus* (Information note, April 2007) <www.unctad.org/Templates/webflyer.asp?docid=8270&intItemID=4431&lang=1> (last visited February 7th 2008).

⁸⁰ Nevitt, Peter K., Fabozzi, Frank J., *Project Financing*, (Euromoney, 7th Edition, London, 2000), p. 26.

⁸¹ MIGA, *Mitigating Risks in Oil, Gas and Mining*, p. 3 <<http://www.miga.org/documents/OGM.pdf>> (last visited February 7th 2008).

- d. The state agreements that are entered into between the State (represented by a government institution or company) and a foreign investor, and which are mainly used in the present by natural resources-rich developing countries to attract foreign investments or employed when the mining project involves large investments⁸². These agreements are also known as development agreements when they can contain principally developmental-oriented obligations or investment agreements when they include principally investment-related provisions⁸³.

These agreements are recognized to present positive and negative aspects. On the positive side, these agreements are generally entered into in a win-win approach⁸⁴, and can be used to fill gaps in the national legislation, to impose additional obligations (linked to development, taxation, the protection of the environment, etc.) to the ones included in the national legislation, or to grant certain guarantees in favour of the investor. On the negative side, the process of negotiation of these agreements can take long times and be very expensive⁸⁵. These agreements usually include one or more contractual mechanisms to provide an extra protection to the investment, as provisions related to the choice of law, international arbitration, and stabilization clauses. The next sub-section focuses on the latter clauses.

Other mechanisms to manage political risk include spreading the risk of the investment (e.g. by entering into Joint Ventures with other parties); using economic, financial and political persuasion as mechanisms of defense; and making the project less risk-vulnerable through associating with the State or local parties, or maintaining the project in a low profile.⁸⁶

⁸² UNCTAD, State Contracts, p. 1-3, <http://www.unctad.org/en/docs/iteiit200411_en.pdf> (last visited December 11th 2007).

⁸³ Cordes, J., and Otto, J., Op. cit. 38, p. 4-8, 4-18.

⁸⁴ Cordes, J., and Otto, J., Op. cit. 38, p. 4-4.

⁸⁵ Pritchard, R., Op. cit. 41, p. 89.

⁸⁶ Wälde, T., Ndi, G., Op. cit. 27, p. 233 - 234.

2.2. Stabilization clauses as a means of investment protection.

Stability and predictability are particularly important for mining investments due to their condition of long term investments, with lengthy payback times and because of being activities exposed to many risks, e.g. geological, commercial, reputation, etc.

At the stage of negotiation of the state agreements, governments may offer stabilization clauses or others guarantees to facilitate the investment decision. But as noted by Sornarajah, these contracts contain from the outset an “obsolescing bargain”, in the sense that the investor’s bargaining power is reduced as the investment prospers⁸⁷. Furthermore, once the investment turns into a sunk cost, it is produced a “hostage” effect by which the investor is exposed to the variety of possibilities that the state possess to damage the investment⁸⁸.

The following lines explore one of the most controversial mechanisms that aim for the necessary stability and predictability required by the investors and contained in the state agreements: the stabilization clauses.

Definition, types and main issues involved

Stabilization clauses included in state agreements are aimed at protecting the investment from the negative effects of the application of new legislation or administrative measures following the conclusion date of the contract⁸⁹, and therefore, to protect the investors against the political risk of their host country⁹⁰.

There are many ways in which a clause can be drafted to provide stabilization to the legal regime regulating a project. Table N°1 gives as example the different techniques of stabilization listed by Professor Maniruzzaman.

⁸⁷ Sornarajah, M. *International Law on Foreign Investment*. (Second Edition, NY, USA: Cambridge University Press, 2004), p. 402-403.

⁸⁸ Wälde, T., *Stabilizing International Investment Commitments: International Law versus Contract Interpretation*, p. 11, (CPMLP, PP13, 1994).

⁸⁹ Verhoosel G., Op. cit. 34, without page number under Part I, A.

⁹⁰ Wälde, T., and Ndi, G., Op. cit. 27, p. 221.

Table N° 2: Stabilization techniques.	
Professor Maniruzzaman has identified the following variety of stabilization techniques ⁹¹ :	
Stabilization techniques	Example(s)
Protect the agreement against governmental legislative or administrative measures that may produce its alteration and annulment.	Article 17 of the Oil Concession Agreement between the <i>Shaikh</i> of Kuwait and AMINOIL: “...The Sheikh shall not by general or special legislation or by administrative measures or by any other act whatever annul this agreement ...”
Grant the agreement the category of <i>lex specialis</i> , and hence determine its supremacy over any subsequent legislation.	Article 2 of an Egyptian contract: “The rules and procedures contained in the annexed clauses have the force of Law, and are enforceable notwithstanding any legislative provisions contrary thereto.”
Insulate the agreement against subsequent inconsistent legislation, so its provisions will prevail in case of discrepancy with future regulations. It can also extend the protection against nationalizations.	1) Article 18.1 of the Syrian petroleum agreement of 2004: “CONTRACTOR and the Operating Company shall be subject to all laws and regulations of local application in force in the S.A.R. (Syrian Arab Republic) provided that CONTRACTOR or the Operating Company shall not be subject to any laws, regulations or modifications thereof which are contrary to or inconsistent with the provisions of this Contract and which are in effect at any time from the Effective Date and throughout the Term of this Contract.” 2) Indonesian agreement provides that: “...The Ministry of Mines, acting on behalf of the Indonesian Government, agrees that during the term of this Agreement it and the Indonesian Government and all its instrumentalities and subdivisions (1) will take no action which is inconsistent with the conduct of the Enterprise in accordance with the provisions of this Agreement, including without limitation, any action of condemnation or nationalization of the Enterprise or any part thereof...”
Incorporate (properly freeze) the law of the host country of a specific date in the agreement. This clause is typically known as <i>stricto sensu</i> stabilization clause.	Ghanaian Mining Agreement: "Except as otherwise expressly provided herein, this Agreement and the Scheduled documents shall be construed and have effect in accordance with law of Ghana as it existed at the 22nd of January one thousand, nine hundred and sixty-two."
Internationalize the agreement by including as governing law clauses of international law or general principles of law recognized by civilized nations, which are more stable than the national law.	1) Vietnamese contract of 1962: “The arbitrators shall base their decision on equity and the principle of international law.” 2) Oman model petroleum agreement of 1981: “(The arbitrators) shall apply the generally accepted customs and usages of the international petroleum industry and principles of law generally recognized by the nations

⁹¹ Summarized from Maniruzzaman, A.F.M., Op. cit. 72, p. 15-47.

	of the world."
Include open-ended formulas as "good faith" or "good will" clauses, and hence, preclude any unilateral modification or termination.	In the arbitration procedure between Amoco International Finance Corporation v. Iran the tribunal observed that: "The principles of good will and good faith apply in practically all systems of law to contracts as well as treaties."
Provide for the continuing stability of the agreement by adjusting its terms to the future legislative or administrative actions of the government, in order to restore the economic equilibrium of the contract.	Azerbaijani production-sharing contract is a good illustration of this trend: "..... In the event that any Governmental Authority invokes any present or future law, treaty, intergovernmental agreement, decree or administrative order which contravenes the provisions of this Agreement or adversely or positively affects the rights or interests of Contractor hereunder, (...), the terms of this Agreement shall be adjusted to re-establish the economic equilibrium of the Parties, and if the rights or interests of Contractor have been adversely affected, the SOCAR shall indemnify the Contractor (and its assignees) for any disbenefit, deterioration in economic circumstances, loss or damages that ensue therefrom." (<i>sic</i>)

Commentators generally recognize the following main types of stabilization clauses:

a. Traditional or "freezing" clauses.

The objective of these clauses is freezing or immobilizing an entire legal regime or just a particular aspect of it (typically the fiscal regime)⁹².

These instruments were initially used as a defense against expropriation, having emerged between the First and Second World Wars, as specific guarantees against the nationalization of US companies by Latin American governments⁹³.

During the 70s and early 80s, these clauses produced a number of arbitration awards, some of which are summarized in Box N° 4 and commented later in this paper⁹⁴.

⁹² As explained by Verhoosel G., Op. cit. 34.

⁹³ Cameron, Peter D., Op. Cit. 44, p. 15.

⁹⁴ *Ibid*, p. 16.

Box N° 4: Examples of arbitral awards regarding stabilization clauses

The following are the principal conclusions of some of the most commented arbitration procedures concerning stabilization clauses, which dealt mainly with nationalizations breaching stabilization clauses in the oil sector⁹⁵:

- *Aminoil v. Kuwait*: the Tribunal decided that the stabilization clauses created a “legitimate expectation” to the investor, which should be considered when assessing the amount of the compensation.
- *AGIP v. the Popular Republic of Congo*: The Tribunal considered that the nationalization in contravention of the stabilization clause was “irregular” and produced the obligation of the host government to pay compensation in full.
- *Aramco v. Saudi Arabia*: The Tribunal decided that the sovereign powers of the state allowed it to be bound irrevocably by the terms of a concession.
- *Texaco v. Libya*: The sole arbitrator decided that the stabilization clauses were valid commitments taken under the sovereign power of the government, and hence, they cannot be disregarded by the same power.
- *Liamco v. Libya*: The award supported that even when the contravention of a stabilization clause was not a wrongful act; it made the state liable to pay compensation.
- *TOPCO v Libya*: The Tribunal awarded that the government does not have the power to nationalize in breach of the contractual commitments included in the stabilization clause.

b. Clauses aiming for economic balance.

The aim of these clauses is primarily to restore the original economic balance of the contract in the face of the change of circumstances that may occur after the conclusion of the contract. Hence, these clauses are based on renegotiation, which is recognized to be a trend in the long-term international investment relationships, provided that it is carried out in good faith, without coercion and in a peaceful manner⁹⁶.

⁹⁵ Obtained from Maniruzzaman, A.F.M., Op. cit. 72, p. 76-84; Wälde T., Op. cit. 88, p. 36-38, Cotula, L., Op. cit. 44, p. 17-18; and Cameron, P.D., Op. cit. 47, p. 54-56.

⁹⁶ Wälde T. and Kolo, A, *Renegotiation and Contracts Adaptation in the International Investment Projects: Applicable Legal Principles & Industry Practices*, in *Transnational Dispute Management*, (Volume I, issue # 01, February 2004), without page number, under conclusions.

This type of clause usually contains balancing or negotiating mechanisms⁹⁷, triggered by the unilateral action of the government. It is important to notice that these clauses are triggered not only if the position of the investor is injured, but also if it is improved⁹⁸.

Contrarily to the traditional or freezing clauses, these clauses were not designed to prevent expropriatory measures from the government, considering that they acknowledge the possibility of the government to exercise its sovereign powers, but provide for negotiations aiming to restore the initial contractual balance between the parties.

In the event that the renegotiation does not succeed, the parties commonly refer their dispute to international arbitration. With regard, it is noteworthy that there are no published international arbitration awards dealing with this kind of stabilization clause⁹⁹, which make us think that the renegotiation to avoid further disputes have been efficient in practice.

This clause has been mainly used for taxation purposes and usually includes exceptions in the case of environmental, health and safety issues¹⁰⁰. Nevertheless, section three of this paper includes and explains the case of Ghanaian Mining Agreements, which contain these clauses aiming to restore the balance when new environmental regulations are approved. These specific Ghanaian clauses have been considered to produce the same freezing effect than the former type of traditional stability clause, considering that the clauses will make the government renounce to regulate in environmental matters due to the fear to loose investments or be obliged to compensate the investor¹⁰¹.

⁹⁷ Cameron, Peter D., Op. cit. 44, p. 17.

⁹⁸ Montembault, B., *La stabilisation des contrats d'Etat a travers l'exemple des contrats petroliers Le retour des dieux sur l'Olympe?*, p. 629. International Business Law Journal, 2003, Part 6.

⁹⁹ Cameron, Peter D., Op. cit. 44, p. 53.

¹⁰⁰ *Ibid*, p. 5.

¹⁰¹ Tienhaara, Kyla, *Mineral investment and the regulation of the environment in developing countries: lessons from Ghana* in International Environmental Agreements, Volume 6, Number 4, December 2006. p. 392.

The above mentioned the main but not the only types of clauses and there are many hybrid forms between the freezing and economic balancing formulas¹⁰².

Time length and extension

Regarding the time length of these clauses, the contract may establish that they either: (i) produce effects through all the project life, or (ii) only for a fixed period of time¹⁰³.

The extension of these clauses also varies. They could be broad and apply to all the possible aspects of legislation (taxation, environmental, labour, etc.) like in the case of the *Mittal* agreement commented in the next section three, or be only targeted in one or more of these aspects. Regarding the latter, it is noteworthy that some stabilization clauses which are targeted only in stabilizing a specific aspect of regulation, could indirectly apply to the environmental regulation; for example, a tax stabilization clause can be considered to prevent the state from approving an environmental levy.

International character of stabilization clauses

Regarding the international character of the stabilization clause, commentators are also divided. For some of them, when the contract is governed by a particular domestic law, the stabilization clause can be modified if the state modifies said national law; while for others, the stabilization clause constitutes an independent obligation governed by international law despite the governing law of the contract¹⁰⁴. Nonetheless, the arbitral practice has been inclined (at least in the Petroleum sector) to require that international law as the governing law to decide that the stabilization is enforceable in the event of a government unilateral action¹⁰⁵.

¹⁰² Cameron, Peter D., Op. cit. 44, p. 54.

¹⁰³ See Cordes, J., and Otto, J., Op. cit. 38, p. 5-25.

¹⁰⁴ Maniruzzaman, A.F.M., Op. cit. 72, p. 68-69.

¹⁰⁵ Cameron, Peter D., Op. cit. 44, p. 72.

Another way of internationalizing the stabilization clauses could be by the means of a MIT or BIT including a “fair and equitable treatment” provision¹⁰⁶ or an “umbrella clause”, as explained later in this paper.

The following sub-sections explain the main principles in conflict in relation with the stabilization clauses, the validity and efficiency and finally a very important standard related to stability: the “fair and equitable treatment”.

2.3. Main principles involved in the discussion of stabilization clauses.

a. Sovereignty over the natural resources:

The permanent sovereignty over natural resources was firstly recognized by a UN General Assembly resolution stating that “the right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the State concerned”.¹⁰⁷

Subsequent UN documents have clarified the extension of this principle, standing out the Charter of Economic Rights and Duties of the States:

“Article 2:

1. Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities.

2. Each State has the right:

(a) To regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations (...)

(b) To regulate and supervise the activities of Transnational corporation within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies. (...)

¹⁰⁶ *Ibid*, p. 73.

¹⁰⁷ Permanent Sovereignty over Natural Resources, G.A. res. 1803 (XVII), 17 U.N. GAOR Supp. (No.17) at 15, U.N. Doc. A/5217 (1962), ART. 1°, see: <<http://www1.umn.edu/humanrts/instate/c2psnr.htm>> (last visited February 3rd 2008).

(c) to nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, (...)¹⁰⁸

A fundamental manifestation of the permanent sovereignty over natural resources is the “succession of law principle”, which recognizes that government regulatory powers cannot be constrained by an agreement with a private party¹⁰⁹.

As can be noted, the principles of sovereignty over the natural resources and succession of law seem *ab initio* to be directly opposed to the existence of the stabilization clauses.

b. *Pacta sunt servanda*

The principle of *pacta sunt servanda* or sanctity of contracts has been expressly recognized in the article 26° of the Vienna Convention on the Law of the Treaties (1969), which states that “every treaty in force is binding upon the parties to it and must be performed by them in good faith”¹¹⁰. This principle –as easily noted- is directly opposed to the principle of succession of laws¹¹¹ and is also considered to apply to contracts.

Stabilization clauses appear to be sustained in the *pacta sunt servanda* and hence question the ability of governments to exercise their absolute sovereign powers through the succession of laws principle.

Investment treaties usually include “umbrella” or “*pacta sunt servanda*” clauses, which purpose is to ensure that each of the parties of a treaty will respect the undertakings entered into with the nationals of the other party.¹¹² As example of a *pacta sunt servanda* or umbrella clause, the previously referred to ECT establishes

¹⁰⁸ Charter of Economic Rights and Duties of States (General Assembly 1974) <<http://daccessdds.un.org/doc/RESOLUTION/GEN/NR0/738/83/IMG/NR073883.pdf?OpenElement>> (last visited January 4th 2008).

¹⁰⁹ Cordes, J., and Otto, J., Op. cit. 38, p. 4-22, 5-2.

¹¹⁰ Vienna Convention on the Law of Treaties (Vienna, 1969), Art. 2, <http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf> (last visited January 4th 2008).

¹¹¹ Cordes, J., and Otto, J., Op. cit. 38, p. 4-22.

¹¹² Kinsella, N. S., and Rubins, N. D., Op. cit. 43, p. 234-235.

that “each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party”¹¹³. According to Rubins and Kinsella, the dominant view regarding these clauses is that they “impose treaty liability” to the host states for the breach of any undertaking given to nationals of their counterparty state in the treaty¹¹⁴, e.g. stabilization clauses included in state agreements

c. *Rebus sic stantibus*

The principle or doctrine of *rebus sic stantibus* or fundamental change of circumstances, is recognized as an exception to the *pacta sunt servanda* principle.

The *rebus sic stantibus* classical formula was recognized in the international law of the treaties in the article 62, numeral 1 of the Vienna Convention, by stating that:

“A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless:

(a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and

*(b) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty.”*¹¹⁵

In relation to the subject, the *Gabcikovo-Nagymaros* decision of the International Court of Justice, related to the unilateral termination of Hungary of the Treaty of 1977 with Slovakia, established that:

“A fundamental change of circumstances must have been unforeseen; the existence of circumstance at the time of the Treaty’s conclusion must have

¹¹³ ECT, (1994) <http://www.encharter.org/fileadmin/user_upload/document/EN.pdf> (last visited February 24th 2008), Art. 10, N°1.

¹¹⁴ Kinsella, N. S., and Rubins, N. D., Op. cit. 43, p. 238.

¹¹⁵ Vienna Convention, Op. cit. 110, Art. 62, N° 1.

*constituted an essential basis of the consent of the parties to be bound of the Treaty ... Moreover, the plea of fundamental change of circumstances [can] be applied only in exceptional cases.”*¹¹⁶

This decision contains the usually recognized basis of this principle: (i) the fundamental change of the circumstances that constituted the essential basis of agreement, and (ii) the fact that this change was not foreseeable at the moment of the conclusion of the agreement.

International tribunals have been reluctant to apply this principle even when it has been invoked in several cases¹¹⁷. In spite of this, some commentators has no doubts that this principle exist in the international law, rather than as implied in the treaties, as “an objective rule of law of nations”¹¹⁸, because of being a common principle recognized (although with different approaches) by most of the principal legal systems in the world, e.g. under the name of “frustration of contract”, “*imprévision*”, “*force majeure*”, “*geschäftsgrundlage*” and others¹¹⁹.

For Verhoosel the application of this doctrine could have provided in the past decades a basis to consider that the development of global environmental awareness as a fundamental change of circumstances that was not able to be foreseen¹²⁰. In the present, considering the advanced level of environmental conscience and uniformed environmental instruments - like the ones described in the MMSD Chapter 11¹²¹ - it is far more difficult to allege that the need to implement a new environmental was not foreseeable at the moment of the conclusion of an state agreement; moreover considering that these agreements are generally entered into by developing countries which - as seen in the previous section - have not generally implemented the environmental instruments or standards that are applied in more development countries (making it foreseeable their future implementation).

¹¹⁶ As quoted by Cotula, L., Op. cit. 44, p. 24.

¹¹⁷ Maniruzzaman, A.F.M., Op. cit. 72, p. 95.

¹¹⁸ As concluded by Maniruzzaman, *Ibid*, p. 96.

¹¹⁹ *Ibid*, p. 155.

¹²⁰ Verhoosel G., Op. cit. 34, without page number under Part I, B. 2.

¹²¹ MMSD, Op. cit. 17

To conclude this point, it is important to mention - following Cotula – the “evolutionary interpretation” doctrine and the “civic” approach to investment contracts, which have been supported by some arbitration tribunals or incorporated in state contracts¹²². The evolutionary interpretation is less restrictive than the *rebus sic stantibus* and establishes that the emergence of new international instruments or any developments in a particular area (e.g. the protection of the environment), have to be taken into account when executing the obligations derived from the state contract¹²³, as the not-to-do obligations contained in stabilization clauses. The “civic” approach to investment contracts recognizes that the state contracts include the “holders of human rights” as a party, and hence, establish an implicit or explicit human rights-exception into stabilization clauses¹²⁴.

2.4. Validity and effects of the stabilization clauses

The main doctrinal controversy about these clauses have focused on their validity under international law, between those who believe they are valid supported on the principle of “sanctity of contract” or *pacta sunt servanda*, and those who consider they are invalid defending the sovereignty powers of the state¹²⁵. More specifically, Wälde has identified the following different views:

- a) The permanent sovereignty over natural resources cannot be derogated by a stabilization clause because of its condition of *ius cogens*, that is to say, that cannot be renounced. Therefore, in the use of their sovereign powers the states will always be entitled to terminate the agreements containing such clause, against the payment of compensation.
- b) The *pacta sunt servanda* doctrine is applicable to the contracts entered into private parties and the states, as it is to the treaties celebrated between countries. Hence, the unilateral contradiction of a stabilization clause by the

¹²² Cotula, Op. cit. 44, p. 24-30.

¹²³ Cotula, Op. cit. 44, p. 25.

¹²⁴ Cotula, Op. cit. 44, p. 27-28.

¹²⁵ Verhoosel G., Op. cit. 34, without page number under Part I, A.

State would be considered illicit, and the corresponding arbitration tribunal should give full effect to what this clause stipulates or at least order the full compensation in favour of the Company.

- c) Stabilization clauses do not provide absolute protection to private investors, and form part of a larger group of legitimate expectations of the investors when entering into the state agreement. According to this view, contracts are supposed to evolve over time affecting the original contractual balance, and the effects of the stabilization clauses shall be assessed finally after balancing all the factors - including the principle of *rebus sic stantibus* - affecting the contracts¹²⁶.

Regarding arbitral jurisprudence, it is important to notice that the practice directly related to stabilization clauses is basically from the 1970s and 1980s awards, dealing with traditional or freezing stabilization clauses protecting (mainly oil) investors against nationalization by the host governments. Box N° 4 contains examples of the principal cases and its conclusions.

The dominant view in international arbitrations was to recognize the validity of stabilization clauses under international law¹²⁷. Most of the awards have also denied the first position of the *jus cogens* state of permanent sovereignty¹²⁸.

Despite recognizing its validity, most of these awards did not consider that these contractual guarantees prevented the state capacity to nationalize¹²⁹. The almost general lack of awards ordering the specific performance of the stabilization clause seems to consider the ultimate sovereignty of the states and the expected lack of enforceability of the award in the future¹³⁰. For this reason these contractual guarantees have been considered more “a psychological deterrent that

¹²⁶ Wälde T., Op. cit. 88, p. 34-36.

¹²⁷ Cotula, L., Op. cit. 44, p. 16.

¹²⁸ Maniruzzaman, A.F.M., Op. cit. 72, p. 76.

¹²⁹ Cameron, Peter D., Op. cit. 44, p. 16.

¹³⁰ Comeaux, Paul E., and Kinsella, N. Stephan, *Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance*, in *New York Law School Journal of International and Comparative Law*, p. 19 (New York: New York Law School Journal, 1994). Also in: <<http://www.kinsellalaw.com/publications/polrisk.pdf>> (last visited July 12th 2007).

a legal one”¹³¹ and also that primarily “they have a 'functional value' in that they strengthen the private contractor's bargaining position”¹³².

Notwithstanding, in the event of the breach of a stabilization clause, the arbitration awards have principally considered them for the purposes of assessing the amount of the damages or to give certainty that these damages will be awarded¹³³, in the sense that they generate the obligation of the government to pay compensation without requiring to prove that a regulatory taking have taken place, that is to say, they establish a lower threshold for the compensation obligations to arise¹³⁴. The doctrinal views regarding the amount of compensation, mostly recognize that the stabilization clauses grants the right to a special right to compensation¹³⁵, which must be related to the new costs and loss of profits produced by the new regulation¹³⁶.

To conclude this point, it must be said that the significance of the above mentioned awards in the present times is questionable¹³⁷ because, as discussed in the previous section:

- There are not many cases of direct expropriation as there are of alleged indirect expropriations.
- It is generally accepted that the states have the sovereign power to expropriate, even though it is done through an environmental regulatory taking.
- The modern stabilization clauses are not targeted in preventing the states to exercise their sovereign powers to expropriate or regulate, but contain elements of renegotiation.
- The arbitrators are more likely to decide on the basis of the fair and equitable treatment – as explored in the next subsection – that considering an indirect expropriation.

¹³¹ Cordes, John and Otto, James, Op. cit. 38, p. 4-26.

¹³² Verhoosel G., Op. cit. 34, without page number under Part I, A.

¹³³ Comeaux, P. E., and Kinsella, N. S., Op. cit. 130; in the same sense Maniruzzaman, A.F.M., Op. cit. 72, p. 164. and Cotula, L., Op. cit. 47, p. 18.

¹³⁴ Cotula, L., Op. cit. 44, p. 18-19 and 30.

¹³⁵ Maniruzzaman, A.F.M., Op. cit. 72, p. 165-166.

¹³⁶ Cotula, L., Op. cit. 44, p. 20; in the same sense Maniruzzaman, *Ibid.*

¹³⁷ Cameron, P.D., Op. cit. 44, p. 56.

2.5. Fair and Equitable Treatment and its relation with stability and stabilization clauses.

The fair and equitable treatment standard (F&ET) is recognized to be linked with the stability of the regulatory regime¹³⁸, and particularly with the *pacta sunt servanda* principle¹³⁹, and which can also provide the stabilization clauses with an increased effect.

This standard appears to be nowadays one of the most discussed issues in relation to international investments¹⁴⁰. Despite the discussions, this standard has been recurrent and extensively alleged by the private party and applied by arbitration tribunals in relation to investment disputes, usually as a basis for ordering the payment of a compensation for damages by the host states¹⁴¹. In general, there is a greater chance of success in alleging a breach of the fair and equitable treatment standard, than to allege the occurrence of an indirect expropriation¹⁴².

Most tribunals have considered this standard as objective, so the state's liability may occur regardless the government's motivations¹⁴³. The *Tecmed v. Mexico* Tribunal has found this standard to be an expression of the good faith principle that must rule in all international relations¹⁴⁴. In general, the threshold of this standard is considered to have been set by the *S.D. Myers v. Canada Tribunal*, which established that the F&ET "occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective"¹⁴⁵.

¹³⁸ Schill, S.W., *Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law*, p. 11 (IILJ Working Paper 2006/6 Global Administrative Law Series) <www.iilj.org/publications/documents/2006-6-GAL-Schill-web.pdf> (last visited January 24th 2008).

¹³⁹ Kinsella, N. S. and Rubins, N. D., *Op. cit.* 43 p. 216.

¹⁴⁰ UNCTAD; *Op. cit.* 68, p. 37.

¹⁴¹ Schill, S.W., *Op. cit.* 138, p. 37.

¹⁴² Cameron, Peter D., *Op. cit.* 44, p. 75.

¹⁴³ Kinsella, N. Stephan and Rubins, Noah D., *Op. cit.* 43, p. 216.

¹⁴⁴ *Tecmed v. Mexico* award (2003), paragraph 153, <<http://icsid.worldbank.org/ICSID/FrontServlet>> (last visited February 24th 2008).

¹⁴⁵ UNCTAD., *Op. cit.* 68, p. 38.

According to Professor Schill, the principles derived from the F&ET are: (i) the requirement of stability, predictability and consistency of the legal framework, (ii) the protection of investor confidence or legitimate expectations, (iii) the legality of the government actions, (iv) the administrative and judicial due process and the possibility to access to justice, (v) the protection against arbitrariness and discrimination, (iv) transparency, and (vii) the requirement of reasonableness and proportionality in the government actions ¹⁴⁶. The following lines explore the stability and predictability of the investment framework, and the protection of legitimate expectations.

Stability and predictability

Stability of the legal and business environment have been expressly understood by arbitral tribunals as “an essential element of fair and equitable treatment”¹⁴⁷, while predictability has been mentioned in the *Tecmed v Mexico* Tribunal recognizing the need of the investors to “know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices and directives, to be able to plan its investment and comply with such regulations”¹⁴⁸. Hence, it has been understood that the F&ET requires that the government act in a manner free from ambiguity¹⁴⁹. Nevertheless and as previously analyzed, this stability and predictability cannot be considered to be absolute and prevent the government from exercising its regulatory powers, let alone in relation to environmental matters.

Protection of legitimate expectations

The protection of the investor’s legitimate expectations has been considered as “the dominant element” of the F&ET standard¹⁵⁰. This is sustained again in the *Tecmed v. Mexico* award, which found that the governments needed “to provide to international investments treatment that does not affect the basic expectations that

¹⁴⁶ Schill, S.W., Op. cit. 138, p. 11.

¹⁴⁷ Quote used in CMS v. Argentina and OEPC v. Ecuador, as referred to by Schill, S.W., *Ibid*, p. 11.

¹⁴⁸ Schill, S.W., Op. cit. 138, p. 12

¹⁴⁹ UNCTAD, Op. cit. 68, p. 39.

¹⁵⁰ As noted by Schill, S.W., Op. cit. 138, p. 15.

were taken into account by the foreign investor to make the investment”¹⁵¹, and the *SME v. Czech Republic* Tribunal, which held that the government “breached its obligation of fair and equitable treatment by evisceration of the arrangements in reliance upon [which] the foreign investor was induced to invest”¹⁵². Hence, the State may contradict the standard of F&ET by substantially altering the legal framework or any representations made by the government, which the investments relied on to proceed with the investment¹⁵³.

In relation to the stabilization clauses, F&ET clause contained in an applicable MIT or BIT may “lend treaty status” to these provisions¹⁵⁴, and hence support the position that these clauses creates a “legitimate expectation” - as he third position described by Wälde in the previous sub-section - granting these clauses an enhanced protection.

3. EXAMPLES OF STABILIZATION CLAUSES CONCERNING THE STABILIZATION OF ENVIRONMENTAL REGULATIONS IN FAVOUR OF MINING COMPANIES.

This section includes different examples of stabilization clauses or agreements related to the mining sector and which present effects specifically on the environmental regulation:

3.1. Stabilization clauses in state agreements.

The following are three examples of stabilization clauses included in state contracts to stabilize in different degrees domestic environmental regulations.

3.1.1. The “Mittal Agreement”¹⁵⁵

This agreement contains the following stabilization clause:

¹⁵¹ Tecmed v. Mexico, Op. cit. 144, para.154.

¹⁵² Kinsella, N. S. and Rubins, N. D., Op. cit. 43, p. 215.

¹⁵³ *Ibid*, p. 215.

¹⁵⁴ Cameron, Op. cit. 44, p. 40.

¹⁵⁵ Mineral Development Agreement between the Government of the Republic of Liberia and Mittal Steel Holdings (2005), Art.XIX, Sections 7 and 9.

“The GOVERNMENT hereby undertakes and affirms that at no time shall the rights ... granted by it under this Agreement be derogated from or otherwise prejudiced by any Law or by the action of inaction of the GOVERNMENT. ... In particular, any modifications that could be made in the future to the Law ... shall not apply to the CONCESSIONNAIRE... In the event of any conflict between this Agreement or the rights, obligations and duties of a Party under this Agreement, and any other Law, ... then this Agreement shall govern the rights, obligations and duties of the Parties.”[emphasis added]

The above clause is a clear example of a traditional or freezing clause, described in sub-section 2.2. In this particular clause, the stabilization protects the terms of the agreement and the legislation of Liberia standing at the moment of the conclusion of the contract, against any future change of the law or administrative measures of the government contradicting the contract. In other words, the *Mittal* clause freezes completely the - environmental and others - conditions contained in the agreement in favour of the investor for the duration of the contract¹⁵⁶. Additionally to this stabilization clause, the contract also incorporated a compensation clause to be effective in the event that the host government breached the agreement¹⁵⁷.

The exaggerated freezing effects of this clause and other parts of the contract, determined serious pressures from the civil society that finally produced its amendment¹⁵⁸, among others, by setting aside the environmental issues from the extent of the stabilization clause¹⁵⁹.

¹⁵⁶ This duration was of 25 years, renewable as informed by Global Witness Heavy, *Mittal Report* (October 2006) p. 5 in: <http://www.globalwitness.org/media_library_detail.php/156/en/heavy_mittal> (last visited 12th July 2007).

¹⁵⁷ The text of this clause is the following: “The GOVERNMENT shall indemnify and hold harmless the CONCESSIONNAIRE and its Affiliates from any and all claims, liabilities, costs, expenses, losses and damages ... as a result of any failure of the GOVERNMENT to honor any provision or undertaking expressed in this Agreement.” *Mittal Liberia MDA*; Op. cit. 154, Art. XXI, Section 3.

¹⁵⁸ The amendment limited the stability only to some fiscal-related commitments included in the agreement, Amendment of the Mineral Development Agreement between the government of the Republic of Liberia and Mittal Steel Holdings Limited (December 28th 2006), Article 16 (E).

¹⁵⁹ Source: Mittal Steel did the right thing – will Firestone? Press Release – 30/04/2007 <http://www.globalwitness.org/media_library_detail.php/539/en/mittal_steel_did_the_right_%20thing> (last visited 10th July 2007).

3.1.2. Zambian Development Agreements.

The following quote corresponds to an environmental clause of the Development Agreement of 1998 entered into between *Chambesi Metals* and the Government of Zambia (referred in the contract as GRZ), which have been repeated in subsequent development agreements celebrated by this country¹⁶⁰:

- “12. *Environmental issues: (...)*
- 12.2. *Subject to compliance by the Company with the Environmental Plan and save as provided in Clause 12.5. below, GRZ [Government of the Republic of Zambia] hereby confirms that for a period of fifteen (15) years from the effective date, the it will not take any action (and will procure no action is taken by any of its ministries, departments or agencies over which it has operational control acting on its behalf) under or enforcing, any applicable law with the intent of:*
- (a) Securing the Company’s earlier compliance with Environmental Laws other than that envisaged by the timetable and conditions set out in the Environmental Plan;*
 - (b) Requiring the Company to clean-up or remove any stock of pollution which was pre-existing at the Effective Date [date of execution of the agreement];*
 - (c) Imposing fines or penalties upon the Company payable under Environmental Laws (or enacting new fines and penalties thereunder) which are payable in respect of the Company’s non-compliance with such Environmental Laws and where the Environmental Plan provides for the remedy of the same in accordance with a specified timetable and the Company is in compliance with that timetable; and*
 - (d) Imposing fines or penalties in respect of the Company’s breach of Environmental Laws in excess of those applying on the Effective Date, adjusted (...) to take account of Zambian inflation since that date.*
- 12.3. *(a) GRZ hereby confirms that the Company and Avmin are not responsible for nor will be held liable for harm, damage, claims or losses of any kind whatsoever incurred or suffered in the past or in the future arising out of or in relation to or in connection with activities undertaken by ZCCM [Zambia Consolidated Copper Mines Limited] prior to the effective date.*

As can be noted, this stabilization clause does not produce a broad stabilization that extends to all the regulatory powers of the state in environmental matters, like the previous *Mittal* clause. In a more limited way, this Zambian clause contains specific commitments to be standing for a period of 15 years, e.g. not to require an

¹⁶⁰ See: Mine Watch Zambia, *Development Agreements*, <<http://www.minewatchzambia.com/agreements.html>> (last visited 11th December 2007).

earlier compliance with the environmental obligations, or not to be held responsible for environmental mining liabilities that were produced before the contract, especially those of the previous owner of the concessions, the state-owned Zambia Consolidated Copper Mines Limited.

3.1.3. Ghanaian Mining Agreements

At least three mining agreements entered into mining companies and the government of Ghana has been found to contain the following text as part of their arbitration clause¹⁶¹:

“The Parties acknowledge and agree that this Agreement was made on the basis of the laws and conditions prevailing at the date of the effective conclusion of the negotiation of this Agreement and accordingly, if thereafter, new laws and conditions come into existence which unfairly affect the interest of either party to this agreement, then the party so unfairly affected shall be entitled to request a re-negotiation and the parties shall thereupon re-negotiate. The parties hereby undertake and covenant with each other to make every effort to agree, cooperate, and negotiate and to take such action as may be necessary to remove the causes of unfairness or disputes.”¹⁶² [emphasis added]

This clause can be qualified properly as a re-negotiation or balancing clause, which – as previously explained - seeks to maintain the equilibrium of the investment conditions existing at the moment of the signature of the contract¹⁶³.

In contrast with the previous examples, this clause does not expressly freeze the environmental regulation of a country or a specific aspect of it, but provides for the re-negotiation of the agreement when one of the parties considers that a new legal provision “unfairly” affects its interests.

¹⁶¹ The three agreements were entered into between Ghana and Canadian Bogosu Resources Ltd. (21/08/87), Canadian Bogosu Resources Ltd. (16/18/88) and Bogosu Gold Ltd. (29/06/01) according to Tienhaara, Kyla, Op. cit. 101, p. 384.

¹⁶² Text according to Tienhaara, Kyla. Op. cit. 101, p. 384-385.

¹⁶³ Maniruzzaman, A.F.M., Op. cit. 72, p. 43.

Nevertheless, this clause suffers from a principal problem: it produces a “chilling effect”¹⁶⁴, in the sense that it is likely to prevent the government from issuing additional environmental regulation, because of the government’s fear to generate compensatory obligations.

A recent Ghanaian draft mining law takes this “chilling effect” to a “deepfreeze”¹⁶⁵ by establishing that the mining investors are not supposed to be affected by any measure of the government for a period of 15 years.

3.2. Stabilization mining agreements.

The following agreements were used in two important mining countries, granting certain stability in favour of the mining companies:

3.2.1. Chilean Framework Agreement for the Cleaner Production

This agreement was entered into between the government of Chile and the large-scale mining sector with ongoing operations, aiming to promote the cleaner production in the operations of these companies. The agreement contains the following clause:

“4. Principles of the framework agreement

For the purpose of elaborating and developing an agenda that includes the definition and achievement of goals, specific objectives, actions, terms and indicators, and agreeing its results, the Technical Committee (integrated by all of the parties) will act according to the following principles:

- *Gradually development through time, of processes of adequacy of the mining industry to new technologies, regulatory and/or market requirements.”*¹⁶⁶

¹⁶⁴ Tienhaara, Kyla, Op. cit. 101 p. 392.

¹⁶⁵ Zarsky, Lyuba, *From Regulatory Chill to Deepfreeze?* in International Environmental Agreements, p. 398. Vol.6, N°4, Dec 2006.

As can be noted, the guaranteed “principle” of a gradual compliance of the legislation does not prevent the government from enacting new environmental laws legislation, but intends to reconcile regulation with the stability of investment over time, by guaranteeing the mining companies that any new law will be gradually effective in time, allowing them to adequate their operation to comply with new legal provisions.

The inclusion of this assurance in the agreement highlights again the importance that an ordinate and predictable approval of environmental laws has for the mining investors.

3.2.2. Peruvian Environmental Administrative Stability Agreement¹⁶⁷

As in the Chilean example, this model agreement was designed to be used by ongoing mining operations, aiming to transitorily stabilize the environmental regulations to allow the mining companies to adequate to new environmental regulations.

“SECOND.- OBJECTIVE OF THE AGREEMENT

*The objective of the present agreement is to guarantee “the holder” (mining company) administrative stability to solve the environmental problems comprised in the “PAMA”, in such a manner that the possible changes in the rules and maximum permissible standards, do not affect them negatively during the period in which this contract is standing”¹⁶⁸
[emphasis added]*

¹⁶⁶ Chilean framework agreement for the cleaner production for the large-scale mining sector (Chile 2002), article 4, <http://biblioteca.unmsm.edu.pe/RedLIEDS/Recursos/archivos/MineriaDesarrolloSostenible/ProduccionLimpia/Acuerdo_Prod.pdf> (last visited 10th December 2007).

¹⁶⁷ At least two Peruvian Mining Companies: Doe Run Peru and Southern Peru Copper Corporation have entered into these stabilization agreements, each for the lapse of ten years. See respectively: <http://www.doerun.com.pe/doe_run_amedioambiente_adequacion.htm> and Note N°52 in http://www.minem.gob.pe/archivos/dgm/estadisticas/excel_conten/notas_inversiones_1992_2007.htm (last visited 15th July 2007).

¹⁶⁸ Model agreement approved by Ministerial Resolution N° 292-97-EM/VMM published on July 12th 1997. For the sake of brevity this paper does not reproduce the entire text, which can be reviewed in its Spanish version in <http://www.minem.gob.pe/archivos/dgm/legislacion/R.M.N_292-1997-EM-VMM.doc> (last visited 11th July 2007).

These contractual instruments granted the mining companies a period of stability (in this case from 5 to 10 years)¹⁶⁹ to adequate their operations to a new set of environmental standards which the Peruvian mining companies had to comply through Programmes for the Adjustment and Environmental Stewardship (PAMAs)¹⁷⁰. In that sense, these agreements guaranteed that no new environmental law would affect them within the stabilization period, allowing them to reach the new standards over time resembling the gradual compliance guaranteed by the prior Chilean Framework Agreement.

4. STABILIZATION CLAUSES AS A SUITABLE PROTECTION

This section describes the main considerations that in opinion of the author of this dissertation should be taken into account in the design of a stabilization clauses to be considered as a suitable protection against some of the potential economic impacts of the environmental regulatory changes, and recommends the stabilization formulas that could provide such suitable protection.

4.1. Considerations of a suitable protection

Based on the analysis of the previous sections, the following are the main considerations that in opinion of this paper should contemplate the government and mining investors when agreeing a stabilization clause:

Adequate assessment of the effects of the clause

First of all, both parties should adequately consider the effects of these clauses:

- Governments shall be aware that – as previously analyzed - any freezing, economic balancing or hybrid form of stabilization clause, producing effects

¹⁶⁹ According to the Third Clause of the Model Agreement, the mining activities had 5 years, while the processing operations had 10 years, Op. cit. 167, 3rd Clause.

¹⁷⁰ Approved by Ministerial Decree N° 011-96-EM/VMM (published January 13th 1996) and Ministerial Decree N° 315-96-EM/VMM (published July 19th 1996).

on the environmental regulation, is expected to generate a freezing effect that is likely to discourage the approval of new environmental regulation. For example, even when the economic balancing clause allow the government to approve new regulations for the protection of the environment, the government is likely to be discouraged from issuing them due to the fear generated by the consequent obligation to compensate the mining investors. Moreover, in the case freezing stabilization clauses the government's breach of one of these clauses will generate the same compensatory fear, accompanied by the concern of damaging the country's image as destination for mining investments.

- Mining companies have to take into account that these clauses are likely to be considered principally for the effects of the payment of compensation, rather than obliging the state to move back from its regulatory measures and let alone preventing an environmental regulatory taking. Albeit this, the stabilization clauses present an important advantage in so far as they are able to trigger the obligation of the government to compensate, even when the damages does not amount to a regulatory taking or when the new regulation is a lawful measure (e.g. non-discriminatory or executed for a public purpose). As previously noted the effectiveness of the compensatory effects of these provisions, could be reinforced by the choice of international law, the inclusion of international arbitration clauses, or by the existence of investment treaties containing “umbrella” or “fair and equitable treatment” clauses.

In assessing the potential effects of these provisions, special importance shall be given to avoid limiting the capacity of the government to implement a proper regulatory protection of the environment, and to the perceived fairness of these effects, as explained in the following points.

Avoid limiting a proper regulatory protection of the environment

Once assessed the effects of the stabilization provision, the most important consideration for both parties is to avoid limiting the capacity of the government to achieve a proper protection of the environment. The “proper protection” is a

subjective concept that must be assessed in each particular case, as done in the next sub-section.

If this capacity is contractually curtailed, both parties may be exposed to the following consequences:

- Be target of strong critics and pressures of national and international stakeholders interested in the proper protection of the environment (e.g. local communities, national and international NGOs and institutions, etc.), which may oblige the government to act in breach of the stabilization clause or force the amendment or cancellation of the same (as occurred in the *Mittal* case).
- Be involved in a procedure for the enforcement of the right to certain environmental quality before national or international courts, and produce the same amendment or cancellation results.

These potential consequences are likely to be accompanied by significant damage to the image of the government and the mining company.

Perception of fairness

Likewise, mining companies shall be especially concerned about the perception of fairness of the effects of the stabilization provisions granted in their favour. Nevertheless the subjectivity of the concept, the author of this dissertation understands again that it is possible to be analyzed in particular cases, as carried out in the following sub-section.

In the case of government and other (especially local) stakeholders the fairness of the effects of these clauses is principally given by avoiding prevent a proper regulatory protection of the environment.

But there are other individuals whose expected perception of the stabilization effects may especially concern the mining company: the person or tribunal in charge of deciding a potential dispute produced by a breach of these provisions. It

is possible that these decision makers may consider more sympathetically the position of the governments when acting legitimately in the protection of the environment, particularly in front of an “unfairly” limiting stabilization clause, and could inclusively decide that the compensation for the breach of these provisions may be considerably reduced or inclusively eliminated in application of the *rebus sic stantibus* principle, “evolutionary interpretation” doctrine, “civic” approach to investment contracts, or any other criteria which take into account the necessary development of environmental law and the special importance of a proper protection of the environment.

4.2. Stabilization clauses as a suitable protection

According to the previous considerations, this part of the paper describes the stabilization provisions which this dissertation considers may be incorporated in state agreements as suitable protections against the potential economical effects of the environmental regulatory changes.

a. Stabilization of particular aspects of the environmental regulation

This dissertation considers that it would be suitable to stabilize certain aspects of the environmental regulatory regime through an environmental freezing, economic balancing or hybrid form of stabilization clause, provided that it only applies to environmental impacts that are not directly related to the operations of the mining company. For example, the implementation of stabilization clauses to avoid the mining companies being held responsible for environmental mining liabilities produced before the initiation of its operations (like the previously quoted clause of the *Zambian Mining Development Agreements*) or the environmental impacts of artisanal and informal miners operating uncontrolled in the mining area of the mining company.

These stabilization clauses may establish that e.g. “the mining company will only be responsible for the environmental impacts produced by its operations” or a similar formula, which in the practice will have the effect of a freezing

clause preventing the state from issuing regulations holding the mining company liable for third parties environmental impacts.

The author of this dissertation understands that the stabilization of this particular aspect of the regulatory powers of the state, does not affect the proper protection of the environment, considering that it is only one possibility in the assortment of solutions that governments have implemented worldwide to solve these environmental problems¹⁷¹, like to impose a levy to the industry as a whole or in specific to the sale of minerals, create environmental funds, etc.

Within the variety of solutions, the option to make an individual mining company the sole responsible of third parties environmental impacts is likely to be easily perceived as unfair (specially by an arbitration tribunal), considering that these environmental impacts are generally unknown, uncertain and exceed the control of the new mining investor; and furthermore, could seriously affect or even “expropriate” the mining investment.

b. Stabilization of environmental standards or other environmental instruments

In the specific case of the stabilization of the environmental standards and other environmental instruments, this paper considers the possibility to apply stabilization provisions under the following conditions and circumstances:

b.1. Following Cameron, it is suitable to establish benchmarks for the development of the standards included in the state contract, for example by the use of international conventions, scientific publications or others¹⁷². This mechanism favours the mining company, considering that grants predictability to the regulatory changes, avoids unilateral actions and subsequent discussions before tribunals, and minimizes the risk of using these new regulations as a means to remove the company from a

¹⁷¹ MMSD, Op. cit. 17, p. 247.

¹⁷² Cameron, Peter D., Op. cit. 44, p. 85.

project¹⁷³. When these benchmarks are referred to recognized international institutions or countries, the standards are likely to properly protect the environment, and also to be perceived as fair by all the interested parties.

- b.2. This dissertation also considers suitable to stabilize certain environmental instruments or standards when the mining companies offer a superior environmental protection that the one provided by the environmental regulatory regime at the moment of the conclusion of the agreement. For example, in a country where mine closure obligations do not exist or cannot provide an appropriate protection, the protection of the environment will be best served by a stabilization clause stabilizing (by any technique) a mine closure plan executed since the beginning of the operation, containing sufficient financial guarantees and post-closure stage, and possibly prepared and controlled by an international reputed institution. In this particular example, the environmental protection will be superior than the one provided by the standing environmental regulatory regime, and hence, the clause is not likely to be perceived as unfair by any of the stakeholders or potential decision makers. An obvious shortcoming of this clause is the possibility of the state to achieve the level of protection stabilized by the provision, in which case it may be recommendable to agree a renegotiation stage, the use of the previously mentioned benchmarks, or other solution depending on the particular aspect of the environmental regulation stabilized.

It must be said as a caveat that, in the previous cases, the suitability of the stabilization clauses must be assessed in a case-by-case basis.

Clause aiming for the gradual compliance of the environmental regulation

A different approach to the freezing, economic balancing clauses and related hybrid forms, is to agree the gradual compliance of the environmental regulations

¹⁷³ *Ibid.*

like in the Chilean Agreement of the Cleaner Production or as the objective of the Peruvian Stabilization Environmental Agreement. This stabilization technique benefits the mining investor by establishing a guarantee against potential arbitrariness in the timing of the implementation of the new environmental regulations. Nevertheless, in opinion of this paper the gradual compliance of the new environmental regulation, is considered to be accompanied with an implicit or explicit exception in special cases in which the urgency of the measure requires an immediate application of new environmental regulation.

Analyzing this recommendation in the light of the previous sub-section, this formula does not prevent the state from issuing new environmental regulation and hence granting a proper protection of the environment, and does not seem to be perceived as unfair by any of the stakeholders or future decision makers.

5. FINAL CONCLUSIONS

This dissertation has concluded that certain stabilization clauses may be suitable to protect the mining investments from the negative effects of the environmental regulatory changes. Nevertheless, it has also stressed the limitations of this clauses e.g. to provide a broad protection against all the possible damaging measures of the government (in which the F&RT appears to be more effective) or against the regulatory takings executed on environmental grounds. Therefore, these clauses need to be complemented by other measures.

Among others, it may be recommendable to accompany the stabilization provisions with renegotiation mechanisms, which are likely to avoid the need to recur to a third party in case of a dispute and hence deteriorate the relationship between the government and the mining company.

Likewise, it is strongly recommendable for the mining company to implement voluntary initiatives to support the solution of the main national environmental problems, specially linked to the impacts caused by environmental mining liabilities, artisanal and informal mining. These initiatives are expected to allow

the mining company to maintain a good relationship with the government, local communities and NGOs, and other stakeholders, and avoid being target of additional environmental obligations.

Finally, mining companies should aim to comply with the standing environmental regulations or voluntarily increase the environmental standards that apply to their operations, to avoid the government's need to establish additional environmental regulations.

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