Advanced Contract Law & Negotiation

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International investment law has introduced a de facto doctrine that places emphasis on providing investors with stability in host countries. Under this rule, host states are required to and obligated under international investment law to provide certain guarantees to investors that their assets and interests will not come under arbitrary attack. In the same vein, it is important to examine the manner in which this new rule of investment law compares with municipal law with regard to the ability of the government to compensate foreign investors for under state law. The ability of the government to change laws and other administrative regulations that affect investor-state relations calls for increased scrutiny on the manner in which these parties determine the terms of the contract.[[1]](#footnote-0)

**Background Investigation**

When a foreign company or entity seeks to enter the borders of a state with the aim of establishing trade ties, it normally does so through the mechanism of the state contract. A state contract is usually the only option in some forms of contracts, such as those for the exploration and production of petroleum and other energy products. The issues that emerge from the construction and enforcement of state contracts include the definition of the scope of investment, exclusion of certain activities, liabilities, and the extent and manner of resolution of disputes in lieu of performance or nonperformance of the parties’ contractual obligations. In this regard, state contracts contain clauses relating to the mode of stabilization, selection of the forum state (choice of law), arbitration, and matters of breach of contract. In most instances, clauses such as those relating to *force majeure* are included in state contracts.[[2]](#footnote-1)

In this regard, the discussion reveals that countries seeking to have more freedom in state contracts tend to focus on avoiding internationally established standards of protection that have become germane to international investment law. In the same breadth, those states interested in implementing the protocols and standards established by international investment law but wishing to retain some independence and discretion opt to adopt a limited regime for the protection of investor interests. Finally, states keen on giving full expression to the emergent jurisprudence. In this regard, they can adopt an unlimited definition of trade terms, such as investment, providing unconditional regimes for the settlement of disputes, as well as the inclusion of umbrella and stabilization clauses in the state contract.

**Discussion on State Contracts**

The definition of a state contract underscores the international relationship between the contracting parties. State contracts are defined as contracts concluded between a state agency (or simply the state) and a foreign national. By their peculiar nature, they tend to cover a wide array of issues, such as financial arrangements, the provision of futures, infrastructural undertakings, and mining contracts. Contracts for the exploration of natural resources are the commonest manifestation of state contracts in state practice. These contracts are commonly known as concession contracts. Since these contracts determine a major part of the country’s GDP, they are strictly controlled by states. For this reason, foreign nationals (both natural and artificial) have to directly deal with the government during the contractual negotiation of terms. For developing countries, foreign direct investment can constitute a key revenue stream. Since states prioritize their interests and have more bargaining power than private individuals, they tend to exert their will on these foreign entities. However, the nature of contemporary international trade demands that states treat these foreign entities with respect since the relationship is reciprocal and mutually beneficial. Because of this, clauses such as those covering events relating to *force majeure*, arbitration, forum of law, and frustration of contracts have been inserted in contracts negotiated at this level. Similarly, it is important to consider the import of bilateral and multilateral treaties on state contracts and how they are affected by the operationalization of these clauses.

Most domestic legal regimes have placed restrictions and checks on the manner in which public funds are utilized. Additionally, state contracts may be terminated depending on the present definitions or conceptualization of public need. The determination of damages in such instances can be problematic since ordinary commercial rules do not apply to such contracts. The termination of state contracts can also occur differently from ordinary commercial contracts.[[3]](#footnote-2) State contracts are sometimes terminable by state action - a mechanism for termination that is not availed to ordinary contracts.[[4]](#footnote-3) These issues imply that state contracts must be treated with the ultimate degree of care, especially in relation to issues such as choice of law, alternative dispute resolution, etc. This unbalanced distribution of rights and obligations necessitates a deeper conversation on the implications of this contractual arrangement.

**Common Clauses in International Investor Agreements (State Contracts)**

The definition of the investment contract is important to the understanding of the various rights and obligations attached to state contracts. In international investment law, the term “investment” has no hard and fast definition. It can always evolve to accommodate the various interests of the contracting parties. By way of example, the 1994 Bilateral Investment Treaty between Britain and the state of Ecuador uses broad language designed to cover every definition of natural resources through the deliberate construction of language. In this specific document, terms such as the provision of concessions for searching for, cultivating, extracting, and exploiting natural resources are frequently used by the drafters of the 1994 BIT. Such a wide definition of terms enables the contracting parties to avoid the limitations that may be imposed by statute in relation to that transaction.[[5]](#footnote-4) This is especially important in concession contracts since they ensure that agreements relating to natural resources are covered by the definitions of the term “investment” under that specific contract of exploration and mining. The use of “business concessions” in state contracts is deliberate and is intended to confer upon the foreign person special privileges.

Some bilateral treaties or state contracts may define foreign investment to encompass a whole variety of contractual rights.[[6]](#footnote-5) In this instance, the investment disciplines are defined to include specific contractual rights, such as revenue sharing arrangements, turnkey provisions, and management contracts. Also, definitional provisions regarding state contracts can be used to incorporate into the definition of “investment” new property rights, such as provisions relating to the acquisition of permits and other pertinent licenses. The application of screening laws to state contracts is also instrumental in helping conceptualize the definitions adopted for the contract. Screening laws usually require that the contract between the foreign investor and the state be subjected to, at a later date, investigation or supervision concerning its functioning by an appointed agency of the state. In this regard, the contract may require that all the administrative licenses that have been procured by the foreign investor be regarded as protected property of the investor. For instance, the Energy Charter Treaty signed between Britain and Ecuador in 1994 provides for mechanisms for the protection of the proprietary rights of the investor in cases of state action. Therefore, under the treaty, the public element has been conclusively neutralized, helping instill investor confidence in the country.

Further, international investment agreements have traditionally provided for the exclusion of certain state contracts from the negotiating table. Under treaties such as the North Atlantic Free Trade Association (NAFTA), procurement contracts initiated by the government are expressly excluded from the scope of international guarantees to investors under the regional treaty. Additionally, the NAFTA arrangement excludes private sale arrangements from the list of protections provided for under relevant state contracts.[[7]](#footnote-6) Thirdly, the inclusion of dispute resolution mechanisms in state contracts has greatly enabled the international investment law regime. The inclusion of a dispute resolution clause in a state contract enables the contracting parties to resolve their disputes in an efficient and less anarchic manner than would be witnessed in domestic adversarial systems of dispute resolution. The determination of the relevant dispute resolution mechanism is dependent on the language adopted by the drafters of the state contract. The wording of the contract will determine whether the jurisdiction of the international investment agreement will extend to the dispute in question.

Further, the inclusion of umbrella clauses in a contract is intended to extend protection to foreign investors from other nationalities with stakes in the investment in question. The nationals of third-party states are protected under the umbrella clauses inserted in state contracts.[[8]](#footnote-7) The protection may cover various aspects of the contract. While there is controversy regarding the exact extent of the protections afforded by these umbrella clauses, it is generally agreed that they cover issues ranging from simple contractual breaches to administrative/legislative edicts.[[9]](#footnote-8) The inclusion of this term or clause is for a good reason - it is intended to avoid the negative outcomes in international law that occasionally present themselves in practice. According to European model laws on the status of umbrella clauses, a special article on the obligation to protect and enforce the investment is imperative.[[10]](#footnote-9) In this sense, states are obligated under umbrella clauses to promote outcomes that improve investment relations.[[11]](#footnote-10)

At the same time, discussions regarding the inclusion of these clauses in state contracts require an investigation into the relationship between these contractual stipulations and the host country's discretion. Since agreeing on a long-term contract may be impeded by political and cultural concerns in the local economy, governments and investors may agree to periodic reviews. These periodic reviews have manifold advantages. Firstly, they avoid political conflicts within the state by placating the electorate that the foreign investor is not going to stay in the country forever as well as to the foreign investor who is presented with an opportunity to continually renew the contract. The state contract may also contain provisions regarding the protection of confidential information or trade secrets. The architecture of these domestic regimes may conflict with international investment law regimes to the extent that such inconsistencies may produce detrimental complexities that may violate international law.[[12]](#footnote-11) For example, a preferential trading arrangement may confer upon a foreign investor or state preferential treatment in the treatment of its goods or services within its domestic borders in violation of the Most Favored Nation (MFN) principle of the World Trading Organization.[[13]](#footnote-12) This is particularly true in procurement contracts between government entities and private investors, much to the chagrin of competitors who may initiate investment proceedings in international proceedings, such as the International Center for the Settlement of Investment Disputes (ICSID).[[14]](#footnote-13)

Similarly, states have certain duties to foreign investors in the context of the state contract. This obligation is borne out of the consideration that the state occupies a stronger negotiation position in such relations on account of its police powers. Thus, several clauses are, as a matter of practice, included in the state contract to reflect this consensus. The introduction of clauses such as stabilization clauses, which are designed to protect the investor by securing the applicable at the material time as the only law governing the contractual relationship, are in favor of the foreign investor. The effect of stabilization clauses is to prevent future amendments to the operant law from varying in any form the terms of the contract as initiated and negotiated under the prevailing law. Further, choice of law provisions may provide for stipulations that ensure that the parties are availed supranational or international/regional alternatives for the settlement of investment disputes, effectually preventing the host state from exercising too much power over the foreign investor. This has the benefit of instilling certainty in business relations between the contracting state or its plenipotentiaries and the foreign investor.

Additionally, forum selection, as well as arbitration clauses, permit the investor to submit investment disputes to (almost always) alternative dispute resolution mechanisms that have the effect of internationalizing the contract and removing it from the jurisdictional reach of the host state.[[15]](#footnote-14) Stabilization clauses are notorious for their reluctance to fetter discretion to the host state in the selection of choice of law alternatives. Under proposed Rules of Conduct established by the United Nations, governments are expected to respect the need for confidentiality. At the same time, there are non-derogation clauses that cement the rights of an investor during state contract bargaining. Further, state contracts are negotiated with additional specifications, such as the need for the government to compensate the investor in case it undertakes any unilateral action that may result in the termination of the contract. Under guidelines established under the World Bank Guidelines for the Treatment of Foreign Direct Investment, rules protecting the interests of the investor are given further expression by the requirement objeting the arbitrary expropriation by the government.

The efficacy of these rules and regulations is varied once they have been rationalized against the overarching principles of international law and investment law.[[16]](#footnote-15) In the context of international law, these clauses are expected to be given expression under the doctrine of *pacta sunt servanda*. The doctrine of *pacta sunt servanda* underpins the edifice of international law. Domestic laws must respect customary and peremptory norms of general international law. For states ratifying international treaties and protocols relating to the enforcement of awards in foreign jurisdictions, such as the New York Convention on the International Enforcement of Arbitral Awards, it is important to ensure that these conventions, once ratified, will not be defeated by the application of municipal law to vary it. To understand the efficacy of these alternatives, it is critical to assess the layered nature of international law.

**5. Conclusion**

The interdependence of international systems under a globalized system of trade conducted by the oversight and supervision of trade bodies such as UNICITRAL, World Trade Organization, and the International Center for the Settlement of Investment Disputes (ICSID) means that states and foreign entities must cooperate to avoid distress in the international systems of capital and trade. The incorporation of clauses such as choice of law, arbitration, *force majeure*, stabilization, and non-derogation clauses helps entrench certainty in business transactions.

The unique nature of these relationships necessitates that a certain amount of trust and certainty be prevalent in international business transactions since they are usually very expensive and have far-reaching consequences in instances of breach or non-performance. Force majeure and arbitration clauses also help to limit the exposure of foreign companies transacting with states to liability by mitigating losses. They also help reduce the costs associated with litigation of this scale. For illustration, cases involving breach of contractual obligations may result in winded and prolonged litigation that may not be in the best interests of the parties (the investor or the government). By resorting to arbitration or other alternative means of dispute resolution, the parties save on time and costs. Also, it helps maintain confidentiality in business arrangements of this nature since they may involve the provision of sensitive goods and services to the government, thus necessitating the need for secrecy in transactions. In the end, these provisions help define the nature of the relationship between the contracting parties and also help reduce the complexities that are associated with the enforcement of significant undertakings between the government and foreign investors.

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