

THE RIGHT TO LEGISLATE VERSUS LEGITIMATE EXPECTATIONS OF INVESTORS – A CASE OF ZAMBIA’S MINING SECTOR

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ABSTRACT

The copper mining industry, traditionally the backbone of Zambia’s economy, was nationalised in the late 1960s re-privatised between 1997 and 2000. During the re-privatisation process, the Zambian Government entered into Development Agreements with the mining investors, and incorporated numerous incentives from the Development Agreements into legislation, with assurances that the legislative landscape would remain unchanged for specified periods of time. Subsequently, various pieces of legislation were amended before the specified periods expired.

This Article focused on the state’s right to legislate as against the legitimate expectations of investors in the mining sector in light of the Development Agreements. The study, underpinned by a doctrinal approach, examined both primary and secondary data obtained from various statutes, decided cases, mining Development Agreements, parliamentary debates and reports, policy documents, relevant international instruments, books, periodicals, journals, reports and internet materials, among others.

The Development Agreements made clear, unambiguous and unconditional promises, on which the investors could found a claim of legitimate expectation, which is protected by law. This protection helps to foster trust between the governors and the governed, forestall abuse of power by the governors, advance fairness and enhance legal certainty. On the other hand, the state has an unequivocal sovereign right to legislate in any manner it deems fit. At the same time, entering into the Development Agreements was clearly an act of sovereignty on the part of Zambia.

1.0 INTRODUCTION

Many low- and middle-income countries have stepped up efforts to attract foreign direct investment as trade and investment liberalisation have intensified in the post independence era. Concurrently, the entry of foreign direct investment into these states has been increasingly scrutinised in terms of its ability to promote or undermine national and international objectives such as poverty reduction and the realisation of human rights.

In Zambia, between 1995 and 2000, as part of the privatisation process, the Zambian Government entered into Development Agreements (DAs) with the buyers of the mining assets, offering the investors numerous incentives, particularly with regard to the tax regime they would be subjected to, in an effort to encourage the mobilisation and entry of fresh capital into the mining sector. To give effect to these incentives, certain legislation was enacted by the Zambian Government, incorporating some of the provisions of these agreements, with assurances in the DAs that the fiscal landscape would not be altered by legislative action for up to twenty years.

In 2007, the Parliament of Zambia enacted amendments to the Mines and Minerals Development Act¹, which were aimed at ensuring that development agreements were subordinate to the law and binding only within the confines of the law. The Government also sought to explicitly provide that there shall be no fiscal term or tax schedule provided in the development agreements and that all fiscal matters should be provided for in the respective tax codes and only cross referenced in the development agreements. This measure was aimed at preventing any attempts to provide for or negotiate any fiscal terms outside the Zambian tax laws and was taken following a statement by the then President of Zambia, Levy Patrick Mwanawasa to the National Assembly² to the effect that in spite of a boom in the mining sector, the majority of Zambians remained poor and that Zambians ought to benefit more from their mineral wealth.

1.1 BACKGROUND

Legal arrangements are an important part of the overall package that a country can offer to potential foreign investors. They define the terms and conditions of foreign investment, the way its costs and benefits are shared and, ultimately, the extent to which it contributes to the country's development goals³. For the investors, legal arrangements are critical as they protect their assets and entitlements, and ensure stability of the regulatory framework governing their

¹ Section 9 of the Mines and Minerals Development Act¹ of 1995

² Official Opening Speech to the First Session of the Tenth National Assembly on 28th October, 2006.

³Cotula, Lorenzo, Regulatory Takings, Stabilisation Clauses and Sustainable Development, , Paper Prepared for the OECD Global Forum on International Investment VII “Best practices in promoting investment for development” Paris, 27-28 March 2008, p.2

activities. It ought to be noted that under international law, host states have the sovereign right to expropriate assets and to regulate activities within their jurisdiction, based on the principle of Permanent Sovereignty over Natural Resources (PSNR). This principle was affirmed in UN Resolution 1803⁴ and is generally recognised as being a principle of customary international law. However, in recognising this right, international law also sets conditions with which host states expropriating foreign investors' assets must comply. Namely, expropriations must be for a public purpose and must be done in a non-discriminatory way, on the basis of due process, and against the payment of compensation.

The right of states to PSNR was affirmed in the case of *Methanex Corporation v. United States of America*⁵. In this case, the arbitrator held that the right to nationalise was unquestionable and part and parcel of state sovereignty. The arbitrator added that contractual commitments not to nationalise were themselves a manifestation and exercise of sovereignty, not its alienation. In the Arbitrator's view, sovereignty encompassed the right of states not to exercise their right to nationalise and to enter binding commitments to that effect. Although the case did not involve stabilisation clauses, the tribunal stated that 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 alios, a foreign investor or investment was 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.

It has been argued that once a long-term and capital-intensive investment is made, the investor is a more or less a hostage of the host state with the financial viability of the investment project depending on the investor's ability to attain a projected return on investment on the one hand, while, on the other hand, the investor is vulnerable to host government action which may undermine such financial viability or even expropriate the investor's assets altogether. Therefore, the legal arrangements are aimed at promoting regulatory stability and could include provisions such as those concerning the regulatory taking doctrine, and project-specific commitments embodied in foreign investment contracts between foreign investors and host states, commonly referred to as stabilisation clauses⁶.

Stabilisation clauses aim to stabilise the terms and conditions of an investment project, and help to manage non-commercial (that is, fiscal or regulatory) risk. In other words, a stabilisation clause is a contractual mechanism aimed at ensuring that the law of the host state, in so far as it impacts on the economic and financial performance of an investment venture, remains

⁴ United Nations General Assembly Resolution 1803 of 1962

⁵ Final Award, 3 August 2005, <http://www.state.gov/documents/organization/51052.pdf>

⁶ Ibid.

unchanged for the duration of the investment venture or such other period as may be agreed between the host state and the investor. It takes the form of a governmental guarantee usually providing that the host state will not, whether by legislative or administrative action, unilaterally alter the terms negotiated under the investment agreement⁷. The purpose of stabilisation clauses is generally threefold: to provide protection from political risk; ensure legal certainty; and encourage foreign investment.

Stabilisation clauses involve commitments by the host government not to alter the regulatory framework governing the project, by legislation or any other means, without adhering to specified conditions, such as consent of the other contracting party, restoration of the economic equilibrium and/or payment of compensation. Stabilisation clauses may take different forms and have evolved significantly over time, with some of the early stabilisation clauses prohibiting nationalisation, and/or requiring the consent of both contracting parties for contract modifications (these were known as “intangibility clauses”). In recent times, the scope of stabilisation clauses has tended to be broader, so as to encompass changes in the regulatory framework falling short of expropriation or contract modification. This could include stabilisation of specific aspects of the investment project, such as the fiscal regime or tariff structure, but could also include much broader commitments to stabilise the regulatory framework governing the investment⁸. Typically, stabilisation clauses contain stipulations that the host government will not change the regulatory framework in a way that affects the economic equilibrium of the project, and will compensate the investor if it does so. A typical stabilisation clause also usually provides for an opportunity of consultation between the host state and an investor by requiring that neither party can abrogate or modify the terms of the investment agreement without the consent of the other party⁹. Thus, the stabilisation clause may open the way to prospective renegotiation of the investment agreement for the mutual benefit of both the host state and the investor.

It is important to note that the fact of the legal validity of stabilisation clauses under international law does not, however, resolve the question of their legality under the domestic law of the host state, with particular regard to constitutional principles relating to the separation of powers and on the competence of the Executive branch of Government to enter into commitments that prevail over legislation adopted by parliament¹⁰. While issues concerning legality of stabilisation clauses under domestic law are likely to vary across national legal systems, the fact

⁷ Faruque, A., ‘Validity and Efficacy of Stabilisation Clauses: Legal protection v Functional value’ (2006) 23 (4) *Journal of International Arbitration*, p.318

⁸ Supra note 1, pp.5-6

⁹ Maniruzzaman, A. F. M ‘Stabilisation in investment contracts and change of rules by host countries: tools for oil & gas investors’, first draft of AIPIN Research Project (2005 – 2006), p.163

¹⁰ Supra note 1, p.8.

remains that each state has the right to make laws regulating the conduct of affairs within its geographical boundaries, including the conditions upon which investors may enter the domestic market. Where stabilisation commitments are in fact unconstitutional, the situation may be complicated by the well established principle of international law that states cannot justify failure to deliver on their international obligations by pleading domestic laws. This was clearly at issue in the case of *Revere Copper v. OPIC*¹¹. In that case, the arbitral tribunal held that under international law, the commitments made in favor of foreign nationals were binding notwithstanding the power of Parliament and other governmental organs under the domestic Constitution to override or nullify such commitments.

Yet, drawing an analogy between treaties and contracts, insights may come from Article 46 of the Vienna Convention. While confirming the general principle that states cannot invoke domestic law rules, this provision also contains an exception for rules of internal law of fundamental importance¹². Arguably, constitutional provisions such as the principle of separation of powers do constitute internal rules of fundamental importance, which the host state cannot violate through entering into investment contracts and which a diligent investor should be aware of before concluding such contracts with the host state¹³. Therefore, the core right of a state to legislate freely appears unharmed by the fact that the state has committed itself to certain restrictions in an agreement with a foreign investor.

Beyond their legality, another key issue is the legal effect of such clauses if their provisions are violated. Violations may include outright expropriation in breach of an intangibility clause, or regulatory change in breach of a freezing clause. In the case of economic equilibrium clauses, parties are under an obligation to negotiate in good faith so as to restore the economic equilibrium following regulatory change; but they are not under an obligation to reach an agreement.¹⁴ Therefore, while failure to reach an agreement does not breach the clause, violations may include refusal to renegotiate, or intentional obstruction of negotiations and possibly refusal to compensate if the clause so provides, as was stated in the *AGIP* case¹⁵. Therefore, payment of compensation emerges as the main legal consequence of breaches of stabilisation clauses. However, it appears there is no known published international arbitral award in which payment of compensation was ordered solely on the basis that a stabilisation clause contained in the investment contract had been breached by the host state. It would appear that there has to be something more than mere breach of a stabilisation clause¹⁶.

¹¹ *Revere Copper & Brass, Inc. v. Overseas Private Investment Corporation (OPIC)*, [1978] 56 I.L.R. 257

¹² Vienna Convention on the Law of Treaties

¹³ Leader, Sheldon, "Human Rights, Risks, and New Strategies for Global Investment", 9 J. Int'l Econ. L. 657 (2006)

¹⁴ Ibid.

¹⁵ *AGIP Company v. People's Republic of the Congo*, Award, 30 November 1979, 21 I.L.M. 726 (1982).

¹⁶ Cameron, Peter D., Prof 'Stabilisation in Investment Contracts and Changes of Rules in Host Countries: Tools for

A contract is an enforceable promise or set of promises, and whatever the legal consequences of non performance. This obligation is self-imposed - it is one that the promisor voluntarily assumes by committing himself to behave in a certain way at some future time¹⁷. A promise invokes trust in future actions, not merely in present sincerity. According to Fried, the convention of promising makes it possible for one to commit oneself to a future course of conduct and for others to count on one behaving in the promised way. This facilitates mutually beneficial exchanges within society. Promising restricts the promisor, but the restriction is self-imposed in order to increase one's options in the long run, and thus is perfectly consistent with the principle of autonomy - consistent with a respect for one's own autonomy and the autonomy of others.¹⁸ In other words, those to whom promises are made have legitimate expectations that the persons who voluntarily make such promises will keep them.

The expectation that promisors will honour their promises is a good reason for enforcing individual promises even where there has been no demonstrable reliance on the part of the promisee. This is entirely compatible with the view that the purpose of promising as an institution is to encourage individuals to rely on one another and that it does so by protecting their reliance interest, which is broadly construed to include their expectancy as well. Within the convention of promising, the obligation to keep a promise is deemed to arise from the promise itself, whether or not there has been any benefit to the promisor or reliance by the promisee¹⁹. Put differently, it is argued that particular promises should be enforced whether or not there has been any reliance on the part of the promisee, that promise-keeping is in general a legal duty because it is wrong to encourage the reliance of others and then disappoint their expectations.

It follows, therefore, that agreements between host states and foreign investors give rise to certain legitimate expectations from the two parties. The breach of a promise, such as those contained in a stabilisation clause in an investment agreement is, by the same token, a wrong requiring redress, usually in the form of compensation. The amount of compensation depends on a range of factors, one of which include the investor's legitimate expectations generated by the presence of a stabilisation clause, as held by arbitrators in *Liamco*²⁰ and *Aminoil*²¹; and the restoration of the economic equilibrium, in the case of economic equilibrium clauses.

Oil & Gas Investors' (2006) 54, 74-75.

¹⁷ Fried, Charles, *Contract As Promise: A Theory of Contractual Obligation*, Harvard University Press, Cambridge, Massachusetts (1981), p.3.

¹⁸ Ibid., pp 13 - 14

¹⁹ Kronman, Anthony Townsend, "Book Review: Contract as Promise" (1981). *Faculty Scholarship Series*. Paper 1067, p.411

²⁰ *Libyan American Oil Company (Liamco) v The Government of the Libyan Arab Republic*, 12 April 1977, 62 ILR 140

²¹ *Government of Kuwait v American Independent Oil Co. (AMINOIL)*, Arbitration Award, [1982] 21 I.L.M. 976 (Aminoil).

1.2 METHODOLOGY

The study employed a qualitative doctrinal approach, an approach which relies on prose, deep analysis and assessment of the issues at hand. This approach is appropriate in the subject of law, where detailed data is required.

(I) Data Collection

Both primary and secondary data were collected. The primary data were obtained from statutes, decided cases, mining development agreements, parliamentary debates and reports, policy documents and other relevant international instruments. Secondary data were collected from books, periodicals, journals, reports, internet materials, and other authoritative documents.

(II) Sampling

The documents to be reviewed were purposively selected to ensure that only documents containing relevant information are reviewed.

(III) Data Analysis

Data were analysed using the thematic method using the themes identified in the Research Questions.

1.3 RESULTS

The key findings of the study were that the existence of a stabilisation clause in the DAs, while giving rise to certain legitimate expectations by the investors, did not extinguish Zambia's sovereign right to legislate a new fiscal regime for the mining sector. Further, the imperative for the Zambian Government to meet its obligations under international law relating to the realisation of human rights in terms of provision of basic needs to its people takes precedence over the protection of the private interests of the investors. Additionally, the breach of the stabilisation clauses in these circumstances was unlikely to result in the award of *restitutio in integrum* but rather an award for compensation to the investors, of which quantum would have to be determined by the tribunal depending on a range of factors.

1.4 DISCUSSION

Based on various studies and arbitral awards, it is apparent that the existence of stabilisation clauses in investment contracts does not take away the right of the host state to legislate. At the

same time, the existence of such stabilisation clauses gives rise to certain legitimate expectations by the investors. Be that as it may, a diligent and conscientious investor would be expected to undertake due diligence to ensure that the commitments being made by the host government (usually represented by the Executive branch) do not exceed the competence and jurisdiction of that authority. As a matter of fact, any investor knows that laws will evolve over time. What is prohibited is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power²². It is, therefore, risky for an investor to operate on the premise that the Executive Branch of a government can commit the Legislature to not changing the law in a given period of time as this would go against fundamental principles of state such as separation of powers.

Tackling issues of scope, interpretation and application of stabilisation clauses calls for choices at a nexus between private and public interests. On the one hand, stabilisation commitments provide investors with a tool to shelter their interests from arbitrary host state action that may affect the investment project, or even undermine its commercial viability altogether. On the other hand, a requirement to compensate investors for even minor regulatory changes may make it more difficult for host states to take measures in pursuit of public interests - particularly poorer ones where the health of public finances may be a major concern - if those measures would affect the economic equilibrium of an investment project²³. This makes it particularly important to carefully define what is within and what is outside the scope of stabilisation commitments - so as to protect investment from arbitrary host state action without impairing host state capacity to pursue its development goals.

It must also be accepted that states may not contract out of compliance with their obligations under international law. Indeed, it is well established in international law that state sovereignty is not unlimited, but qualified by, among other things, international obligations concerning the realisation of human rights and the protection of the environment. Therefore, states cannot commit themselves not to exercise rights they do not have – such as a right to exercise sovereignty in a way that does not take account of international obligations. In other words, states cannot commit themselves not to take measures that they are required to take under international law. With particular regard to human rights, state sovereignty is limited by the international obligation to realise fundamental human rights. In providing commitments to the investor, the host state cannot impair the human rights held by individuals and groups that may be affected by the investment project. Therefore, as much as stabilisation clauses are valid and legally binding, their scope is restricted in that they cannot impair the human rights held by third

²² Cotula, Lorenzo, Pushing the Boundaries vs. Striking a Balance: The Scope and Interpretation of Stabilisation Clauses in Light of the *Duke v. Peru* Award, Accessed at HeinOnline on Wednesday April 12, 09:03:51 2017, p.29

²³ Supra note 21, p. 31

parties; and they cannot prevent genuine host state action to progressively realise human rights²⁴. On the basis of this reasoning, the scope of stabilisation clauses is limited by a “compliance with international law”²⁵ exception, whether explicitly or implicitly.

Furthermore, although compensation was ordered in a number of leading arbitration awards of the 1970s and 1980s in which tribunals ruled in favour of the validity of stabilisation clauses, such as, *inter alia*, in the *AGIP* and *LIAMCO* cases, stabilisation clauses in these awards targeted expropriation or a similar confiscatory measure. It is, therefore, plausible to state that compensation was ordered in these arbitral awards not because there had been breach of a stabilisation clause but because under customary international law, the state has a right to expropriate the property owned by a foreign investor provided, among other conditions, the state paid compensation to the foreign investor²⁶. The relevance of these arbitral awards to stabilisation clauses not targeting expropriation is, therefore, unclear. There appear to be no published awards dealing with stabilisation provisions of the modern variety, which appear to be no more than agreements to agree and expropriation claims are unlikely to be accepted as a basis for compensation.

1.5 CONCLUSION

Tensions between investor protection and the sovereign right to regulate have long been an issue. It is argued that in accordance with each State's undeniable right and privilege to exercise its sovereign legislative power comes the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a stabilisation clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. Additionally, states cannot abrogate their international obligations on the realisation of human rights under the guise of endeavouring to comply with the provisions of a contract with an investor. Further, as stabilisation commitments entail a particularly serious limitation on the exercise of state sovereignty, it has been argued that they must be expressly stipulated and cover a relatively limited period of time. In the case of Zambia, while the stabilisation clauses were expressly stated, they covered a very lengthy period of time; in fact, it has been argued that in some cases they went beyond the expected life of the mining assets. The Zambian Government claimed that it took measures to alter the mining sector fiscal regime on account of the very low contribution of the sector to the national revenues amidst high poverty levels in the country. The implication of this statement is that the government was unable to meet its obligations to provide basic needs to its people partly because of the tax concessions given in the DAs.

²⁴ Ibid., p.30

²⁵ Ibid., p31

²⁶ Leader, Sheldon, “Human Rights, Risks, and New Strategies for Global Investment”, 9 *J. Int'l Econ. L.* 657 (2006)

Although there is no binding precedent under international arbitration, it is common for tribunals to quote earlier awards. In this light, based on the *ratio decidendi* in previous arbitral awards such as the *AMINOIL* case, it is posited that while the stabilisation clauses in the Zambian DAs were valid and legal, it is unlikely that the Tribunal would award an investor *restitutio in integrum* for Zambia's breach of the provisions of these clauses. It is more likely for the Tribunal to award compensation, recognising the legal effect of stabilisation devices but interpreting them in a restrictive manner. This appears to strike a balance between the legitimate investor's need for stability and the sovereignty of the host state, particularly in disputes concerning the adoption of bona fide social and environmental measures.

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