

# LEGAL ISSUE BRIEF

---

Issue 1, No. 1, Sept 2019

## Renegotiating Production Sharing Contracts in Light of Stabilisation Clauses

Yahaya Shamsu, LL.B, LL.M, BL, MLD  
Legislative Support Service Department

### 1. Introduction

The relations between host countries and international oil companies (IOCs) are often contained in long-term agreements which may be in form of concessions, joint venture agreements, production sharing contracts (PSCs), risk service agreements, amongst others. These agreements are high-risk, capital intensive and long-term, involving activities of the investor in the host country, from exploration to the development and finally decommissioning of oil fields. The risks involved in upstream petroleum exploration include the geological, commercial, technical, managerial, natural disaster risks and political risk.<sup>1</sup>

The risks involved in exploration and production of hydrocarbons necessitates host governments to provide incentives to IOCs. One of such incentives is the insertion of a

stabilising clause in a PSC in order to attract foreign investment. This clause is a contractual risks management tool to protect IOCs from attempts by the host government to modify the agreement through subsequent changes in legislation. The clause provides that neither party may change the terms of the agreement without the consent of the other.<sup>2</sup>

Despite the existence of stabilisation clauses, many host countries regularly seek to assert their sovereign rights over natural resources by attempting to increase their share from PSCs, especially when crude oil prices are on the rise. In Nigeria, in recent years there has been a clamour for the review of the Federal Government's share of revenue under the PSCs between the various IOCs and the Nigerian National Petroleum Corporation. This clamour is based on the provisions of the Deep Offshore and Inland Basin Production

---

<sup>1</sup> Regulatory Expropriation, Investment Protection and International Law: When Is Government Regulation Expropriatory and When Should Compensation Be Paid? [https://www.researchgate.net/publication/268056452\\_Regulatory\\_Expropriation\\_Investment\\_Protection\\_and\\_International\\_Law\\_When\\_Is\\_Government](https://www.researchgate.net/publication/268056452_Regulatory_Expropriation_Investment_Protection_and_International_Law_When_Is_Government)

[Regulation Expropriatory and When Should Compensation Be Paid](#)

(accessed on 06/10/2019).

<sup>2</sup> Timothy B. Hansen, 'The Legal Effect Given Stabilisation Clauses in Economic Development Agreements', [1987] *Va. J Int'l L* (28) p. 1015-1016.

Sharing Contract Act (PSC Act)<sup>3</sup>. Section 16(1) of the PSC Act requires the Federal Government to review the share of revenue accruable to the Federation, pursuant to a PSC, whenever the price of crude oil exceeds \$20 per barrel. However, the Federal Government has not adjusted the revenue accruable to the Federation over the years despite the fluctuating increase in the price of crude oil beyond \$20 per barrel.<sup>4</sup> In 2017, the Ministry of Petroleum resources disclosed that the Federal Government was considering reviewing the PSCs, due to the fact that it lost about \$21 billion over a period of 20 years due to the failure to review the PSCs.<sup>5</sup>

Unfortunately, when many of the existing investment agreements were signed, most developing countries lacked the enforcement capacity to ensure maximum benefit from their natural resources reserve.<sup>6</sup> In spite of the insertion of stabilisation clauses, many host countries seek to assert their sovereign right to enjoy maximum benefits and to avoid adverse consequences from the exploitation of petroleum which may be compromised if stability is an express term of the agreement. Is it therefore arguable that stabilisation

clauses do in fact provide the requisite immunity against host government action.

Against this backdrop, this brief seeks to examine how host governments can effectively renegotiate production sharing contracts despite the existence of stabilisation clauses in such contracts.

## 2. Issues to be Considered

- i) What is the principle of sovereignty over natural resources?
- ii) What is a stabilisation clause in a production sharing contract?
- iii) How can host governments renegotiate production sharing contracts despite the existence of stabilisation clauses?

## Principle of Sovereignty over Natural Resources

In the past, it was a common practice for most developing countries rich in oil reserves granted concessions over their oil resources to IOCs. Gradually, as the tide of resource nationalism began to rise, most host countries sought to re-negotiate their contractual

---

<sup>3</sup> CAP. D3. LFN, 2004.

<sup>4</sup> Supreme Court Orders Federal Government to Increase its Revenue Share under Oil Production Sharing Contracts.  
<[https://andersentax.ng/supreme-court-orders-federal-government-to-increase-its-revenue-share-under-oil-production-sharing-contracts/?utm\\_source=Mondaq&utm\\_medium=syndication&utm\\_campaign=View-Original](https://andersentax.ng/supreme-court-orders-federal-government-to-increase-its-revenue-share-under-oil-production-sharing-contracts/?utm_source=Mondaq&utm_medium=syndication&utm_campaign=View-Original)>  
(accessed on 04/10/2019).

<sup>5</sup> A coup against PSC Contractors? – Re: Attorney General of Rivers State & 2 Others v. Attorney General of the Federation: Impending review of Nigeria PSC Act.

<<https://www.templars-law.com/a-coup-against-psc-contractors-re-attorney-general-of-rivers-state-2-others-v-attorney-general-of-the-federation-impending-review-of-nigeria-psc-act/>>  
(accessed on 04/10/2019).

<sup>6</sup> Natural Resources and Violent Conflict Options and Actions.  
<<http://documents.worldbank.org/curated/en/578321468762592831/pdf/282450Natural0resources0violent0conflict.pdf>>  
(accessed on 14/10/2019).

agreements with investors in favour of production sharing contracts. The rise in nationalistic feelings has continued till today with attempts at nationalisation of companies coupled with increase in taxes and royalties especially when the price of crude oil per barrel is on the increase.<sup>7</sup>

Sovereignty over natural resources is indeed one of the most controversial principles of international law. The principle was introduced by the United Nations<sup>8</sup> and is aimed at reinforcing developing countries right to enjoy the benefits of resource exploitation. The principle also aims to allow the alteration of inequitable legal agreements under which foreign investors were granted title to exploit resources in the past or even to annul such agreements for being incompatible with the principle of sovereignty over natural resources.<sup>9</sup> It is a principle of customary international law and has its legal origin in the UN Resolution 1803.<sup>10</sup> Furthermore, the UN General Assembly in 1974 adopted the Charter of Economic Rights and Duties of States (CERDS). Article 2 of the CERDS provided guarantees complete permanent sovereignty allowing each state to become the sole authority to decide on the possession, use and disposal of all its wealth, natural resources and economic activities.

In Nigeria, the right to ownership and control of natural resources under is a matter recognised by the Constitution of the Federal Republic of Nigeria, 1999 (as altered). The Constitution in Section 44 (3) and item 39 Schedule II of the Exclusive Legislative List vests the control and management of the natural resources and hydrocarbon operations on the federal government for the common good and benefit of the citizens.

In the case of *Attorney-General (A.G.) of Rivers State & 2 Others vs A.G of the Federation*, the [Supreme Court](#) delivered a Consent Judgment which mandated the Federal Government to increase its share of revenue under oil Production Sharing Contracts whenever the price of crude oil exceeds \$20 per barrel in line with Section 16 (1) of the PSC Act. If this judgment is implemented by the Federal Government, the implication is that the Federal Government's share of revenue under PSCs would increase and the IOC's share of revenue under PSCs would invariably reduce.<sup>11</sup> In that situation, the question may be asked as to what is the legal implication of agreements entered into which contain a provision or a clause that protects a party (IOCs) from unilateral amendment of contracts that alters the sharing formula contained in a PSC. This question would be addressed in the next section.

---

<sup>7</sup> Halina Ward, "Resource nationalism and sustainable development: a primer and key issues" <<https://pubs.iied.org/pdfs/G02507.pdf>> (accessed on 14/10/2019).

<sup>9</sup> Nico Schrijer, *Sovereignty over Natural Resources: Balancing Rights and Duties* (Cambridge University Press, 1997) p. 1-3.

<sup>10</sup> UN Resolution 1803 (xvii) of 14 December 1962.

<sup>11</sup> 'Supreme Court Orders Federal Government to Increase Its Revenue Share Under Oil Production Sharing Contracts' <<http://www.mondaq.com/Nigeria/x/760500/Oil+Gas+Electricity/Supreme+Court+Orders+Federal+Government+To+Increase+Its+Revenue+Share+Under+Oil+Production+Sharing+Contracts>> (accessed on 09/10/2019).

## Stabilisation Clauses in Production Sharing Contracts

Stabilisation clauses are provisions inserted in international petroleum contracts to restrain a host government from exercising state power to abrogate or otherwise intervene in agreements concluded with foreign companies.<sup>12</sup> By agreeing to the insertion of a stabilisation clause, the host state makes a commitment to refrain from unilateral actions that may modify the terms of the agreement entered into with a foreign investor.<sup>13</sup> It is essentially a popular risk management tool that can create some feeling of security when faced with adverse governmental measure that purports to alter international contracts.<sup>14</sup>

Stabilisation clauses aim to protect the IOCs, by restricting the legislative or administrative power of the Host State, as sovereign in its country, from amending the PSC or even to annul the agreement.<sup>15</sup> The long duration of investment contracts makes them susceptible to political and economic influences which may not be foreseeable when the contract was concluded, but which can affect the terms of the contract. It is for this reason that IOCs

seek reassurances that the host state are willing to abide by the sanctity of contract.<sup>16</sup>

There are different types of stabilisation clauses. A traditional stabilisation clause seeks to freeze the law of the host state as it existed at the time the agreement was signed between the parties. Another type of stabilisation clause requires both parties to perform the contract in good faith. While the former type of stabilisation clause expressly prohibits the host state from enacting any law that might have a negative effect on the agreement, the latter simply implies that there should be no unilateral modification or termination of the agreement.<sup>17</sup>

In reality, governments can make and alter laws through subsequent legislation. Besides, a contract is not a strong instrument that can fetter the legislative authority of a sovereign. Thus, unless there is in existence an external authority to enforce stabilisation clauses, such clauses are virtually ineffective.<sup>18</sup> Where disputes arise, host states seek to undermine the validity of stabilisation clauses as being contrary to their sovereign rights. Many host states criticise such clauses by claiming that the government agency within the state which signed the stabilisation clause did not even have the authority to do

---

<sup>12</sup> T.W. Walde, G. Ndi, 'Stabilizing International Investment Commitments: International Law versus Contract Interpretation' [1996] *Tex. Int'l Law Journal* (31) p. 215-216.

<sup>13</sup> Jose Macedo, 'From Tradition to Modernity: Not Necessarily an Evolution - The Case of Stabilisation and Renegotiation Clauses' [2011] *OGEL* 2 (9) (1) <[www.ogel.org](http://www.ogel.org)> (accessed on 12/02/2019).

<sup>14</sup> Joseph Nwaokoro, 'Enforcing Stabilisation of International Energy Contracts' [2010] *Journal of World Energy Law and Business* (3) (1) p. 103.

<sup>15</sup> Bernardini, P. 'Stabilization and Adaptation in Oil and Gas Investments' [2008] *Journal of World Energy Law & Business* (1) (1).

<sup>16</sup> Joseph Nwaokoro (n 14) pp. 104-105.

<sup>17</sup> Amaechi D. Nwokolo, 'Is There a Legal And Functional Value of the Stabilisation Clause in International Petroleum Agreements?' *CEPMLP Annual Review* 8 (2004) <<http://www.dundee.ac.uk>> (accessed on 05/10/2011).

<sup>18</sup> Sornarajah, M., *The International Law on Foreign Investment* (2<sup>nd</sup> edn, Cambridge University Press, United Kingdom, 2004) pp. 407-410.

so and, therefore, the state cannot be bound by such un-authorized actions.<sup>19</sup> Cases do exist where courts did decide in favour of states in conformity with the above argument.<sup>20</sup> However, in majority of cases, arbitral tribunals have held that stabilisation clauses are valid and therefore compensation must be paid whenever it has been breached.<sup>21</sup>

In instances where a host state acts in breach of a stabilisation clause, an arbitral award may enjoin the host state to refrain from applying the new laws or may order it to compensate the IOC for the breach.<sup>22</sup> Although the state might raise claim of sovereign rights in order to avoid the effects of the stabilisation clause, the state's agreeing to insertion of the clause is a sufficient argument to convince the arbitration tribunal that the foreign investor is entitled to compensation for any damage<sup>23</sup>. Thus in *AGIP Co. SpA v. Government of the Popular Republic of Congo*,<sup>24</sup> the arbitral tribunal held that the nationalisation by the respondent (host state) was in breach of both domestic and international law because it breached the stabilisation clause contained in the agreement and ordered the respondent to pay compensation to the claimant.

---

<sup>19</sup> Ibid.

<sup>20</sup> See the case of *SPP Ltd v. Egypt* (1983) 22 ILM 752.

<sup>21</sup> Margarita T B Coale, "Stabilisation Clauses in International Petroleum Transactions" [2001] *Denv. Journal of Int'l Law and Policy* p. 229.

<sup>22</sup> Bernardini (n 15) p. 101.

<sup>23</sup> Ibid.

<sup>24</sup> ICSID Case No. ARB/77/1.

<sup>25</sup> M. Coale, "Stabilization Clauses in International Petroleum Transactions" [2002] *Den Journal of Int'l Law and Policy* (30) p. 219.

## Renegotiating Production Sharing Contracts

Contractual risks in PSCs especially price volatility and economic and political risks, can lead to calls for renegotiation of agreements and claims to sanctity of contracts. These risks can be addressed through agreed terms and an appropriate Internal Revision and Adaptation System (IRAS).<sup>25</sup> Through an effective renegotiation and adaptation mechanism, parties can create a balanced Internal Adaptation System (IAS), aimed to guarantee investment security for IOCs and political or socio-economic acceptability for host states.<sup>26</sup> The major approaches to re-aligning contractual efficiency and established equilibrium of parties is to make the adjustment automatic or achieved in a manner stipulated in the contract so that the economic balance struck between the parties on the effective date of the contract is re-established.<sup>27</sup>

It is therefore reasonable to argue that parties to a PSC should have a right to renegotiate obligations in long-term international commercial contracts, as a result of an unforeseen changes in the underlying circumstance(s).<sup>28</sup> Insertion of renegotiation clause is a new approach to resolve doubts

<sup>26</sup> Thomas W. Wälde, "Renegotiating Acquired Rights in the Oil and Gas Industries: Industry and Political Cycles Meet the Rule of Law" [2008] *Journal of World Energy Law Bus* (1) (1) 55-97.

<sup>27</sup> A.F.M. Maniruzzaman, "The Pursuit of Stability in International Energy Investment Contracts: A Critical Appraisal of the Emerging Trends" [2008] *Journal World Energy Law & Business* (1) (2) pp. 127-131.

<sup>28</sup> Abba Kolo and Thomas .W. Wälde, 'Renegotiation and Contract Adaptation in the International Investment Projects: Applicable Legal Principles &

concerning the legal effectiveness of stabilisation clauses and the host state's desire to assert its sovereign right over natural resources. This entails an arrangement or agreement that if future laws are enacted which affect the IOCs share in a PSC, negotiations shall be entered into in good faith in order to reach a solution agreeable to the parties, in order to maintain the economic equilibrium of the agreement.

The renegotiation clause offers parties to a PSC protection against the hardship caused by a change of circumstances which were present at the time of the signing of the agreement. By undertaking to renegotiate the agreement in good faith, in case of any change, the host state binds itself to conduct negotiations with the foreign investor rather than unilaterally altering the terms of the agreement.<sup>29</sup>

Renegotiation clauses usually provide that any law, regulation or any other government act subsequent to the original contract that negatively affects the investor's contractual interests will entitle him the right to request for the contract renegotiation and that the host country will have the obligation of entering into such renegotiations in good faith. A typical renegotiation clause will provide that either the host government or foreign investor has the right to request for the contract adaptation if its equilibrium is negatively affected under the occurrence of

an event that is beyond the control of both parties.<sup>30</sup>

Indeed, one of the major reasons for the growing popularity of a renegotiation clauses in national laws has been attributed to their greater flexibility and versatility. A further argument for using renegotiation clauses instead of stabilisation clauses is that host governments usually enter into agreements with IOCs to explore and develop natural resources at a time when the government is not certain as to the extent, quality, and future prices of the natural resources. This underscores the need for a legislation that is flexible and amenable to changing circumstances in both domestic and international political and economic situations.<sup>31</sup>

The other reason is related to the principle of permanent sovereignty over natural resources which allows a government to unilaterally repeal or amend legislation relating to the exploitation of its natural resources. In this regard, a renegotiation clauses allows the government to regulate the various matters within its jurisdiction such as the environment, tax, fixing the price levels, production control, labour matter, safety and all other matters that fall within a government's powers.<sup>32</sup>

In Nigeria, the Petroleum Industry Bill (PIB) was drafted essentially based on the National

---

Industry Practices', [2003] *OGEL Journal* (1) (2) p. 1-48.

<sup>29</sup> Bernardini, (n 15) p. 102.

<sup>30</sup> Hadiza Tijjani Mato, "Role of Stability and Renegotiation in Transnational Petroleum Agreements" *Journal of Politics and Law* [2012] (5) (1) p. 35.

<sup>31</sup> K. Hossain, S.R. Chowdhury (eds.), *Permanent Sovereignty over Natural Resources in International Law*, (London, 1984).

<sup>32</sup> Linnet Mafukidze, 'Legislative Drafting Tools for Stabilization Provisions and Economic Balancing Provisions' [2010] *Eur. Journal of Law Reform* (12) (58) p. 94.



Oil and Gas Policy 2004.<sup>33</sup> The policy provided for a review of operating agreements, contracts, and memorandums of understanding governing the operations of the upstream oil and gas sector with a view to ensuring that the Nigeria's gains from oil and gas business are maximized.<sup>34</sup> In this regard, the Federal Government aims to carry-out an overhaul of the government petroleum revenue system in the last four decades through the PIB. Accordingly, from the perspective of the Federal Government, the existing PSCs were assessed as 'bad deals' for Nigeria, which call for renegotiations and reviews.<sup>35</sup>

The National Assembly split the PIB into four parts, the Petroleum Industry Governance Bill; the Petroleum Industry Administration Bill; the Petroleum Industry Host Community Bill; and the Petroleum Industry Fiscal Bill (PIFB). The Petroleum Industry Governance Bill was passed by the Nigerian legislature in the second quarter of 2018, and sent to the President for assent. The President declined assent, citing some constitutional and legal issues. The PIFB, if passed into law, would amongst other things, repeal the Inland Basin Production Sharing Contract Act (DOIBPSCA).<sup>36</sup> The PIFB transitional provisions seek to remove tax

allowances/tax credits; this would negatively impact companies operating in the deep-water regions, under PSCs.<sup>37</sup>

A look at the 2005 Nigerian Model PSC terms on renegotiation and review states that-

"...This Contract shall not be amended or modified in any respect except by mutual consent, in writing, of the Parties..."<sup>38</sup>

"...The Parties agree that the commercial terms and conditions of this Contract are based on the existing fiscal terms in accordance with the provisions of the Deep Offshore and Inland Basin Production Sharing Contracts Act, 1999. If such fiscal terms are changed, the Parties agree, subject to Clause 27.3, to review the terms and conditions of this Contract affected by such changes to align such terms and conditions with the fiscal terms..."<sup>39</sup>

This model of review clauses envisages future events and changes (especially regulatory) that could affect the commercial and fiscal equilibrium of parties. It fails to qualify the 'change' mentioned, thus 'change' could mean 'any change'. This is very ambiguous and could serve as a tool of confusion. Furthermore, no time limit to renegotiations is stipulated as to when 'change' occurs; the referral to arbitration if

---

<sup>33</sup> National Oil and Gas Policy for Nigeria.

<<https://www.petroleumafrika.com/national-oil-and-gas-policy-for-nigeria/>>  
(accessed on 07/10/2019).

<sup>34</sup> Ibid.

<sup>35</sup> Tade Oyewunmi, 'Stabilisation and Renegotiation Clauses in Production Sharing Contracts: Examining the Problems and Key Issues'  
<[file:///C:/Users/Pool%206/Downloads/Stabilisation and Renegotiation Clauses in Production Sharing Contracts\\_OGEL2011.pdf](file:///C:/Users/Pool%206/Downloads/Stabilisation%20and%20Renegotiation%20Clauses%20in%20Production%20Sharing%20Contracts_OGEL2011.pdf)>

(accessed on 07/10/2019).

<sup>36</sup> Insight: Nigerian Petroleum Industry Fiscal Bill— Encouraging Investment?

<https://news.bloombergtax.com/daily-tax-report-international/insight-nigerian-petroleum-industry-fiscal-bill-encouraging-investment>  
(accessed on 14/10/2019).

<sup>37</sup> Ibid.

<sup>38</sup> Clause 26.2, Nigerian Model Production Sharing Contract 2005 (Extract) (Source: Barrows, New York)

<sup>39</sup> Ibid (Clause 27.1)

there is a failure to agree is not stated; the procedure and conditions for resolving and addressing conflict of interests before legal disputes arise is not provided for; another pertinent question is at what point will the negotiations be deemed to have broken down completely?<sup>40</sup>

It is submitted that the best option for parties to a PSC in the quest for long-term contractual efficiency is to strike the right balance by inserting a properly drafted renegotiation clause in the agreement. As Walde points out, negotiation to a smaller share in a profitable PSC is better than the option of full exit and a compensation claim in international arbitration, with no guarantee of winning the case.<sup>41</sup> In this wise, what is required is careful drafting of provisions that provide for renegotiation or re-adjustment so that there is a detailed provision of the situations that may be deemed to be significant on the economy or environment necessitating amendments, with the aim of avoiding ambiguity.<sup>42</sup>

Consequently, where the provision is drafted in clear and unambiguous terms, and also in accordance with the principle of state sovereignty over natural resources, the host state will not be prevented from exercising its sovereign powers for public good and in the public interest.<sup>43</sup> This further means that the host state can also regulate the activities of foreign investors who conduct exploration and production of oil and gas resources in a

manner that is detrimental to the environment without fear of compensation, occasioned by stabilisation clauses.<sup>44</sup>

### 3. Conclusion

This brief discussed the effective renegotiation of production sharing contracts. This is in view of the fact that production sharing Contracts are usually signed with stabilisation clauses attached. The significance of such clauses is that regulatory and tax regimes will not be adjusted without compensation to the IOC. The IOC's normally insist on such clauses in order to reduce political and economic risks. Investors usually insist upon stabilisation clauses to be included into contracts as a precondition for an agreement to be reached thus relying on the principle of "sanctity of contracts". Sovereign states, of course, wish to make regulations, effect fiscal changes and make legislations within their sovereign territory. The middle point is when parties in 'good faith' incorporate a renegotiation clause into the contract, to deal with changes in underlying circumstances.

Presently, IOC's have huge investments in many developing countries. While the IOCs are technologically advanced, host states have large oil reserves. The two actors thus have to co-operate with each other to protect the sanctity of contracts and the enhancement of a harmonious business relationship conducive to both parties. This can be

---

<sup>40</sup> Oyewunmi (n 22).

<sup>41</sup> Walde (n 12).

<sup>42</sup> K. Adams, 'Contract Drafting: Revisiting Materiality - The Ambiguity at the Heart of a Fundamental Concept' [2007] *New York Law Journal*.

<sup>43</sup> A.F.M. Maniruzzaman, 'Damages for Breach of Stabilisation Clauses in International Investment law: Where Do We Stand Today?' [2007] *IELTR*, (11) (12) p. 246-251.

<sup>44</sup> Mafukidze (n31) p. 93.



**National Institute for Legislative and Democratic Studies  
National Assembly**

achieved through insertion of well drafted  
renegotiation clauses in PSCs.