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When is compensation payable for breach of a stabilisation clause? The case for the cancelled mining development agreements in Zambia

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DECLARATION

I, MORGAN MUKWASA, hereby declare that this dissertation is my original work, and other works cited or used are clearly acknowledged. This work has never been submitted to any University, College or other institution of learning for any academic or other award.

Signed: ……………………………………………………………..

Date: ………………………………………………………………..

This dissertation has been submitted for examination with my approval as University supervisor.

Signed: …………………………………………..

Rafia DeGama

University of Pretoria

Date: ……………………………………………

DEDICATION

To my wife Milika and son Wankumbu, for being deprived of your deserved quality time with me as a result of the research and writing that went into this dissertation.

ACKNOWLEDGEMENT

First and foremost, I want to thank God the almighty for my successful completion of the programme. Special thanks go to my wife Milika for her understanding and support during the programme. While this study was undertaken under the supervision of Mrs. Rafia DeGama, it benefitted greatly from the comments of Professor A.F.M Maniruzzaman, Director of Legal Research and Postgraduate Degrees in law, School of Law, University of Portsmouth, United Kingdom. The study also benefitted immensely from the comments of Professor John Lungu, Professor of Economics and Management, School of Business, Copperbelt University, Zambia. To you all, I thank you most sincerely for your honest and valuable comments on my earlier drafts of this thesis. I also wish to thank the Australian Aid for meeting half of my expenses for the programme. Finally, I wish to extend my heartfelt gratitude and thanks to the Centre for Human Rights for giving me an opportunity to pursue a master's degree programme at the University of Pretoria, and especially to all the staff for their academic and administrative assistance.

LIST OF ABBREVIATIONS

BIT	Bilateral Investment Agreement
CSOs	Civil Society Organisations
ICSID	International Centre for the Settlement of Investment Disputes
KCM	Konkola Copper Mines
MAC	Material Adverse Change
MAE	Material Adverse Effect
MCM	Mopani Copper Mines
NAFTA	North American Free Trade Area
OECD	Organisation for Economic Cooperation and Development
VAT	Value Added Tax
ZCCM-IH	Zambia Consolidated Copper Mines Investment Holdings
ZCCM	Zambia Consolidated Copper Mines
ZDA	Zambia Development Agency

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SUMMARY OF THESIS

The main focus of this thesis is the threshold beyond which compensation is payable for breach of a stabilisation clause. The discussion is based on the tax stability clauses contained in the mining development agreements unilaterally cancelled by the Government of the Republic of Zambia in early 2008.

The outstanding characteristic feature of the tax stability clauses was government's undertaking that it shall not, for the stability periods ranging between 10 to 20 years, introduce new fiscal measures resulting in a "material adverse effect" on the distributable profits of the mining companies or the dividends received by the shareholders of the companies. Government further undertook to 'fully' and 'fairly' compensate mining companies should such measures be introduced during the stability periods.

The question investigated by the thesis is whether the fiscal measures introduced by government in early 2008, as amended in 2009, have resulted in a "material adverse effect" on the distributable profits of mining companies or the dividends received by the shareholders of the companies and, therefore, entitle mining companies to compensation from government.

The main findings of the thesis, among others, are that:

- The threshold beyond which the obligation to pay compensation is triggered varies considerably depending on the specific contractual formulation of the stabilisation clause involved. However, it is significantly lower than the threshold beyond which host States must pay compensation in regulatory taking cases.
- Although there are several international arbitral awards in which payment of compensation has been ordered for breach of a freezing stabilisation clause, there is no known similar award in cases involving breach of an economic equilibrium stabilisation clause.
- Even in cases in which compensation has been ordered for breach of a stabilisation clause, there is no evidence of how much the presence of a

stabilisation clause contributes to the total quantum of the compensation awarded. The tribunals either take a "contractual perspective" or an "expropriation perspective" to arrive at their respective decisions on the quantum of compensation.

- International arbitral tribunals take into account any ‘excessive’ or ‘windfall profits’ made by investors in deciding the quantum of compensation payable to the investor for breach of a stabilisation clause.
- The tax stability clauses contained in the mining development agreements cancelled by the Zambian government are typical economic equilibrium stabilisation clauses.

Based on these findings, among others, the thesis has concluded that there are equal chances that the Zambian government may or may not be ordered to pay compensation to the aggrieved mining companies. Notwithstanding this conclusion, however, the thesis has noted that government’s unilateral cancellation of the mining development agreements has potential to negate the country’s investment image.

Against this background, the recommendation of the thesis is that government and the aggrieved mining companies must engage in discussions with a view to reaching at an amicable solution to their standoff. The rationale behind the recommendation is that an amicable solution presents a perfect opportunity for both parties to come up with a decision that is mutually beneficial to their interests. Also it is less costly than international arbitration.

CHAPTER ONE

INTRODUCTION

1.1 Background to the study

Copper mining has been the mainstay of Zambia's economy since the first commercial copper mine was opened in 1928.[1] At its peak in the late 1960s and early 1970s, copper mining accounted for more than 80 percent of Zambia's foreign exchange earnings, over 50 percent of government revenue and at least 20 percent of total formal sector employment in the country.[2] In 1969, Zambia even attained the status of a middle-income country thanks to the wealth earned from copper mining.[3]

But the situation changed during the 1980s and 1990s. The collapse of the price of copper on world metal markets coupled with lack of investments in mining machinery and prospecting activities by the then state-owned Zambia Consolidated Copper Mines (ZCCM) brought about underperformance of the copper mining sector and consequently reduced copper revenue for government.[4] The reduced copper revenue left government with no option but to start borrowing from international financial institutions in order to maintain the existing social and economic infrastructure as well as for balance of

1 The first commercial copper mine in the country, Roan Antelope Mine, was opened in Luanshya in today's Copperbelt Province. See A Dymond 'Undermining development? Copper mining in Zambia' (2007) 3; J Lungu 'Copper mining agreements in Zambia: renegotiation or law reform?' (2008) 35 *Review of African Political Economy* 404; N Simutanyi 'Copper mining in Zambia, the developmental legacy of privatization' (2008) 1, Institute for Security Studies Paper 165; and J Lungu 'The politics of reforming Zambia's mining tax regime' (2009) 6 Southern Africa Resource Watch Issue 8 http://www.sarwatch.org/sarwadocs/Politics_Reforming_Zambia_Mining_Tax_Regime.pdf (accessed on13 August 2009). See also President L P Mwanawasa's 2008 Speech to the National Assembly of the Republic of Zambia http://www.zambian.economist.com (accessed on 12 August 2009); and President RB Banda's 2009 Speech to the National Assembly of the Republic of Zambia http://www.boz.zm/publishing/speeches/PresidentRupiahBandaParliamentOpeningSpeech.pdf (accessed on 4 October 2009).

2 Simutanyi (n 1 above). See also Lungu (n 1 above) (2008). Even now, copper is still Zambia's main export product as well as the country's main foreign exchange earner. Meanwhile, Zambia is presently Africa's largest producer of copper.

3 Lungu (2008) (n 1 above).

4 Lungu (2008) (n 1 above) at 405; Lungu (2009) (n 1 above) at 11-12; Simutanyi (n 1 above) at 2; and Mwanawasa (n 1 above).

payments support.[5] By 1994, Zambia was no longer a middle-income country but the 25th poorest country in the world.[6]

With state-owned copper mines making a loss of up to US$1 million a day[7] and the price of copper still low on world metal markets, government was forced to privatize the mines in the late 1990s and early 2000s.[8] The desperation with which foreign direct investment was needed in the mining sector resulted in the enactment of the Mines and Minerals Act of 1995 which set out very generous fiscal incentives to attract new investors in the sector, in addition to the general incentives available to all investors as set out in the Investment Act also of 1995.[9]

Section 9 of the 1995 Mines and Minerals Act permitted government, 'for the purpose of encouraging and protecting large-scale investments in the mining sector', to enter into mining development agreements which would, among other things, set out the fiscal incentives applicable to mining companies investing in large scale mining projects. The section also permitted government to give tax stability periods to mining companies in order to enable them recoup their investment.

In exercise of the power conferred on it by section 9 of the 1995 Mines and Minerals Act, government signed several mining development agreements with the new mining companies between 1997 and early 2000s.[10] The agreements contained tax stability periods ranging from 15 to 20 years with an undertaking by government to fully

5 Lungu (2008) (n 1 above) at 405. See also Simutanyi (n 1 above) at 2.
6 Lungu (2008) (n 1 above) at 405.
7 Lungu (2008) (n 1 above) at 408. See also Lungu (2009) (n 1 above) at 16.
8 Lungu (2008) (n 1 above) at 405- 409; Lungu (2009) (n 1 above) at 16-17; and Simutanyi (n 1 above) at 3.
9 As above.
10 The mining companies that signed development agreements with government between 1997 and early 2000s include Cyprus Amax Kansanshi Plc; Chibuluma Mines Plc; Mopani Copper Mines Plc; Chambishi Metals Plc; and NFC Africa Mining Plc. Those that signed their development agreements between 2004 and 2006 include Konkola Copper Mines Plc; Equinox Copper Ventures Limited; and Albidon Zambia Limited.

and fairly compensate investors in the event that it breached the tax stability clauses.[11] The justification for these long stability periods was the then prediction that the price of copper on world metal markets would remain low for several years and that because of the low copper prices it would take long for mining companies to recoup their investments.[12]

It turned out that the price of copper on world metal markets rose from an average of US$ 1, 714 per tonne in 2001 to US$6, 893 per tonne in 2007, an increase of over 400 percent.[13] This unprecedented increase in copper prices resulted in calls from Civil Society Organisations (CSOs) and Opposition political parties, among other stakeholders, for government to renegotiate the mining development agreements.[14] The calls for renegotiating the mining development agreements were also supported by the World Bank.[15] The basic argument of those calling for the renegotiation of the agreements was that Zambia and her citizens were not getting the maximum benefit from the booming world metal prices because mining companies were paying low taxes based on the generous concessions contained in the mining development agreements.[16]

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11 The mining development agreements for Chibuluma Mines Plc; Cyprus Amax Kansanshi Plc; Mopani Copper Mines Plc; Chambishi Metals Plc; and NFC Africa Mining Plc give each of these mining companies a 15 year stability period while the original mining development agreement for Konkola Copper Mines Plc signed on 31st March, 2000 gave the company a 20 year stability period. Copies of the mining development agreements were accessed by the author at http://www.minewatchzambia.com (on 12 September 2009).

12 Mwanawasa (n 1 above).

13 Mwanawasa (n 1 above); see also Lungu (2008) (n 1 above) at 409. According to Professor John Lungu, the average copper price on the London Metal Exchange was between US$1,558 per tonne and US$1,815 before the year 2004. By April 2008, the price of copper on world metal markets was well above US$ 8, 000 per tonne of copper while at the time of writing this paper it was well over US7, 500.00 per tonne of copper.

14 Lungu (2009) (n 1 above) at 18-19.

15 Lungu (2009) (n 1 above) at 18. See also ‘ World Bank official advises Zambia to re-negotiate mining agreements’ *People’s Daily Online* 29 March 2007 at 1 http://english.peopledaily.com.cn/200703/29/eng20070329-362023.html (accessed on 21 July 2009).

16 Lungu (2008) (n 1 above) 409-410; Lungu (2009) (n 1 above) 18-19; and Mwanawasa (n 1 above), See also ‘Mining companies face taxing problem’ *Mail &Guardian Online* 18 February 2008 at 1, http://www.mg.co.za/article/2008-02-18-mining-companies-face-taxing-problem (accessed on 21 July 2009).

But instead of renegotiating the mining development agreements, government "decided to put in place a new fiscal and regulatory framework for the mining sector"[17]. Both the new regulatory framework and the new fiscal regime entered into force on 1st April, 2008.

The new regulatory framework was expressed through the newly enacted Mines and Minerals Development Act No. 7 of 2008, which repealed and replaced the Mines and Minerals Act of 1995. Among other things, the new Act cancelled all existing mining development agreements rendering them non-binding on the Republic "notwithstanding any provision to the contrary contained in any law or in any such mining development agreement".[18] It also prohibited government from signing any new mining development agreements.[19]

On the other hand, the new mining fiscal regime saw, among other changes, an increase of mineral royalty tax from 0.6 % to 3 %.[20] According to government, the new fiscal regime would ensure that "the nation received a fair return from its resources while maintaining a globally competitive mining industry"[21] at 47% effective tax rate.[22]

1.2 Statement of the problem

As already mentioned above, the mining development agreements cancelled by the 2008 Mines and Minerals Development Act contained tax stability clauses for periods ranging between 15 to 20 years. Not unexpectedly, therefore, major mining companies opposed the introduction of the new mining fiscal regime arguing that the cancelled

17 Mwanawasa (n 1 above).
18 Section 160(1) of the Mines and Minerals Development Act No. 7 of 2008.
19 Section 159 of the Mines and Minerals Development Act No. 7 of 2008.
20 The new mining fiscal regime is discussed in detail in chapter 4.
21 See the 2008 National Budget Address delivered to the National Assembly on 25th January, 2008, by Honourable Ng'andu Magande, then Minister of Finance and National Planning. See at 19 – 20.
22 Mwanawasa (n 1 above).

mining development agreements were still binding on government.[23] They also argued that the new tax regime would make mining financially unsustainable in the country.[24]

On its part, government maintained that the development agreements were no longer binding on the Republic of Zambia and that all mining companies were expected to comply with the new tax regime.[25] This was despite some mining companies threatening legal action for breach of their respective mining development agreements.[26]

In 2009, the effects of the global financial crisis left government with no option but to revisit some aspects of the mining fiscal regime introduced in 2008. The global financial crisis saw copper prices fall from an unprecedented US$8, 500 high per tonne to below US$3,500 per tonne.[27] As a result of the falling copper prices on international markets, mining companies experienced serious operational difficulties which saw some of the companies scale down their operations while others were put on care and maintenance.[28] This resulted in about 12 000 jobs being lost in the country's mining sector.[29] In order to help mining companies reduce their operational costs and cope with the effects of the global financial crisis, government decided to amend some aspects of the mining fiscal regime introduced in 2008.[30]

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23 'Mining companies face taxing problem' (n 16 above). See also Lungu (2008) (n 1 above) at 409-413.

24 "Zambia: Mines reject tax regime" *The Times of Zambia* 2 December 2008, www.afrika.no/Detailed/15993/html (accessed on 7 July 2009).

25 'Zambia won't reimburse mining firms' *Zambia Daily Mail* 14 August 2009 at 4.

26 "Zambia: Mines reject tax regime" (n 24 above). See also Lungu (2009) (n 1 above) at 20.

27 C M Fundanga, 'Global Financial and Economic crisis and its effect on the Zambian economy' (2009) at 2, http//www.boz.zm (accessed on 6 September 2009).

28 See 2008 National Budget Speech (n 21 above) at 22.

29 D Green "A copper-Bottomed crisis? The impact of the global economic meltdown on Zambia" (2009) 5-7. http//www.oxfam.org.uk (accessed on 6 September 2009). See also "Zambia will not reintroduce controversial copper tax, Minister says" http://www.mining-technology.com/news/news62875.html (accessed on 28 August 2009).

30 The price of copper on international markets has since recovered and remained well above US$7,500.00 per tonne of copper. As a result of the recovery of copper prices, some stakeholders have been calling on government to reintroduce the aspects of the new fiscal regime which were scrapped during the 2009 amendment. But while mining companies have not hidden the fact that they are benefitting from the current recovery of copper prices, they claim that

However, even the 2009 amendments do not appear to have persuaded mining companies to accept the new fiscal regime. This is because some mining companies have continued raising issues with government on the impact that the new fiscal laws have had on their mining operations. Government has since announced that "in the spirit of dialogue and especially because of the need to attract investors in Zambia's quest for development", it has decided to engage mining companies in "extensive talks" regarding the concerns raised by mining companies on "the impact that the current laws and the resultant tax measures have had on the incentives that had been tied to the development agreements".[31]

Meanwhile, Cyprus Amax Kansanshi Plc, one of the mining companies opposed to the new tax regime, has referred the matter to international arbitration in accordance with the provisions of the development agreement it signed with government.[32] The company's main argument is that the new tax measures are in breach of the tax stability clause contained in the development agreement.[33]

The fact that Cyprus Amax Kansanshi Plc has referred the matter to international arbitration raises the possibility of the Zambian government being ordered to pay

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they have been "hurt by production costs which had surged in tandem with the price recovery". See "Mining companies reject windfall tax" *Business Post* 26 January, 2010 at III.

31 "Mining companies reject windfall tax" (n 29 above); See also "State ready to meet mining firms" *Times of Zambia* 20 January, 2010 at 7.

32 See 'Mines still paying tax' *Zambia Daily Mail* 30 October 2009, http://www.daily-mail.co.zm/media/news/viewnews.cgi?category=11&id=1256881836 (accessed on 30 October 2009). It must be mentioned that although it is only Cyprus Amax Kansanshi Plc which is known to have referred the matter to arbitration, Mr. Felix Nkulukusa, Chief Budget Analyst at the Ministry of Finance and National Planning told the parliamentary Committee at its sitting in April 2010 that government is still owed in excess of K1 trillion by mining companies in unpaid windfall taxes introduced in 2008 because mining companies have disputed the taxes based on the tax stability clauses contained in the cancelled mining development agreements.

33 Although Equinox Minerals (owners of Lumwana Mine) have not referred the matter to international arbitration, they recently announced that they were deferring the payment of taxes totaling US$36.2 million due for the period 1st April 2009 and 31st December 2009 because the company "believes that its development agreement overrides the current changes to the Zambian tax regime". This means that there is potential for this matter to go to arbitration if an agreement is not reached between government and Equinox Minerals. See "Equinox Minerals defers payment of taxes to government" *Business Post* 16 March 2010, I-III.

compensation for breach of a tax stability clause in the event that the arbitration tribunal finds in favour of the company.

According to the tax stability clause[34] of the mining development agreement signed between government and Cyprus Amax Kansanshi Plc, government shall pay full and fair compensation to the company if the introduction of new tax measures results in a "material adverse effect" on the company's distributable profits or the dividends received by shareholders of the company. Unfortunately, the development agreement signed by Cyprus Amax Kansanshi Plc does not define the phrase 'material adverse effect'. But it is unlikely that a different meaning might have been contemplated other than the one contained in the development agreement signed by Mopani Copper Mines Plc. In the Mopani Copper Mines Plc development agreement, the phrase is defined as "a material adverse effect on the condition (financial or otherwise) of the company which has or may have a material adverse effect on the company's present or future ability to operate the Assets and Facilities pursuant to the scheduled programs".[35]

1.3 Thesis statement and research questions

This study argues that while the tax measures introduced by the Zambian government during the 2008 fiscal year and amended during the 2009 fiscal year may appear to be in breach of the tax stability clauses contained in the cancelled mining development agreements, they have not resulted in a "material adverse effect" on the distributable profits of mining companies or the dividends received by the shareholders of the

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34 See clause 14.3 of the Cyprus Amax Kansanshi Plc mining development agreement. The taxation stability clauses contained in the mining development agreements for Chibuluma Mines Plc; Mopani Copper Mines Plc; Chambishi Metals Plc; and NFC Africa Mining Plc have a similar wording but the one contained in the Konkola Copper Mines Plc mining development agreement is slightly different.

35 See clause 1.1 of the mining development agreement signed by Mopani Copper Mines Plc. See also clause 1 of the Amended and restated mining development agreement signed by KCM which defines 'Material Adverse Economic Effect' as "a material adverse effect on the financial condition of KCM which has or would reasonably be expected to have a material adverse effect on KCM's present or future ability to operate the Business as now conducted or to be conducted pursuant to the Approved Programme of Mining and Metal Treatment Operations and/or Normal Operations".

companies. Consequently, the aggrieved mining companies may not be awarded compensation by international arbitration tribunals.

To construct the argument, the following research questions will be used: (1) what is the nature and legal status of stabilisation clauses? (2) What is the prevailing international arbitral practice on the issue of compensation for breach of a stabilisation clause? (3) What are the main features of the 2008 mining fiscal regime of Zambia, as amended in 2009, and how are they different from the main features of the fiscal regime stabilised in favour of mining companies through the cancelled mining development agreements?

1.4 Significance of the study

This study is relevant not only to the government of the Republic of Zambia and the mining companies affected by the cancellation of the mining development agreements but also to academics.

For both the government of the Republic of Zambia and the affected mining companies, the study offers them an opportunity to be aware of what to expect from international arbitration tribunals in terms of issues that the tribunals are likely to take into account in deciding whether or not to order government to pay compensation for breach of the tax stability clauses.

For academics, the study presents a unique opportunity for them to examine the factors which arbitration tribunals should take into account in deciding whether or not to make an order for payment of compensation when breach of a stabilisation clause has been established. The study is of particular interest because there appears to be 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.[36] It would appear that there has to be something more than mere breach of a stabilisation clause.

1.5 Definition of concepts

In this study, unless the context suggests otherwise, "mining development agreement" means an agreement signed between the Government of the Republic of Zambia on the one hand, and a mining company on the other hand, in accordance with the provisions of section 9 of the 1995 Mines and Minerals Development Act of Zambia; and "stabilisation clause" means a contractual clause in a private investment contract between an investor and a host state that aims at addressing changes in law in the host state during the life of the project.[37]

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36 See A F M Maniruzzaman, 'Damages for breach of stabilisation clauses in international investment law: where do we stand today? (2007) *International Energy Law & Taxation Review* 246 – 247. Professor Peter D Cameron has also argued that 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 stabilization clauses, such as in the *Agip v Congo*, *BP v Libya*, *Liamco v Libya* and *TOPCO v Libya* cases, stabilization clauses in these awards targeted expropriation (or a similar confiscatory measure) as the 'event' to be prohibited". In his view, compensation was ordered in these arbitral awards not because there had been breach of a stabilization 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 pays compensation to the foreign investor. He has therefore doubted the relevance of these arbitral awards to stabilization clauses not targeting expropriation. He has also argued that although "the more recent awards concerning indirect expropriation are potentially relevant in connection with the imposition of fiscal obligations that alter the economic balance struck between the parties at the time that the contract became effective, there appear to be no published awards dealing with stabilization provisions of the modern variety, which are sometimes no more than 'agreements to agree". He believes that the awards made in cases of alleged indirect expropriation "offer only a small comfort to investors" and that "each case has to be analyzed in the light of its particular facts, but the general conclusion is that expropriation claims are unlikely to be accepted as a basis for compensation". P D Cameron 'Stabilization in Investment Contracts and Changes of Rules in Host Countries: Tools for Oil & Gas Investors' (2006) 54, 74-75, http://iba.legis.state.ak.us/sga/doc-log/2006-07-05-aipn-stabilization-camaron-final.pdf (accessed on 16 September 2009).

37 A Shemberg 'Stabilization Clauses and Human Rights' (2008) vii http://www.ifc.org/ifcext/media.nsf/Content/Stabilization_Clauses_Human_Rights (accessed on 17 September 2009). It must be mentioned that although the focus of this paper is on contractual stabilisation clauses, there are several other stabilising techniques and mechanisms, some of which are highlighted in Chapter 2. If all stabilisation techniques and mechanisms are taken into account, the notion of stabilisation can be taken to mean "all of the mechanisms, contractual or otherwise, which aim to subject the contract provisions to specific economic and legal conditions

1.6 Literature Review

Several scholarly works exist on the nature, purpose and categories of stabilisation clauses.[38] Most of the works also cover extensively the issues regarding the validity, bindingness and consequences for breach of stabilisation clauses.[39]

The existing literature makes it clear that both scholarly opinion and the arbitral jurisprudential practice on the validity and bindingness of stabilisation clauses are

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which the parties considered appropriate at the time that the contract was concluded". See Cameron (n 36 above) at 28.

38 For more on the nature, purpose and categories of stabilisation clauses, see Cameron (n 36 above) and Shemberg (n 37 above). See also P Bernardini, 'Stabilization and adaptation in oil and gas investments' (2008) 1 *Journal of World Energy Law & Business* 98; M T B Coale, 'Stabilisation clauses in international petroleum transactions' (2002) 30 *Denver Journal of International Law and Policy* 218; P E Comeaux and N S Kinsella, 'Reducing political risk in developing countries: Bilateral investment treaties, stabilisation clauses, and MIGA & OPIC investment insurance' (1994) 15 *New York Law School Journal of International and Comparative Law* 1; L Cotula, 'Reconciling regulatory stability and evolution of environmental standards in investment contracts: towards a rethink of stabilization clauses' (2008) 1 *Journal of World Energy Law & Business* 158; C T Curtis, 'The legal security of economic development agreements' (1988) 29 *Harvard International Law Journal* 317; A Faruque, 'Validity and Efficacy of stabilisation clauses: Legal protection v Functional value' (2006) 23 (4) *Journal of International Arbitration 317;* F V Garcia-Amador, 'State responsibility in case of stabilisation clauses' (1993) 2 *Journal of Transnational Law and Policy* 23; A F M Maniruzzaman, ' Some reflections on stabilisation techniques in international petroleum, gas and mineral agreements' (2005) *International Energy Law and Taxation Review* 96; A F M Maniruzzaman, 'The pursuit of stability in international energy investment contracts: a critical appraisal of the emerging trends' (2008) 1 *Journal of World Energy Law & Business* 121; A F M Maniruzzaman, 'Stabilization in investment contracts and change of rules by host countries: tools for oil & gas investors', first draft of AIPIN Research Project (2005 – 2006) http://lba.legis.state.ak.us/sga/doc_log/2006-03-15_aipn_stabilization-maniruzzaman_first_draft.pdf (accessed on 16 November 2009); B Montembault, 'The stabilisation of state contracts using the example of oil contracts: a return of the gods of Olympia?' (2003) *International Business Law Journal* 593; W Peter, 'Stabilisation clauses in state contracts' (1998) *International Business Law Journal* 875; T W Walde and G Ndi, 'Stabilizing international investment commitments: international law versus contract interpretation' (1996) 31 *Texas International Law Journal* 215; T B Hansen, 'The legal effect given stabilisation clauses in economic development agreements' (1987 – 1988) 28 *Virginia Journal of International Law* 1015; and M Flores, ' A practical approach to allocating environmental liability and stabilising foreign investment in the energy sectors of developing countries' (2001) 12 *Colorado Journal of International Environmental Law and Policy* 141.

39 See especially Cameron (n 36 above); Walde and Ndi (n 38 above); Cotula (n 38 above); Peter (n 38 above); Maniruzzaman (n 38 above) (2008); Garcia-Amador (n 38 above); Curtis (n 38 above); Comeaux and Kinsella (n 38 above); Coale (n 38 above); Hansen (n 38 above); and L Cotula, 'Regulatory takings, stabilization clauses and sustainable development' (2008), Paper submitted to the OECD Global Forum on International Investment, http://www.oecd.org/dataoecd/45/8/40311122.pdf (accessed on 17 September 2009). But see also Berger, K P 'Renegotiation and Adaptation of International Investment Contracts: The Role of Contract Drafters and Arbitrators' (2003) 36 *Vanderbilt Journal of Transnational Law, 1360.*

sharply divided. Two different schools of thought take sides on the issue. The first school of thought comprises those who argue for the validity and bindingness of stabilisation clauses while the second school of thought comprises those who argue against.

However, even those who argue against the validity and bindingness of stabilisation clauses recognise that breach of a stabilisation clause by the host state must, as of right, entitle the investor to be compensated in damages.[40] They also agree that any amount of compensation awarded for breach of an investment contract containing a stabilisation clause must reflect the presence of a stabilisation clause by being higher than the amount awarded for breach of a contract that does not contain a stabilisation clause.[41] In other words, the presence of a stabilisation clause in an investment contract must give rise to payment of higher compensation than would be paid if the contract did not contain a stabilisation clause.

The only problem is that even in cases in which compensation has been previously ordered, no quantification of damages, specifically for breach of a stabilisation clause, can be discerned in the total quantum of compensation awarded.[42] In the words of Professor Maniruzzaman, "either the arbitral tribunal characterised the nationalisation of foreign investment in violation of the classic stabilisation clause as unlawful and exceptionally awarded *restitutio in integrum* as in Texaco v Libya, or in other cases characterised government interferences with contract in any form as lawful and resorted to a method that led to the highest possible amount of compensation as the fair market value of the property".[43]

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40 See Curtis (n 38 above) 348 – 349; Walde and Ndi (n 38 above); and Maniruzzaman (n 36 above). See also T W Walde, 'Remedies and compensation in international investment law' (2005) 2 *Transnational Dispute Management Journal* 68 – 69; T W Walde and B Sabahi, 'Compensation, damages and valuation in international investment law' (2007) 3 *Transnational Dispute Management Journal* 42; and E Lauterpacht, 'Issues of compensation and nationality in the taking of energy investments (1990) 8 *Journal of Energy and Natural Resources law* 241.

41 As above.

42 Maniruzzaman (n 36 above) at 246 – 247.

43 As above.

That is for breach of a classic or traditional ‘freezing’ stabilisation clause. In the case of a more modern stabilisation clause which seeks “to restore the financial position of the investor to that on the effective date when the contract was signed”[44], no known published international arbitration award has dealt with this type of stabilisation clause.[45]

Consequently, it remains to be seen whether an international arbitration tribunal can order payment of compensation solely on the basis of a claim by an investor that a stabilisation clause contained in the investment contract has been breached by the host state. As already stated above, it would appear that there has to be something more than mere breach of a stabilisation clause.

1.7 Research methodology

This is a desk and library literature based research. It analyses both the relevant primary and secondary sources of information on the topic. Internet sources have also been used widely.

Primary sources of information include the: (a) Constitution of the Republic of Zambia; (b) Zambian Mines and Minerals Development Act, 1995; (b) Zambian Mines and Minerals Development Act, 2008; (c) relevant Zambian fiscal laws; (d) Interpretation and General Provisions Act, chapter 2 of the laws of Zambia; (e) various mining development agreements signed between the government of the Republic of Zambia and mining companies; and (f) published arbitral awards dealing with issues touching on stabilization clauses.

Secondary sources of information include the: (a) relevant Journal articles; (b) study reports on stabilization clauses; (c) papers written by academics and researchers on issues relevant to the study; and (d) speeches and daily newspapers containing information relevant to the issues under discussion.

44 Cameron (n 36 above) at 53.
45 As above.

The approach to the information obtained from these sources is analytical in nature. The aim is to build on the existing literature on stabilization clauses but with particular focus on the question of compensation for breach of the clauses.

1.8 Outline of chapters

This study consists of five chapters.

Chapter one introduces the study.

Chapter two discusses the nature and legal status of stabilisation clauses.

Chapter three focuses on the international arbitral practice on the issue of compensation for breach of stabilisation clauses.

Chapter four discusses the mining fiscal regime before and after the era of mining development agreements in Zambia, presenting both arguments for and against payment of compensation to the mining companies aggrieved with government's decision to cancel the agreements.

Chapter five makes some concluding remarks for the study while at the same time offering some recommendations.

1.9 Scope and limitations of the study

The conclusion of this study on whether or not the Government of the Republic of Zambia must compensate mining companies for breach of the taxation stability clauses contained in the cancelled mining development agreements is very much tied to the price of copper on international markets. The reason is that the question whether or not the new tax measures have resulted in a 'material adverse effect' on the financial condition of the mining companies is, subject to the issue of the cost of production as discussed under the assumptions underlying the study, very much dependent on how much profit the mining companies are making under the new tax regime with the price of copper above $2, 500.00 per tonne when compared to the profit they were making under the stabilised tax regime with the price of copper below $2, 000.00 per tonne.

Therefore, in terms of scope, the relevance of the study is particularly limited to the period starting from 2008 when the new mining fiscal regime was introduced in Zambia and ending at such time as the price of copper on world metal markets will fall below $2, 500.00 per tonne.[46]

It is also important to acknowledge that this study has not been without obstacles, especially with regard to the accessibility of information. In particular, the accessibility of full copies or texts of some international arbitral awards very relevant to the study has been problematic. Consequently, reliance has, in unavoidable circumstances, been made on the summaries of awards as contained in some of the works consulted during the study.

1.10 Assumptions underlying the study

The assumption underlying this study is that since 2008 when the Zambian government introduced the controversial new tax measures, the rise, if any, in the cost of operating mining projects in the country, has not been as high as the rise in the price of copper on world metal markets. It is further assumed that there will not be any significant rise in such cost during the period relevant to this study. The basis of the assumption is that until the current debate on the need for government to reintroduce the aspects of the 2008 fiscal regime scrapped by the 2009 amendment following the recovery of copper prices in the aftermath of the global financial crisis that affected the world, none of the mining companies opposed to the new tax regime has ever raised the issue of an increase in the cost of its operating costs as a basis for opposing the new tax regime.

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46 US$2, 500.00 per tonne of copper has been selected as the reference price for two reasons. Firstly, the financial models presented by most mining companies during negotiations for mining development agreements did not anticipate that the price of copper would rise beyond US$2, 500.00 per tonne of copper. Secondly, the windfall tax introduced in the new mining fiscal regime (discussed in detail in chapter 4) was payable at the rate of 25 percent when the price of copper is US$2,500 to US$3,000 per tonne; at 50 per cent when the price is between US$3, 000.00 and US$3,500.00 and 75 per cent when the price exceeds US$3,500.00. This means that as far as government was concerned, any profit made by mining companies when the price of copper is above US$2, 500.00 per tonne was over and above the normal profits anticipated by mining companies and should therefore be shared with government.

The only argument has been that the new tax measures might make mining economically unsustainable ‘in future’.

CHAPTER TWO

THE NATURE AND LEGAL STATUS OF STABILISATION CLAUSES

2.1 Introduction

This chapter discusses the nature and scope of stabilisation clauses; the purpose of stabilisation clauses; the categories of stabilisation clauses; the extent of the practice of using stabilisation clauses; the effectiveness of stabilisation clauses; the validity and bindingness of stabilisation clauses; and the remedies available to investors in the event that a host state breaches a stabilisation clause.

2.2 Nature of stabilisation clauses

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 unchanged for the duration of the investment venture or such other period as may be agreed between the host state and the investor.[47] 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 agreement[48].

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 party.[49] Thus, it may open the way to prospective renegotiation of the investment agreement for the mutual benefit of both the host State and the investor.[50]

47 Walde and Ndi (n 38 above) at 220 – 221.
48 Faruque (n 38 above) at 318.
49 Maniruzzaman (n 38 above) (2005 – 2006) at 163.
50 As above.

Another important characteristic of a stabilisation clause is that its language never leaves doubt as to the intention of the clause namely to provide guarantee against future unilateral modification or alteration or termination of the contractual regime.[51] This characteristic nature of stabilisation clauses was confirmed by the tribunal in *Amoco International Finance Corporation v. Iran*.[52] In that case, the clause that Iran was alleged to have breached was couched in the following words:

> "The provision of any current laws and regulations which may be wholly or partly inconsistent with this Agreement shall, to the extent of any such inconsistency, be of no effect in respect of the provisions of this Agreement."[53]

The tribunal held that the clause was not a stabilisation clause in the usual meaning of the term "since that term normally refers to contract language which freezes the provisions of a national system of law chosen as the law of the contract as of the date of the contract, in order to prevent the application to the contract of any future alteration of this system...".[54] In the tribunal's interpretation, the above reproduced clause applied only to the laws and regulations existing at the time of execution of the agreement and, therefore, provided no guarantee for the future as stabilisation clauses are supposed to do.[55]

A further aspect worth mentioning is that when they first appeared in international investment agreements during the First and Second World Wars, stabilisation clauses were used as a contractual mechanism to protect foreign investment ventures from "acts of nationalisation" or expropriation[56]. Today, however, investor concerns being addressed through stabilisation clauses have broadened to include "the risk of arbitrary or discriminatory legislation against the investor,...physical or creeping expropriation by the host state, nullification of the contract pursuant to national law, or more specific

51 Maniruzzaman (n 38 above) (2005 – 2006) at 13.
52 Iran-U.S.C.T.R. vol. 15 (1987-II), Award No. 310-56-3 of 14 July, 1984 at 189.
53 As above at 236.
54 As above at 239.
55 As above.
56 Cameron (n 36) above at 15.

fiscal issues of accelerated depreciation and amortization of assets, long loss carry-forward periods, royalty rates, or guarantees that foreign exchange can be repatriated or kept in a protected offshore account".[57] Stabilisation clauses are also being used to protect investment ventures from the cost of adjusting to changes of the environmental and social legislation.[58]

2.3 Scope of stabilisation clauses

In terms of scope, stabilisation clauses are either "comprehensive or limited".[59] A stabilisation clause is comprehensive in scope if it "encompasses a restriction upon a change of the whole range of legislative competences by the host state"[60]. Such a clause aims at nothing short of complete insulation of all contractual undertakings from any change in the applicable law of the host state.

On the other hand, a stabilisation clause that is limited in scope aims at insulating the State's contractual undertakings from a specific legislation only. The specific legislation could be tax legislation, labour legislation, or the legislation relating to repatriation of profits or the transfer of foreign exchange[61]

2.4 Purpose of stabilisation clauses

Depending on the stand point from which one is looking at them, stabilisation clauses are meant to serve a threefold purpose. They provide protection from political risk; ensure legal certainty; and encourage foreign investment.[62]

2.4.1 Protection from political risk

The protection of investment from political risk is always high on the agenda of investors and stabilisation clauses are often considered as the appropriate mechanism for

57 Shemberg (n 37 above) at 4. See also Walde and Ndi (n 38 above) at 220.
58 Shemberg (n 37 above) at 4.
59 Faruque (n 38 above) at 318.
60 As above.
61 As above.
62 Maniruzzaman (n38 above) (2005-2006) at 4; and Shemberg (n 37 above) at 4-5.

achieving the desired protection.[63] Investors see stabilisation clauses as neutralising the effect of prerogatives of the host state that would otherwise allow it to unilaterally modify the key conditions responsible for the financial and economic performance of the investment venture.[64]

Lenders of the money used by investors also consider stabilisation clauses as essential to the bankability of an investment project, particularly in emerging markets.[65] To them, the inclusion of a stabilisation clause in an investment agreement is "a way to ensure that the host state will not enact laws that eliminate or damage the commercial viability of the project, or take other actions to make loan repayments more difficult".[66]

As will be discussed later, however, a stabilisation clause, on its own, offers "little more than psychological comfort"[67] to an investor. This is because in practice, its effectiveness depends very much "on whether it is buoyed by a well-tailored arbitration clause, including governing law and arbitration venue, to provide a nexus to international arbitration".[68]

2.4.2 Ensuring legal certainty

The future behaviour of any government can never be certain.[69] For several reasons, a host State may decide to unilaterally modify or cancel an investment agreement.[70] But what every investor wants is certainty and predictability in the legal environment

63 Political risk is understood as the occurrence of events in the political sphere (governmental actions, politically motivated insecurity in the country, and international conflict) which impede the normal operations of a business venture and detrimentally impact the commercial viability of the venture. See Walde and Ndi (n 38 above) at 234.

64 Peter (n 38 above) at 875.

65 Shamburg (n 37) above at 5.

66 Shemberg (n 37 above) at 4. See also Walde and Ndi (n 38 above) at 220.

67 J Nwaokoro 'Enforcing stabilization of international energy contracts' (2010) 3 (No. 1) *Journal of World Energy Law & Business* 103.

68 As above.

69 Faruque (n 38 above) at 322. See also Walde and Ndi (n 38 above) at 220-221.

70 According to Professor Peter D Cameron, the motives behind the host states' unilateral cancellation of investment agreements are far from being uniform although, in the case of petroleum agreements, steep rise in international oil prices plays a major role. Other reasons include internal political pressures within host states. See Cameron (n 36 above) at 20-24.

governing the investment project. Though questionable, stabilisation clauses are seen as providing the much needed legal certainty and predictability by policing government behaviour so that investors know beforehand what their rights shall be in the event of change of law.[71]

2.4.3 Attracting foreign investment

On their part, host States see stabilisation clauses as an important incentive for attracting foreign investment in the country. According to one commentator, some countries even go to the extent of accepting "sweeping stabilisation clauses, along with other terms that appear to tilt the project in favour of the investor, as a way of securing a large investment project and enticing further investment in the country".[72]

2.5 Categories of stabilisation clauses

Stabilisation clauses exist in several shapes and forms.[73] Some of them are categorised as freezing clauses while others are categorised as economic equilibrium clauses. There is also a hybrid of freezing and economic equilibrium clauses.

Freezing stabilisation clauses are designed to make new laws inapplicable to the investment while economic equilibrium clauses are designed to make new laws applicable to the investment venture on the condition that the investor must be compensated for the cost of complying with the new laws[74]. Hybrid stabilisation clauses share some aspects of both freezing and economic equilibrium stabilisation clauses.

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71 Faruque (n 38 above) at 322. See also Cameron (n 36 above) at 22.

72 Shemberg (n 37 above) at 5.

73 For more on the different categories of stabilisation clauses, see Shemberg (n 37 above) at 4-9; Faruque (n 38 above) at 318-321; Curtis (n 38 above) at 346 -347; Cameron (n 36 above) at 28-31; Cotula (n 38 above) at 160-162; Coale (n 38 above) at 222 – 223; and Maniruzzaman (n 38 above) (2008) at 122-131.

74 Shemberg (n 37 above) at 4-9.

Freezing stabilisation clauses are further divided into two subcategories. These are full freezing stabilisation clauses and limited freezing stabilisation clauses.[75] Full freezing stabilisation clauses are those which purport to freeze both fiscal and non fiscal issues, usually for the duration of the project. On the other hand, limited freezing stabilisation clauses aim to protect the investor from a limited set of issues only, such as tax and customs issues.

Economic equilibrium stabilisation clauses are also further divided into two subcategories namely full economic equilibrium and limited economic equilibrium clauses. Full economic equilibrium stabilisation clauses are those that protect against the financial implications of all changes of law by requiring compensation or adjustments to the contract to compensate the investor when changes occur while limited economic equilibrium stabilisation clauses protect against financial implications of some limited set of changes in law or after specified costs are incurred.[76] Limited economic equilibrium stabilisation clauses require compensation or adjustments to the deal to compensate the investor only when the covered changes occur.

As for hybrid clauses, they, like economic equilibrium stabilisation clauses, do not make investors automatically exempt from new laws. But, like freezing stabilisation clauses, they explicitly include the granting of exemptions from laws as one method to ensure that the investor is not financially impacted by new laws.[77]

Stabilisation clauses are also sometimes classified as either *strict sensu* or 'intangible'. "The main difference between the stabilisation clause *strict sensu* and an intangible clause is that while the former intends to protect investors from host state legislative intervention in the contract through changes in the applicable law or the enactment of new legislation, the later aims to protect them from the host state's

75 This further categorisation basically refers to the scope of stabilisation clauses already discussed above.
76 Shemberg (n 37 above) at 7-9.
77 As above.

exercise of administrative power to change or modify the contract unilaterally."[78] Thus, a stabilisation clause *strict sensu* is one that limits the legislative competence of the State whereas an intangible stabilisation clause is one that shields the investor against the exorbitant powers of the government acting as public authority to change the terms of an investment agreement.[79]

2.6 Extent of the practice of using stabilisation clauses

The practice of using stabilisation clauses 'is widely established across industries and regions of the world'.[80] One recent study found that stabilisation clauses of one kind or the other are in use in Sub-Saharan Africa; North Africa; Eastern and Southern Europe; South and Central Asia; the Middle East; Latin America; and the Caribbean.[81] The study also found that stabilisation clauses are in use in some Organisation for Economic Cooperation and Development (OECD) countries.

However, stabilisation clauses are particularly prevalent in developing countries. The reason is that the "concern over political risk, often accentuated by a past history of nationalisations, other undue political interference, and/or frequent reporting of indicators of an 'uncivilised' situation (insecurity, civil war, endemic corruption, lack of effective rule of law and public order, general noncompliance with law, and rebellious sub-central powers)"[82] make foreign investors insist on stabilisation guarantees in developing countries.

It must be mentioned that the fact that investors see developing countries as more politically risky investment destinations than developed countries has even forced some developing countries to enact pieces of legislation that provide for the guarantee

78 Faruque (n 38 above) at 319-320. See also Coale (n 38 above) at 223 and Curtis (n 38 above) at 346-347.
79 Faruque (n 38 above) at 320. See also Maniruzzaman (n 38 above) (2005 – 2006) at 8.
80 Shemberg (n 37 above) at 4.
81 Shemberg (n 37 above) at 18.
82 Walde and Ndi (n 38 above) at 222-223.

of contractual stability between the State and the foreign investor.[83] The aim is to reassure investors that governments of such States will respect their contractual commitments to investors.

In developed countries, however, the situation is completely different: investors do not usually insist on stabilisation guarantees and, when they do, they rarely succeed because the concern over political risk in those countries is almost nonexistent.[84]

Stabilisation clauses are also particularly prevalent in natural resource and energy investment projects for the simple reason that the duration and risk exposure in these projects "is particularly long, capital investment particularly intensive, and project risk (geological, commercial, and political) particularly acute".[85]

2.7 Stabilisation techniques other than contractual stabilisation clauses

Other than the contractual stabilisation clauses described above, there are various other stabilisation techniques and mechanisms at the disposal of investors. One such technique has been described, in recent literature, as treaty stabilisation.[86] This technique is associated with the rising prominence of notions such as 'fair and equitable treatment'; 'legitimate expectation'; and 'umbrella' clauses whose general tendency "is to contain the stability of contract between the host State and a foreign investor irrespective of a stabilisation clause in it, but more so when its presence in it operates as a booster".[87]

Another stabilisation technique often used in some countries is the promulgation of the investment contract itself as a special law thereby according supremacy to the

83 AFM Maniruzzaman, 'National laws providing for stability of international investment contracts: a comparative perspective' (2007) 8 *The Journal of World Investment & Trade 233.*

84 Walde and Ndi (n 38 above) at 223.

85 Walde and Ndi (n 38 above) at 222-223. See also Shemberg (n 37 above) at 4; Cotula (n 38 above) at 160; and Faruque (n 38 above) at 317-318.

86 Maniruzzaman (n 38 above) (2008) at 122 - 123.

87 A F M Maniruzzaman 'The issue of resource nationalism: risk engineering and dispute management in the oil and gas industry' (2009) 5 *Texas Journal of Oil, Gas and Energy Industry Law* 92.

contract as *lex specialis* over current or subsequent legislative enactments.[88] This technique is particularly common in oil producing countries whose constitutional and legislative framework demand that Petroleum contracts negotiated with international oil companies must be promulgated into special law for them to be valid.[89] “The advantage of this legal technique is that it is not always easy for a legislative body of the host state, let alone the governmental authorities, to interfere with the contract straightaway as there are various formalities to go through before it can happen”.[90]

2.8 Effectiveness of stabilisation clauses

As earlier mentioned, a stabilisation clause, on its own, offers no “more than psychological comfort”[91] to an investor. Its effectiveness depends “on whether it is buoyed by a well-tailored arbitration clause, including governing law and arbitration venue, to provide a nexus to international arbitration”.[92]

2.8.1 The Arbitration clause

One of the realities that developing countries have to grapple with is the fact that their legal systems are not trusted by foreign investors from developed countries: foreign investors are always apprehensive of the possibility that in the event of a dispute with the host State, the decision of the host State’s judicial system could be manipulated against their interest.

The provision for international arbitration is often seen as not only a safeguard against such apprehension but also as a source of stability for the relationship between the host State and the investor, as well as the contractual regime.[93] According to one commentator, providing for international arbitration could even be more important than the governing law of the contract alone because

88 As above.
89 As above.
90 As above.
91 Nwaokoro (n 67 above).
92 As above.
93 Maniruzzaman (n 87 above) at 93.

"an international arbitral tribunal might interpret the chosen host state's law in light of international law on the basis of various international elements of the contract concerned, and thus could come up with an acceptable decision on the dispute. On the other hand, even if non-national law or international law is chosen as the governing law of the contract, a court in the host state deciding the dispute might not even give effect to that chosen law, owing to the peculiarity of the host state's legal system".[94]

2.8.2 The Governing Law Clause

The sanctity of the contract has never prevented the national legislator from changing its own laws. In addition, "a state may face exceptional circumstances requiring it to legislate, notwithstanding the stabilisation clause in its contract to the contrary, in order to protect the public interest".[95] In practice, this means that incorporating the host State's law as the governing law of the contract cannot offer the much needed protection because the host State can change its law at any time by virtue of its sovereign authority thereby undermining the protection intended by the clause.[96]

It is against this background that incorporating international law or some other non-national legal systems, rules, and principles as the governing law of the contract is regarded as the only sure way of protecting the contract from the sovereign powers of the host States. The reason is that providing for international law or some other non-national legal systems or principles as the governing law of the contract takes "the contract out of the influence or the jaw of the otherwise applicable national law of the host State".[97] Needless to mention, it is beyond the scope of the host State's sovereign authority to change any law other than its domestic law.[98]

However, it must be mentioned that the fact that international law "is not a self-sufficient legal system to deal with every aspect of state contracts" presents its own

94 As above.
95 Maniruzzaman (n 38 above) (2005 – 2006) at 162.
96 Nwaokoro (n 67 above) at 110. See also Maniruzzaman (n 87 above).
97 As above.
98 As above at 95.

practical difficulties and challenges when it comes to dispute resolution in cases involving contracts governed by international law.[99] For this reason, the emerging trend among contract drafters is to provide for the application of both international law and the law of the host state.[100] This new approach, it is submitted, is the most logical one because, as will be discussed later, stabilisation commitments are only valid and binding under international law if they are granted in accordance with the constitutional and legislative framework of the host State.

2.9 Validity and bindingness of stabilisation clauses

The question of the validity and bindingness of stabilisation clauses on host States has, for several decades now, been a subject of intense scholarly debate.[101] Scholarly opinion has remained sharply divided between those who, on the one hand, argue that stabilisation clauses are valid and binding on host States and those who, on the other hand, argue that the clauses are not valid and binding on host States.[102] To date, there is no consensus among scholars.[103] Arbitral jurisprudence on the matter reveals equally divergent views among international tribunals.[104]

What is not in dispute, however, is that both arguments for and against the validity of stabilisation clauses always take into account the law applicable to the contract in which the stabilisation clause is contained. And since the emerging trend, as mentioned earlier, is to make both the national law of the host State[105] and the principles of international law applicable to the contract, the validity and bindingness of

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99 As above at 91.

100 As above.

101 For more on the debate regarding the validity of stabilisation clauses, see Walde and Ndi (n 38 above) at 238- 246; Maniruzzaman (n 38 above) (2005-2006) at 66-83; and Peter (n 38 above) at 882-885.

102 As above.

103 Berger (n 39 above) at 1360.

104 Walde and Ndi (n 38 above) at 238-246 and Hansen (n 38 above) at 1017.

105 The national law of the host State is often expressly chosen by parties to an investment agreement as the law applicable to the agreement or as one of the laws applicable to the agreement. It is also often applicable because of the host state’s conflict of law rules, the conflict of law rules of other national laws, the international law or because of transnational *lex mercatoria*. See Walde and Ndi (n 38) above) 238.

stabilisation clauses can be best appreciated if discussed from the stand point of both the national law of host States and the principles of international law.

2.9.1 Validity and bindingness of stabilisation clauses under national law

The consensus among different scholars is that where the law applicable to the investment agreement is the national law of the host State, stabilisation commitments given by the host State are only valid if the host State's legal and constitutional framework provides for them.[106] The inclusion of a stabilisation clause in an investment agreement does not create any binding commitment on the part of the host State if the stabilisation clause is invalid under the constitutional and legislative framework of the host state.[107]

Sadly for investors, the continuing effect of any stabilisation clause that is valid under the host State's national law "is in the hands of the national legislature".[108] The reason is that in the exercise of its sovereign legislative powers, the national legislature is at liberty to change any national law permitting the grant of stability commitments. In Zambia, for example, the 1995 Mines and Minerals Act which permitted government to grant stability commitments to mining companies was repealed and replaced by the Mines and Minerals Development Act of 2008. As mentioned earlier, the 2008 Act introduced new changes, among others, the express provision that the mining development agreements entered into between government and mining companies under the repealed Act would no longer be binding on the Zambian government notwithstanding anything contained in any other law or in the mining development agreements themselves.[109] Consequentially, this also meant that the tax stability commitments granted to mining companies in line with the provisions of section 9 of the repealed Act would no longer be binding on government.

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106 Cameron (n 36 above) at 13 – 15; Cotula (n 38 above) at 162; and Walde and Ndi (n 38 above) at 238 – 239.

107 As above.

108 Walde and Ndi (n 38 above) at 239.

109 Section 160 of the Mines and Minerals Development Act, No. 7 of 2008.

But in the words of some commentators, "while it is difficult to argue for any effect to be given to stabilisation clauses invalid *ex ante* under national law, it is different if such guarantees were legally granted and then subsequently invalidated with retroactive effect".[110] In other words, a stabilisation clause that is valid under national law cannot be subsequently invalidated with retrospective effect. This being the position, does it follow that the tax stability commitments granted by the Zambian government to mining companies under the 1995 Mines and Minerals Act, and subsequently invalidated with retroactive effect under the 2008 Act, are still valid and binding on the Zambian government?

For the affected mining companies, not only the stability commitments but also the mining development agreements are still valid and binding on the Zambian government.[111] But for the Zambian government, both the stability commitments and the mining development agreements are no longer binding on the Republic because of the changes introduced by parliament via the new law.

Apparently, it appears that the position taken by government can be justified by some provisions of the country's constitution. Article 79(7) of the Constitution of Zambia expressly empowers parliament to make laws with retrospective effect. Further, Article 139(12) (c) (ii) and (iii) expressly provides that where any written law repeals another written law, the repeal shall, *if an express intention appears to that effect*,[112] affect not only the previous operation of any provision so repealed or anything duly done or suffered under any provision so repealed but also any right, privilege, obligation or liability acquired, accrued or incurred under any written law so repealed.[113]

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110 Walde and Ndi (n 38 above) at 239.

111 Detailed arguments of the mining companies affected by the Zambian government's cancellation of mining development agreements are discussed in chapter 4 below.

112 Author's emphasis.

113 Incidentally, some provisions of section 14(3) (b) of the Interpretation and General Provisions Act, chapter 2 of the laws of Zambia, appears to contradict Article 139(12) (c) (ii) and (iii) of the constitution. Section 14(3) (b), (c) and (e) of the Act provides that where a written law repeals in whole or in part any other written law, the repeal shall not- (b) affect the previous operation of any written law so repealed or anything duly done or suffered under any written law so repealed; or

The implication of Article 79 (7) of the constitution of Zambia, as read with Article 139(12) (c) (ii) and (iii), is that the Zambian legislative body acted within its sovereign powers when it retrospectively cancelled all the mining development agreements signed by government pursuant to section 9 of the repealed Mines and Minerals Act. Clearly, therefore, it cannot be seriously contended by mining companies that the cancellation of the mining development agreements (and consequently any rights and privileges acquired or accrued under the agreements) is of no effect under Zambian law because the constitution allows parliament to do so. Against this backdrop, it is submitted that the where the constitutional and legislative framework of the host State permits the national legislature to enact of laws with retrospective effect, any stabilisation commitment granted in accordance with the national law of such host State may be subsequently invalidated with retrospective effect. It is precisely for this reason that incorporating the host State's law as the governing law of the contract does not, in practice, offer any protection to investors.

2.9.2 Validity and bindingness of stabilisation clauses under international law

Under international law, the question whether stabilisation clauses are valid and binding on the host State is one that seeks to address arguments on "whether the state's

(c) affect any right, privilege, obligation or liability acquired, accrued or incurred under any written law so repealed; or (e) affect any investigation, legal proceeding, or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture or punishment as aforesaid, and any such investigation, legal proceedings, or remedy may be instituted, continued or enforced, and any such penalty, forfeiture or punishment may be imposed, as if the repealing written law had not been made. Thus, one may argue that the repeal of the 1995 Mines and Minerals Act cannot affect the rights and privileges accrued to mining companies under that Act. However, the Interpretation and General Provisions Act is subordinate to the republican constitution and, consequently, cannot override the provisions of the constitution on the effect of a repealed law.

sovereign powers, otherwise recognised in international law, can be limited by contractual obligations freely assumed" by the host State.[114]

In the 1970s and 1980s, those who questioned the validity of stabilisation clauses claimed that the clauses were inconsistent with the principle of permanent sovereignty over natural resources.[115] Their basic argument was that a host State cannot, in the face of the State's sovereign power, contractually bind itself by means of stabilisation provisions in an investment agreement.[116]

On the other hand, those who argued in support of the validity of stabilisation clauses contended that there was nothing in the principle of state sovereignty that prevented a State from contractually binding itself by means of stabilisation provisions in an investment agreement as long as all constitutional and legislative requirements of such State were respected.[117] They further contended that "a State is in fact exercising its sovereign rights when it agrees to the inclusion of a stabilisation clause" in an investment agreement.[118]

Presently, the general view of most scholars is that stabilisation clauses are valid and enforceable against host States under international law.[119] However, there are some commentators who still question the validity of the clauses.[120]

Those who argue in support of the validity and bindingness of stabilisation clauses under international law cite at least three reasons in support of their argument. Firstly, they argue that international arbitration case-law has on several occasions ruled in favour of the validity of stabilisation clauses. *Texaco v Libya*[121]; *AGIP v Congo*[122];

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114 Curtis (n 38 above) at 348.
115 Maniruzzaman (n 38 above) (2005 – 2006) at 66.
116 Maniruzzaman (n 38 above) (2005-2006) at 68 -70; Peter (n 38 above) at 882; and Hansen (n 38 above) at 1017 – 1018.
117 Maniruzzaman (n 38 above) (2005 – 2006) at 70; Montembault (n 38 above) at 599 – 613; and Peter (n 38 above) at 882.
118 Hansen (n38 above) at 1018 and 1024 – 1031.
119 Cotula (n 38 above) at 162 - 164; Faruque (n 38 above) at 323; Peter (n 38 above) at 882 - 883; Maniruzzaman (n 38 above) (2005 – 2006) at 66 – 68; and Cameron (n 36 above) at 54.
120 Berger (n 39 above) at 1360.
121 [1977] 53 I.L.R. 389.

Revere Copper v OPIC[123]; and *Kuwait v Aminoil*[124] are among the several international arbitral awards often cited as giving effect to the validity and bindingness of stabilisation clauses.[125]

Secondly, they point to the fact that host States have continued executing investment agreements containing stabilisation clauses.[126] This state practice, it is argued, "must be interpreted as reflecting the *opinio juris* of the contracting States because the obligations undertaken are expressed in legally binding form and the stabilised agreements are adopted against the background of widely publicised arbitral awards holding such agreements to be internationally binding".[127]

Thirdly, they rely on the fact that several developing countries now explicitly provide for stabilisation clauses in their national legislation as a way of attracting foreign investment.[128]

Despite the foregoing, it would appear that the question regarding the validity of stabilisation clauses under international law is, at best, still unsettled. Three reasons can be advanced for this conclusion. Firstly, the international arbitral awards often cited to support the argument that stabilisation clauses are valid were concerned with the classic type of stabilisation clauses which sought to prohibit outright physical expropriation and similar confiscatory measures rather than lesser forms of regulatory change[129]. Consequently, their authority on the validity of stabilisation clauses must be taken as relating only to the classic or traditional type of stabilisation clauses.[130] So far,

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122 Award of 30 November 1979, 21 I.L.M. 726 (1982).

123 [1978] 56 I.L.R. 257

124 [1982] 21 I.L.M. 976.

125 Cotula (n 38 above) at 162 – 164; Peter (n 38 above) at 882 – 884; Montembault (n 38 above) at 612 – 612; Cameron (n 36 above) at 54; and Maniruzzaman (n 38 above) (2005 – 2006) at 66 – 68.

126 Maniruzzaman (n 38 above) (2005 – 2006) at 66 – 68; Curtis (n 38 above) at 350- 351; and Peter (n 38 above) at 882 – 883.

127 Curtis (n 38 above) at 350-351.

128 Cotula (n 38 above) at 163.

129 Cotula (n 38 above) at 164 – 165.

130 As above.

there is no known published arbitral award which has addressed the validity of economic equilibrium stabilisation clauses.[131]

Secondly, although stabilisation clauses were present in the investment agreements which formed the subject of the international arbitral awards cited in support of the argument for the validity of stabilisation clauses, the issue of the validity of stabilisation clauses was largely obscured in the *ratio decidendi* of the awards.[132] It was the fact of expropriation rather than breach of a stabilisation clause that weighed heavily on the decision of the arbitral tribunals presiding over those cases.[133]

Thirdly, the fact that host states have continued executing investment agreements containing stabilisation clauses cannot in itself lend support to the validity of stabilisation clauses.

Admittedly, the fact that most developing countries are now providing for stabilisation clauses in their national legislation is very relevant to the question whether the clauses are valid and binding under international law. This is because even when international law is the applicable law, "the principle that stabilisation clauses are lawful and binding under international law must be qualified to exempt clauses that are entered into in clear violation of domestic law rules of fundamental importance".[134] Thus, any contractual stability commitments granted to an investor by the host State are only valid and binding under international law if they are, in the first place, valid and binding under the constitutional and legislative framework of the host State.

2.10 Remedies for breach of stabilisation clauses

In the words of Professor Cameron, "States can revise contracts unilaterally. The real issue in designing the appropriate stabilisation mechanisms is not so much *whether* the

131 Cameron (n 36 above).
132 Walde and Ndi (n 38 above).
133 Cameron (n 36 above) at 52.
134 Cotula (n 38 above) at 165.

host government can unilaterally change the contractual relationship but rather what is the result of such legislative action for the investor in terms of lump sum damages or possible specific performance of stabilisation mechanisms".[135]

It is therefore understandable that some drafters of investment agreements ensure that they specify, in the agreement, the remedies available to the investor in the event that the host State breaches the stabilisation commitments made in favour of the investor. For example, the already mentioned mining development agreements signed between the Zambian government and foreign mining companies had a provision for government's undertaking to "reimburse" the mining companies or, at the option of the companies, to make offsetting changes in any law, statute, regulation or enactment applicable to the companies, to ensure that t h e companies are "fully and fairly compensated for any loss, damages, or costs incurred by" by the companies as a result of government's breach of the taxation stability commitments.[136]

Where the investment agreement provides for the remedy in the event of breach of a stabilisation commitment, it is always easy for the arbitral tribunal to decide the redress available to the investor when the breach occurs. But where the investment agreement is silent on the remedy intended by the parties to the agreement, then guidance must be sought from the principles of the law of contract. This is because from the stand point of the law of contract, stabilisation clauses are fundamental terms of contract whose breach is as serious as the breach of any other fundamental term of the contract. Consequently, the remedies available for breach of any fundamental term of contract are also available for breach of a stabilisation clause. These include rescission, specific performance and payment of damages.[137]

However, payment of financial compensation remains, by far, the most common and principal sanction for breach of a stabilisation clause in international economic

135 Cameron (n 36 above) at 52.
136 All the cancelled mining development agreements have a similar provision in this regard.
137 J Y, Gotanda, 'Damages in lieu of performance because of breach of contract' (2006) Villanova University School of Law Working Paper Series No. 53 1.

law.[138] The reason is that compensation is "the one remedy that is traditionally seen as the least intrusive into sensitive areas of government sovereignty because the international tribunal does not tell the government what to do specifically, but asks it to pay in the fungible currency of money for harm done".[139] Also, investors see financial compensation as the best expression of their interest in the investment project affected by breach of the host State's obligations while for host States "pride, prestige, and domestic political sensitivities against imposition of commands from abroad is more important than the much more anonymous role of money".[140]

That damages[141] are often "the principal means of substituting for performance or complementing other remedies" in contract disputes between transnational contracting parties[142] is particularly fitting for cases involving breach of economic equilibrium stabilisation clauses. This is because the very essence of economic equilibrium stabilisation clauses is that in the event that the clause is breached and the host State fails to restore the economic equilibrium of the investment venture, then the host State must compensate the investor for any expenses incurred by the investor in complying with the newly imposed regulatory or administrative framework.

However, it must be emphasised that in all cases the remedies available to the investor for breach of a stabilisation clause ultimately depend on the language in which the relevant provisions of the investment agreement are couched. For example, the agreement may provide for payment of compensation or, at the option of the investor, permit the host State to make offsetting changes in the law in favour of the investor.

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138 Walde (n 40 above) at 36.

139 Walde (n 40 above) at 37; see also Walde and Sabahi (n 40 above) at 8.

140 As above.

141 In this study, the terms 'compensation', 'damages' and 'indemnification' are being used interchangeably as meaning one and the same thing. Ordinarily, however, a distinction is sometimes drawn between the meaning of 'compensation' and the meaning of 'damages' (indemnity). The former is sometimes understood to be less linked to an unlawful act, as for example, when compensation is due for an otherwise lawful expropriation. On the other hand, the latter has a closer connection to unlawful conduct in general and, more specifically, breaches of contract. For more on how these, see Walde (n 40 above) at 36-37; and Walde and Sabahi (n 40 above) at 2-3.

142 Gotanda (n 137 above).

2.11 Conclusion

Stabilisation clauses are still a very reliable political risk management tool for investors. In practice, however, stabilisation clauses do not prevent host States from unilaterally revising or terminating contracts signed with foreign investors: the only real protection guaranteed by stabilisation clauses appears to be the obligation they place on host States to compensate investors in the event of any unilateral revision or termination of the contract.

CHAPTER THREE

INTERNATIONAL ARBITRAL PRACTICE ON COMPENSATION FOR BREACH OF STABILISATION CLAUSES

3.1 Introduction

This chapter discusses the legal basis for payment of compensation when a stabilisation clause has been breached; the threshold beyond which the obligation to pay compensation is triggered; the international arbitral jurisprudence on compensation for breach of stabilisation clauses; and the factors that affect the amount of compensation.

3.2 Legal basis for payment of compensation

The legal basis for payment of compensation when a stabilisation clause has been breached is not difficult to discern. Firstly, "it is a fundamental principle of law that contractual undertakings must be respected. The rule of *pacta sunt servanda*, therefore, has application to all types of agreements, including those between investors and the host State".[143] This entails that the general requirement that parties to a contract must honour their contractual commitments applies to host States with the same force as it does to parties to an ordinary contract. The result is that in the event of failure by the host State to honour its contractual commitments, the investor is, like any other party to an ordinary contract, entitled to payment of compensation, among other remedies available for breach of contract.[144]

Secondly, a stabilisation clause is, by its very nature, a very fundamental express term of the contract whose breach must attract the usual serious consequences that follow the breach of a fundamental term of contract. The reason is that a stabilisation clause is an "attempt to bind the State to a greater extent than a normal contract would

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143 D E Vielleville, and B S Vasani, 'Sovereignty over natural resources versus rights under investment contracts: which one prevails?' *Transnational Dispute Management (TDM)* Vol. 5, issue No. 2, published in April 2008, at www.transnational-dispute-management.com (accessed on 30 November 2009), 7.

144 Walde and Ndi (n 38 above) at 236.

seem to do".[145] It is considered as adding "emphasis, intensity and strength" to the contract.[146] Consequently, breach of a stabilisation clause amounts to breach of a very fundamental term of contract meriting payment of compensation to the investor. In the words of Professor Garcia-Amador,

> "…breach of any of the obligations emanating from the contractual relationship entails responsibility, but when there is a breach of an obligation involving an explicit State's promise to respect the agreement, the breach logically becomes a more serious act or omission, entailing a higher degree of responsibility. It is also logical to think that the higher degree of responsibility will affect the measure of reparation".[147]

Thirdly, the existence of a stabilisation clause in an investment agreement creates a legitimate expectation on the part of the investor that the host State will, without any excuse whatsoever, honour any stability commitments made in favour of the investor.[148] In the event that the investor's legitimate expectation is frustrated by the host State's failure to honour the stability commitments, the investor must be "indemnified" for any loss resulting from such failure.[149]

3.3 Threshold for payment of compensation

International law recognizes the right of sovereign States to regulate various matters falling within the State's jurisdiction such as tax, environment, labour, public health and safety issues, among others.[150] In addition, a State may, as earlier mentioned, face exceptional circumstances requiring it to regulate or legislate for the public good even when doing so would be contrary to the State's contractual commitments.[151] In both instances, the "principal issues that arise are whether the State's regulatory actions can

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145 As above.
146 Walde and Ndi (n 38 above) at 237.
147 Garcia-Amador (n 38 above) at 49-50.
148 Maniruzzaman (n 36 above) at 247; and Cotula (n 38 above) at 166.
149 Maniruzzaman (n 36 above) at 247.
150 Maniruzzaman (n 38 above) (2008) at 141.
151 As above.

be tantamount to indirect expropriation or regulatory taking, and if not whether such actions in violation of a relevant stabilization clause would be so".[152]

While the distinction between a compensable taking or indirect expropriation and a non-compensable regulation remains unclear in customary international law, both recent State practice and international arbitral jurisprudence makes it clear that a simple regulatory change resulting from the State's bona fide exercise of its regulatory powers does not amount to indirect expropriation and, therefore, not compensable even if it results in economic injury to the investor.[153] Incidentally, it is perfectly possible for any such simple regulatory change to amount to breach of a stabilisation clause and, therefore compensable. The discussion that follows illustrates.

The threshold beyond which the obligation to pay compensation is triggered varies considerably depending on the specific contractual formulation of the stabilisation clause involved.[154] In the case of breach of a freezing stabilisation clause, the host State's obligation to pay compensation is triggered as soon as the regulatory changes, legislative or administrative, are applied to the investment project.[155] On the other hand, the host State's obligation to pay compensation in the case of breach of economic equilibrium clauses "is only triggered where a minimum threshold is met – namely where the economic equilibrium of the contract is affected".[156]

Regarding the precise point at which the economic equilibrium of the investment project is deemed to have been affected, some economic equilibrium clauses usually provide guidance by requiring that there should be a 'material adverse affect' on the economic benefits of the project or a 'material decrease in project benefits or company value'.[157] However, others merely refer to "regulatory change impairing implementation or adversely affecting value – without requiring these effects to be 'material'".[158]

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152 As above.
153 As above at 142.
154 Cotula (n 38 above) at 166.
155 Cotula (n 38 above) at 166- 167.
156 As above.
157 As above.
158 As above.

Consequently, there is always a degree of uncertainty as to the precise point at which the host State's obligation to pay compensation is triggered for breach of an economic stabilisation clause[159]. This is particularly so where the negative impact of regulatory change is modest.[160]

The uncertainty surrounding the threshold for the host State's obligation to pay compensation for breach of an economic stabilisation clause is worsened by the fact that what constitutes a "material adverse effect" is often not defined and, where it has been defined, the definition itself is often a subject of different interpretations. In the words of Professor Maniruzzaman,

> "It should be mentioned that in very few contracts the trigger of economic rebalancing is specifically defined. The simple use of the terms such as 'material change' (as in the Indian Model PSC), 'adversely affected' (as in the Azeri PSC), 'significantly affect', 'materially affect', 'materially adverse affect', 'Profound Changes in Circumstances', 'material adverse change' (MAC) or 'MAE' in an economic balancing provision may be prone to conflicting interpretations in different contexts…. Often, in contracts some broad definition of some of the aforementioned terms could be found which may again generate further issues in specific situations while interpreting them".[161]

The point made by Professor Maniruzzaman is illustrated by the mining development agreements signed between the Zambian government and foreign investors in the late 1990s and early 2000s. Government undertook to compensate mining companies if it introduced fiscal measures which resulted in a 'material adverse

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159 As above.

160 As above.

161 Maniruzzaman (n 38 above) (2008) at 129. The difficulty associated with the interpretation of what constitutes a "material adverse effect" has also been acknowledged by Professor Kenneth A. Adams. According to him, case law on "material adverse effect" (MAE) or "material adverse change" (MAC) provisions leaves no doubt that the meaning of the word 'material', in the sense in which it is used in the provisions, is problematic due to the fact that it is an inherently vague (but not ambiguous) word. See K A Adams 'A legal – usage analysis of "material adverse change" provisions' (2004) Vol. X *Fordham Journal of Corporate and Financial law* 23- 27.

effect' on the distributable profits of mining companies or the dividends received by shareholders of the companies.[162] But in most of the development agreements, the phrase 'material adverse effect' was not defined. And for the agreements in which the phrase was defined, the definition was so broad that it is almost impossible to discern what the negotiators and drafters of the agreements really meant by the phrase.

For example, the restated mining development agreement signed between government and Konkola Copper Mines Plc defined "material adverse Economic effect" as 'a material adverse effect on the financial condition of KCM which has or would reasonably be expected to have a material adverse effect on KCM's present or future ability to operate the Business as now conducted or to be conducted pursuant to the Approved Programme of Mining and Metal Treatment Operations and/or Normal Operations'[163]. A similar broad definition was inserted in the mining development agreement signed between government and Mopani Copper Mines Plc. In that agreement, "material adverse effect "was defined as 'a material adverse effect on the condition (financial or otherwise) of the company which has or may have a material adverse effect on the company's present or future ability to operate the Asserts and Facilities pursuant to the Scheduled Programmes'.[164]

Clearly, these two definitions are too broad for any clear understanding of what really constitutes a "material adverse effect" on the distributable profits of the mining companies or the dividends received by the shareholders of those companies. Neither can they be said to be of any help regarding the precise point at which the "material adverse effect" occurs to the financial position of the companies.

Notwithstanding, the threshold beyond which host States must pay compensation for breach of a stabilisation clause is significantly lower than the threshold for which

162 The mining development agreements signed by Cyprus Amax Kansanshi Plc; NFC Africa Mining Plc; Chibuluma Mines Plc; and Chambishi Metals Plc do not define "material adverse effect" though the phrase is used in the taxation stability clauses included in the agreements.

163 Clause 1 of the Amended and Restated Development Agreement.

164 Clause 1 of the mining development agreement assigned between the Zambian government and Mopani Copper Mines Plc.

compensation is payable in indirect expropriation cases.[165] According to one commentator, "freezing clauses require payment of compensation for regulatory change regardless of its impact".[166] The same commentator further notes that "even the standard of 'material impact' used in some economic equilibrium clauses appears to be significantly lower than the 'substantial deprivation' standard [required in indirect expropriation cases]. What is required for this threshold to be met is not government interference that affects the very viability of an investment project but, rather, less intrusive forms of government action that affect the cost–benefit equilibrium of the investment".[167]

That the threshold beyond which the obligation to pay compensation for breach of a stabilisation clause is significantly lower than the threshold required for compensable regulatory taking is supported by a number of arbitral awards on creeping expropriation cases.

In the petroleum agreement that gave rise to the dispute in *Occidental Exploration and Production Co. v Republic of Ecuador*[168], there was a contractual provision to make corrections if tax changes impacted on the 'economy' of the contract. In the company's contract, another provision stipulated a similar type of obligation to make a correction factor if there was an unforeseen modification in the tax regime which has an impact on the economy of the contract. The company argued that the host State's refusal to refund VAT payments was tantamount to expropriation (i.e. indirect expropriation) of its investment. Rejecting the company's argument, the tribunal noted that the deprivation to the company needed to affect a significant part of the investment before creeping expropriation could be said to have occurred, which was not apparently the case here.

165 Cotula (n 38 above) at 167.
166 As above.
167 As above.
168 LCIA Case No UN3467, Final Award of 1 July 2004. For summary of the facts and main issues discussed in the award, see Cameron (n 36 above) at 60-62.

Meanwhile, the tribunal in *EnCana v Republic of Ecuador*[169] held that ‘‘in the absence of a specific commitment from the host Sate, the foreign investor has neither the right nor any legitimate expectation that the tax regime will not change, perhaps to its disadvantage, during the period of the investment’’. The tribunal also noted that ‘‘even if there were such a commitment (e.g. to a tax freeze or ‘tax holiday’), this would not convert a breach of contract or the denial of a legitimate expectation into an expropriation’’.[170]

The *EnCana* tribunal further noted that by its very nature all taxation reduces the economic benefits which an enterprise would otherwise derive from an investment, and only in exceptional cases can a tax measure which is general in character be judged as equivalent in effect to an expropriation of the enterprise itself.[171] According to the tribunal, the fact that denial of VAT refunds and the recovery of VAT refunds wrongly made did not prevent the company from functioning profitably nor to engage in the normal range of activities of extracting and exporting oil was enough reason to hold that no creeping expropriation had occurred in the matter. Creeping expropriation could only occur if the company was brought to a standstill and the rewards from its activities made so marginal or unprofitable that the company lost its character as an investment.[172] The tribunal was of the view that only if a tax law is extraordinary, punitive in amount or arbitrary in its incidence would issues of indirect expropriation be raised.[173]

Another limited interpretation of the term ‘tantamount to expropriation’ was given in *Pope& Talbot v Government of Canada.*[174] In that case, a NAFTA tribunal found that even if the investor’s argument could be accepted that the profits of the enterprise had been significantly reduced by a change in Canadian lumber export quotas, it was

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169 LCIA Award & Partial Dissenting Opinion. For summary of the facts and main issues discussed in award, see Cameron (n 36 above) at 65-66.

170 Cameron (n 36 above) at 65-66. See also Maniruzzaman (n 38 above) (2008) at 145.

171 Cameron (n 36 above) at 65.

172 As above.

173 Cameron (n 36 above) at 66.

174 Interim Award of 26 June, 2000, 40 ILM 258 (2001). For summary of the facts and main issues discussed in the award, see Cameron (n 36 above) at 63.

necessary to produce more tangible forms of interference in business operations before it could be said that expropriation had occurred.[175]

In all these arbitral cases, compensation was denied on the ground that a simple regulatory change affecting an investment venture cannot amount to indirect expropriation and cannot, therefore, attract compensation from the host state. But as earlier mentioned, any simple regulatory change can result in breach of a stabilisation clause and, therefore, attract compensation.[176] That being the position, one cannot help but wonder whether the arbitral tribunals could have ruled differently had the claims in those cases been founded on breach of a stabilisation clause rather than creeping expropriation. Would payment of compensation have been ordered?

Obviously, any attempt to try and discern whether the tribunals could have ruled differently will be pure speculation. This is because even for claims based on breach of a stabilisation clause, the investor has to satisfy certain conditions before the claim can succeed. For example, a claim based on breach of an economic stabilisation clause may not succeed unless there is proof that the breach of the clause has resulted in a "material adverse effect" on the economy of the investment project.

But notwithstanding the conditions which must be satisfied before a claim founded on breach of a stabilisation clause can succeed, it is submitted that there are at least two reasons to believe that the tribunals in the cases just referred to above could have ordered payment of compensation if the claims were based on breach of a stabilisation clause.

Firstly, the very fact that any simple regulatory change affecting an investment venture might give rise to compensation in cases of breach of stabilisation clauses is enough reason to suggest that the regulatory changes complained of in those cases, while not amounting to creeping expropriation, may have amounted to breach of a stabilisation clause. This is reinforced by the fact that in cases of breach of a

175 Cameron (n 36 above) at 63.
176 Maniruzzaman (n 38 above) (2008) at 146.

stabilisation clause, what is required for the compensation threshold to be met "is not government interference that affects the very viability of an investment project but, rather, less intrusive forms of government action that affect the cost–benefit equilibrium of the investment".[177]

Secondly, arbitral jurisprudence leaves no doubt that where there is a specific stability commitment by the host State; any subsequent changes in the regulatory or legislative framework in breach of the stability commitment are compensable. This was the view taken in *Methanex Corp v United States of America, Award.*[178] In that case, the tribunal observed 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 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[179].

A similar observation was made by an International Centre for the Settlement of Investment Disputes (ICSID) tribunal in *Parkerings v Lithuania* wherein it was observed that:

> "it is each State's undeniable right and privilege to exercise its sovereign legislative power. A State has 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. As a matter of fact, any businessman or investor knows that laws will evolve over

177 Cotula (n 38 above) at 167.
178 Award of 5 August 2005.
179 As above. See also Maniruzzaman (n 38 above) (2008) at 145.

time. What is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power".[180]

These two arbitral awards reinforce the observations of the tribunal in *EnCana v Republic of Ecuador* that ''in the absence of a specific commitment from the host Sate, the foreign investor has neither the right nor any legitimate expectation that the tax regime will not change, perhaps to its disadvantage, during the period of the investment''.[181]

Therefore, where there are specific or express commitments by the host State not go against any stability commitment made in favour of an investor, any regulatory change, however simple, might trigger the obligation of the State to pay compensation.

That any simple regulatory change may amount to breach of a stabilisation clause and attract payment of compensation can also be supported from the point of view of the notions of fair and equitable treatment; legitimate expectation; and umbrella clauses. According to one commentator, the general tendency of these notions" is to contain the stability of contract between the host State and a foreign investor irrespective of a stabilisation clause in it, but more so when its presence in it operates as a booster".[182] It is worth mentioning that although these notions emanate from treaty based arbitration cases, they give effect to the stability of the contractual relationship between a host State and a foreign investor.[183] In *Occidental Exploration and Production Co. v Republic of Ecuador* already cited above, the tribunal observed that ''the stability of the legal and business framework is … an essential element of fair and equitable treatment''.[184] The tribunal in *Sempra Energy International v The Argentine Republic* also emphasised that ''what counts is that in the end the stability of the law and the observance of legal obligations are assured, thereby safeguarding the very

180 Award of 11 September 2007, ICSID Case No ARB/05/8, Para 332. See summary by Professor Maniruzzaman (38 above) (2008) at 145-146.
181 As above.
182 Maniruzzaman (n 38 above) (2008) at 147.
183 As above.
184 Parkerings v Lithuania, Award of 11 September 2007, ICSID Case No ARB/05/8, Para 183.

object and purpose of the protection sought by the treaty".[185] The tribunal went on to state that the principle of 'fair and equitable treatment standard' "ensures that even where there is no clear justification for making a finding of expropriation . . ., there is still a standard which serves the purpose of justice and can of itself redress damage that is unlawful and that would otherwise pass unattended".[186]

3.4 Previous compensation awards on economic stabilisation clauses

So far, there is no known published international arbitral award which has dealt with the breach of an economic stabilisation clause.[187] Consequently, it remains to be seen in what precise circumstances the international arbitration tribunals would order compensation for breach of an economic stabilisation clause.

However, there are a number of published arbitral awards which have addressed issues of fair and equitable treatment and indirect expropriation and which are believed, by analogy, to have a bearing on the likely enforceability of economic stabilisation clauses.[188] For example, the tribunal in *CMS Gas Transmission Co v Argentine Republic*[189] ordered the Republic of Argentina to pay compensation on the basis that by adopting various measures in disregard of certain stabilisation clauses in the contract, the government of Argentina had affected the claimant's certain rights and violated the standard of "fair and equitable treatment" owed to it under the applicable bilateral investment protection treaty. Other arbitral awards which have addressed issues of fair and equitable treatment and indirect expropriation include those which have already been referred to above such as *Occidental Exploration and Production Co. v Republic of Ecuador; EnCana v Republic of Ecuador; Pope& Talbot v Government of Canada; Methanex Corp v United States of America;* Parkerings-Compagniet v Lithuania*;* and *Sempra Energy International v The Argentine Republic*.

185 Case No ARB/02/16) [28 September 2007] Para 300.
186 As above.
187 Cameron (n 36 above) at 54.
188 As above.
189 (ICSID Case No ARB/01/08), 12 May 2005.

3.5 Previous compensation awards on freezing stabilisation clauses

In a number of cases involving outright nationalisation or expropriation of the investor's property in disregard of a freezing stabilisation clause, the international arbitration tribunals have made it very clear that such nationalisation or expropriation, whether lawful or unlawful, gives rise to the obligation to pay compensation if carried out in breach of a stabilisation clause.

3.5.1 Revere Copper v. Overseas Private Investment Corporation [190]

In 1967, a Jamaican subsidiary of Revere made an agreement with the Jamaican government regarding the construction and operation of a mining plant in Jamaica, which provided for tax stability. Seven (07) years later, a newly elected government announced that it would not be bound by the existing aluminium contracts and issued a series of measures that stripped Revere Copper of some of its investment guarantees. Further ignoring the tax stability agreement, the government increased taxes and royalties, citing changes in the economic environment as justification for the increases. Within a year of the implementation of the newly announced measures, Revere Copper's revenues dropped substantially forcing the company to shut down the plant. In the arbitration proceedings which followed, the arbitration tribunal observed that although mere breach of contract does not constitute expropriation, government's repudiation of the tax stability agreement in this case directly prevented the company from exercising effective control over the use or disposition of its property. Thus, the tribunal found that expropriation had occurred and ordered the government of Jamaica to pay compensation.

190 [1978] 56 I.L.R. 257

3.5.2 AGIP v Popular Republic of the Congo[191]

In this case, AGIP relied upon a stability guarantee given by the government of the Republic Congo not to apply any laws or decrees that would alter the company's legal status. An International Centre for the Settlement of Investment Disputes (ICSID) tribunal found that Congo's nationalisation of AGIP's interests constituted a repudiation of the stabilisation clauses in the agreement resulting in, inter alia, a loss of profit for AGIP on the venture. Consequently, the tribunal awarded AGIP "full compensation" including damnum emergens and lucrum cessans.

3.5.3 Government of the State of Kuwait v. American Independent Oil Co[192]

In this case, Article 17 of the concession agreement provided that the concession could not be annulled or altered by legislation or regulations unless jointly agreed by the parties. There was a supplemental agreement which also provided that the concession could not be terminated before the end of its term except by surrender or by default. In its arbitral award on the case, the tribunal expressed the view that the purpose of the stabilisation clauses in the concession agreements was only to prohibit measures of a confiscatory character and not lawful nationalisation. But the tribunal did not hesitate in making a finding that the stabilisation clauses in the agreements had the effect of assuring "proper indemnification" to the company in the event of nationalisation. The tribunal also held that the stabilisation clauses in the agreements created a legitimate expectation with respect to damages and that the legitimate expectation had to be taken into account. In other words, compensation was payable because of the legitimate expectation created by the presence of stabilisation clauses in the concession agreements.

It must be observed that in both the *Revere Copper* and *AGIP* awards, the tribunals held that nationalisation in the face of an agreement which includes a

[191] Award of 30 November 1979, 21 I.L.M. 726 (1982).
[192] [1982] 21 I.L.M. 976.

stabilisation clause is a breach of that clause. A similar conclusion was reached in *Texaco v Libya*[193] in which the tribunal ordered the Libyan government to pay *restitutio in integrum* to *Texaco* as the remedy for the breach of a stabilisation clause and unlawful expropriation.

On the other hand, the tribunal in the *Aminoil* award held that nationalisation in the face of an agreement which includes a stabilisation clause is not a breach of the clause and, therefore, not unlawful. That was also the view taken by Dr Mahmassani, the sole arbitrator in *Liamco v Libya*[194]. He concluded that Libya's nationalisation was not a breach of the stabilisation clause in the agreement between the parties.

While it is noted that the tribunals in these nationalisation arbitral cases adopted different approaches, the most important point for purposes of this study is that host States were ordered to pay compensation in all the awards. Unfortunately, even in these and various other international arbitration cases where the breach of a stabilisation clause was in issue, “no quantification of damages, specifically for such breach, in the total quantum of compensation awarded by the tribunal can be discerned”.[195] According to Professor Maniruzzaman, “either the tribunal characterised the nationalisation of foreign investment in violation of the classic stabilisation clause as unlawful and exceptionally awarded restitutio in integrum as in Texaco v Libya, or in other cases characterised government interferences with contract in any form as lawful and resorted to a method that led to the highest possible amount of compensation as the fair market value of the property”.[196] In other words, tribunals either took a "contractual perspective" or an "expropriation perspective" to arrive at their respective decisions on the quantum of compensation payable for breach of a stabilisation clause.[197]

193 [1977] 53 I.L.R. 389.
194 20 ILM 1 (1981).
195 Maniruzzaman (n 36 above) at 247.
196 As above.
197 As above.

Clearly, therefore, the role played by the presence of a stabilisation clause in the actual quantum of compensation remains to be seen.[198] Thus, while the possibility of tribunals ordering compensation for breach of a stabilisation clause is real, an investor who chooses to rely solely on the host State's breach of a stabilisation clause as basis for his claim of compensation has very little comfort to draw from the arbitral jurisprudence.[199] It would appear that the chances of such a claim succeeding may only be enhanced if the claim is reinforced by other claims such as failure of the host State to observe the 'fair and equitable treatment' standard.

3.6 Factors that affect the amount of compensation

Several factors affect the amount of compensation payable for breach of a stabilisation clause. But two of them particularly merit some attention here. The first one is that the presence of a stabilisation clause in an investment agreement is in itself an important factor that should affect the quantum of compensation payable to the investor.[200] In the words of Professor Walde, "governments have the power to cancel contracts by legislative fiat – an act of expropriation. The question is if the added presence of a stabilisation clause should lead to increased compensation. If one would ignore the existence of a stabilisation clause for compensation purposes and allow expropriation with normal compensation, the added presence –of the stabilisation commitment would have no effect".[201] But as already noted above, the extent, if any, to which the presence

198 Maniruzzaman (n 36 above) at 246.

199 In *Duke Energy International Peru Investments No. 1 Ltd v. Republic of Peru*, an International Centre for the Settlement of Investment Disputes (ICSID) tribunal, in its award dated August 18, 2008, held that Peru had violated a contractual stability commitment owed to a Bermudan subsidiary of Duke Energy when it levied taxes in response to a corporate restructuring undertaken by Duke. The tribunal ordered Peru to pay US $18,440,746 plus simple interest for breach of a contractual tax-stabilization commitment. If Peru had not applied for the annulment of the award, the award could have really been the first of its kind to decisively deal with the issue of compensation for breach of a contractual stability commitment. See 'ICSID tribunal finds breach of certain tax stabilization commitments owed to Duke Energy, but absolves Peru of other breaches; tribunal awards $18.4 Million in damages' *INVESTMENT ARBITRATION REPORTER* Volume 1, No. 8, August 26, 2008 http://www.iareporter.com/Archive/IAR-08-26-08.pdf (accessed on 24 October 2009).

200 Maniruzzaman (n 36 above) at 246.

201 Walde (n 40 above) at 68.

of a stabilisation clause may affect the quantum of compensation remains to be seen in practice.

The second factor that affects the quantum of damages is the investor's cost, if any, of complying with the new changes introduced in breach of a stabilisation clause.[202] The higher the cost of complying with changes resulting from the breach of a stabilisation clause, the higher the quantum of compensation that is likely to be ordered.

But in the same vein, tribunals have jurisdiction to take into account any 'excessive profits' made by the investor in deciding the quantum of compensation.[203] Thus, the quantum of compensation awarded to the investor may be reduced by the fact that the investor has made excessive profits.

3.7 Conclusion

While there are several international arbitral awards in which payment of compensation has been ordered for breach of a freezing stabilisation clause, there is yet to be a similar award in the case of breach of an economic stabilisation clause. Also, even though there is legally nothing that can prevent an international arbitration tribunal from ordering compensation for breach of an economic stabilisation clause, the fact that the role played by the presence of a stabilisation clause in the actual quantum of compensation is yet to be seen means that there must be something more to justify payment of compensation even for breach of economic stabilisation clauses.

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[202] Cotula (n 38 above) at 166.
[203] Walde and Sabahi (n 40 above) at 38 – 39.

CHAPTER FOUR

THE MINING FISCAL REGIME BEFORE AND AFTER THE ERA OF MINING DEVELOPMENT AGREEMENTS IN ZAMBIA

4.1 Introduction

This chapter focuses on the Zambian mining fiscal regime before and after mining development agreements in the country. In particular, the chapter discusses (a) the fiscal regime contained in the repealed Mines and Minerals Act of 1995; (b) the fiscal regime stabilised in favour of mining companies through the cancelled mining development agreements; (c) the fiscal regime introduced by government in the 2008 fiscal year; (d) the response of mining companies to the 2008 fiscal regime; (e) the 2009 amendment and whether it eliminates the justification for mining companies to be compensated; and (f) the impact of government's unilateral action on investor perception of Zambia's investment climate.

4.2 The mining fiscal regime under the 1995 Mines and Minerals Act

It will be recalled that the 1995 Mines and Minerals Act was designed to attract foreign investment in the country's mining sector. Against this backdrop, the Act contained a number of provisions on fiscal and other incentives. For example, section 67 allowed for the deferment of the payment of mineral royalty tax if, during any period for which payment of mineral royalty tax is due as prescribed under the Act, the cash operating margin of the holder in respect of mining operations in the mining area falls below zero.[204]

Also, section 96 provided for relief from income tax[205] in the form of deductions in respect of capital expenditure while section 97 provided for relief from customs and excise duties, and from any other duty or impost levied under the Customs and Excise Act, in respect of all machinery and equipment (including specialised motor vehicles)

[204] Section 67(3) of the Act.
[205] The nature and extent of deductions was outlined in Schedule 4 of the Act.

required for any of the activities carried on or to be carried on in pursuance of the right or otherwise for the purposes of the investment.

In addition to the fiscal incentives outlined above, the 1995 Mines and Minerals Act permitted government to enter into mining development agreements with mining companies. According to section 9(2) of the Act, the mining development agreements entered into under the Act could contain provisions binding on the "Republic" in relation to:

> (a) mining operations under a large-scale mining licence, or the financing of any mining operations under such a licence;
>
> (b) the circumstances or the manner in which the Minister or the director shall exercise any power or discretion conferred on them by the Act in respect of the licence;
>
> (c) the settlement of disputes arising out of or relating to the agreement, the administration of the Act, or the terms or conditions of a large-scale mining licence, including provisions relating to the settlement of any such dispute by international arbitration; and
>
> (d) the privatisation of the Zambia Consolidated Copper Mines Limited and any matters specified in the Second Schedule in which the Minister responsible for finance may, after consultation with the Minister responsible for such portfolio, *make such stability commitments in relation to the said matters as the Minister may consider necessary*.[206]

4.3 The mining fiscal regime under the era of mining development agreements

The legislative intention behind section 9 of the 1995 Mines and Minerals Act was that government, in its efforts to encourage and promote large scale mining investments in the country, should be allowed to hold negotiations with investors prepared to make

[206] Author's emphasis.

huge investments in the country and, if necessary, to give such investors fiscal incentives over and above those contained in the Act. That this was the intention behind section 9 of the Act was evident in the provisions of the mining development agreements signed between government and the mining companies.

Firstly, the fact that section 9 of the Act allowed for each mining company to negotiate its own separate mining development agreement made it possible for each company to also negotiate its own separate fiscal regime. Secondly, the fact that the law allowed each mining company to negotiate its own separate fiscal regime meant that each company could negotiate as many tax concessions as its bargaining power could possibly allow. The result was that the country had no uniform fiscal regime for mining companies during the era of mining development agreements: each mining company had a separate fiscal regime wholly contained in a "Tax Schedule" annexed to its mining development agreement.

Admittedly, however, the issue of each mining company negotiating a separate fiscal regime did not prevent government from striving for some form of uniformity in the tax concessions granted to mining companies. Government negotiators tried to ensure that some aspects of the concessions being granted to mining companies were, as far as possible, similar. For example, Konkola Copper Mines Plc and Mopani Copper Mines Plc were granted the same rates of mineral royalty tax and corporate tax.[207] So were Chibuluma Mines Plc and Chambishi Metals Plc.[208]

For purposes of this study, a very important point to note is that during the negotiations leading to the signing of mining development agreements, the fiscal incentives contained in the 1995 Mines and Minerals Act were, at best, treated as

207 The rate of mineral royalty tax was 0.6% on the net back value while the rate of corporate tax was 25 %. See clauses 1(1.2) and 3 of the Tax Schedule annexed to the amended and restated development agreement signed by Konkola Copper Mines Plc; and clauses 1(ii) and 2(i) of the Tax Schedule annexed to the development agreement signed by Mopani Copper Mines Plc.

208 The rate of mineral royalty tax was 2 % on the net back value while the rate of corporate tax was 35% (before listing on the Lusaka Stock Exchange) and 30% (after listing on the Lusaka Stock Exchange). See clauses 1(ii) and 2(i) of the Tax Schedule annexed to the development agreement signed by Chibuluma Mines Plc, and clauses 1(2) and 2(i) of the Tax Schedule annexed to the development agreement signed by Chambishi Metals Plc.

government's "offer" which was subject to negotiation. That this was so is confirmed by the fact that both Konkola Copper Mines Plc and Mopani Copper Mines Plc negotiated mineral royalty tax at the rate of 0.6 %[209] despite the rate payable under section 66(1) of the Act being 3 %. Similarly, Chibuluma Mines Plc and Chambishi Metals Plc negotiated to pay 2% mineral royalty tax even though the rate payable under the Act was 3%.[210]

A cursory perusal of the tax schedules annexed to the various mining development agreements reveals that the tax concessions granted to mining companies were many and generous.[211] Professor John Lungu has very helpfully summarised the concessions by observing that

> "despite the Mines and Minerals Act specifying that mineral royalties should be set at percent for those holding large-scale mining licences, the rate negotiated by most mining companies was 0.6 percent of the gross revenue of minerals produced. The agreements also allowed companies to carry forward losses for periods of between 15 and 20 years on a 'first-in, first-out' basis. The companies were also granted deductions of 100 percent of capital expenditure in the year in which the expenditure was incurred and were exempted from paying customs and excise duties or any other duty or import taxes levied on machinery and equipment. This exemption was extended to other contracting firms importing machinery for mines development. The agreements also reduced the corporation tax from the original 35 percent to 25 percent. Further, government undertook not to amend any of these tax regimes after the agreement was struck, for as much as between 15 and 20 years".[212]

The above concessions were stabilised in favour of mining companies through tax stability clauses contained in the mining development agreements. The tax stability

209 As n 206 above.
210 As n 208 above.
211 Perusal of the tax schedules annexed to the various mining development agreements signed by mining companies shows that tax concessions concentrated on relief from income tax; withholding tax; mineral royalty tax; import and excise duty; and Value Added Tax (VAT).
212 Lungu (2009) (n 1 above) at 15.

clauses, while not drafted in exactly the same language, were largely similar. In order to appreciate the nature and effect of the stability commitments made by government, it is necessary to reproduce one of the tax stability clauses here. The taxation stability clause contained in the mining development agreement[213] signed by Cyprus Amax Kansanshi Plc was couched in the following terms:

Taxation Stability

14.1 GRZ undertakes that it will not for a period commencing at the Effective Time and ending fifteen (15) years following the date the Company commences Normal Operations:

(a) increase corporate income tax or withholding tax rates applicable to the Company (or decrease allowances available to the Company in computing its liability to such taxes) from those prevailing at the date hereof; or

(b) otherwise amend the VAT and corporate tax regimes applicable to the Company including without limitation those pertaining to the carry forward of losses from those prevailing on January 1 6 , 1997; or

(c) impose new taxes or fiscal imposts on the conduct of Normal Operations,

so as to have, in each case, a material adverse effect on the Company's Distributable Profits or the dividends received by its shareholders.

GRZ further undertakes that for the same period ending fifteen (15) years following commencement of Normal Operations, it will not:

213 Clause 14 of the mining development agreement.

(d) increase:

(i) the rate of royalty, royalty base, method of calculation, or terms of payment from that in effect in accordance with section 66 of the Act, prevailing at the date hereof at a rate not to exceed three per cent. (3%) of the netback value (as "net back value" is currently defined therein); or

(ii) import duty rates (including the IDF) applicable to the Company so as to result in the weighted average import duty rate (inclusive of the IDF) to which the Company is subject on the import of goods and materials required for Normal Operation and which would, at the date hereof, be exempt from customs and excise duties under Section 97(l) of the Act, above the level of .five per cent (5%); or

(iii) import duty rates (including the IDF) applicable to the Company so as to result in the weighted average import duty rate (inclusive of the IDF) to which the Company is subject on the import of goods and materials required for Normal Operation and which do not fall under Clause 14.1 (d)(ii), above the level of twenty per cent (20%); or

(iv) the rural electrification levy applicable to the company’s purchases of power from the level applicable on the date hereof; or

(e) impose other royalties or duties on Normal Operations,

so as to have a material adverse effect on the Company's Distributable Profits or the dividends received by its shareholders.

14.2 Upon expiry of the period specified in Clause 14.1, GRZ shall, in any event, ensure that no law, statute, regulation or enactment shall be passed or made which would discriminate against the Company in respect of any such matters as are referred to in Clause 14.1 or otherwise in its conduct of Normal Operations or any other circumstances under this Agreement when compared to other mining companies or joint ventures conducting similar operations on a scale equivalent to those conducted by the Company in Zambia provided that GRZ will be at liberty to pass or make my such law, structure, regulation or enactment to enable the performance or amendment of a development agreement entered into by it and another mining company or joint venture prior to the expiry of such period.

14.3 GRZ covenants to reimburse the Company (or, at its option, make offsetting changes in any law, statute, regulation or enactment applicable to the Company) to ensure t h e Company is fully and fairly compensated for any loss, damages, or costs incurred by it by reason of a failure by GRZ to comply with the provisions of Clauses 14.1 and 14.2.

4.3.1 The arbitration, governing law and renegotiation clauses in the agreements

The above reproduced provisions on tax stability commitments were reinforced by the provisions of arbitration and governing law clauses. A typical arbitration clause provided in very mandatory terms that any dispute, disagreement, controversy or claim arising out of or relating to the agreement, including the interpretation or performance of the provisions of the agreement or the breach, termination or validity of the agreement would be referred to and finally resolved by arbitration.[214] On the other hand, a typical governing law clause provided that the mining development agreement shall be governed by and construed in accordance with the laws of Zambia as supplemented by relevant rules of international law.[215]

The agreements also contained a renegotiation clause. Otherwise styled as a variation clause, the renegotiation clause permitted parties to add to, substitute for, cancel or vary all or any of the provisions of the agreement.[216]

4.4 The mining fiscal regime introduced in the year 2008

As mentioned earlier, tax concessions contained in the cancelled mining development agreements were negotiated against the backdrop of low copper prices on international metal markets.[217] Most mining development agreements were signed at a time when copper prices were below US$2,000.00. By 2007, however, copper prices on world metal markets had risen from an average of US$ 1, 714 per tonne in 2001 to US$6, 893 per tonne, an increase of over 400 percent.[218] This unprecedented rise in world copper prices resulted in "loud calls on the government to renegotiate the agreements"[219] in order to enable the country maximise its benefits from the booming copper prices. The

214 See clause 19.1 of the mining development agreements for Chibuluma Mines Plc; Chambishi Metals Plc; and NFC Africa Mining Plc. For Cyprus Amax Kansanshi Plc; Konkola Copper Mines Plc; and Mopani Copper Mines Plc, see clauses 18, 21 and 22 respectively.

215 See clause 20.1 of the mining development agreements for Chibuluma Mines Plc; Chambishi Metals Plc; and NFC Africa Mining Plc. For Cyprus Amax Kansanshi Plc; Konkola Copper Mines Plc; and Mopani Copper Mines Plc, see clauses 19, 24 and 25 respectively.

216 See clause 22.1 of the mining development agreements for Chibuluma Mines Plc; Chambishi Metals Plc; NFC Africa Mining Plc; and Cyprus Amax Kansanshi Plc. For Konkola Copper Mines Plc and Mopani Copper Mines Plc, see clauses 26 and 27 respectively.

217 Mwanawasa (n 1 above); Lungu (2008) (n 1 above) at 409.

218 Mwanawasa (n 1 above); Lungu (2008) (n 1 above) at 409. At the time of writing this paper, the price of copper on world metal markets was still above US$ 7, 500 per tonne.

219 Mwanawasa (n 1 above).

calls were made by several stakeholders including opposition political parties and civil society organisations.[220] The World Bank also joined the calls.[221]

The increasing pressure on government to renegotiate the mining development agreements was acknowledged by then Republican President Dr Levy Patrick Mwanawasa, SC, in his 2008 Speech to the National Assembly. In the speech, the President informed the nation that his government had received a report from a special team of experts appointed to study the issue in great detail[222] and that based on the findings of the team; his government had concluded that "the development agreements in their present form and in the current circumstances are unfair and unbalanced".[223] The President also announced that because "the development agreements no longer meet their stated purpose of providing maximum benefits to the Zambian people and an appropriate return to the mining companies"[224], his government had "decided to put in place a new fiscal and regulatory framework for the mining sector"[225].

Both the new regulatory framework and the new fiscal regime entered into force on 1st April, 2008. The new regulatory framework was contained in the Mines and Minerals Development Act No. 7 of 2008, which repealed and replaced the Mines and Minerals Act of 1995. Section 160(1) of the new Act was unambiguous in its declaration that "any development agreement which is in existence before the commencement of this Act shall, notwithstanding any provision to the contrary contained in any law or in the development agreement, cease to be binding on the Republic from the commencement of this Act".

220 Lungu (2009) (n 1 above) at 18-19; see also Mwanawasa (n 1 above).
221 Lungu (2009) (n 1 above) at 18; see also 'World Bank official advises Zambia to re-negotiate mining agreements' *People's Daily Online* 29 March 2007 1 http://english.peopledaily.com.cn/200703/29/eng20070329-362023.html (accessed on 21 July 2009).
222 Mwanawasa (n 1 above).
223 As above.
224 As above.
225 As above.

On the other hand, the new mining fiscal regime[226] included:

(a) an increase of corporate tax from 25 per cent to 30 per cent;

(b) an increase of mineral royalty tax from 0.6 per cent to 3 per cent (this time on gross value rather than on net back value);

(c) an introduction of withholding tax on interest, royalties, management fees and payments to affiliates or sub-contractors in the mining sector at 15 per cent;

(d) an introduction of a variable profit tax of up to 15 per cent on taxable income which is above 8 per cent of gross income;

(e) an introduction of a windfall tax to be triggered at different price levels for different base metals. For copper, the windfall tax will be 25 per cent when the copper price is between $2.50 to $3.00 per pound or $2,500 to $3,000 per tonne; 50 per cent when the price is

226 As above. It must be noted that in the same speech, President Mwanawasa made another very important policy announcement which is yet to be implemented. He announced that the Zambian Government would no longer sign special agreements with investors in the mining sector and eventually with investors in all sectors of the country's economy because government would soon incorporate into relevant fiscal laws all the incentives intended for investors. At the time of the announcement in 2008, section 17 (j) of the Zambia Development Agency Act No. 11 of 2006 permitted the Board of the Zambia Development Agency (ZDA) to promote private investment by "endeavouring to conclude investment promotion and Protection agreements with prospective investors". Following the announcement, section 17 (j) of the Zambia Development Agency Act would, under normal circumstances, have been amended to reflect the new government policy as announced by President Mwanawasa. To date, however, the section has remained unchanged. The implication is that any investor in the mining sector who has been granted an investment licence under the provisions of the Zambia Development Agency Act qualifies to negotiate an investment promotion and protection agreement with the Zambia Development Agency Board. Needless to mention, this means that investors in the mining sector may still secure several incentives through investment promotion and protection agreements. This possibility is reinforced by section 58 of the same Act which permits the Minister responsible for Finance, for purposes of promoting major investment in an identified sector or product, to specify additional incentives for the investor.

between $3.00 and $3.50 and 75 per cent when the price exceeds $3.50;

(f) the separation of hedging income from mining activity for tax purposes; and

(g) the reduction of capital allowances from 100 per cent to 25 per cent. Government also proposed to ring fence capital expenditures for new projects. These will only become deductible when the projects start production.

The reference price on which these taxes would be based would be the price tenable at the London Metal exchange, Metal Bulletin or any other metal exchange market recognised by the Commissioner General of taxes.[227]

For government, these new tax measures would ensure that "the nation received a fair return from its resources while maintaining a globally competitive mining industry"[228] at 47% effective tax rate.[229]

At this point, it is worth observing that, like Zambia, there are several countries which have previously introduced measures aimed at benefiting more from their mineral or energy resources in the midst of increasing mineral or energy prices on international markets. For example, in the wake of ever-rising energy prices in early and mid 2000s, Bolivia, Ecuador and Venezuela claimed a right to a greater share in the profits of their natural resources.[230] The claim paved way for the introduction of new tax measures requiring investors to pay higher taxes. In some instances, the investors' private property was actually nationalised. Thus, apart from enacting the Hydrocarbon Law (3058) in May 2005 requiring investors to alter their contracts and pay greater revenue taxes, the Bolivian government issued a Supreme Decree in May 2006 nationalising the

227 See 2008 National Budget Speech (n 21 above) at 20.
228 As above at 19 – 20.
229 Mwanawasa (n 1 above).
230 Maniruzzaman (n 87 above) at 84.

hydrocarbon sector.[231] The nationalisation raised government's share of the sales from 50% to 82% from the biggest fields.[232]

Similarly, the government of the Republic of Ecuador reformed its Hydrocarbon Law in April 2006 introducing a requirement that foreign oil companies must pay to the state 50% of their "extraordinary income".[233] With the electoral win of President Rafael Correa, the percentage of the extraordinary income payable to the state was increased to 99% by a decree.[234]

On its part, the Venezuelan government announced in early 2006 the mandatory conversion of the Orinoco Belt association agreements and risk profit-sharing agreements into jointly owned enterprises with Petroleos de Venezuela, S.A. ("PDVSA"), Venezuela's state-owned company.[235]

Some developed countries with investors in their oil and gas sector also sought to benefit more from the rising energy prices of the early and mid 2000s. In December 2005, the British government retrospectively increased the rate of tax for oil and gas producing companies in the North Sea to 50%.[236] And in Canada, Alberta's Finance Minister ordered a complete review of Alberta's royalty and tax regimes with the goal of ensuring that Albertans received a fair share from the energy development through royalties, taxes, and fees.[237] The order was issued in 2007.

4.5 Reason for government's unilateral action

It will be recalled that the cancelled mining development agreements contained a renegotiation clause. The renegotiation clause permitted parties to add to, substitute for, cancel or vary all or any of the provisions of the agreement. Thus, it provided a window of opportunity for government and the mining companies to renegotiate the mining

231 As above.
232 As above.
233 Maniruzzaman (n 87 above) at 85.
234 As above.
235 Maniruzzaman (n 87 above) at 96.
236 As above.
237 As above.

development agreements for the mutual benefit of both parties. Yet government chose the route of unilateral action. Why?

According to the then Minister of Mines and Minerals Development Dr Kalombo Mwansa, government unilaterally cancelled the mining development agreements because “none of the mines were willing to renegotiate because they never responded to our correspondence”[238].

But according to the Chamber of Mines of Zambia General Manager Mr. Fredrick Bantubonse, all mining companies had accepted government’s request to renegotiate the mining development agreements and they were therefore “surprised when Minister of Finance and National Planning, Ng'andu Magande, during his Budget address in Parliament announced new tax measures for the mining companies as they were still waiting for the committee to invite them to the negotiating table”[239].

Needless to mention, the above cited conflicting statements from government and the mining industry makes it practically impossible to discern who is telling the truth between the two sides. What is certain, however, is the fact that the presence of a renegotiation clause in the cancelled mining development agreements entailed an obligation on the part of the Zambian government to invite mining companies to renegotiate the agreements and, simultaneously, a corresponding obligation on the part of the mining companies to acquiesce and renegotiate in good faith.[240] Under normal circumstances, government could resort to unilateral action only when all the efforts of renegotiation had failed to yield positive results.[241]

4.6 The response of mining companies to the 2008 fiscal regime

In their response to the newly announced mining fiscal regime, most mining companies made it very clear that they were not, at least in principle, against the idea of government increasing taxes. That most mining companies were not necessarily

238 See ‘Mining companies face taxing problem’ (n 16 above) at 3.
239 See “Zambia: Mines reject tax regime” (n 24 above).
240 Maniruzzaman (n 38 above) (2005 – 2006) at 163.
241 As above.

against the idea of government introducing new changes to the mining fiscal regime was clear in the counter proposals which the companies made, through the Zambia Chamber of Mines, to the expanded Parliamentary Committee on Estimates and Revenues.[242]

The counter proposals which were made by the mining companies have been aptly summarised by Professor John Lungu. According to him, mining companies

> "stated that while they were agreeable to the royalty rate being raised to 3 per cent it must be graduated from 1 to 3 per cent. How this was going to be applied has not been explained. The mining companies also objected to the 15 per cent windfall tax in preference for 12.5 per cent. They also made it very clear to the parliamentary committee on estimates and revenue that they would only accept the introduction of a windfall and a variable tax and not both. They further objected to the reduced capital allowance in preference for the status quo. This they said would maintain the viability of mining investments and also maintain the ability of the companies to fund further investments".[243]

In their individual arguments against the new tax regime, seven[244] major mining companies advanced mainly two reasons. Firstly, they argued that the new tax measures could not apply to mining companies that had signed mining development agreements with government because the agreements were still binding on the Republic of Zambia.[245] Secondly, they contended that the new tax regime would make mining financially unsustainable in the country.[246]

Konkola Copper Mines Plc argued that the new tax regime was detrimental and jeopadised the company's ability to generate surpluses and raise funds for infusion

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242 Lungu (2008) (n 1 above) at 411.
243 As above.
244 These were Mopani Copper Mines Plc; Konkola Copper Mines Plc; Chibuluma Mines Plc; Lumwana Mines, Cyprus Amax Kansanshi Mines Plc; Luanshya Copper Mines Plc; and NFC Africa Mines Plc. See "Zambia: Mines reject tax regime" (n 24 above).
245 "Zambia: Mines reject tax regime" (n 24 above).
246 As above.

towards the growth and extension of the mine's life.[247] According to the company's operations manager, the new tax regime was "contrary to the fundamental requirement for sustainable development and growth of the copper mining industry, which had passed through a decline phase and is now in the phase of recovery".[248]

Chibuluma Mines Plc argued that the investment made by the key shareholders, Metorex, would not be recouped and that there would be no dividends to Metorex and ZCCM-IH.[249] The company's general manager called for an independent review of the proposed tax changes on the viability of mines noting that as a result of the proposed tax changes, the taxation rate for the company was going to increase from 22% to 50% over the life of the mine.[250]

For Cyprus Amax Kansanshi Plc, the argument was that the company would have problems with the shareholders if government went ahead to implement the proposed 2008 tax regime.[251] The company warned that government would be liable for any costs incurred by the company in complying with the new tax regime.[252]

On its part, Mopani Copper Mines Plc (MCM) contended that the new tax regime had the potential to destabilise the company's long-term plans of expansion and recapitalisation while Lumwana Mines argued that the company expected government to respect the binding nature of the mining development agreement between government and the company because the agreement "formed a key project document" and further that the fiscal incentives granted to the company "formed the basis of the financial model".

Not surprisingly, the Chamber of Mines of Zambia agreed with the arguments advanced by individual mining companies. In the words of the Chamber's General Manager, Mr. Fredrick Bantubonse, the new tax regime was "too severe and it might

247 As above.
248 As above.
249 As above.
250 As above.
251 As above.
252 As above.

trigger economic recession, with obvious consequences being unemployment and poverty…"[253] Mr. Bantubonse further claimed that according to the information obtained by the Chamber of Mines from tax experts, the new tax measures would result in an effective tax rate of 79% and not 47% as claimed by government.[254]

The unavoidable conclusion one draws from the arguments of mining companies as outlined above is that as far as the companies were concerned, the new tax measures would result in total collapse of the mining sector in the country. And if the argument of Chibuluma Mines Plc is anything to go by (i.e. that the new tax measures would mean that the investment made by the company's key shareholders would not be recouped and that there would be no dividends to paid to the shareholders), one would be justified to also conclude that the new tax measures would result in "a material adverse effect on the Company's distributable profits or the dividends received by the company's shareholders".

But such a conclusion seems avoidable for at least three reasons. Firstly and as already stated above, most mining companies were not, at least in principle, against the move by government to introduce a new mining fiscal regime considering the unprecedented rise in copper prices. It is the manner in which government proceeded to effect the changes that raised concern among some companies; they wanted government to consult them before effecting the new tax changes as required by the mining development agreements they signed with government.[255]

Secondly, when one considers the counter proposals made by mining companies as against the tax measures announced by government, one comes to the conclusion that government's announced measures were not completely outrageous, particularly given the fact that it is natural for every tax payer to want to continue paying as little tax as possible. Indeed, it would be naive for one to expect that the mining companies,

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253 'Mining companies face taxing problem' (n 16 above).
254 As above.
255 This was made clear by Cyprus Amax Kansanshi Plc. See "Zambia: Mines reject tax regime" (n 24 above).

whose only real motive is to make as much profit as they possibly can, would publicly admit that the new tax measures announced by government were fair. The reason is that by its very nature, any form of tax increase results in decreased profits for companies.

The conclusion that the new tax measures introduced by government were not completely outrageous is supported by the statement that is attributed to Mr. Kevin van Niekerk, Vice President of Equinox Minerals (EQN-T) (the developers of Lumwana copper mine). He is quoted as having said that "one needs to remember that what the government is asking for is not unrealistic, according to current mining tax standards. With current copper price, the companies currently mining in Zambia are benefiting quite greatly…."[256]

Thirdly, Konkola Copper Mines Plc, despite its arguments as highlighted above, publicly stated that it would comply with the new tax measures as announced by government.[257]

Thus, it would appear, based on the counter proposals made by mining companies and the observations of Mr. Kevin Niekerk as quoted above, that any claim that the 2008 mining fiscal measures resulted in "a material adverse effect" on the distributable profits of the mining companies or the dividends of the shareholders of the companies would be an exaggeration of the impact that the new fiscal regime had on mining companies. One would even go further and argue that government was, in the circumstances, justified in going ahead to enact the proposed fiscal changes into law despite the opposition from mining companies.

4.7 The 2009 amendment: eliminating the justification for compensation

The global financial crisis that affected the world in the last quarter of 2008 did not spare mining companies operating in Zambia. The fall in copper prices from an unprecedented

256 "Zambian president proposes increased mining taxes", *SARWATCH* 19 July 2009 2, http://www.sarwatch.org/component/content/article/206-zambian-president-proposes-increased-mining-taxes (accessed on 19 July 2009).

257 Lungu (2008) (n 1 above) at 411.

US$8, 500 high per tonne to below US$3,500 per tonne resulted in serious operational difficulties for most of the mining companies operating in the country.[258] Consequently, some mining companies scaled down their operations while others were put on care and maintenance. This resulted in about 12 000 jobs being lost in the country's mining sector.[259]

Concerned about the continued loss of jobs in the mining sector, government decided to help mining companies reduce their operational costs in the 2009 fiscal year. This was done by revisiting some aspects of the 2008 mining fiscal regime. In particular, government decided to (a) remove the windfall tax and retain only the variable profit tax; (b) allow hedging income to be a part of mining income for tax purposes; and (c) increase capital allowance to 100 %.[260] In addition to these measures, government decided to reduce customs duty on Heavy Fuel Oil from 30 % to 15 % and to remove customs duty on copper powder, copper flakes and copper blisters.[261] Further, copper and cobalt concentrates were included on the import deferment scheme for VAT purposes.[262]

Thus, the 2008 fiscal regime, as amended in 2009, effectively gave the mining companies the tax regime they wanted through their counter proposals to the expanded Parliamentary Committee on Estimates and Revenues in 2008.[263]

With copper prices recovering to over US$7, 500 per tonne since the last half of the 2009, some stakeholders have been calling on government to reintroduce the scrapped windfall tax.[264] But mining companies have vehemently opposed the reintroduction of the windfall tax warning that the move could plant uncertainty in future

258 See the 2008 National Budget Speech (n 21 above) at 22.
259 See Green (n 29 above).
260 All these measures were announced in the 2009 National Budget Speech. See (n 21 above) at 22.
261 As above.
262 As above.
263 See (n 24 above).
264 "Mining companies reject windfall tax" *Business Post* 26 January, 2010 at III.

investments in the mining sector.[265] The mining companies have stated that while they "were benefiting from the current high metal prices on the international market, they had been hurt by production costs which had surged in tandem with the price recovery".[266]

But is it true that the production costs have surged in tandem with the price recovery of copper as claimed by mining companies? Available information suggests that the claim by mining companies that production costs have surged in tandem with the price recovery of copper is highly questionable. It is questionable because according to Craig Williams, the President and Chief Executive Officer of Equinox Minerals (the owners of Lumwana Mine), the operating costs of Lumwana Mine for the period 1st April 2009 to 31st December 2009 "averaged US$1.49 per pound of copper".[267] During the same period of just nine (09) months, Lumwana Mine recorded a net profit of USS195.7 million.[268]

Meanwhile, First Quantum's net earnings rose from $4.6 million in 2003 to $152.8 million in 2005 while the operating profit for Konkola Copper Mines increased from $52.7 million in the year 2005 to $206.3 million in the year 2006.[269]

Granted, the operating costs for mining companies can never be the same because the companies use different technologies and methods of mining. But going by the operating costs disclosed in relation to Lumwana Mine, it would be an exaggeration for any mining company to claim that its operating costs exceeded US$3.00 during the same period.

It is also common knowledge that despite the price of copper having slumped in the first and second quarters of 2009, the price has since recovered to levels well above US$7, 500.00 for most part of the first and second quarters of 2010. The result is that mining companies have continued making very huge profits compared to the money they are contributing to the national treasury by way of taxes. The huge profits that

265 As above.
266 As above.
267 "Lumwana Mine records $195.7 m profit" The Post, 12 March, 2010 at 12.
268 As above.
269 Lungu (2008) (n 1 above) at 409.

mining companies are currently making, coupled with the profits they made between the period 2004 and 2008 before government introduced the new fiscal regime, makes it difficult to imagine how the new fiscal measures may have resulted in a "material adverse effect" on the profits of mining companies or the dividends received by shareholders of these companies. Indeed, it would be insincere for any mining company to claim that it is worse off under the current fiscal regime and price of copper than it was under the previous tax regime and price of copper below US$3.00 per pound.

Therefore, without doubt, government is entitled to counterclaim that mining companies have made 'excessive profits'. And since international arbitral tribunals have jurisdiction to consider and act on the host State's counterclaim that the investor has made "excessive profits",[270] the likelihood of government not being ordered to pay any compensation is real. In the alternative, government may be ordered to pay only nominal compensation.

But this is not to suggest that there is no possibility of government's unilateral action being condemned in damages. The reason is that there are other issues that are likely to bear on whether or not government should be ordered to pay compensation to the aggrieved mining companies. For example, the fact that Zambia has signed Bilateral Investment Agreements (BITs) with some of the home States of the aggrieved mining companies is an issue that is likely to weigh heavily on what the final decision should be.[271] The BITs incorporate certain notions which, according to one commentator, provide "the stability of contract between the host State and a foreign investor irrespective of a stabilisation clause in it, but more so when its presence in it operates as a booster".[272] The notions of fair and equal treatment; legitimate expectation; and

270 Walde and Sabahi (n 40 above) at 38 – 39.

271 For example, NFC Africa Mining Plc, a Chinese owned company, may want to take advantage of the provisions of the Bilateral Investment Agreement between Zambia and China. For more on how State's obligations in BITs relate to breach of stability commitments, See Maniruzzaman (n 38 above) (2008) at 147 – 156.

272 As above.

umbrella clauses are of particular interest in this regard because their breach attracts compensation.[273]

It must be mentioned that recent treaty arbitral jurisprudence suggests that the ‘notion of fair and equitable treatment’ must be interpreted in terms of the stability, predictability and consistency of the host State’s legal framework, among others. Thus, the tribunal in *Occidental Exploration and Production Co. v Republic of Ecuador*[274] held that ‘‘the stability of the legal and business framework is … an essential element of fair and equitable treatment’.[275] The tribunal was of the view that the law of the host State must not be amended after the investor has invested ‘in an important manner’.[276]

And in *Sempra Energy International v The Argentine Republic*[277], the tribunal remarked thus: ‘‘What counts is that in the end the stability of the law and the observance of legal obligations are assured, thereby safeguarding the very object and purpose of the protection sought by the treaty’’.[278]

Regarding the notion of legitimate expectation, the fact that government expressly undertook to “fully and fairly” compensate mining companies in the event of breach of the tax stability clauses might be interpreted as creating a legitimate expectation on the part of mining companies that they are entitled to compensation for government’s unilateral action. The possibility of such an interpretation is reinforced by the observations of the tribunal in *Parkerings- Compagniet v Republic of Lithuania*[279] wherein it was stated that “the expectation is legitimate if the investor received an explicit promise or guaranty from the host State, or if implicitly, the host State made

273 As above.
274 LCIA Case No UN3467, Final Award of 1 July 2004.
275 As above at para 183.
276 As above at para 184.
277 (Case No ARB/02/16) [28 September 2007].
278 As above at para 300.
279 ICSID Arbitration Case No ARB/05/8 (11 September 2007).

assurances or representation that the investor took into account in making the investment".[280]

Another issue that may arise is whether the new mining fiscal regime has the effect of 'creeping expropriation' or 'confiscatory taxation'.[281] If it is proved by mining companies that the new fiscal regime has a 'creeping expropriation' or 'confiscatory taxation' effect, the government is liable to compensate the mining companies. But this issue must be viewed in the context of what has already been stated in chapter 3 that the threshold for compensation for indirect expropriation is higher than the threshold for compensation for breach of a stabilisation clause. Thus, if government's liability is not established based on breach of the tax stability clauses, it is unlikely that liability can be established based on a claim that the new tax measures amount to 'creeping expropriation' or 'confiscatory expropriation'.

The implication of the foregoing is that neither government nor mining companies can be sure that the tribunal will rule in their favour if the matter is left to be decided by way of arbitration. Therefore, the best option for both the government and mining companies is to engage in discussions with a view to arriving at a mutually acceptable solution.

On its part, government has already publicly announcement that "in the spirit of dialogue and especially because of the need to attract investors in Zambia's quest for development", it has decided to engage mining companies in "extensive talks" regarding the concerns raised on "the impact that the current laws and the resultant tax measures have had on the incentives that had been tied to the development agreements".[282] The announcement has been welcomed by mining companies and it is hoped that the discussion will result in a mutually beneficial solution for both parties.

Against this backdrop, it is suggested that the starting point for "extensive talks" between government and mining companies must be for mining companies to adduce

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280 As above.

281 Walde and Sabahi (n 40 above) at 23 – 24.

282 See also "State ready to meet mining firms" *Times of Zambia* 20 January 2010 at 7.

conclusive evidence that the new tax regime under the current price of copper has resulted in a “material adverse effect” on their profits or the dividends received by their shareholders. Otherwise, the huge profits made by mining companies between 2004 (when the price of copper started rising) and 2008 when the new fiscal regime was introduced, coupled with the profits made since the recovery of the price starting from the third quarter of 2009, are more than enough to offset any expenses or losses incurred by mining companies as a result of complying with the new fiscal regime.

4.8 Conclusion

The 2009 amendment essentially gave mining companies the fiscal regime they had counter- proposed in response to the 2008 fiscal regime. With copper prices recovering to almost US$8, 000.00 per tonne since the end of the global financial crisis, there can be no doubt that mining companies are enjoying ‘excessive profits’ from their investments. These ‘excessive profits’ coupled with the huge ‘windfall profits’ made by the companies between 2004, when the price of copper started rising, and 2008 when the new fiscal regime was introduced, are more than enough to offset any expenses or losses incurred by mining companies as a result of complying with the new fiscal regime.

However, there can be no doubt that government’s decision to unilaterally cancel the mining development agreements sent a wrong message about Zambia as an investment destination. Therefore, there is need for government to reassure investors that it can still be trusted to respect the commitments it makes to foreign investors. In this regard, government’s decision to engage mining companies in discussions over the impact of the new fiscal regime on mining operations is timely and will help rebuild investor confidence in the country’s investment climate.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.1 Conclusion

This paper has shown that international arbitral tribunals are yet to pronounce themselves on the practical consequences of the host State's breach of economic equilibrium stabilisation clauses. Therefore, the very fact that the tax stability clauses contained in the mining development agreements cancelled by the Zambian government are typical economic equilibrium clauses means that neither the aggrieved mining companies nor the Zambian government can, with confidence, predict the outcome of international arbitration on the issue. In other words, there are equal chances that the Zambian government may or may not be ordered to pay compensation to the aggrieved mining companies.

That there is so far no evidence of how much the presence of a stabilisation clause contributes to the total quantum of compensation awarded for breach of a stabilisation clause should also be enough reason for the aggrieved mining companies to think twice before pursuing the route of international arbitration. The possibility that tribunals may take either a "contractual perspective" or an "expropriation perspective" to arrive at their respective decisions on the quantum of compensation[283], if liability of the Zambian government is established, implies that mining companies must be prepared to prove more than just mere breach of a stabilisation clause.

Also to be taken into account by mining companies still interested in pursuing the route of international arbitration is the fact that the tax stability commitments contained in the cancelled mining development agreements did not prohibit government from introducing new tax measures: the commitments merely prohibited government from introducing tax measures whose result is a "material adverse effect" on the financial position of the mining companies. Logically, this implies that the mere fact that

[283] Maniruzzaman (n 36 above) at 247.

government introduced a new mining fiscal regime cannot, in itself, give rise to liability for government to compensate the mining companies: government's liability can only be established by concrete evidence showing that the new mining fiscal regime has resulted in a "material adverse effect" on the distributable profits of mining companies or the dividends received by the shareholders of the companies.

Undoubtedly, however, government's unilateral cancellation of the mining development agreements cannot be said to augur well for Zambia's quest to remain as one of the attractive investment destinations in Africa and the world at large. In this regard, government's recent decision to engage mining companies in discussions over the impact of the new fiscal regime on mining operations is timely and will help rebuild investor confidence in the country's investment climate.

5.2 Recommendation

It is obvious that an amicable solution to the concerns raised by mining companies on the impact of the new mining fiscal regime is in the best interest of both the Zambian government and the mining companies themselves. This is because an amicable settlement, when compared to arbitration, will serve a lot of costs for both government and mining companies.

For government, an amicable solution will also provide a window of opportunity for reassuring investors that Zambia still stands ready to respect her commitments made to foreign investors. This kind of reassurance is necessary for government to rebuild investor confidence that Zambia is still an attractive investment destination. It is therefore recommended that the implementation of government's decision to engage mining companies in discussions over the impact of the new fiscal regime on mining operations should not be delayed.

However, the starting point for the discussions between government and mining companies must be for mining companies to adduce evidence of the negative impact, if any, that the new mining fiscal regime has had on their mining operations.

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