OFFICE OF THE UNITED NATIONS HIGH COMMISSIONER FOR HUMAN RIGHTS
SPECIAL PROCEDURES OF THE HUMAN RIGHTS COUNCIL
Mandate of the Special Representative of the Secretary-General on Human Rights and Transnational Corporations and Other Business Enterprises

STABILIZATION CLAUSES AND HUMAN RIGHTS

London, Thursday 22 May 2008

CONSULTATION SUMMARY

I. INTRODUCTION

Sub-paragraphs (a) (b) and (e) of the initial mandate given to the Special Representative of the UN Secretary-General (SRSG) on Business and Human Rights specifically required him to consider both companies' and states' roles with respect to the business and human rights debate. Sub-paragraph (a) asked the SRSG to "identify and clarify standards of corporate responsibility and accountability for transnational corporations and other business enterprises with regard to human rights." Sub-paragraph (b) asked the SRSG to "elaborate on the role of states in effectively regulating and adjudicating the role of transnational corporations and other business enterprises with regard to human rights, including through international cooperation." Sub-paragraph (e) requested him to "compile a compendium of best practices of states and transnational corporations and other business enterprises..."

In addition to other projects on the nature of state roles vis-à-vis business and human rights, the SRSG considered the possible impacts of trade and investment agreements on the ability of states to fulfill their duty to protect against business-related human rights abuses. To this end, the SRSG embarked on a joint-project with the International Finance Corporation (IFC) focusing on state contracts or host government agreements (HGAs) (those signed by private investors and host states for investment projects including extractive, infrastructure and services) and, in particular, the use of stabilization clauses in these agreements. Stabilization clauses are contractual clauses that aim to guarantee that domestic laws with respect to investments will remain unchanged. In essence, they either do not allow new laws to apply to investments or they offer compensation to investors for compliance with new laws. Concerns have been raised that such clauses limit a state's ability to effectively legislate in line with their international human rights obligations.

In deciding to embark on the joint-project on stabilization clauses, the SRSG observed that the views of stakeholders greatly differ regarding the linkages between stabilization clauses and human rights. He also observed that stakeholders have had no direct engagement on this important aspect of HGAs.

The SRSG is deeply appreciative to the IFC for funding and managing this research. He also recognizes that the IFC's involvement reflects its ongoing interest in advising private sector clients on

ways to promote investment that is consistent with principles and standards of sustainable development.

The research and its resulting report Stabilization Clauses and Human Rights (the "Report") includes a comparison of HGAs. The sample included 88 actual and model agreements. From that sample, it was observed that stabilization clauses are sometimes drafted in a manner which may exempt investors from the obligation to comply with new environmental and social laws, or which may provide investors with an opportunity to be compensated for complying with such laws. The sample of HGAs gathered for this study showed that this was more likely to be the case in HGAs from countries outside the OECD than in HGAs from OECD countries.

In his 2008 report to the Human Rights Council, the SRSG proposed a conceptual and policy framework "to anchor the business and human rights debate, and to help guide all relevant actors." The framework comprises three core principles: the state duty to protect against human rights abuses by third parties, including business; the corporate responsibility to respect human rights; and the need for greater access by victims to effective remedies. In June 2008 the Human Rights Council was unanimous in "welcoming" the policy framework. It extended the SRSG's mandate for another three years, and asked him to "operationalize" the framework in order to provide concrete guidance to states and businesses. The SRSG intends to continue work on HGAs, and more broadly on investment and trade issues, under the framework principle of the state duty to protect, though of course the issues are also relevant to the other two principles.

II. GOALS OF THE CONSULTATION

The joint research project with the IFC was designed specifically to stimulate multi-stakeholder engagement. Thus it was decided to hold consultations to discuss the findings as well as to develop a future agenda to build on those findings. The first consultation was held in London, UK. It was hosted by the law firm Clifford Chance and supported by the IFC. This will potentially be followed further regional consultations on the Report. It is envisaged that the consultation process may lead to the following outcomes:

- A set of further questions for the SRSG to consider during the next mandate period with respect to stabilization clauses and investment agreements.
- Recommendations and suggestions (including examples of existing approaches) regarding mechanisms that integrate respect for human rights and support sustainable development, while protecting investors from legitimate concerns regarding changes in law.
- Proposals for future work within the UN system, or by other international organisations and groups, in relation to stabilization clauses and human rights.

The consultation included representatives from states, corporations and civil society as well as academics and legal practitioners. Annex 1 contains a list of participants and their affiliations.

In order to encourage full and frank discussion, the consultation was held under the Chatham House rule. Accordingly, set out below is a general record of the discussion, without attribution of particular statements or proposals.

III. CONSULTATION SUMMARY

A. SRSG INTRODUCTION

SRSG John Ruggie opened the day by summarizing the creation of his mandate as an answer to a difficult impasse that had developed among government, company representatives and civil society organizations regarding business and human rights issues. He introduced a conceptual framework for moving the discussion forward and discussed how his work on stabilization clauses in investment agreements fits into the framework.

The first part of the framework is the state duty to protect from abuses by third parties, including corporations. It is often stressed that governments are the most appropriate entities to make the difficult balancing decisions required to reconcile different societal needs. But in the area of business and human rights, the SRSG questions whether governments have got the balance right. Research and consultations indicate that most governments take a narrow approach to managing the business and human rights agenda. It is often segregated within its own conceptual and (typically weak) institutional box.

Typically, human rights concerns are kept apart from, or heavily discounted in, other policy domains that shape business practices, including commercial policy, investment policy, securities regulation, and corporate governance. The human rights policies of states in relation to business need to be pushed beyond their narrow institutional confines. Governments need to ensure that human rights compliance becomes part of defining an ethical corporate culture. And they need to consider human rights impacts when they sign trade agreements and investment treaties, and when governments provide export credit or investment guarantees for overseas projects in contexts where the risk of human rights challenges is known to be high.

The framework's second component is the corporate responsibility to respect human rights—meaning, in essence, to do no harm. In addition to legal compliance, companies are subject to what is sometimes called a social license to operate—that is, prevailing social expectations. The corporate responsibility to respect human rights is the baseline expectation for all companies in all situations.

Access to remedy is the third principle. Even where institutions operate optimally, disputes over adverse human rights impacts of companies are likely to occur, and victims will seek redress. Currently, access to formal judicial systems is often most difficult where the need is greatest. And non-judicial mechanisms are seriously underdeveloped—from the company level up through national and international spheres.

HGAs and stabilization clauses are largely developed in isolation from states' obligations relative to human rights. The SRSG underscored that such instruments are directly relevant to his mandate: first and foremost because fulfilling the state duty to protect against human rights abuses requires that states don't tie their hands as a result of other commitments. Investor rights must be protected from arbitrary and discriminatory acts. But we must find ways to ensure the mutually supportive relationship of these two critical policy objectives. Stabilization clauses are also directly relevant to the company responsibility to respect, as companies should ensure the agreements they negotiate will not interfere with the enjoyment of rights and the state's ability to protect against abuse.

B. DISCUSSION OF THE REPORT AND ITS KEY FINDINGS

Some key findings of the Report were presented and participants were given the opportunity to comment on these findings and the Report in general. It was noted by way of introduction that stabilisation clauses are a commonly used contractual mechanism for managing "change in law risk" associated with foreign investment. These clauses are prevalent in long term investments in the natural resources sector and also in fixed tariff sectors such as water, power and transport. One participant noted that the Report's finding of a strong regional split in how HGAs are designed with respect to regulatory change between OECD and non-OECD states was consistent with another international organisation's experience of cross-border investment projects.

It was mentioned that the European Commission had expressed reservations about including stabilisation clauses in HGAs in light of the Commission's concern to ensure member states are not hindered in any way from implementing EU laws.

It was noted that the Report did not seek to assess actual human rights impacts of stabilization clauses or HGAs. Instead it looked at what potential obstacles the text of agreements might pose to states fulfilling the duty to protect. A number of participants questioned whether there was a need for further research into actual human rights impacts in light of the Report's findings.

It was suggested that a focus on stabilization clauses could ignore other issues impacting the state duty to protect, such as the re-writing of national laws in order to attract foreign investors. Additionally, a comment was made that in order to understand the different approaches to protecting investors from change in law risk it is necessary to look at the market in which an investment is made; for example, in the context of a public utility privatisation programme in a liberalised market the burden of new regulation will typically be shared between investors and ultimately with consumers.

Overall, participants agreed that the Report provides a useful snapshot of current practice. Additionally, the Report was welcomed as a catalyst for multi-stakeholder dialogue regarding the integration of respect for human rights, and also sustainable development principles, into HGAs. However, it was also emphasized that stabilization clauses are only one part of the picture and that the surrounding context is extremely relevant. One participant was concerned that the Report could be difficult to interpret accurately unless more is known about the projects for which the clauses were drafted. For instance, in order to assess possible human rights impacts, it would be important to know the contracting parties, the details of the project and the specifics of the market for which the host government agreement was negotiated, including the specific regulatory context. In this connection it was noted that the HGAs used in the study were provided by the IFC and a number of international law firms and also that many of the HGAs had been provided on condition that they remain confidential. It was also noted that the HGAs reviewed for the purposes of the study, while they represent a useful cross-section of drafting practice, may not be a representative sample.

There was broad interest in furthering consultation and advancing work on the issue as the SRSG continues his work.

C. ROUNDTABLE DISCUSSION

Participants next engaged in a roundtable discussion on differing interests with respect to stabilization clauses. The interest of investors in legal stability was emphasised, as were the interests of governments and civil society (particularly in the developing world) in preserving adequate legislative discretion to facilitate legal reform and sustainable development.

In the afternoon the participants discussed how these interests can be served while ensuring respect for the human rights obligations of host states. Lastly, the participants offered recommendations for further work that might be undertaken by the SRSG.

The different perspectives discussed can be summarized as follows:

- Stabilization and human rights is only one aspect of understanding the contractual issues in relation to broader sustainable development (social, environmental and economic) issues.

- Ensuring stabilization does not interfere with the state duty to protect human rights requires understanding stabilization in relation to other provisions in HGAs, the project context and the wider legal context.

- It is appropriate for a private investment agreement to protect against non-bona fide or arbitrary and discriminatory government conduct, but the nub of the issue is how to deal with legitimate and bona fide measures that may have a financial impact on the investor.

- It appears that there is a class of extreme clauses still in effect, and still being drafted, that should be eliminated from practice. A widespread consensus was expressed against the use of "freezing clauses" (those clauses that provide an outright exemption from new laws passed in the host state) which were objected to on various grounds including that they are in fact, unlikely to be enforceable.

- It is worth exploring whether a stabilization clause which prohibited discriminatory and arbitrary changes in law but which expressly recognised the possibility that laws would change throughout the life of the project would be broadly acceptable to investors.

- It was suggested by several participants that sustainable development should be the lens through which stabilization clauses, and indeed HGAs, are analysed. This would require looking at the negotiation process, including issues regarding transparency, access to information and the specific content of the agreement including the role played by domestic and international laws in respect of a particular project. A number of participants expressed the opinion that the drafting of stabilization clauses should not only take account of economic, social and environmental issues but must remain flexible enough to allow the host government to fufill current and future obligations under international law.

- Although it was acknowledged that environmental and social laws might have an economic impact on an investment, it was also agreed that protection against extreme fiscal changes is a legitimate concern for investors and so a tool is needed to deal with this different risk.

- It was suggested by several participants that the role of donors could be important in terms of shaping the drafting practice of HGAs.

- A discussion took place as to whether the debate was best framed in terms of "changes in law as investor *risk*" or "changes in law as investor *cost*". It was noted that investors and funders approach the change in law issue as a "risk".

- The role of the investor's legal advisors was also discussed, including the intersect between drafting stabilization clauses and lawyers' professional ethics. There was general agreement

that lawyers could contribute positively to the development of risk management processes that were sensitive to human rights.

- It was noted that the clause's principal purpose is a negotiating tool and that its major use is in informal negotiations with the host government to minimize the financial impact of new laws on the investment. It was suggested that investors were unlikely to use arbitration or other formal procedures to oppose sensible, bona fide and non-discriminatory improvements in the laws of the host country (whether fiscal, environmental, social or otherwise). The "tipping point" at which an investor would take steps to formally enforce a stabilisation clause was a high because of the costs involved and the wish of many investors to remain on good terms with the host government.

- There was concern expressed about host countries legislating by contract (creating special rules for individual investors in the host government agreement itself). There seemed to be some agreement that this could pose both administrative and legal difficulties for investors as well as for states. In particular, it was noted that in certain states where new legislative frameworks were adopted in haste the result can be incomplete or ineffective legislation. However, it was also argued that certain types of investments required legislation that did not yet exist in the host state.

- There was concern expressed about using the word "balancing", as some felt it inappropriate when discussing the competing interests of investors and host state human rights duties. They suggested that human rights duties should not be "balanced" against investor interests but instead investor and state needs must be secondary to human rights requirements.

- There was broad acknowledgement that there is sometimes an imbalance in negotiating strength between investors and governments that can make it difficult to negotiate fair HGAs, with investors generally in the stronger bargaining position.

- There was considerable interest in proposals to draft stabilisation clauses in ways that would allow governments to implement new environmental and social laws affecting the project. It was left open what might be the appropriate benchmarks that would allow proper regulation of projects while providing investors with adequate reassurance.

D. PROPOSALS FOR ADDITIONAL RESEARCH AND INITIATIVES INCLUDED:

Participants made the following proposals for additional research and initiatives on the link between host government agreements and the protection of human rights under the SRSG's extended mandate.

1. CONTINUE TO RAISE AWARENESS AND FOSTER DISCUSSION:

- Continue consultations, in particular in regions outside the OECD.

2. LEARN MORE ABOUT IMPACTS OF STABILIZATION AND HGAS WITH RESPECT TO HUMAN RIGHTS AND SUSTAINABLE DEVELOPMENT:

- Research to integrate the issue of special economic zones and how stabilisation works either inside the context of HGAs or in these zones generally.

- Research on the links between stabilization clauses and bi-lateral and regional investment treaties.

- Research to look at state-owned enterprises (SOEs) and their HGAs specifically.

- Research on transparency, including whether HGAs are generally confidential; the actors that make host government agreement transparency possible and capacity building for both investors and host states.

- Research on HGAs not covered by stabilization clauses in order to better understand how companies have faired when new legislation is proposed.

- Research the historical and current democratic oversight of these agreements, what is the access to compensation for people negatively impacted by projects, can clauses be challenged by ordinary citizens and if so, in what ways?

- Research the differences between stabilisation clauses across different markets within a state or region. Do stabilisation clauses differ according to the market and the investment, or according to the perceived risk to the investor in that particular state regardless of market practice?

- Research into the different bargaining strengths and elements within the context of negotiation of investment agreement, including perceptions from investors about the host state's risks, the host state's desire to attract investment, competition from other host states, the investment's expected benefit, the role played by the parties' professional advisors, and the broader implications of the specific investment in the host state and how this is seen in the global market.

3. MOVE TOWARDS SOLUTIONS:

- Look to improve the "enabling environment" for "good" HGAs, in particular consider the effect of corruption, lack of transparency and non-competitive tendering and procurement process on the eventual form of HGAs.

- Foster better practice by doing comparative research on existing models of HGAs and national and international laws and policies regarding contractual mechanisms for dealing with change in law risk.

- Fashion better tools for risk management by researching case law, and money damages and also the issue of regulatory certainty.

- Broaden understanding of investment agreements in context. Use a sustainable development perspective to move the agenda forward looking at economic, environmental and social aspects of investment agreements, not just stabilization, but other clauses and issues that directly impact rights and sustainable development.

- Explore incentives for good HGAs such as the Equator Principles and applying human rights standards with financial incentives. At the same time put together training in host states to build capacity for negotiating HGAs.

- Explore opportunities to develop model clauses and edit existing models to integrate a human rights and sustainable development perspective into the models.

- Explore opportunities for capacity building in developing countries including amongst negotiators, lawyers and civil society.

IV. Next Steps

Dialogue on stabilization and human rights will now continue in regional consultations planned tentatively for Africa, Latin America and the USA. The comments and suggestions are contributing to the ongoing planning of the program of work for the SRSG over the next three years. Consultation on the Report will be finalised in the first quarter of 2009. The next stages of work on investment and human rights and specifically on stabilization will emerge in part from these consultations and will be described in a consultation report released in the first quarter of 2009.

ANNEX 1 - CONSULTATION PARTICIPANTS

Motoko Aizawa, International Financial Corporation

Abayomi Akinjide, Association of International Petroleum Negotiators

Lucy Baker, Bretton Woods Project

Nathalie Bernasconi, Center for International Environmental Law

Chester Brown, UK Foreign and Commonwealth Office

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ANNEX 2 – AGENDA

9:30 - 10:00 Registration

10:00 - 10:15 Welcome - Professor John Ruggie, Special Representative of the Secretary General on Business and Human Rights

10:15 - 11:00 Presentation of the Research - Andrea Shemberg, Legal Advisor to the SRSG and author of the Report on Stabilization Clauses and Human Rights

questions and/or comment on the Report and the research.

11:00 - 11:15 Tea & Coffee

11:15 - 11:30 Moderator's Introduction - Gerald Pachoud, Special Advisor to the SRSG

11:30 - 13:00 Roundtable Discussion

- Change in law as risk - why do investors need stabilization clauses?
- Can stabilization clauses in investment agreements be inconsistent with the state's duty to protect? What risks might they pose?
- How do principles of sustainable development inform this discussion?
- The perception of risk - why do governments offer legal stability to foreign investors?
- The risk of a "one size fits all" approach - how does the approach to change in law risks differ across jurisdictions and across sectors?

13:00 - 14:00 Lunch

14:00 - 15:15 Roundtable Discussion

- How can the different interests be balanced with the state duty to protect – and what does best practice look like?
- What opportunities are there to shape practice in future, and which actors can help to improve practice?

15:15 - 15:30 Tea & Coffee

15:30 - 16:30 Roundtable Discussion

- Developing recommendations for future steps that might be taken to build on the Report and the day's discussion