

# Commercial contracts in international oil and gas industry



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This paper aims to address the issues associated with long term petroleum contracts concluded between the state and international oil companies in terms of the political risks investors tend to face in such contracts as well as the risk of change of circumstances brought about not by the act of the parties but rather by the time. In doing so, the efficiency of both stabilization and renegotiation clauses, as means of mitigating these mentioned risks, are critically examined. It argues that stabilization clauses are highly problematic with regard to their validity and effect as they would normally conflict with the very well established principle of international law of state sovereignty, also these clauses are limited only to the change of regulatory framework and does not take into consideration the effect of change of other circumstances which may have a considerable impact on the parties' obligations. Whereas, renegotiation clauses can be useful to reduce the impact of changes not only the legal framework of the host state but also other circumstances which are beyond the control of the parties should proper and clear mechanisms and criteria for implementing these clauses be provided for within the clause.

It is widely recognized that regulatory stability of any given state is an essential element of promoting and encouraging investment in general and to attract and secure the confidence of potential foreign investors in particular.[1] This is certainly the case for energy projects where investors are vulnerable to wide variety of risks throughout the project's life, given the long duration and the capital intensive characters of these projects. In addition, the vurnability of petroleum contracts to the change of circumstances, which may be beyond their control such as price fluctuation

in the international energy market, can make the contractual arrangement that was once profitable becoming highly undesirable a few years later.[2]

Not to mention the very fact that one of the parties of these contracts is state or its agency may well raise the investors concerns that the contractual arrangements once have been secured at the time of negotiating can be disregarded by unilateral state's act later.

Therefore, it has been the tendency of oil and gas investors to seek protection against these risks by providing for legal mechanism in the contract in order to mitigate their impact throughout the project period.

These legal mechanisms tend to be in the form of stability guarantees offered by the state, either stabilization clauses or renegotiation clauses, as well as providing for arbitration to be the manner of dispute resolution.

However, while the latter has become a stable and widely recognized clause aiming to ensure the netiaulty and fairness of resolving disputes arising between the states and IOCs, the former has generated much concern over their legal validity and effect, simply because of the fact that the main objective of these clauses is to fetter the state's right to legislate and regulate for reasonably long period of time.

It is the aim of the second chapter to critically analyze the different views given to stabilization clauses in scholars' writing and the relevant arbitration awards in terms of their legal validity under both national and international law and the extent to which these clauses can prevent the state from exercising its sovereign power within its territory. Arguing that the sharp divide among scholars and arbitrators in this regard proves the insufficient and uncertain nature of these clauses, which in turns makes the capability of <https://assignbuster.com/commercial-contracts-in-international-oil-and-gas-industry/>

these clauses to provide absolute protection to oil and gas investor questionable.

Chapter three goes on to further affirm the conclusion reached in the second chapter through using the example of the Russian petroleum experiment, where the existence of stabilization clauses led to decreasing cooperation between the state and the industry and resulted in disrupting the parties' relationship as the petroleum activities went on, given the fact that the Russian Petroleum Law concerned only encouraging the exploration activities while lifting many essential aspects unregulated with the view that if the oil was to be found, new legislation would be enacted. It is from this chapter where this paper comes to the conclusion that not only does stabilization clauses conflict with the principle of state sovereignty and may well be held invalid as a result, but also these clauses have appeared to be inconsistent with the parties needs to flexible mechanism in order to mitigate the risk of changes of circumstances brought about by time rather than parties acts.

Finally, chapter four aims to advocate the recent trend of inserting renegotiation clauses into oil and gas contracts as the proper manner to mitigate not only the political risk of state behavior but also other commercial risks associated with petroleum projects, which in the latter case even the host state can enjoy the protection offered by this device. On the other hand, this chapter also recognizes the fact that renegotiation clause may be too flexible, and thus run the risk of the contract being open-ending. Therefore, this chapter argues that the success of this clause depends, to very large extent, on the specific drafting agreed by the parties and whether

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a clear mechanism and guidance have been provided to address potential disputes.

Thus, this paper argues that the state's right to legislate and to regulate should not be subject to negotiation, nor to be used as an incentive for the purpose of attracting investment as such commitment is difficult to be fulfilled in the long term. Furthermore, stabilization clauses have proved to be inefficient and difficult to predict as well as inconsistent with the parties needs in such a long term contract. Whereas, renegotiation clauses can achieve the parties' aims and objectives of sustaining the agreed contractual arrangements and encouraging cooperation needed in long term contracts through flexible legal mechanisms.

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