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**Research Report**

## Beware of freezing clauses in international investment agreements

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## **Columbia FDI Perspectives**

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### **Beware of freezing clauses in international investment agreements**

by

Tarcisio Gazzini \*

One of the main reasons for the growing discontent with international investment agreements (IIAs) is the perception that undue restrictions are being placed on the regulatory powers of governments. Indeed, adequate protection of regulatory powers has been a key feature of initiatives aimed at rethinking the legal protection of foreign investors, either by progressively replacing IIAs with domestic legislation,<sup>1</sup> or by reconsidering model bilateral investment treaties (BITs).<sup>2</sup>

In this context, it is rather surprising to find in IIAs clauses like those contained in a significant number of Italy's BITs, normally in combination with preservation-of-rights clauses. Article 12(3) of the BIT concluded in 1998 between Italy and Mozambique, for instance, provides:

Whenever, after the date when the investment has been made, a modification should take place in laws, regulations, acts or measures of economic policies governing directly or indirectly the investment, the same treatment shall apply upon request of the investor that was applicable to it at the moment when the investment was agreed upon to be carried out.<sup>3</sup>

The meaning of Article 12(3) seems sufficiently clear. It provides all investors of the other contracting party a total exemption from unfavorable laws, regulations, acts, or measures of economic policies adopted by host countries. From a different perspective, it neutralizes the exercise of subsequent regulatory powers to the extent that such exercise is directly or indirectly detrimental to covered investors. One may assume that the clause was included at the insistence of the capital-exporting party.

The clause can be considered as the treaty equivalent of the most robust form of stabilization provisions, the so-called "freezing clauses".<sup>4</sup> Traditionally inserted in government contracts, these clauses protect foreign investors against subsequent unilateral action by host countries in the form of total or partial exemption from regulations enacted during the term of a contract. They arise mainly within extractive industries in sub-Saharan Africa, Eastern and Southern Europe and Central Asia.<sup>5</sup>

Freezing clauses remain problematic, although their drafting has recently been more respectful of the rights and duties of host countries regarding the protection of societal values. They may prevent governments from pursuing their economic and social policies, and even have a “chilling effect” due to the exposure to claims of breach of contract, especially before arbitral tribunals. Israel’s Supreme Court has recently struck down a natural gas plan due to a freezing clause exempting foreign investors from regulatory changes in taxation, antitrust limitation and export quota for ten years.<sup>6</sup> The decision is a powerful reminder of the importance not to restrict unduly the regulatory powers of host countries.

The inclusion in IIAs of clauses such as Article 12(3) above has much more serious consequences than contractual freezing clauses, for at least three main reasons:

- First, unlike freezing clauses contained in contracts, whereby specific commitments are given to particular investors, a treaty clause applies to *all* current and future investments covered by a treaty, making these immune to subsequent regulatory activities.
- Second, clauses like Article 12(3) are drafted in particularly broad terms as to the nature and content of the legal instruments affecting foreign investors as well as their impact on foreign investments.
- Third, investors of other countries that have a treaty with the host country may invoke the most-favored-nation treatment obligation to benefit from clauses such as Article 12(3). This could amplify exponentially the effects of freezing clauses (according to UNCTAD’s database,<sup>7</sup> for instance, Italy and Mozambique have, respectively, 75 and 20 BITs in force with third countries). One may wonder whether the contracting parties were fully aware of the potential implications of applying these clauses beyond the treatment of their respective investors.

Freezing clauses can turn treaties into treacherous legal products, and governments should have a clear and compelling interest in neutralizing them. Indeed, concerned governments may be advised to closely review their IIAs to detect these clauses and carefully assess their implications. If appropriate, they should take steps to remove these clauses. This could be achieved simply and inexpensively through exchanges of letters, preferably with effect from the date at which the other party accepts the proposed amendment. Alternatively, parties may avail themselves of any other means permitted under the law of treaties, including the conclusion of protocols, a task facilitated by the bilateral character of most of these treaties.

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<sup>1</sup> South African Protection of Investment Act (2015), art. 12.

<sup>2</sup> Indian Model BIT (2016), art. 16.

<sup>3</sup> Identical or similar clauses are contained in Italy’s BITs with Angola, Armenia, Azerbaijan, Bosnia, Cameroon, Kazakhstan, Macedonia, Moldova, Tanzania, Uganda, and Uzbekistan.

<sup>4</sup> For an explanation of the different types of stabilization clauses, see Audley Sheppard and Antony Crockett, “Are stabilization clauses a threat to sustainable development?,” in Marie-Claire Cordonier Segger et al., eds., *Sustainable Development in World Investment Law* (Leiden: Kluwer, 2010), pp. 333-50.

<sup>5</sup> Andrea Shemberg, “Stabilization clauses and human rights,” May 27, 2009, available at <http://www.ifc.org/wps/wcm/connect/9feb5b00488555eab8c4fa6a6515bb18/Stabilization%2BPaper.pdf?MOD=AJPERES>. See also Human Rights Council, “Principles for responsible contracts,” May 25, 2011, A/HRC/17/31/Add.3.

<sup>6</sup> See Joel Greenberg, “Israel’s supreme court blocks Leviathan gasfield deal,” *Financial Times*, Mar. 28, 2016.

<sup>7</sup> Available at <http://investmentpolicyhub.unctad.org/IIA>.

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