Pushing the Boundaries vs. Striking a Balance: The Scope and Interpretation of Stabilization Clauses in Light of the Duke v. Peru Award

Lorenzo Cotula

I. INTRODUCTION

This article discusses a recent ICSID award that found a breach of a tax stabilization commitment made by the government of Peru to a foreign investor through a set of ‘Legal Stability Agreements’. As Duke v. Peru is the first published award on stabilization commitments since the 1980s, the reasoning of the tribunal is of particular interest.

The article places the award within the broader context of ongoing debates on stabilization; discusses facts and key findings of the case; analyses the tribunal’s reasoning on stabilization commitments; develops broader reflections on the interpretation and application of these commitments; and concludes with some thoughts on legal policy. While the award concerns a tax dispute, at the heart of the author’s commentary are concerns about possible implications for host state action in pursuit of sustainable development goals – such as regulation raising applicable social and environmental standards.

II. THE GREAT STABILIZATION DEBATE, AND THE RELEVANCE OF DUKE V. PERU

Stabilization commitments are a legal device to manage non-commercial (that is, fiscal or regulatory) risk. They involve a contractual or legislative commitment by the host government not to alter the regulatory framework governing an investment project outside specified circumstances – such as investor consent, restoration of the economic equilibrium and/or payment of compensation. Stabilization commitments respond to investors’ need for protection from regulatory change that may adversely

---

1 Dr Lorenzo Cotula, Law Degree (University ‘La Sapienza’ of Rome), MSc (London School of Economics), PhD (University of Edinburgh), is Senior Researcher – Law and Sustainable Development at the International Institute for Environment and Development (IIEED), in the UK. He can be contacted at lorenzo.cotula@iied.org. The author would like to thank Antony Crockett, Howard Mann, Andrea Shemberg and Halina Ward for their useful comments on earlier drafts of this article; responsibility for the views expressed and any errors made lies entirely with the author.

2 Duke Energy International Peru Investments No. 1 Ltd. v. Republic of Peru, Award on the Merits, 18 August 2008, ICSID Case No. ARB/03/28. An annulment proceeding is currently pending before an ICSID ad hoc committee.
affect the investment, particularly as the balance of negotiating power shifts in favour of the host state during project implementation.

Discussions about stabilization devices were popular in the 1970s and early 1980s, when the outcome of several high-profile arbitrations depended on the legal effects attributed to stabilization clauses embodied in oil concession contracts. In the early 1990s, interest in these clauses seemed to have subsided, with international attention shifting to the booming number of investment treaties.

However, recent years have witnessed renewed interest in stabilization devices, particularly with regard to investment projects in developing and transition economies. Evolution in contractual practice points to a shift away from ‘freezing clauses’ (whereby the applicable domestic law is the one in force at the time the contract is concluded, to the exclusion of subsequent legislation) toward greater use of ‘economic equilibrium clauses’ (which link regulatory change to restoration of the economic equilibrium of the project, including through payment of compensation), mainly because of the greater flexibility and versatility associated with the latter clauses. A sizeable academic literature has explored trends in contractual practice and discussed the legal effect of stabilization commitments.

Recent years have also witnessed growing scrutiny over the way in which stabilization devices might constrain government action taken in pursuit of the public interest, or to protect third-party interests such as those of people who may be adversely affected by an investment project. Concerns have been raised, for example, about the possible implications that a duty to compensate investors for losses suffered as a result of regulatory changes may have for host state action to improve applicable social and environmental standards. Such action may be taken in order to realize human rights, or in pursuit of sustainable development goals. Sustainable development can be broadly defined as the policy imperative to balance economic, social and environmental considerations so as to meet the needs of today’s generation without compromising the ability of future generations to meet their own needs. Key sustainable development

---