

LEGAL CHALLENGES OF THE PROVISION OF STABILIZATION CLAUSE IN UZBEKISTAN

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ABSTRACT

Capital inflow from abroad is an important tool for a developing country such as Uzbekistan to improve its economic situation. Foreign investment serves as the basis for the stabilization of areas such as employment, the introduction of new technologies and experience exchange within companies. Investment activity provides advantages for foreign investors as well. Through investment opportunities, investors obtain the ability to increase the volume of production and to improve the production process of modern enterprises. Although investment activity has significance for developing countries and foreign investors, the unstable regulation of developing states hinder the foreign investor, risk in starting their business. In this regard, a stabilization clause is a key device to prevent the possible risk that foreign investor may have. Stabilization clauses provide the chances for foreign investors to plan and avoid any newly adopted adverse changes in law.

Key words: *international investment law, investment contracts, stabilization clause, freezing clause, investor guaranties.*

O‘ZBEKISTONDA STABILITSION BANDLARINI TA’MINLASHNING HUQUQIY MUAMMOLARI

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ANNOTATSIYA

Xorijdan kapital oqimi O‘zbekiston kabi rivojlanayotgan davlat uchun iqtisodiy ahvolini yaxshilashda muhim vosita hisoblanadi. Xorij sarmoyasi aholi bandligini ta’minlash, yangi texnologiyalarni joriy etish, kompaniyalar o‘rtasida tajriba almashish kabi sohalarni barqarorlashtirish uchun asos bo‘lib xizmat qilmoqda. Investitsion faoliyat xorijiy investorlar uchun ham qulayliklar yaratadi. Investitsion imkoniyatlar orqali investorlar ishlab chiqarish hajmini oshirish va zamonaviy korxonalarining ishlab chiqarish jarayonini yaxshilash imkoniyatiga ega bo‘ladilar. Rivojlanayotgan davlatlar va xorijiy investorlar uchun investitsiya faoliyati muhim ahamiyatga ega bo‘lsa-da, rivojlanayotgan davlatlardagi beqaror tartibga solish

xorijiy investorga o'z biznesini boshlashda xavf tug'diradi. Shu munosabat bilan barqarorlashtirish bandi xorijiy investor yuzaga kelishi mumkin bo'lgan xavfning oldini olish uchun asosiy vositadir. Barqarorlik bandlari xorijiy investorlarga qonundagi yangi qabul qilingan salbiy o'zgarishlarni rejalashtirish va oldini olish imkoniyatini beradi.

Kalit so'zlar: *xalqaro investitsiya huquqi, investitsiya shartnomalari, barqarorlashtirish bandi, muzlatish bandi, investor kafolatlari.*

INTRODUCTION

Foreign trade and investment serve as driving forces in strengthening the economy in developing countries. However, foreign investment into their territories does not mean just attraction of financial capital but also the opportunity to strengthen a stagnant economy.¹ In spite of great economic and industrial potential, the inflow of foreign investors in developing countries is considerably low. At present, one of the main hindrances in creating a favorable investment climate in developing countries is the inconsistency of legal regulations and the potential political risk to foreign investors it brings.² Foreign investors lose confidence in developing countries that have unstable legal condition, and they are often unwilling to gamble with long term investments without any strong guarantees of protection from adverse legal changes. Therefore, government should provide clear and stable legal regulation for investment agreements in order to maintain the inflow of direct foreign investment into the economy of the hosting country.

As a developing country, Uzbekistan has recently experienced a great deal of changes in the economy, which has in turn required reforms in investment legislation. Since independence in 1991, legislative reforms regarding investment agreements have changed three times. One of the important changes is the provision of the "stabilization clause." A stabilization clause is used in investment contracts as an effective legal remedy to provide guarantees to foreign investors.³ The concept of stabilization clauses dates back to the period between the two World Wars, when American companies started to include stabilization clauses into their concessions as a response to Latin American countries engaging in policies of nationalization of investments. At that time, the purpose of this clause was "aim[ed] to protect contracts from being subject to legislative or administrative measures occurring after the

¹ Roman Kalis, "Legal Environment for International Investment in Uzbekistan," https://www.law.muni.cz/sborniky/cofola2008/files/pdf/mps/kalis_roman.pdf.

² Ibid

³ Sar Meriç, "Stabilization Clauses in International Investment Contracts," Academia.edu, http://www.academia.edu/8776599/stabilization_clause_in-international_investment_contracts.

conclusion of a contract.”⁴ In current research stabilization clause is defined as a device to provide a balance between the parties’ interests and protect them from the possible harm.

In developing countries such as Uzbekistan, stabilization clauses can result in restrictions that limit the States’ sovereignty in enacting any new laws on investment. In order to clarify the focus of this paper, this chapter will explain the problem, paper and purpose statements as well as provide a map of the structure used in this study.

In international investment law, there are various interpretations of stabilization clauses, which argue about their actual efficiency when applied to investment contracts between a State and foreign investor, and when it is included in investment legislation of a host country. The current study aims to study both stabilization clauses in investment contracts and in national legislation.

In investment contracts, host states can grant stabilization clauses to accommodate investors’ interests and attract future investment by providing a high level of warranty.⁵ This clause allows a foreign investor to sue the host state for not fulfilling their obligation under the investment contract and get compensation for harm.⁶ However, for a developing country with an unstable economy and inconstant legislation, stabilization clauses may not be always be beneficial. When granting stabilization provisions, the state may risk limiting its sovereign power to enact new laws.

Another issue of competing incentives occurs with the court and international arbitration process, which are related to the validity of stabilization clause under national law. In developing countries, the host state argues that their national law governs an agreement because it involves the concept of state sovereignty. In case of a breach of contractual terms where a stabilization clause is included, an arbitral or court award may instruct the state to cease from applying new laws.⁷ However, if the State finds the stabilization clause invalid under national law, the stabilization clause may lose its power to secure the contract provisions. Such opposing interests, and the disparity of power contracting parties have, often leads to adverse results for both host-state and foreign investor. Thus, one of the most important issues is to create a balance between the interests of contracting parties – to provide the opportunity for foreign investors to plan their business in advance without restricting

⁴ Camilo A. Rodriguez-Yong and Karol X. Martinez-Muñoz, “The Andean Approach to Stabilisation Clauses,” *International Journal of Private Law* 6, no. 1 (December 3, 2012): 67–87, doi:10.1504/IJPL.2013.050528.

⁵ Gehne, Katja, and Romulo Brillo, “Stabilization Clauses in International Investment Law: Beyond Balancing and Fair and Equitable Treatment.” No. 2013/46. Working Paper, 2014., http://www.nccr-trade.org/fileadmin/user_upload/nccr-trade.ch/wp2/Stab_clauses_final_final.pdf

⁶ Howse Robert. “Freezing Government Policy: Stabilization Clauses in Investment Contracts.” *Investment Treaty News* (2011),” http://www.iisd.org/itn/wp-content/uploads/2011/04/iisd_itn_april_2011_en.pdf.

⁷ Ibid.

the host state from enacting state policy.⁸ Given the importance to this issue, there is need to examine the application, accurate interpretation and fulfillment of stabilization clauses both in investment contracts and national legislation.

1. The role of the stabilization clauses in investment contracts

A stabilization clause is a provision in investment contracts that serves to immunize the foreign investor from possible future governmental actions or changes in the law that may be detrimental.⁹ The inclusion of a stabilization clause in an investment contract gives legal protection to a foreign investor and creates legal certainty during the life span of the project in the host country. In practice, stabilization clauses are often included in contracts that are related to industrial projects such as infrastructural development or public service projects. These projects typically require large a amount of investment and could become effectively important to the development of the country.¹⁰

The theory of investment law identifies several types of stabilization clauses, including full freeze and equilibrium clauses. The full freeze clause aims to ensure that the law applicable to the contract will not change during the active term of the project.¹¹ This type of stabilization clause was prevalent in arbitration cases throughout the 1970s and 1980s and still in use today. The second type is the equilibrium clause, which is more commonly in use by developing countries. The main purpose of an equilibrium clause is to protect investors against financial consequences that may arise from the changes in the national law of the host country¹² and create an economic balance between the parties.¹³

There are some critical differences between freezing clauses and equilibrium clauses. The freezing clause contractually prohibits the government from enacting any legislation that would contradict the terms of an investment contract.¹⁴ With the freeze clause, a host country is not allowed to make any changes in legislative regulation that could affect a project. For developing countries, the freezing clause is disadvantageous because the sovereignty to enact new laws have become restricted by

⁸ Moshe Hirsch, "Between Fair and Equitable Treatment and Stabilization Clause: Stable Legal Environment and Regulatory Change in International Investment Law" http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2272952.

⁹ Christopher T. Curtis, "Legal Security of Economic Development Agreements, The," *Harvard International Law Journal* 29, 321

¹⁰ Moshe Hirsch, "Between Fair and Equitable Treatment and Stabilization Clause: Stable Legal Environment and Regulatory Change in International Investment Law," *Journal of World Investment & Trade*, 2011

¹¹ A. Al Faruque, "Typologies, Efficacy and Political Economy of Stabilisation Clauses: A Critical Appraisal," *Oil, Gas & Energy Law Journal (OGEL)* November 1, 2007.

¹² Shemberg, Andrea. "Stabilization Clauses and Human Rights: A Research Project Conducted for IFC and the United Nations Special Representative of the Secretary-General on Business and Human Rights."

¹³ *Ibid*

¹⁴ Meriç, "Stabilization Clauses in International Investment Contracts."

the promises of legal stability to the foreign investors. Despite this problem, some countries continue to rely on this clause as tool to attract foreign investment into their economies.¹⁵

In contrast, many scholars feel that equilibrium clauses represent a more modern type of stabilization clause, as they leaves room for negation and adjustment to the new legal changes under the contract provisions. With this type of clause, an investor must comply with a new law that has been passed after a contract agreement; however, the state assumes the obligation to compensate or restore the terms of the original agreement. In addition, this clause allows both sides to provide favorable compliance or delay the application of the new law.¹⁶ Foreign investors tend to prefer equilibrium clauses rather than the freezing clause”, because the clause is more likely enforceable, as it does not limit the sovereignty of state to enact the new law or amendments and limit the scope of compensation for the harm. The clearer frame also leads to the accelerated solution of conflicts. Such balance between the parties and the efficiency of application of economic equilibrium clauses increase the interest of potential contracting parties to include the stabilization clause. Thus, economic equilibrium clause aims to seek prevention from particular economic issues that may come out after the new changes established in legislation.¹⁷ This clause does not limit the state to enact a new legislation, but impose on the parties the duty of negotiating in good faith aiming to restore the economic equilibrium of the original agreement.¹⁸

Stabilization clauses in fact cannot protect a contract as whole, although in international investment contracts it can be a device to provide a certain stability of agreement provisions during the life of the investment project.¹⁹ Both parties of a contract are concern to include the stabilization clause, although they have different incentives and interests. In international investment law such contrasting interests and incentives of the parties led to a debate on the real necessity of stabilization clause in investment contracts. The debate can be observed from two different perspectives: the first point states that existence of stabilization clauses are for foreign investors to foresee the legal condition in a potential host.²⁰ In contrast, the second point emphasizes that stabilization clauses are invalid under international law. Sovereignty over natural resources is a *jus cogens* form where there can be no diminishing of state

¹⁵ Ibid. 13-14

¹⁶ Rodriguez-Yong and Martinez-Muñoz, “The Andean Approach to Stabilisation Clauses,” 61.

¹⁷ Meriç Şar, “Stabilization Clauses in International Investment Contracts | - Academia.edu,” 2016, http://www.academia.edu/8776599/STABILIZATION_CLAUSES_IN_INTERNATIONAL_INVESTMENT_CONTRACTS.

¹⁸ Rodriguez-Yong and Martinez-Muñoz, “The Andean Approach to Stabilisation Clauses,” 69.

¹⁹ Gehne, Katja, and Romulo Brillo "Stabilization Clauses in International Investment Law: Beyond Balancing and Fair and Equitable Treatment."

²⁰ Ibid.

power. Hence, a stabilization clause would be invalid and a state, making use of principles of public international law, can continue enacting new legislation, and in some arbitration cases to breach an agreement, without compensation.²¹

Consequently, it is not clear whether such a device as “stabilization clause” does indeed impose a blanket prohibition on the host state to change its domestic legislation under international law; or whether they only bind the host government to compensate the investor if deviating from the stabilization provisions. Considering this ambiguity treatment of stabilization clauses in international investment law the issue relates to the question of validity of stabilization provisions in investment contracts with developing countries. These countries present us that e frequent updates of legislation are unavoidable.²²

Some scholars critically define the implementation of stabilization clause into state contracts, arguing that such provision is just a way to attract more foreign investment, and the situation and promises may change after the agreement enter into force. Peter D Cameron in his work says that in spite of stabilization clauses countries defines their sovereignty power confidently, asserting the arguments of public interest.²³ In addition, Herbert Smith mentioned that some countries have a strict principle, which does not allow a contract with private individual to fetter the executive power of the state.²⁴

2. Stabilization Clauses in Uzbekistan’s legislation

Today, foreign investors in Uzbekistan enjoy favorable treatment, equal to local investors, as well as specific benefits. For example, *The Law on Investments and Investment activities (2019)* states that, in addition to other guarantees, if a situation occurs in which a subsequent legislative act worsens the condition for the foreign investor, then the previous legislation is applied as far back as ten years. Furthermore, the foreign investor has the right to benefit from new provisions in a changed law that would be advantageous to them. Moreover, Uzbekistan provides tax benefits for direct investment that follows the required minimum amount of investment shown in law.²⁵

²¹ Hirsch, “Between Fair and Equitable Treatment and Stabilization Clause,” 2011.

²² Kališ, Roman. "Current Issues of Investing in Developing Countries.", 2009 <http://sauron.law.muni.cz/sborniky/cofola2009/files/contributions/Roman%20Kalis.pdf>

²³ A. F. M. Maniruzzaman, “The New Generation of Energy and Natural Resource Development Agreements: Some Reflections,” *Journal of Energy & Natural Resources Law* 11, 4 November 1, 1993. See also, Peter D Cameron “Reflection on Sovereignty over Natural Resource and the Enforcement of Stabilization Clause” March, 2013.

²⁴ Clinch, David, and James Watson. "Stabilisation Clauses—issues and trends." *Herbert Smith Freehills* (2010), <http://documents.lexology.com/35f7c716-7a61-4687-ba7b-ec21a8737911.pdf>.

²⁵ “Investment Policy of the Republic of Uzbekistan | ‘UZINFOINVEST’ the Information Support & Foreign Investments Promotion Agency.”

Because of investment laws, Uzbekistan has achieved some level of development that includes successful agreements with foreign investors. These successes have led to some improvement in the economy and benefits to both sides. For instance, in 2008, the Uzbekistan government and General Motors formalized a contract that led to the building and selling of vehicles in Eastern Europe and Central Asia. As a result, this helped Uzbekistan to promote its cars to other markets. Another example is an agreement with HUAWEI, a Chinese company, involving telecom operations. Currently, HUAWEI provides equipment and service solutions to the National Operator Uztelecom, Unitel, Ucell, Perfectum Mobile and East Telecom in Uzbekistan.²⁶ Meanwhile, the country also benefited from such investment projects. For instance, the implementation introduced into Uzbekistan market led to the grow of partnership with foreign companies; increased the rate of employment; and improved the skills of local specialist on particular sphere by the exchange of partners experience.

In sum, the evolution of investment legislation in Uzbekistan since independence has resulted in some improvements in the economy while also creating a more positive atmosphere to invite foreign investors. So far, the laws have not been fully realized and present numerous challenges. To constant the legal environment for foreign investors and manage the risk from further legislative changes is one of the key points to create a favorable investment environment. Considering the given benefits and ambiguities in investment legislation there are two main weaknesses that can be defined: 1) instability of investment legislation; 2) and vulnerability of guaranties within investment legislation.

CONCLUSION

Considering scholarly discussions, and the practices of foreign countries, this research has thoroughly analyzed and concluded on the importance and effectiveness of stabilization clause for the countries with developing economy. As those developing countries face frequent changes in legislation, and as a result lose attractiveness for foreign investors. Application of stabilization clauses both in national legislation and in investment contracts can offer potential to reach the balance of interests of states and foreign investors. In order to solve the aforementioned weaknesses of Uzbekistan's legislation and to reach an effective application of stabilization clauses, this paper proposes following suggestions. First, *neutralization of an investment project from newly adopted laws should be established*; second, *widening the scope of compensation for breaches of contract*

²⁶ Ibid.

should be provided in the law; third, implementation of an economic equilibrium clause, which is beneficial for Uzbekistan, should be included in investment contracts.

Another feature that should be modified in Uzbekistan investment law is the scope of area that stabilization clauses can be applied to. Investment law should define the scope of stability guarantees and clarify whether a stabilization clause protects an investment from all further adverse changes of law, or it covers just a particular area of tax policy. On this point, the *Andean approach* might be implemented into national legislation.

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