STABILITY OF INVESTMENT CONTRACTS AND THE GLOBALIZATION OF FINANCE

1.1 INTRODUCTION

Multinationals operating mostly in developing countries always want security of tenure for their capital investment in such countries. They inject into investment contracts provisions that seek to preserve not only the life span of the agreement but its essential terms. In seeking to achieve this, legitimacy of maintaining the status quo is often sought from the principle of sanctity of contract and other principles of international economic law. This is in the main was the situation before the intensification of globalization of finance. With the globalization of finance and the mobility it gave to international capital, stability of investment contracts seemed to have come under a marked strain, particular from the ranks of multinational which earlier on had been too obsessive about it. *The mission of this paper is to examine the various principles of international economic law that are often raked up to support stability of investment contracts, how these stand up to the challenge of globalization and who in today's economic realism is that interested instability of investment contracts.*

1.2 CONCESSIONS IN COLONIAL AND POST COLONIAL AFRICA

Capital investment by the developed countries in the developing countries started mostly in the colonial era. Investment at this period involved the granting of concession by the developing countries to multinational companies from the developed world. The concessions were granted in most cases by the colonial authorities. Under the concession framework, the multinational made a direct investment for the purpose of exploiting a particular natural resource. In many cases, the concession amounted to a virtual assumption of sovereignty by the trans-national corporation (TNC) over the host country's resources. It excluded the host country from participating in the ownership, control and operation of the undertaken. The TNC was given extensive and plenary rights to exploit the particular mineral resource and was in effect assured of that mineral resource from the point of extraction. The concession rights were for inordinate long terms. For example, the Ashanti Goldfields Corporation in Ghana has a term of 90 years, the oil concessions granted to oil companies in Nigeria ranged form 40 to 60 years subject to renewal, and the asbestos concessions in Swaziland extended as far as 100 years. In many cases, the consideration for these exclusive benefits was minimal, a nominal rent of 150 pounds plus one or two bottles of rum. For instance, British Gold mint for 135 pounds was given a 40 years concession to mine gold in Kuate in the Ashanti gold mines of Ghana.[1] There were no provisions for renegotiating the concessions that virtually guaranteed the TNC's private ownership of the mine , the shaft, the fixed assets, the equipment, the stores and the mineral itself.

1.3 LEGAL PERSPECTIVES ON STABILITY OF INVESTMENT CONTRACTS

Before committing substantial resources to long term agreement as concessions joint ventures, service contracts etc. TNC"s carry out elaborate financial projections and cash flow analysis in order to determine the expected returns on their investment. In making these projections and calculations, they demand that governments unequivocally spell out the full range of fiscal impositions such as taxes, royalties, duties, rents, bonus considerations to be stipulated on the transaction for the entire duration of the agreement. For example, in the oil concession by Nigeria to Shell in the Oyakama area of the Niger Delta, Shell in 1961 required Nigeria to fix the royalties and rents that Shell will pay to the country for a period for 15 years.[2] They contended further that bankers and other financial institutions will not provide them financing for their projects unless they present to them definite long-term contracts concluded with host governments which spell out in great details the entire fiscal package and contain iron-cast guarantees form host governments regarding these financial arrangements.

So TNC"s were concerned with stability and predictability of investment contracts as prerequisites for prudent investment sought to achieve such stability through stipulation of stability clauses in investment contracts. These aimed at freezing the essential premises of the agreement by strictly prohibiting any legislative or administrative act which derogates form or is otherwise inconsistent with the provisions of the agreement. The imposition of nay fiscal changes in the general industrial or commercial sectors in excess of the fiscal changes provided in the agreement, expropriation, nationalization and any other form of intervention in the enterprise like the amendment of laws such as corporate and tax laws which were in force at the date of the agreement were seriously resented by transactional corporations. For instance, the Valco Agreement of Ghana provides that the proper law for the agreement shall be the law of Chana at the time of agreement.

After independent, some newly independent states asserted the concept of permanent sovereignty over natural resources as a sine qua non of national independence economic self-reliance. In this, they sought and obtained support from the various resolutions of the United Nations on the issue. On that basis, they sought to renegotiate concessions contracts or nationalize TNC's that enjoyed such concessions. TNCs were opposed to thee, arguing that the concessions must be preserved on the grounds of sanctity of contract. This assertion was based on the Anglo-American conception that conceives contract as the most convenient tool of capitalism, inspired by a proud spirit of laissez faire individualism. The classical idea of contract is a private bargain struck by parties of equal beginning strength and firmly rooted in the freewill of the parties (it is an institution of the market place in every day capitalist society) guided by the free will theory of contract. Courts were extremely hesitant to render a contract void as against public policy to readjust the bargain hesitant to render a contract void as against public policy to readjust the bargain struck by the parties as it is in the supreme interest of the social order that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held scared and enforced by the courts of justice. This is the sanctity of contract theory. By it, TNCs deemed a concession a definitive deal-fixed regime of obligations, rights, impositions and benefits which does not admit of various or modification of the terms of agreement. Any departure from such a transaction was deemed repugnant to sanctity of contract. In colloquial language once a party has made his 'kill' in a deal the transaction.

Subsequently, courts began to apply an objective theory of contract, which enabled them to intervene actively to rectify contractual provisions on grounds of equity. Such intervenient makes nonsense of the will theory of freedom of contract. It follows that there is no immutable doctrine of contract and that developing countries are perfectly entitled to invoke ideas of fairness and equity in reviewing contracts which were inimical to the national interest. Sanctity of contract has never been treated as absolute and an unqualified principle in any of the major legal systems. The French doctrine of imprevision and the concept of good faith all provide for the review of contracts in appropriate cases by reference to objective criteria not traceable to the will of the parties. According to the doctrine of imprevision, an alteration of contractual rights between a state and a foreign company can take place upon the occurrence of a subsequent event not foreseen by the parties which ahs rendered the obligation of one party so onerous that it may be assumed that if he had it in contemplation eh would not have made the contract at least on terms he made it. Unger English law, there is no similar provision sparing of course the common law principle of frustration which excuses the strict performance of a contract because it has become impossible or illegal to do so.

The barest acquaintance with the actual circumstances surrounding the conclusion of concessions between metropolitan companies with African chiefs disposes of the will theory of freedom of contract. The hollowness of the pretense that colonial transactions with illiterate chiefs are freely negotiated translations between parties of equal bargaining strength is quite evident. Metropolitan companies were offered privileged investment interests in the colonies and given such grostesquely favourable terms as would scarcely survive the collapse of colonialism. It is patent fallacy to characterize such interests as grounded on contracts freely negotiated by parties of equal bargaining strength. The circumstances surrounding the conclusion of these transactions belie all the classical theory of freedom of contract. In such circumstances, host governments of newly independent states consider renegotiation or restructuring of these arrangement as a legitimate part of the decolonisation process. Even the modern variant of these transactions which is investment agreement between the government of a developing country and a TNC cannot be truly described as arm-length transactions rooted in the free will of parties of equal bargaining power because of the superior negotiation skills, knowledge and more favourable bargaining positions which TNC's usually command at the inception of the relationship. For instance, in the negotiation between Ghana and Reynolds of America in respect of Volta River Project of Ghana in the early 1960s, Kwame Nkrumah the Ghanian president was so anxious to conclude the deal that while urging his officials to negotiate for the best terms, firmly directed them to come to some terms at all costs.[3] This no doubt gave the foreign companies a superior negotiating position.

Again, a long-term investment agreement concerning the exploitation and marketing of a natural resource of a country is anything but a private contract as an institution of the market place. It is rather a major instrument of public policy, a prominent feature of a development plan. These transactions provide a framework for a joint public enterprise in which the government and the foreign partner engage in the development of a strategic public utility. These transactions lie more in the domain of public law than in the province of private contract and consequently the traditional individualistic doctrines as well as the speculative rules devised for the exchange of fungible commodities in a market regime are clearly not applicable to them. It follows that these transactions cannot be insulated from the pressures, which impinge on public institutions such as political change in the country, changed economic conditions and the general expectations of the public.

To further immunize such contracts form possible variation by host states, jurists from capital exporting countries have argued that the peculiar features of an investment agreement between a government and a foreign company makes it an international agreement and therefore subject to such international legal doctrines as *pacta sunt servanda* (i.e. agreement must be kept at all costs).[4] The implication of this argument is that the contractual interest of an alien constitutes an acquired right and can not be invaded by the state even upon the payment of prompt, adequate and effective compensation to which aliens are parties. Other jurists from multinational states sought to insulate investment agreements from the operation of the host state by classifying the investment as an independent and self-sufficient system of law regulating the range of relations between the host government and the foreign company without reference to any municipal law.[5] In effect, the investment agreement creates a separate, self-contained body of legal principles, which exclusively govern relations between the host state and the transnational corporation. Other jurists talked of acquired rights and succession by which they meant successive state governments are bound to keep to the terms of the agreement.

On the issue of investment agreements being international agreements governed by *pacta sunt servanda*, such an *argument* may be met by another principle of international law *clausula rebus sic stantibus* which sanctions the revision of investment agreements on grounds of equity and fundamental change in circumstances.

As regards the theory that investment agreements create an independent exclusive and self-sufficient legal system, this is patently untenable on the grounds that the validity of any agreement must itself derived from some external legal order, be it international or municipal.[6] It follows that the concept of immunity implied in these terms cannot be sustained without reference to some legal system.

CASES OF RENEGOTIATION OF INVESTMENT CONTRACTS

Despite the armory of traditional law, foreign companies and governments actuated by a shrewd sense of realism, if not equity, have come to accept the renegotiation or restructuring of colonial agreements. This development represents the triumph of common sense and equity over formal doctrines. Some of the more realistic investors have since abandoned the idea that an investment contract constitutes an inflexible structure, which must be rigorously enforced to the letter and have humorously suggested that a concession agreement may be regarded as an agreement to make concessions.

Principle 21 of the United Nations Stockholm declaration of 1972 and principle 2 of the U.N. Rio Declaration 1992 provides that each state has the sovereign right to exploits its own resources pursuant to its own developmental and environmental policies. Provisions of international legal instruments such as this effectively place under nation states the power to deal with their natural resources in a manner that advances their economic well-being. This entails a right to renew for instance concession contracts entered into by a state with a transnational corporation over natural resources if to do so is the means that will realized the country's economic objective

Pursuant to this realism, Nigeria in 1967 renegotiated its oil concessions with some TNCs,. Jamaica, renegotiated its bauxite concession agreements with the United State of America and Canadian Companies. In a famous statement on the crisis that led to the renegotiation, the Jamaican Prime Minister declared that sanctity of contract would not be allowed to override the compelling demands of economic necessity.[8]

Renegotiation is acknowledged as an integral feature of foreign investment. In this regard, OPEC has declared that changed economic circumstances provide a legitimate basis for host governments to renegotiate petroleum agreements. In resolution No. 16 of 1968, OPEC declared that governments have a right to negotiate contracts when TNC's serving as operators receive excessively high net earnings after taxes. The Secretary General of the International Center for Settlement of Investment Disputes has also advocated the adoption of renegotiation and review clauses in investment agreements as a mechanism for avoiding or containing conflicts and investment

disputes.[9] Accordingly, a growing number of investment agreements now stipulate various formulae for renegotiation For instance, the agreement between the government of Papua New Guinea and Bougainville Copper Ltd. 1974 provided that the parties will meet at an interval of 7 years to consider in good faith whether the agreement was operating fairly to each of them and if not, to use their best endeavours to agree upon such changes to the agreement as may be requisite in that regard.[10]
Similarly, the on shore (Voltaian Basin) Petroleum agreement between the government of Ghana and Shell-Exploration and Product Company of Ghana a subsidiary of Shell International, contains the following provision;

> "It is hereby agreed that if during the term of this agreement, there shall occur such changes in the financial and economic circumstances relating to the petroleum industry, operating conditions in Ghana and marketing conditions generally as materially affect the fundamental economic and financial basis of this agreement, then the provisions of this agreement may be reviewed or renegotiated with a view to making such adjustments and modifications as may be reasonable having regard to the operator's capital employed and the risk incurred by him, always provided that no such adjustments and modifications shall be made within 5 years after the commencement of production of petroleum in commercial quantities from the production area."[11]

In the agreement between Nigeria and Chevron, it was agreed that the agreement can only be renewed after an interval of 5 years.[12]

With the advent of globalization of finance, investment by developed countries in developing countries has increased by many folds, national economics having been liberated from restrictions on capital flows. Now the ruling spirit is how a nation state may attract foreign investment and not how to curb the flow of such investment. That is why countries are privatising to pave way for the in flow of foreign capital.

Foreign direct investment by developed countries in developing countries according to a World Bank Statistic was 23.5% in 1995 and 45.7% in 1996. Portfolio equity flows was 3.2% in 1990. 11.0% in 1992, 32.1% in 1995 and 45.7 in 1996.[13]

Foreign investments by the developed world in the developing countries is either foreign direct investment (FDI), which could be private or public, or portfolio investment which is invariably private. Foreign direct investment if private is mainly by multinationals. The investment is usually long-termed involving the acquisition of capital equipment, factories etc. Usually the TNC is involved in the management of this type of investment. Portfolio investment, is also known as indirect foreign investment, on the other hand is mainly by individual, companies and institutional investors like Pension funds, insurance

companies, trust schemes, etc. they are usually short-term investments that do not involve investors in the management of the investment. They are referred to as hot money flows because of the ease with which they cross national borders.
The world over, capital market has largely been liberalized. The size and structure of the financial markets of developing countries have undergone rapid changes in recent times. Deregualtion and globalization of financial markets has been an important part of structural adjustment programmes supported by World Bank and the IMF. The IMF and World Bank's role in investment particularly in 3rd world countries like Nigeria essentially has to do with providing guarantee schemes for foreign investors under schemes such as Multilateral Investment Guarantee Agreement (MIGA). These international financial institutions also lend money to third world countries with requirements such as the implementation of SAP. As developing countries implement adjustment programmes, they remove curbs and restrictions on investments capital flows to facilitate the integration of domestic markets with the global capital.

Apart from the Structural Adjustment Programme (SAP), many investment agreements also insist on the opening up of financial markets of developing countries World Trade Organization (WTO) is an example of such organizations. Besides the problems earlier mentioned concerning foreign investment in third world countries, international investment recently has acquired a rather volatile nature particularly portfolio investment, which because of its instability has come to be referred to as 'hot money flows'. They move in a country at short notice and leave at short notice. The Mexican, Thailand and recently Argentinean crises are testimonies to the economic crisis such funds can generate in a country.[14]

Want of stability of these investment contracts led to huge capital flight when distress signals started manifesting themselves in these developing economics. The consequences of such capital flight to these economies include macro economic non performance and wide scale pauperisation of the people. This sometimes leads to political instability as recently happened in Argentina which in two weeks produced five presidents.

1.5 CONCLUSION

In the light of the volatile character of foreign investment considered above, there is a reversal in the desire for stability of investment contracts. Multinationals, which hitherto were keen on stability of investment contracts are no longer that keen especially if the investment is portfolio investment. With respect to this kind of investment, they are more interested in speculation in profit and shifting elsewhere when losses appear likely. It is third world countries that are now interested in stability of investment contracts because it is they that are vulnerable to capital flight. Today, the big challenge before developing countries is not merely how to attract foreign investment but how to keep it within their borders. It is in this wise that they may have to place reliance on the various international economic law principles examined in tense paper, shaky as these principles may be. After all, the multinationals when the instability of these contractual agreements was working against them relied on these principles to achieve some stability. There is nothing stopping the developing countries from benefiting from this precedent.

ENDNOTE AND REFERENCE

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