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Pitfalls of Developing Host Countries Contracts with Multinational Corporation

(Case Study - Guyana-ExxonMobil Petroleum Agreement)

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Introduction

Countries worldwide are interested in developing their natural resources to promote their country's socio-economic interests. They do so by engaging multinational corporations (MNCs) which have the necessary technical, financial and management capacity to undertake large complex projects. Developed countries with a sophisticated legal and institutional framework, backed up by their investment capacity, are in a position to negotiate and execute fair and reasonable contracts. Developing countries, lacking these characteristics and with no prior experience, are vulnerable to unfair and unreasonable contracts.

The stakes are very high for developing countries to ensure that these projects are successful. Invariable, they depend on the benefits from a single project or a select few projects to kick-start the socio-economic development of their nations and the betterment of the lives of their citizens. MNCs are also eager to ensure the success of the project as they provide large amounts of foreign direct investment (FDI) into the project.

Desirable development is viewed from the capital, technology, jobs, management skills and incomes that FDI brings to the government and its citizens. On the other front, multinationals are criticized for repatriating more earnings from developing countries than they infuse by FDI, thus undermining the country's balance-of-payment position. It is argued that the multinational's operations drain away local capital and brainpower toward their project, drying up the other sectors of the economy. This phenomenon has been referred to as the "Dutch Disease"[1]

[1] The Economist coined this term in 1977. It was used to describe the phenomenon that came out of the decline of the Netherlands' economy despite the discovery and exploitation of vast reserves of natural gas deposits. The decline came in two ways. Firstly, from the moving of resources from the manufacturing and other sectors to the gas sector and; secondly by inducing a spending effect that increased the demand for the country's currency leading to an appreciation of the currency exchange rate, causing Netherlands' products to become more

The Organization for Economic Cooperation and Development (OECD) Guidelines for MNCs are expressly intended "to ensure that the operations of these enterprises are in harmony with the national policies of the countries where they operate"[2] These guidelines are similar to the draft UN Code of Conduct for Multinational Corporations. It states "Transnational corporations should/shall make every effort to allocate their decision-making powers among their entities as to enable them to contribute to the economic and social development of the countries in which they operate"[3]

This paper argues that for a country to be successful from the joint natural resource project with the MNC, its fiscal, monetary and socioeconomic policies must be grounded in a robust legal and regulatory framework. It will examine the essential features of international agreements between host government states and MNCs. It will also dwell on dispute resolutions through international litigation and international commercial arbitration.

In the final section, it will use the legal framework to examine an actual agreement, the Guyana-ExxonMobil Petroleum Agreement[4], as it is unfolding. It will support the case that Guyana is unlikely to optimize the benefits from the Agreement and is not in a position to rescind or modify the Agreement due to its inadequate legal framework, among other constraining factors. Guyana is a small, impoverished country with a population of 750,000, hindered by non-existent or inadequate physical, financial, legal, technical and institutional infrastructure, and a

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expensive, hurting exports. This phenomenon has been resurrected in more recent times in the Sub-Saharan resource-rich countries, including Nigeria and Chad.

[2] OECD Guidelines for Multinational Enterprises – Responsible Business Conduct Matters. http://mneguidelines.oecd.org/MNEguidelines_RBCmatters.pdf.

[3] United Nations Draft Code of Conduct on Transnational Corporations[1983 version]. https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2891/download.

[4] A copy of the Agreement is available at https://dpi.gov.gy/download/petroleum-agreement-between-the-government-of-the-cooperative-republic-of-guyana-and-esso-exploration-and-production-guyana-limited-cnooc-nexen-petroleum-guyana-limited-hess-guyana-exploration-limit.

Government accused of secrecy and lack of transparency. The oil revenues over ten years are expected at US$600b[5]. Guyana's annual budget is a mere US$1.5b.

Critical Features of a Natural Resource Contract

Unconscionability

It is of utmost importance that the terms of the contract are well articulated in the negotiations and formation of the resource and FDI contracts. Courts are reluctant to interfere with the sanctity of the freedom of the agreement just because the exchange is unfair. But may do so in some cases of unconscionability where the terms are extremely unjust or overwhelmingly one-sided in favour of the party who has superior bargaining power, that they are contrary to good conscience. The Supreme Court of Canada (SCC) in *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*[6] accepted the unconscionability doctrine to excise an unfair exclusion clause. In the more recent Ontario Court of Appeal decision in *Heller v Uber Technologies Inc*[7] the Court moved beyond procedural unconscionability and ushered in the inclusion of other contractual terms in the substantial unconscionability doctrine. Whether international commercial contracts between weak developing countries and large powerful MNCs have scope to argue unconscionability has not been readily forthcoming to date. However, the questions are being framed as, for example, for Oil and Gas Revenues: Are Governments Getting a Fair Deal? In their article, entitled "Why do African countries negotiate

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[5]World Oil Magazine reported that ExxonMobil's 13th discovery offshore Guyana brings estimates recoverable oil resources offshore Guyana to 5.5 billion barrels with potential to double that amount. https://www.worldoil.com/news/2019/4/23/exxonmobil-makes-13th-discovery-offshore-guyana.

[6] 2010 SCC 4 (CanLII), [2010] 1 SCR 69

[7] 2019 ONCA 1(CanLII) [Heller] Uber Technologies Inc. has been granted leave of appeal to the Supreme Court of Canada. The ONCA found that "The Arbitration Clause represents a substantially improvident or unfair bargain. It requires an individual with a small claim to incur the significant costs of arbitrating the claim under provisions of the ICC Rules, the fees for which are out of all proportion to the amount that may be involved. And the individual has to incur those costs up-front" (para. 68).

unfair resource contracts", the authors explored the phenomenon of the resource curse which they refer to as where natural resource abundance yields poor development outcomes. They argue that attention should be paid to the bargaining process, the negotiation stage where abuse of authority and corruption often occur within the "law-politics-business" matrix. It is not the legality of contractual agreements that is to put into question, but their substantial value for sustainable development[8].

This research paper is of the broader view that business and legal considerations generally cannot be separated at any stage of the contract, be it at the bargaining, negotiation, formation, performance, dispute resolution or termination stage.

The Parties to the Contract

It is vital to ensure that the contracting parties have the requisite authority and resources to engage in all aspects of the contract. It is not unheard of situations where large MNCs use their abundant resources and reputation in the industry to negotiate lucrative contracts with developing countries but then set up subsidiaries with no assets or employees to be the legal contracting parties. The MNCs will then provide all the capital, employees and intellectual property for the work during the contracting period. All profits are repatriated to the MNCs. In this way, the MNC is not directly responsible to the developing country for defects and liabilities emanating from the contract under the privity of contract doctrine.

A case may arise where the oil extraction Production Agreement is silent on, say, the issue of abandonment and decommissioning of oil wells. The developing country would have little comfort from seeking redress from the subsidiary "paper" company. It would want to include the

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[8] Ayangafac C., Bulcha D., Bekele S. (2016) Why Do Some African Countries Negotiate Unfair Natural Resource Contracts?. In Nyeck S. (eds.) Public Procurement Reform and Governance in Africa. Contemporary African Political Economy. Palgrave Macmillan, New York.

MNC as a party to the dispute. But on the contract, the MNC is not a party. Courts and arbitrators will have to decide based on law and facts whether the MNC is a party in the dispute. The developing host country will have to demonstrate that the MNC is the "alter ego" of the subsidiary and that there are legal precedents to support the doctrine of the alter ego company being placed in the shoe of the contracting subsidiary.

The starting point is that "The corporate form normally insulates shareholders, officers, and directors from liability for corporate obligations; but when these individuals abuse the corporate privilege, courts will disregard the corporate fiction and hold them liable individually." Disregard of the corporate fiction in this manner is also referred to as "piercing the corporate veil."[9]

Under the alter ego theory, the court may disregard the corporate shield where such unity exists between one corporation and other corporations, that holding that corporate entity alone as liable would promote injustice. However, in the case of a parent-subsidiary relationship, to fuse the parent company and its subsidiary for jurisdictional purposes more is needed. The claimant must prove that the parent's degree of control over the business operations and affairs of the subsidiary is greater than that normally associated with common ownership and directorship over the internal business operations of the subsidiary. In a decided case where an employee sued for wrongful dismissal and won an award, he was not able to enforce the order from the employer because the employer had no means of paying, the Ontario Court of Appeal found the parent company liable under the common employer doctrine. In summarizing the legal reasoning, the court stated:

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[9] Elizabeth S. Miller, The Limits of Limited Liability: Veil Piercing and other bases of Personal Liability of Owners, Governing Persons, and Agents of Texas Business Entities. Page 1.

> As long as there exists a sufficient degree of relationship between the different legal entities who apparently compete for the role of employer, there is no reason in law or in equity why they ought not all to be regarded as one for the purpose of determining liability for obligations owed to those employees who, in effect, have served all without regard for any precise notion of to whom they were bound in contract. What will constitute a sufficient degree of relationship will depend, in each case, on the details of such relationship, including such factors as individual shareholdings, corporate shareholdings, and interlocking directorships. The essence of that relationship will be the element of common control (para. 30)[10]

It would be in the interest of the developing country to ensure that the MNC with the capital resources is a signatory party to the contract. In the alternative, an indemnity deed should be extracted from the MNC to cover all actual and contingent liabilities of the operating company.

Taxation

Policymakers use tax incentives to attract MNCs. Developed countries use investment tax credits, accelerated capital cost allowance, research and development grants and favouring export activities, among other traditional measures, to entice MNCs. Developing countries, unable to match the offerings of developed countries, offer low or zero corporate income tax rates and preferential tax regimes. These rates and preferences are contractually bargained but arrived at in light of the asymmetry of information power in favour of the MNCs. Developing countries expect that MNCs' operations will result in jobs for locals, transfer technology and other local content benefits.

[10] Downtown Eatery (1993) Ltd. v. Ontario, 2001 CanLII 8538 (ON CA).

MNCs are adept at structuring their legal framework so that the low tax or tax-free income from these countries are then channelled to their resident state that charges low or no corporate income tax. Thus, not only the host country's tax base is eroded, but the negative spillover to other countries continues.

It is generally recognized that no or only nominal tax jurisdictions (referred to as tax havens) and harmful preferential tax regimes (which levy differential taxes on distinguishable tax bases, such as banking, insurance, intellectual property holding and "other relevant" sectors) " affect the location of financial and other service activities, erode tax bases of other countries, distort trade and investment patterns and undermine the fairness, neutrality and broad social acceptance of tax systems."[11] Low or no tax on geographically mobile income is recognized as the gateway for other harmful tax practices. It seeps countries' revenues and is seen as unfair between preferred MNCs and other taxpayers, plus it can result in political risks for governments.

The OECD[12] Highlighted four harmful features of tax heavens:

1. no or low effective tax rate;
2. lack of transparency in the operation of legislative, legal or administrative provisions;
3. lack of effective exchange of information by having in place laws and policies from which MNCs benefit from strict secrecy rules, preventing scrutiny from tax authorities; and
4. no requirement of substantial activities in the host jurisdiction, thus attracting investments and transactions that are purely tax-driven.

[11] Para. 4 OECD (1998), Harmful Tax Competition: An Emerging Global Issue, OECD Publishing, Paris, https://doi.org/10.1787/9789264162945-en.
[12] Ibid.

In recognition of the crisis caused by these harmful tax practices, individual countries, regional and international organizations are taking actions to tackle the problem. The general thrust is to shift towards source-based taxation to ensure that profits are taxed where economic activities generating the profits are performed and where value is created. It is universally acknowledged that while this approach can be incorporated into the domestic law of the taxing jurisdiction, it alone is not sufficient to guarantee the tax base of a country. The United Nations Handbook states:

> Without adequate transparency and disclosure of tax information to the taxing authorities, even the most carefully designed substantive tax rules will fail to protect the base. Thus, an important part of BEPS (revenue Base Erosion and Profit Shifting) work targets the more administrative issues of transparency and disclosure. Ultimately, the goal is to ensure that the tax authorities have adequate and appropriate access to the information necessary for the effective administration of the law.[13]

Developing countries face several challenges in securing information, transparency, and disclosure from MNCs and other tax jurisdictions. The authorities are inhibited by both domestic law and domestic enforcement impediments. They lack the technical personnel with the requisite training and experience in complex areas such as transfer pricing and other countries' tax and accounting laws. Other administrative barriers identified in the UN Report[14] include regular attrition of highly trained staff; technological limitations to the ability to receive, manage, store and work with different types of data; inadequate systems for identifying and matching taxpayers; and existing culture of limited tax compliance.

[13] Page 571, United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries Second Edition. https://www.un.org/esa/ffd/wp-content/uploads/2017/08/handbook-tax-base-second-edition.pdf
[14] Ibid, Page 578,

In recognition of the need for developing countries to build up their tax administration capacity, the International Monetary Fund (IMF), the OECD, the United Nations, and the World Bank have collaborated in setting up a “Platform for Collaboration on Tax” (Platform) to offer support and assistance[15] A "draft toolkit" to assist developing countries in transfer pricing analysis was developed by the Platform[16]. Also, the United Nations Development Program (UNDP) and the OECD jointly set up the “Tax Inspectors without Borders” (TIWB)[17] Project to assist in building tax capacity. In this project, both developed and developing countries tax experts work side-by-side on local tax audit matters.

In summary, developing countries not only suffer from domestic constraints in accessing and using MNCs' information, but they also lack the channels of treaty network to obtain information on MNCs from other tax jurisdictions. Therefore, these countries must implement the requisite tax laws and build up their domestic tax administration capacity, along with fostering treaty network with other countries. This endeavour does not come without high financial costs to developing countries, but the major international organizations are willing to offer support and assistance.

[15]. International Monetary Fund-OECD-United Nations-World Bank, "The Platform for Collaboration on Tax: Concept Note" (19 April 2016), available at https://www.imf.org/external/np/sec/pr/2016/pdf/pr16176.pdf.
[16]. World Bank, "The Platform for Collaboration on Tax Invites Comments on a Draft Toolkit Designed to Help Developing Countries Address the Lack of Comparables for Transfer Pricing Analyses," (24 January 2017), available at http://www.worldbank.org/en/news/press-release/2017/01/24/ the-platform-for-collaboration-on-tax-invites-comments-on-a-draft toolkit-designed-to-help-developing-countries-address-the-lack-of-comparables-for-transfer-pricing-analyses.
[17] OECD-UNDP, Tax Inspectors Without Borders, “Progress Report and 2016 Work Plan for Discussion and Approval,” at 1 (16 April 2016), available at http://www.tiwb.org/About/governing-board/governing-board-progressreport-and-2016-work-plan.pdf.

Corruption, Bribery and False Accounting

The Foreign Corrupt Practices Act of 1977 (FCPA)[18] was enacted in the United States in reaction to revelations from the Watergate Special Prosecutor that U.S. companies had routinely won foreign orders through bribery of officials of foreign governments. The FCPA imposes criminal penalties on individuals and enterprises that bribe officials of foreign governments or public international organizations.[19] It also makes it a crime to make false or misleading entries on a company's books for any purpose whatsoever.

In 1977, member states of the OECD signed the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Convention).[20] The OECD Convention requires all member and non-member states who have ratified the Convention to implement legislation similar to the FCPA with limited amendments. It recommends that the legislation should be interpreted broadly. In the commentary on the FCPA, the Senate Committee[21] defined the word corrupt to connote an evil motive or purpose or an intent to influence the recipient. It does not require the act of bribery to be fully consummated or succeeds in producing the desired results. It also cast the net widely. For example, under the FCPA, not only are US individuals, companies and subsidiaries subject to prosecution under the Act for corrupt practices abroad but covers foreign companies, foreign individuals, and foreign subsidiaries of the US operating in US territorial jurisdiction. Given that the OECD's member states are the wealthiest countries, where all the major MNCs reside, they are subject to the OECD Convention.

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[18] Pub. L. No. 95-213, 91 Stat. 1494 (as amended in 1988 and 1998).
[19] Johnson, The Foreign Corrupt Practices Act (Low et al., Chapter 15, page 251).
[20] http://www.oecd.org/g20/topics/anti-corruption/newguidelinestomultinationalenterprisesandtheoecdanti-briberyconvention.htm.
[21] S. REP. No. 114, 95th Cong., 1st Sess. 8 (1977).

On 31 October 2003, the United Nations General Assembly adopted the United Nations Convention against Corruption (UNCAC). The Convention covers five main areas: preventive measures, criminalization and law enforcement, international cooperation, asset recovery, and technical assistance and information exchange. The Convention includes many different forms of corruption, such as bribery, trading in influence, abuse of functions, and various acts of corruption in the private sector.[22] As of August 2018, 140 countries signed the Convention.

In its 2019 Surveys of counties' corruption perception index (CPI), Transparency International's (an NGO founded in order to combat global corruption) managing director, Patricia Moreira says: "Corruption chips away at democracy to produce a vicious cycle, where corruption undermines democratic institutions and, in turn, weak institutions are less able to control corruption"[23]. Most developing countries occupy the worst CPI ratings which correlate with countries that have weaker democratic institutions and political rights. This condition poses a strategic problem for MNCs operating in developing countries. Although the MNCs are located in home countries that have anti-corruption norms that are institutionalized, they operate directly or through subsidiaries in developing countries "where they regularly encounter pressure to engage in corrupt practices such as bribery"[24]. Thus, MNCs are faced with the problem of how to manage the challenges inherent in conforming to conflicting home and host countries' institutional environments. Ultimately, MNCs must be mindful of the consequences of being in breach of the laws, such as the FCPA, in their home countries. Also, they must recognize that their activities to achieve legitimacy in one country will affect their legitimacy in other countries.

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[22] http://www.unodc.org/unodc/en/corruption/tools_and_publications/UN-convention-against-corruption.html
[23]. Transparency International – Surveys 29 January 2019 – How Corruption Weakens Democracy. Found at: https://www.transparency.org/news/feature/cpi_2018_global_analysis.
[24] Beets SD. 2005. Understanding the demand-side: issues of international corruption. Journal of Business Ethics 57: 65–81.

It is, therefore, to the MNCs' advantage to identify and manage the risks of corruption by having standard policies and preventative measures in both the home and host countries. These may include:

1. Systems designed to prevent violations, such as prohibit direct or indirect payments to foreign officials, prohibit false entries in the company's books and records, and requiring compliance with local laws;
2. Procedures designed to prevent or detect policy violations;
3. Design and conduct internal audits to identify corrupt practices; and
4. Anticorruption training programs.

Host countries must sensitize to the reality that "Businesses need and deserve a level playing field to invest and create jobs. Put simply, when the playing field is uneven, businesses cannot make a positive contribution to economic and social development".[25]

Dispute Resolution

International commercial disputes between private persons of different states or between a state and a private person of another state or between a private person of one state and an intergovernmental organization (IGO) of another state will typically end up in arbitration or in a municipal court.[26] Resolving these disputes can be highly complex. The municipal court may have limited jurisdiction in terms of its competence or ability to try international disputes.

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[25] This comment came from Angel Gurria, OECD Secretary-General, in a speech on the New Guidelines to Multinational Enterprises and the OECD Anti-bribery Convention at the Manufacturers Association of Isreal Seminar in 2012. Found at https://www.oecd.org/about/secretary-general/newguidelinestomultinationalenterprisesandtheoecdanti-briberyconvention.htm
[26] Municipal courts are also known as "domestic" courts in some countries.

Foreign states may use the doctrine of sovereign immunity[27] to claim exemption from the duty to appear before a court. However, the situation has changed substantially over the past 50 years. State agencies that carry out commercial activities (such as national airlines or national shipping lines) are now commonly treated as having no immunity.[28] Due to the nature of some agreements, such as those involving oil and gas, where large investments are required over a protracted period, there are significant risks. Thus, investment companies are cautious to ensure the stability and security of their investments. Many international commercial agreements include "stability of agreement" clauses, as part of the risk management. These clauses may expressly prevent the parties from amending or rescinding the agreement in any way or without the prior written consent of the contractor or mutual written consent of the parties. Also, without a satisfactory degree of stability, the host countries may not be able to attract investors. The role of the stabilization clause is to strengthen the legal relationship between the host state and the foreign investor. The stability clause may insulate the agreement from any change of the laws of the state from retrospective or prospective effect. It provides protection from political risks, such as capital transfer restrictions, expropriation, breach, and war. Foreign investors can take comfort from the fact that "investment tribunals in the twenty-first century have unanimously considered it (stabilization clause) valid and legally binding, with compensation necessary upon its breach".[29]

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[27] According to the Canadian Encyclopedic Digest: With some exceptions, a court has no jurisdiction over proceedings against a foreign sovereign state, its property, its head of government, or any department of its government. Generally, the courts will not issue a writ directed to a foreign sovereign state, and therefore a foreign sovereign state cannot be sued. Nor do proceedings lie against a person or an international organization and its members entitled to diplomatic immunity by treaty or legislation. Found at Westlaw Next Canada CED Conflict of Laws 11.4 para. 53.

[28] August, Mayer, Bixby, International Business Law (Sixth Edition), 2013 ("August et al."). Page 128.

[29] Alisher Umirdinov, The End of Hibernation of Stabilization Clause in Investment Arbitration: Reassessing Its Contribution to Sustainable Development, 43 Denv. J. Int'l L. & Pol'y 455 (2015). Page 456.

Unlike developing countries with their relative weaknesses in terms of bargaining power, lack of financial resources or technological know-how, poor legal infrastructure and high political risk, many OECD countries, absent these weaknesses, do not consent to stabilization clauses in their contract with foreign investors. Professor Erkan, referring to a recent U.N. International Finance Corporation study of the stabilization clause, noted that several countries adopted English common law as part of their national laws invalidate the effect of stabilization clause, since "the state cannot be prevented… from performing functions essential to its existence." This is because of their internal constitutional orders, which do not let a former government conclude the agreement that binds the next government[30].

The downside of the traditional freezing type stabilization clause is the lack of flexibility to adapt to changes in circumstances that may upset the mutuality of the contract and require incorporating changes to re-establish financial equilibrium between the parties. For example, the volatile swings in oil prices may have a considerable impact on oil contracts without recourse to changing the agreement since the stabilization clause freezes the legal situation at the time of signing the contract.

In an extensive examination of stabilization clauses, John G. Ruggie in his Report[31], while recognizing that OECD countries do not face the same inherent weaknesses as developing countries, points to the more balanced and nuances stabilization clause between OECD countries and foreign investors. The Report suggested that OECD governments with more sophisticated

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[30] Mustafa Erkan, International Energy Investment Law: Stability Through Contractual Clauses, Wolters Kluwer (Law & Business) 2010.

[31] Ruggie, J., (March 2008). Stabilization Clauses and Human Rights: A research project conducted for IFC and the United Nations Special Representative to the Secretary-General on Business and Human Rights. https://www.business-humanrights.org/sites/default/files/reports-and-materials/Stabilization-Clauses-and-Human-Rights-11-Mar-2008.pdf.

negotiating capacity can avoid blanket "freezing" clauses that constrain policy regulation that affects broad or specific regulatory fields.

An ideal stabilization clause would neither limit the state's bona fide public policy role, nor does it expose the foreign investor to arbitrary actions of the host state. This type of stabilization clause is referred to as an economic equilibrium clause (“EEC”). There is also some experimentation with the "hybrid" stabilization clause, which is a combination of freezing and EEC clauses.

The Ruggie study,[32] noting the difficulties with obtaining random samples of contracts due to the confidential nature of contracts, analyzed 76 contracts and 12 model contracts from the 1900s and 2000s. Extracts of stabilization clauses were provided by participating law firms. The findings revealed a trend toward EECs (64), moving away from freezing clauses (13), hybrid (6) and no stabilization clause – in OECD countries (5). It concluded with a recommendation to improve the transparency of contracts. It states: "Because long-term investments can have major positive and negative human rights consequences, investors and governments should consider publishing investment contracts and project information that can have a positive effect on rights. Such publication would inform the affected community and provide those in the host state with an important assurance of the legitimacy of the process. The public sharing of contracts also provides a more level playing field to host states and investors, giving both parties access to a library of contracts to reference when new contracts are negotiated. Furthermore, published contracts are open to public scrutiny, which may mean that parties to those contracts will act with a greater sense of fairness in negotiating them”[33].

[32] Ibid
[33] Ibid, at page 43.

The negotiation of stabilization clauses in secret contributes to developing countries being made hostage to regulatory straightjacket with no opportunity for exposure and protest before the signing of the contract. As a means of countering this regulatory capture, the contract or at least specific clauses should be approved by parliaments and, or independent regulatory agencies. The Ruggie Report pointed out that stabilization is only one small aspect of an investment contract and encourages research in the issue of potential corruption associated with the negotiation and implementation of investment contracts.[34] Strengthening governance mechanisms, including grassroots education and empowerment, can serve as a means to buffer against future regulatory uncertainty.

Flexible stabilization clauses require the parties to enter into negotiations to restore the original economic balance of the contract. Thus, the clause does not seek to prevent the host government from changing the law or renegotiating the contract so long as the economic impact on the original bargain is maintained. The stabilization clause may also include certain carve-out clauses for the balancing of responsibilities of the host government and the foreign investor in areas of protection of health, safety, labour, taxation, and the environment.

Flexible stabilization clause is of great importance when one considers that "despite carefully negotiated and varied contractual guarantees and protections approximately half of all long-term infrastructure investment contracts end up being renegotiated with a repositioning of the parties that introduce materially significant changes to the terms of the original contractual agreement."[35]

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[34] Ibid

[35] Set M.M. Stodder & Ryan J. Orr, Understanding Renegotiation and Dispute Resolution Experience in Foreign Infrastructure Investment - Proceedings of the 2nd General Counsels' Roundtable February 10-11, 2006, 7 J. World Investment & Trade 805 (2006).

The literature on how international commercial arbitrators view EECs is minimal. In a singular landmark case decided by the International Centre for Settlement of Investment Disputes (ICSID), it referred to the essential correction factor in the EEC. The Tribunal stated "For the foregoing reasons, the Tribunal deems that the application of a correction factor is mandatory when a tax affects the economy of the PSCs (Product Sharing Contracts)… Otherwise stated, the correction factor must restore the economy of the PSC to its pre-tax modification level".[36]

In addition to the stabilization clause, international investors and host countries adopt other measures to deal with the inherent risk in commercial contracts. They would include the choice of law and the legal vehicle for resolving disputes.

The settlement of international commercial disputes poses particular difficulties for the courts to deal with through litigation. Parties to the dispute may wish to avoid the formal process conducted in a public courtroom. They may want to the dispute to be settled with relative speed, but in a court system, they must wait until the court has time to hear it; this can mean many months or even years before the case is heard and then subject to an appeal process. In a court process, the parties have no input in selecting the judge. Invariably, commercial disputes involve highly specialized and technical matters that require specialist attention. Judges are not necessarily trained to deal with these issues. Litigation, involving attorney fees, pre-trial costs for depositions and interrogatories, records searches, and court costs can be very costly.

Many of the difficulties encountered in litigation are overcome by international commercial arbitration. "Arbitration is now the principal method of resolving international disputes involving states, individuals, and corporations. This is one of the consequences of the increased

[36] Burlington Res., Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability. https://www.italaw.com/sites/default/files/case-documents/italaw8208_0.pdf

globalization of world trade and investment. It has resulted in increasingly harmonized arbitration practices by specialized international arbitration practitioners who speak a common procedural language, whether they practice in England, Switzerland, Nigeria, Singapore, or Brazil".[37] The arbitration process allows the arbitrator to control what evidence is allowed and engages a limited evidence process with no subpoenas, no interrogatories, and no discovery process. In binding arbitration, the parties have no appeal option. However, some arbitration decisions may be reviewed by a judge and vacated or set aside if it can be proved that the arbitrator was biased.

It is critical to be clear as to what law governs an international commercial agreement to avoid conflict of laws. In general contract law, the law that regulates the contract must have a nexus to the place where the economic activity is being conducted. However, where international parties are involved, they may choose to deal with certain aspects of the contract by way of international law. There is no fixity of jurisdiction of international law as in each country's sovereign law. International law is made up of a hierarchy of sources of law that are accepted through a mixture of contractual and consensual arrangments that are confirmed and developed by abundant international practice and case law. The International Court of Justice (ICJ) relies on a hierarchy that places International Conventions at the apex, followed by International Customs, General Principles of law and at the base, judicial decisions and teachings of publicists[38]. Article 38(2) of the ICJ statute added: "This provision shall not prejudice the power of the Court to decide a case *ex aequo et bono*, if the parties agree thereto". One distinct advantage of international commercial arbitration over litigation is that international arbitration rules[39] commonly provide for decisions *ex aequo et bono.* So long as the parties expressly consent, this concept allows decision-makers to dispense with the rigidities of strict rules of law and "permit considerations of equity, justice and fairness"[40]. However, the UNCITRAL Model Law expressly states: "In all

[37] Nigel Blackaby and Constantine Partasides, Redfern & Hunter on International Arbitration Sixth Edition (London: Oxford Press). Page 1.
[38] Charter of the United Nations and the Statute of the International Court of Justice, Chapter 2 Article 38 (1): https://treaties.un.org/doc/source/docs/charter-all-lang.pdf#page=23
[39] Included in Article 21(3) ICC; Article 28(3) UNCITRAL; Article 10(2) ILC; Clause 11 ICSID.
[40] ICSID Review - Foreign Investment Law Journal, Volume 11, Issue 1, Spring 1996, Pages 37–63.

cases, the arbitral tribunal shall decide in accordance with the terms of the contract…"[41] It is provided that the contract terms reflect the true intention of the parties and do not conflict with the mandatory provisions of the law. Thus, the *ex aequo et bono* concept has limited flexibility. International contracts are governed by a mixture of municipal law and international law.

Some aspects of the Agreement, such as arbitration, will spell out the laws, processes, language, and institutions to be used. For example, in the case of a foreign investment dispute, the arbitration clauses will typically include: the Parties, Notice requirement, Subject matter, Arbitration Body (usually, ICSID), Seat of the arbitration (covering the applicable jurisdiction of law), the Arbitration Rules (UNCITRAL), Selection of Arbitrators, the language for the proceedings, and the recognition and enforcement Convention[42]. Most of the international arbitration centres are located in OECD countries. This may pose particular problems for developing countries' representatives due to the unfamiliarity of the jurisdiction, inconvenience, and costs. Many arbitration clauses are preceded by stepped measures to resolve disputes through negotiations, conciliation, and mediation before reaching the adversarial arbitration stage.

The Guyana-ExxonMobil Petroleum Agreement

This section of the paper will conduct a brief review of the Guyana-ExxonMobil Petroleum Agreement[43] in light of the preceding analysis with particular emphasis on the dispute resolution section. It will give an opportunity to predict some of the problematic issues that are likely to result and how they may be addressed.

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[41] Article 28(4) UNCITRAL Model Law on International Commercial Arbitration 1985 With amendments as adopted in 2006.

[42] The New York Convention is a United Nations Convention that applies to the recognition and enforcement of foreign arbitral awards and the referral by a court to arbitration. As of September 2019, there are 161 contracting states to the Convention. http://www.newyorkconvention.org/

[43] Supra Note 4

Guyana, a former British colony, is a common law nation. It has a long-standing border dispute with its superior military neighbour, Venezuela. Venezuela is claiming two-thirds of Guyana's territory, including the maritime zone with Guyana's oil reserves. It has not hesitated to use aggressive military force against Guyana's attempts to explore its oil resources in the disputed area[44]. Against this backdrop and a new government anxious to act after being out of Government for 23 years signed the petroleum agreement in secrecy.

There is a general consensus that the terms of the Agreement represent an unfair deal for Guyana. Guyana received a meagre $18m signing bonus compared to neighbouring Brazil's $2.1b for less known reserves[45]. It agreed to a 2% royalty compared to an average 12.5% in the industry, according to the Law Library of Congress'Survey.[46] The Agreement stipulated that "Profit Oil" after Contract Costs shall be shared: Contractor fifty per cent (50%) and Minister fifty per cent (50%).[47] Guyana has no control over the determination and valuation of the costs, including pre-contract costs, intellectual property appropriations, and transfer-pricing mechanism.

Later examination of other terms of the contract will demonstrate that Guyana cannot be considered as having a fair and equitable deal from this Agreement. This begs the answer to the question of whether the agreement should be renegotiated or rescinded because of its unconscionable terms.

ExxonMobil negotiated the agreement with the Guyana Government and then shared out the oil blocks with other multinational corporations (MNCs), Hess Corporation (30%), CNOOC Limited (25%) and itself (45%). The MNCs incorporated three paper companies with zero assets, zero capital, and zero employees in tax havens of Cayman Islands, Barbados and Bahamas respectively. These Paper companies register three local Contracting Companies (Contractors) in Guyana. These Contractors signed the contract with Guyana. Thus, the MNCs are two levels

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[44]. On 22 December 2018, the Venezuelan navy intercepted two of ExxonMobil research vessels carrying out seismic work in the disputed maritime area.
[45] Agencia Brazil (10/10/19) at http://agenciabrasil.ebc.com.br/en/economia/noticia/2019-10/auction-oil-exploration-areas-brazil-yields-21-bi
[46] The Law Library of Congress, Global Legal Research Center: Crude Oil Royalty Rates in Selected Countries (January 2015). https://www.loc.gov/law/help/crude-oil-royalty-rates/crude-oil-royalty-rates.pdf.
[47] Supra note 4, Article 11.4.

removed from the legal arrangement. This arrangement has two distinct advantages for the MNCs. It provides for excellent tax avoidance vehicles and excludes any direct liabilities to the MNCs. The Contractors act as a conduit for transferring costs from the MNCs and repatriating profits to them. Unless they provide indemnities for the contracting companies, they are not directly responsible for their obligations.

The issue of indemnity is critical for remedial work such as abandonment and decommissioning of oil projects. The Guyana-ExxonMobil Petroleum Agreement in Article 20.1(d)(iii)(hh)[48] states that the Minister within seven days after the date of abandonment program and budget are approved shall obtain an undertaking from an Affiliated Company of each of the Parties to ensure the provision of financial and technical resources necessary to conduct the approved abandonment programme. However, the Affiliated Companies are not identified nor are any standby letter of credit as a performance bond given to secure the decommissioning and abandonment "good and faithful performance". Further, Article 26.6 refers to a Bridging Deed to facilitate the comprehensive resolution of related disputes. This Deed is a transition between the Agreement signed by the previous government in 1999 and the Agreement signed by the current government in 2016. The Minister has not provided an answer as to whether the Deed exists and whether it will be made available for examination.[49] This can become a significant issue when wells are abandoned or decommissioned and for post-contractual costs, including environmental degradation. The Contractors would have repatriated all their profits to their holding companies up-line and have no assets to bear. Guyana would have to seek the Arbitrators' consent to bring in the original parties with assets, namely, Exxon Mobil Corporation, Hess Corporation, and CNOOC Limited as parties to the dispute. It will then have to prove that they were in principle

[48] Ibid.

[49] Kaieteur News - Stabroek Block bridging deed still not public three years later – Transparency advocate (September 22, 2019). https://www.kaieteurnewsonline.com/2019/09/22/three-years-later-stabroek-bridging-deed-still-not-public-transparency-advocate-questions-what-govt-has-to-hide/

and fact, the alter egos of the contracting companies. This will involve a lengthy and costly process that Guyana cannot afford.

The Bridging Deed would be useful to shed light on what financial arrangements were made for the transition from 1999 when little or no oil reserves were known to 2016 when large known oil reserves were confirmed. There is no indication that Guyana gained any financial benefit from this new information when the Agreement was signed in 2016. Furthermore, Exxon Mobil Corporation sold off 55% of its oil blocks to other MNCs but Guyana did not receive any direct or indirect financial benefit from this transaction. The profits made by Exxon Mobil Corporation on this sale completely avoided any taxation by the Guyana Government.

The taxation of MNCs is a serious concern as these companies are adept at shifting their tax bases to minimize tax liability. However, the Guyana-ExxonMobil Petroleum Agreement has added egregious features to this phenomenon. The Agreement provides for the Contractors to pay no tax, value-added tax, charge or other imposts.[50] The agreement makes provision for the Minister of the Government of Guyana to pay the tax on behalf of the Contractors and for the Commissioner-General of Guyana Revenue Authority to issue tax certificates to Contractors evidence of payment.[51] This arrangement raises serious local and international concerns. Guyana is deprived of a major source of income. At the same time, it raises concerns about international

[50] Article 15 – Taxation and Royalty states "Subject to ……, no tax, value-added tax, duty, fee, charge or other impost shall be levied at the date thereof or from time to time thereafter on the Contractor or Affiliated Companies in respect of income derived from the Petroleum Operations or in respect of any property held, transactions undertaken or activities performed for any purpose authorized or contemplated hereunder…"
[51] Article 15.4 - The Minister hereby agrees: (a) that the sum equivalent to the tax assessed pursuant to Article 15.2 and 15.3 will be paid by the Minister to the Commissioner General, Guyana Revenue Authority on behalf of the Contractor…..". Article 15.5 states "... The Minister shall note that he is paying the income taxes on behalf of the Contractor, so that the Commissioner General, Guyana Revenue Authority can properly prepare the receipts required under this Article 15.5.

tax evasion. The Contractors are provided with tax receipts for which no tax was paid but may be presented to other tax jurisdictions to avoid double taxation.

The Agreement was negotiated and held in great secrecy. The contents of the Agreement were disclosed nineteen months later after the persistent clamour for information from the Parliamentary Opposition, the Press, and Transparency activists. The Government first denied receiving a signing bonus then refused to account for the funds through the Consolidated Fund.[52] It took over two years, the passing of a vote of a no-confidence motion against the Government, and the threat of legal action at the High Court before the funds were transferred to the Consolidated Fund. During the whole episode, the Contractors and their parent companies did not venture to clear the air on the matter.

Guyana is a constitutional democracy, but many of its institutions are weak, and politicians are using them to their advantage. The President unilaterally appointed the Chairman of the national and regional Elections Commission despite provisions in the Constitution prohibiting this. The matter was adjudicated at the Caribbean Court of Justice (CCJ)[53] that the President breached the Constitution by this unilateral action. More recently, the CCJ ruled that the Government failed to abide by a no-confidence motion that was validly passed by a majority of 33 members of Parliament for the motion to 32 against the motion. The Guyana Court Appeal had earlier ruled that the motion was not validly passed as they had interpreted that 32 no votes was larger than 33 yes votes.

[52] Laws of Guyana: Financial Administration and Audit Act Cap 73:01 (1st January 1962) Article 17 states under the caption (Revenues collected to be paid into revenues: O.39/1966A): “Principal receivers of revenues shall cause the gross revenue collected by their departments to be paid into the Consolidated Fund…”.
[53] CCJ is Guyana’s final court of appeal.

Many institutions, including the Chancellor and the Chief Justice of the judiciary, are not given security of tenure or are starved of operating funds. The Chancellors and the Chief Justices have been in acting positions for the past 18 years. It is well understood that the judiciary's security of tenure is an essential condition of maintaining the independence and freedom of those services from political or partisan control. The Integrity Commission has publicly declared that it has no funds to carry out essential functions. Guyana occupies the position of being Percieved as More Corrupt on the Corruption Perception Index[54].

Weak democratic institutions are less able to control corruption which in turn undermines democratic institutions[55]. With Guyana likely new-found wealth from its petroleum reserves, democratic institutions need to be even more vigilant against corruption.

This paper has made a case for the proposition that Guyana has a grossly unfair deal in the Guyana-Exxon Petroleum Agreement and would, therefore, wish to rescind or favourably amend the terms of the Agreement. Article 26.1 states that the Parties shall make reasonable efforts to resolve amicably all disputes by negotiation. However, a careful reading of the Stability of Agreement clause freezes the legal situation at the time of signing the contract. It provides no room for flexibility or an economic equilibrium in favour of Guyana. It states: Except as may be expressly provided herein, the Government shall not amend, modify, rescind, terminate, declare invalid or unenforceable, require renegotiation of, compel replacement or substitution, or otherwise seek to avoid, alter, or limit this Agreement without the prior consent of the

[54] Supra Note 23.
[55] Ibid.

Contractor.[56] This will suggest that negotiation would cover matters relating to the performance of the contract only rather than the terms of the contract.

The Agreement provides for the Parties to submit any dispute to the ICSID for arbitration before three (3) arbitrators. In the event, the ICSID refuses to register a request for arbitration any Party may submit the Dispute to the American Arbitration Association (AAA). The AAA shall administer the arbitration pursuant to the rules of UNCITRAL, including appointing three arbitrators. The seat of the arbitration shall be in Washington DC, USA and the proceeding conducted in English. The Government of Guyana will not be in a position to plead sovereign immunity. Article 26.3 of the Agreement states: The Government hereby irrevocably waives any claim to immunity for itself, its agencies, its enterprises, and any of its assets with regard to any arbitration.

The Agreement makes no mention of an *ex aequo et bono* provision, which would have given the arbitrators the flexibility and freedom to avoid the rigidities of the law and permit considerations of equity, justice and fairness.

The prognosis for renegotiating the terms of the Agreement is very bleak. The water-tight freezing stability clause, the waiving of sovereign immunity, absence of an *ex aequo et bono* provision, and the commencement of the performance of the contract (the contract is in its executed/performance stage rather than at an executory stage), all weigh heavily against Guyana being successful at an Arbitration to rescind or modify the Agreement. Without a strong case, Guyana will be ill-advised to spend its scarce dollars and legal resources over a protracted period with little chance of a favourable outcome. Guyana would be better advised to seek a good faith and conscionable review for fair and equitable terms as a goodwill gesture from the MNCs.

[56] Supra. Note 4.

Conclusion

International commercial contracts can involve complex business and legal issues, especially when they deal with large engineering and natural resource industries over a protracted period. Developing host countries are vulnerable when contracting with mega multinational corporations because of their inherent weak bargaining position. It is incumbent upon their governments to take all necessary measures to ensure that they secure the best possible contractual terms and the performance of the contract.

The Guyana-ExxonMobil Petroleum Agreement represents a classic case of the Government's missteps where a developing host country failed to negotiate and secure the best possible contract for its citizens. It contracted with the Multinationals' paper companies with no asset and obtained no firm financial security for the performance of the contract and the abandonment and decommissioning of the project. It authorized the Contracting companies to pay no tax of any sort during the entire term of the agreement but will command its tax authorities to provide evidentiary receipts that the Contractors did pay assessed income tax. The Government waived its sovereign immunity while agreeing to the most draconian freezing stability clause that denies any renegotiation or modification of the signed contract. The only income from the project is 2% royalty of oil sales and 50% of the oil profit after costs which the Government has no control over.

This Paper highlighted critical areas of international commercial contracts and points to the shortcomings of developing host countries face. It relates these issues to a relevant contract as it is unfolding. Many lessons can be learned from the Guyana-ExxonMobil Petroleum Agreement. But, perhaps, the most important is that Governments need to act responsibly within a robust legal framework by seeking proper professional business and legal advice and be held

accountable for their actions through democratic institutions and processes. There cannot be any room for secrecy and actual or perceived corruption.

The Multinational Corporations also need to pay heed to the UN and OECD Guidelines recommending that they conduct their operations in harmony with the national policies of the host countries and contribute to the economic and social development of the countries in which they operate[57]. Ultimately, are the host Government and its citizens getting a fair and equitable deal and are the investments of the multinational corporations protected?

[57] Supra, Notes 2 and 3.

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