

Legal Effects of Risk Management in Petroleum Contracts: a Case Study of the KRG's Production Sharing Contracts

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Abstract

Contracting has the potential to create many risks during its implementation for both parties; care in managing these risks can prevent the institutions from these hazards. In this regard, Managing risk or what can be called risk management is a key issue for international petroleum companies when they invest in other countries (Host governments) due to the uncertainty of the legal and financial atmosphere in a foreign country. The Kurdistan Regional Government (KRG) has recently signed more than 50 Production Sharing Contracts (PSCs) with the various multinational corporations around the world; foreign investors, in these contracts, insisted on having many clauses as a guarantee to exclude any potential risks that might have a negative effect on their financial position. This paper will mainly focus on the legal effects of these risk management clauses; freezing clauses articulated in the PSCs between the KRG and the foreign oil companies will be the main subject of the study.

Introduction

International energy contracts, like any other long-term international investment contracts, between a foreign investor and the host State are often exposed to various political and economic risks, especially in developing countries.¹The parties may include provisions in the contract intending to insulate the contractual relationship from any subsequent governmental legislative or administrative measures that may have the effect of annulling or altering such relationship. The purpose of such tool is to keep the investor's rights unaffected by subsequent enactments or other governmental measures.²There are plentiful contractual measures through which a party makes an investment in the oil and gas fields. The most important category is represented by agreements in the field of petroleum exploration and production; they might be in the form of concession agreements, production sharing contracts, service contracts or other types of

¹Frank Alexander, 'Comment on articles on stabilization by PieroBernardini, Lorenzo Cotula and AFM Maniruzzaman' Journal of world energy law and Business, 2009, p.1-4.

²A.F.M. Maniruzzaman, 'The pursuit of stability in international energy investment contracts: A critical appraisal of the emerging trends', Journal of World Energy Law & Business, 2008, Vol. 1, No. 2, p.121-122.

contractual relations.³ There are two major characteristic of these contracts. The first one is having a contract signed with the host state (state entity), and the second one is their duration, which is normally longer than common commercial agreements in other sectors.⁴ These two characteristics can be understood as a main reason behind the high rate of risk taken truly by foreign companies. Risk management is taken seriously by all categories of corporations, particularly multinational companies. It has been their top priority and their most significant objectives according to the recent surveys conducted in this field.⁵ One of the major means to safeguard the rights and exclude legal risks of oil companies is freezing provision; where the host government guarantees that the relationship shall not be unilaterally revised and any laws or regulations pertinent to the Stabilized Element(s) that may be passed after the effective date of the agreement shall not apply to the International Oil Companies.⁶

Research objectives

There are many risks facing the oil companies in host states due to the financial and legal instability in host countries from the petroleum companies' perspectives. Thus, commonly, international companies working in oil industry insist on having some provisions to guarantee their rights. The research focuses on the risk management tools utilized by companies, particularly freezing clause stated in the agreements signed with the KRG. It is vital for the KRG to deal with the impact of such clause when it freezes its regulations and it cannot change its laws except by the parties' approval. Research in this field had not been conducted before.

Research problems

There are many risks face the foreign companies working in the host country which should be managed properly by the companies; risks including financial, political and legal. In this regard, companies are insisting on having some safeguards to protect their position; one mechanism is to enforce a clause known as freezing in order to ensure the stability of legislation. This clause can be found in the PSCs signed by the KRG with foreign corporations that left no choice for the KRG to change related regulations. The problematic issue for both parties is the validity of this clause as an effective tool for managing risk due to the legal disputes between the federal government and the KRG over the legitimacy of concluded contracts.

Research methodology

An analytical approach has been adopted in conducting the research; the concept of risk management will be discussed with freezing clause as effective mechanism of managing risk by looking at all related provisions in the KRG regulations and contracts.

³ Dr.Kawan Ismael, *Oil Exploration and Production, Comparative Study* (2011) first edition, at p.4-9.

⁴B.Piero, 'Stabilization and adaptation in oil and gas investments' *Journal of World Energy Law and Business* 1, No.1 2008, p.1-5.

⁵Kenneth A. Froot, David S. Scharfstein and Jeremy C. Stein, 'Risk Management: Coordinating Corporate Investment and Financing Policies' *The journal of finance* 68, No.5 December 1993, p. 1629-1634.

⁶ Frank Alexander, 'Comment on articles on stabilization by PieroBernardini, Lorenzo Cotula and AFM Maniruzzaman' *Journal of World Energy Law & Business*, 2009, Vol. 2, No. 3, p.243-247.

Research Outline

The research has been divided into six parts; the meaning of risk management will be explained in the first part, followed by the application of risk management in the second part. The third part will be dedicated to freezing clause with classification of this clause in fourth part. The validity of the provision and its applications in the KRG's production sharing contracts will be discussed in the fifth and sixth part of the paper.

I. Meaning of risk management

Risk management is a relatively recent corporate function. Historical milestones are helpful to illustrate its evolution. Modern risk management started after 1955, particularly after the Second World War when large companies with diversified portfolios of physical assets began to develop self-insurance against risks. The concept of risk management in the financial segment was revolutionized in the 1970s, when financial risk management became a priority for many companies including banks, insurers, and non-financial enterprises exposed to various price fluctuations such as risk related to interest rates, stock market returns, exchange rates, and the prices of raw materials or commodities.⁷ The main objective of risk management is to create a situation when the company can handle its risks and uncertainties. Aven and Renn have defined risk as 'Uncertainty about severity of the events and consequences (or outcomes) of an activity with respect to something that humans value'.⁸ Meanwhile, Diones has defined risk management as 'a set of financial or operational activities that maximise the value of a company or a portfolio by reducing the costs associated with cash flow volatility'.⁹ Investors can therefore reduce risk by including in their contracts clauses like renegotiation, international arbitration, choice of law, adaptation clauses as well as stabilization clauses or freezing clause. The concept risk management has been defined in the business dictionary as 'the identification, analysis, assessment, control, and avoidance, minimization, or elimination of unacceptable risks. An organization may use risk assumption, risk avoidance, risk retention, risk transfer, or any other strategy (or combination of strategies) in proper management of future events'.¹⁰ In the world of finance, risk management refers to the practice of identifying potential risks in advance, analyzing them and taking precautionary steps to reduce/curb the risk.¹¹ Furthermore, the Investopedia, which is an academic dictionary for investment terms, has defined risk management as "the process of identification, analysis and either acceptance or mitigation of uncertainty in investment decision-making. Essentially, risk management occurs anytime an investor or fund manager analyses and attempts to quantify the potential for losses in an investment and then takes the appropriate

⁷ Georges Dionne, 'Risk Management: History, Definition and Critique' Interuniversity Research Center on Enterprise Networks, Logistics and Transportation, 2013, p.1-4.

⁸Terje Aven and Ortwin Renn, ' *Risk Management and Governance* (Springer 2010), p. 1-7.

⁹ Georges Dionne, (note 7), p.4-8.

¹⁰ Derived from an online Business Dictionary, available at [<http://www.businessdictionary.com/definition/risk-management.html#ixzz3lwZaOxmj>] accessed on 16 July 2015.

¹¹ Terje Aven and Ortwin Renn, (note 8), p. 9-12.

action (or inaction) given their investment objectives and risk tolerance. Inadequate risk management can result in severe consequences for companies as well as individuals. For example, the recession that began in 2008 was largely caused by the loose credit risk management of financial firms.”¹² Simply put, risk management is a two-step process - determining what risks exist in an investment and then handling those risks in a way best-suited to your investment objectives. Risk management occurs everywhere in the financial world. It occurs when an investor, particularly multinational oil companies, invest in the foreign country and there might be a high potential of risk where they are not familiar with the investment environment in the host state.

II. Risk management application

Exploration and production of hydrocarbons is a high-risk venture. Geological concepts are uncertain with respect to structure, reservoir seal, and hydrocarbon charge. On the other hand, economic evaluations have uncertainties related to costs, probability of finding and producing economically viable reservoirs, technology and oil price. Even at the development and production stage the engineering parameters embody a high level of uncertainties in relation to their critical variables (infrastructure, production schedule, quality of oil, operational costs, reservoir characteristics etc.). These uncertainties originated from geological models and coupled with economic and engineering models involve high-risk decision scenarios, with no guarantee of successfully discovering and developing hydrocarbons resources.¹³

Regarding monitoring and review processes of risk management, effective risk management requires a system for reporting and auditing to ensure effective system to identify hazards and examined that appropriate risk control measures have been taken. Furthermore, it must make a periodic review of the policy and the levels of compliance with laws, and a review of the performance criteria for identifying development opportunities. It must be remembered that the same dynamic institutions, operating in a dynamic and changing environment. Thus, identifying changes in the institutions and the environment necessary in which it operates and works of appropriate amendments to the systems.¹⁴ As long as petroleum industry characterised with a high level of risk, international oil companies are encouraged to avoid investing in those countries that may lack political and legal stabilities.¹⁵ Investors do not invest in the risky environment which might lead to lose profit or even the whole project because of financial, political and legal uncertainty.¹⁶ The

¹² Derived from Investopedia, available at [<http://www.investopedia.com/terms/r/riskmanagement.asp>] accessed on 11 August 2015.

¹³ Saul B. Suslick, 'Uncertainty and Risk Analysis in Petroleum Exploration and Production' UNICAMP Institute of Geosciences and Center of Petroleum Studies, at p.1-5. available at [<http://www.ige.unicamp.br/terrae/V6/PDF-N6/T-a3i.pdf>] accessed on 8 of August 2015.

¹⁴ Egyptian Risk Management Association (ERMA), available on [www.ferma.eu/.../a-risk-management-standard-arabic] accessed on 7 August 2015.

¹⁵ Talal A.Q. Al-Emadi, 'Stabilization clauses in international joint venture agreements' International Energy Law Review (2010), p. 1-4.

¹⁶ Rafael La Porta and others, 'Investor protection and corporate governance' J Financ Econ 3(2000) 58(1), p. 3-6.

developing countries, in particular oil rich countries, have witnessed a history of violence and political turmoil after the Second World War which makes the investment rather more difficult.¹⁷ The guarantees that investors insist to be included in petroleum contracts with the host state are various;¹⁸ the main focus of the second part would be on freezing clause or regulatory stability for the Oil Companies working in the Kurdistan region of Iraq.

III. Freezing clause¹⁹ as an effective tool of risk management

Regulatory constancy is generally considered to be crucial in attracting foreign investors, particularly in natural resource projects where a long-term investment is a major feature.²⁰ For example, according to the opinion of the Head of State Investment Corporation in Russia, Yuri Petrov, changing legislation has a negative effect on investment and he states 'change of legislation is the biggest risk facing potential investors.'²¹ Stabilisation clause can be defined as 'a contractual device developed in response to such concerns: it attempts to insulate petroleum contracts from changes in the legal environment surrounding them.'²² Due to the stream of nationalisation and expropriation which had took place between the First World War and Second World War in most of the oil rich countries, particularly in Latin America, IOCs have sought of inclusion of certain clauses, known as stabilisation clauses; in order to secure their position toward the host country's amendment in existing legislation which had a negative impact on the agreements regulating their relationships.²³ In modern contracts, this clause might permit amendments in the host government's legislations on the condition that these changes do not have any effects on the interests of investors (Mainly international oil companies). This might be written under this structure: 'This agreement shall be construed in accordance with the Petroleum and Tax Laws and related regulations in force on the date of execution. Any amendments to, or repeal of such laws or regulations, shall not affect the contract rights or obligations of the contractor without its consent.'²⁴ It is very common to see this clause in production sharing agreement compare to other

¹⁷ Ibid, p. 7-10.

¹⁸ Such as Stabilisation clause, choice of law, force majeure, dispute settlement, Currency Conversion and Profit Repatriation clauses. See Klaus Peter Berger, 'Renegotiation and Adaption of International Investment Contracts: The Role of Contract Drafters and Arbitrators' Vand. J. Transnat'l L. (2003) 36, p. 1349-1350.

¹⁹ Freezing and Stabilization can be used interchangeably.

²⁰ Lorenzo Cotula, 'Reconciling regulatory stability and evolution of environmental standards in investment contracts: Towards a rethink of stabilization clauses' The Journal of World Energy Law & Business (2008) 1(2), p. 158-162.

²¹ Mark A. Stoleson, 'Investment at an Impasse: Russia's Production-Sharing Agreement Law and the Continuing Barriers to Petroleum Investment in Russia' Duke Journal of Comparative & International Law (1997) 7(2), p. 679.

²² Abdullah Faruque, 'Validity and Efficacy of Stabilisation Clauses: Legal Protection vs. Functional Value' Journal of International Arbitration (2006) 23(4), p. 317.

²³ R.Doak Bishop, *International Arbitration of Petroleum Disputes: The Development of a "lexPetrolea"* (University of Dundee, Centre for Energy, Petroleum and Mineral Law and Policy 1997), p. 1158.

²⁴ Noah Rubins & N. Stephen Kinsella, *International Investment, Political Risk and Dispute Resolution* (Oceana Publications 2005), p.51.

contractual form such as concessionary system; because in PSC the ownership of the resource is belong to the host state and it is under their sovereignty.²⁵

IV. Classification of freezing provisions in international contracts:

There are many forms of clauses by which foreign investors demanding the stable legal condition in the host government. Freezing, where the host country ensures that the relationship shall not be unilaterally revised; and included in that safeguard is the promise that any laws or regulations pertinent to the stabilized element that may be passed after the effective date of the agreement shall not apply to the oil companies, examples of this category are Guyana, Cambodia, Honduras, Kazakhstan, Mozambique, Nepal, Philippines, Thailand, Trinidad & Tobago, and Tunisia.²⁶ Furthermore, there is another type of this clause which is called 'Specified Economic Balancing' this means where if the host government takes applicable unilateral sovereign action that results in revision of the stabilized element, then the contract shall be amended (revised in addition to the specified unilateral sovereign action by HC that upset the economic balance in the first place) in a specified fashion so that the economic balance between the parties, as described on the effective date of the contract, may be re-obtained; Applicable to Production Sharing Agreements (may be limited to value of host country share of 'profit petroleum' under PSCs) such as Ecuador, Jamaica and Peru). On the other hand, there is another form which is different from the last one and known as 'Non-Specified Economic Balancing' which is applied but without specifying what such amendment shall be and without providing that such an amendment shall be determined as a result of negotiations between the host country and the international oil companies; Applicable to PSCs (may be limited to value of HC share of 'profit petroleum' under PSCs) (Azerbaijan, Cambodia and Turkmenistan). There are many more forms of this clause such as: Negotiated Economic Balancing, Government Pays-Without Limitation, Government Pays-With Limitation, Government Indemnifies-With Limitation and Government Indemnifies-Without Limitation'.²⁷ The KRG has applies the first category which is known as freezing clause.

V. The effectiveness of freezing provision in oil contracts

With regard to the validity of freezing clauses under domestic and international law, the main question is: are those clauses effective in preventing the host state from amending or changing legal or fiscal regimes? The issue of legal validity of freezing section considered to be a very complicated process.²⁸ Walde has described as 'one of the most complex issues in international economic law in view of the fact that strands of arguments from international law (state responsibility, law of treaties) of national law, of conflict of law (both international and national conflict of laws) and

²⁵Tade Oyewunmi, 'Stabilisation and renegotiation clauses in production sharing contracts: examining the problems and key issues' *International Energy Law Review* (2011), p.t 3-7.

²⁶ R Doak Bishop, (note 23), p.1131.

²⁷ Frank Alexander, (note 6), p.244-246.

²⁸Amaechi David Nwokolo, 'Is there a Legal and Functional Value for the Stabilisation Clause in International Petroleum Agreements?' *CEPMLP Annual Review* (2003) 8, p. 9.

possibly of an “international lex mercatoria” come together and can be arguably applied.²⁹ Despite the fact that there is uncertainty to the consequences of violating this clause, there is a general consensus upon the validity of stabilisation clause under national and international law.³⁰ El-Kosheri and F.Raid, for example, have argued that to the extent of expressing consent by both parties toward stabilisation clause in petroleum agreements, there is a mutual obligation to respect this clause in the context of their contract agreed upon. They further indicated that the state would enter into all contracts under the framework of its public law, by virtue of the same law; state can partly waive its sovereignty and grant certain immunity to oil companies as a private party in this contractual obligation.³¹ In addition, the sanctity of contracts and (Pacta sunt servanda) are meant to be the ancient principles ruling the contract under both municipal and international law; these principles are also guarantee the fulfilment of most international obligations, particularly the implementation of treaties.³²

However, the main challenges facing this clause, as it is suggesting by some, is the contradiction of this clause with the principle of Permanent Sovereignty over Natural Resources practised by the host state to freely exploit its natural resources throughout the country.³³ Nonetheless, this argument is refused as an impediment to validate stabilisation clause. For example, Schriver argues that sovereignty does not only produce rights for the government, but rather it is a source of responsibility and it is considered to be a base of co-operation among countries.³⁴ Moreover, another argument in favour of validity of stabilisation clause is related to the continuity of host governments to provide this safeguard in their petroleum contracts even after the UN resolution regarding the permanent sovereignty as an indication of a good faith.³⁵ Thus, it can be noticed that this clause is a temporary limitation imposed by state itself without forcing by outer authority and the host country should respect its implication to create a sphere of investment and to attract foreign investors to invest on its land.

²⁹ Thomas Walde and George Ndi, 'Stabilizing International Investment Commitments: International Law Versus Contract Interpretation,' *Tex. Int'l L J* (1996) 31, p. 238.

³⁰ Abdullah Faruque, (note 22), p. 323-324.

³¹ Ahmed S. El-Kosheri and Tarek F. Riad, 'The Changing Roles in the Arbitration Process (With Regard to the Applicable Law Governing the New Generation of the Petroleum Agreements)' *Arab Law Quarterly*, (1986) 1(5), p. 479-499.

³² Amaechi David Nwokolo, (note 28), p. 10-14.

³³ Eduardo Jimenez de Arechaga, 'State Responsibility for the Nationalization of Foreign Owned Property' *NYUJ Int'l L. & Pol.* (1978) 11, p. 179-182.

³⁴ Schriver, 'The Changing Nature of State Sovereignty' *British Year book of International Law* (1999) 65 p. 71.

³⁵ Abdullah Faruque, (note 22), p. 323-329. UN General Assembly Resolution, Permanent sovereignty over natural resources, 1803 (XVII) of 14 December 1962

VI. Freezing clause in the KRG's model of PSC

The KRG's oil and gas law 2007 does not contain any articles regarding freezing clauses, unlike the 2006 proposed draft which did contain limited provisions applicable to taxation matters.³⁶ However, this clause has been mentioned in article 43 of the KRG's model of PSC:

"The GOVERNMENT guarantees to the CONTRACTOR, for the entire duration of this Contract, that it will maintain the stability of the fiscal and economic conditions of this Contract, as they result from this Contract and as they result from the laws and regulations in force on the date of signature of this Contract. The CONTRACTOR has entered into this Contract on the basis of the legal, fiscal and economic framework prevailing at the Effective Date. If, at any time after the Effective Date, there is any change in the legal, fiscal and/or economic framework under the Kurdistan Region Law or other Law applicable in the Kurdistan Region which detrimentally affects the CONTRACTOR, the terms and conditions of the Contract shall be altered so as to restore the CONTRACTOR to the same overall economic position as that which CONTRACTOR would have been in, had no such change in the legal, fiscal and/or economic framework occurred."³⁷

Despite having a valid agreement between foreign investor and host country, from the perspective of the host country the amendments of the existing legislations or enactment of the new ones is a manifestation of their sovereignty.³⁸ The host government always claims having authority and permanent sovereignty over its natural resources, on the basis of the UN General Assembly Resolution on Permanent Sovereignty over Natural Resources.³⁹ When it comes to the Kurdistan Regional Government, the crucial question would be: is it possible for the KRG to provide this safeguard and restrict government's power while they do not possess sovereignty. What would be the guarantee for the Oil Companies who signed oil contract with the KRG with stabilization clauses, if the Federal Government, as the only entity in Iraq to have sovereignty, has practiced its power in changing terms and condition of those contracts or enact new legislation which has negative impact on the oil companies' interest in the region.

According to the Iraqi constitution 2005, Kurdistan is the only recognized federal region in Iraq.⁴⁰ Constitutionally, all legislation that contradicts with this constitution is considered to be void and shall not be enacted whether by Federal Government or Regional Authorities in the KRG.⁴¹ This is quite similar with other federal states elsewhere that the Federal Government has authority to legislate

³⁶Article 49 (3) of the Kurdistan Draft Petroleum Act 22 October 2006.

³⁷Article 43(3) of the KRG model of the PSC, available at [http://www.krg.org/pdf/3_krg_model_psc.pdf] accessed on 17 July 2015

³⁸Amaechi David Nwokolo, (note28), p. 3-5.

³⁹ UN General Assembly Resolution, Permanent Sovereignty over Natural Resources, 1803 (XVII) of 14 December 1962, available at: [<http://unispal.un.org/UNISPAL.NSF/0/9D85892AC6D7287E8525636800596092>] accessed on 20 June 2013.

⁴⁰Article 1 and 117 of the Iraqi constitution 2005.

⁴¹Article 13(2) of the Iraqi Constitution 2005.

throughout the country. For instance, in Nigeria, the National Assembly has legislative competence to make laws “with respect to any matter”.⁴² Further, formulating commercial policy across regional and governorate boundaries in Iraq are in the hand of Federal Government.⁴³ Thus, they might enact new legislation that has negative effect on the investors in the region as they always claim to have this right over the oil contracts concluded by the KRG.⁴⁴ The influence of the federal powers is clear when they forced the KRG to put an article in the Kurdistan Draft Petroleum Act in 2003 to review all PSCs which entered into force before the law was passed in order to ensure their consistency with the “standards established in the law.”⁴⁵

However, the KRG has changed this provision later in its Petroleum Law in 2007 and they guaranteed the validity of ‘any agreement related to Petroleum Operations entered into by the regional government prior to the entry into force of this Law, and approved by the Minister, shall remain in force.’⁴⁶ Moreover, the argument by the KRG to secure the stability of the legislation inside and outside the region is supported by the content of article 121 (2) of the Iraqi constitution states ‘In case of a contradiction between regional and national legislation in respect to a matter outside the exclusive authorities of the Federal Government, the regional power shall have the right to amend the application of the national legislation within that region.’⁴⁷ Nonetheless, this article 121(2) can be relied on only if the KRG is able to prove its authority in the management of petroleum sector in the region. In this regard, as it has been discussed in chapter three, the KRG officials have emphasized in many occasions their authority over oil and gas matters and they consider it as an exclusive power of the region depending on the core of article 112 of the Iraqi constitution.⁴⁸ In addition, Another way of utilising this safeguard, even if it had not been articulated in the KRG’s model of PSC, is by returning to the Civil Code applicable in the KRG which is stated the principle of Non-retroactivity of laws;⁴⁹ because in the *Libyan American Oil Company v. Government of the Libyan Arab Republic* case it had been emphasised that this principle is consistent with the core

⁴² Section 4 of the Constitution of the Federal Republic of Nigeria 1999, available at [<http://www.nigeria-law.org/ConstitutionOfTheFederalRepublicOfNigeria.htm>] accessed on 7 Sep.2015.

⁴³ Article 110 (3) of the Iraq Constitution 2005.

⁴⁴ Rex J.Zedalis, 'Foundations of Baghdad's Argument that Regions Lack Constitutional Authority Over Oil and Gas Development Agreements' *Journal of Energy and Natural Resources Law* (2008) 26(2), p. 309-313.

⁴⁵ Peter D. Cameron, 'Contracts and Constitutions: The Kurdish Factor in the Development of Oil in Iraq' *International Journal of Contemporary Iraqi Studies* (2011) 5(1), p. 86-89.

⁴⁶ Article 57(1) of the Kurdistan Petroleum Law 2007.

⁴⁷ Peter D. Cameron, (note 45), p. 90-95.

⁴⁸ Ben Holland 'Are Kurdistan's Oil Contracts Constitutional?' (2012), available at: [<http://www.cms-cmck.com/Hubbard.FileSystem/files/Publication/63538de4-c6c3-47ee-aea9-c58e03f60e57/Presentation/PublicationAttachment/de7979f5-590b-44a9-ae76-c5d5fc52b686/ADIPEC%20BH%20Kurdistan%20copy.pdf>] accessed on 8 Sept 2015.

⁴⁹ Article 10 of the Iraqi Civil Code 1951 available at: [http://www.law.fsu.edu/journals/transnational/vol16_1/stigall.pdf] accessed on 11 Sept 2015.

of stabilisation clause and they have the same effect.⁵⁰ The KRG's argument is also supported by the concept of stabilisation clauses adopted in their PSC model. This kind of clause in the KRG's model, unlike the traditional form which is known as freezing stabilisation clause, has been described by Evaristus Oshionebo as a modern form of stabilization that attempts to 'maintain economic equilibrium between the parties'.⁵¹ Al-Emadi has indicated that this type of clause does not freeze the legislative competence of the host country and does not contradict with the concept of sovereignty, but rather its purpose is to obligate both parties to perform their obligation with good faith.⁵² This opinion is quite consistent with what Curtis has argued that having stabilisation clauses in the production sharing agreements would certainly provide an extra safeguard for the oil companies, even if it fails to prevent the host country from altering or amending the existing rules or terms unilaterally; as the breach of this clause might cause damage to the company and it leads to the equitable compensation by the host country.⁵³

This contemporary stabilisation clause which has been adopted by the Kurdistan Regional Government is considered to be more attractive from the perspective of both Oil Companies and the KRG due to some factors. Firstly, it is additional guarantee for the Oil Companies while the sovereignty of Iraq is preserved and they have absolute power to issue new legislations and orders.⁵⁴ Secondly, this clause is no longer aims to prevent the host country from expropriating or nationalising its petroleum industry throughout new legislations. Instead, its purpose is to provide remedy to the OC if the host state's action harmfully affects the project by adjusting the terms of the agreement to keep the OC in the similar financial position as it was in the date of signing the contract.⁵⁵ Thus, it can be realised that on the one hand, the Federal Government does not need to be concerned as long as this clause does not restrict its legislative power; On the other hand and in a similar vein, the oil companies working in the Kurdistan Region, as long as the KRG has offered such a guarantee as an extra safeguard. If any disagreement occurs between the KRG and the oil companies, the Kurdistan's model of PSC is offering mechanisms to solve these disputes.

Another guarantee which can be found in the KRG's model of PSC is the availability of virtually all mechanisms of settling disputes between the Parties or between any one or more entities constituting the contractor and the government.⁵⁶ The Kurdistan's model has adopted both adversarial and non-adversarial methods

⁵⁰Libyan American Oil Company v. Government of the Libyan Arab Republic, 20 I.L.M 31 (1981) at paragraph 60.

⁵¹Evaristus Oshionebo, 'Stabilization clauses in natural resource extraction contracts: legal, economic and social implications for developing countries' *Asper Review of International Business & Trade Law* (2010) 10, p. 4-6.

⁵²Talal A.Q. Al-Emadi, (note 15), p. 1-4.

⁵³ Christopher T. Curtis, 'The Legal Security of Economic Development Agreements' *Harv. Intl L.J.* (1988) 29, p. 349.

⁵⁴Talal A.Q. Al-Emadi, (note 15), p. 1-4.

⁵⁵ J. NnaEmeka, 'Anchoring Stabilization Clauses in International Petroleum Contracts' *Int Lawyer* (2008) 42(4), p. 1326-1328.

⁵⁶ Article 42(1) of the KRG's model of PSC.

for dispute settlement which are available in international business transactions.⁵⁷ For instance, article 42 of the KRG's model of PSC has regulated this clause as follows '.....the parties to the Dispute shall first seek settlement of the dispute by negotiation....'⁵⁸ 'If the Dispute cannot be resolved by negotiation in accordance with Article 42.1 (a).....any party to the Dispute may seek settlement of the dispute by mediation in accordance with the London Court of International Arbitration (LCIA) Mediation Procedure....'⁵⁹ 'If the Dispute is not settled by mediation in accordance with Article 42.1 (b).....any party to the Dispute may refer the Dispute to, and seek final resolution by, arbitration under the LCIA...'⁶⁰ Moreover, it has adopted Expert Determination with regard to some specific disputes.⁶¹ This attitude is very similar with the one which has been utilised by the recent version of Indonesia's production sharing contracts; whereby the disputes should be first settled amicably, if the attempts fail the parties will resort to arbitration.⁶² Dispute settlement clauses in production sharing contracts are considered to be significant; as the disputes are likely to rise, particularly when the host country violate its obligations under stabilisation clauses.⁶³ There are plenty of other safeguards that have been demanded by investors to protect their position under petroleum contracts in host states such as Choice of Law clause, Force Majeure clause, Currency Conversion and Profit Repatriation clauses.⁶⁴

Conclusion

The paper has shed light on the concept of risk management and its application in the context of oil and gas industry. The main focus in the research is on assessing risk by oil companies and trying to prevent any potential risk that might be occurred in the atmosphere of legal instability. At the same time, the legal impacts of such provision enforced by the companies on the host state that might negatively affect the legal position of states.

Risk management is considered the key issue when it comes to international petroleum contracts between host countries and foreign companies; investors usually looking for a safe environment to do their investment, particularly financial, political or legal stabilities. There are many tools by which companies can obtain this certainty. One of the major mechanisms is adopting freezing clause by international companies to safeguard the stability of the valid regulations in the host country. The practice of freezing of IOC's contractual rights has progressed over the decades from the

⁵⁷ Mobolawa, O. Akinoye. 'The Legal Framework for Dispute Resolution in International Business Transactions' (2005), available at: [<http://www.dundee.ac.uk/cepmlp/gateway/?news=28038>] accessed on 28 July 2015.

⁵⁸ Article 42(1)(a) of the KRG's model PSC.

⁵⁹ Article 42(1)(b) of the KRG's model PSC.

⁶⁰ Article 42(1)(c) KRG's model of PSC.

⁶¹ Article 42(2) of the KRG's model of PSC.

⁶² Karen Mills and Mirza A Karim, 'Disputes in the oil and gas sector: Indonesia' *The Journal of World Energy Law & Business* (2010) 3(1), p. 56-58.

⁶³ Mobolawa, O. Akinoye. (note 57).

⁶⁴ Klaus Peter Berger, 'Renegotiation and Adaption of International Investment Contracts: The Role of Contract Drafters and Arbitrators' *Vand.J.Transnat'l L.* (2003) 36, p. 1349-1350.

traditional freezing approach to a more modern and sophisticated economic balancing one where the State's right to exercise its sovereign authority is balanced by the protection of the foreign investor's interest. Based on the principle of party autonomy, the parties to the oil and gas agreements are generally free to stipulate what laws they wish to apply to their agreement. In practice, it is usual to notice that the choice of law to govern oil and gas agreements is the domestic law of the host state. Behind the desire of host states' to have their national law govern the contractual rights and obligations is simply because they are more familiar with it compared to other laws. Therefore, the host state's law has continued to be the preferred law to a very large extent across contracts in developing countries. On the other hand, host states (who still need to encourage international investment) are aware that international oil and gas companies are not always comfortable (they can be uncertain of the some host country's undeveloped laws) with host states' national laws. Hence, stability is often required by the international oil and gas companies.

Recommendations

- Despite the fact that the KRG has accepted some provisions for protecting foreign companies as a tool for excluding legal risks, it can insist on its right of amending some part of regulations, particularly in the future if the KRG will decided to alter some parts of the contracts or enforcing more conditions to foreign investors in favour of itself.
- It is for the KRG to realize its rights in public contracting under the governing laws as the common pattern in contracting is having discretionary powers and privileges for the host country. Thus, the KRG has to work in a way not to abandon this authority and try to keep balance its interests and oil companies'.
- In this regard, the KRG needs to review the concluded contracts with the foreign corporations in order to regain power, particularly if it intended to adopt other contractual forms such as service contracts.
- Moreover, the KRG has to improve managerial skills in order to overcome all issues that might face it in terms of risk management with oil companies. Another way to enhance the KRG's legal position is to work on adopting renegotiation clause in petroleum contracts and regulations that allow adapting the terms and conditions.

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پوخته‌ی توژیینه‌وه

كۆمه‌لی مه‌ترسی دروست ده‌بیت بۆ لایه‌نه‌كانی گریه‌سه‌ست له كاتی جیه‌جیه‌كردنی، ئەم مه‌ترسیانه ده‌كریت رێگریان لیبكریت به هۆی باش مامه‌له‌كردن له كاتی دارشتن و جیه‌جیه‌كردنی ناوه‌روکی گریه‌سه‌سته‌كاندا. ئیداره‌كردنی مه‌ترسیه‌كان بابه‌تیکی پر بایه‌خه بۆ كۆمپانیا نیوده‌وله‌تیه‌كانی بواری نه‌وت كاتیک وه‌به‌ره‌یتان ده‌كهن له ولاتانی بیانییدا به‌هۆی هه‌موو ئەو ناجیگیریه یاسایی و داراییانه‌ی كه هه‌یه. حكومه‌تی هه‌ریمی كوردستان نزیكه‌ی په‌نجا گریه‌سه‌ستی نه‌وتی له جۆری هاوبه‌شی له به‌ره‌م واژۆ كردووه له‌گه‌ل كۆمه‌لی له كۆمپانیا نیوده‌وله‌تیه‌كان. له‌م گریه‌سه‌ستانه‌دا وه‌به‌ره‌ینه بیانیه‌كان پینداگری ده‌كهن له‌سه‌ر هه‌بونی چه‌ند مه‌رچ و كۆتیک به مه‌به‌ستی زامنكردن و دورخستنه‌وه‌ی هه‌ر مه‌ترسیه‌ك كه كاریگه‌ری نه‌رینی هه‌بێ له‌سه‌ر پینگیه‌ی دارایی كۆمپانیاكان. ئەم توژیینه‌وه‌یه به شێوه‌یه‌کی سه‌ره‌کی تیشك ده‌خاته سه‌ر كاریگه‌ری یاسایی ئەو میكانیزمانه‌ی كه به‌كاردین و به‌تایبه‌تیش مه‌رجی سه‌قامگیری یاسایی كه له گریه‌سه‌سته نه‌وتیه‌كانی حكومه‌تی هه‌ریمی كوردستاندا جیگیركراوه.

ملخص البحث

التعاقد يولد مخاطر عديدة اثناء تنفيذها لكلا الطرفين , الحذر في ادارة هذه المخاطر يمكن أن تمنع المؤسسات من تعرض لهذه المخاطر خلال ابرام و تنفيذ عقد .ادارة المخاطر هي مسألة رئيسية بالنسبة لشركات النفط الدولية عندما تقوم بالالتسمارات في بلدان الأخرى (الدول المضيفة) , وذلك بسبب عدم التيقن من المناخ القانوني والمالي في الدولة الأجنبية (الدولة المضيفة).وقعت حكومة إقليم كردستان في الأونة الأخيرة أكثر من خمسين عقداً من عقود أقتسام الانتاج ,مع عدة شركات متعدد الجنسيات من مختلف بقاع العالم. المستثمرون الاجانب في هذه العقود, اصرو على وجود العديد من البنود كنوع من الضمان و لأستبعاد المخاطر المحتملة التي قد يكون لها تأثير سلبي على وضعهم المالي , ستركز هذه البحث على الاثارالقانونية لبنود ادارة المخاطر هذه , وستكون شرط استقرار القانوني الواردة في هذه العقود (عقود أقتسام انتاج) المبرمة بين حكومة إقليم كردستان وشركات النفط الأجنبية ستكون الموضوع الرئيسي لهذه الدراسة .