INTERNATIONALIZATION OF ECONOMIC DEVELOPMENT AGREEMENTS: A REVIEW OF CONTRACTUAL SAFEGUARD CLAUSES

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ABSTRACT
Internationalization is a principle of international practice which operates with the aim to protect international investments and foreign investors from the actions and legal systems of host nations. Therefore, the need to abstain from domestic legal coverage birthed the theory of internationalization. This paper, fundamentally, considers the nature of Internationalization of Economic Development Agreements (EDAs). Furthermore, it examines the theory of internationalization, and discusses the different contractual safeguard clauses used at the international platforms to ensure that the choice of parties and parties’ independence from the domestic legal system of a host state is preserved. This paper revealed that Internationalization is fundamentally a principle of international practice which seeks to allay the fears of foreign investors from the confines of domestic legal systems. It goes further to reveal that stabilization and arbitration clauses are indispensable principles in EDA, the application of which has resulted in tremendous progress in international investments. This paper established that international law is both strenuously opposed by legal theorists and lacks the support of established precedents of international case law known as stare decisis. The paper further established that EDA agreements acquire sanctity as contracts now rests on the principle of Pacta Sunt Servanda, as legislative powers are eroded.

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1.0. Introduction

Transnational Corporations (TCs) all across the globe have made attempts to protect their investments from the actions, and legal system, of host states. In doing this, TCs focus on internationalizing contracts in order to completely abstain from the coverage of domestic legal regime. As a result, mechanisms have been put in place to apply directly to influence transnational corporate relationships. However, these mechanisms can be examined from three distinct perspectives or classifications. These classifications are: international dispute resolution panel which can provide neutral decisions enforceable against the state which are mostly located abroad; the applicable law clauses to exclude the domestic legal system of the contracting state, totally or partially; and inserting in the contract what is commonly called a ‘stabilization clause’, which freezes the contracting state’s legal system and prohibits the public authority from undertaking any measure affecting the relationship.¹

The concept of internationalization is themed on some contractual safeguard clauses which includes, but not limited to: stabilisation clauses, arbitration clauses, choice-of law clauses, and general principle of law. In this light, Jaenicke opined that the incorporation of a stabilization clause in an investment contract between the host state or any of its agencies and investor, if coupled with an arbitration clause, further strongly suggests the

intention of the parties to insulate their contractual relations from the reach of the law of the host state.\(^2\)

Against this backdrop, this paper is aimed at examining the internationalization of economic development agreement, while considering contractual safeguard clauses. To achieve this objective, this paper will be divided into three (3) parts. Part I is the introduction of the paper, which gives an overview of the subject. It goes further to outline the content of the paper. Part II will deal with an overview of the concept of internationalization, under which the contractual safeguard clauses will be discussed. Part III will be the conclusion of the paper.

2.0. Concept of Internationalization

The concept and theory of Internationalization is a fundamental part of this paper. Its understanding is integral to the appraisal of the subject. Internationalization, a theory strongly advanced by Rene-Jean Dupuy and FA Mann, postulates that no matter what law parties to a contract choose, as the proper law of the contract, International Law superimposes its choice, which applies automatically as the overriding governing law.\(^3\)

By so doing, the theory is projected to give the contractual relations between a State and a foreign investor the status of a quasi-treaty, a internationalized contract, governed by international law. This type of contract became known as ‘state contract’ as a result of developments that came up after the Second World War.


Although internationalisation of investment contracts was applied in the disputes arising from petroleum concessions in the Middle Eastern States, yet, it is fundamental to note that the most authoritative arbitral illustrations of the theory of internationalization, seem to be the 1958 Aramco Award,⁴ 1977 Texaco v Libyan Award,⁵ and the Sapphire International Petroleum Ltd. v National Iranian Oil Co,⁶ where it endeavoured to keep the parties to the EDAs immune from the laws and courts of the host State. It sought to achieve this, by removing the EDA from the host State’s jurisdiction and subject it to an immutable supranational system,⁷ while directly substituting it with international laws, which neutralizes sovereign power of state to change.

By so doing, EDA agreement acquires sanctity as legislative powers are eroded and the contract now rests on the principle of Pacta Sunt Servanda, through which the sanctity of contract is epitomized. In achieving this, EDA employs its two basic elements, stabilization clause and arbitration clause, as parts of most EDAs in the oil industry. Therefore, the theory of internalization reiterates the relevance of the sanctity of contract and stabilisation clause in EDAs. Furthermore, it helps to allay the fears of foreign investors, international arbitration bodies such as International Centre for the Settlement of Investment Disputes (ICSID), has become recognised and accepted by many countries. It suffices to state that the theory of internationalization is a concept founded on the viability of other sub-theories. Therefore, these elements that give rise to the internationalization theory will be considered subsequently.

⁴ Saudi Arabia v Arabian American Oil Company (Aramco) (1963) 27 ILR 117.
⁵ ibid. It was one of the three Libyan oil disputes.
⁶ (1963) 35 ILR 136.
2.1. Stabilisation Clauses in EDAs

The primary objective of the use of stabilization clauses in EDAs is to create stability, consistency and predictability of the agreed terms. This will therefore prevent impunity and flagrant unilateral change and violation of the agreement. The main intention is therefore to protect the investor’s contractual rights from the action of the legislative or executive arms of the State. Stabilization clauses are often regarded as an additional evidence of the intended internationalization of the contractual relationship. By virtue of the internationalization theory, the EDA contract containing a stabilisation clause became an internationalized contract governed by rules of international law. This rule makes the stabilisation clause valid. However, one issue that need be examined is to what extent this objective can be achieved. What are the defects and challenges of the use of stabilisation clauses?

The basis of the stabilisation clauses is that the State is bound by the terms of the agreements. It is aimed at protecting the multinational oil companies against the legislative or administrative powers of the host State, as sovereign in its country and legislator in its own legal system, from effecting unilateral changes or even revoke the contract. The multinational corporations perceive it as a means of injecting stability into the agreements. In other words, it reinforces the principle of sanctity of contract by shielding the foreign investor or contractor against arbitrary actions of the State. This is demonstrated in the Petroleum Agreement among the Republic of Ghana, Ghana National Petroleum Corporation,

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Kosmos Energy Ghana and the E.O. Group in Respect of West Cape Three Points Block Offshore Ghana (dated 22\textsuperscript{nd} July 2004).\textsuperscript{10}

The stabilization clause is an attempt to create an enclave status for the agreement and thus protect the agreement from future changes in the law of the host State. The basic idea behind a stabilization clause is to ensure that future changes in the legislation of the host State do not vary the terms of the contract on the basis of which entry or contract was made. They seek to stabilise the law at the moment the contract is entered. These clauses are mainly aimed at financial stability. This in turn creates the need to curb the host State’s power to make new law or legislation which can adversely affect the economy power of an investment. Such guarantees are very common in petroleum production or mining agreements.

Stabilisation clauses take several forms which includes the agreements, taking priority over any subsequent provisions, enacted, which will not favour the interest of the investor; modification of the terms and conditions which is only allowed by mutually written consent of the parties; and the law of the host State applicable which is the law in force at the time the contract was concluded. These clauses are usually directed against tax increase, imposition of fiscal change and amendment of law in force on the date of the agreement and nationalisation.\textsuperscript{11} The inclusion of stabilisation clauses is therefore an affirmation of the principle of 	extit{Pacta Sunt Servanda} and sanctity of contract. For instance, the stabilisation clause contained in a concession agreement of 1933 between the State of Iran and Anglo-Iranian Oil Company provides concession shall not be annulled by the Government and the terms therein


\textsuperscript{11} Piero Bernardini. ‘Stabilization and Adaptation in Oil and Gas Investments’ (2008) 1 Journal of World Energy Law and Business 98.
contained shall not be altered either by general or special legislation in the future or by administrative measures or any other acts whatever of the executive authorities.\textsuperscript{12}

A traditional stabilisation clause is found in traditional concession agreements, and is used to freeze the law of the host State as it stood when the agreement was concluded. The main objective of the traditional form of the stabilisation clause as demonstrated in all arbitral awards is the freezing of applicable domestic law, the fiscal regime, environmental controls and other regulations. It also prevents the destruction of the contract itself before the contract expires. In general, the government is contractually prohibited from making laws that were inconsistent with the agreement. However, a modern stabilisation clause which is designed for a production sharing participation, or service agreement provides that after the effective date of the agreement, if there is a change in the domestic law that results in a material adverse impact on the economic valued derived from operations by the contractor, the State (NOC) will ensure that the contractor will derive the same economic benefits that it would have derived if the change in the law had not been affected.\textsuperscript{13}

In modern day petroleum contracts in Nigeria, stabilization clauses are not utilized. Hence, in the production sharing contract, it is provided that no term or provision of these contracts including the agreement of the parties to arbitration, shall prevent or limit the government from exercising its inalienable right to change or terminate its contract with the other party. Although where there is a liability for breach of

\textsuperscript{12} Agreement between the Imperial Government of Persia and the Anglo-Iranian Oil Company Limited made at Tehran on 29 April, 1933, art 21.

contract, damages may be awarded. Moreover, the Government of Nigeria has deemed it necessary to include stabilization clauses in its gas contracts. The Act, contains a stabilisation clause, which granted the project for a fixed duration.

In the United States, stabilisation clauses are, at a minimum, unenforceable. The US Supreme court in *Georgia v City of Chattanooga* did not mince words in stating this position. According to the apex court, the taking of private property for public use, upon just compensation is so often necessary for the proper performance of governmental functions that the power is deemed essential to the life of the State. It cannot be surrendered, and if attempted to be contracted away, it may be resumed at will. As a matter of constitutional theory what the investor intends to achieve through stabilisation clause may not be possible.

In Mongolia, the foreign investment law permits the inclusion of stabilisation clauses in agreements by foreign investors. But it is hard to implement such a critical provision of law in actual practice. For instance, the negotiation on a stability agreement between the Mongolian Government and Ivan Hoe

14 L Atseghua, *Oil and Gas law in Nigeria, Theory and Practice* (3rd edn, Fifers Lane Publisher 2012).
15 Ibid 298.
17 464 U.S. 472
18 Art 19 (2) reads as follows; “... this agreement shall contain provisions to ensure stable tax conditions during certain period and state the objectives and amount of the investment, its implementation period and rationale to revoke the agreement”.

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Mines was faced with strong public protest. There is also the problem of inequality. Stabilisation clauses might indicate undue favours granted to foreign investor. Some governments have faced political criticisms from domestic entrepreneurs as a result. Also, in Liberia, the agreement between the government and Mittal Steel to exploit Liberia’s iron ore reserves for a period of 25 years contained a stabilisation clause which restricted the government’s capacity to introduce new laws in the areas of human rights, the environment, and taxation. This agreement faced criticism in Liberia and was renegotiated to eliminate the obnoxious terms.

To Sornarajah, a stabilisation clause can only serve as a mere comforter to the foreign investor, who may derive some protection from promise secured from the State not to apply new legislation to the contract. Sornarajah has also expressed the view that stabilization clauses are invalid because they have to contend with the principle of permanent sovereignty over natural resources, and the domestic constitutional law of the host state.

International arbitrations have rightly come to terms with the position that the future of a country’s national economy cannot be controlled by stabilization clauses. Thus, in the Amin oil Award the tribunal while agreeing that no doubt contractual limitations on the State’s rights to nationalisation are juridically possible, but would involve serious undertaking. It ruled the possibility of interpreting the stabilization clauses of the agreements.

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22 ibid 284.
23 Aminoil Award, 21 ILM 976 (1982), para 95.
concession contract as absolutely forbidding nationalisation.\textsuperscript{24} Nonetheless, some countries include stabilisation clauses as guarantees to enable the country attract foreign investments, nothing more.

2.2. Choice of Law and its application in EDAs
The generally accepted principle is that the choice by the parties is limited to the legal system with which the contract has contacts. All major legal systems now recognise that the parties to the contract have autonomy to determine the law applicable to the contract. One of the limitations to this is that the mandatory rule of the State, relevant to the contract, cannot be ignored by simply resorting to choice of law technique.\textsuperscript{25} Such mandatory rules may be on foreign investment entry legislation, environmental legislation, legislation on transfer of technology and legislation preventing anti-trust practices and malpractices affecting consumer interest.\textsuperscript{26} Every nation has mandatory rules that govern particular transaction or relationships, which demand to be applied notwithstanding the choice of a foreign legal system. It is the essence of mandatory rules that they defeat [any contrary] agreement of the parties.\textsuperscript{27} A practical example of choice of law clause in a petroleum contract of Ghana provides in clause 26.1, which provides that:

This Agreement and the relationship between the State and GNPC on one hand and Contractor on the other shall be

\begin{footnotesize}
\begin{enumerate}
\item ibid para 96
\item IO Agbede et al, \textit{The Law and Practice Of International Trade} (University of Lagos Press1992).
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governed by and construed with the laws of the Republic of Ghana consistent with such rules of international law as may be applicable, including rules and principles as have been applied by international tribunals.  

Matters concerning the protection of the environment, labour relations, taxations, foreign trade and exchange rate regulation and expropriation issues fall mostly within the legislative competence of the host State. In the natural resources sector, the host State exercise even greater controls relating to ownership, pricing, taxation and the environment which quite disagrees with the purpose of the choice of law clause. The aim is to remove the agreement from municipal law of the host state and connect to some external contacts. According to Higgins, the best way to avoid sole reliance on domestic law is one has to say, by having a governing law clause that introduces international law. These external contacts of foreign investment contracts are supposed to justify the application of neutral principles of law to the agreement, which includes: the general principles of law, transnational law or simply international law. The idea behind this is that the security of foreign investment contracts can only be assured when they are not regulated by the municipal law of the host State.

The choice of law now appears to be unnecessary since in most of the developing countries, the legal systems have been

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28 Qureshi and Ziegler (n 10).

29 Sonarajah, (n 21) 285.

reformed and developed to meet the current practices in the petroleum industry. Some now have sophisticated laws to meet international standards and practices particularly in the natural resources sector.

The choice of law clause derives its validity from the principle of party autonomy. In this case, parties have autonomy to choose the law which is applicable to the foreign investment contract. From the perspective of private international law, such a choice of law by parties must be honoured and enforced. In the foreign investment contract, there is much doubt that party autonomy itself can support the idea that the host State’s law application to an EDA can be excluded. In the area of foreign investment contracts, the fact that a State is a party to the EDA denotes important consequences by significantly placing limit on the scope of the free choice of law. However, there are several overwhelming objections to the application of choice of law principle to EDA. The theory of internationalization of State contracts supports that international law superimposes parties’ choice, applies automatically as the overriding law.\(^{31}\) This is one of the greatest obstacles to the theory. Its clauses attempt at subverting the domestic law by referring for example, to (public) International law as the governing law.\(^ {32}\) This is contrary to the view opined by Agbede who maintain that the practical and convenient approach is for parties to make express choice of the applicable law in the written contracts where practicable.\(^ {33}\)

\(^{31}\) Becker (n 7) 92.


\(^{33}\) Agbede (n 26) 115.
2.3. Arbitration applying international law to EDAs

Arbitration is the legal method of settling disputes between parties by a mutually agreed-upon-third party who has the authority to determine an award. The award is a legally binding decision.\(^{34}\) Thus mutuality and consent are central to arbitration. Particularly important are arbitrations between a host state and a foreign investor (investor-state arbitration). The jurisdictional power to settle disputes through arbitration emanates from a contract that contains an arbitration clause.\(^{35}\) The clause is thus referred to as an arbitration clause. This contractual relationship is termed a written agreement to submit present or future differences to arbitration whether an arbitrator is named therein or not.\(^{36}\) For instance, when parties in an oil transaction involving multinationals and states agree to arbitrate, there is a legal obligation to accept the terms of the award. Arbitration clause ensures that disputes in relation to the State contract is said to give rise to an inference that the contract has been subjected to an external system. Its inclusion in the contract allows a choice of neutral forum for the settlement of disputes which arise from the agreement to be made by the parties.

The foreign investor will not have much confidence in the ability of the courts or other tribunal of the host State. He believes that the host States government will exert influence on

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\(^{34}\) 'Award Definition'

\(^{35}\) Olasupo Shasore, ‘Jurisdiction and Sovereign Immunity in Nigerian Commercial Law, the Nigerian Commercial Law (The Nigerian Institute of International Affairs 2007).

\(^{36}\) Qureshi and Ziegler (n 10).

Petroleum Agreement among The Republic of Ghana, Ghana National Petroleum Corporation, Kosmos Energy Ghana Hc And The E.O. Group In Respect Of West Cape Three Pions Block Offshore Ghana (Dated 22\(^{nd}\) July 2004).
the court. There is also the fear of State sovereign immunity. In other words, the inclusion of such clause in the contract guarantees foreign investors the exclusion of the jurisdiction of domestic courts of the State party and its laws. The direct application of international law on corporations has featured prominently in the cases in which arbitral bodies have applied rules of international law to settle disputes between a host State and foreign investor.\(^{37}\)

Arbitration is for example chosen as dispute resolution method in government concessions and construction contracts.\(^{38}\) In *Texaco Overseas Petroleum Co. v Libya Arab Republic*,\(^{39}\) the arbitrator held that international law governed the issues. The basis being that the investment contract had become internationalized. The three arbitration- *Abu Dhabi, Qatar and Aramco* cases\(^{40}\) cited the dictum that the law applicable to the concession agreements is the law of the host state, the arbitrators refused the application of the domestic law which would have otherwise applied as the applicable law on two grounds. The first reason, is the lack of relevant rules in the legal systems of developing states. This became a justification for the application of general principles of law rather than the law of the host state. For instance, in the Abu Dhabi and Qatar cases, arbitrators rejected the law of Abu Dhabi and Qatar on the ground that these national laws were not sophisticated enough to deal with complex transactions. This was aptly

\(^{37}\) ‘The high-water mark arbitrations arising from Libya’s expropriation in 1971 of oil concessions which it had granted to foreign companies’. See also R Gardiner, *International Law* (Pearson Longman 2002).

\(^{38}\) Article 23 of the Exploration and Production Sharing Agreement which is used by the Libyan National Oil Corporation, includes a choice for CC arbitration.

\(^{39}\) (1979) 53 IL R p. 387.

expressed in the Abu Dhabi dispute were Lord Asquith acknowledged that if any municipal legal system was applicable, it would prima facie be that of Abu Dhabi. But the arbitrators then rejected the law of Abu Dhabi arguing, that no such law could reasonably be said to exist…it is fanciful to say that in this very primitive region, there is any settled body of legal principles applicable to the construction of modern commercial instrument…41

The second reason for applying general principles of law to concession agreements was based on the belief of the arbitrators that a concession contract in these terms could not have been intended by the private parties. In the Aramco case, after hearing the foreign company’s argument that the company was unaware of the incompetence of Islamic law at the time of making the concession contract, the arbitrator concluded that even though the Muslim law had been agreed by the parties, the dispute should be settled according to the law, which a reasonable man would purport to apply.42

It should be noted that the first three arbitrations that supported the idea of supranational rules did not really mean that Public International Law should be the law applicable to concession contracts. Rather they suggested that it would be fair if the concession arrangements were settled according to the

41 8 ILR 144 (1951).
42 The tribunal reached its decision based on the following:
“Matters pertaining to private law are, in principle, governed by the law of Saudi Arabia but with one important reservation. That law must, in case of need, be interpreted or supplemented by the general principles of law, by the custom and practice in the oil business and by notions of pure jurisprudence, in particular whenever certain private rights – which must inevitably be recognized to the concessionaire if the concession is not to be deprived of its substance-would not be secured in unquestionable manner by the law in force in Saudi Arabia.” Aramco Case 27 ILR 117 (1958).
principles of justice, equity and good governance.\textsuperscript{43} In the oil or petroleum development industry, arbitration appears to be the most favoured dispute resolution method.\textsuperscript{44} Thus in the contract between State of Israel and the Iranian Oil company considered by the French Supreme court in 2005, choice for arbitration was included.\textsuperscript{45} The use of arbitration has increased in recent times due to expanding international activity and globalisation.

ICSID is one of the favoured arbitration fora in this respect. Its use or process provides or affords parties the opportunity to make the process very flexible and adaptable without much interference from public bodies.\textsuperscript{46} But despite its growing role and success in international commercial activities, there remains some resistance to arbitration.\textsuperscript{47} This is more common with contracts concluded with so called ‘developing States’. Sometimes these countries are wary of international arbitration because it is considered an erosion of their State authority. Thus, in some countries there remains resistance to arbitration. Arbitration is not allowed for government contracts.\textsuperscript{48}

\textsuperscript{43} (1953) 20 Quatar Arbitration ILR 534.


\textsuperscript{45} State of Israel v National Iran Oil Company (French Supreme Court, Fer 01, 2005, case No. 01-13;742/02-15. P. 237.

\textsuperscript{46} Parties have opportunity to choose their own decision-maker while that is usually not possible in court proceedings.

\textsuperscript{47} “As is well known, until the 1970s many states in South America and Africa fiercely resisted arbitration and insisted on local jurisdiction for investment disputes” P. Wautele, note 99, p. 56/58.

\textsuperscript{48} This is apparently the case in Dubai (see Art. 36 of the LAW NO.6 of 1977 on contracts of Government Department in Dubai Emirate which provides that; "No contract where Dubai Government or nay of its arbitration outside Dubai courts"
In some countries the resistance may snowball into guerrilla tactics,\textsuperscript{49} if allowed. The resistance has made some States wrestle out of arbitration already accepted. The tactics is to rely on the plea of sovereign immunity as a technique to avoid submission to arbitration.\textsuperscript{50} Some States had adopted non-appearance to express disapproval with the arbitral tribunal process.\textsuperscript{51} It is sometimes argued whether arbitration survives the termination of the contract. In commercial contracts involving States, an arbitration agreement does not survive the termination of the contract. Where a State seeks to terminate the agreement unilaterally through adoption of legislation, at least from the State’s point of view, the arbitration clause will be terminated along with the whole contract.\textsuperscript{52} Thus, many developing States are suspicious about the arbitration methods for resolving investment dispute. According to Sornarajah, since international arbitration had its genesis in the framework of international law rules on investment protection, it is regarded as tainted with the same fault of prejudice and partiality.\textsuperscript{53} Jennings resort to elements like arbitration to internationalize the contract has remained a controversy.\textsuperscript{54} Arbitration clauses have flexible and voluntary nature. These characters make it unsuitable for investment contract disputes which possess public element.

\textsuperscript{49} Wautele (n 44).
\textsuperscript{50} *ELF Aquitaine Iran v NIOC arbitral award* *Revue de L’ arbitrage* 40 1 (1984).
\textsuperscript{51} As was e.g. the case for three arbitrations which followed the nationalization of the Libyan Oil operations.
\textsuperscript{52} Sornarajah (n 21) 287.
\textsuperscript{53} Sornarajah (n 21) 9.
According to Lazar, arbitral tribunals may not be a veritable forum for balancing competing social, economic, environmental and political concerns. Furthermore, it has also been observed that arbitration is a private system that resolves disputes without laws or jurists. The State contracts are matters of public law because of the public interest element. Under most national legal systems public law disputes are not arbitral. The arbitration clause cannot guarantee the application of international law, so international arbitrators still may apply local laws. This is affirmed in the World Bank’s Convention which permits an ICSID Tribunal to apply in the absence of a choice of law by parties, the law of the host State. However, it must be noted that ICSID and investment treaties in their investment disputes in mechanisms elevate a contract to a different level. However, the validity of these clauses in subverting the State’s legal system has remained unsuccessful. It has been argued by critics that the contractual devices which attempt to internationalise the EDAs are defective. There is further argument that they lack validity under international law, and the breach of contract by State

55 Lazar further opined; “With the institutionalization of arbitration as a de facto dispute resolution regime there is a risk that the global trading regime will provide financial interest with and unprecedented and decidedly undemocratic opportunity to challenge restrictions and regulations which they (corporations) believe hinder their ability to do business”. Lydia Lazar NAFTA: Structural Damage to the Ship of the State?

56 Ibid. (n 19) 103.

57 Ibid.

58 C Chukwumerije, Choice of Law in International Commercial Arbitration (Quorum Books 1994).

59 Sornarajah (n 21) 288.


61 Sornarajah (21) 284.
does not result in international responsibility. These contracts are maintained as contractual relationship between a private investor or entity and a State. It is not an international agreement, and therefore, should not be governed by international law.

3.0. Conclusion
The theories of internationalization affirms the relevance of the sanctity of contract and stabilisation clause in EDAs. This makes contracts of this nature stable and predictable. With internationalization, the fears of foreign investors are allayed. Through internationalization, parties to a contract exercise their right to autonomy, while availed the opportunity to choose the proper law of the contract. The development and practice of internationalization has been greatly expressed through the stabilization clause and arbitration clause, both of which have made meaningful progress to ensure that the right of parties to an investment or a contract or a transnational corporation is preserved, while preserving the sanity and sanctity of contracts and international relations.