Investment contracts and sustainable development

How to make contracts for fairer and more sustainable natural resource investments

Lorenzo Cotula

Investment contracts and sustainable development

How to make contracts for fairer and more sustainable natural resource investments

Lorenzo Cotula

First published by the International Institute for Environment and Development (UK) in 2010

ISBN: 978-1-84369-765-7 ISSN: 1605-1017

To contact the author, please write to:
Lorenzo Cotula, IIED, 4 Hanover Street, Edinburgh EH2 2EN
lorenzo.cotula@iied.org

For a full list of publications please contact:
International Institute for Environment and Development (IIED)
3 Endsleigh Street, London WC1H 0DD, United Kingdom
newpubs@iied.org
www.iied.org/pubs

A catalogue record for this book is available from the British Library

Citation: Cotula, L. (2010) *Investment contracts and sustainable development: How to make contracts for fairer and more sustainable natural resource investments*, Natural Resource Issues No. 20. IIED, London.

Design by: Eileen Higgins, email: eileen@eh-design.co.uk
Cover photo: A balanced deal? Weighing of raw gold in an African gold town
© argus / Hartmut Schwarzbach / Still Pictures
Printed by Park Communications, UK on 100% recycled paper using vegetable oil basked ink.

Contents

List of boxes

List of figures

List of tables

Acronyms

BOT	Build, operate and transfer
BTC	Baku-Tbilisi-Ceyhan pipeline
CSO	Civil society organisation
DCF	Discounted cash flow
EIA	Environmental impact assessment
EITI	Extractive Industry Transparency Initiative
EPA	Environmental protection agency
EPC	Exploration and Production Concession [Mozambique]
ESIA	Environmental and social impact assessment
FAO	Food and Agriculture Organization of the United Nations
FOI	Freedom of information
ICC	International Chamber of Commerce (Court of Arbitration)
ICSID	International Centre for the Settlement of Investment Disputes
IFC	International Finance Corporation
IIED	International Institute for Environment and Development
IISD	International Institute for Sustainable Development
HGA	Host government agreement
IGA	Inter-governmental agreement
ISO	International Organization for Standardization
LCIA	London Chamber of International Arbitration
MP	Member of parliament
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
OGEL	Oil, gas and energy law
PSA	Production sharing agreement
PSJV	Richtersveld Pooling Sharing Joint Venture [South Africa]
RMC	Richtersveld Mining Company [South Africa]
TRIMS	WTO Agreement on Trade-Related Investment Measures
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
VAT	Value added tax
WAGP	West African Gas Pipeline
WTO	World Trade Organization

Acknowledgements

This guide was prepared for 'Legal tools for citizen empowerment', a programme steered by the International Institute for Environment and Development (IIED). The programme is generously supported, through a framework agreement with IIED, by Danida (Danish International Development Agency), DFID (the UK Department for International Development), DGIS (Directorate-General for Development Cooperation, the Netherlands), Irish Aid, Norad (Norwegian Agency for Development Cooperation), SDC (Swiss Agency for Development and Cooperation) and Sida (Swedish International Development Agency). The views expressed in the guide do not necessarily represent those of the supporting institutions involved.

Parts of the guide are based on training sessions carried out in Ghana and Central Asia. The trial training in Ghana was held in February 2009, and was organised by IIED and the Centre for Public Interest Law (CEPIL). Training participants included government officials, parliamentarians, civil society organisations and media agencies. The trial training in Central Asia and the Caucasus was held in Kazakhstan in April 2009, organised by IIED and Kazakhstan Revenue Watch, and funded by the Soros Foundation. This training session targeted civil society organisations from Azerbaijan, Kazakhstan, Kyrgyzstan and Mongolia.

Linda Siegele and Emma Wilson provided extensive and invaluable input to two sections of the guide, and contributed to the trainings in Ghana and Central Asia. Dominic Ayine and Anton Artemyev led the organisation of the trainings in Ghana and Central Asia, respectively. Dominic Ayine, Ingilab Ahmadov, Bamidele Aturu, Ali Nakyea and Jacob Manyindo presented country experiences at the Ghana training, while Ben Garside presented on advocacy strategies and the role of communication technologies. Ingilab Ahmadov, A. Batpurev, Saule Ospanova, Sergei Solyanik and Natalya Yantsen presented experiences at the Central Asia training. Training participants in both Ghana and Central Asia also contributed useful insights. Participants in the Central Asia training helped test the role-play featured at the end of this guide.

I would like to thank all those who facilitated access to the contracts I examined to prepare this guide. Some contracts are explicitly cited in the guide, many others are not. I would also like to express my sincere gratitude to all the experts who have read and commented on earlier drafts of the guide or parts of it. Antony Crockett, Titus Edjua, Mary Footer, Andrea Shemberg, John Southalan, Kyla Tienhaara, Sonja Vermeulen and Halina Ward read sections of the guide. Elizabeth Bastida, Luke Danielson, Howard Mann, Lou Wells and Emma Wilson read the entire manuscript. The precious comments and suggestions provided by these reviewers made a real difference to the finalisation of this guide. Khanh Tran-Thanh ably steered proof-reading, design and production. Of course, responsibility for the views expressed and for any errors lies entirely with the author.

Executive summary

In recent years, economic liberalisation, improved transport and communication systems, and the global demand for energy, minerals and agricultural commodities have fostered investment in agriculture, mining and petroleum projects in many lower- and middle-income countries. Increased investment may create opportunities to promote sustainable development and improve living standards in recipient countries, but it also creates risks. For example, if governments make resources available to prospecting investors, people may lose access to key livelihood assets like land, water, wood and grazing, whilst environmental damage may have lasting effects on the resource base and repercussions on public health.

Investment contracts are crucial to define the terms of an investment project and the extent to which it advances – or undermines – sustainable development goals like poverty reduction and environmental sustainability. The capacity of governments to negotiate and manage investment contracts and the capacity of civil society, parliamentarians and the media to scrutinise government dealings with incoming investors can make a real difference to designing and implementing deals that are favourable to people in the host country.

This guide discusses options to structure investment contracts in ways that maximise the investment's contribution to sustainable development. The focus is on foreign investment in the natural resource sector and on lower- and middle-income countries. The guide draws on test trainings in Ghana and Central Asia and aims to provide up-to-date and comprehensive learning material for both host governments and civil society. It can be used as a background document for training sessions, but it may also be used by readers accessing the material on their own.

Negotiations for investment contracts can be extremely complex and the guide only provides the foundations for understanding general contractual issues and processes. The content is pitched at an entry to intermediate level: the guide does not require specialised legal expertise, but it does assume a degree of familiarity with investment issues. The guide aims to identify the main issues and map options, rather than provide detailed solutions. It is in no way meant to replace professional legal advice.

The guide tackles several interlinked topics, each representing a (set of) key lever(s) for sustainable development in investment contracts:

- Choice among, and framing of, contract models to maximise sustainable development outcomes, for example through promoting more inclusive business models in the design and implementation of an investment project;

- Tools to maximise the economic benefits to the host country, including public revenues and non-revenue benefits like investment commitments, technology transfers and infrastructure development, as well as local content provisions that shape the extent to which the investment project creates local employment and business opportunities;

- Tools to balance economic with social and environmental considerations: environmental and social impact assessments and management systems, safeguards in land takings, social investment requirements and legal remedies for groups adversely affected by an investment project;

- Stabilisation and renegotiation clauses, which concern the evolution of the contractual relation over time and may be used to reconcile the investor's need for a degree of stability with preserving host state capacity to take action in the public interest even if it adversely affects the project;

- Dispute settlement, including contractual provisions to regulate investment disputes that may arise under the contract and proper handling of disputes when they arise;

- Confidentiality provisions – acknowledging that although commercial confidentiality concerns may be at stake, openness and public scrutiny are essential to maximising sustainable development outcomes.

The guide also provides an overview of relevant legal frameworks, highlighting how investment contracts can only be properly understood if read in conjunction with a wider range of applicable legal instruments, and briefly discusses the contracting process – namely, the negotiation and management of investment contract. Finally, the guide provides background material for a role-play to apply the concepts discussed in the more theoretical sections.

Introduction

1.1 Topic and rationale

Natural resource investment: risks and opportunities

In recent years, many lower- and middle-income countries have stepped up efforts to attract foreign investment in natural resource projects like mining, petroleum and agriculture for food, fuel and other commodities like rubber. Economic liberalisation, improved transport and communication systems, and the global demand for energy, minerals and agricultural commodities have fostered investment in the natural resource sector – including in parts of the world that were previously of lesser interest to international investors. In sub-Saharan Africa, for example, foreign investment flows amounted to nearly US$64 billion in 2008, with the natural resource sector accounting for a major share (UNCTAD, 2009). This is a new record level, up from previous levels of over US$30 billion in 2007, about US$22 billion in 2006 and US$17 billion in 2005 (UNCTAD, 2008).

Increased investment may create new opportunities to promote sustainable development and improve living standards in recipient countries, for example via economic growth and increased government revenues. For poorer countries with relatively abundant natural resources, incoming investors may bring capital, technology, infrastructure, know-how and market access, which may play an important role in catalysing economic development. And in some of the poorest countries, natural resources may constitute one of the few sectors that can be of interest to outside investors.

However, many past natural resource investments have delivered disappointing contributions to sustainable development, or have even undermined its pursuit – a circumstance that is captured by the notion of 'resource curse'. Desired economic opportunities may not be realised if investment plans are not properly implemented, dealings with local businesses are limited, employment is mainly temporary or seasonal and government revenues are constrained by tax breaks and other financial incentives that host governments grant to investors. If public revenues generated by investments are misused, they contribute little to sustainable development.

In addition, economics is only one aspect of sustainable development. To achieve goals like poverty reduction and environmental sustainability, economic factors need to be balanced with social and environmental considerations. In this regard, natural resource investment projects raise significant challenges, especially where local people depend on natural resources for their livelihood. If governments make resources available to prospecting investors, people may lose access to key livelihood assets like land, water, wood and grazing. Environmental damage may have lasting effects on the resource base and repercussions on public health.

Photo: Lorenzo Cotula

Having a clear direction: signpost to an open-pit mine in the Sikasso region, Mali

Given these major risks and opportunities, the extent to which natural resource investments advance or undermine sustainable development goals depends to a large extent on their governance – on how decisions are taken and by whom, and on the terms and conditions regulating each investment project.

Elected governments have a mandate to make choices at the national level. The national constitution may also give oversight powers to parliament and independent regulatory agencies. But investment decisions can have major and lasting implications for the development goals and pathways pursued by the host country. Vigorous public debate and public scrutiny by the media and civil society are therefore essential to make good strategic choices about what is best for the country.

The nature of the debate inevitably varies across countries and sectors. For example, petroleum operations require large investments; key issues for public debate may include the place of the sector in the overall development strategy, the regulation of investment and the management of revenues. On the other hand, agricultural production can be undertaken by farms of various sizes and using different cultivation methods. In many parts of the world, family farmers have proved to be highly dynamic and responsive to market forces, and it should not be assumed that large-scale investment is the way to go. Vigorous public debate on the future of the agricultural sector, and on the roles of smallholders and agribusiness within it, is vital to make good strategic choices.

Where outside investment is seen as an element of national sustainable development strategies, getting the best possible deal is essential to maximise their contribution to sustainable development goals like poverty reduction and environmental sustainability.

Why contracts matter

Investment contracts are crucial to define the terms of an investment project and constitute a key instrument of governance. They determine the distribution of risks, costs and benefits of the project. They shape the extent to which the investment provides public revenues and creates income-generating opportunities through employment and linkages with the local economy. Contracts also shape the balance between these economic considerations and the other pillars of sustainable development – namely, social and environmental aspects. For example, contracts may protect the people, livelihoods and ecosystems affected by an investment and may provide channels for local people to have greater control over their own future.

If well designed and implemented, contracts can maximise the contribution of natural resource investment to sustainable development goals. But badly drafted or executed contracts may impose unfavourable terms on the host country often for long periods of time, sow the seeds of disputes and undermine the pursuit of policy goals like poverty reduction and environmental sustainability.

Although contractual terms are not always easy to enforce, contracts do influence behaviour. If an investor feels that the host government has breached its contractual obligations, it can refer the dispute to international arbitration where the host state has consented to this. International arbitration is a process whereby a neutral third party solves the dispute through a binding decision.

Arrangements for enforcing arbitral decisions have proved quite effective. Where breaches were found, international arbitrators have awarded investors large amounts of public money in compensation. Legal fees alone can amount to millions of dollars. And where governments were unwilling to pay up, investors have been able to seize host state assets held abroad. In addition, governments are often under pressure to comply with contracts in order to keep attracting investment. Even if negotiations as opposed to legal channels are preferred, legal claims may affect the parties' negotiating power – for instance, when a party knows it would lose its case if the matter went to arbitration or enforcement proceedings.

Getting the contract right is therefore key to minimising the risks and seizing the opportunities created by natural resource investment.

Box 1. Key concepts

An **investment contract** is an agreement concluded between an investor and the host government (or a state-owned enterprise) for the purposes of regulating a specific investment project. Outside extractive industries, contracts may also be concluded with a private entity based in the host country, including companies or other structures controlled by local communities.

Contracts should not be confused with investment treaties, which are concluded between two or more states to regulate establishment and treatment of all investments by nationals of one state in the territory of the other state(s).

Investment contracts may take many different forms, including concessions or 'production sharing agreements' for the exploitation of mineral and petroleum resources, 'host government agreements' for the construction and operation of pipelines and land concessions or leases for agricultural investments.

An **investor** is an entity that provides contributions (capital and technology, for example) and carries the commercial risks of an economic activity. An investor may range from a private company through to a state-owned enterprise, acting either individually or in a consortium.

The focus of this guide is on foreign investors – entities controlled by a national of a state other than the country where the investment takes place. Control of a company may occur through majority ownership of equity shares or through more subtle relations among companies that are part of the same business group.

Foreign investors may include privately or state-owned enterprises that may use a wide range of investment vehicles (and for this reason the guide uses the broad term 'investor' instead of 'company').

The **host country** is the country where the investment takes place. In extractive industries, the host country is typically represented by the executive branch (the 'host government') or a state-owned company, which owns subsoil resources. Contracts with private entities are possible in other sectors (for example, land leases for agricultural investments), in which case the private entity may be a company, a community trust, a customary authority or another institution. A single investment project may cover more than one host country (for example, cross-border pipeline projects).

An **affected community** is a group of people that is directly affected by an investment project. For example, the implementation of a natural resource investment may entail the taking of lands on which a group of people depend for their livelihood and food security. More indirect impacts, for example where a large-scale agricultural investment depresses local prices and thereby affects local producers, are not considered in this guide.

Affected communities are often internally differentiated on the basis of factors like wealth, income, status, gender and age. Within the context of natural resource investments, this diversity can translate into differentiated interests, negotiating power and impacts.

Ensuring that affected communities have voice in the decisions concerning the investment and participate in the benefits generated by it is an essential ingredient of a successful investment project. In some cases, this may involve the signing of agreements between the investor and the affected community, even where the investor obtains resource rights from the host government rather than local groups.

Civil society refers to a broad range of non-profit and non-governmental organisations. Though usually not party to investment contracts, civil society organisations may play a useful role by scrutinising the negotiation and implementation of these contracts or by providing support to local people affected by an investment project.

Civil society may represent different and sometimes conflicting interests, including environmental, development, human rights, labour and transparency organisations, and associations of local producers.

Strengthening capacity as a strategy for change

Getting the contract right requires a balanced negotiating capacity between investors and host states. Recent experience of the renegotiation of mining and agricultural concessions in Liberia shows the difference that investing in the government's capacity to negotiate can make. An independent evaluation of this renegotiation noted significant improvements, namely, an increase in public revenues, requirements to source labour, goods and services locally, and the relocation of certain processing activities to the host country. Determined political will at the highest level, a clear negotiating strategy, a strong negotiating team within an influential government institution and world-class external legal and other advice were all crucial to this outcome (Kaul *et al.*, 2009).

Governments have varying capacities to negotiate and generalisations should be avoided. Nevertheless, in many lower- and middle-income countries, contract negotiations are often affected by imbalances in negotiating capacity between investors and governments. Besides differential access to skills and expertise, other factors may put the host government in an unfavourable position during the negotiation: high staff turnover in key government agencies, inadequate preparation, poor use of the expertise available in the country and corruption. After the contract is signed, opportunities may be missed if a host government is unable to adequately monitor implementation and sanction non-compliance. Strengthening the capacity of host governments to negotiate new contracts and manage existing ones can make a real difference, as it enables them to get the best possible deal for sustainable development.

In addition, vigorous scrutiny of contract negotiation and management by parliament, civil society and the media is key to promoting sustainable development. These players can perform an important role by holding governments and investors to account. Yet these players do not always have the expertise to effectively oversee how their government handles relations with investors. Strengthening capacity for independent scrutiny of contracts is therefore another essential part of strategies to maximise the benefits and minimise the risks of natural resource investment.

Finally, with growing awareness of the business case for responsible practice, it is also important for investors to have a good understanding of how contracts can be negotiated to maximise sustainable development outcomes. In many cases, this may not result in lower returns or higher risks, so long as contracts are structured in appropriate ways.

Yet, there are few learning materials available on how to negotiate investment contracts to maximise sustainable development in the host country. A pioneering work from the 1970s that focuses on mining (Wells and Smith, 1976) raises some key points that are still relevant today. A large and authoritative body of literature on transnational contracts emerged in the late 1970s and 1980s, with authors like Thomas Wälde playing an important role. The UN Commission on Transnational Corporations, active in the same period, contributed valuable research and capacity building work on investment contracts.

More recent works have provided important contributions about the regulation of transnational corporations (Muchlinski, 2007) and of industries like mining (UNECA, 2002; Campbell, 2009). Also, UN human rights institutions have spelt out the human rights implications of investment contracts and have issued – or are preparing – guidance on that aspect (Ruggie, 2008; De Schutter, 2009). The International Institute for Sustainable Development (IISD) has developed a model investment treaty (as opposed to contract) that explicitly links investment protection to the promotion of sustainable development (Mann *et al.*, 2006). Excellent materials on revenue issues have been published by the Revenue Watch Institute that focus on extractive industries and on a civil society audience (e.g. Goldwyn, 2008). The Revenue Watch Institute has also published reports on transparency in contracting (Rosenblum and Maples, 2009) and on lessons learned from the recent renegotiation of natural resource concessions in Liberia (Kaul *et al.*, 2009).

But there is no recent and comprehensive learning material for both host governments and civil society on how to structure investment contracts in a way to maximise the investment's contribution to sustainable development.

About this guide

This guide attempts to fill that gap. It is about how to structure investment contracts for natural resource projects in ways that maximise the investments' contribution to sustainable development goals. Key sustainable development goals include poverty reduction and environmental sustainability. The focus is on natural resource investments in lower- and middle-income countries.

This guide is primarily aimed at host country government agencies, parliamentarians and civil society organisations (CSOs). There may be differences in visions and interests between these different groups. For example, civil society may emphasise different priorities compared to governments. Also, even within these groups there may be a diverse range of actors who have different and maybe even conflicting interests. For example, within government, national oil companies and environmental protection agencies may have different priorities.

Yet all of these groups can play an important role to ensure that investments contribute to sustainable development: government agencies by negotiating good contracts and properly monitoring their implementation; parliamentarians and civil society by scrutinising government negotiations and advocating for better deals.

The guide may also be of interest to businesses eager to ensure that their investments contribute to sustainable development, both in the countries receiving the investment and internationally.

This guide can be used as a background document for training sessions targeting government officials, parliamentarians and civil society as well as for trainings of trainers. To be most effective, the trainings should be tailored to the specific capacity building needs as well as the relevant country and sectoral context. The guide may also be used by readers accessing the material on their own.

The text is based on legal research undertaken by IIED and partners since 2004, and on trial training sessions for government officials, parliamentarians, civil society and the media. The trainings took place in Ghana and Central Asia in early 2009. They focused on extractive industry contracts and this guide draws extensively on that sector. It also includes experiences from other natural resource sectors, particularly agriculture, because it recognises that cross-sectoral learning can facilitate advances in contractual practice.

Negotiations for investment contracts can be extremely complex because they typically involve a large number of sophisticated and context-specific technical, legal, economic and financial issues. The guide provides the foundations for understanding general contractual issues and processes, focusing on the legal aspects. The content is pitched at an entry to intermediate level: the guide does not require specialised legal expertise, but it does assume a degree of familiarity with investment issues. The guide aims to identify the main issues and map options, rather than provide detailed solutions. It is in no way meant to replace professional legal advice.

1.2 The concept of sustainable development and its implications for investment contracts

Different people define sustainable development in different ways and coming up with a universally accepted yet specific enough definition is a big challenge. In this guide, sustainable development is broadly defined as the policy imperative to balance economic, social and environmental considerations so as to meet the needs of today's generation without compromising the ability of future generations to meet their own needs. This definition develops the idea proposed in 1987 by the Bruntland Report, which first institutionalised the concept of sustainable development (World Commission on Environment and Development, 1987).

Structuring contracts to maximise sustainable outcomes recognises that, from a host country perspective, attracting investment is not an end in itself, but a means to an end. The ultimate goal is to improve living conditions and enable people to have greater control over their lives, whilst respecting the environment. Therefore, offering safeguards to prospective investors to encourage them to invest is only part of the story – the other part is to establish proper safeguards to ensure that the investment does contribute to pursuing that ultimate goal. This entails:

- Maximising economic benefits for people in the host country, including affected communities. Economic benefits may include public revenues and non-revenue benefits such as capital contributions, income generation through the creation of employment and business opportunities, capacity building, technology transfers and infrastructure development (economic pillar);

- Minimising negative impacts on people's lives, for instance linked to land takings or resource degradation, and ensuring that economic benefits are distributed equitably and used for poverty reduction and broad-based development (social pillar); and

- Minimising environmental damage from project implementation and promoting investments in more environmentally friendly sectors such as renewable energy (environmental pillar).

In addition, the 1992 Rio Declaration on Environment and Development clarifies that sustainable development entails putting people at the centre of the development process (principle 1). This means more than just enabling people in poorer countries to have access to consumer goods. It means empowering people to have greater control over decisions and processes that affect their lives, including choices on the type of development and the development pathways pursued.

The Rio Declaration also states that 'environmental issues are best handled with participation of all concerned citizens, at the relevant level' (principle 10). Sustainable development therefore also requires inclusive public debate in investment policies, and accountability and public scrutiny in contract negotiation and management. Accountability is usually defined to include transparency (publicly accessible information in appropriate forms at the right time), answerability (ability to respond to feedback and to justify why any decision or course of action is followed instead of another) and liability (clear and operational mechanisms for grievances to be raised and, where necessary, sanctions to be applied). Public scrutiny involves effective parliamentary supervision and vibrant civil society and media monitoring of negotiations between government and investors.

It is important to note that structuring contracts to maximise the investment's contribution to sustainable development does not entail coming up with a 'model contract' that is universally applicable. As there are different contexts there must also be different contracts – what works in one context may not work in another. Each contract represents trade-offs and compromises between the conflicting interests of the parties and between the multiple objectives that the same party may pursue. For example, strict investor commitments to social investment programmes or to local sourcing of labour, goods and services may increase project costs and thus push the investor to seek concessions on public revenues. Similarly, investors are usually only prepared to take higher risks if these come with higher rewards; as a result, removing or weakening host government commitments to provide regulatory stability may also put pressure on public revenues.

Whilst this guide highlights the contractual options that tend to lead to better sustainable development outcomes, parties may decide to compromise on one aspect in exchange for concessions on another. Prioritising certain issues and options is a key element of each party's negotiating strategy.

1.3 Outline

The next sections tackle several interlinked topics, each representing a (set of) key lever(s) for sustainable development in investment contracts:

- Choice among, and framing of, contract models to maximise sustainable development outcomes, for example through promoting more inclusive business models in the design and implementation of an investment project (section 3);

- Tools to maximise the economic benefits to the host country, including public revenues and non-revenue benefits like investment commitments, technology transfers and infrastructure development (section 4), as well as local content provisions that shape the extent to which the investment project creates local employment and business opportunities (section 5);

- Tools to balance economic with social and environmental considerations: environmental and social impact assessments and management systems, safeguards in land takings, social investment requirements and legal remedies for groups adversely affected by an investment project (section 6);

- Stabilisation and renegotiation clauses, which concern the evolution of the contractual relation over time and may be used to reconcile the investor's need for a degree of stability with preserving host state capacity to take action in the public interest even if it adversely affects the project (section 7);

- Dispute settlement, including contractual provisions to regulate investment disputes that may arise under the contract and proper handling of disputes when they arise (section 8);

- Confidentiality provisions – acknowledging that although commercial confidentiality concerns may be at stake, openness and public scrutiny are essential to maximising sustainable development outcomes (section 9).

The next section provides an overview of relevant legal frameworks, highlighting how investment contracts can only be properly understood if read in conjunction with a wider range of applicable legal instruments. It also briefly discusses the contracting process – namely, the negotiation and management of investment contract. A final section (section 10) provides background material for a role-play to apply the concepts discussed in the guide. Few but carefully selected sources for further reading on the main issues are recommended at the end of most sections, prioritising materials available online; a full list of references is provided at the end of the guide.

Further reading

MMSD (2002) *Breaking New Ground: Mining, Minerals and Sustainable Development*. IIED, London. http://www.iied.org/pubs/display.php?o=9084IIED.

Legal frameworks and contracting process

2.1 A web of contracts within the broader legal framework

Contracts should not be viewed in isolation. To be understood, contracts must be considered within the broader legal framework – in other words, within the wider web of contracts they are part of, and in light of the national and international law that regulates them.

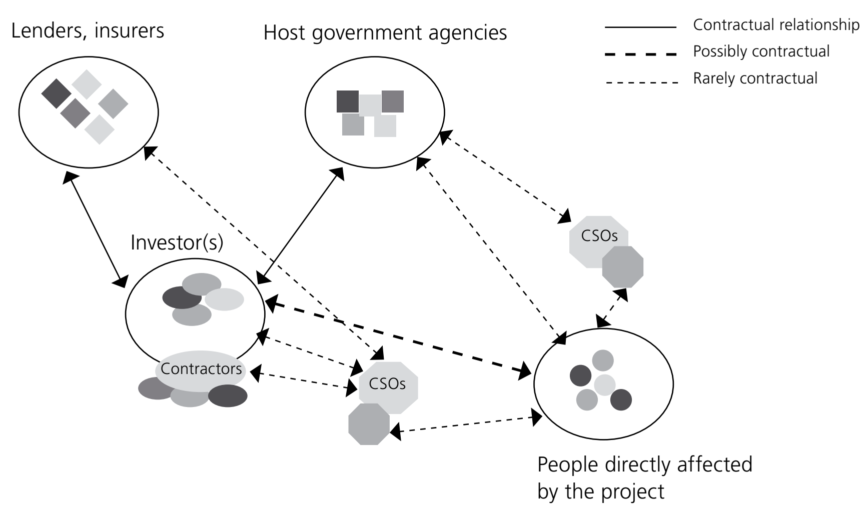
A web of contracts

This guide focuses on contracts between the investor and the host government but most investment projects are regulated by a number of different contracts, rather than just a single contract (see Box 2). It is easy to see why, for example, if we consider that an investment project in the oil and gas sector typically:

- Requires the regulation of multiple stages and activities such as exploration, production and transportation as well as multiple issues, including governance structures, conduct of activities, financing, applicable standards, revenue sharing and risk management;

- Involves multiple parties, including consortium members, lenders, insurers, contractors, suppliers and host government agencies. It may also affect a wider constituency, such as people who may lose land or suffer environmental damage, particularly in onshore projects; and may attract advocacy from civil society organisations (see Figure 1).

Figure 1. An investment project – parties and stakeholders



Box 2. The web of contracts in a real-life example

The Chad-Cameroon oil development and pipeline project involves the development of oilfields in southern Chad with the construction and operation of a 1070km-long pipeline from the oilfields to the coast of Cameroon. The contracts regulating this project include:

- A concession contract between the consortium of oil companies and the government of Chad, regulating the exploration and development of the oil fields in Chad, and a joint operating agreement regulating relations among consortium members;
- Two 'host government agreements' (HGAs) between two joint ventures controlled by the consortium (one in each country) and the governments of Chad and Cameroon, which regulate the construction and operation of the pipeline;
- Shareholder agreements determining the contributions of consortium members into the two joint ventures, and a cooperation agreement between the two joint ventures in order for them to operate the pipeline as an integrated system;
- An inter-governmental agreement (IGA) between Chad and Cameroon, committing the two governments to facilitating the construction and operation of the pipeline;
- Lending agreements between project companies and both private and multilateral lenders, as well as between the World Bank and the governments of Chad and Cameroon, which regulate the financing of the project.

Several other contracts regulate relations with service providers, contractors and off-takers (i.e. buyers of oil). An Environmental Management Plan was developed for the project, and is cross-referenced in several agreements (for instance, in the loan agreements between the World Bank and the two host governments).

These contracts were signed over an extended period of time. The original concession agreement in Chad was signed in 1988. The contracts for the construction of the pipeline were signed in 1998. The loan agreements with the World Bank were only signed in 2001.

In some investment projects, contracts may also be concluded between the investor and affected communities, for instance to define the nature and value of social investment schemes like schools and clinics. This type of contract is sometimes called 'community development agreement'. In the West African Gas Pipeline (WAGP) project, 14 Memoranda of Understanding were concluded between the West African Gas Pipeline Company and communities impacted by the project in Benin, Ghana, Nigeria and Togo. The agreements involve social investment programmes in the areas of education, health, water and sanitation, income generation and capacity building.

The role of national law

The national law of the host state may set rules on the conduct of economic activities in the relevant sector (through land, mining or petroleum codes, for example) and regulate key issues like taxation, revenue management, environment protection and land takings.

The relationship between contracts and national law varies. In some countries, national legislation provides detailed rules as well as model contracts to be used as a starting point for negotiations. In these cases, applicable rules are mainly determined by national law and model contracts so negotiations may focus on specific issues like the fiscal regime. At the other end of the spectrum, some contracts are fully negotiated between the parties and provide much of the legal regime governing the investment. This is often the case in host countries where national law is weak.

From a sustainable development perspective, it is important to have a robust national legal framework in place. This crucially determines the extent to which a country is prepared to maximise the sustainable development outcomes of an incoming investment. It is therefore better to strengthen the national legal framework, than to keep weak national law and negotiate separate, tailored rules under unequal power bargaining relations with investors. When individual investment projects are negotiated, time and cash-flow pressures may make it more difficult to strengthen the protection of local or public interests that may be adversely affected by an investment. In addition, generally applicable law reform may lend itself more easily to vigorous public debate on strategic policy choices, increase transparency of legal regimes, create incentives for local as well as foreign investment, and provide greater equality of treatment between investment projects and between people affected by different projects. This does not mean that the contract cannot be used to secure higher standards than those required under national law – as will be discussed in section 6.

Some contracts purport to prevail over national legislation in case of conflict. This situation raises important issues because it may allow the executive to undermine the application of legislation passed by parliament. Even if the contract is ratified by parliament, and thereby acquires the same legal value as national legislation, exempting the project from generally applicable legislation may create disparities of treatment – for example, if improvements to social and environmental standards stipulated by national law do not apply to an investment project. In practice, the parliamentary ratification of contracts may not always be as closely scrutinised as ordinary bills, so there is still some risk of bypassing the democratic process. These issues are discussed further in section 7.

Besides the articulation between the national legal system and the transnational contract, the relationship between national law and local interests and systems of rights is also important. In many countries, people that depend on natural resources for their livelihoods have developed sophisticated systems of rules to manage resources. For example, in much of Africa, lack of financial resources and of institutional capacity in government agencies, lack of legal awareness, socio-political deals between government and customary chiefs and, often, lack of perceived legitimacy of official rules and institutions all contribute to limit the outreach of state legislation in rural areas. On the ground, people tend to continue to apply 'customary' systems that are based on usually unwritten rules and found their legitimacy on 'tradition' – although in reality these systems have much evolved during colonisation and since independence.

While in many jurisdictions the rights created by these local systems have no legal value, some countries have taken steps to legally recognise and protect these rights, including in the face of incoming investment. Ensuring that national law properly links to these local systems and protects rights based on them is a key step to ensure that affected communities participate in investment decisions and benefits. As will be further discussed in section 6, national law (or the investment contract) may also require the signing of community development agreements between the investor and affected communities. This is the case, for instance, for the mining and forestry sectors in Ghana, where these contracts are referred to as 'social responsibility agreements' (Ayine, 2008).

International law and investment protection

In addition to contracts and national law, investment projects are also regulated by international law. Investment treaties between the host and home countries may provide legal devices to protect foreign investment from host state interference, for example by requiring host governments not to discriminate against investors from the other state party, to treat investors in a fair and equitable way and to pay compensation in case of expropriation. Investment treaties may also strengthen the legal value of investment contracts, by requiring states to respect their contractual commitments vis-à-vis investors from other states (these treaty provisions are usually called 'umbrella clauses'). The rules of international investment law in principle do not apply to domestic investments – though some domestic investors have been able to benefit from this protection by establishing companies in a foreign country covered by an investment treaty.

If an investor feels wronged by the host state, it may have legal remedy not only through the contract, but also through legal claims based on applicable investment treaties. Indeed, the existence of an umbrella clause in the investment treaty can turn a breach of contract into a violation of international law. Also, the investor may claim that the contract or even spoken statements made by the host government during negotiations created 'legitimate expectations' that the investment project will be implemented as planned; these expectations are legally protected under the provisions of investment treaties that require states to accord investors a 'fair and equitable treatment'.

Therefore, special attention should be paid to the careful negotiation of investment treaties. Negotiations are usually based around 'model treaties' prepared by capital-exporting countries. These model treaties tend to focus on investment protection. However, the IISD recently developed a model treaty that is specifically designed to maximise the investment's contribution to sustainable development (Mann *et al.*, 2006).

The IISD model treaty features the 'classical' provisions that protect investors' rights, for example with regard to compulsory takings. At the same time, however, it entrenches mechanisms to maximise the sustainable development contribution of the investment. It also features safeguards for people who may be affected by investment projects protected under the treaty. For example, the IISD model treaty requires the investor to undertake a pre-establishment environmental and social impact assessment that complies with the laws of the host state or those of the home state, whichever is more rigorous. Investors are also required to maintain an environmental management system and uphold human rights in the state and community where the investment takes place. The IISD model treaty is accompanied by a handbook for government negotiators and from a host country perspective constitutes an excellent resource for the negotiation of investment treaties.

When negotiating contracts, it is important to find out whether the investment would be protected by an existing investment treaty, and if so what level of protection that treaty would offer. Establishing whether the investment is covered by an investment treaty would require a thorough examination of the investor's corporate structure. This is because the investor may locate some of its companies in a third country, specifically to benefit from investment treaties which that country may have signed with the host country (a practice sometimes referred to as 'treaty shopping').

It must be borne in mind that the full implications of an investment treaty may only be understood by examining other investment treaties that the host state may have entered into. This is because the investment treaty may feature a 'most favoured nation clause', which means that an investor covered by the investment treaty has a right to benefit from any more favourable treatment granted by the host state to investors from third countries, including through other investment treaties.

International law and standards: safeguards for affected people and environments

In addition to protecting foreign investment, international treaties affirm the fundamental human rights and internationally recognised environmental principles that must be respected in project implementation. At the global level, key human rights treaties include the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights. Both were adopted by the United Nations in 1966, and have since been ratified by a large number of states. The ratification and implementation of human rights treaties is an important part of sustainable development goals. Fundamental human rights like the right to an adequate standard of living, including food and housing, or the right to a clean environment may be used by local people to defend their interests if they are affected by an investment project. As with safeguards provided by national law, the ratification of and genuine commitment to human rights and environmental treaties influence how prepared a country is to maximise the sustainable development outcomes of incoming investment.

Outside the realm of law, international standards in social and environmental matters may be specified in the institutional policies of lenders. If a project receives funding from the World Bank, the International Finance Corporation (IFC) or regional development banks, it must comply with the lender's performance standards on impact assessment, resettlement, indigenous peoples and other issues concerning the management of social and environmental risks. In the Chad-Cameroon project, for instance, World Bank lending required application of the Bank's standards, which were in many respects more generous than the national laws of Chad and Cameroon (with regard to land takings, for example). The 'Equator Principles', a voluntary benchmark used by the financial industry, extend the application of the IFC's performance standards to large projects funded by the commercial lenders that have signed up to the Principles.[1]

Performance standards such as those developed by the IFC are available for all investment projects to use, even if the IFC is not involved. During contract negotiations, host governments and CSOs may therefore feel confident requesting or advocating that these international standards be applied, as well as demanding compliance with national law. If international standards are applicable (due to lender conditionality or otherwise), CSOs can play a particularly important role in scrutinising compliance.

In addition, the Guidelines for Multinational Enterprises adopted by the Organisation for Economic Co-operation and Development (OECD) are to date the most comprehensive multilateral instrument on corporate responsibility.[2] Among other things, General Policy 2 of the Guidelines states that multinational enterprises should respect the human rights of those affected by their activities. The Guidelines are not legally binding. But the investment contract may explicitly require compliance with them, making non-compliance a violation of the legally binding contract.

Many other bodies of international standards may be relevant. This includes sector-specific standards, for instance in petroleum or mining, and standards applicable across sectors. An example of the latter is the 'ISO 14000' series developed by the International Organization for Standardization (ISO), which relates to environmental management systems.

Issues of alignment

Given that a single investment project is typically regulated by a large number of contracts and normative frameworks, it is important to ensure that the different contracts are consistent among themselves and with applicable national and international law. This is not easy because contract negotiations often involve many different lawyers. Leaving aside extreme cases of unregulated inconsistencies between contracts, poorly aligned contracts may undermine the pursuit of sustainable development goals.

1. 'The Equator Principles – A Financial Industry Benchmark for Determining, Assessing and Managing Social & Environmental Risk in Project Financing', adopted in 2003 and revised in 2006 (www.equator-principles.com).
2. First adopted in 1976, the Guidelines were last revised on 27 June 2000 (text available at http://www.oecd.org/document/28/0,3343,en_2649_34889_2397532_1_1_1_1,00.html). At the time of writing, a consultation to further revise the Guidelines was ongoing.

This is illustrated by experience from the Chad-Cameroon project. In Chad, revenue management was regulated by a World Bank-inspired Petroleum Revenue Management Law. This originally stipulated that almost all of oil the revenue should be spent on priority sectors such as health, education and infrastructure and that revenue management would be overseen by a committee including civil society representatives. The law was adopted as it was a condition laid down by a key lender, the World Bank, and this was clearly stated in the loan agreement between the Bank and the government of Chad.

Once the pipeline had been constructed and the oil started to flow, the government of Chad unilaterally amended this law. It added security activities to the list of priority sectors for use of oil revenues, and reduced the share of revenues subject to the scrutiny of the revenue oversight committee. The World Bank suspended its loan to the government of Chad but it could not stop the consortium from continuing to pay royalties to the government: conditionalities on revenue management were included in the loan agreement between the Bank and Chad but they were not referred to in the concession contract between Chad and the consortium. This example illustrates the importance of understanding the many different legal instruments that affect an investment project and of integrating advances on sustainable development in all key project contracts.

2.2 The contracting process

The process in which the contract is concluded and managed is crucial to getting the best deal for sustainable development. It is worth briefly discussing the formation of contracts, the arrangements for managing contracts once they are signed as well as broader issues affecting the contracting process. Issues of transparency and public participation in the contracting process are discussed separately in section 9.

Choosing the right investor

Government capacity to scrutinise competing investors and investment proposals is an essential first step. The financial, economic and technical viability of an investment proposal and the economic, social and environmental risks involved in the investment would require close scrutiny, as would the proposed debt-to-equity ratio (i.e. the relationship between the capital contributed by the investor and the amount of lending needed to finance the project). Very high debt-to-equity ratios may make the project vulnerable to downturns in the financial markets. They may also affect government revenues, as much of the income generated by the project would have to be used to repay debt and interest.

In addition, it is prudent to carefully scrutinise the investor itself, particularly concerning its track record on delivering previous investment contracts and in handling disputes that may arise. The advantages and disadvantages of having a company with multiple investments in the country should be specifically considered, for instance with regard to possible implications for dispute settlement (an investor with several projects at stake may take a more conciliatory attitude in disputes concerning one investment). A range of other factors may also be considered – for example, the attitude of the investor's home government in protecting the interests of its nationals overseas.

In some industries, such as oil and gas, there is considerable experience with competitive tendering, from which sectors like mining and agriculture can learn. If properly structured, the tendering process can enable the host country to get a better deal from incoming investment. Indeed, contract negotiations are typically characterised by information asymmetries (imbalances in knowledge). In extractive industries, the investor often has a better understanding than the host government of the value of subsoil resources, which may for example be due to the investor's geological surveying activities in the project area. Competitive bidding may help the government obtain more revenue for its resources than it would gain through individual negotiations with an investor.

The ability of a host government to implement a competitive tendering process depends on the attractiveness of natural resource investment options in the country and on the structure of the industry itself. In addition, to administer an effective tendering process requires the capacity to properly frame public tendering and scrutinise competing investment proposals. It is also necessary to have safeguards to minimise the risks of rigging and corruption. Minimum safeguards would include choosing bidding variables (the parameters determined by bidders, on the basis of which the contract is allocated) that can be objectively compared. They would also include prohibiting 'add-ons' to the contract after the winning bid has been selected. This may involve, for instance, designing a standard model contract, with some areas left blank that need to be completed by the bidders.

Contract negotiation

If contracts are to be individually negotiated, bargaining power and skills influence the outcomes. Careful preparation and a clear negotiating strategy can make a significant difference to the outcome of negotiations. This strategy would need to include the identification of the key sustainable development objectives along with the tools to pursue them; a review of the main issues and likely expectations of the other party; the identification of areas where concessions and compromises are possible; and a plan for the flow of negotiations and negotiation tactics. As mentioned in section 1, the successful renegotiation of mining and agricultural concessions in Liberia was due in part to the effective strategy developed by the government negotiating team (Kaul *et al.*, 2009).

If needed, host governments should consider strengthening their negotiation skills. These skills may be different to what many people may consider effective in negotiations. For example, being a 'tough' negotiator is often regarded as an asset and the threat to walk away can indeed be a useful tactic. But tough stances can also result in deadlock. To reach more mutually acceptable solutions,

Keeping the investment on track: mine workers pushing a cart full of ore at a silver mine in the Cerro Rico, Bolivia

it is important to understand the concerns that the other party may have (e.g. why they would like a certain provision to be included in the contract) and to think imaginatively about alternative ways of addressing those concerns.

In any case, professional expertise in business, legal, financial and other matters concerning contract negotiation and the industry can make a real difference. Particularly complex transactions require highly specialised expertise, which may not be present in in-house legal counsels and government departments. Also, state-of-the-art financial modelling is essential to enable the host government to make informed choices in the negotiation. Advice from experts familiar with sustainable development can help to structure the project contracts in a way that maximises sustainable development outcomes. It is also prudent to establish clear and effective arrangements for managing and coordinating advisors, particularly where advice is provided by multiple sources.

Contract management

A good contract is one that is not only well drafted but also properly implemented. Good drafting may facilitate implementation – for instance, by clarifying roles and responsibilities, sanctions and rewards. Contract provisions that require the parties to regularly review how the contract is working and to share information (e.g. through periodic reporting requirements) may help with contract implementation. Such provisions are usually included in extractive industry contracts.

The contract may also set up institutions to keep track of project implementation. For instance, in production sharing agreements for oil projects, a management committee is often made up of consortium members and the national oil company. The management committee may monitor the costs and progress of project implementation and together develop work plans. Similarly, a land lease for a rubber plantation in Liberia establishes a coordination committee of seven members, three of whom are appointed by each party and one (the chair) is appointed jointly or, in case of disagreement, is appointed alternately each year by each party. Under the land lease, the coordination committee has no managerial role but it discusses issues concerning labour, environmental, safety and other aspects where the needs of the parties may have to be coordinated. In practice, these committees and the host government's participation in them are often not very effective.

Dispute settlement clauses are also important to clarify what happens in case of disagreement over legal or technical issues. They are further discussed in section 8.

For the host government, implementation requires well thought-out contract management processes. Dedicated resources are needed to make the most of the opportunities offered by participation in management and other committees established by the contract. Also, calculating and collecting revenues from projects requires the technical ability to understand often complex contractual revenue-sharing provisions. In this regard, dedicated host government units with strong expertise and high-level political backing are key to collecting revenues, monitoring implementation and sanctioning non-compliance.

In addition to government agencies that manage the contract, there is also a role for a wider range of regulatory agencies. For example, the national environment protection agency (EPA) can monitor compliance with environmental legislation and standards – provided it has a clear mandate to do so, as well as effective tools and adequate resources to access information and sanction violations. Independence from the executive branch and proper communication with CSOs are essential to increase the effectiveness of this regulatory supervision. Proper coordination among the various government agencies involved in the project is important to the smooth implementation of the investment.

Investment projects may provide opportunities for strengthening the host government's capacity to manage contracts. For example, some contracts require the investor to pay specified sums to the government in order to finance institutional support to the government agencies responsible for the relevant economic sector. Financial contributions may also be provided to specialised agencies like EPAs, for example through earmarking some taxes. But there are also risks in making regulatory agencies financially dependent on the investment project, as it may create in-built biases that favour the unhindered continuation of the project.

It is also important to protect regulatory agencies from institutional capture – whereby government agencies do not perform their regulatory functions properly due to distorted incentives. For instance, if a national oil company has both regulatory functions and commercial duties (as an equity holder in an oil project, for example), there may be the risk that it does not scrutinise the project as thoroughly as it should. Separating commercial and regulatory functions may be a useful way of addressing this issue.

The investor needs to ensure that all subcontractors and suppliers involved in the project comply with the contract that it has signed with the host government. For example, if the contract with the government requires compliance with specific social or environmental standards, the investor needs to include these requirements in its contracts with subcontractors and suppliers. The investor also needs to establish procedures to monitor compliance and sanction non-compliance.

The 'political economy' of contracts: the project cycle, conflicting interests, conflicts of interest

Before discussing specific contract models and provisions, it may be worth briefly mentioning the power relations and conflicting interests that tend to arise in the contracting process. These aspects will inevitably play a central role in the negotiation and management of the investment contract.

The changeable balance of negotiating power among contract parties and other stakeholders profoundly influences the negotiation and management of investment contracts. Negotiating power is in turn influenced by economic factors that vary considerably over time and depending on the sector.

During the early stage of large investment projects like those in the oil and gas sector, there are high costs, high levels of risk and large capital injections to undertake exploration or build infrastructure and pipelines. At the project design stage, the host government, under pressure to attract investment, may agree to concessions.

But once most of the investment has been made (for instance, once the infrastructure is built), the balance of negotiating power tends to shift away from the investor in favour of the host government: the investor cannot easily move its assets without major economic loss and the project becomes vulnerable to host state action to capture a greater share of the project benefits (a phenomenon sometimes referred to as 'obsolescing bargain').

Similar considerations may be made with regard to mining projects or agricultural investments that require large capital injections, for instance to build irrigation systems or processing facilities.

Due to these considerations, it may be beneficial for the host country to include a renegotiation clause in the contract. This clause would enable a party to request the renegotiation of the contract, or aspects of it, if specified circumstances materialised. Renegotiation may also be triggered by the expiration of a period of time specified in the contract – for example, where the overall duration of the contract is split into two terms, with possibility to renegotiate key aspects after the first term.

It is important to acknowledge that contract negotiation and management typically involve the balancing of conflicting interests. The most obvious scenario is the different interests that each party in the contract has (investor, host government). Yet each party may also have to balance conflicting internal interests. For example, the host government includes agencies with different and possibly conflicting objectives, such as a national oil company and the ministry responsible for the environment. Quite often, some of the most delicate parts of the negotiation occur between different host government agencies. In this respect, it is important for the host government to enter negotiations with the investor based on a clear negotiating strategy that is supported by the key government departments.

In addition to the interests of those parties in the contract, there may be a wider set of interests at stake (people affected by the project, organisations supporting them). It may be necessary to strike a delicate between the interests of people directly affected by the project and the wider public interest. Balancing economic growth with social and environmental considerations is at the very heart of sustainable development. Some of the tools discussed in the next sections provide options for addressing these issues.

Further reading

On the wider legal framework

Mann, H., K. von Moltke, L.E. Peterson and A. Cosbey (2006) *Model International Agreement on Investment for Sustainable Development – Negotiators' Handbook*, 2nd Edition. IISD, Winnipeg. http://www.iisd.org/investment/model/. Model investment treaty and accompanying handbook for negotiators.

On the contracting process

Kaul, R. and A. Heuty with A. Norman (2009) *Getting a Better Deal from the Extractive Sector – Concession Negotiation in Liberia, 2006-2008*. Revenue Watch Institute, Washington DC. http://www.soros.org/resources/articles_publications/publications/liberia_20090302. Lessons from the recent renegotiation of a mining and a land concession in Liberia.

Contract models

3.1 Setting the scene

Great diversity of contracts

The nature and content of investment contracts vary considerably across jurisdictions and sectors. Different legal traditions have different ways of conceptualising and regulating contracts. For example, French speaking countries tend to prefer legal solutions suited to the 'civil law' tradition that was originally developed in continental Europe, in particular in France. English-speaking countries may be more familiar with the options provided by the 'common law' tradition that originated in England.

In addition, cross-sectoral differences in economics and business cycles (for instance, between mining, oil and agriculture, and within mining between different minerals or within agriculture between different crops) mean that there are many different types of contracts. As mentioned earlier, how much contracts are negotiated also varies – from standardised contracts annexed to the national legislation that regulates them to fully negotiated agreements that purport to prevail over national law.

What is a contract model?

A contract model is a basic template for distributing the risks, costs and benefits of an investment project. To identify the relevant contract model it is necessary to answer questions such as: is the host government mainly collecting revenues while the investor runs the project (the basic concession model), or are the investor and the host government (or a state-owned enterprise) joining forces to implement the project together (through a joint venture)?

Discussions on contract models usually focus on contracts between investors and host governments. There is also limited but growing experience with contractual arrangements that directly involve people living in the area where the investment takes place, for instance by enabling them to have an equity participation in the project. Some of this experience is briefly mentioned in this section.

No silver bullet, the devil is in the detail

Each model has advantages and disadvantages. The choice of a model is inevitably influenced by the specific context. The contexts vary not only according to the economics of the industry, but also, for instance, depending on the ability of state or private entities in the host country to contribute capital and share project risk.

In addition, whether a contract is beneficial to the host country and to local people is determined not so much by the abstract contract model but rather by its detailed provisions. It depends on how the model is structured. For example, joint ventures may enable greater local control over business decisions, higher public revenues and increased local business capacity. Or joint ventures may only nominally involve local parties in business decisions and the joint operation of economic activities may not happen in reality. In addition, costs charged by suppliers affiliated to the investor may take up a high proportion of the revenues generated by the joint-venture company.

A final caveat

Although models can help identify the main features of a deal, in real-world transactions typologies are of limited use and hybrids are commonly used. It is important to look at each contract's detailed provisions, rather than its name, in order to understand its content and implications. Despite its name, Mozambique's Model 'Exploration and Production Concession' (EPC) for petroleum projects is in effect a production sharing agreement, not a concession.

The next few sub-sections discuss the basic features of three contract models that are commonly used in natural resource investments: concessions, production sharing agreements and joint ventures. Key contract provisions are analysed in greater depth in sections 4 to 9.

3.2 Resource development versus royalties and fees: concessions and leases

Concessions are contracts whereby the government grants the investor the exclusive right to exploit natural resources or run utilities or other public services in a given area for a specified period of time, in exchange for payment of royalties, taxation and fees. Concession contracts do not in principle involve collaboration in production activities: the investor runs operations and the government receives revenues. But local partners may be involved in production under local content provisions that can be included in the concession (these provisions are discussed in section 5).

Concessions are commonly used in extractive industries – particularly in mining, while in petroleum they have been partly replaced by other contracts. As to utilities and public services, concessions may be used as part of 'build-operate-and-transfer' (BOT) deals, whereby the investor undertakes the construction and financing of an infrastructure facility and operates and maintains it for an agreed period of time, during which the investor can charge fees for its use. At the end of the agreed period the facility is transferred to the government.

In agricultural investments for food or fuel, investors may acquire a long-term land lease from the government. Government leases are particularly common in countries where most or all of the land is owned by the state – as is the case in many African countries. In essence, leases are similar to concessions (and in fact, in some jurisdictions they are explicitly called 'concessions'): the government allocates natural resource rights to the investor, who implements the investment project and makes cash payments to the government (rental fees, taxes).

In some projects in Africa, government-allocated land leases have combined elements of a resource lease and a BOT scheme. This may mean that for the investor, cash payments are low, absent or qualified by long holiday periods during which no fee is due. The host government may still benefit because the investor commits to infrastructure development – for example, with regard to the construction of irrigation facilities. Under the terms of these deals, the investor builds and operates irrigation infrastructure, runs the irrigated farm for the duration of the contract and transfers facilities to the host government at the end of the lease.

Concessions for subsoil resources are typically concluded with host government agencies, as the state owns mineral and petroleum resources in most jurisdictions. But, for land deals, there is growing experience with leases granted to investors by local landholders, rather than the host government. For example, a 2008 land lease between Mondi Ltd, a South African timber company, and the Siyathokoza Community Trust in South Africa allows the company to grow and own timber and to conduct commercial forestry operations on the community's land. In return, the community trust receives indexed and periodically reviewed fees. This deal was concluded as part of a land restitution settlement involving the investor, the community trust and the South African government. Similarly, a recent deal concluded by the Indian agribusiness company Varun in Madagascar entails a combination of a land lease and arrangements to source agricultural produce from local producers, including a direct contract with 13 associations of local landholders.

Local economic benefits in concession or lease schemes are mainly shaped by the amount of public revenues (discussed in section 4) as well as by the nature of requirements and enforcement mechanisms on minimum investment, local content and capacity building.

3.3 Sharing produce: production sharing agreements (PSAs)

Basic model

In agriculture, sharecropping contracts between local farmers have been used for a long time in many parts of the world. Typically one party provides land, the other labour and instead of paying a fixed cash rent, produce is split between the two parties based on an agreed formula. Over the past few decades, this basic contract model has been adapted to investment contracts, particularly in the oil sector – although it remains rare in gas and mining projects.

Production sharing agreements (PSAs) in oil contracts are usually concluded between the investor and the host state or, more commonly, a state-owned national oil company. While there are many variants, the investor participates in activities by providing financial and technical services to the national oil company (e.g. it funds exploration, development and production). In return, it receives a share of oil to recover costs ('cost oil') and make a profit ('profit oil'). The state receives a share of the profit oil. Sharing is based on contractually agreed formulae – whether fixed shares or, more commonly, sliding scales based on output or rate of return (these issues are discussed in greater depth in section 4).

The investor may also be required to pay bonuses – lump-sum payments at specified times, such as contract signature, oil discovery and landmark stages in production. A management committee made up of representatives from both the international oil consortium and the national oil company manages the contract.

Comparison with concessions and joint ventures

As in the case of concessions, PSAs entail that the investor runs oil operations at its own risk (in contrast to a joint venture, for example); but the host state receives a share of petroleum, rather than tax and royalties. However, hybrids are also possible: as in concessions, the investor may be required to pay income tax on its share of oil and royalties based on the value of production. In addition, as in a joint venture, the national oil company may hold an interest in the consortium. In these cases, the host government contribution may be 'carried' (i.e. paid for) by other consortium members and the government repays this contribution from its share of profit oil.

Compared to concessions, PSAs tend to be more complicated to negotiate and administer. They require significant host state capacity in terms of proper legal, financial and technical expertise. Due to this complexity, PSAs also tend to be more difficult for the public to scrutinise. Whether PSAs can be financially more beneficial to host countries than concessions depends on their specific sharing provisions, compared to tax and royalty rates under concessions.

3.4 Joint venture agreements

Concept and application

Joint ventures involve contracts between the investor and a local partner, with a view to jointly running a business venture. Contracts may entail setting up a jointly owned company incorporated in the host state and managed by a board where both parties are represented (incorporated joint ventures). Joint ventures may also be run on the basis of contracts alone, without the creation of a separate legal entity owned by the parties (unincorporated joint ventures).

Unincorporated joint ventures offer greater flexibility than incorporated ones, although they require additional efforts to contractually develop governance structures (incorporated ventures can rely on the generally applicable company law that is in force in the state where the joint-venture company is established).

Unincorporated joint ventures also lack legal identity and therefore limited liability – differently to incorporated joint-venture companies, where the parties are only responsible for liabilities up to the value of their contributions in the company. Lack of limited liability may increase the accountability of the investment towards people who may suffer damage caused by it; but in large, long-term and capital-intensive investments lack of limited liability tends to be a major drawback from the investor's point of view. However, in practice this issue is circumvented through the limited liability of the joint-venture parties themselves, which are typically companies, and 'joint operating agreements' in the petroleum sector are commonly structured as unincorporated joint ventures.

In lower- and middle-income countries, joint ventures for natural resource projects often involve an entity owned by the host state. There is also growing experience of joint ventures involving community groups, particularly in agriculture. For example, Namibia's Kavango Biofuel Project led to the establishment of a joint venture to farm jatropha, with equity participations held by the investor and the Kavango Jatropha Farmers' Association – a legally constituted body representing growers. Farmers contribute land, the investor capital. Farmers who wish to grow jatropha are contracted and paid by the joint-venture company (Jull *et al*., 2007). Joint ventures with local farmers have also been established in South Africa (Greenburg, 2009) and Malaysia (Majid-Cooke, 2002; Vermeulen and Goad, 2006).

Joint ventures with local groups in extractive industries are more difficult, although not impossible. This is due to the economics of these investments and to the fact that subsoil rights are usually vested with the state rather than with landholders. An interesting example from South Africa is outlined in Box 3.

The pros and cons of a joint venture

Joint ventures are often considered to be a more favourable option for host countries. Compared to concessions and PSAs, joint ventures tend to give the host country partner greater control over the project and its benefits – not only in terms of revenue but also, in principle, of transfer of technology and knowhow. But it is important to carefully assess options in light of the specific context. In practice, joint ventures are not always the most favourable option, as much depends on their specific terms. They also have drawbacks and it may be useful to recall the most important ones.

Negotiating a joint venture tends to be a very complex exercise, requiring a high level of legal and technical expertise. Whether joint ventures really do result in higher revenues depends on the deal. In practice, many joint ventures with the host government are not genuine partnerships. From the investor's perspective, offering the host government a small equity participation can be an effective risk management tool, as it would create incentives for the government to facilitate the continued implementation of the investment project. But a small equity participation would add little in terms of public revenues and local control over the project.

Dividends depend on the profitability of the joint-venture company. In practice, they may only start being paid after several years of implementation. Even then, dividends may be low if the costs of the joint-venture company are inflated due to above-market prices paid by the company for the goods and services supplied by other companies affiliated to the investor or to below-market prices paid by the investor's affiliates for the products sold by the joint-venture company. This issue is commonly referred to as 'transfer pricing' and is further discussed in section 4.

During contract negotiations, the increased public revenues brought by dividends from the joint-venture company may be compensated by lower taxes, royalties and other public revenues paid by the joint-venture company; conversely, higher revenues may be achieved in ways other than equity participation (through higher taxation, for instance).

It cannot be assumed that a joint-venture agreement will result in transfers of technology and know-how – these issues would need to be specifically negotiated for. In this regard, much depends not only on the legal issues, but

Box 3. The Richtersveld Pooling Sharing Joint Venture (PSJV)

This joint venture agreement was signed between Alexkor Ltd (a South African state-owned diamond mining company), the South African government and the Richtersveld community, a group of pastoralists based in the northwest of South Africa.

The agreement followed a long-standing legal battle whereby the Richtersveld community sought restitution of the resource rights it was stripped of during apartheid. This restitution was made possible through the Land Restitution Act 1994, adopted after the democratic transition. In 2003, the Constitutional Court held that the community was entitled to restitution of rights over land *and minerals* found in it (*Alexkor Ltd v. Richtersveld Community and Others*). The Court referred the case back to a lower court for final determination. Alexkor retained its marine mining rights off the coast of the disputed land.

In 2007 the parties reached an out-of-court settlement involving, among other things, land restitution and the establishment of the joint venture between Alexkor and Richtersveld Mining Company (RMC), a vehicle of the Richtersveld community.

Under the terms of the agreement, Alexkor and RMC put their marine and land mining rights under the control of the joint venture. The state recapitalised Alexkor for it to inject capital into the PSJV. Alexkor has 51 per cent and RMC the remaining 49 per cent in the PSJV. Each party has three members on the Joint Board, which appoints an Executive Committee to oversee day-to-day operations.

Mining joint ventures with local communities are very rare - though in South Africa not unique. Several factors made the Richtersveld deal possible. First, the Legal Resources Centre, a South African non-profit organisation, supported the community throughout its court battle and during most of the negotiations. Second, the fact that the community held mining rights gave it significant leverage; this is a rare situation, as in most jurisdictions minerals are owned by the state. Third, the South African state supported this and similar deals through funding, facilitation and policy incentives (e.g. mining legislation requires certain levels of 'historically disadvantaged South African' ownership to qualify for new mining licences). It is worth noting that Alexkor is wholly owned by the state.

Sources: Alexkor Ltd v. Richtersveld Community and Others; http://www.atns.net.au/agreement.asp?EntityID=3923; http://www.dpe.gov.za/home.asp?id=20.

also on the extent to which the host country partner fully seizes the opportunities offered by the deal. For instance, in ventures involving the host government, much depends on whether government agencies make sure that the joint-venture company recruits the best local nationals, rather than sending government officials purely on the basis of seniority.

It may also be complicated to handle the shared management of joint ventures, particularly due to differences in cultures and objectives; an agreed business plan is an important ingredient for success. From a civil society perspective, joint ventures involving host governments may require greater public scrutiny, because if the government has an equity participation in the project this may exacerbate conflicts of interest between the government's roles as regulator and equity holder – although genuine government involvement in the joint-venture company tends to be rare.

Joint ventures require the host country partner to be able to participate in project costs and risks. If the project fails, the host country partner may incur major losses, which is not the case under concessions, leases and PSAs. This potential outcome requires a thorough assessment of the benefits of holding an equity stake in the project and of alternative options (can a similar result be achieved, for instance, through taxation?). It also necessary to weigh up the benefits against the risks and costs involved in equity participation.

Experiences of joint ventures that involve local farmers in agricultural investment projects are mixed. In South Africa, for example, joint ventures have been established as part of the land redistribution programme. As land is slowly changing hands, some agribusiness companies have established joint ventures with farm workers that have now become land owners, so as to ensure continuation of agricultural production.

While these schemes appear promising, critics have pointed out that the agribusiness company usually retains effective control over all business decisions; that some schemes are structured so that individual equity ownership is conditioned on continued employment; and that only in a few cases have the joint-venture companies paid out dividends due to transfer pricing, whilst the main source of revenue for local participants is employment wages (Greenburg, 2009).

Shortcomings in joint ventures with local farmers have also been documented in Malaysia, where there is considerable experience with these transactions – for example in palm oil (Majid-Cooke, 2002; Vermeulen and Goad, 2006).

Contributions, equity shares and representation

For a joint venture to be meaningful and beneficial to the host country, it is crucial to negotiate the parties' contributions, equity shares and board representation. It is important to clarify and properly value each party's contribution to the joint venture – whether financial, technological, knowhow or natural resource rights. Where the host country partner makes in-kind contributions (e.g. rights over land, water, subsoil resources) mechanisms are needed to ensure the proper valuation of these assets. It is also vital to clarify roles and responsibilities in jointly running the business.

Equity shares define participation in profits and losses. As equity shares are usually linked to the parties' contributions, valuing these contributions correctly is key to getting the equity shares right. It is also important to have safeguards to protect equity stakes from dilution through subsequent capital increases. This may happen if during implementation the project requires additional capital and the joint-venture company therefore issues new shares. But the host government may not be able to contribute additional resources. If the other joint-venture party/ies or third parties contribute additional capital then the host government may see its stake in the project diluted. Mechanisms to deal with these problems may include shareholder loan arrangements, whereby the investor(s) pre-finance the host government's additional capital contribution and are subsequently repaid from the government's share of project revenues.

Board representation issues include mechanisms to appoint board members and safeguards for minority shareholders (as the investor is unlikely to give up a majority shareholding to the local partner). It is important to note that board representation does not necessarily need to match capital contributions and equity shares – the contract may well provide for board representation based on a wider set of criteria than just economic value. For example, the parties may have an equal number of representatives on the board even if their capital contributions and equity shares are different. The contract may give the host government representation in the board even in absence of any equity participation. Safeguards for minority shareholders may include quorum and qualified majority voting requirements; a right of veto over particularly important business decisions; and the right to obtain information from the management of the joint-venture company and to inspect documentation. Effective accountability mechanisms are essential to ensure that board members representing the host government do not get co-opted by the investor.

Discussions regarding board representation usually focus on the board of a joint-venture company. However, this board often has limited influence, as key decisions are taken by the investor that controls the joint-venture company. Where circumstances allow, the local partner may seek to negotiate representation in the board of the holding company itself.

3.5 Contract models in the wider web of contracts

As discussed in section 2, investment contracts typically form part of a wider web of contracts. Therefore, the models discussed above are often used in conjunction with other contractual arrangements. For example, joint venture agreements may involve ancillary contracts between the joint-venture company and its shareholders – in other words, contracts linked to the joint venture

Table 1. Contract models compared

	Concession	PSA	Joint venture
Use	Extractive industries, land, services/utilities	Petroleum	Very versatile, potentially any sector
Project activities & risks	Investor	Investor	Shared
Host country benefits	Public revenues (tax, royalties and fees); in some deals, infrastructure development	Share of petroleum; public revenues (taxes, bonuses, possibly royalties)	Public revenues; dividends
Pros	More straightforward to administer than PSAs	If carefully structured, can increase overall government take and subject the investment to greater government oversight	Can increase host government control over project – although this may also be negotiated in absence of an equity participation Can provide opportunities for greater public revenues (dividends) and for transfer of technology and know-how
Cons	More limited host government control over project, limited local business capacity building	Complex to negotiate, administer and scrutinise Information asymmetries are a challenge	Host country partner is usually expected to participate in project costs and risks Difficulties in joint management May heighten conflicts of interest between host government roles as equity holder and public-interest regulator

agreement whereby shareholders provide assets or services to the joint-venture company. Ancillary contracts may include technology transfer agreements, land leases or construction contracts.

In these cases, it is important to address conflicts of interest that may arise between shareholders contributing assets or services and the joint-venture company. The latter should be able to enforce rights under its ancillary contracts with shareholders, for example. It is also important to clarify the relationship between ancillary and joint venture contracts, particularly whether non-compliance with an ancillary contract justifies terminating the joint venture (Hewitt, 2001).

Contracts similar to the models discussed above are used in conjunction with other contracts in biofuel and agri-food projects, where land leases may be combined with 'contract farming' arrangements. Contract farming schemes usually involve a series of separate contracts between an investor and (groupings of) local farmers. These arrangements vary widely, depending on the countries, crops and companies involved. Usually, local farmers grow and deliver a specified quantity and quality of agricultural produce at an agreed date. In exchange, the investor (usually an agribusiness company) makes certain contributions upfront, such as credit, seeds, fertilisers, pesticides and technical advice, all of which may be subtracted from the final purchase price. The company also agrees to buy the produce supplied, which is usually at a specified price.

There are several issues that need to be taken care of when negotiating contract faming deals, such as enforceable investor commitments to buy produce at the agreed price and detailed specification of quality standards to minimise possible abuse by investor (Eaton and Shepherd, 2001).

The combination of a land lease with contract farming may be effective if the investor needs to have direct control over a certain share of production (for instance to ensure minimum production levels to feed a processing plant) but is also willing to collaborate with local farmers to share risks and maintain good relations with the local population.

Where an investor is seeking a government-allocated land lease, the host government may promote local sourcing of produce by including in the lease contract an explicit requirement that the investor source a certain percentage of its produce through contract farming or other similar arrangements with local suppliers. The lease contract may also peg the price obtained by local farmers to the price of export sales. For example, the 2008 Concession Agreement between Firestone Liberia Inc and the government of Liberia, concerning a land lease for a 118,900-acre rubber plantation and not involving contract farming, states that, where rubber is purchased from local farmers, the price must be determined on the basis of the concessionaire's export sale price during the previous month, 'less all costs of sale incurred and a reasonable mark-up'; the contract also requires investor to provide the government with the information needed to calculate prices and monitor compliance (section 7.6).

Further readings

Eaton, C. and A.W. Shepherd (2001) *Contract Farming; Partnerships for Growth*. FAO, Rome. http://www.fao.org/DOCREP/004/Y0937E/y0937e00.htm#toc.

Hewitt, I. (2001) *Joint Ventures*, 2nd Ed. Sweet & Maxwell, London.

Radon, J. (2005) "The ABCs of Petroleum Contracts: License-Concession Agreements, Joint Ventures, and Production-Sharing Agreements", in Tsalik, S., and A. Schiffrin (eds) *Covering Oil: A Reporter's Guide to Energy and Development*, pp. 61-85. Open Society Initiative, New York. http://archive.revenuewatch.org/reports/072305.shtml

Maximising economic benefits for the host country

The distribution of economic costs, risks and benefits defines the economic equilibrium of the contract – that is what the investor, host government and other stakeholders get from the deal. Irrespective of the contract model chosen, some deals may be mutually beneficial, whilst others may be unbalanced. In the longer-term, skewed deals are unlikely to be sustainable because the party losing out may seek a renegotiation or even renege the contract altogether. There have been many examples of new governments renegotiating unbalanced contracts when coming into power – in some cases, in order to fulfil specific pledges made during the electoral campaign. The growing spread of bilateral investment treaties and growing use of international arbitration reduce room for host government action that may adversely affect investment projects. But reaching a mutually beneficial deal is ultimately in the best long-term interest of both parties.

This section discusses some of the elements that shape the economic benefits for host countries and local populations. Local content provisions that require specified shares of labour, goods and services to be sourced locally are one of the key levers, but these are discussed separately in section 5.

4.1 Public revenues

Payments to the host government are an important way in which the host country can benefit from a natural resource investment. The rules regulating these payments are often referred to as the fiscal regime and define the government take of the revenues generated by the project. The relative importance of revenues compared to other benefits varies; some deals may place greater emphasis on investor commitments to infrastructure development, for example.

Despite their importance, revenue issues are only briefly touched upon here. This is because there is already excellent material on this subject that has been developed by institutions with specialised expertise like the Revenue Watch Institute (see for instance Goldwyn, 2008, which provided an important starting point for IIED's research on this topic). The Revenue Watch Institute is currently preparing a training manual that discusses revenue issues extensively.

Different revenue streams

Depending on the contract model, the fiscal regime may involve some or all of the following revenue steams:

- Royalties, which are periodic payments based on the value of production (i.e. gross revenues; 'ad valorem' royalties), on production volume ('specific' royalties – currently more rare), on profit (profit-based royalties) or on output price. Royalties may be calculated on the basis of fixed rates or on a sliding scale that depends on factors like production levels or profitability;

- Taxes, including taxation of profits (i.e. net income) and indirect taxation like value added tax (VAT) and taxes on import and export;
- Fees such as land rentals based on acreage size or application fees for licences, contract renewals and other procedures;
- In extractive industry contracts, bonuses, including one-off payments (for instance at contract signature or commercial oil discovery) and regular, fixed payments (for instance after production reaches specified levels);
- In PSAs, the government's share of profit oil, whether in cash or in kind, calculated on the basis of fixed shares or, more commonly, of sliding scales based on changing output level or rate of return;[3]
- In joint ventures, dividends, i.e. the share of profits that is not reinvested into the joint-venture company but distributed to the joint-venture parties.

Good maths and well thought-through decisions: working out what works best for the country

Broadly speaking, from the host country's perspective, maximising the investment's contribution to sustainable development would require maximising the government's take. It would also entail maximising the duration of revenues over time, from project start to after its closure, and evening out fluctuations in revenue flows. Beyond these broad objectives, much depends on the context and preferences. Five key points may be made in this regard.

First, the nature and form of the government take will inevitably vary depending on project-specific circumstances. It may therefore be misleading to simply compare absolute levels of government take across projects, countries or even regions. For instance, exploration and development costs vary greatly depending on local geology and infrastructure. Commercial and non-commercial risks vary greatly, for example, depending on features of the host country's national legal system. The quality of the resource extracted also varies (e.g. oil quality, mature versus new oilfields).

Commodity prices vary over time, so that contracts negotiated at different times look different. Finally, negotiating power matters a great deal, and is influenced by a number of context-specific factors: the balance of negotiating skills

3. In a nutshell, the rate of return is the relationship between the money earned (or lost) by a project and the capital invested in that project. This rate varies over the duration of the project as the project moves from high costs and low or no revenues (during the construction phase, for example) towards profitability (as oil produced starts to be commercialised).

between the investor and the host government, the strategic importance of the project to the investor (and the availability of alternative projects) and the extent to which the host government needs foreign investment in order to implement the project.

Second, it should also be borne in mind that different types of public revenues require different levels of host government capacity to administer them. Choices regarding the appropriate combination of revenue streams need to take this practical aspect into account. For example, bonuses are particularly straightforward to administer and royalties tend to be easier to manage than income tax. It may therefore make perfect sense for different countries to opt for different fiscal regimes.

Similarly, a 'progressive' fiscal regime involves higher tax rates when commodity prices are higher and therefore enables the host government to receive greater revenues if commodity prices go up. But progressive regimes also tend to be more difficult to administer and may not be a realistic option in some contexts.

Third, different combinations of revenue streams cause different outcomes – not only in terms of overall government take, but also in terms of when it is delivered and of the distribution of project risks. For example, both ad valorem royalties and income taxes are influenced by production levels and sale prices. But their revenue implications are very different, as income tax is only due when the project becomes profitable, whilst ad valorem royalties are due irrespective of profitability. A contract emphasising income taxation over royalties may generate lower levels of public revenues in the early stages of the project – until, that is, the project becomes profitable enough to generate income tax.

At the same time, different revenue structures tend to result in different levels of total government take over the project's lifespan. This is because there may be trade-offs between getting money sooner and getting more money. For example, an investor may be prepared to offer the government more if it can recover costs and make profits more quickly. Therefore, a fiscal regime where the government take is concentrated in the latter part of project duration (for example, a regime emphasising revenues based on profits rather than on gross production) may result in higher levels of total government take – though these may only be cashed in later in the project (UNECA, 2002).

Fourth, project revenues are inherently cyclical and the project produces impacts before and after any revenues are generated. It is possible to structure the fiscal regime in ways that address these issues. On the first point, project revenues are likely to vary over time as a result of changing world commodity prices. When prices are higher, so tend to be project revenues, whilst lower prices tend to negatively affect revenues. All else being equal, lower project revenues would result in lower public revenues to the host country. The host government may seek to even out public revenues. They may establish a stabilisation fund, which enables saving money when prices are high to deal with needs arising when prices are low. They may also consider negotiating for a more even flow of public revenues – with a higher share in bad years and a lower one in good years.

On the second point, natural resource projects may cause major adverse impacts on local environments and societies during the construction phase (e.g. through land takings and disruption of traditional livelihoods) and after project closure (as livelihood opportunities through employment and business links come to an end, whilst environments may suffer damage in the decommissioning process). These impacts tend to occur at a time when the project does not yet generate revenues or revenue flows cease. Apart from establishing robust safeguards for people and ecosystems (discussed in section 6), host governments may seek to negotiate for some revenues to be paid upfront and for some revenue streams to continue after the project ends.

Fifth, from a sustainable development perspective, taxation is not just a source of government revenue – it is also a public policy tool, that may be used in social and environment matters. In environmental policy, for example, recent regulation has emphasised an incentives-based approach, whereby behaviour is promoted or discouraged through tax incentives (e.g. higher taxes, or tax breaks) rather than prohibitions and sanctions. For example, carbon taxation (an environmental tax on emissions of carbon dioxide) may be used as a tool to promote use of cleaner technologies.

Taking into account all the factors outlined above, there is no single silver-bullet solution for negotiating public revenues. The most important matter is that decisions on the fiscal regime are based on an accurate understanding of what is achievable in a given investment project and of the different options available. Computer-generated financial modelling is an indispensable tool to support these decisions. Vibrant scrutiny of government decisions in these matters is essential to ensure that the interest of the host country is maximised.

4.2 Safeguards concerning the fiscal regime

Regardless of the fiscal regime chosen, safeguards within the fiscal regime can make a significant difference in maximising public revenues. For example, if fixed cash payments are used (such as rentals for land leases) it may be prudent to denominate payments in international currency, and to regularly adjust them for inflation.

Transfer pricing

Several types of revenues are influenced by the price of supplies purchased and products sold by the project. By charging (or reporting for tax purposes) lower prices when selling to affiliate companies based outside the host country, the investor can artificially depress the local subsidiary's revenues and profits, and thus the public revenues due by that subsidiary. Similarly, the purchase (or reporting) of supplies from affiliate companies at prices above market value can also depress the revenues of the local subsidiary. The practices of manipulating prices to shift income for tax purposes are commonly known as 'transfer pricing'.

These issues are extremely complex and a thorough treatment is beyond the scope of this guide. National tax law usually contains provisions to deal with tax avoidance (for a fuller discussion, see Muchlinski, 2007). Contract provisions may also help address these issues. For example, the contract may explicitly require that sales to affiliates take place at 'arm's-length fair market prices' (i.e. at the price that would be charged to non-affiliates on the open market), and may index sales prices to international spot market prices where these exist and are publicly available. Indexation may also be tied to downstream prices, for instance in aluminium.

The definition of affiliates requires attention, so as to include not only companies directly linked to the investor by relations of control via shareholding (such as subsidiaries) but also a broader set of companies with which the investor may have long-term contractual relations. Examples of contractual provisions on these issues are provided in Box 4.

The contract may also give the host government the right to contest prices in sales to affiliates. For example, a 1996 agreement to extend a 'contract of work' for a mining project in Indonesia requires prices to be equivalent to arm's-length market transactions and sales to affiliates to be approved by the government. If the government believes the price to be low, it may request arbitration by a committee.

Minimum capitalisation

Broadly speaking, capitalisation refers to the money that a company has for its operations. Investors often operate by establishing a local subsidiary in the host country. The level of capitalisation of the subsidiary (i.e. the money that the investor is prepared to put into it) usually limits the investor's legal liabilities. It is therefore important for the host government to avoid having to deal with an 'empty-shell' subsidiary that has no or little capital – not only for tax purposes but also to ensure that environmental or any other liabilities that may arise can be covered.

National legislation, or in default the contract, may require minimum levels of capitalisation. Host governments can also scrutinise loans among affiliates and the extent to which project proposals rely on external lending for their implementation ('debt-to-equity ratio'). These issues are extremely complex and cannot be adequately addressed in this guide.

Excess profits

Another important issue concerns the ability of host governments to receive higher revenues if commodity prices go up during the project, thereby generating higher–than-expected profits. Investment contracts for natural resource projects are often long-term, sometimes spanning several decades. If the contract is negotiated at a time of low prices and price hikes occur when the project is in its operational phase, higher profitability may translate into higher public revenues – but not necessarily to the level hoped for by the government.

Some governments have sought to address this issue through windfall taxes on excess profits. In other words, they adopt new legislation imposing higher tax rates on the higher–than-expected profits generated by the project. This

Box 4. Transfer pricing provisions in two contracts from Liberia

Amended and Restated Concession Agreement between the Republic of Liberia and Firestone Liberia Inc, 22 February 2008 (rubber plantation project)

'[…] Any transaction between Firestone Liberia and an Associate, with respect to Production shall be on the basis of competitive international prices and such other terms and conditions as would be fair and reasonable had the transaction taken place between unrelated parties dealing at arms' length. Such prices for export sales shall be determined to the extent practicable by reference to publicly available international reference prices or indices […].'

The provision goes on to specify export sales prices to Affiliates for different categories of rubber. For example, 'for technically specified rubber (dry rubber) the export sales price shall be the simple average of the prior month's daily closing price on the Singapore Commodity Exchange of TSR20 plus US$ 0.0012 per pound quality differential'. If the Singapore Commodity Exchange price 'is no longer published or if either party believes that such price is no longer representative of arms-length prices for export sales, the Parties shall meet and make such adjustments as may be required' (section 7.2).

Amended Mineral Development Agreement among the Government of the Republic of Liberia, Mittal Steel (Liberia) Holdings Limited and Mittal Steel Holdings A.G., 28 December 2006 (iron ore mining project)

'Affiliate' shall mean, with respect to a specified Person, another Person that directly, or indirectly through one or more intermediaries, Controls or is Controlled by or is under common Control with the Person specified. For purposes of this definition, 'Control' means the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of a Person, whether through the ability to exercise voting power, by contract or otherwise' (article I(2)).

'The CONCESSIONAIRE shall: […]
d. Conduct the Operations and all other activities related thereto, including lending, borrowing, and the purchase or sale of goods or services, with its Affiliates and Associates on arms' length terms and pricing, except as specifically provided herein;
e. Except with respect to short-term loans and other cash management arrangements for working capital purposes, refrain from making loans to Affiliates without the consent of the GOVERNMENT' (article XX)

'"The CONCESSIONAIRE shall maintain contemporaneous documentation evidencing the basis and calculation of transfer prices in respect of transactions between the CONCESSIONAIRE and its Affiliates and shall, upon the GOVERNMENT's request, provide such documentation to the GOVERNMENT and/or its auditors' (article XXVI (5)(d)).

practice is likely to be opposed by investors, who feel that high returns are justified by the high risks involved in natural resource projects (many mineral explorations are unsuccessful and successful projects must provide high enough returns to cover the costs of these ventures). Windfall taxes in violation of contractual commitments may expose the host government to legal challenges before international arbitral tribunals – as in the case *Sergei Paushok v. Mongolia*, for example. In the past, these tribunals (discussed in section 8) have awarded large amounts of money to investors as compensation for unfair treatment from host governments.

On the other hand, it is possible to build flexible mechanisms directly into the contract. Renegotiation clauses may trigger a revision of contractual terms if specified circumstances materialise. In addition, progressive fiscal regimes automatically increase tax rates in line with profitability or commodity price rises. But, as discussed, there may be trade-offs between the progressive nature of the fiscal regime and its ease of administration.

4.3 Revenue management

Misused public revenues generated by investments contribute little to sustainable development. Revenue management is regulated by national law and is outside the scope of contracts – and hence outside the scope of this guide. But transparency in the way revenues are managed is central to efforts to maximise the sustainable development contribution of investment contracts. Therefore, a brief digression on this topic may be useful.

There is some experience of national regimes that have explicitly entrenched transparency requirements in legislation and even identified priority areas in which revenues must be spent. There is also experience with establishing and managing public funds fuelled by the revenues generated by natural resource projects – such as stabilisation funds to shelter the national economy from fluctuations in mineral revenues and 'future generations' funds to save revenues for future use (on these types of funds, see UNECA, 2002).

A well-known if rather unsuccessful example of national regime in Africa concerns Chad's Petroleum Revenue Management Law of 1999. As mentioned in section 2, this law was adopted as a condition for World Bank lending to the Chad-Cameroon project. In its original version, the law provided for the majority of the project's oil revenues to be spent on health, education, infrastructure, rural development, the environment and water (articles 7 and 8). It also provided for 10 per cent of oil revenues to be placed in a 'Future Generations Fund', which was supposed to be spent on projects to support livelihoods once the oil reserves had run out (article 9). In addition, the law established an oversight committee, which included two representatives of civil society organisations, whose role was to supervise the implementation of this legislation (articles 14 and 16).

However, as discussed, the government of Chad subsequently amended the Petroleum Revenue Management Law, adding security activities to the priority sectors for use of oil revenues and abandoning the Future Generation Fund. In 2008, the government of Chad repaid in full its World Bank loans, thereby terminating the Bank's involvement and influence. In any case, the committee overseeing revenue management had been riddled with difficulties since the beginning and this experience is not an encouraging one for developing robust mechanisms to ensure transparency in revenue management.

National legislation can also require that a proportion of project revenue is devolved to local government bodies in the project implementation area. In several jurisdictions, for instance, mining legislation allocates a share of mining revenues (often royalties) to lower levels of local government. In other cases, general tax legislation can transfer a certain share of taxes paid by all businesses involved in natural resource investments to local government (in Mali, for example). The balance to strike in these cases is between ensuring that people who live in the project areas benefit from the investment, particularly given the negative social and environmental impacts they may suffer, on the one hand; and enabling the central government to redistribute wealth nationally, including to more deprived and less resource-rich areas, on the other.

At the international level, sectoral initiatives to promote transparency in revenue management exist in some industries. The Extractive Industry Transparency Initiative (EITI) was launched in 2002 and involves governments, the private sector and civil society. The EITI requires companies to disclose payments made to the government and governments to disclose revenues received in relation to extractive industry projects. These payments and revenues are then checked against each other for any discrepancies. Disclosure of public revenues provides civil society with an effective weapon to hold governments to account for the way they spend public money. More than 40 countries have so far pledged to implement the EITI. There is a vast literature on the EITI – readers may refer to Goldwyn (2008) for an excellent starting point.[4]

4.4 Non-fiscal economic benefits: investment commitments

Work programmes

Public revenues are not the only possible economic benefit for the host country. Non-fiscal aspects may also provide important economic benefits. Depending on the economic sector, this may include investor commitments to contribute minimum levels of investment over project duration and to implement agreed work programmes within specified timeframes. Specific targets may also be included with regard to project outputs (e.g. reaching defined production levels within agreed timeframes).

4. For more information about the Extractive Industries Transparency Initiative, visit http://eitransparency.org/.

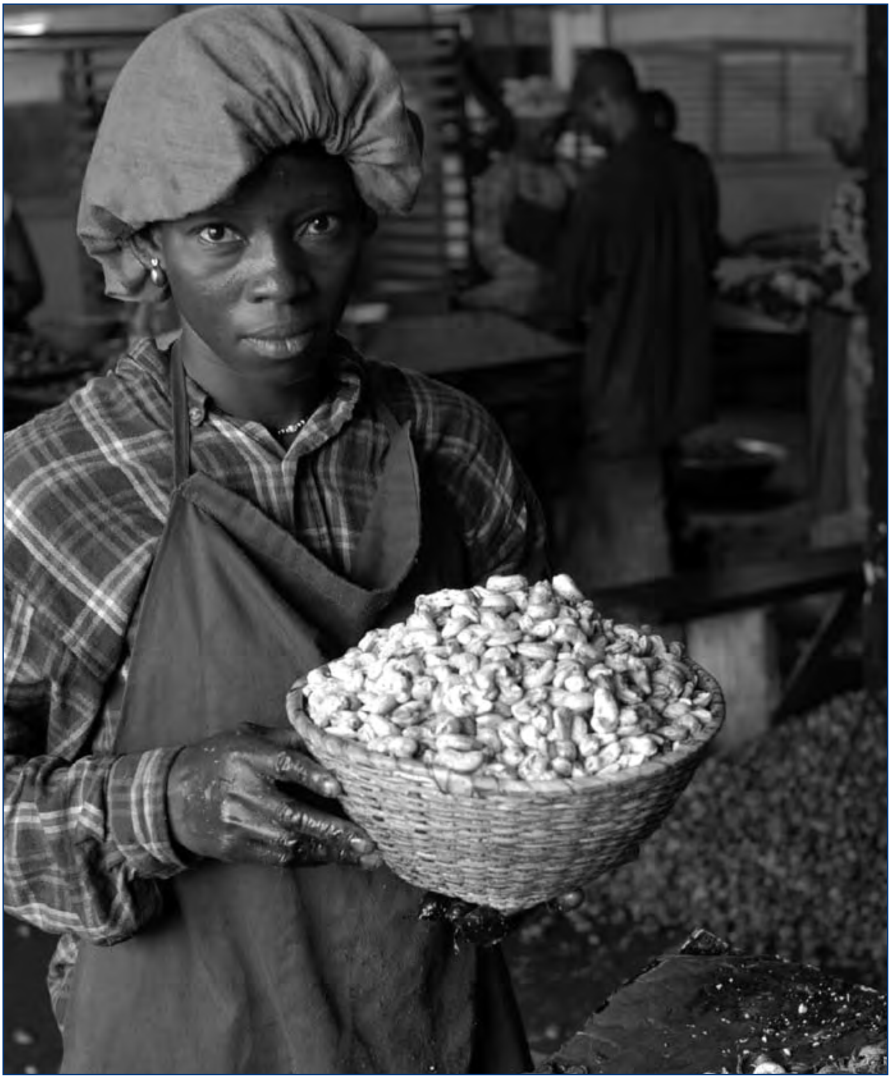


Photo: Joerg Boethling/Still Pictures

Delivering benefits: worker in a cashew nut factory, Burkina Faso

For instance, in regulating the exploration of an oilfield, a PSA may require the investor to undertake geological surveys and drill a specified number of exploratory wells within agreed timelines. Commitments to undertake exploration within agreed timelines may indirectly accelerate public revenues because the bulk of the revenue streams would only start flowing if and when exploration results in a commercial discovery, and the project enters the production phase. The host country would gain little if the investor 'sits' on the resource.

Investors will probably want to be flexible with the implementation of the project and resist rigid commitments to work programmes and timelines. In the extractive industry, lack of adequate information at the pre-exploration stage may also make it difficult to draft detailed commitments in the contract. But, from a host country perspective, investment commitments are only useful if they are credible – in other words, clear and enforceable. This means that the investor's work programme needs to be clearly defined and cover the following: exploration, production and/or other targets; minimum financial commitments (preferably in international currency); employment creation; and timelines for delivery (Stein, 2005). Escape clauses may be included, for instance to deal with force majeure.

These various aspects are interrelated. For example, financial commitments should be equivalent in value to the estimated minimum cost of work programmes (Stein, 2005). It is also advisable to link commitments to both these aspects together. In other words, the investor would have to satisfy both minimum work and financial commitments for a particular year (Stein, 2005).

Effective structuring of these commitments requires monitoring systems and sanctions for investor non-compliance. To assist with monitoring, the investor should be asked to keep accurate data and records and to report on a regular basis to the relevant government agencies. Suggestions for sanctions include making serious non-compliance a ground for contract termination, though the contract may first enable the investor to remedy the breach within a specified timeframe. Less serious breaches may be sanctioned with financial penalties. For instance, Mozambique's model EPC contract contains provisions along these lines and fines may be obtained from bank guarantees provided by all private companies and by the parent company of the operator (article 4). In these cases, if the investor does not comply, the government can get money from the guarantee.

As with public revenues, it is important to avoid dealing with an empty-shell local subsidiary, as this may have insufficient assets to implement the project and deal with any environmental and other liabilities that may arise. Apart from minimum capitalisation requirements under national law, the host government may sign a separate contract with the investor's parent company, requiring the latter to guarantee the due and punctual fulfilment of its subsidiary's obligations. This was done, for instance, in the 'mutual assurances agreement' annexed to the 1997 PSA for the Karachaganak oilfield in Kazakhstan.

Infrastructure development

Work programmes aside, investors may also make commitments to develop the infrastructure, maybe to partly or wholly replace public revenues. For instance, some recent, large agricultural investments in Africa involve low cash revenues but the main benefit for the host country is the investor commitments to build irrigation facilities and other infrastructure.[5] In order to make these commitments credible, it is vital to have clear and enforceable provisions within the contract.

5. Social investment programmes for the benefit of affected communities in the project area are discussed separately in section 6.

It is better to structure targets centred on outputs (what infrastructure is to be delivered by when and at what specifications) because they tend to be more effective than targets on inputs (how much investment to put in and by when). Also, given that infrastructure development may partly replace public revenues, proper valuation of the infrastructure provided is crucial to getting the economic equilibrium right.

There is a wealth of contracting experience in investment commitments in petroleum PSAs which can be used when negotiating other contracts where investment commitments play a crucial role in the economic equilibrium of the deal. This is the case in some recent government-allocated land leases for agriculture.

Commitments to infrastructure development need to be complemented by provisions concerning the maintenance and servicing of the infrastructure as well as efforts to ensure that people understand how to operate it locally.

4.5 Other non-fiscal economic benefits

Involvement in downstream activities

In contract negotiations, the host country may further benefit by seeking to strengthen local business capacity and opportunities. Besides 'local content' provisions, discussed in the next section, contracts may stipulate that a share of downstream activities be undertaken in the host country. This type of measure may distort trade and only makes economic sense where downstream activities can be undertaken efficiently in the host country.

For example, the renegotiation of the above-mentioned Firestone land concession in Liberia required the investor to build a timber processing plant with minimum capacity to utilise a share of the wood produced by the rubber plantation regulated by the contract (section 13).

In the oil sector it may be difficult to ask the investor to develop refineries in the host country because the viability of these facilities may depend on factors that are unknown at the time of contract negotiation, such as the amount of oil discovered and information about the relevant market. Yet it may be possible to include such provisions in countries that are already producing crude oil and where there are good prospects of further discoveries (Stein, 2005).

Technology transfer

The transfer of technology and know-how is also an important force for local capacity building. Where properly structured, joint ventures may be used to facilitate this – but even here technology-transfer provisions must be carefully negotiated for. This is because the investor is likely to put limitations on the use of technology and know-how, particularly outside of the project. An extensive discussion of technology transfer is provided in chapter 11 of Muchlinski (2007).

Use of infrastructure

Permitting third parties such as local businesses to use roads, railways and other infrastructure built by the investor can facilitate local livelihood activities. The contract may specify that third-party use be provided free of charge but it may also be on condition that it does not unduly impede the investor's activities. Negotiations may also make it possible to require the investor to build extensions to the project infrastructure in order to enable third parties to benefit from its use. For example, a major energy project may provide the opportunity to build transmission lines that provide local villages with access to electricity.

Social investment provisions included in the contract or in national legislation may require the investor to provide infrastructure like schools, roads and clinics – in other words, infrastructure that is specifically built for the benefit of affected communities. These aspects are discussed separately in section 6.

Local marketing

Whilst the investor may try to have exclusive control over market decisions, contracts can also regulate the export of strategic assets like petroleum or food, particularly in times of crisis. This is an area where contracts in agriculture may learn from established contractual experience in extractive industries. Some PSAs necessitate a percentage of the investor's oil share to be sold on the domestic market, or enable the host government to request or purchase petroleum from the investor in times of national emergency or shortfall in domestic supply. Contracts may require the government to pay a fair market price and compensate investors for losses, but sometimes discounted prices are provided for.

Further reading

On public revenues

Goldwyn, D.L. (ed) (2008) *Drilling Down – The Civil Society Guide to Extractive Industry Revenues and the EITI*. Revenue Watch Institute, Washington DC. http://www.revenuewatch.org/news/publications/drilling-down.php.

UNECA (2002) *Managing Mineral Wealth – Training Materials on Management of Mineral Wealth and the Role of Mineral Wealth in Socio-economic Development*. United Nations Commission for Africa, Addis Ababa. http://www.uneca.org/eca_resources/.../sdd/Mining_%20modules_final.pdf.

On non-revenue benefits

Stein, S.W. (2005) 'Non-Fiscal Elements in Petroleum Production Sharing Agreements in Developing Countries', *Oil, Gas & Energy Law Intelligence* (OGEL) Vol. 3, Issue 1. http://www.gasandoil.com/ogel.

Maximising economic benefits: local content[6]

5.1 Concept

Local content provisions require the investor to employ and train local staff and contractors, and/or to procure local goods and services during the implementation of the investment project. These provisions may be included in the investment contract, or in national legislation. In this context, 'local' refers to employees and suppliers that are nationals of the host state, even if they have no direct link with the locality where the investment project is implemented. Often, employment opportunities created by an investment project may be taken by groups from other parts of the country.

Rationale

Local content requirements are a means by which governments seek to ensure that investment projects generate employment and business opportunities for the national economy. They may also be a way to promote investment in strengthening local business capacity, for instance through on-the-job learning, formal training opportunities and transfer of know-how. These potential benefits make local content requirements an additional way of maximising the economic benefits of an investment project to the host country.

From the investor's perspective, local content requirements may strengthen the investor's 'social licence to operate', by creating greater support for the investment in the host country. Local content may also enable longer-term savings by using local labour or reducing transportation costs for supplies.

Limits and trade-offs

Local content provisions do have significant limitations and may require trade-offs in other parts of the contract. If sourcing local labour, goods and services increases project costs, the investor will probably want to compensate this by paying lower public revenues. For example, some PSAs explicitly state that costs incurred by the investor for training programmes are 'recoverable costs': the investor can fully recover these costs once oil revenues start to flow, by reducing the amount of 'profit oil' to be split with the host government. Thus, there may be a trade-off between local content and public revenues.

There may be further trade-offs when maximising local content along with promoting higher safety, social and environmental standards, particularly in countries with limited local business capacity. In these cases, the rigorous enforcement of international standards, such as requirements for certification to ISO 14001 (environmental management systems) and ISO/OHSAS 18008 (health and safety) may create barriers for local businesses. At the same time, waiving these standards to help local companies access the contracting chain may weaken compliance with international standards.

6. Linda Siegele and Emma Wilson provided extensive and invaluable input to this section.

Photo: Lorenzo Cotula

Sowing the seeds of local business capacity? A biofuels project in Mozambique

Finally and quite importantly, local content requirements can distort trade and may be viewed with suspicion due to their inherently protectionist nature. If inappropriately designed and managed, these requirements may result in high levels of inefficiency and may be exploited for patronage purposes by national elites in government and business. For example, investors and their contractors or suppliers may come under pressure from government and local authorities to hire favoured contractors.

In other words, local content requirements may not always be the most efficient way to maximise benefits to national and local economies. Therefore, from a host country perspective, the decision to include local content requirements (instead of, say, seeking higher levels of public revenues to be spent on training or higher social investment commitments) needs to be considered taking account of the context.

The role of international treaties

The host government's ability to include local content requirements may be affected by international obligations that the government may be committed to, for example through free trade or investment treaties (see Box 5). Therefore, before signing up to these treaties, it is advisable for a host government to understand the potential ramifications on their ability to use local content requirements in future contracts.

Box 5. Local content requirements: restrictions from trade and investment treaties

The World Trade Organisation (WTO) Agreement on Trade-Related Investment Measures (TRIMS) prohibits measures that are inconsistent with state commitments not to discriminate against non-nationals ('national treatment') and to remove quantitative restrictions. These commitments are embodied in articles III and XI of the General Agreement on Tariffs and Trade, which is also part of the WTO. The TRIMS agreement lists examples of prohibited measures and local content requirements concerning trade in goods are prohibited under these norms (local content provisions on employment and services are outside the scope of the TRIMS agreement).

In contrast, most investment treaties do not contain provisions restricting local content requirements. Some treaties do, however. This is the case, for example, of the free trade agreement between the United States and the Central American Free Trade Area. This agreement includes a chapter on investment that is effectively equivalent to an investment treaty. Article 10.9 of this chapter prohibits parties from according preference to nationally produced goods in key aspects of investment processes.

Remedies for violations differ between WTO and investment treaties. The WTO focuses on disputes between states: a challenge to a prohibited local content requirement would need to be brought to the attention of WTO bodies by the investor's home state. In contrast, investment treaties and some regional free trade agreements give investors direct access to international remedies, namely through investment arbitration (discussed in section 8). Direct access for investors makes arbitration a much more effective remedy than state-to-state dispute settlement. It is possible that host states are more likely to see local content requirements challenged if they are inconsistent with investment treaties.

5.2 Structuring local content provisions to maximise local opportunities

If local content requirements are an option, careful contract drafting and effective implementation are key to make them work in practice. Vague commitments to give priority to local labour and suppliers are unlikely to make a real difference to economic opportunities in the host country.

This section provides a few tips on how to structure effective local content provisions. As investment projects often involve long chains of contractors and subcontractors, it is useful to clarify that local content requirements apply to economic activities run by subcontractors and to extend reporting requirements to these players.

Labour

Effective local content provisions to maximise local employment opportunities would:

- Require that, all else being equal, priority be given to local nationals in recruitment, training opportunities and promotions;

- Set specific percentage targets for positions reserved to local nationals, possibly differentiated by categories of employment (e.g. unskilled labour versus technical and managerial positions; temporary versus permanent employment);

- Establish sliding scales, whereby the local employment percentage targets increase during the duration of the project. In the early stages of the project local workers may be predominantly in unskilled positions, but ambitious sliding scales coupled with capacity-building requirements can increase the numbers of local employees in technical and managerial positions;

- Feature robust on-the-job training requirements, including through minimum annual financial commitments, to open up professional development opportunities for the local workforce;

- Require compliance with local labour law.

Training

Training and other capacity-building requirements may well go beyond the employment context. Contracts may require the investor to pay specified sums to the host government in order to set up scholarship endowments for local nationals, including advanced studies overseas. They may also enable secondments, whereby selected host government technical officials (e.g. geologists, mining engineers) receive training at the investor's facilities.

Goods and services

With regard to local content provisions concerning goods and services, the investor will probably want to ensure that using local content does not result in lower quality or higher costs. But it is possible to frame local content provisions that require the investor to give priority to local goods and services if the cost, quality and/or time of delivery are comparable internationally.

It is also possible to require that priority be given to local suppliers even if this increases project costs. For example, the contract may require the investor to give preference to national suppliers if their costs are within a certain percentage of alternative suppliers available internationally (for instance, no more than 10 per cent above the cost of comparable, internationally available suppliers).

Depending on the local business capacity, it is also possible to include specific percentage targets for local goods and services that the project must meet. For example, the International Project Agreement for the West African Gas Pipeline states that 'not less than 15% (by value) of the goods and services used in the construction of the Pipeline System will be sourced from Local Businesses' (article 28.3).

Proper thinking is needed where sourcing goods and supplies locally has implications for project costs. Given the trade-offs that may arise between local content requirements on the one hand and public revenues and other project benefits on the other, it is important to have a clear understanding of what cost the host country is prepared to pay to promote stronger links with the local economy.

Box 6 illustrates these issues with clauses from a recent concession contract concerning a rubber plantation in Liberia.

Implementation

To successfully implement the local content plan it is vital to have clear reporting requirements for the investor (and its subcontractors) so they can demonstrate compliance with contractual provisions. This may involve periodic reporting of progress made, in relation to both absolute values and percentage targets as relevant.

Several additional factors can make a difference in ensuring that contractual provisions translate into real influence on business practice including: a properly staffed and clearly mandated government agency responsible for monitoring compliance; established channels that enable dialogue between the investor, the government and other stakeholders; as well as credible financial and other penalties in case of investor non-compliance

Box 6. Good practice in local content provisions

Amended and Restated Concession Agreement between the Republic of Liberia and Firestone Liberia Inc, 22 February 2008 (rubber plantation project)

'Section 11 Employment and training
11.1. Employment. Employment practices of Firestone Liberia shall conform to Law. In no case shall Firestone Liberia hire non-Liberian citizens for unskilled labor positions. Firestone Liberia shall give preference for employment at all levels of financial, accounting, technical, administrative, supervisory and senior management positions and other skilled positions to qualified Liberian citizens as and when they become available, it being the objective of the Parties as soon as is practicable that the operations and activities of Firestone Liberia under this Agreement should be conducted and managed primarily by Liberian citizens. Subject to availability of qualified applicants, Firestone Liberia shall cause Liberian citizens to hold at least 30 per cent of the ten most senior management positions within 5 years of [entry into force], and at least 50 per cent of such positions within 10 years of [entry into force]. […]

11.2. Training. In furtherance of the objectives stated in Section 11.1, Firestone Liberia shall provide for the training of Liberian citizens in order to qualify them for the positions described in that Section and, as required by its operations under this Agreement, Firestone Liberia shall also provide on-the-job training, utilize vocational training facilities in Liberia, and undertake whatever other measures are necessary and reasonable to achieve the objectives stated in Section 11.1 (including, subject to operational needs and economic conditions, scholarships for qualified Liberian employees to pursue relevant advanced studies abroad). Firestone Liberia has affirmed that, as part of its support for education in Liberia, it shall also provide a total of US$ 115,000 annually […] in scholarships for Liberian citizens through a program to be administered by Firestone Liberia […]. In addition, Firestone Liberia shall provide US$ 50,000 annually in support of the University of Liberia's College of Agriculture. […]

Section 12 Use of Liberian Products and Services
When purchasing goods and services related to Firestone Activities, Firestone Liberia shall give preference to goods produced in Liberia by Liberian citizens, and services provided by Liberian citizens, who are resident in Liberia […] which are equal to or better than comparable goods and services obtainable from other Persons taking into account price, quality, delivery schedules, availability and other terms. In addition, Firestone Liberia agrees to include in each contract or work order with its major contractors and other Associates a provision requiring them to adhere to the requirements of this Section, and to require their sub-contractors to do so, with respect the any activities undertaken in Liberia by such Associates and major contractors (and their sub-contractors), on behalf of Firestone Liberia. Subject to the foregoing, Firestone Liberia may freely contract with any Person.'

Managing social and environmental risks

6.1 Introduction

The previous two sections focused on the economic benefits that the host country may gain from the investment contract. Yet natural resource investment projects are also often associated with major social and environmental risks, linked for instance to land takings and environmental damage. Balancing economic gains with social and environmental risks is central to achieving sustainable development. Tackling social and environmental risks may also be necessary to realise internationally recognised human rights, for example the right to an adequate standard of living, including food and housing, and the right to a clean and healthy environment.

Therefore, establishing robust mechanisms to minimise social and environmental risks is an essential part of structuring investment contracts to maximise sustainable development outcomes. This includes:

- Environmental and social impact assessment and management systems;
- Safeguards in land takings;
- Enforceable social investment commitments; and
- Accessible and effective remedies for people adversely affected by the project.

In these areas, the balance between contractual provisions and national law varies across countries. Some contracts contain lengthy provisions on impact assessment, others merely refer to national law. A well developed national legal system would regulate all the issues mentioned above. In principle, national rules applicable to all investments are more effective and equitable than project-specific rules set in contracts. In addition, if strict rules are embodied in national law, non-compliance would be a violation of national law rather than a mere breach of contract.

But contracts can also play a useful role in regulating social and environmental risks. A contract may explicitly state that national legislation does apply to the project, dispelling any doubts to the contrary. It may also require compliance with stricter rules and standards, particularly if national law falls below what is internationally acceptable. For example, the contract may explicitly require compliance with key international human rights treaties. As discussed in section 2, the contract may also require compliance with the OECD Guidelines on Multinational Enterprises and with the performance standards of international lenders like the World Bank, the IFC and regional development banks.

Compliance with lender standards is necessary in projects that receive financing from multilateral or ‘Equator Principles’ lenders. For example, if the project obtains a loan from the World Bank, the IFC or a regional development bank, it must comply with the relevant performance standards. But, even if multilateral institutions are not a lender, their standards may still be referred to in any investment contract and applied by any project. This is a key pillar of the Equator Principles, which extend IFC standards to projects financed by commercial banks. Therefore, governments can feel confident insisting that contracts refer to the performance standards outlined in the institutional policies of multilateral lenders, and CSOs can feel comfortable to put pressure on their government to do so.

Investors may be willing to apply higher standards than those required under national law for reputational reasons, to obtain loans or simply on moral grounds. On the other hand, in some cases, investors may request exemptions from generally applicable social and environmental legislation – for example, if laws on environmental protection or natural parks would hinder project implementation. These exemptions are not considered good practice within the industry and should be avoided; although in certain circumstances it may be possible to offset any damages suffered with other measures.

Box 7. The concept of risk

Broadly speaking, risk is the possibility of suffering or causing harm or loss. The magnitude of a risk is defined by the consequence multiplied by the likelihood of its occurrence. A useful way of analysing risk involves plotting consequences against their likelihood:

Likelihood of occurring	Consequence: Insignificant	Minor	Moderate	Major	Catastrophic
Almost certain		X	X	X	X
Likely			X	X	X
Possible				X	X
Unlikely					X
Rare					

Mitigating and allocating potential risks is a key function of the contract. At the very least, the contract should address the risks identified with an 'x' and should clarify how the parties are expected to deal with the consequences should these risks materialise.

6.2 Impact assessments, management plans and applicable standards

Environmental and social impact assessments (ESIAs) aim to assess the likely or potential impacts of a proposed project before the project is approved. They also identify and assess alternative options to the one proposed and consider preventative or mitigating actions. Management plans identify how a particular risk (e.g. oil spills) would be dealt with throughout the duration of the project

Impact assessments

By requiring comprehensive ESIAs for projects likely to significantly affect the environment or local people, national law (environmental legislation, sectoral laws like mining and petroleum codes) can make a real difference to sustainable development goals.

To perform this role effectively, national law should clarify the criteria and procedures for determining if a project may significantly affect the environment. It should also stipulate that the ESIA be undertaken during the early stages of project design and that it should include local consultation and opportunities for the public or affected people to comment on early drafts. Government and civil society may play an important role by closely scrutinising how ESIAs are conducted. World Bank and IFC performance standards provide useful guidance on ESIA best practice.

Where needed, openly worded national rules may be supplemented by more specific provisions in the contract. For example, in Kazakhstan, the 1997 PSA for the Karachaganak oil and gas field contains a nine-page article XVII and two separate annexes (schedules 17-A and 17-B) on environmental work programmes, including a baseline environmental study, impact assessments, regular environmental monitoring and reporting, an environment management plan and other programmes. These contractual provisions clarify what issues must be addressed by these programmes, the procedures for their review and acceptance (or rejection) by government agencies, mechanisms for their periodic revision and so on.

In the agricultural sector, the 2008 Concession Agreement between Firestone Liberia Inc and the government of Liberia, concerning a 36-year land lease for a 118,900-acre rubber plantation, requires reviews and potential modifications to the environmental management plan at least every five years. Any modifications must be approved by the government (section 15(c)).

To make ESIAs meaningful, it is vital to have robust methodologies, reliable baseline research, proper understanding of the complex local environmental and social contexts, and appropriate accountability and incentive structures. Past experience suggests that social and environmental risks have often been underestimated – an issue already noted by the World Commission on Dams (2000).

For example, an independent evaluation of impacts in the oilfield areas of the Chad-Cameroon project (Barclay and Koppert, 2007) found that impact assessments and management plans had 'substantially underestimated' the land area needed by the project – by 65 per cent for lands taken permanently and by nearly 100 per cent for lands taken temporarily. The number of people affected was also underestimated: originally, it was expected that 60-150 households would be eligible for resettlement but by 2006 this figure had risen to about 900 households.

In addition, care is needed to ensure that any mitigation measures included in the impact assessment are duly integrated in dealings between the investor and its subcontractors and suppliers. This may include specific reference to ESIA documents in subcontracts but also more specific guidance and training on how to implement the mitigating measures. Guidance and training are especially important if local contractors and suppliers have limited business capacity.

Applicable rules and standards

It is also crucial to identify the substantive rules and standards applicable to project activities. It is good practice to demand full compliance with current and future national law and with evolving international standards. Formulae making compliance with these standards subject to economic feasibility would undermine the application of the standards, particularly if there are no independent means to verify economic feasibility. These requirements are only effective if they apply not only to the investor party to the contract but also to its subcontractors and suppliers.

Specific systems may be needed to deal with industry-specific environmental hazards, such as oil spills or, in the case of gold mining, cyanide waste. It is sensible to ensure that the contract requires the investor (and its subcontractors) to take all immediate action necessary to prevent further environmental damage and to restore the environment to pre-existing conditions. Provisions clarifying the investor's liability for damages caused by oil spills may also be useful (and are discussed further below).

In addition, thorough decommissioning provisions (in petroleum), mining site rehabilitation and closure provisions (in mining) and other similar clauses that regulate social and environmental standards at the end of a project are very important. They are more powerful if accompanied by financial guarantees (e.g. in the form of trust funds) provided by the investor in the early stages of the project.

When contracts refer to international standards, these standards should be directly relevant, easily identifiable and clearly formulated. In some industries, contracts routinely refer to international 'industry good practice' standards but these have not been clearly developed. It is more useful to refer to specific bodies of standards where they exist - such as World Bank or International Finance Corporation safeguard policies, or standards determined by international treaties.

For example, the Roxby Down Indenture of 1982, an uranium/copper mining contract from Australia, requires compliance with the 'codes or recommendations presently issued or to be issued from time to time by the International Commission on Radiological Protection or the International Atomic Energy Agency' (section 10.1(e)).

Precautionary principle

The 'precautionary principle' is one of the pillars of the concept of sustainable development. It may have major implications for the regulation of the environmental aspects of an investment project. Principle 15 of the 1992 Rio Declaration on Environment and Development states:

‘In order to protect the environment, the precautionary approach shall be widely applied by States according to their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation.’

The precautionary principle provides guidance on how to assess environmental risks and measures to address them. Lack of full scientific knowledge alone cannot be used to justify inaction. This means that governments may take measures to protect the environment even where there is no full scientific certainty about the consequences or likelihood of a given impact. The precautionary principle may also change the burden of proof between investors and regulatory agencies responsible for environmental sustainability (UNECA, 2002).

Monitoring and sanctions

To hep host government agencies to supervise the project, the contract can require the investor to regularly monitor and report the environmental impact of the project and pay funds earmarked for specific government agencies, including an environmental protection agency. It is also possible to have detailed contract provisions requiring the investor to provide environmental information, which can help the government manage natural resources that may be affected by the project, such as water.

The effectiveness of environmental monitoring can be increased if the contract establishes mechanisms for regulatory agencies to acquire data from sources other than the investor itself. This may include the right of regulatory agencies to conduct periodic inspections of project facilities, and third-party monitoring and verification.

The ‘polluter pays’ principle is a key principle of sustainable development. It means that investor or its subcontractors are responsible for environmental liabilities and third-party claims relating to environmental pollution, and for costs to close the project. The polluter pays principle means that costs for environmental damage are allocated to party who has most control over it. This can create an effective incentive for minimising damage. To achieve this, national law (or in default the contract) must set environmental fines at appropriate levels – otherwise it may be cheaper to pollute and compensate than to prevent damage.

Some contracts (for instance, in oil and gas) exempt the investor from paying environmental fines, except in cases of ‘gross negligence, reckless behaviour or wilful misconduct’. This means that liability for environmental pollution that is not deemed to be caused by this type behaviour is taken on by the host government. But it can be hard to show that there has been gross negligence or misconduct, not least due to challenges in gathering evidence. Provisions of this type are therefore not considered best practice because they undermine incentives to prevent environmental damage.

6.3 Safeguards in land takings

On-shore natural resource investment projects entail, to varying degrees, the taking of land, whether on a permanent or temporary basis (e.g. during construction works). They can also involve limiting local resource rights through the creation of servitudes (for instance, a 'right-of-way' allowing a pipeline operator to access land that it does not own) and other restrictions on use of resources (e.g. bans on tree planting). Resettlement is a particularly intrusive form of land taking, as it involves the physical relocation of people (not all land takings entail relocation).

Land taking is particularly an issue in large-scale agriculture investments because land allocated to individual projects may reach several hundred thousands of hectares. Takings also happen in other sectors, including extractive industries: the evaluation report mentioned above, on the Chad-Cameroon pipeline project, found that about 12,000 people had been affected in the oilfield areas alone (Barclay and Koppert, 2007).

These processes may have far-reaching detrimental impacts on people who crucially depend on land and natural resources for their livelihoods such as local farmers, pastoralists, hunters or foragers. In many parts of the world, land also has an important spiritual value and provides the foundations for social identity and social networks. As guidance issued by the Food and Agriculture Organization (FAO) states: 'Compulsory acquisition is inherently destructive. Even when compensation is generous and procedures are generally fair and efficient, the displacement of people from established homes, businesses and communities will still entail significant human costs' (FAO, 2008:5).

Given the significance of these impacts, land taking issues should be fully addressed in the environmental and social impact assessment. The ESIA should clearly assess the extent of negative impacts (for example, the number of people likely to be resettled or suffer takings), compare project design options to minimise these impacts and develop mechanisms to mitigate and compensate these impacts during project implementation. The points made in the previous subsection, for instance with regard to the need for proper local consultation, apply to the part of the ESIA that specifically deals with land takings.

Public purpose, negotiated acquisitions

The terms for compulsory taking of land are usually set by national laws. Virtually all countries have legislation that enables government to take (or 'expropriate') property if it is in the public interest to do so. In other words, governments can acquire land even without the consent of landholders. In exchange, governments are usually required to pay compensation and to respect certain procedures. The idea behind this is that if the government wants to build a school or a hospital, individual rights must be reconciled with the interests of the wider society.

But in many lower- and middle-income countries, legislation allowing the compulsory acquisition of land in the public interest has been used to make land available not only for schools or hospitals but also for commercial investment projects in the mining, petroleum or agriculture sectors. Such projects may well be in the public interest because they may promote economic development and generate public revenues. Also, in the real world, the lines between public and private interests may be blurred. For example, if a public infrastructure project is built through a public-private partnership, there is both public interest and profit motives at work (as in a toll road built on the basis of 'build-operate-and-transfer' arrangements, discussed in section 4).

However, in purely commercial ventures, it is better practice to obtain the consent of local landholders through negotiations rather than compulsory takings. The decision to take land on a compulsory basis for commercial projects would require a clear and demonstrable case that should be subject to thorough public scrutiny.

In making these choices, it must be borne in mind that land takings can raise major human rights issues. The land and resource rights of affected communities, even when based on 'customary systems' that have no legal recognition under national law, constitute 'property' protected by the human right to property. This right is internationally recognised by the Universal Declaration of Human Rights (article 17), the American Convention on Human Rights (article 21), the African Charter on Human and Peoples' Rights (article 14) and the European Convention on Human Rights (article 1 of Protocol 1). The Inter-American Court of Human Rights has specifically interpreted the right to property as protecting the collective rights customarily held by indigenous and tribal peoples over their ancestral territories – for instance, in the cases *Mayagna (Sumo) Awas Tingni Community v. Nicaragua, Maya Indigenous Communities of the Toledo District v. Belize, Sawhoyamaxa Indigenous Community v. Paraguay* and *Saramaka People v. Suriname.*

Where people depend on natural resources for their food security, rights to these resources are also protected by the right to adequate food, a human right recognised as part of the broader right to an adequate standard of living under the Universal Declaration of Human Rights (article 25) and the International Covenant on Economic, Social and Cultural Rights (article 11). At the very minimum, the right to food requires that any loss of natural resources that negatively affects food security must be offset by improvements in access to other livelihood assets such as income and off-farm employment. This means that those who lose out should have access to at least the same quantity and quality of food as before the intervention.

Similar considerations can be made with regard to the right to housing, which is also part of the broader right to an adequate standard of living. General

Comment No. 7 of 1997, adopted by the UN Committee on Economic, Social and Cultural Rights, spells out the implications of this right for forced evictions.[7]

In addition, where investment projects affect indigenous and tribal peoples, international law requires governments and investors to seek the free, prior and informed consent of these groups. This principle is enshrined in the 1989 Convention Concerning Indigenous and Tribal Peoples in Independent Countries, adopted by the International Labour Organisation (Convention No. 169). This Convention is legally binding for the states that have ratified it. CSOs are increasingly calling for free, prior and informed consent to be mainstreamed in national legislation and project planning.

The recent judgment of the Inter-American Court of Human Rights in the case *Saramaka People v. Suriname* illustrates the implications of human rights law for cases where an investment project results in the taking or limitation of existing natural resource rights. The case concerns the government allocation of mining and timber concessions within the traditional territory of a tribal people and was mainly decided under the right to property provision included in the American Convention on Human Rights. The Inter-American Court found that the collective right to property of the Saramaka people is not absolute and can be limited by the government through the granting of natural resource concessions. However, for these concessions to comply with international human rights obligations, the state must ensure the effective participation of the Saramakas in decision-making and, for particularly intrusive investment plans, it must seek their free, prior and informed consent. The state must also guarantee that the Saramaka people receive 'a reasonable benefit' from the investment.

Box 8. Local consultations in Mozambique

Although all land is formally state-owned in Mozambique, the Land Act 1997 requires prospecting investors to consult 'local communities' before receiving a land lease from the government. Local land use rights are protected regardless of whether they are formally registered, although there is a procedure to register collective landholdings. Overall, the implementation of this progressive legislation has fallen short of expectations, and some large-scale biofuel projects have been controversial. But in the cases where external organisations supported local people, there were better outcomes and negotiations for community joint ventures in tourism are underway in several places.

Source: Tanner and Baleira (2006), with integrations

Compensation regimes

Compensation regimes and related procedural safeguards can make a difference to ensuring continued enjoyment of fundamental human rights like the right to food and the right to housing. It must also be recognised, however, that to many people no amount of money is adequate compensation. This is particularly the case where cash compensation would not enable affected communities to gain access to alternative land, for instance due to limited development of land markets. It is also the case where land has special cultural and spiritual values.

7. Available at http://www.unhchr.ch/tbs/doc.nsf/(Symbol)/959f71e476284596802564c3005d8d50?Opendocument.

Also, as discussed in section 3, payment of cash compensation is not the only possible outcome as far as the acquisition of land by the project is concerned. Apart from in-kind compensation in the form of provision of alternative land, affected communities may be able to contribute land rights into a joint venture with the investor, in which they obtain an equity stake. This option may be more readily available in investments where land is a particularly valuable asset, as in agriculture. Some examples of this solution are briefly discussed in section 3.

National law can play a central role in defining compensation regimes. The terms and conditions for takings vary widely among countries and regions. In many lower- and middle-income countries, however, national regimes provide rather weak protection to local interests. In Africa, for example, some recurrent features tend to undermine the position of local land users: limited or qualified legal protection on mainly state-owned land, inaccessible procedures for documenting land rights, compensation only for loss of improvements such as buildings and crops rather than land, and below-market and outdated official compensation rates. Some African countries have taken steps to strengthen legal protection of local land rights, but implementation often remains unsatisfactory.

Where national law does not (yet) provide adequate safeguards, contracts can be used to raise applicable standards, by requiring compliance with internationally accepted standards. For example, Performance Standard 5 of the International Finance Corporation (IFC), concerning land acquisitions, calls for the minimisation of involuntary resettlement, with preference to be given to negotiated settlements over compulsory takings. It also calls for the improvement or at least restoration of livelihoods of the affected people to pre-project levels, through compensation at full replacement cost and additional assistance as required, and for suitable systems to deal with grievances. As discussed earlier, governments can feel confident insisting that contracts refer to these standards, even if the IFC is not a lender.

Compensation to restore affected communities to a position that is at least equivalent to their position pre-acquisition is a key pillar of a fair system for compulsory takings – whether under a contract or under generally applicable national law. Developing ways to do this in contexts where major power imbalances exist between affected communities, investors and government, and where people attach special importance to land is a difficult challenge, however.

Some lessons may be gained from valuation methods commonly used for the taking of investors' assets. The 'discounted cash flow' (DCF) method, for instance, entails valuing assets by summing up their projected cash flow, discounted to present value. Applied to tree crops, for example, this would involve the capitalisation of projected annual yields and is likely to give more favourable results than outdated standard rates fixed in government regulations. Affected communities may prefer to receive annual payments instead of one-off compensation and it is possible to earmark some revenue streams to these communities.

There is growing experience with developing comprehensive and sophisticated arrangements to deal with compensation for loss of natural resource rights and for any damage or disturbance suffered. Large projects funded by multilateral institutions like the World Bank have been at the forefront of these efforts. For example, the Chad-Cameroon project involved sophisticated arrangements to compensate losses not compensable under national law, to top up compensation rates for compensable losses and to implement community- and regional-level compensation schemes.[8] However, making these regimes work in practice is a big challenge. For instance, major shortcomings in the implementation of the compensation plans for the Chad-Cameroon pipeline have been documented by CSOs in both Chad and Cameroon.

Continuing rights

National law and investment contracts may also provide for the continued enjoyment of local rights as long as they are consistent with project implementation. The ESIA would typically establish the extent to which the coexistence of local and investor's resource rights is possible.

For example, Mozambique's 2008 Model Exploration and Production Concession (EPC) Contract states that a lawful occupier of land in the concession area 'shall retain any rights he may have to graze stocks upon or cultivate the surface of the land, except to the extent that such grazing or cultivation interferes with Petroleum Operations'. It also requires the investor to exercise its rights 'reasonably so as to affect as little as possible the interests of any lawful occupier of land in the EPC Area' (article 27).

Specific rules on compensation may be established in cases where coexistence results in damage to crops, trees or other local assets, and/or in restrictions in local people's use of their resources (for instance, through bans on tree planting along pipeline corridors).

6.4 Social investment programmes

People living in areas affected by investment projects bear disproportionately the social and environmental costs of the project – for example, in terms of disruption during the construction phase or environmental damage. These costs may not be fully offset by one-off compensation, whilst employment opportunities may be seized by people migrating from other parts of the country.

Social investment programmes in project areas are a means of sharing some of the project benefits with affected communities and may involve the construction of schools, clinics, water facilities and other infrastructure.

8. The project's Environmental Management Plan, which includes the Cameroon Compensation Plan and the Chad Resettlement and Compensation Plan, is available online at http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/AFRICAEXT/EXTREGINI/EXTCHADCAMPIPELINE/0,,menuPK:843277~pagePK:64168427~piPK:64168435~theSitePK:843238,00.html

Social investment versus other benefits

There are complex issues surrounding the design of social investment programmes. Building schools and clinics is a key government task so should the investor take responsibility for it? This would probably mean a decrease in revenues paid to the government so the question stands: is it better for the investor to build the school or for the investor to pay revenues and for the government to take charge of the social infrastructure? If schools, clinics and other infrastructure are indeed built by investors what structures are in place to ensure that they are properly maintained and run in the longer term?

Answers to these questions vary according to the context. In defining their advocacy positon, civil society need to judge the extent to which government agencies may be trusted to make proper use of public money. From the investor's perspective, social investment programmes may be considered part of the company's social responsibility and may help to establish local support for the investment project.

Reconciling local choice with integration in project contracts

Including details on social investment plans in the investment contract is a useful way of making the investor more accountable. This does raise some practical challenges. On the one hand, decisions regarding the type of social investment should be made by the people most directly concerned. On the other hand, integrating social investment commitments into the contract between the investor and the host government would make them binding and enforceable. There are various ways to tackle this tension.

One option is for the investor-state contract to determine the economic value of the investor's social investment programme and leave the definition of precise social investments to beneficiaries. In contexts of extreme poverty, actual infrastructure delivery may be more effective than large cash transfers, due to the lack of local capacity to manage large sums and supervise works, and to the risk of local tensions and embezzlement.[9]

The investment contract between the investor and the host government may determine the value of social investment commitments as a percentage of the revenues generated each year by the project. For instance, the 2003 Stability Agreement between AngloGold Ltd and the government of Ghana, which extends the duration of the investor's existing mining lease, requires the investor to establish or maintain a community trust for each mine, and to contribute 1 per cent of profits to community works that are be determined outside the contract (section 4.01(b) and schedule 4.01(b)).

As sale prices affect revenues, commitments tied to revenues or profits need to be coupled with mechanisms to tackle 'transfer pricing' (discussed in section 4).

9. As highlighted by a recent embezzlement trial in a mining community of Mali: *Ministère Public c. Samba Mariko, Chô Mariko et Sirakorontji Mariko.*

Although contexts vary, it is usually more effective to tie investor commitments to revenues ('turnover') rather than profits, as in that case the implementation of social investment does not have to wait for the project to become profitable.

Enabling affected communities to have access to social investment benefits from the start is particularly important as investment projects may have far-reaching negative impacts on local livelihoods in the construction phase, for instance via the taking of land. But revenues only materialise when the project enters the production phase. To deal with this issue, other reference figures may be used for calculating social investment levels, provided they are clearly defined.

For example, the 1997 PSA for the Kashagan oil and gas field in Kazakhstan requires the consortium to pay 1 per cent of the annual oil development expenditures or US$5 million (whichever is greater) to fund social and infrastructure projects proposed by local governments (article 20.2). What constitutes 'development expenditures' is clearly defined in the accounting procedures annexed to the contract (schedule VI). This approach seems quite effective and straightforward because it is relatively easy to monitor and not subject to project profitability or revenues.

Other options to make investor commitments legally binding include making the conclusion of enforceable 'community development agreements' between the investor and affected communities a condition for the award of the contract or annexing a list of social investment programmes to the investment contract itself. As already mentioned, Ghana's forestry and mining legislation requires investors to conclude 'social responsibility agreements' with affected communities. These agreements are a type of community development agreement. They regulate the conduct of economic activities so as to minimise disruption for affected communities. They also commit the investor to provide social infrastructure like schools and clinics. In these cases, it is important to establish mechanisms to ensure the representativeness of those negotiating on behalf of affected communities and their accountability to community members. Clear and enforceable language and adequate local capacity to negotiate deals and monitor implementation are also essential (Ayine, 2008).

In addition, the First Schedule of Kazakhstan's Karachaganak PSA lists social infrastructure projects proposed by the local government and timely execution of these projects is part of the investor's main obligations under the contract (section 4.1). Letting elected local governments decide on specific projects is a positive feature provided that there is downward accountability. This cannot be assumed and specific measures may be needed to prevent elite capture of funds and corruption. Measures inevitably vary according to the context; one example may be requirements for the investor to prove the genuine involvement of local villagers in consultation meetings. Where local government bodies have weak capacity, project revenues may be earmarked to strengthen their effectiveness and accountability.

Photo: Lorenzo Cotula

Get up, stand up – community training on how to negotiate social responsibility agreements in Ghana's forestry sector, organised by the Centre for Public Interest Law

Considerable experience with community development agreements has emerged in some sectors and jurisdictions – such as mining in Australia and Canada, where mining contracts often involve direct negotiations between the investor and indigenous groups having native title.[10]

Monitoring and sanctions

For social investment commitments to work, they must be backed up by effective monitoring and credible sanctions in case of non-compliance. Some contracts explicitly exclude compliance with social investment commitments from the government's right to terminate the agreement for investor non-compliance. This weakens the legal value of commitments on social investment.

As social investment programmes are part of the overall economic equilibrium of the contract, there is no obvious reason why serious non-compliance with social investment commitments should not be grounds for the host state to terminate the investment contract. It should follow the same procedure as non-compliance with other investor commitments – such as serving the investor with notice requesting compliance within a reasonable timeframe before terminating the contract (as discussed in section 4).

10. On agreements with indigenous groups in Australia, see Fitzgerald (2005) and the website http://www.atns.net.au/default.asp.

The contract may also provide for alternative measures, however, particularly for less serious non-compliance. Alternative measures may include financial penalties and specific performance, whereby the government is empowered to provide the social investments directly and recover costs with interest and penalties from the investor (assuming the social investment is one that can be provided by the government).

National legislation may also play a role in covering the following issues: making written and legally enforceable agreements between the investor and local communities a legal requirement for the award of natural resource rights; requiring the public disclosure of important information that will help local people to develop a negotiating position and to monitor the project (e.g. with regard to current and projected project revenues); promoting downward accountability of community representatives; making such agreements legally binding and enforceable; and providing government agencies with a clear mandate and adequate resources to monitor compliance.

6.5 Legal remedies for affected communities

In cases where affected communities feel wronged by the implementation of an investment project, legal remedies against the government or the investor are mainly determined by the national legislation of the host state. For instance, remedies for environmental damage may include injunctions to stop damaging activities, the restoration of conditions to pre-damage state and compensation for losses suffered or for non-provision of expected benefits. Liability of the investor's parent company in its home country may also be relevant, but is not covered here.

Investment contracts may contain relevant provisions although they usually refer back to the domestic legislation of the host state. For instance, the 2003 International Project Agreement for the West African Gas Pipeline (WAGP) requires the investor to pay affected 'land owners and lawful occupiers of land' 'fair compensation' for damage caused, in compliance with relevant domestic legislation (article 21.9).

Nevertheless, local people may find it difficult to exercise their right to compensation if their crops, trees, livestock or buildings are damaged. Apart from the practical impediments that often limit access to court for people affected by investment projects, legal constraints under national law may include requirements on standing (i.e. the ability to sue – for instance, where community-based organisations are not recognised as a legal entity); burden of proof (e.g. proving causation between activity and damage and negligence on the part of the investor); statutes of limitation (whereby lawsuits can only be brought within a short timeframe, in contrast with the time it takes to overcome lack of resources and legal awareness); limited availability of injunctions for projects perceived to be in the national interest; and low levels of compensation.

Possible solutions include establishing grievance mechanisms within the project, which may be more accessible than national courts. This is an explicit requirement under the Equator Principles (discussed in section 2). Where multilateral lenders like the World Bank, the IFC or regional development banks are involved, grievance procedures are provided by these institutions. For instance, the Chad-Cameroon pipeline project resulted in the establishment of two World Bank Inspection Panels, one for Chad and one for Cameroon. Several cases involving natural resource investments have also been brought to the IFC Compliance Advisor/Ombudsman.[11]

For countries that have adhered to the OECD Guidelines for Multinational Enterprises, complaints may also be brought to the 'National Contact Point' established in the country where the investor is based or operates. For example, the United Kingdom National Contact Point recently found that a mining project implemented by a UK-based investor in India had not complied with the Guidelines, and issued recommendations to remedy the violations (*Survival International v. Vedanta Resources Plc*).

In addition, it is possible to frame national law so as to minimise legal constraints on access to courts. For example, burden of proof requirements can be particularly challenging. If appropriate, strict (as opposed to negligence-based) liability for damage may make it easier for people to obtain redress: claimants would have to prove causal link between project activity and damage, but not negligence. Strict liability may be applied to certain types of damage. For instance, the latest Energy Charter Treaty Model HGA for cross-border pipelines, adopted in 2007, provides for strict liability with specific regard to damage caused by oil spills (article 16(3)).

A possible compromise between strict and negligence-based liability could be to reverse the burden of proof: claimants would not have to prove negligence but the investor may avoid liability by proving that no negligence was involved.

11. See http://www.cao-ombudsman.org/cases/ for a full list.

Further reading

On ESIAs

IFC (2006a) *Performance Standard 1: Social and Environmental Assessment and Management System*. International Finance Corporation, Washington DC. http://www.ifc.org/ifcext/sustainability.nsf/Content/PerformanceStandards.

IPIECA (2004) *A Guide to Social Impact Assessment in the Oil and Gas Industry*. International Petroleum Industry Environmental Conservation Association, London. http://www.ipieca.org/activities/social/downloads/publications/sia_guide.pdf.

On land takings

FAO (2008) *Compulsory Acquisition of Land and Compensation*. Food and Agriculture Organization of the UN, Rome. http://www.fao.org/docrep/011/i0506e/i0506e00.htm. Guidance on the safeguards to be provided for compulsory acquisitions.

IFC (2006b) *Performance Standard 5: Land Acquisition and Involuntary Resettlement*. International Finance Corporation, Washington DC. http://www.ifc.org/ifcext/sustainability.nsf/Content/PerformanceStandards

On social investment

Ayine, D.M. (2008) *Social Responsibility Agreements in Ghana's Forestry Sector*. IIED, London. http://www.iied.org/pubs/display.php?o=12549IIED.

A wealth of documentation on the negotiation of agreements with indigenous peoples in Australia's mining sector is available at http://www.atns.net.au/default.asp.

Stabilisation and renegotiation

7.1 Stabilisation and renegotiation clauses: what they are and how they work

Stabilisation clauses

Stabilisation clauses are a legal device to manage non-commercial (that is, fiscal or regulatory) risk. The host government makes a contractual commitment to only alter the tax and regulatory framework governing an investment project, or specific aspects of it, in specified circumstances – such as investor consent, restoration of the economic equilibrium of the contract and/or payment of compensation.

Stabilisation clauses respond to the investor's need for protection from arbitrary or discriminatory changes in applicable rules that may adversely affect the investment. As mentioned in section 2, long-term and capital-intensive investments tend to involve a shift in the balance of negotiating power in favour of the host government during the project. Once most of the investment has been made, the investor becomes vulnerable to arbitrary action that may undermine the financial viability of the investment or even expropriate the investor's assets altogether.

Stabilisation clauses aim to shelter investors from such adverse action. They may also help the project to secure loans, particularly in financing techniques where creditworthiness and debt security are based on the revenue expected to be generated by an investment project, rather than on the investor's overall assets ('project finance'). In these cases, debt repayment depends on the generation of projected cash and arbitrary changes in rules that affect the cash flow (e.g. an increase in costs) would undermine the position of lenders. Lenders are therefore likely to scrutinise the stability of the contractual terms when assessing the 'bankability' of the investment.

Renegotiation clauses

Changing circumstances and often long contract durations may require the parties to renegotiate the contract or parts of it during the lifespan of the investment project. Including explicit renegotiation clauses in the contract may reduce uncertainty by identifying the events that would trigger a renegotiation, by determining the process to renegotiate the contract or parts of it and by setting out the objectives that the renegotiation should pursue. The contract may also include clauses that require the parties to periodically review some aspects of the contract.

Although stabilisation and renegotiation clauses may seem to pursue conflicting aims, in practice they are closely related. In the real world, changes in circumstances over long project durations are inevitable. Therefore, stabilisation clauses that seek to prevent any changes in applicable rules may be unworkable in practice. Commitments on regulatory stability can be framed so as to trigger a renegotiation when a regulatory change occurs. The aim of the renegotiation would be to restore the economic equilibrium of the contract after the regulatory change. These clauses combine elements of stabilisation and renegotiation, as they stabilise the economic equilibrium rather than the regulatory framework itself ('dynamic stability').

The renegotiation of contracts with an objective other than the restoration of the original economic equilibrium raises a range of separate issues that cannot be adequately discussed in this guide (on lessons learned from two recent renegotiations in Liberia, see Kaul *et al.*, 2009).

Legal validity and effect

It must be borne in mind that international arbitrators, who may be requested to settle disputes between investors and states (see section 8), tend to take contractual commitments on regulatory stability very seriously. In *Texaco v. Libya*, the arbitrator ruled that stabilisation clauses are valid and have legal effect in international law. This view was followed, with some variants, in the subsequent cases *Kuwait v. Aminoil, AGIP v. Congo*, and *Revere Copper v. OPIC*. This backing of the validity and legal effects of stabilisation clauses was also reiterated in more recent arbitrations although they did not specifically deal with those clauses, such as *Methanex v. US* and *Parkerings v. Lithuania*. Most recently, the arbitral award in the case *Duke v. Peru* ordered the host government to pay compensation for a breach of its stabilisation commitments. Provisions included in investment treaties, whereby the state parties commit themselves to honouring contractual undertakings *vis-à-vis* nationals of another state party ('umbrella clause'), may further strengthen the value of stabilisation clauses. Overall, these arbitrations suggest that, if the host government acts in breach of a stabilisation clause, it must compensate the investor for losses suffered. It is therefore prudent to assess thoroughly whether such a clause should be included in the contract and if so to negotiate carefully its scope, structure and content.

This section discusses the sustainable development implications of stabilisation and renegotiation clauses. These implications can be wide-ranging but the section focuses on cases where the application of these clauses is triggered by regulatory changes in social and environmental matters.

7.2 Content and scope

Stabilisation and renegotiation clauses come in all forms and shapes The types of clauses most commonly used in contractual practice for natural resource investments include (Berger, 2003; Bernardini, 2008; Shemberg, 2008):

- 'Freezing' clauses, whereby the national law governing the contract or specified parts of it are frozen in time. This means that the law applicable to the project is the one in force in the host state at a specified date, usually the date when the contract is signed. Legislation subsequently introduced (depending on the clause, any legislation or laws in a specific area like taxation) does not apply to the project, though some freezing clauses enable the investor to 'opt-in' if the new rules are more favourable;

- 'Consistency' clauses, whereby the national legislation of the host state only applies to the project if consistent with the investment contract – in other words, the contract prevails over national law or specific parts of it;

- 'Economic equilibrium' clauses, which enable changes in applicable rules but require the government to restore the original economic equilibrium of the contract or, in default, to pay compensation. The clause may explicitly clarify the events that would trigger its application (for example, regulatory change that has 'material' impact on the economic equilibrium). Restoration of the economic equilibrium may occur through renegotiation or through mechanisms specified in the contract, such as changes to some tax rates or extensions in project duration. Where renegotiation is the mechanism used, the clause may clarify not only the objective pursued (restoring the economic equilibrium) but also aspects of the negotiation process.

These diverse types of clauses may be combined into hybrid provisions. Examples of the different types of clauses and of possible hybrids are provided in Box 9.

Trends in contractual practice show a shift away from freezing clauses towards a greater use of economic equilibrium clauses. This is mainly due to the greater flexibility and versatility offered by these clauses. However, a recent study found that freezing clauses are still common, particularly in sub-Saharan Africa (Shemberg 2008).

Scope

The scope of stabilisation commitments varies widely. In some cases, these commitments only stabilise specific aspects like the fiscal regime or the tariff structure in public utility projects. For example, the recent *Duke v. Peru* arbitration involved a tax-only stabilisation commitment included in a 'Legal Stability Agreement' between the government of Peru and the investor.

Other stabilisation clauses are much broader. For example, the host government agreement between Turkey and the BTC consortium for the construction of the Baku-Tbilisi-Ceyhan pipeline contains a very broad provision that: 1) defines regulatory change in very broad terms, to encompass not only a legislative but also judicial or administrative interpretation of existing legislation and ratification of international treaties; 2) covers both discriminatory measures against the investment project and general legislation; and 3) explicitly includes regulation in health, safety and environmental matters (see Box 10).

The BTC stabilisation clause is remarkably broad. It triggered vigorous civil society campaigning and even the investor subsequently agreed voluntarily to scale it back through a unilateral undertaking (which is further discussed below).

Box 9. Examples of clauses

Freezing and consistency clauses
The 1998 COTCO-Cameroon Establishment Convention for the construction and operation of the Cameroon section of the Chad-Cameroon oil pipeline contains both 'freezing' and 'consistency' clauses. These commit the government of Cameroon 'not [to] modify [the] legal, tax, customs and exchange control regime in such a way as to adversely affect the rights and obligations of COTCO', and not to apply to the project any legislative, regulatory or administrative measures inconsistent with the Convention (articles 24 and 30).

Economic equilibrium clauses
The 2003 International Project Agreement between Benin, Ghana, Nigeria and Togo on the one hand and the West African Gas Pipeline Company on the other, for the construction and operation of the West African Gas Pipeline (WAGP) contains an economic equilibrium clause (article 36). Under this clause, if regulatory change (including legislation, court decisions and ratification of international treaties) 'has a material adverse effect on the Company', or if it 'causes the benefits derived by the Company from the Project […] or the value of the Company to the shareholders to materially decrease'; then the state must restore the Company and/or the Shareholders to the same or an economically equivalent position it was/they were in prior to such change. In default, it must pay 'prompt, adequate and effective compensation.'

Hybrid clauses
The 1997 PSA for the Karachaganak oil and gas field in Kazakhstan provides that regulatory changes (laws, treaties) that have an adverse effect on the investor's position in the contract do not apply to the project – this is similar to a typical freezing clause. However, regulatory changes relating to 'defence capability, national security, ecological safety, protection of health and morality' do apply, but the investor is entitled to compensation – thereby functioning like an economic equilibrium clause (section 29.3).

7.3 Implications for sustainable development

To maximise the investment's contribution to sustainable development, it is important to assess whether some degree of stabilisation is indeed required for the investment to be viable or obtain lending; to tailor the scope and content of any stabilisation clauses to what is specifically required for a given investment; and to develop ways to reconcile the investors' legitimate need for protection against arbitrary treatment with maintaining the host state's ability to pursue sustainable development goals, for instance through regulation in social and environmental matters.

Protection against arbitrary changes in applicable rules is important for investment promotion and may facilitate investments that contribute to sustainable development goals – for instance, by protecting renewable energy projects against the unfair removal of public subsidies and tax breaks.

But the risks of signing up to excessively broad stabilisation commitments need to be properly taken into account. Too sweeping commitments may constrain the pursuit of sustainable development goals over the usually long duration of investment projects. As discussed in section 1, sustainable development entails a careful balancing of social, environmental and economic considerations. This balancing act is not definitive, but constantly evolves as circumstances change and calls for state action in social or environmental matters.

Box 10. Extracts from the BTC-Turkey Host Government Agreement of 2000, article 7.2

'If any domestic or international agreement or treaty; any legislation, promulgation, enactment, decree, accession or allowance; any other form of commitment, policy or pronouncement or permission has the effect of impairing, conflicting or interfering with the implementation of the Project, or limiting, abridging or adversely affecting the value of the Project or any of the rights, privileges, exemptions, waivers, indemnifications or protection granted or arising under this Agreement […] it shall be deemed a Change in Law […].'A 'change in law that affects the economic equilibrium of the project will require Turkey to pay compensation'.

In addition, the government must restore the economic equilibrium of the contract if this is affected, 'directly or indirectly, as a result of any change (whether the change is specific to the Project or of general application) in Turkish Law (including any Turkish Laws regarding Taxes, health, safety and the environment) […] including changes resulting from the amendment, repeal, withdrawal, termination or expiration of Turkish Law, the enactment, promulgation or issuance of Turkish Law, the interpretation or application of Turkish Law (whether by the courts, the executive or legislative authorities, or administrative or regulatory bodies) […]'.

For instance, changes in applicable rules may be required when as new hazards are discovered, new technologies developed, new treaties signed or as public perceptions of acceptable levels of risk evolve. Concrete examples of state action include measures to minimise local social and environmental impacts, for instance by tightening compensation or local consultation requirements, or measures introducing strict liability or reversing the burden of proof for particular types of damage. State action to tackle global environmental challenges may also be relevant, such as regulation to tackle climate change through introducing or tightening carbon taxation or emission trading schemes.

In all of these cases, if host states have to compensate investors for losses suffered, it may be more difficult for states to act in social and environmental matters if the economic equilibrium of an investment project is thereby affected. This issue is particularly acute in poorer countries where there may be major concerns surrounding the health of public finances and where the national legal framework to protect environments or local livelihoods may not be well developed at project inception.

7.4 Some tips for host government and civil society

The inclusion of a stabilisation clause should not be presumed

An investor seeking a stabilisation commitment should be expected to demonstrate its need and to negotiate for it. It is useful to explore alterative ways to mitigate regulatory risk, such as insurance and involvement of multilateral lenders. If a government agrees to enter into a stabilisation commitment, it may seek to compensate the reduced regulatory risk for the investor with higher economic benefits for the host country, for instance in the form of greater public revenues.

Restrict any stabilisation commitments to protection from arbitrary treatment genuinely needed by the project

Stabilisation clauses are there to ensure protection from arbitrary changes in applicable rules and the text of the provision should make this explicit. It is important to exclude action genuinely taken in the public interest from stabilisation commitments.

This can be done not only by wording the clause around arbitrary, discriminatory or similar treatment, but also by explicitly stating that public-purpose measures are outside the scope of the clause (see Box 11 for some examples). Investors can be reminded that international treaties (on human rights, for example) cannot be overruled by contracts and therefore that exceptions to the scope of stabilisation commitments to allow for changes to applicable rules and standards in line with evolving international law exist implicitly even if they are not explicitly mentioned in the contract. In order to reduce uncertainty, it is in the investor's best interest to clarify the scope of its protection by making exceptions for public-interest measures explicit.

The range of measures covered by the stabilisation provision also deserves attention. It is not good practice to uncritically take all-encompassing stabilisation clauses from pre-existing contract models. If tax, exchange rates, tariff structures or other similarly specific issues are the real investor's concern then any stabilisation commitments may be tailored to these needs. If lending and the project's bankability is the issue, a stabilisation clause may have sufficient duration to ensure debt repayment, which may be shorter than the full contract term. For example, the 2003 Stability Agreement between AngloGold Ltd and the government of Ghana has a duration of 50 years but its freezing clause applies for 15 years only (section 2.06 of the contract).

Avoid freezing clauses under all circumstances

Freezing clauses tend to leave no room for regulatory change. Economic equilibrium clauses are also restrictive because they require the restoration of the economic equilibrium including through compensation – but they do not actually freeze applicable law.

Freezing clauses are likely to be unlawful and unenforceable in many jurisdictions, as they may conflict with constitutional norms on the separation of powers (which mean that the government cannot enter contractual commitments that undermine current or future legislation adopted by parliament). Freezing clauses are also quite inflexible: faced with a breach, the investor can either put up with it or go to arbitration, which risks undermining the entire project. Given their greater flexibility, choosing economic equilibrium over freezing clauses also makes good business sense from the investor's perspective.

Even when combined with elements of an economic equilibrium clause into a hybrid provision, freezing clauses are impractical, are widely perceived as outmoded and are best avoided.

It is also prudent to avoid clauses that grant the investor the right to demand the 'better treatment' between current and future laws, and 'most-favoured-company' provisions that enable the investor to benefit from any more favourable treatment granted to other companies. The latter type of clause contrasts with the fact that each project inevitably has different cost and risk structures, so that concessions on the fiscal regimes given to a project may not be relevant to another one.

Focus on economic equilibrium and fair procedures

The current trend is towards combining greater flexibility and security of contracts. By combining elements of both stabilisation and renegotiation, economic equilibrium clauses are an effective tool to square that circle. These clauses can be structured in creative ways, beyond the standard approach of requiring the government to compensate the investor. For example, the clause may allow the parties to extend the duration of the contract to restore the economic equilibrium.

Economic equilibrium clauses also lend themselves to placing emphasis on fair procedures to deal with regulatory change, rather than on predefined outcomes. For example, the contract may require the parties to negotiate 'in good faith' to restore the economic equilibrium and establish a defined procedure to deal with irreconcilable disagreements (such as determination by an independent expert).

It is also useful to limit economic equilibrium clauses to changes that have a significant impact on the project and to exclude those of lesser impact. The clause may also refer to more specific thresholds linked to the financial model underpinning the contract.

Seek 'double-edged' economic equilibrium clauses

Economic equilibrium clauses can require the parties to negotiate and restore the economic equilibrium in cases not just where host action negatively affects the project but also when this action either directly or indirectly improves the economic benefits generated by the investment (as provided by article 29.3(b) of the Karachaganak PSA, for example).

Box 11. Limiting the scope of stabilisation clauses: some examples

The 2003 BTC Human Rights Undertaking is a unilateral commitment of the BTC consortium not to interpret the very broad BTC stabilisation clauses (cited earlier) in a way that constrains host state action from pursuing human rights goals. However, state action must meet specified requirements aimed at preventing abuse – namely it must be:

- 'Reasonably required' by international treaties; or
- Required by the public interest and in accordance with domestic law, provided that domestic law is no more stringent than the highest standards of the European Union, World Bank or international treaties.

This means that if required by or in line with international and comparative law and standards, regulatory change is exempted from stabilisation commitments. While this caveat may protect the investor from abuse, it effectively sets a cap on host state regulation. This may not be an issue in countries where domestic legislation is significantly below international standards. But it may cause problems in areas where international standards themselves are not well developed and in cases where host states need to respond quickly to new (or newly discovered) social or environmental hazards which are yet to be dealt with internationally.

Mozambique's 2008 Model Exploration and Production Concession (EPC) Contract contains an economic equilibrium clause that explicitly refers to discrimination against the investor as grounds for discerning what is in or out the scope of the stabilisation clause (in contrast to the BTC contracts, which explicitly include non-discriminatory regulation). It is worth noting in full the wording of the second part of this clause (section 27.13):

'The provisions of this Article shall not be read or construed as imposing any limitation or constraint on the scope, or due and proper enforcement, of Mozambican legislation which does not discriminate, or have the effect of discriminating, against the Concessionaire, and provides for the protection of health, safety, labor or the environment, or for the regulation of any category of property or activity carried on in Mozambique, provided, however, that the Government will at all times during the period of Petroleum Operations ensure that [...] measures taken for the protection of health, safety, labor or the environment are in accordance with standards that are reasonable and generally accepted in the international petroleum industry.'

Under this clause, the key factors to consider when determining whether state action falls within the exception are: 1) whether it is discriminatory; 2) whether it relates to specified categories of issues, namely the protection of health, safety, labour or the environment, or the regulation of property; 3) whether the measure is 'reasonable'; and 4) whether the standards are generally accepted in the international petroleum industry. The latter condition is not very useful, as in some cases action may have to be taken even if there is a gap in petroleum industry standards. It may also be a source of uncertainty, as standards in the industry are not codified.

The latest Energy Charter Treaty Model HGA for cross-border pipelines, adopted in 2007, contains a very broad stabilisation clause but also an explicit exception that excludes social and environmental matters (more specifically, government action concerning 'environmental protection, safety, employment, training, social impact or security') from the scope of that clause – so long as the measures are non-discriminatory and in line with international rules (article 37).

Further reading

Berger, K.P. (2003) "Renegotiation and Adaptation of International Investment Contracts: The Role of Contract Drafters and Arbitrators", *Vanderbilt Journal of Transnational Law* 36(3): 1347-80.

Bernardini, P. (2008) "Stabilization and Adaptation in Oil and Gas Investments", *Journal of World Energy Law & Business*, 1(1): 98-112.

Cameron, P.D. (2007) "Stabilization in Investment Contracts and Change of Rules by Host Countries: Tools for O & G Investors", Association of International Petroleum Negotiators. http://www.aipn.org/modelagreements/research.asp.

Maniruzzaman, A.F.M. (2008) "The Pursuit of Stability in International Energy Investment Contracts: A Critical Appraisal of the Emerging Trends", *Journal of World Energy Law & Business* 1(2): 121-157.

Shemberg, A. (2008) *Stabilization Clauses and Human Rights*, A research project conducted for the International Finance Corporation and the United Nations Special Representative to the Secretary General on Business and Human Rights. http://www.ifc.org/ifcext/sustainability.nsf/AttachmentsByTitle/p_StabilizationClausesandHumanRights/$FILE/Stabilization+Paper.pdf

Dispute settlement

8.1 Contract management and dispute settlement

Section 2 briefly discussed mechanisms to manage the contract during project implementation (government institutions, joint committees). The settlement of disputes that may arise from the contract is a key part of contract management. The focus here is on disputes between the investor and the host government, which are often referred to as 'investment disputes'. It is important, however, that the web of contracts provides remedies for all wrongs that may be suffered by all the parties involved in the project. Legal remedies for affected communities are discussed separately in section 6.

Multiple mechanisms to settle investment disputes, focus on international arbitration

Investment disputes may be settled through negotiation, mediation or conciliation (these practices are commonly referred to as 'alternative dispute resolution'). Where differences cannot be reconciled, litigation before the domestic courts of the host state is usually the default option. However, investment contracts commonly contain provisions to deal with dispute settlement and may enable the parties to settle disputes through international arbitration rather than in domestic courts. International treaties and national laws may also give investors direct access to international arbitration. The past few years have witnessed a boom in arbitrations addressing claims brought by foreign investors against host states. A number of these cases raise important questions about public policy choices concerning sustainable development.

Given the widespread use of arbitration and its direct implications for sustainable development, this section focuses on that dispute settlement mechanism. However, it should not be presumed that the contract will feature an arbitration clause. Also, contract provisions that require attempts to settle by negotiation and mediation before going to litigation or arbitration may help the parties to prevent disputes from escalating and from jeopardising the continuation of an investment project.

Investors tend to value international arbitration. Arbitration offers an alternative to resolving disputes in the domestic courts of the host state – where, depending on the country, there may be risks of political interference in the judicial process or cumbersome and lengthy procedures. Arbitration leads to a binding and enforceable decision and often to the award of damages that far exceed the amounts that would be available under national law in many jurisdictions. Arbitration is particularly prized by investors in lower- and middle-income countries. Yet bilateral investment treaties offer access to arbitration for nationals from the states of both parties and regional treaties like the North American Free Trade Agreement (NAFTA) have enabled investors to bring arbitration proceedings against the United States and Canada.

8.2 International arbitration in outline

In relation to investment disputes, international arbitration refers to the settlement of a dispute between the investor and the host state by an impartial third party.[12] In effect, arbitration provides an alternative to the national courts system that would otherwise be responsible for settling the dispute. By taking a dispute to arbitration, the investor will seek to enforce a commitment that the government has made through the contract, or through an applicable treaty or law. The investor will typically allege that the government has taken action that violates that commitment – or failed to take action where it was required to.

Legal basis and outcome

Investors may only go to arbitration, instead of national courts, if this is allowed by arbitration clauses within the contract, national legislation or investment treaties. This means that arbitration may be an option even if it is not mentioned in the contract ('contract-based arbitration') but provided for under an investment treaty ('treaty-based arbitration') or national law. It is also worth mentioning, as discussed in section 2, that 'umbrella clauses' in an investment treaty may make contractual breaches a violation of the treaty, so that there may be links between claims enforceable under the contract or the treaty.

The multiple routes into arbitration may provide investors with a choice of arbitration fora or of procedural rules to apply in resolving the dispute – for instance, if the contract and an investment treaty offer different options. It is advisable to deal with this issue in the contract, clarifying the relationship with any other available avenue to arbitration. During negotiations, it is also prudent to watch out for potential 'treaty shopping' practices (see section 2), as complex corporate structures located in different countries may enable the investor to claim protection and initiate arbitration under several treaties.

The decision of the international arbitrators is referred to as an arbitral 'award' (effectively, a document very similar to a court judgment). The award is binding for the parties. If the arbitral tribunal judges in favour of the investor, the award usually orders payment of compensation. Amounts awarded can be quite significant and may be substantially higher than those awarded by domestic courts. In the case *Ceskoslovenska Obchodni Banka*, for example, the investor was awarded the record-setting amount of US$867 million. This makes it all the more important to get the contract right – contractual commitments coupled with international arbitration may significantly constrain government action.

12. International arbitrations concerning investment disputes typically deal with disputes between an investor and a state. They should be distinguished from other forms of international arbitration, particularly those to settle disputes between states (e.g. on boundaries or other matters).

Ad hoc and institutional arbitration

There are a variety of models of international arbitration. 'Ad hoc' arbitral tribunals are established to settle a specific dispute and do not have institutional links with an established body. They usually involve a panel of three arbitrators chosen by the parties, although sole arbitrators are also possible. Commonly, each party appoints an arbitrator and these two arbitrators appoint a third arbitrator, who chairs the tribunal. If the two parties are not able to agree on the third arbitrator, relevant contract provisions or arbitration rules may empower an institution (such as the Permanent Court of Arbitration) to appoint the chair (the institution indicated by the parties is said to act as the 'appointing authority').

Ad hoc arbitrations apply the procedural rules chosen by the parties. Commonly, the contract (or a treaty or law) refers to the Arbitration Rules adopted in 1976 by the United Nations Commission on International Trade Law (UNCITRAL), though it may also be possible to include modifications to these established rules. The UNCITRAL Rules are currently being revised.

'Institutional' arbitrations are administered and supervised by an existing institution, such as the World Bank-hosted International Centre for the Settlement of Investment Disputes (ICSID), the Paris-based Court of Arbitration of the International Chamber of Commerce (ICC), or the London Chamber of International Arbitration (LCIA). Each of these fora has its own set of procedural rules. Arbitrators are still usually chosen by the parties or at least the parties have some say in the appointment process. Recent years have witnessed the growing use of institutional arbitrations such as ICSID.

Substantive rules

The substantive law is the one that regulates the substantive matter to the dispute, rather than the procedure itself. When arbitrators adjudicate a dispute, they must apply the law that has been chosen by the parties (e.g. the law identified in the investment contract). From a host country perspective, it is advisable to have the national law of the host state in the contract. Investors may seek to complement this with a reference to international law, but choosing the national law of a third country like the law of England and Wales, as is sometimes done, is not in the best interest of the host country. In treaty-based arbitrations, the applicable law is set out in the treaty itself.

If the parties have not explicitly chosen the law, the applicable law is determined by looking at 'conflict of law' rules (i.e. the norms of national and international law that determine which legal system governs a transaction); and by the rules regulating the arbitration (e.g. article 42 of the ICSID Convention, which requires arbitrators to apply the national law of the host state and relevant norms of international law).

Arbitrators are not bound by precedent – i.e. by previous judgments or arbitral awards. But in practice they do tend to take account of, and refer to, previous arbitral decisions.

Enforcement

In contrast to the judgments of domestic courts, the enforcement of arbitral awards is specifically regulated by global treaties such as the ICSID Convention and the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The New York Convention has been ratified by more than 140 states. This makes arbitral awards easier to enforce than court judgements.

The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards requires state parties to recognise awards as binding and to enforce them within their jurisdiction. However, article V of the New York Convention enables states to refuse enforcement if major defects affected the arbitral proceedings, or where enforcement would be contrary to the public policy of the country. The latter exception refers to the fact that in many jurisdictions some issues may not form the object of arbitral proceedings (for example, criminal matters), and that the substance of a decision may in some cases be in conflict with public policy.

Article 54 of the ICSID Convention commits states parties to recognise awards issued by an ICSID tribunal as binding and to enforce them within their jurisdiction as if they were final judgements issued by their own courts. The ICSID Convention does not contain an exception like article V of the New York Convention. But it does provide some narrowly defined grounds for the annulment of an ICSID award through a special procedure under article 52 of the ICSID Convention.

On the basis of these provisions, if the host state fails to comply with an award, the investor may seek to enforce the ruling in the national courts of a third country where the host state holds interests, for instance through seizing goods or freezing bank accounts, provided that the third state is party to the ICSID or New York Convention as relevant.

8.3 Addressing public and third-party interests: the need for balanced expertise and open proceedings

Not just commercial disputes

From a sustainable development perspective, it is crucial that dispute settlement mechanisms adequately address all the interests involved in investment disputes – including both commercial and non-commercial interests. In many recent and ongoing arbitrations there is much more at stake than purely commercial matters. This is not simply because awards need to be paid from the public purse but also because public policy and third-party interests may be directly affected.

For example, several recent arbitrations concerning water concessions or privatisation schemes[13] have raised issues of great relevance to the progressive realisation of the right to water, which is protected under international human rights law (Peterson and Gray 2003). Investment disputes may also arise from action taken by the host state to protect a public interest or the interests of third parties (e.g. environmental legislation or standards in favour of indigenous communities).

In these cases, the outcome of arbitration proceedings may significantly affect the lives and environments of many. These proceedings are especially important because, in contrast to court judgements, arbitral awards are not subject to appeal (ICSID arbitrations involve an annulment procedure but only for major defects such as corruption or manifest excess of powers).

Ensuring balanced expertise

In order to take all these wider interests into account, it is necessary to ensure that arbitral tribunals have expertise in all the significant branches of law, including investment, environmental and human rights law. The most experienced arbitrators tend to come from a commercial or investment law background. But it is up to the parties to appoint arbitrators and to ensure that the expertise on the arbitral tribunal is well balanced.

Host governments are therefore able to play a key role in shaping the composition of the tribunal – not only by appointing the right state-appointed arbitrator but also by scrutinising the arbitrator appointed by the other party. Reading about an arbitrator's earlier awards or academic publications may provide useful insights into their views. The tribunal for a pending ICSID arbitration includes an arbitrator with expertise in environmental law as well as investment law – though the case does not directly concern environmental issues.[14]

Transparency and non-party participation

Transparency and openness of international arbitration proceedings are vital to ensure that broader interests are properly taken into account. Yet, as proceedings are mainly private, procedural rules usually entail restrictions on access to oral hearings, on the dissemination of information concerning the dispute and on the publication of the arbitral award. There usually are also restrictions on the ability of civil society organisations, public interest lawyers and other groups that are not directly party to the dispute to file submissions with the arbitral tribunal in order to draw the tribunal's attention to matters of public policy (these actions are called non-party or '*amicus curiae*' submissions).

13. E.g. *Compañía de Aguas del Aconquija v. Argentina*; and *Biwater v. Tanzania*.
14. *Mobil Investments Canada Inc. and Murphy Oil Corporation v. Canada*.

All the issues mentioned above vary considerably a amongst different arbitration systems. The lack of procedural transparency is particularly problematic in ad hoc arbitrations and in some institutional arbitration fora where it is quite possible for the public not to be aware of a pending or decided dispute. On the other hand, arbitrations handled by ICSID or initiated on the basis of specific treaties like NAFTA have seen some positive developments in recent years. UNCITRAL Rules are very flexible. They grant the tribunal considerable discretion as long as the parties are treated equally. The tribunal may use this discretion to allow non-party participation but in practice this has so far happened only in some recent NAFTA cases. The ongoing revision of UNCITRAL Rules may increase transparency requirements in UNCITRAL arbitrations (see Table 2).

Table 2. Transparency and non-party submissions in different arbitration fora

	UNCITRAL[15]	ICC	ICSID
Advertisement of case	No	No	Yes (pending cases are listed at www.worldbank.org/icsid)
Written non-party submissions	The current rules do not state anything on this matter. Article 15 empowers the tribunal to conduct the arbitration as it deems appropriate, and thus to accepts such submissions, provided that parties are given equality of conditions. But submissions have not yet been admitted in practice – except for cases brought under NAFTA (*Methanex v. US*)	The rules do not state anything on this matter but non-party submissions are not allowed in practice	Yes after 'consulting' the parties (Rule 37(2)). Likely to be accepted if the submission would assist the tribunal to decide on a legal or factual issue. Requirements: within scope, significant interest of the non-party in the dispute. Admitted in *Biwater v. Tanzania*
Public access to case documents	The current rules do not state anything on this matter, but public access is not allowed in practice	The rules do not state anything on this matter, but public access is not allowed in practice	Denied in *Biwater v. Tanzania*
Public access to hearings	Need for the parties' consent (article 25(4))	Need for the parties' consent (article 21(3))	Need for the parties' consent (Rule 32(2)), denied in Biwater v. Tanzania
Publication of award	Only with consent of both parties (article 32(5))	No	Consent of the parties is required (Rule 48), but it is commonly done (http://icsid.worldbank.org/ICSID/Index.jsp)

15. The UNCITRAL Arbitration Rules 1976 are currently being revised.

For instance, the recently amended ICSID Arbitration Rules empower arbitrators to allow non-parties to file written submissions (Rule 37(2)). When deciding whether to allow written submissions, arbitrators must consult (but not necessarily obtain the consent of) the parties. In addition, arbitrators must consider whether submissions are likely to assist in deciding the case and whether the submission comes from a person or entity with a significant interest in the proceeding. Beyond these criteria, arbitrators enjoy considerable freedom.

An ICSID tribunal may also allow non-parties to attend oral hearings – but only if the parties consent (Rule 32(2)). Access to case documents (a crucial pre-requisite for informed non-party submissions) remains similarly constrained. ICSID awards are commonly published in law journals and are available on the Internet – although publication of the award requires the consent of the parties involved (article 48 of the ICSID Rules).

As regards arbitrations brought under NAFTA, a 2001 'Note of Interpretation' issued by the NAFTA Free Trade Commission improved public access to documents relating to arbitration proceedings, subject to protection of confidential business information. In addition, a 2003 Commission decision established a process for non-party submissions. These submissions were first accepted in 2001 in *Methanex v. US*, a NAFTA case arbitrated under UNCITRAL Rules.

These positive developments have been spearheaded by civil society organisations through pioneering non-party submissions and broader policy advocacy. IISD played a key role in this, including through non-party submissions in *Methanex* and in *Biwater*. Civil society non-party submissions have since increased, as exemplified by the *Glamis* arbitration, where several non-party submissions were filed, including by an indigenous group affected by the disputed investment.

Arbitral tribunals have paid varying degrees of attention to these submissions. The *Methanex* award made explicit reference to the IISD non-party submission. The non-party submission by five CSOs in the *Biwater* case was referred to extensively in the award. Anecdotal evidence suggests that in some cases the arguments brought by non-parties influenced the tribunal's thinking or its handling of witness statements. Even if it appears that there is no major impact on the arbitration process, non-party submissions may play a role in improving public awareness and galvanising mobilisation.

Despite these positive developments, openness remains problematic both in some institutional arbitrations and to a greater extent in ad hoc arbitrations.

Photo: Oliver Wolff / VISUM/Still Pictures

In troubled waters? Worker checking equipment in a flooded oilfield, Kazakhstan

8.4 Some tips for host government and civil society

Frame arbitration clauses properly

It is advisable to give proper thought to the formulation of any arbitration clauses included in the contract. The arbitration clause may require parties to try to settle the dispute by negotiation or mediation before being able to access arbitration. Governments may also consider negotiating an 'exhaustion of domestic remedies' clause that requires investors to seek justice from domestic courts and only go to arbitration if justice is denied. Investors are likely to resist this, however, as it would make it more difficult for them to access arbitration. At the very least, the host government may seek a 'fork-in-the-road' provision clarifying that, if there is a choice between arbitration and domestic courts, and if the investor chooses to go to domestic courts first, it loses the right to go to arbitration.

Ensure transparency in arbitration clauses

As different arbitration systems involve different degrees of transparency and non-party participation, contracts can favour more open arbitration systems like ICSID. For states that are not parties to the ICSID Convention, reference may still be made to the ICSID Rules of Arbitration as the rules governing the arbitral proceeding. Requirements on greater transparency may also be integrated in arbitration clauses that may be included in relevant investment treaties. The IISD model investment treaty, referred to in section 2, contains extensive text on transparency in arbitral proceedings (Mann *et al.*, 2006).

In addition to the intrinsic benefit of transparency, greater openness may also increase public pressure on investors to drop cases that are highly controversial due to the implications for social justice or environmental sustainability. For example, some recent ICSID arbitrations involving water concessions attracted significant public attention and in at least one instance the investor dropped its case.

If a dispute arises, get expert advice

If a dispute about the contract is brought to international arbitration, it is imperative to seek professional legal advice. Investment arbitrations can be very complex and having specialised support from international law firms with a leading arbitration practice can make a real difference to the case. Not only do these firms have more experience but they also have access to earlier awards that may not be publicly available. It is prudent to set aside adequate resources to cover legal fees should a dispute arise.

Legal advice is essential throughout the management of the contract, so as to prevent arbitrations in the first place. It is also important to seek specialised legal advice from the very moment the government receives notice of arbitration. Governments may be tempted to settle through negotiation out of fear of an unsuccessful arbitration, particularly if the measure challenged is not seen as a policy priority (which in some contexts may include social or environmental regulation). But before settling, it is important to establish whether the investor does have a strong legal case – experience suggests that this is not always the case because notices of arbitration may actually be part of a negotiating strategy.

Make sure the right arbitrators are on the tribunal

The composition of the arbitral tribunal is crucial. In some cases, parallel arbitrations on similar facts have reached different conclusions. It is therefore important for the host government to pay due care and thought to appointing the right arbitrator – not only a 'friendlier' arbitrator, but also (crucially from a sustainable development perspective) somebody who has expertise on all the legal issues at stake (under investment, human rights or environmental law, for example) and is therefore able to consider all aspects involved. In the same way, it is prudent to carefully scrutinise (and challenge if necessary) the arbitrator appointed by the other party, and the third arbitrator chosen by the arbitrators appointed by the parties. The third arbitrator chairs the tribunal and is usually the most influential.

The role of civil society: advocacy and non-party submissions

Civil society can play an important role by putting pressure on their government to implement some of the points outlined above, such as ensuring that arbitration clauses provide for transparency in arbitral proceedings.

If public interest or third-party interests are at stake, CSOs can also play a more hands-on role in individual investment disputes, namely through preparing non-party submissions for the arbitral tribunal. This can be a powerful tool for influencing the tribunal's analysis of the case. From a sustainable development perspective, the benefits of civil society involvement in international arbitration far outweigh concerns about possible delays in the process and about loss of confidentiality. There is no reason why governments genuinely pursuing the public interest should oppose civil society involvement.

As arbitration is an eminently legal process, non-party submissions are more effective if they stick to professional legal arguments and strategies, avoid general political statements and comply with prescribed procedures (A4ID, 2008b).

Further reading

On arbitration in general

A4ID (2008a) *At a Glance Guide to Arbitration*. Advocates for International Development, London. http://www.a4id.org/at-a-glance-guides/default.aspx.

On non-party submissions

A4ID (2008b) *At a Glance Guide to Amicus Curiae & International Investment Arbitrations*. Advocates for International Development, London. http://www.a4id.org/at-a-glance-guides/default.aspx.

Transparency[16]

9.1 The case for transparency

It is often argued that investment contracts typically deal with highly sensitive commercial issues, which would justify protecting the confidentiality of the negotiation, of key project information and of the contract itself. Investors may be concerned that access to sensitive information may give competitors a commercial advantage. Equally, host governments may be concerned that future investors might invoke favourable treatment granted in earlier contracts in order to extract better terms than the government may be prepared to offer in the present.

These arguments do not stand up to closer scrutiny. The basic financial terms of many deals are known in the industry even if they are not accessible to the public (Rosenblum and Maples, 2009). Demands for the uncritical extension of treatment granted to earlier investment projects may be resisted on the basis of different economic situations (for example, if more favourable treatment was granted to earlier projects this may be justified by the need to promote investment in a marginal mine) and of the changing negotiating power of all the parties (for example, if the host government has acquired greater capability to manage the sector as a result of earlier investments).

On the other hand, contracts signed with host governments are not just commercial transactions – they are also tools for public policy: they set the terms and conditions of investment and affect the livelihoods and environments of many. Lack of transparency and public scrutiny in contract negotiation and management creates the breeding ground for corruption and, more generally, for deals that do not maximise the public interest.

Public disclosure of contracts may promote better contractual terms. Firstly, transparency may increase pressure for more balanced contracts because the parties may be held more easily accountable for the deals they sign up to. Secondly, a pool of publicly available contracts can be a powerful way of strengthening the negotiating capacity of host governments, for instance by highlighting the diverse contractual options that might be available in different circumstances.

Greater transparency is also a public good in itself. Citizens have a right to know how their government is managing the natural resources it owns on behalf of the nation (Rosenblum and Maples, 2009). Access to information and public participation in decision-making are key pillars in the concept of sustainable development (under principle 10 of the 1992 Rio Declaration on Environment and Development).

16. This section draws heavily on Rosenblum and Maples (2009).

It is therefore necessary to strike a better balance between protecting genuine concerns about commercial confidentiality and enabling maximum transparency and public scrutiny. It requires measures to ensure transparency of the contracting process and proper framing of any confidentiality clauses included in the contract.

This section discusses these issues, focusing on contracts signed between an investor and the host government or a state-owned corporation. Purely private transactions are not covered here. Also, whilst each project typically involves a wider web of contracts (see section 2), the focus here is on the investment contract between the investor and the host government.

9.2 Transparency in the contracting process

Most investment contracts are negotiated confidentially. Some aspects of contracting may be public – for instance, where public tendering is used. In other cases, the very existence of the negotiation process may not be publicly known.

In some industries, a specific confidentiality agreement may be signed at the early stages of the negotiation. A confidentiality agreement protects the confidentiality of any technical, financial or other commercially valuable information exchanged during the negotiation, which is especially relevant if negotiation breaks down. For example, in negotiations for a joint venture, a confidentiality agreement may require the parties not to disclose or use information other than in connection with the joint venture. Should the negotiations fail, both parties would have to return or destroy information, and keep the negotiation confidential (Hewitt, 2001).

There may be good reasons to keep parts of the negotiation confidential. Putting aside the investor's concern about commercially valuable information, confidentiality may also better enable the parties to make mutual concessions without losing face, and thus make it easier to reach a compromise.

But, given the important public interests at stake, it is important to establish effective mechanisms to ensure transparency in the contractual relationship. As already mentioned with regard to arbitration, a government genuinely pursuing the public interest has little to fear from greater transparency and civil society should feel confident to push for greater scrutiny.

Vigorous public debate on strategic policy choices

Even before starting the negotiation of individual contracts, there can be a lively public debate on the development of policy orientations, laws and model contracts. These documents represent strategic policy decisions (for instance, about whether and how efforts should be made to attract foreign investment in particular sectors) and provide the framework for the subsequent negotiations of individual contracts.

This point is illustrated by the recent and growing trend towards large-scale land acquisitions in Africa – including for instance a 450,000-hectare biofuel project in Madagascar. In countries that are major recipients of land-based investments, the acquisition of land on such a large scale will have significant and lasting repercussions for local livelihoods, national food security and the nature of agricultural development.

This situation calls for strategic thinking and vigorous public debate on a number of issues: the future of agriculture, the place of large- and small-scale farming within it, and the role and nature of outside investment. For this debate to be meaningful, it must take place even before engaging in any individual contract negotiations.

Public input into contract negotiations

The host government may also seek input from the public during the negotiation of individual contracts, particularly in the early stages of contracting (e.g. public tendering, evaluation or award process). This may involve time-limited and focused consultations. In these cases, disclosure of the main points of the project is key to enable an informed public response. The design of these consultation systems may also be the object of consultation (Kaul *et al*., 2009).

Parliamentary approval of contracts

For major investment projects, parliamentary approval of deals negotiated by the government can increase public scrutiny. It may also provide greater safeguards for investors, as the contract in effect becomes an Act of Parliament. Parliamentary approval is already a legal requirement for natural resource contract in some jurisdictions (in Ghana, for instance).

However, some conditions need to be in place for this mechanism to enable genuine scrutiny. In order to make well informed decisions, parliamentarians need adequate time and information, as well as technical assistance from experts in the field. Politicians may also consider using parliamentary processes as a forum for public debate, for instance by inviting civil society organisations to express their views on proposed contracts. Finally, for parliamentary scrutiny to be robust, parliamentarians should be able to propose amendments to the contract, rather than making a 'take-it-or-leave-it' decision.

The role of procedural rights

'Procedural rights' may provide an additional way to gain greater public scrutiny not only of contract negotiation but also of contract management. Procedural rights are legal entitlements that enable the public to have a say in government decisions. They concern access to information, public participation in decision making, and the ability to seek judicial review of adverse decisions.

Procedural rights may be established by international law – for instance, under the 1998 Aarhus Convention, which specifically deals with environmental information (see Box 12). National law may also establish procedural rights, for instance under 'Freedom of Information' (FOI) legislation that allows the public to request access to information held by public bodies.

FOI legislation usually contains exceptions, which commonly include trade and commercial secrets. In other words, the public body holding the information can refuse disclosure if it can show that disclosure would damage trade and commercial secrets. However, depending on the national legal system, for this exception to be applicable it must be shown that the information is not already in the public domain. This is an important caveat because information not available to civil society may be known in industry circles and as such deemed to be in the public domain (Rosenblum and Maples, 2009).

In addition, the public body may be legally required to show that disclosure is likely to cause substantial harm to the investor's competitive position – a circumstance that would need to be proved on a case-by-case basis rather than assumed (Rosenblum and Maples, 2009).

Transparency requirements under sectoral initiatives

In some industries, transparency in specific aspects of contracting has been improved through sectoral initiatives. For example, the Extractive Industry Transparency Initiative (EITI) requires companies and governments that are parties to it to publish revenues generated by extractive industry projects. The EITI was briefly referred to in section 4, and is discussed in greater detail in Goldwyn (2008).

Hooks in impact assessments

Finally, procedures for social and environmental impact assessments (see section 6) may also enable the public scrutiny of investment projects – if not of the contracts themselves. In the Chalillo Dam case (*BACONGO v. Department of the Environment and Belize Electric Company Ltd*), for instance, a civil society organisation challenged a large dam project in Belize by seeking judicial review of the environmental impact assessment. Even though the case was ultimately unsuccessful, it helped to raise awareness and promote debate about the project.

Box 12. Procedural rights under the Aarhus Convention

For states parties to it (mainly in Europe and Central Asia), the 1998 Aarhus Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters recognises:

- The public's right to obtain access to environmental information, with exceptions granted on several grounds (e.g. confidentiality of commercial and industrial information) that are to be interpreted in a restrictive way (article 4);
- The right of 'the public concerned' (i.e. those likely to be affected by a decision) to be informed about proposed projects that are likely to have a significant effect on the environment; and to be able to participate in decision making 'when all options are open', and expect decision-makers to take these views into 'due account' (article 6); and
- The right of 'the public concerned' with a 'sufficient interest' (which explicitly includes NGOs) to access judicial review procedures to challenge the legality of decisions, acts or omissions (article 9).

9.3 Confidentiality clauses

Investment contracts typically contain provisions protecting confidentiality of information. These provisions are often drafted in very open terms to include the contract itself, negotiations or action taken under it, any related documentation (e.g. reports, compilations, data, studies and other materials) and key project information. Contracts usually restrict the ability of the parties to disclose this information, unless both parties mutually agree to it. In some cases, confidentiality clauses feature some narrowly defined exceptions, concerning for instance disclosure required by stock exchange regulations, negotiation of financing arrangements, international arbitrations and other aspects.

Confidentiality clauses that are too strict may undermine the ability of the public to scrutinise the investment project, and of people adversely affected by the project to claim their rights. When regulating confidentiality in contracts, genuine commercial concerns need to be balanced with the public interest. There are some ways to do this including:

- If the contractual relationship involves sharing genuinely sensitive commercial information (for instance, concerning the investor's cost structures in exploration and development), a confidentiality clause may be included to protect these specific aspects. In these cases, it is necessary to clearly define what type of information is confidential and therefore protected, and for the parties to have to prove on a case-by-case basis that a particular piece of information falls within that category;

- Clauses prohibiting the disclosure of confidential information without the consent of both parties can be qualified by language requiring that such consent cannot be unreasonably withheld or delayed. They can also clarify that if the public interest outweighs commercial considerations, information should be made public;

- Protection of confidential information can also be subject to exceptions concerning disclosure required by law (including not only stock exchange regulations, as is frequently done, but also freedom of information legislation), or for the purpose of protecting health, safety and the environment, particularly in emergency situations;

- As a public policy tool, it is good practice for the contract itself not to be confidential; if specific aspects of the contract constitute genuinely confidential information, they may be redacted before publication;

- Separate, more stringent clauses may be used to protect from disclosure proprietary information, particularly in contracts involving technology transfers.

Box 13. Examples of confidentiality clauses

Denmark's Model License of 2005 for the Exploration and Production of Hydrocarbons (quoted in Rosenblum and Maples, 2009)

'[Information can be disclosed if] no legitimate interest of the Licensee requires the information to be kept confidential; essential public interests outweigh Licensee's interest in maintaining confidentiality […].'

Best practice clause proposed by Rosenblum and Maples (2009)

'This Agreement will be published in [government gazette/federal register] or publicly available at [ministry website / ministry library / parliamentary records]. Information in relation to activities under these agreements shall be kept confidential if requested by a Party, to the extent that such Party establishes that confidentiality is necessary to protect business secrets or proprietary information. Such confidentiality is subject to [relevant disclosure laws], as well as to applicable laws and regulations, including stock exchange and securities rules, and requirements for the implementation of the Extractive Industries Transparency Initiative.'

Further reading

Goldwyn, D.L. (ed) (2008) *Drilling Down – The Civil Society Guide to Extractive Industry Revenues and the EITI*. Revenue Watch Institute, Washington DC. http://www.revenuewatch.org/news/publications/drilling-down.php.

Rosenblum, P. and S. Maples (2009) *Contracts Confidential: Ending Secret Deals in the Extractive Industries*. Revenue Watch Institute, Washington DC. http://www.revenuewatch.org/news/publications/RWI-Contracts-Confidential.pdf

For more information about the Aarhus Convention, visit the following websites: http://www.unece.org/env/pp/ and http://aarhusclearinghouse.unece.org/.

For more information about the Extractive Industries Transparency Initiative, visit http://eitransparency.org/.

A role-play[17]

This section provides the basis for a more interactive part of training sessions based on this guide: a role-play. Parts A and B of the section are for all training participants. Part-C briefings are for the relevant group only, and should be printed/photocopied and distributed to each group individually.

Part A – Setting it up

Steps

- Create four groups among the participants:
  - Government;
  - Investors;
  - Lenders;
  - Civil society organisations;
- Based on short briefing notes tailored to each group, participants in plenary discuss the task – to develop a negotiating position and strategy on a specific aspect of an investment contract: environmental assessment and standards;
- Each group discusses its own strategy, developing a negotiating *position* on the environmental standards to apply to the project (should there be an environmental impact assessment? If so how should it be carried out, with what monitoring and for how long?), and a negotiating *strategy* (what levers may be applied to achieve the group's goals?);
- During group work, bilateral contact between two groups, public or otherwise, is possible – for example, a group may send a delegation to exchange with another group;
- Back in plenary, each group presents its negotiating position and strategy to the other groups;
- In plenary, participants discuss negotiating positions and strategies – why are certain groups taking a certain position, why are they are using those particular levers?
- Participants vote on the most successful group – who carried the day? Participants cannot vote for their own group.

Rules of the game

- Members of one group may consult with members of another;
- Groups may form alliances – for instance, civil society may (or may not!) seek to link up with lenders to push for higher environmental standards;
- Assigned roles must be maintained during the course of the game;
- Group members may consult with facilitators to clarify roles and procedure.

17. Linda Siegele and Emma Wilson provided extensive and invaluable input to this section.

Part B – The context (to be distributed to all groups)

Major oil reserves were discovered earlier this year in Petrostan, a country otherwise mainly dependent on agriculture, fishing and some manufacturing. Apart from old-fashioned fields developed and largely abandoned a long time ago, Petrostan has no significant petroleum experience. Lacking capital, modern technology and knowhow, the government of Petrostan is hoping to attract private sector investment.

Complex negotiations for an oil production contract and a pipeline-related host government agreement (HGA) are ongoing with Oil-for-Profit Plc, a global industry leader that has led exploration activities in Petrostan. Oil-for-Profit Plc is hoping that, once contracts are finalised, much of the funding for the pipeline might be obtained from Stash-of-Cash Plc, a large international commercial bank subscribing to the Equator Principles.

The production contract and HGA must be approved by the Petrostan Parliament to become effective. MPs sitting on the parliamentary Energy Committee have signalled in the media that they might be prepared to invite input from civil society – organised in an umbrella grouping called Coalition for Civil Society Action for Sustainable Development - before approving the contracts.

Negotiations between Petrostan and Oil-for-Profit Plc are difficult due to disagreement on key issues like the nature of the production contract – with the state favouring a joint venture, the investor a PSA. It seems that a draft contract does exist, but its shape and content are unknown to those not directly involved in negotiations.

Most recently, negotiations have stalled over disagreement about a specific issue – the definition of environmental standards applicable to the project. Given recent environmental advocacy by civil society in neighbouring Mineland and the effects of a global campaign against one of the leading mining companies working there, defining environmental standards is proving a central issue in the negotiation.

Petrostan's existing Environment Code was adopted in the 1970s and is largely outdated. The Code does require an environmental impact assessment (EIA), but provides no details as to how it should be carried out. An EIA was carried out under these rules before exploration, but its scope and findings are not public. Last year, the government (through the Environmental Protection Agency) drafted a new bill that would bring environmental legislation in line with the most recent international developments.

Among other things, the bill introduces more stringent EIA requirements (for example, new EIAs will need to include a local consultation process). It also removes the need to prove negligence in establishing corporate liability for certain types of environmental damage and for specific industries seen as high-risk ('strict liability'). As a result of this reform, strict liability would apply to environmental damage caused by oil spills.

Petrostan has ratified an investment treaty with Thirstland, the home country where Oil-for-Profit Plc is based, including a provision on direct access to arbitration; key international human rights treaties; and the Aarhus Convention, an international treaty which grants the public rights regarding access to information, public participation and access to justice in governmental decision-making processes on matters concerning the environment.

Part C – Briefings for each group

Part-C briefings are only intended for the relevant group and should not be shown to the other groups. This is important to the game, as it reflects the information asymmetries arising in real-life negotiations.

Group 1. Government of Petrostan

Motivations

- Maintain sovereignty over natural resources;
- Determined to start commercial operations as soon as possible, so as to generate revenues to rescue troubled public finances, and create employment and local benefits ahead of next year's general elections;
- Pursue a joint-venture arrangement between Oil-for-Profit and the national oil company, so as to maximise revenues and build national capacity (the current draft contract is for a PSA);
- Keep negotiations and contracts confidential;
- Maximise local content requirements so as to increase local employment and business opportunities;
- Transfer of technology and know-how, including the improvement of environmental performance;
- Conflicting concerns regarding environmental standards. The EIA undertaken before exploration was minimalistic. Given the weak legislation in force, keeping that EIA confidential and referring to it as valid may enable the project to go ahead without a new EIA. The Environmental Protection Agency wants to push through the new Environment Bill. But the national oil company is concerned that the more stringent EIA/consultation requirements may delay revenues, employment and business opportunities. The national oil company is also concerned that the new liability rules may scare investors off and may have negative implications for local-content contractors.

Limitations

- Capacity: lacks risk capital and technical/human resources – ultimately needs the investor in;
- Corruption – how to ensure that government negotiators pursue the country's public good?
- Lack of communication between central government agencies and local administration.

Group 2. Oil-for-Profit Plc – The investor

Motivations

- Profits to shareholders:
  - Ensure long-term viability of investment;
  - Reduce costs;
  - Mitigate risk;
- World leader in the industry and with advanced technology and know-how – but concerns about the financial health of the company increase pressure to start production as soon as possible so as to generate revenues and consolidate market shares;
- Because of this pressure and in spite of a commitment to minimising environmental harm, the company is concerned about subjecting the project to the new Environment Bill and its more demanding (and time-consuming) EIA process. The EIA undertaken before exploration was minimalistic; but given the weak legislation in force, keeping that EIA confidential and referring to it as valid may enable the project to go ahead without a new EIA;
- Pursue a PSA (the current draft contract is for a PSA); concerned that a joint venture with the national oil company would not work due to lack of national capacity and risk capital;
- Keep negotiations and contracts confidential to protect commercial interests;
- Ensure predictability in the regulatory framework: particularly concerned about possible changes to environmental legislation, especially the new liability rules, which may significantly increase project costs. It is estimated that it would be difficult or very costly to get proper insurance cover for that type of environmental liability;
- Maintain world-wide corporate reputation and avoid adverse campaigning (e.g. from environmental groups);
- Secure effective financing mechanisms – need lenders for project to go ahead (not enough corporate finance to fund the pipeline).

Limitations

- Difficult to understand workings within host country decision-making;
- Reputational risk – need to keep civil society and local populations reasonably happy;
- Needs lenders in.

Group 3: Stash-of-Cash Plc – The lender

Motivations

- Pursue commercial goals through lending that maximise returns whilst minimising risks;
- Ready to lend to the project if this can start generating revenues early enough. Concerned that some of the provisions of the new Environment Bill may delay revenues (tighter EIA requirements);
- Keep negotiations and contracts confidential to protect commercial interests;
- Keen to have some direct host government involvement in the project for mitigating political risk;
- Ensure predictability in the regulatory framework: particularly concerned about possible changes in environmental legislation, especially the new liability rules, which may increase project costs. It is estimated that it would be difficult or very costly to get proper insurance cover for that type of environmental liability;
- Having subscribed to the Equator Principles, ensure compliance with applicable social/ environmental standards, including IFC performance standards;
- Maintain world-wide corporate reputation and avoid adverse campaigning (e.g. from environmental groups);
- Concerned that increasing local content requirements in contexts with weak local business capacity may compromise environmental standards.

Limitations

- Reputational risk – need to keep civil society and local populations reasonably happy.

Group 4. Coalition for Civil Society Action for Sustainable Development (COCSASD) – Civil society organisations

Motivations

- Promote community welfare, environmental protection, public participation in decision-making and ensure that these issues are taken seriously in ongoing contract negotiations;
- Determined that new activities with major potential environmental impacts like petroleum must be regulated by the new Environment Bill rather than the outdated legislation in force;
- Concerned that government, investor and lender pressures for commercial operations to start soon may result in corners being cut, for instance with the EIA;
- Convinced that the EIA carried out was minimalistic, determined to gain access to it (note that Petrostan has ratified the Aarhus Convention);
- Leave room for improving environmental standards over the duration of the proposed project as needed;
- Concerned that a joint venture arrangement with a newly established oil company and tight local content requirements in contexts with weak local business capacity may compromise environmental standards (including, in the case of the joint venture, due to possible conflicts of interest between the state's role as regulator and its equity stake in the project).

Limitations

- No history of government inclusion of civil society;
- Divisions amongst campaigning groups;
- Lack of awareness / support within communities.

References

Literature

A4ID (2008a) *At a Glance Guide to Arbitration*. Advocates for International Development, London. http://www.a4id.org/at-a-glance-guides/default.aspx.

A4ID (2008b) *At a Glance Guide to Amicus Curiae & International Investment Arbitrations*. Advocates for International Development, London. http://www.a4id.org/at-a-glance-guides/default.aspx.

Ayine, D.M. (2008) *Social Responsibility Agreements in Ghana's Forestry Sector*. IIED, London. http://www.iied.org/pubs/display.php?o=12549IIED.

Barclay, R. and G. Koppert (2007) "Chad Resettlement and Compensation Plan –Evaluation Study", study jointly commissioned by the International Finance Corporation and Esso Exploration and Production Chad Inc., Groupe d'Etude des Populations Forestières Equatoriales, Paris. http://siteresources.worldbank.org/INTOGMC/Resources/chad_resettlement_evaluation_report.pdf.

Bernardini, P. (2008) "Stabilization and Adaptation in Oil and Gas Investments", *Journal of World Energy Law & Business* 1(1): 98-112.

Cameron, P.D. (2007) "Stabilization in Investment Contracts and Change of Rules by Host Countries: Tools for O & G Investors", Association of International Petroleum Negotiators. http://www.aipn.org/modelagreements/research.asp.

Campbell, B. (ed) (2009) *Mining in Africa – Regulation and Development*. Pluto Press, London and New York.

De Schutter, O. (2009) "Large-Scale Land Acquisitions and Leases: Eleven Principles to Address the Human Rights Challenge", Statement issued by the UN Special Rapporteur on the Right to Food, 11 June, available at http://www.srfood.org/index.php/en/documents-issued/other-documents-issued.

Eaton, C. and A. W. Shepherd (2001) *Contract Farming; Partnerships for Growth*. FAO, Rome. http://www.fao.org/DOCREP/004/Y0937E/y0937e00.htm#toc.

FAO (2008) *Compulsory Acquisition of Land and Compensation*. Food and Agriculture Organization of the UN, Rome. http://www.fao.org/docrep/011/i0506e/i0506e00.htm.

Fitzgerald, A. (2005) "Mining Agreements in the Regulation of the Australian Minerals Sector", in Bastida, E., T. Wälde and J. Warden-Fernandez (eds) *International and Comparative Mining Law*. Kluwer law International, The Hague.

Goldwyn, D.L. (ed) (2008) *Drilling Down – The Civil Society Guide to Extractive Industry Revenues and the EITI*. Revenue Watch Institute, Washington DC. http://www.revenuewatch.org/news/publications/drilling-down.php.

Greenburg, S. (2009) *Thinking Beyond Share Equity Schemes in Land Reform: How about Going Small?* South African Civil Society Information Service, Johannesburg. http://www.sacsis.org.za/site/News/detail.asp?iData=357&iCat=253&iChannel=1&nChannel=News

Hewitt, I. (2001) *Joint Ventures*, 2nd ed. Sweet & Maxwell, London.

IFC (2006a) *Performance Standard 1: Social and Environmental Assessment and Management System*. International Finance Corporation, Washington DC. http://www.ifc.org/ifcext/sustainability.nsf/Content/PerformanceStandards.

IFC (2006b) *Performance Standard 5: Land Acquisition and Involuntary Resettlement*. International Finance Corporation, Washington DC. http://www.ifc.org/ifcext/sustainability.nsf/Content/PerformanceStandards.

IPIECA (2004) *A Guide to Social Impact Assessment in the Oil and Gas Industry*. International Petroleum Industry Environmental Conservation Association, London. http://www.ipieca.org/activities/social/downloads/publications/sia_guide.pdf.

Jull, C., P.C. Redondo, V. Mosoti and J. Vapnek (2007) *Recent Trends in the Law and Policy of Bioenergy Production, Promotion and Use*. Legal Paper Online 68. FAO, Rome. http://www.fao.org/legal/prs-ol/lpo68.pdf.

Kaul, R. and A. Heuty, with A. Norman (2009) *Getting a Better Deal from the Extractive Sector – Concession Negotiation in Liberia, 2006-2008*. Revenue Watch Institute, Washington DC. http://www.soros.org/resources/articles_publications/publications/liberia_20090302.

Majid-Cooke, F. (2002) "Vulnerability, Control and Oil Palm in Sarawak: Globalization and a New Era?", *Development and Change* 33: 189-211.

Maniruzzaman, A.F.M. (2008) "The Pursuit of Stability in International Energy Investment Contracts: A Critical Appraisal of the Emerging Trends", *Journal of World Energy Law & Business* 1(2): 121-157.

Mann, H., K. von Moltke, L.E. Peterson and A. Cosbey (2006) *Model International Agreement on Investment for Sustainable Development – Negotiators' Handbook,* 2nd Ed. IISD, Winnipeg. http://www.iisd.org/investment/model/.

MMSD (2002) *Breaking New Ground: Mining, minerals and sustainable development*. IIED, London. http://www.iied.org/pubs/display.php?o=9084IIED.

Muchlinski, P. (2007) *Multinational Enterprises and the Law*. 2nd Ed. Oxford University Press, Oxford.

Peterson, L.E., and K.R. Gray (2003) "International Human Rights in Bilateral Investment Treaties and in Investment Treaty Arbitration". IISD, Winnipeg.

Radon, J. (2005) "The ABCs of Petroleum Contracts: License-Concession Agreements, Joint Ventures, and Production-Sharing Agreements", in Tsalik, S., and A. Schiffrin (eds) *Covering Oil: A reporter's Guide to Energy and Development*. Open Society Initiative, New York. http://archive.revenuewatch.org/reports/072305.shtml.

Rosenblum, P, and S. Maples (2009) *Contracts Confidential: Ending Secret Deals in the Extractive Industries*, Revenue Watch Institute, Washington DC. http://www.revenuewatch.org/news/publications/RWI-Contracts-Confidential.pdf.

Ruggie, J. (2008) "Protect, Respect and Remedy: A framework for business and human rights", Report of the UN Special Representative to the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Entities, 7 April, UN Doc. A/HRC/8/5. http://www.unglobalcompact.org/docs/issues_doc/human_rights/Human_Rights.../29Apr08_7_Report_of_SRSG_to_HRC.pdf.

Shemberg, A. (2008) *Stabilization Clauses and Human Rights*, A research project conducted for the International Finance Corporation and the United Nations Special Representative to the Secretary General on Business and Human Rights, March 11. http://www.ifc.org/ifcext/sustainability.nsf/AttachmentsByTitle/p_StabilizationClausesandHumanRights/$FILE/Stabilization+Paper.pdf.

Stein, S.W. (2005) "Non-Fiscal Elements in Petroleum Production Sharing Agreements in Developing Countries", *Oil, Gas & Energy Law Intelligence* (OGEL), Vol. 3, Issue 1. http://www.gasandoil.com/ogel.

Tanner, C., and S. Baleira (2006) "Mozambique's Legal Framework for Access to Natural Resources: the impact of new legal rights and community consultations on local livelihoods", FAO LSP Working Paper No. 28. FAO, Rom. http://www.fao.org/es/esw/lsp/policy.html.

UNCTAD (2009) *World Investment Report 2009 – Transnational Corporations, Agricultural Production and Development*. United Nations Conference on Trade and Development, Geneva and New York. http://www.unctad.org/templates/WebFlyer.asp?intItemID=5037&lang=1.

UNCTAD (2008) *World Investment Report 2008 – Transnational Corporations and the Infrastructure Challenge*. United Nations Conference on Trade and Development, Geneva and New York. http://www.unctad.org/Templates/webflyer.asp?docid=10502&intItemID=4629&lang=1&mode=downloads.

UNECA (2002) *Managing Mineral Wealth – Training Materials on Management of Mineral Wealth and the Role of Mineral Wealth in Socio-economic Development*. United Nations Commission for Africa, Addis Ababa. http://uneca.org/eca_resources/Publications/sdd/Mining_%20modules_final.pdf

Vermeulen, S. and N. Goad (2006) *Towards Better Practice in Smallholder Palm Oil Production*. IIED, London. http://www.iied.org/pubs/display.php?o=13533IIED.

Wells, L.T. Jr. and D. N. Smith (1976) *Negotiating Third World Mineral Agreements: Promises as Prologue*. Ballinger, Cambridge MA.

World Commission on Dams (2000) *Dams and Development: A New Framework for Decision-Making*. Earthscan, London.

World Commission on Environment and Development (1987) *Our Common Future: Report of the World Commission on Environment and Development* ("Bruntland Report"), Annex to UN Doc A/42/427, 4 August 1987. Available at http://www.un-documents.net/wced-ocf.htm.

Cases

AGIP Company v. People's Republic of the Congo, Award, 30 November 1979, 21 (1982) ILM 726.

Alexkor Ltd v. Richtersveld Community and Others, Constitutional Court of South Africa, (2003) CCT19 [South Africa].

BACONGO v Department of the Environment and Belize Electric Company Ltd, [2004] UKPC 6, Judgement of the Judicial Committee of the Privy Council, 29 January 2004 [Belize].

Biwater Gauff (Tanzania) Ltd. v United Republic of Tanzania, Procedural Order No 5, 2006, ICSID Case No. ARB/05/22, 2 Feburary 2007.

Ceskoslovenska Obchodni Banka A.S. v. Slovak Republic, Award, ICSID Case No. ARB/97/4, December 29, 2004.

Compañía de Aguas del Aconquija SA and Vivendi Universal v. Argentina, Award of 21 November 2000 16 *ICSID Rev.—FILJ* 641 (2001); and Decision on Annulment, 3 July 2002, 19 *ICSID Rev.—FILJ* 89 (2004).

Duke Energy International Peru Investments No. 1 Ltd. v. Republic of Peru, Award, 18 August 2008, ICSID Case No. ARB/03/28.

Glamis Gold Ltd. v. United States of America, Award, 14 May 2009, NAFTA Arbitration under UNCITRAL Arbitration Rules.

Government of Kuwait v. American Independent Oil Co. (Aminoil), 24 March 1982, 21 ILM 976.

Maya Indigenous Communities of the Toledo District v. Belize, Inter-American Commission of Human Rights, Report No. 40/04, Case 12.053, 12 October 2004, http://www1.umn.edu/humanrts/cases/40-04.html.

Mayagna (Sumo) Awas Tingni Community v. Nicaragua, Inter-American Court of Human Rights, Judgement, 31 August 2001, http://www1.umn.edu/humanrts/iachr/AwasTingnicase.html.

Methanex Corp. v United States of America, Decision of the Tribunal on Petitions from Third Persons to Intervene as *Amici Curiae*, 15 January 2001.

Methanex Corp. v. United States of America, ICSID Final Award, 3 August 2005, http://www.state.gov/documents/organization/51052.pdf.

Ministère Public v. Samba Mariko, Chô Mariko et Sirakorontji Mariko, Justice de Paix ACE de Bougouni (Mali), 26 June 2008.

Mobil Investments Canada Inc. and Murphy Oil Corporation v. Canada, ICSID Case No. ARB(AF)/07/4 (pending).

Parkerings-Compagniet AS v. Lithuania, Award, 11 September 2007, ICSID Case No. ARB/05/8, available at http://ita.law.uvic.ca/documents/Pakerings.pdf.

Revere Copper & Brass, Inc. v. Overseas Private Investment Corporation (OPIC), Arbitral Tribunal, 24 August 1978, 56 ILR 257.

Saramaka People v. Suriname, Inter-American Court on Human Rights, Judgement, 28 November 2007, www.forestpeoples.org/.../suriname_iachr_saramaka_judgment_nov07_eng.pdf.

Sawhoyamaxa Indigenous Community v. Paraguay, Inter-American Court on Human Rights, Judgement, 29 March 2006, http://www1.umn.edu/humanrts/cases/12-03.html.

Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v. Mongolia, Arbitration under UNCITRAL Rules, Order on Interim Measures, 2 September 2008, available at http://ita.law.uvic.ca/.

Survival International v. Vedanta Resources Plc, UK National Contact Point for the OECD Guidelines for Multinational Enterprises, Complaint from Survival International against Vedanta Resources Plc, Final Statement, 25 September 2009, http://www.oecd.org/document/59/0,3343,en_2649_34889_2489211_1_1_1_1,00.html.

Texaco Overseans Petroleum Company and California Asiatic Oil Company v. The Government of the Libyan Arab Republic, 19 January 1977, 53 ILR 389.

Contracts

While many investment contracts are confidential, some of the contracts referred to in this guide are available on the internet (the revenant relevant industry is indicated in brackets):

Agreement between the Government of the Republic of Sierra Leone and Sierra Rutile Limited, 20 November 2001, available at http://www.sierra-leone.org/Laws/2002-4.pdf [mining].

Amended and Restated Concession Agreement between the Republic of Liberia and Firestone Liberia Inc, 22 February 2008, available at www.revenuewatch.org/news/publications/RWI_Liberia_Firestone.pdf [agriculture].

Amended Mineral Development Agreement among the Government of the Republic of Liberia, Mittal Steel (Liberia) Holdings Limited and Mittal Steel Holdings A.G., 28 December 2006, available at www.revenuewatch.org/news/publications/RWI_Liberia_Mittal.pdf [mining].

Contract Farming Agreement between Varun Agriculture SARL and Each Association of 13 (Thirteen) Different Plains (Bemanevika, Bekapila, Mahatsinjo, Ambohitoaka, Mahadrodroka, Manandriana, Ankaizina i, Ankazina ii, Bealanana, Maevarano, Amparay, Ankobalava, Ampatsifatsy) in Sofia Region [Madagascar], signed on 26 January 2009, available at http://farmlandgrab.org/2849 [agriculture].

Host Government Agreement between and among the Government of the Republic of Turkey and the State Oil Company of the Azerbaijan Republic, BP Exploration (Caspian Sea) Ltd., Statoil BTC Caspian AS, Ramco Hazar Energy Limited, Turkiye Petrolleri A.O., Unocal BTC Pipeline Ltd., Itochu Oil Exploration (Azerbaijan) Inc., Delta Hess (BTC) Limited, signed on 19 October, 2000, available at www.foe.co.uk/resource/evidence/turkey_btc_agreement.pdf [oil].

International Project Agreement for the West African Gas Pipeline, concluded on 22 May 2003 between Benin, Ghana, Nigeria, and Togo, on the one hand, and the West African Gas Pipeline Company Ltd, on the other, available at http://41.204.59.211:81/ind.php?rpt=1 [gas].

Model Intergovernmental and Host Government Agreements for Cross Border Pipelines, Energy Charter Secretariat, Second Edition, 2007, http://www.encharter.org/index.php?id=182 [oil and gas].

Roxby Downs Indenture [Australia], signed on 3 March 1982, available at http://www.austlii.edu.au/au/legis/sa/consol_act/rdra1982384/sch1.html [mining].

Some governments post contracts on the web. For example, tens of mining contracts are available online from countries like Australia (websites vary depending on the state – see e.g. http://www.slp.wa.gov.au/legislation/statutes.nsf/main_mrtitle_466_currencies.html for Western Australia) and the Democratic Republic of Congo (a full list of contracts available for download can be found at http://www.minfinrdc.cd/contrats_partenariat.htm).

International, freely accessible databases of contracts exist for some types of agreements – see for example the database of 'contract farming' arrangements at the FAO Contract Farming Resource Centre (http://www.fao.org/ag/ags/contract-farming/toolkit/contract-links/en/?no_cache=1).

Finally, contracts may be downloaded for a fee from online databases operated on a commercial basis, such as the Barrows collection (http://www.barrowscompany.com/) and the Oil, Gas & Energy Law (OGEL) portal (http://www.ogel.com).

Natural Resource Issues

IIED's Natural Resource Issues series aims to present timely, easy to read, peer-reviewed material on cross-cutting themes of significance to natural resource sectors, including biodiversity, energy, forests, food and agriculture, land and water. Each issue reviews a selected issue of contemporary importance, describes some original work exploring it, and draws conclusions that are particularly relevant for policy makers, researchers and other protagonists in the field concerned.

Other reports in the Natural Resource Issues Series are available from IIED on request and can be downloaded from www.iied.org:

1. Rural livelihoods and carbon management. 2000. Bass *et al*.

2. Laying the foundations for clean development: preparing the land use sector. A quick guide to the clean development mechanism. 2002. Auckland *et al*.

3. Integrating global and local values: a review of biodiversity assessment. 2002. Vermeulen and Koziell.

4. Local action, global aspirations: The role of community conservation in achieving international goals for environment and development. 2006. Roe *et al*.

5. Towards better practice in smallholder palm oil production. 2006. Vermeulen and Goad.

6. Environment at the heart of Tanzania's development: Lessons from Tanzania's National Strategy for Growth and Reduction of Poverty (MKUKUTA). 2007. Assey *et al*. (also available in Swahili).

7. Fair deals for watershed services in Bolivia. 2007. Asquith and Vargas.

8. Fair deals for watershed services in the Caribbean. 2007. McIntosh and Leotaud.

9. Fair deals for watershed services in Indonesia. 2007. Munawir and Vermeulen.

10. Fair deals for watershed services in India. 2008. Agarwal *et al*.

11. All that glitters: A review of payments for watershed services in developing countries. 2008. Porras *et al*.

12. Fair deals for watershed services in South Africa. 2008. King *et al*.

13. Fair deals for watershed services: Lessons from a multi-country action-learning project. 20010. Bond and Mayers.

14. Creating and protecting Zambia's wealth: Experience and next steps in environmental mainstreaming. 2009. Aongola *et al*.

15. Tenure in REDD: Start-point or afterthought? 2009. Cotula and Mayers.

16. Incentives to sustain forest ecosystem services: A review and lessons for REDD. 2009. Bond *et al*.

17. Water ecosystem services and poverty under climate change: Key issues and research priorities. 2009. Mayers *et al*.

18. Community management of natural resources in Africa: Impacts, experiences and future directions. 2009. Roe *et al*. (also available in French).

19. Sharing the benefits of large dams in West Africa. 2009. Skinner *et al*. (also available in French).

To contact IIED regarding the Natural Resource Issues series please email the Series Editor,
James Mayers – james.mayers@iied.org or the Series Coordinator, Nicole Armitage – nicole.armitage@iied.org

Investment contracts and sustainable development: How to make contracts for fairer and more sustainable natural resource investments

Economic liberalisation, improved transport and communication systems, and the global demand for energy, minerals and agricultural commodities have fostered natural resource investment in many lower- and middle-income countries. Increased investment may create opportunities to improve living standards, but it also creates risks such as environmental damage and loss of key livelihood assets like land, water and grazing. Investment contracts define the terms of an investment project and the extent to which it advances – or undermines – sustainable development. Government capacity to negotiate and manage contracts and civil society capacity to scrutinise government dealings can make a real difference to getting a better deal from natural resource investment. Drawing on test trainings in Ghana and Central Asia and targeting host governments and civil society, this guide discusses how to structure investment contracts for natural resource projects in ways that maximise the investment's contribution to sustainable development.

Natural Resource Issues No. 20

ISBN: 978-1-84369-765-7
ISSN: 1605-1017

International Institute for Environment and Development