

# Chapter 5

Related General Guidance  
for Contracts



## Chapter 5

# Related General Guidance for Contracts

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Previous chapters have addressed some of the specific issues around procedural and substantive rights and obligations in relation to environmental, social and economic clauses in investment contracts. But for them to be effective there must also be a range of surrounding processes and obligations that apply not just to these issues but to the contract as a whole. It is to this set of issues that we turn now.

### 5.1 Ensure third-party rights are protected

The sudden burst of on-site activities during the feasibility study and ESIA stages can signal to local communities the possible magnitude of the development impacts to come from the proposed project, both positive and negative. From this stage on, the project proponent will have to manage the concerns and expectations of the local officials and communities, while moving the project activities forward. Engagement with local communities will help reveal their needs and wants, and the project proponent will be making commitments to address them. Promises will also be made informally in casual encounters with community members (such as a pledge to keep dust and noise down during construction or to pay compensation for domestic animals being run over). The proponent will have to be extremely vigilant in capturing all these commitments, large and small. In some cases, commitment registries are used to memorialise commitments made and to display them transparently for all to see. In most cases, they are enshrined in the ESMP or other plans or agreements. Regardless of the methods used, it is key that communities trust the project to capture and honour commitments.

Commitments can be memorialised on paper, but this will not give people the legal right of enforcement, unless conscious efforts are made to create such right. Commitment registries and benefit plans, if publicly disclosed, can create a moral obligation

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for the project and possible enforcement by public sentiment, but not necessarily a legal obligation. If the project is receiving financing from one or more multilateral development banks (MDBs), implementation of the plans required to mitigate negative impacts under the MDBs' environmental and social safeguard policies or standards will be covenanted by the borrower (the project proponent) in the loan agreement. This will be a legally enforceable obligation, enforceable by the MDBs. Yet even these long-term lenders will stay with the project for only a few years, whereas the project life will likely extend to up to three decades. The investment contract is one of the better places to enshrine commitments, so that the contracting authority can monitor and enforce them in the case of failure to implement. Another way to create legal leverage is to turn the commitments into an agreement with local communities, or another third party.

In the case of large-scale or complex commitments, especially those designed as mitigation to negative impacts, such as large-scale resettlement, community economic development programmes, indigenous people's development plans, or biodiversity offsets, a free-standing plan is desirable to ensure proper documentation, implementation and follow-up. The plans should be referenced in the contract. This way, at least the contracting authority is in a position to require that the private operator implement the plans. Even in these cases, communities do not have a direct right of enforcement, unless the contract specifically names them as third-party beneficiaries. Hence, a third-party beneficiary clause in favour of the beneficiaries of various mitigation plans in an investment contract is one way of ensuring a contractual right and leverage of affected persons. Another intermediary measure would be to state that material non-compliance with mitigation plans should attract the same sanctions as material non-compliance with the contract provisions themselves (also see Section 4.4).

A direct agreement between the project and the local authority and/or one or more representatives of the affected community will be a superior instrument for ensuring legal enforceability. Community development agreements (CDAs) are frequently used in the extractives sector to assure the affected communities of local economic and social development, including the funding obligation. This is often done as a mitigation measure to community-wide impacts from projects; it is also a way to

share the project's wealth with communities and to maintain the project's social licence to operate. Close to 40 jurisdictions mandate community development in mining laws (though not necessarily CDAs), many of which are Commonwealth jurisdictions.<sup>1</sup> CDAs are particularly prevalent when indigenous peoples' land, rights or interests may be implicated in the project. Ample examples of CDAs exist and can be searched in CCSI's database. Some agreements are structured as a tripartite agreement between the project, local government, and the affected communities, in order to ensure enforceability and protection of all parties' rights and interests. There are no technical reasons why similar arrangements cannot be used in other sectors to ensure that communities are able to enforce community development and other commitments that run to them.

Formal agreements are also used in the case of complex mitigation arrangements that require an active role for a third party. For instance, a biodiversity offset and management plan may require a non-governmental organisation (NGO) as an offset manager, whose terms of engagement would be best captured in an agreement between the project and the NGO, rather than a reference in the investment contract. In rare cases, communities can be offered an opportunity to purchase equity in the project company.

### **Box 5.1 Ensuring community ownership through purchase of equity in the project company**

The Model Project Development Agreement for the Government of Nepal for hydroelectricity projects of less than 500MW contemplates the possibility of project-affected people purchasing equity in the project company:

[Section 15.5] 'All Project Affected People required to be resettled and rehabilitated as a result of the Project, including all persons residing permanently in the district of the Project Area at the date on which the construction activities for the Project commence, may, by written notice to the Company and/or the GON [the Government of Nepal] in the period from the Effective Date to two years beyond COD [commercial operation date], exercise an option to purchase up to a ..... equity share in the Company at face value. On receipt of such notice, the Company shall make arrangements to sell the requested equity share in the Project to such people in consultation with the GON.'

Such an arrangement will obviously have to be finalised via a direct contractual agreement between the project company and the purchaser of the shares.

**Source:** Model Project Development Agreement (for Hydropower Projects with installed capacity less than 500MW) (Nepal).

A material failure to implement the agreements, or persistent failure to correct breaches of agreements should be designated as a breach of the investment contract and should attract the same sanctions as material non-compliance with the contract provisions themselves. However, it is generally the case that affected stakeholders would prefer breaches of commitments to be rectified amicably and flexibly rather than to pursue judicial or arbitral remedies.

### **Guidance VIII: Respecting third-party rights**

- ✓ The social, environmental and economic rights and benefits for local communities should be enforceable by the local communities, and not only by the contracting authority.
- ✓ Community development agreements and other third-party agreements are the best vehicle for creating direct legal right of enforcement by communities or other affected third parties.
- ✓ When plans are used and mentioned as mandatory in the contract, the contract could name the third parties as third-party beneficiaries under the contract.
- ✓ A material failure to implement the plans or agreements, or persistent failure to correct breaches of plans or agreements should be designated as a breach of the investment contract and should attract the same sanctions as material non-compliance with the contract provisions themselves.

## **5.2 Transparency of contracts<sup>2</sup>**

Transparency underpins sustainable development in multiple ways. Prior disclosure of project information greatly aids the quality of participation of project-affected people in consultation, which in turn can contribute to improved project design and outcomes. Disclosure of project information allows local communities to understand the nature and scope of project commitments, which in turn enables them to participate in project monitoring and enforce obligations that affect them. Transparency, as a governance and human rights concept, is a prerequisite for accountability of both the contracting authority and the private operator. And transparency is a means to eradicate corruption throughout the project life cycle, including in bidding and construction stages. Beyond these project-level benefits are broader benefits. Some governments have reasoned that transparency of investment can enhance their reputation and stimulate additional investment.

*Transparency, as a governance and human rights concept, is a prerequisite for accountability of both the contracting authority and the private operator, as well as a means to eradicate corruption.*

In the extractives sector, transparency of projects and contracts has been a recognised industry best practice for two decades, and many contracts are publicly available in well-organised databases, as already mentioned above. However, not all governments and investors follow this best practice. To support this or similar best practice, and to encourage the infrastructure and other sectors to follow suit, this Resource advocates for transparency commitments to be embedded in the investment contract, and for the lawyer to advocate for transparency throughout the project life cycle.

An investment contract should not constrain the contracting parties to keep the terms of the parties' agreement confidential; instead, it should set out the principle of presumption in favour of disclosure, and allow the parties to freely disseminate key project information, such as the ownership structure of the project company, the financial structure of the project (especially the financial incentives offered by the government), the project contract, and the full monitoring information, such as the performance reporting by the private operator, and any reports generated by the project company for submission to the regulator (whether the contracting authority or another agency). If necessary, the parties should agree at the outset what may constitute proprietary business information or sensitive information that would not be subject to the presumption in favour of disclosure; however, they should be aware that much of this information may already be in the public domain. This is often the case with commercial information that is disclosed to industry press for promotional purposes. In some countries, the entire contract is part of parliamentary record and accessible by anyone who seeks it. Amendments and modifications to the contract should also be disclosed.

### **Box 5.2 Ghana's Petroleum Register**

In 2018, Ghana launched its new petroleum register, which discloses a wide range of information on the companies extracting the country's oil, including the actual contracts. It joins 29 countries that are members of the Extractive Industries Transparency Initiative (EITI) which have published at least some oil, gas and mining contracts.

**Source:** EITI (2018), 'The Journey to Contract Disclosure in Ghana' (blog), available at: <https://eiti.org/blog/journey-to-contract-disclosure-in-ghana>

**Box 5.3 Nigeria's transparency initiative:  
PPP contracts disclosure web portal**

Within the first 100 days of the administration of President Buhari, Nigeria pledged to promote transparency in all ministries and departments, and as part of such commitment, launched the Infrastructure Concession Regulatory Commission (ICRC) PPP Contracts Disclosure Web Portal in September 2017. The rationale for the Portal is to expose consistent project processing procedures from the project start in order to signal efficiency in its ability to process investments, to explain the important features of service standards and the PPP contract, and to demonstrate good project performance, while repelling corruption. This in turn is expected to attract additional foreign capital and expertise to bridge the infrastructure gap in Nigeria.

ICRC requires contract parties to disclose the following items on its portal:

- Financial structure of the SPV (special purpose vehicle)
- Redacted PPP contract
- Renegotiations and renegotiated contract
- Performance information

**Source:** ICRC (2017), 'PPP Contract Disclosure Portal: Key to Improvement of Infrastructure Deficit in Nigeria?', available at: <https://www.lexology.com/library/detail.aspx?g=eda7a188-1cc6-45ac-93d4-71c3e9cb3005>

Also see: World Bank (2016), *A Framework for Disclosure in Public-Private Partnership Projects*, available at: <https://www.worldbank.org/en/topic/publicprivatepartnerships/brief/a-framework-for-disclosure-in-public-private-partnership-projects>

Lawyers can play a valuable role in a project team, beyond providing mechanical legal advice. Clients look up to lawyers as a voice of reason and moral authority and expect to receive legal and even business or non-legal advice based on the lawyer's knowledge and direct experience. In this vein, lawyers can also be an advocate for transparency within governments, and push for disclosure portals and other disclosure mechanisms to make it easier for the public to access project information and contracts. The World Bank's Framework for Disclosure in PPPs (see Box 5.3) provides a blueprint for how this can be done in the context of PPPs for infrastructure projects, but the principles and approaches are equally relevant in other investment sectors and structures.



### **Guidance IX: Transparency of contracts**

- ✓ Each contracting party should be free to disclose the investment contract when concluded.
- ✓ If the contract contains truly sensitive or proprietary information, it can be redacted. It is important to note that redactions lead to questions as to what is withheld and why.
- ✓ An online, publicly accessible database can be used as an access point for public contracts.
- ✓ After material modification or amendment, the contract should be disclosed again.

### **Sample Text: Transparency**

#### **World Bank Guidance on PPP Contractual Provisions (2019) Section 10.3**

*[Note: These provisions were excerpted from the World Bank's Guidance on PPP Contractual Provisions. Although they are intended for PPP contracts, they will work well with contracts in other sectors. The authors of this Resource both provided extensive comments on the draft Guidance in an effort to improve its content from a sustainability perspective. While the overall quality of the Guidance is uneven, the provisions excerpted here have improved from the previous versions and represent a good reference point for lawyers. The drafting tips that appear in bubbles in the Guidance were deleted as they are technical and refer to other sections of the Guide.]*

#### **'Public Relations and Publicity**

1. The Private Partner shall not by its directors, officers, employees or agents, and shall procure that its Sub-contractors shall not, communicate with representatives of the press, television, radio or other communications media on any matter concerning the PPP Contract without the prior written approval of the Contracting Authority.
2. The Private Partner may not represent the views of the Contracting Authority on any matter, or use the name of the Contracting Authority in any written material provided to third parties, without the prior written consent of the Contracting Authority.

#### **Publication of the PPP Contract in the public domain**

3. The Parties agree that the provisions of this PPP Contract [and insert any other relevant documents defined as the Project Agreements] shall, subject to Clause (7) below, not be treated as Confidential Information and may be disclosed without restriction and the Private Partner acknowledges that the Contracting Authority, subject to Clause (7) below, is entitled to:
  - a. publish this PPP Contract [and some of the Project Agreements] on a website; and
  - b. publish (on the internet or otherwise) a summary of the PPP Contract [and the Project Agreements and any associated transaction document] which shall include

**Sample Text: Transparency (Continued)**

- i. the terms and conditions of the PPP Contract [and the Project Agreements and any associated transaction document] and
  - ii. any document or information arising out of or connected to the PPP Contract [and the Project Agreements and any associated transaction document], including performance of the PPP Contract [and the Project Agreements and any associated transaction document].
4. The Parties agree that Base Case Equity IRR information shall not be treated as Confidential Information and the Private Partner acknowledges that the Contracting Authority intends to publish such information on a website.
  5. The Parties agree that information in respect of any direct or indirect change in ownership which has actually taken place shall not be treated as Confidential Information.

**Confidentiality**

6. For purposes of this PPP Contract, 'Confidential Information' means:
  - a. information (however it is conveyed or on whatever media it is stored) the disclosure of which would, or would be likely to, prejudice the commercial interests of any person, trade secrets, commercially sensitive intellectual property rights and know-how of either Party, including all personal data and sensitive personal data; and
  - b. the sub-set of Confidential Information listed in Column 1 of Part I – Commercially Sensitive Contractual Provisions and Column 1 of Part II – Commercially Sensitive Material of Schedule [insert reference to the Commercially Sensitive Information Schedule] in each case for the period specified in Column 2 of Parts I and II of such Schedule ("Commercially Sensitive Information").
7. Clause (3) above shall not apply to Confidential Information which shall, subject to Clause (9) below, be kept confidential for the periods specified in Schedule [insert reference to the Commercially Sensitive Information Schedule].
8. The Parties shall keep confidential all Confidential Information received by one Party from the other Party relating to this PPP Contract [and any Project Agreements] or the PPP Project and shall use all reasonable endeavors to prevent their employees and agents from making any disclosure to any person of any such Confidential Information.
9. Clauses (7) and (8) above shall not apply to:
  - a. any disclosure of information that is reasonably required by any person engaged in the performance of their obligations under the PPP Contract for the performance of those obligations;
  - b. any matter which a Party can demonstrate is already, or becomes, generally available and in the public domain otherwise than as a result of a breach of this Clause [Confidentiality];
  - c. any disclosure to enable a determination to be made under Clause [insert reference to Dispute Resolution clause] or in connection with a dispute between the Private Partner and any of its sub-contractors;

**Sample Text: Transparency (Continued)**

- d. any disclosure which is required pursuant to [insert reference to legislation containing public disclosure obligations] as well as any other statutory, legal (including any order of a court of competent jurisdiction) or Parliamentary obligation placed upon the Party making the disclosure or the rules of any stock exchange or governmental or regulatory authority concerned;
- e. any disclosure of information which is already lawfully in the possession of the receiving Party, prior to its disclosure by the disclosing Party;
- f. any provision of information to:
  - i. the Parties' own professional advisers or insurance advisers; and/or
  - ii. the Lenders or the Lenders' professional advisers or insurance advisers or, where it is proposed that a person should or may provide funds (whether directly or indirectly and whether by loan, equity participation or otherwise) to the Private Partner to enable it to carry out its obligations under the PPP Contract, or may wish to acquire shares in the Private Partner in accordance with the provisions of this PPP Contract to that person or their respective professional advisers but only to the extent reasonably necessary to enable a decision to be taken on the proposal; and/or
  - iii. international or bilateral financial institutions involved in the PPP Project as Lenders, political risk insurers or guarantors; and/or
  - iv. any rating agency which may be engaged to provide a rating or rating assessment in relation to any Senior Debt;
- g. any disclosure by the Contracting Authority of information relating to the design, construction, operation and maintenance of the PPP Project and such other information as may be reasonably required for the purpose of conducting a due diligence exercise, to any proposed new private partner, its advisers and Lenders, should the Contracting Authority decide to re-tender the PPP Contract or undertake any market testing;
- h. any registration or recording of the required permits and property registration required;
- i. any disclosure of information by the Contracting Authority to any other relevant authority or their respective advisers or to any person engaged in providing services to the Contracting Authority for any purpose related to or ancillary to the PPP Contract; or
- j. any disclosure for the purpose of:
  - i. the examination and certification of the Contracting Authority's or the Private Partner's accounts;
  - ii. any examination pursuant to [insert reference to any auditing obligations for public contracts] of the economy, efficiency and effectiveness with which the Contracting Authority has used its resources;
  - iii. complying with a proper request from either Party's insurance adviser, or insurer on placing or renewing any insurance policies; or

**Sample Text: Transparency (Continued)**

- iv. (without prejudice to the generality of Clause (d) above) compliance with [insert reference to any laws requiring disclosure (e.g. environmental laws)]].
- 10. When disclosure is permitted under Clause (9) above, other than Clauses (9)(b), (d), (e), (h) and (j), the Party providing the information shall ensure that the recipient of the information shall be subject to the same obligation of confidentiality as that contained in this PPP Contract. [The Private Partner shall expressly inform any person to whom it discloses any information under this Clause [Confidentiality] of the confidentiality restrictions set out in this Clause [Confidentiality] and shall procure its compliance with the terms of this Clause [Confidentiality] as if it were Party to this PPP Contract and the Private Partner shall be responsible for any breach by any such person of the provisions of this Clause [Confidentiality].]
- 11. Where the Private Partner, in carrying out its obligations under the PPP Contract, is provided with information relating to [end users], the Private Partner shall not disclose or make use of any such information otherwise than for the purpose for which it was provided, unless the Private Partner has obtained the prior written consent of that [end user] and has obtained the prior written consent of the Contracting Authority.
- 12. On or before the expiry date, the Private Partner shall ensure that all documents or computer records in its possession, custody or control, which contain information relating to [end users] including any documents in the possession, custody or control of a Sub-contractor, are delivered up to the Contracting Authority.
- 13. The provisions of this Clause [Confidentiality] are without prejudice to the application of [insert any relevant law governing official secrets or national security information].<sup>1</sup>

**MMDA, Preamble and Article 30.1**

[...]

Whereas, the Parties recognize that this Agreement is of fundamental public importance and that it is and by its nature ought to be freely and publicly available on request to any person requesting it;

[...]

Art. 30: This Contract is a Public Document

**30.1 This Contract a Public Document**

- a. This Agreement and the Documents required to be submitted under Section 2.4, by any past and present Parties is a public document, and shall be open to free inspection by members of the public at the appropriate State office and at the files designated in the following subsection (e), and at the Company's office in the State during normal office hours.
- b. There shall be a presumption that any information regarding this Agreement, or the activities taken under this Agreement is public, other than Confidential Information.
- c. All reports and submissions by the Company to the State, and all responses by the State, are freely available on request to the State

**Sample Text: Transparency (Continued)**

or the Company, provided that Confidential Information may be redacted prior to disclosure.

- d. The Company shall maintain document files to facilitate public access to this Agreement and the Documents, and informed participation in all Consultation required by this Agreement. These files shall contain this Agreement, the Documents, all adopted updates and amendments thereto, and information on payments and reporting under Section 30.0 of this Agreement. These files shall be maintained at the following locations and shall be open to all members of the public during normal business hours:
- e. On payment of a reasonable fee prescribed by the State, any member of the Public shall be entitled to obtain a copy of this Agreement from the appropriate State office or at the Company's offices listed above.

### 5.3 From enforcement to compliance promotion: Monitor and report on project performance and material events

Where investment contracts are part of the investment-making process, their execution is a crucial milestone in a project life cycle. Without the contract, no financing can flow and no construction can begin. (Of course, signing a contract in and of itself is not a guarantee for financing or construction, since other conditions precedent may still have to be met.) As a result, much effort and resources are expended to enable the contracting parties to reach this milestone. Until this point in the project life cycle, project monitoring and reporting seem distant activities that hardly merit any attention. Consequently, contracts often fail to specify the scope of these obligations in detail, and contracting parties frequently neglect this important aspect during project implementation.

Concluding a contract marks the beginning point of what is intended to be a long-term relationship between the investor, the government, and in many cases the local communities. This view allows one to better understand the need for the contract to set out the processes and institutions needed to manage the contract over, potentially, several decades. It is in this context that this section should be viewed.

It is also important to understand that the traditional concept of enforcement of the legal obligations of the project company, whether derived from national law or the contract, is being

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challenged. The old view of large government departments whose function it is to inspect sites, monitor compliance, issue orders where compliance is poor or non-existent, and take legal measures against the company in court when needed has become largely dysfunctional or is non-existent today. This is not just a developing country issue, but applies equally to developed countries. Governments, often facing demands for lower taxes and smaller government, have simply stopped funding these enforcement activities. Investors understand that the impact of this is to significantly reduce the chances of being caught in violation of their obligations, and that any risks of fines being imposed is small.<sup>3</sup> Yet compliance remains a critical issue, and especially for the local communities that may be most immediately and seriously impacted by non-compliance with the sustainability-related obligations.

Investors and governments must understand that the concept of a social licence to operate is an ongoing concept. It does not automatically remain in effect throughout the life of the project but must be maintained with a sense of deliberateness every year of operation of the project.

*The core of a compliance promotion model is routine, usually annual, reporting and monitoring obligations.*

Fortunately, these challenges have a common solution that shifts the traditional enforcement model to a community-based compliance promotion model. It seeks to shift the project company from evaluating the risk of being caught not complying to an understanding that its social licence to operate is dependent on demonstrating its compliance with agreed social, economic and environmental obligations. The core of a compliance promotion model is routine, usually annual, reporting and monitoring obligations.

Monitoring and reporting obligations are activated once the project operator enters into the construction phase, gathers sufficient data on key performance indicators and parameters, and reports on its performance using an appropriate reporting format that is accessible to the national and local stakeholders. Monitoring and reporting inform the private operator and the contracting authority of project performance, and can help improve poor performance through corrective actions. Because of its importance, some contracts stipulate that monitoring data should be verified by a third party on an annual basis.<sup>4</sup> Project reports can inform other host government agencies, such as those in charge of the environment or labour matters, that can make appropriate protective interventions as necessary.

The private operator should inform the project's contractors and subcontractors of the project's obligations with respect to environmental, social and economic sustainability, and be legally required to pass on the appropriate requirements to them in order to ensure these entities comply with them.

Project reports also inform stakeholders, including the affected communities. In fact, community members need not be passive recipients of project data; they can play a proactive role by participating in project monitoring activities, and even in the enforcement of contractual provisions that affect them. Without monitoring and reporting, the project will not know about its performance and has nothing to tell its stakeholders.

Meaningful monitoring is facilitated first by contractual transparency, as discussed above. Stakeholders need to be clear about the scope of the project and the respective obligations of the contracting parties.

The contract should establish KPIs for the project's environmental, social and economic development performance, as discussed in the sections on the substantive obligations in these areas. The indicators should reflect issues of importance to the project and the stakeholders. Obviously the KPIs will differ significantly from project to project and sector to sector. For instance, in the case of infrastructure projects, indicators regarding service quality, regularity of service, physical accessibility, affordability, acceptability and safety considerations would be meaningful to consumers of these services, other stakeholder groups, members of the public generally, the

#### **Box 5.4 Community employment in the Far North in Canada**

Remote environments are among the hardest places to manage employment issues in large-scale investments. In one mine on Canada's northern territories where indigenous peoples predominate, the investors had promised a designated number of jobs for local employment. But the company found that while it could still scramble and meet the targets, the turnover rate of employees was almost 75 per cent every year, making it hard to have a consistent workforce and to stay on target. Neither the employees nor the company were achieving their goals. The company engaged the community to find out why the turnover rate was so high. The community elders found this was because the employees tended to have lower wages and less rewarding jobs and, most importantly, no career paths. When the company adopted stronger measures to promote career paths instead of just a job, retention rates reversed, with less than 25 per cent turnover every year. The monitoring process here led to stronger compliance with the targets and better results for all stakeholders.

contracting authority, and other government agencies. Data on these KPIs should be collected regularly, and should be disaggregated by stakeholder groups whenever possible to ensure that priority is given to those who are worst off, and that targeted interventions (whether by the contracting authority or another agency of the host government) can be directed to these people as necessary. Similarly, the key targets set out in the contract for social projects, employment opportunities, gender equality, local purchasing, etc., can be measured and reported against, showing progress or lack of progress in achieving the contractual obligations in these areas.

The private operator and the contracting authority both have obligations to report on the project performance, including appropriate corrective actions taken in the case of incidents and issues, at least annually. The private operator should be responsible for issuing the project's sustainability reports.

Many companies are wary of ongoing public reporting obligations. In some cases, this is due to the perception that any failure to fulfil an obligation can be seen as a breach of the ongoing contract, which should not be shared with those outside the project. Thus, it is important to understand the role of KPIs in relation to compliance in order to achieve positive results. In practical terms, this means highlighting the KPIs as targets, not as absolute compliance issues. This allows a failure to meet the targets to be treated as part of the long-term engagement with the community to achieve

### **Box 5.5 Financial mechanisms to ensure corrective action**

The private operator should set up one or more financial mechanisms to ensure adequate funds are available for contingencies, corrective actions, or project closure to avoid shortfalls and failure to remedy harm created by the project. This should be a general provisioning that is separate from specific budgets to be set up for implementation of one or more of the plans described in this Guidance. By way of example, projects can purchase **insurance policies** and **performance bonds** for certain specified events, including extreme weather events. In addition, **escrow accounts, sinking funds or contingency funds** can be established for specific events, and **indemnity** can be used in the case of damage caused to the environment or people. Financial provisioning is particularly important at the end of the project, which could face significant site rehabilitation obligations and economic obligations to the local community, and yet be short on funds and human resources to address them; as a result, some jurisdictions require **closure plans and financing** for their implementation, especially in the mining sector.



and exceed the obligations. It is only when there is an ongoing failure to remedy the poor performance, and a failure to show good faith efforts to correct non-compliance, that issues will rise to the level of a material breach of the contract allowing enforcement action or even termination of the contract. Some projects use various financial measures (see Box 5.5) to ensure that funds are available in the event of performance failures and contingencies to pay for corrective action.

Projects have many types of sustainability reporting formats to choose from, depending on many factors, from internal strategy and sector-wide preferences, to regulatory requirements. The contracting authority may have regulatory reporting obligations to the central government or may take it upon itself to provide its own assessment of project performance under applicable law. These reports should be publicly available on the project website and an appropriate site of the government. The contracting parties are also jointly responsible for timely provision of information to stakeholders on material events and incidents that pose a risk to them or otherwise may concern them.

### **Guidance X: Options for compliance promotion**

- ✓ The contract should anticipate the project's monitoring and reporting needs and allocate the responsibilities appropriately between the contracting parties.
- ✓ Community members should be enabled to participate in project monitoring.
- ✓ The private operator should inform the project's contractors and subcontractors of the project's obligations with respect to environmental, social and economic sustainability, and be legally required to pass on the appropriate requirements down to them in order to ensure these entities comply with them.
- ✓ Targets should be well defined and measurable but should be treated as goals to be achieved collaboratively rather than black and white compliance issues. This allows all parties to learn as the project unfolds. At the same time, a persistent failure to achieve the goals, or to make best efforts to achieve them, should be elevated to an issue of material compliance with the project company's obligations.
- ✓ Regular disclosure of the project's monitoring information will enable affected communities to act as de facto enforcers of specific obligations owed to them.

*It is important for the applicable law clause to clarify first that the domestic law of the host state is the overall applicable law.*

## 5.4 Applicable law

Chapter 3 addressed the relationship between different sources of law that might apply to foreign investments: domestic law, investment contracts and international investment treaties. It looked at the ‘right’ and ‘wrong’ form of relationships. In contract terms, one aspect of these issues will play out in what is usually referred to as an ‘applicable law’ clause. An applicable law clause sets out what the governing law of the project and the contract is and, often, what law will apply in the event of a dispute that goes to court or an arbitration tribunal.

In this context, it is important for the applicable law clause to clarify first that the domestic law of the host state is the overall applicable law. This may seem obvious, but it is only in recent practice that this has been fully recognised. Until the last decade or so, it was common for contracts to identify the law of New York, England, France or other former colonial powers or commercial or financial centres as the law governing the contract and project. The thinking on this was that these bodies of law were better developed to deal with commercial disputes and stayed more consistent than the laws in developing countries, leading to more predictable legal environments. This approach is no longer seen as appropriate. Governments should ensure that the applicable law is defined as the law of the host state, since all aspects of the project’s activities will be effectively subject to the laws of the host state.

A second issue is what source of law prevails in the event of conflict: the applicable law or the contract. In our view, the law should prevail and the contract should be required to be consistent with the applicable local law. As discussed in Chapter 3, the contract should be used to implement the applicable law in the specific circumstances of the project at hand, not displace that law. Governments should strive to have as much of the legal regime applying to investments in the domestic law as possible to have the most transparent and consistent application of the law, avoid unnecessary negotiations with each large-scale investor, minimise the opportunities for corruption and imbalances in results, and promote an environment that respects domestic law.

A third issue is often the role of international law in these contracts. In some instances, international law is defined as part of the applicable law, often as a supplement to the domestic law. This is often also seen in applicable law clauses that provide

for a specific application of international law to investment contracts between governments and foreign investors. This can be acceptable, as long as international law is a supplement to and does not displace the host state law as the primary applicable law.

These details are consequential and lawyers should ensure they are correct in order to preserve the appropriate relationship between the domestic law, the contract and international law.

### **Guidance XI: Applicable law**

- ✓ The domestic law of the host state should be defined as the applicable law governing the contract and the project.
- ✓ Contracts should comply with the applicable domestic law, and not contain provisions in breach of the laws. Contracts should be negotiated to implement the domestic law applicable to an investment, not replace it.
- ✓ Governments should strive to have as much of the legal regime applying to investments in the domestic law as possible to have the most transparent and consistent application of the law, avoid unnecessary negotiations with each large investor, and minimise the opportunities for corruption and imbalances in results.
- ✓ Contracts should, where necessary, particularise the application of the domestic law to a specific project, providing sufficient detail to ensure it is clear and enforceable in terms of the obligations on the investor and government parties.

### **Sample Text: Applicable Law**

#### **MMDA, Article 35**

This Agreement shall be governed by and construed in accordance with the laws of the State, including international treaties and bilateral investment treaties to which the State is a party (collectively, "Applicable Law").

#### **World Bank Guidance on PPP Contract Clauses, 2019, sample drafting 11: Governing Law**

(1) This PPP Contract and any non-contractual obligations arising out of or in connection with it are governed by and shall be construed in accordance with the laws of [country].\*

\* The governing law selected in a PPP Contract determines the legal system whereby the rights and obligations under the PPP Contract will be determined. Typically, the national law of the Contracting Authority will be the applicable law. (NB: this note accompanies the above text and is included here for clarity of the intended outcome.)

## 5.5 Avoid stabilisation of non-fiscal laws

For many years, developing country governments were advised that in order to attract large investments they had to make multiple concessions to investors on tax or other incentives and on stabilising the law applicable to the investment. The former point is beyond the scope of this Resource, though we note with some urgency the more recent work of the IMF and OECD and others indicating that tax incentives are generally not a good means of attracting and maintaining investments.<sup>5</sup>

A stabilisation clause (sometimes also referred to as a change in law clause)<sup>6</sup> in investment contracts sets out how changes in law after the execution of the contract will affect the rights and obligations of the parties. Traditionally, stabilisation clauses precluded the application of new laws for the duration of the contract, thus freezing the law applying to the investment as of the day the contract is signed. Alternatively, the clause would allow the new laws to apply, but require the government to compensate the company for any costs of complying. These clauses became known as economic equilibrium clauses and provided economic guarantees to the project company.

Foreign investors and their lawyers, governments are told, will insist on one form or another of these clauses, and argue that the contract will not be bankable without it, especially in countries that are deemed to have an unstable legal environment. Naturally, domestic investors have long been critical of the practice because they are bound by national law as it evolves. More recently, its use has been criticised by civil society organisations and experts for chilling the right and obligation of the host state to protect the environment and people in accordance with its own vision of sustainable development, or pursuant to commitments to reflect obligations under international law in domestic law.<sup>7</sup>

The issue of stabilisation is divided into two parts. The first is fiscal stabilisation, dealing with taxes and other government revenues from a project. This is again beyond the scope of this Resource.<sup>8</sup> The second part is often referred to as non-fiscal stabilisation, and notionally includes any law or regulation that is not fiscal in nature. This would include all of the environmental, social and economic development issues addressed in this Resource. This Resource seeks to address non-fiscal stabilisation.

The prevalence of stabilisation in investment contracts was analysed in some detail by the IFC in a report prepared for Prof. John Ruggie in his capacity as special representative of the UN Secretary General on Business and Human Rights during the preparation of the UNGPs.<sup>9</sup> This report found that the highest percentage of contracts deploying non-fiscal stabilisation clauses was in sub-Saharan Africa, with somewhat lower levels in other developing country regions. The most extreme type of stabilisation clauses (e.g., complete freezing of national law for the duration of the investment contract, some of them extending for 99 years) were prevalent in the mining sector in Africa.<sup>10</sup> The research found virtually no non-fiscal stabilisation clauses applying in the OECD countries. The study also found that these clauses could have significant impacts on the ability of developing countries to meet their international human rights obligations, as they prevented governments from developing new human rights laws that applied to major economic actors in their countries.

Professor Ruggie, in Addendum 3 to his report on the UNGPs: *Principles For Responsible Contracts: Integrating The Management Of Human Rights Risks Into State-Investor Contract Negotiations: Guidance For Negotiators*,<sup>11</sup> concluded that:

*Contractual stabilization clauses, if used, should be carefully drafted so that any protections for investors against future changes in law do not interfere with the State's bona fide efforts to implement laws, regulations or policies in a non-discriminatory manner in order to meet its human rights obligations. (Principle 4)*

This report also suggested that the private operator factor into its project and financial planning the potential implications of the evolution of the host state's national law.

While this appears on the surface to be a fairly narrow limitation on the use of non-fiscal stabilisation clauses, in practice this is not the case. This is because Ruggie's conception of human rights includes economic and social development rights as well as environmental rights that had begun to solidify as human rights, such as the human right to clean water, while his work was in progress. Thus, a good deal of what is addressed in this Resource is, in principle, covered by the Responsible Contracting<sup>12</sup> framework for business and human rights.

The contracts reviewed for this Resource, which dated from 2010 to 2018, indicate that the practice of stabilisation is in a state of flux. Of the extractive contracts, over 60 per cent of the oil, gas and mining contracts have stabilisation clauses, whereas just under 25 per cent of the agribusiness contracts stabilised new laws. Almost all the infrastructure contracts reviewed contained one kind of stabilisation clause or another. While many contained the traditional, broad stabilisation clauses, several excepted environmental, labour, and health and safety laws from the scope of change in law.

Given the ongoing controversy and flux in drafting, it was not a surprise that the OECD took up the issue again in the context of preparing its Guiding Principles on Durable Extractive Contracts, from 2016–2019. Principle VII of this document now states:

*Durable extractive contracts are consistent with applicable laws, applicable international and regional treaties, and anticipate that host governments may introduce bona fide, non-arbitrary, and non-discriminatory changes in law and applicable regulations, covering non-fiscal regulatory areas to pursue legitimate public interest objectives. The costs attributable to compliance with such changes in law and regulations, and wholly, necessarily and exclusively related to project specific operations, should be treated as any other project costs for purposes of tax deductibility, and cost recovery in production sharing contracts.*

***Within the decade after Prof. Ruggie tied his position on non-fiscal stabilisation to not interfering with the attainment of human rights, the OECD went beyond this to delegitimise the use of non-fiscal stabilisation provisions in extractive contracts.***

Thus, within the decade after Prof. Ruggie tied his position on non-fiscal stabilisation to not interfering with the attainment of human rights, the OECD went beyond this to, for all practical purposes, delegitimise the use of non-fiscal stabilisation provisions in extractive contracts. While the OECD text is focused on the extractives sector, as many experts had previously identified the extractives sector as the one most exposed to risks from changes in law due to the high cost of initiating projects and the lengthy return period in many cases, there is no compelling reason why the principle should be limited to that sector. It stands to reason that the same principle should apply to other sectors similarly exposed. In practice, this should include all sectors for which this Resource is relevant, including agribusiness and infrastructure.

In the unusual situation where a change in law results in the inability of an investor to perform its obligations or makes the project financially unsustainable, the contracting authority and the private operator should agree to engage in good faith discussions which might eventually lead the parties to agree to renegotiate the terms of the contract.<sup>13</sup>

### **Guidance XII: Non-fiscal stabilisation**

- ✓ Governments should not agree to accept clauses stabilising the non-fiscal laws applying to an investment.
- ✓ If, despite this clear guidance, governments choose to agree to a stabilisation clause, they should ensure that, consistent with Principle VII of the OECD Guiding Principles on Durable Extractive Contracts, non-fiscal laws such as environmental, labour, health and safety, disclosure and other related laws that aim to protect people and the environment should be excluded from any stabilisation provisions (sometimes also called change of law provisions).
- ✓ Governments should acknowledge that the costs to companies of meeting changes in law should be treated as tax deductible expenses of the company in keeping with other operational expenses.
- ✓ Companies should anticipate changes in national law as an ongoing process and budget to comply with changes in the normal course of affairs.

### **Sample Text: Stabilization or Change in Law**

*[Note: We do not include this as a model to adopt, as explained in §5.5. However, this text does show the complexity that can result from negotiation complex stabilization clauses, and the many risks that can be incurred in this complexity.]*

#### **Model Concession Agreement for Hydro less than 500MW (Nepal)**

**'Change in Law'** means the:

- A. adoption, promulgation, bringing into effect, repeal, amendment, reinterpretation, change in application, change in interpretation or modification after the date hereof of any Laws of Nepal, by any GON Agency, or by a competent court of Nepal;
- B. imposition of any material condition not required as of the date hereof in connection with the issuance, renewal or modification of any Government Approval, by any GON Agency;
- C. change or modification of the Generation Licence by any GON Agency (other than as requested in response to a petition therefor by the Company agreeable to the GON); or
- D. the imposition of other obligations imposing a cost on the Company, which in case of any of the above, establishes either a material increase in cost, material reduction in revenue, or material delay

### **Sample Text: Stabilization or Change in Law (Continued)**

in schedule as a consequence of any requirement for the design, construction, financing, ownership, operation or maintenance of the Hydro Property that is materially more restrictive than the most restrictive requirements (i) in effect as of the date hereof, (ii) specified in any applications, or other documents filed in connection with such applications, for any specified Government Approval, or (iii) agreed to by the Company in this Agreement, but excluding a Change in Tax.

The term 'Change in Law' shall not include any imposition, adoption, promulgation, bringing into effect, repeal, amendment, reinterpretation, change in application, change in interpretation or modification (a) implemented to address and rectify any Company Event of Default or any action or inaction on the part of the Company which is inconsistent with this Agreement, or (b) relating to the areas of human rights, labour, environment, and health and safety matters.

#### **'Change in Tax' [...]**

### **17. CHANGE IN LAW**

#### **17.1 Change in Law – Remedies**

17.1.1 If there is a Change in Law or Change in Tax (other than a Change in Law or Change in Tax leading to termination pursuant to Section 18 during the period from the Agreement Date to the date falling twenty (20) Years after COD, the Company shall provide the GON with fully evidenced written notice of the nature and anticipated effect of the material increase in cost, material reduction in revenue, or material delay in schedule, as the case may be, which has arisen as a result of the Change in Law or Change in Tax. Provided that any change in Royalty and income tax shall in no case constitute Change in Law and Change in Tax.

17.1.2 The written notice shall be accompanied by the certificate of the auditor of the Company setting out full confirmation of the accuracy of the statements prepared by the Company and submitted to the GON.

17.1.3 If GON accepts the effect of the Change in Law or Change in Tax as set out in the written notice provided by the Company, the time limits and deadlines for the performance by the Company of its obligations under this Agreement which are affected by such Change in Law or Change in Tax shall be extended for as long as the Company is delayed in complying with its obligations in this Agreement because of the occurrence of such Change in Law or Change in Tax or the effects of such Change in Law or Change in Tax.

17.1.4 If GON accepts the effect of the Change in Law or Change in Tax as set out in the written notice provided by the Company, the Company shall first fund any such material increase in costs incurred or material reduction in revenue through:

- A. the proceeds which the Company is entitled to claim from the Export Offtaker under the Export Power Purchase Agreement; and
- B. the proceeds of any insurance policies which have been taken out by the Company, including the proceeds from the insurance policies required by Section 15.14.

17.1.5 In the event that the Company is unable to fully recover such material increase in costs incurred or material reduction in revenue through the methods specified in Section 17.1.4, provided that the Company has fully exercised all its



**Sample Text: Stabilization or Change in Law (Continued)**

rights to claim such costs or loss of revenue under the Export Power Purchase Agreement and the applicable insurance policies, the GON shall compensate the Company for such material increase in costs incurred or material reduction in revenue which remain outstanding by means of one, or a combination of, the following (determined at the sole discretion of the GON):

- A. reducing the Energy Royalty payable by the Company to the GON under Section 15.22; and/or
- B. reducing the Capacity Royalty payable by the Company to the GON under Section 15.22; and/or
- C. reallocating all, or a proportion of, the electrical energy which is to be provided to the GON by the Company free of charge under the Domestic Free Power Purchase Agreement and Section 15.15.

The Company shall sell any additional electrical energy reallocated by the GON under Section 17.1.5(C) into the market on arm's length commercial terms and at a price which is not less than that being paid under the Export Power Purchase Agreement.

17.1.6 In the event that the Company is unable to fully recover such material increase in costs incurred or material reduction in revenue through the methods specified in Section 17.1.5, provided that the Company has satisfied its obligations under Section 17.1.5 to mitigate the effects of such Change in Law or Change in Tax, GON shall reimburse the Company for any remaining material increase in costs incurred or material reduction in revenue which it is entitled to recover under this Section 17.1 within sixty(60) Days after presentation to it by the Company of an invoice and full supporting documentation with respect thereto.

17.1.7 The Company shall not be entitled to make a claim under Sections 17.1.4, 17.1.5 and

17.1.6 until such point as the total material increase in costs incurred or material reduction in revenue as a result of Changes in Law and/or Changes in Tax have reached an aggregate amount of [GON to insert amount based on value of Project cost and commercial agreement with the Company].

17.1.8 The time to be extended and the amount to be compensated as a result of the Change in Law or Change in Tax as specified in Sections 17.1.3, 17.1.5 and 17.1.6 shall be determined by the Compensation Committee of Independent Experts as referred to in Section 16.5.4. If either Party does not accept decision of the Compensation Committee of Independent Experts, such matter may referred to an arbitration in accordance with Section 21.

17.1.9 If the GON does not accept the effect of the Change in Law or Change in Tax as set out in the written notice provided by the Company under this Section 17.1, the matter shall be referred to an arbitration for resolution in accordance with Section 21.1. The arbitral tribunal shall make its determination with respect to the effect of the Change in Law or Change in Tax, as the case may be, within thirty (30) Days of such referral.

17.1.10 If the arbitral tribunal determines that the effect of the Change in Law or Change in Tax is not as set out in the written notice provided by the Company under this Section 17.1, the time limits and deadlines and/or the costs payable by the GON shall not be revised.

**Sample Text: Stabilization or Change in Law (Continued)**

17.1.11 If the arbitral tribunal concludes that the effect of the Change in Law or Change in Tax is as set out in the written notice provided by the Company under this Section 17.1, the arbitral tribunal shall determine the extension to the time limits and deadlines for the performance by the Company of its obligations under this Agreement and/or the level of costs reimbursable by the GON to the Company.

17.1.12 If the level of costs fixed by the arbitral tribunal is more than [GON to insert amount based on specifics of each project], or the revised timetable fixed by the arbitral tribunal provides for a movement to the timetable set out in the Agreement of more than [GON to insert time period based on specifics of each project], the GON may elect to terminate this Agreement in which case the provisions of Section 18 shall apply.

17.2 Change in Law in favour of the Company

In case of increased revenues due to the Change in Law or Change in Tax, the Company shall reimburse to the GON the amount as determined by the Compensation Committee of Independent Experts.'

## 5.6 Dispute avoidance and dispute settlement

Disputes are an inevitable part of any relationship and a contractual relationship for investment is no exception. As noted previously, the completion of a contract is the beginning of a long-term relationship, not an end point in itself. Thus, to manage the ups and downs of the relationship, a series of dispute settlement provisions is needed to promote de-escalation of disputes rather than immediate escalation to courts or arbitral tribunals. This section explores these steps. To give this context, it begins with a discussion of why immediate recourse to international arbitration, a preferred option of international investors, is not the preferred approach here. It then sets out several sequential tools short of litigation, options for domestic litigation, and finally international arbitration. This section seeks to provide an avenue forward through the complexity and expectations that allows governments to identify their best options for promoting strong long-term relationships, while at the same time ensuring effective dispute settlement when needed.

Turning to a discussion of international arbitration first is important for context. In international investment relationships, investor-state dispute settlement (ISDS) has taken on a life

of its own.<sup>14</sup> This has created multiple risks for governments, especially in developing countries. These risks include chilling the host state's right and duty to regulate, and imposing costly, lengthy and non-transparent arbitration proceedings, often in foreign countries, which can result in high arbitral awards against the host state.<sup>15</sup> Indeed, several ISDS cases have seen awards over US\$2 billion.<sup>16</sup> At least one known investment contract-based arbitration, against Nigeria, recently crossed the US\$2 billion level in a tax case.<sup>17</sup>

ISDS cases have in fact been triggered in relation to international investments by disputes related to environmental, social or economic sustainability, such as new legislation on these matters,<sup>18</sup> projects being denied for failing ESIA processes,<sup>19</sup> the protection of environmental and cultural rights of indigenous peoples,<sup>20</sup> the protection of local waters and waterways,<sup>21</sup> and cultural property issues.<sup>22</sup> Arbitral awards against host states can be rendered by commercial arbitrators who remain blind to public policy, sustainability, and broader international law considerations, giving rise to billions of dollars of awards against states, big enough to affect national budgets. This in turn can significantly diminish the ability of national governments to pay for social programmes, such as health and education services. Some predict that the global coronavirus pandemic will unleash a new wave of ISDS cases that will disable developing countries for years to come.<sup>23</sup>

Consequently, it is absolutely worthwhile not only from a legal point of view but also from a sustainable development and human rights perspective<sup>24</sup> to avoid ISDS and to seek amicable resolution of disputes, especially those involving sustainability, whenever possible. This is especially important because the interests of communities and other affected stakeholders will not be formally represented in arbitral and legal proceedings to settle disputes, even those that concern them.

The experience to date with ISDS through arbitration is primarily through arbitrations under investment treaties, regional integration agreements that include investment chapters, international arbitration provisions in national laws, and of course provisions in investment contracts. Often this layering of rights results in guaranteed access to international arbitration, many times in two or more arbitral proceedings being initiated, and all of this side-stepping national judicial process altogether. Even as IIAs undergo various reforms of the

*It is worthwhile not only from a legal point of view but also from a sustainable development and human rights perspective to avoid ISDS and to seek amicable resolution of disputes whenever possible.*

types currently being discussed at UNCITRAL,<sup>25</sup> investment contracts can easily create an ironclad right of the investor to international arbitration of their choice. When asked to explain such provisions, investors and their counsel will insist that international arbitration in Western venues that applies familiar arbitration rules, frequently those of the International Chamber of Commerce (ICC), is a sine qua non of international investment.<sup>26</sup> As this is patently not the case, lawyers should be aware that host states have several possible options.

These options include, in sequence and in order of preference for developing country governments:

- Alternative dispute settlement through mediation or the use of other non-litigation processes;
- Recourse to expert assessors for technical issues;
- Recourse to domestic courts;

### **Box 5.6 Force majeure and COVID-19**

*Force majeure* clauses have become much discussed due to the COVID-19 pandemic. *Force majeure* clauses should allocate the contracting parties' responsibilities fairly in the event of a *force majeure* event, but also seek to provide clarity on what constitutes a *force majeure* event. Not all environmental, social and economic sustainability risks should be borne by the state. For example, labour disputes, strikes and lockdowns on the project premises are definitely not *force majeure* events, and even those that escalate into national events should not be a *force majeure* event if it originated with the project. Similarly, as discussed in Section 4.5, many extreme weather events from climate change are increasingly foreseeable, which means these events should be excluded from *force majeure* provisions and responsibilities to prevent damage from such events should be clearly allocated by the contract. In the case of *force majeure* affecting the Contracting Authority, it should not have to compensate private operators for lost revenue and costs due to events classified as *force majeure* events, as this is inconsistent with the basic principles underlying the concept of *force majeure*. Additional detailed guidance will undoubtedly be needed in the near future in terms of the impacts of COVID-19 on *force majeure* provisions, such as the treatment of 'pandemic' events, as well as government actions, such as lockdowns, that impact the cash flow and profits of private operators.

When a *force majeure* is triggered, the responsibilities of both parties in relation to the steps to be taken afterward should be clear. *Force majeure*, it should be noted, does not trigger the automatic termination of the contract, but puts in place obligations to discuss the impacts of the event over time, determine mitigating measures that can be taken, and only as a last resort termination of the contract. In other words, it triggers requirements to save the contractual relationship and project prior to allowing for termination.

- Nationally based arbitration or regionally based arbitration;
- International arbitration after exhaustion of national court remedies; and finally
- International arbitration as a first recourse of right.

Before turning to these individual elements, it is worth noting that, in addition to a well-designed provision on dispute resolution, investment contracts should strive to allocate responsibilities clearly and fairly, with a view to avoiding escalation of disputes and ISDS. This is important not only for disputes between the contracting parties, but also for disputes between the private operator and the communities involving the protection of the environment and the rights of affected people. These disputes can potentially escalate into disputes between the contracting parties. In fact, this entire Resource is designed to steer contracting parties toward clear allocation of responsibilities related to sustainable development issues to avoid disputes between them, and with the affected communities.

In order to minimise the risks of disputes escalating, the contracting parties should pay attention to the following practice pointers on preventing and mitigating disputes:

- As a matter of contract provision and contract management, the contracting parties should agree to notify each other of relevant events and incidents, share pertinent information, and consult with each other frequently for early identification of problems before they escalate. This is especially the case with the implementation of the various plans mentioned in this Resource – the closer the parties are in touch and better they co-ordinate with each other, the more likely it is that the parties will reach an outcome that is better for them and for the affected communities.
- For sustainability-related disputes, the contracting parties can learn from decades of experience by the alternative dispute resolution (ADR) community that tackles environmental and social conflicts around the world. Many contracts build in an ADR process, such as mediation, as a required step before the parties proceed to formal arbitration or legal proceedings.

- The parties can also consider the use of an expert or a panel of experts to resolve technical disputes. One advantage with this technique is that the parties need not educate arbitrators or judges about technical issues with which they have no familiarity. But if the issues are more than technical or complex and also involve members of affected communities, for instance, then the contracting parties should either ensure that the panel of experts includes at least one expert who is competent to address community issues, or defer the matter to a different mechanism.
- A grievance mechanism is a non-judicial or operational-level mechanism suited to addressing project-level complaints from people in the local communities or otherwise impacted by the project. It can also be used in the context of workplace complaints. It enables the project to gauge people's response to the project, and to prevent grievances from escalating into community unrest, protests against the project, and violence. Large-scale conflicts involving communities should be treated with care and may merit an involvement of independent and neutral facilitators.<sup>27</sup> Even conflicts that appear small to the company should be treated with care as the issues may often be much bigger for the individuals involved.
- The project can also consent to submit to the jurisdiction of a local judicial forum designed to enable claims and disputes involving natural citizens of the host state for resolution.<sup>28</sup>

If disputes cannot be settled by the above remedies, the government should seek to have disputes resolved in the national courts. This is the usual option in developed countries, and should be the starting point in all countries. A simple provision that disputes arising from this contract shall be resolved by the national courts of the host state is all that is needed.

That being said, it is a reality that in some cases the foreign investor will insist on other recourses. Some options are available to address this short of international arbitration as a first recourse:

- A provision that allows the parties to agree to arbitration in the event a dispute arises can signal a willingness to have arbitration if needed, but not commit the state to it immediately. In other words, this would be a provision to consider arbitration with the other party if needed.
- Arbitration under national arbitration rules in the host state or a neighbouring state with similar legal culture can meet the need of an investor for arbitration while remaining more familiar in legal culture and geography to the host state. The availability of high-quality national arbitration facilities is an important element for this option to work. It should be noted that even if regional or international arbitration is adopted, this can be under the national arbitration law (or alternative dispute resolution law) of the host state, thus maintaining critical legal linkages to the national law of the host state.
- Many areas of the global South have strong regional arbitration institutes and processes. In francophone Western and Central Africa, the leading arbitral institution is the Common Court of Justice and Arbitration based in Abidjan, Côte d'Ivoire, which was established by the Organization for the Harmonization of Business Law in Africa (also known as 'OHADA', its French acronym). Egypt has the Cairo Regional Centre for International Commercial Arbitration. In the Commonwealth, Mauritius has a strong centre affiliated with the London Court of International Arbitration and Singapore is well known for its International Arbitration Centre. All have good reputations for independence and are viable and reasonable options.
- International arbitration in these forums or in more traditional places such as London, Paris, Washington or New York can be permitted, but only after local court remedies have been exhausted and the dispute not resolved. This notion of exhaustion of local remedies was common in international law until three or four decades ago, when direct access to ISDS began to grow.

- Finally, direct recourse to international arbitration at the World Bank's International Centre for the Settlement of Investment Disputes (ICSID), under UNCITRAL's arbitration rules, in Stockholm, London or The Hague can be considered. If this occurs, the recourse permitted and the applicable arbitration rules should be clearly designated.

If international or even national arbitration is engaged, the government lawyers should be aware of several issues that need to be addressed in establishing a process they wish to have.<sup>29</sup> Five critical issues here are:

- **Clear identification of the applicable law:** This has been addressed in Section 5.4 in general terms. It is important to clearly designate the national law and the contract as the primary applicable law, and international law as only a supplementary source. The government should not agree to a process that downgrades the national law as the primary source of applicable law.
- **Transparency:** Almost all commercial arbitrations are conducted in a confidential setting. Arbitrations involving governments are split between being more public under IIAs dispute settlement and usually private under investment contracts. Given the value of transparency in international investment discussed in Section 5.2, we recommend that governments strongly consider applying the transparency provisions of UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration, 2014, to the contract-based arbitration. These Rules, while developed for treaty-based arbitration, are fully applicable to contract-based arbitration. They can be incorporated into the arbitration provisions of the contract and will then be binding and effectively supplement any other arbitration rules identified in the contract. Governments are strongly encouraged to move in the direction of full transparency in this regard.
- **Third-party funders:** International arbitration against government is now a big business. As such, it has attracted financial investors whose business



is investing in claims against governments. These so-called third-party funders, which include hedge funds, pay the costs of the arbitration process, the lawyers and usually an adverse costs award in exchange for a percentage of the award the company wins if it does so. The practice is also known as champerty. It is important for governments to know if the case is being run by third-party funders or if it is fully in the hands of the investor, in order to prevent conflicts of interest for the arbitrators, counsel and for overall transparency in the process. Governments will have to insist on a clause requiring a full declaration of the presence, identity and role of third-party funders if they agree to arbitration.

- **Waivers of sovereign immunity:** States have what is known as sovereign immunity under international law. This means they cannot be sued by private parties for their sovereign acts. For arbitration to work, the government must waive this immunity from suit. An agreement to arbitrate constitutes such a waiver in practice. However, there is a second immunity for sovereign states relating to enforcement of an award against the state. This immunity prevents sovereign state property used for statecraft purposes from being seized to enforce an award. This can include embassies, central bank offices, military equipment, and closer to home even parliament buildings and other government buildings. Investors will always seek a written waiver of this immunity from enforcement in an arbitration clause. Our recommendation is simple: say no. This should simply not be agreed to by the government.
- **Waiver of other recourse:** Finally, there is the issue of the ability of investors to have multiple recourses. This should be addressed in the contract by expressly allowing the investor (including its owned investment) one recourse only. To do this, there should be what is known as a fork in the road clause for choosing local courts or arbitration. Once a path is chosen, the other is no longer available. But the risk of multiple recourse goes beyond that. Arbitrations are often

commenced under domestic law provisions, contracts and applicable investment treaties. What is important to note here is that in such a scenario, the company only has to win once to win. The government, however, has to win every time not to lose. This unfair system can be stopped by insisting on an express waiver of any other arbitration rights in the contract, expressly including any arbitrations under applicable international investment treaties or chapters of regional economic agreements. Such waivers must also be clear that it is any arbitration relating to the underlying measure of the government impacting the investor that is being waived. Preventing several options for arbitration being cumulated is critical for the success of an arbitration process for governments.

The above presents a complex chain of issues. The notion that arbitration clauses can be as simple as saying the two parties consent to arbitration under a designated set of rules and leave it at that is outdated.<sup>30</sup> The above issues reflect a number of lessons learned by governments and practitioners from previous experiences.

### **Guidance XIII: Dispute avoidance and dispute settlement**

- ✓ Dispute settlement provisions should be comprehensive and clear and ensure a step-by-step approach to resolving disputes.
- ✓ The tools with the lowest risk of escalating disputes should be tried first, including mediation, expert reports, and other ADR options.
- ✓ National courts remain the first choice for formal dispute settlement. This should be the default position of governments.
- ✓ Only if this cannot be achieved should arbitration be considered, beginning with arbitrations in national settings, then regional and finally as a last resort international.
- ✓ Arbitrations should be transparent and open. Third-party funders, if permitted, should be made known at the beginning of the arbitration.
- ✓ Arbitration provisions are growing in complexity to ensure against misuse and multiple proceedings. These issues have to be taken seriously and addressed in writing in the contract to protect governments from such practices.

**Sample Text: Dispute Avoidance and Dispute Settlement****MMDA Art. 27: Rights of Citizens of the State**

## 27.1 Company Grievance Mechanism

- a. The Company shall, at its own expense, promptly respond to communities' concerns related to the Mining Project as outlined in paragraph 23 of IFC Performance Standard 1.
- b. Where not established under a community development agreement, the Company will establish a grievance mechanism to receive and facilitate resolution of the affected communities' concerns and grievances about the Company's environmental and social performance. The grievance mechanism should be proportionate to the risks and adverse impacts of the Project. The grievance mechanism should be established in Consultation with the communities who are anticipated to use it, through an understandable and transparent process that is culturally appropriate and readily accessible to all segments of the affected communities, at no cost to the affected communities and without retribution. The mechanism should not impede access to judicial or administrative remedies. The Company shall inform the affected communities about the mechanism in the course of its community engagement process.

## 27.2 Forum for Claims and Disputes Involving Natural Citizens of the State

A natural citizen of the State who has a claim or dispute regarding the Project may submit such claim or dispute for resolution under Applicable Law, or under an applicable customary law dispute resolution mechanism recognized under Applicable Law. The Company consents to the jurisdiction of local institutions for these purposes.

**MMDA Art. 30.1(c)**

- (c) All reports and submissions by the Company to the State, and all responses by the State, are freely available on request to the State or the Company, provided that Confidential Information may be redacted prior to disclosure.

**MMDA Art. 36.1: Periodic Review**

## 36.1 Modification and Review

This Agreement shall upon written request of a Party, be subject to periodic review once every five (5) years after the Effective Date for the purpose of good faith discussions to consider any proposed modification(s) to this Agreement as may be necessary or desirable in the light of any substantial changes in circumstances that may have occurred during the previous five (5) years, or experience gained in that period. The Parties agree always to be open to discussing any matter which may help maximize the positive development benefits of the Project, or minimize its undesirable impacts. Nothing herein shall preclude a Party from requesting the other Party to initiate discussions regarding any provision herein, provided that this Agreement shall remain in effect during the period during which the parties are conducting such discussions.

## Notes

- 1 CCSI (2017), *Requirements for Community Development in Mining Laws*, available at: [http://ccsi.columbia.edu/files/2014/09/Mining-Community-Development-Requirements-Summary-Table-CCSI-2017\\_February.pdf](http://ccsi.columbia.edu/files/2014/09/Mining-Community-Development-Requirements-Summary-Table-CCSI-2017_February.pdf); also see: Loutit, Jennifer, Jacqueline Mandelbaum and Sam Szoke-Burke (2016), *Emerging Practices in Community Development Agreements*, CCSI, available at: <http://ccsi.columbia.edu/files/2016/02/Emerging-practices-in-CDA-s-Feb-2016-sml.pdf>
- 2 There is a close relationship between transparency and anti-corruption measures. The Commonwealth Secretariat has recently published the 'Commonwealth Anti-Corruption Benchmarks'. These are good practice 'benchmarks' covering 25 areas. They have been developed in consultation with member countries for about two years. The Benchmark 'package' has four parts: an Introduction (explaining the purpose and scope of the Benchmarks), Principles (short statements of principle for each of the 25 Benchmarks), the Benchmarks themselves (setting out the standards and actions required to meet the Benchmark), and Guidance (explaining the choices in the Benchmarks, and the connections to existing international standards and practice).
- 3 The current model can be described as a 'Catch Me if You Can' model: Government investigators rarely go to facilities to monitor compliance; if they do they have to find the violation, which may well be hidden on any given day; if they find it, officials in capitals have to approve enforcement action; political decision-makers may then oppose enforcement actions; if actions go ahead, new investigations will happen and investigators can often be bribed; and if all else fails, the fines are usually low enough to simply be the cost of doing business. So the attitude is: 'even if you catch me, I don't really care'. This section offers an alternative approach to this model of enforcement.
- 4 This is standard practice among MDBs when they finance high-risk (or 'Category A') projects.
- 5 IMF, OECD, UN and World Bank (2015), *Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment. A report to the G-20 Development Working Group by the IMF, OECD, UN And World Bank*, available at: <http://www.oecd.org/tax/tax-global/options-for-low-income-countries-effective-and-efficient-use-of-tax-incentives-for-investment.pdf>
- 6 For a quick primer on stabilisation clauses, see Thomson Reuters Practical Law, 'Glossary: Stabilization Clause', available at [https://uk.practicallaw.thomsonreuters.com/1-501-6477?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/1-501-6477?transitionType=Default&contextData=(sc.Default)&firstPage=true)
- 7 Amnesty International (2006), *Human Rights, Trade and Investment Matters*, p. 31, available at: <https://www.amnestyusa.org/files/pdfs/hrtradeinvestmentmatters.pdf>
- 8 For further information see: OECD (2019), *OECD Guiding Principles on Durable Extractive Contracts*, Principle VIII and accompanying explanatory text. Available at: <http://www.oecd.org/dev/Guiding-Principles-Durable-Extractive-Contracts-2020.pdf>
- 9 IFC (2009), *Stabilization Clauses and Human Rights. A research project conducted for IFC and the United Nations Special Representative of the Secretary-General on Business and Human Rights*, available at: <https://www.ifc.org/wps/wcm/connect/0883d81a-e00a-4551-b2b9-46641e5a9bba/Stabilization%2BPaper.pdf?MOD=AJPERES&CACHEID=ROOTWORKS/PACE-0883d81a-e00a-4551-b2b9-46641e5a9bba-jqeww2e>. Motoko Aizawa designed and managed this research project for the IFC.

- 10 Ibid.
- 11 UN OHCHR (2015), available at: [https://www.ohchr.org/Documents/Publications/Principles\\_ResponsibleContracts\\_HR\\_PUB\\_15\\_1\\_EN.pdf](https://www.ohchr.org/Documents/Publications/Principles_ResponsibleContracts_HR_PUB_15_1_EN.pdf)
- 12 Ibid.
- 13 As set out in Principle VII of the OECD Guiding Principles on Durable Extractive Contracts.
- 14 The latest ISDS trend can be easily accessed from UNCTAD's Investment Dispute Settlement Navigator, accessible at <https://investmentpolicy.unctad.org/investment-dispute-settlement>. This section will only take note of the fact that as of the end of 2019, over 1,000 known investment treaty-based ISDS cases existed, of which 343 cases are pending. Of the concluded cases, 36 per cent have been decided in favour of the state, and 29 per cent in favour of the investor.
- 15 For example, see: Mattli, Walter and Dietz, Thomas (eds) (2018), *International Arbitration and Global Governance*, Oxford University Press; and CCSI (2018), *Rethinking International Investment Governance*, available at: <http://ccsi.columbia.edu/files/2018/09/Rethinking-Investment-Governance-September-2018.pdf>
- 16 The top 10 amounts for arbitral awards as of June 2020 are set out by UNCTAD (UNCTAD Investment Policy Hub, 'Investment Settlement Dispute Navigator', available at: <https://investmentpolicy.unctad.org/investment-dispute-settlement>). They include one at US\$40 billion, and the remaining top nine between US\$8.6 billion and US\$1.1 billion against Russia, Venezuela and Ecuador, among other states.
- 17 Esso Exploration and Production Nigeria Ltd. (now owned by Exxon) and Shell Nigeria Exploration and Production Company Ltd. in 2009. The case is reported at IAREporter (2019), 'Analysis: \$2.7 Billion Award By Fortier and Brower Surfaces ...', available at: <https://www.iareporter.com/articles/analysis-2-7-billion-award-by-fortier-and-brower-surfaces-as-a-result-of-nigerian-efforts-to-block-enforcement-ruling-in-favor-of-shell-and-exxon-entities-touched-on-constitutional-questions-as-we/>.
- 18 For example, South Africa's Black Economic Empowerment legislation was challenged in *Piero Foresti, Laura de Carli and others v Republic of South Africa* (ICSID Case No. ARB(AF)/07/1). This challenge lasted several years and was ultimately withdrawn by the company when permits it was seeking were granted.
- 19 For example, the successful claim against Canada after a permit was denied for a quarry, *Clayton and Bilcon of Delaware Inc. v Government of Canada* (PCA Case No. 2009-04).
- 20 For example, *Glamis Gold Ltd. v United States of America*; and recently in Colombia, a number of arbitrations have followed a decision not to allow mining in a highly sensitive watershed that also has special relationships with indigenous peoples.
- 21 For example, Canada is facing an ongoing challenge to a law banning fracking for gas under the St Lawrence River in Quebec, *Lone Pine Resources Inc. v Canada* (ICSID Case No. UNCT/15/2)
- 22 For example, *Parkerings v Lithuania* concerned the World Heritage status of part of Vilnius, and the type of construction allowed in the protected area.
- 23 Law firms have started to issue client advisories and run webinars, using headlines such as 'The Coming Wave Of COVID-19 Arbitration - Looking Ahead' (by Alston Bird). Whether these law firm postings are a warning of a surge in ISDS cases or a promotion of such a surge is in the eye of the reader. Clearly concerned about the potential consequences of increased ISDS cases, CCSI has issued a call for ISDS moratorium;

see CCSI (2020), ‘Call for ISDS Moratorium During Covid-19 Crisis and Response’, available at: <http://ccsi.columbia.edu/2020/05/05/isds-moratorium-during-covid-19/>, whereas IISD has urged governments to protect against ISDS claims in the midst of COVID-19 (see IISD (2020), ‘Protecting Against Investor-state claims amidst COVID-19: a call to action for governments’, available at: <https://www.iisd.org/sites/default/files/publications/investor-state-claims-covid-19.pdf>). CSOs are also running campaigns against ISDS; for example, Both Ends, a Dutch CSO, through an ‘open letter to governments’, is asking them to ‘take immediate action to ensure that the duty of governments to regulate in the public interest is safeguarded and put beyond the scope of ISDS claims.’

- 24 UN OHCHR and Heinrich Böll Stiftung (2018), *The Other Infrastructure Gap: Sustainability, Human Rights and Environmental Perspectives*.
- 25 The official UNCITRAL reform website is at [https://uncitral.un.org/en/working\\_groups/3/investor-state](https://uncitral.un.org/en/working_groups/3/investor-state). Multiple elements of the reform process are reviewed here by IISD (<https://www.iisd.org/projects/uncitral-and-reform-investment-dispute-settlement>).
- 26 World Bank (2019), Guidance for PPP Contractual Provisions, p. 198: “In Developed Markets, the Contracting Authority will generally opt for domestic courts. The selection of an established arbitral institution and of institutional procedural rules is of particular importance in many developing countries, where PPP Projects are unlikely to be bankable if recourse to acceptable arbitration arrangements or offshore courts with established PPP expertise is not agreed.” Available at: [https://ppp.worldbank.org/public-private-partnership/sites/ppp.worldbank.org/files/documents/Guidance\\_on\\_PPP\\_Contractual\\_Provisions\\_EN\\_2019\\_edition.pdf](https://ppp.worldbank.org/public-private-partnership/sites/ppp.worldbank.org/files/documents/Guidance_on_PPP_Contractual_Provisions_EN_2019_edition.pdf)
- 27 For example, see: The Compliance Advisor Ombudsman, *Building Consensus: History and Lessons from the Mesa de Diálogo y Consenso*. CAO-Cajamarca, Peru. Monographs 1 through 3.
- 28 MMDA, Section 27.2.
- 29 A recent report by the Commonwealth Secretariat supports addressing a number of key issues in international arbitration. See: *Study of International Commercial Arbitration in the Commonwealth*, forthcoming. A key finding of the study, based on interviews with lawyers, arbitrators, chambers of commerce, and others, was that there is a strong desire to retain arbitration in-country, and to develop local arbitration centres and local arbitration practitioners.
- 30 In the context of infrastructure, see, for example, World Bank (2019), Ch. 11; and in mining, see Fry, Jason and Louis-Alexis Bret (2019), *The Guide to Mining Arbitrations*, available at: <https://globalarbitrationreview.com/edition/1001343/the-guide-to-mining-arbitrations-first-edition>