



# Guiding Principles for Durable Extractive Contracts

Advanced draft for public comment until 30 March 2018

## Context

At the Fourth Plenary Meeting of Policy Dialogue on Natural Resource-based Development held in December 2015 at the OECD in Paris, participating governments, industry and civil society agreed to pursue the dialogue on how contracts can be designed to withstand the test of time.

Participants identified an increasing frequency in the demand for the re-negotiation of extractive contracts, and noted the ~~instability~~ ~~uncertainty~~ that this demand can create in respect of investment and sustainable economic growth. Consequently, participants discussed different contractual mechanisms to deal with change with the objective of working towards a set of guiding principles that host governments and investors can use as a common reference to build mutual trust during contract negotiations, and structure extractive contracts for the long term.

**Comment [EL1]:** Suggest replacing with “uncertainty”, it may be more accurate here and it may avoid confusion with the stability principles addressed later in the document

This document is an output of the multi-stakeholder Negotiation Support Forum, an integral part of the OECD Policy Dialogue on Natural Resource-based Development’s Work Stream 3 on “Getting Better Deals”. The Negotiation Support Forum comprises a multi-stakeholder group of subject matter experts from government, the private sector, civil society and international organisations.

The *Guiding Principles for Durable Extractive Contracts (Guiding Principles)* set out eight principles and supporting commentary that host governments and investors can use as a common reference for future negotiations of enduring, sustainable and mutually beneficial extractive contracts. They aim to provide guidance for the content and negotiation of durable extractive contracts that can reduce or eliminate the drivers of renegotiation and can provide adaptive and flexible provisions that, ~~for example,~~ can automatically adjust to prevailing market conditions. An initial draft of the *Guiding Principles* was prepared by the OECD Development Centre, serving as Secretariat, and was discussed at the Seventh Meeting of the Policy Dialogue on Natural Resource-based Development held on 30 November 2016 at the OECD in Paris. Following that meeting, the *Guiding Principles* were revised by the OECD Development Centre and benefitted from the input of the Friends of the Negotiation Support Forum, who met via teleconference to review subsequent drafts on 31 January, 28 March and 2 May 2017. As part of the consultation process, an informal expert workshop was held on 7 April 2017 at the OECD in Paris. Subsequently, a draft of the *Guiding Principles* was submitted for consideration during the Multi-Stakeholder Consultations of the Eighth Meeting of the Policy Dialogue on Natural Resource-based Development held on 17 June 2017 at the OECD in Paris, and further revised following teleconferences on 25 July and 30 November 2017. The current version reflects thorough and inclusive consultation ~~and~~ ~~convergence~~ ~~built within~~ ~~amongst~~ the Friends of the Negotiation Support Forum working group and participants in the Negotiation Support Forum.

**Comment [EL2]:** Self-adjustment to market conditions is only one of many desirable attributes of durable contracts

**Comment [EL3]:** This implies more alignment than may actually exist at this point

The OECD Development Centre invites public comment on the advanced draft of the *Guiding Principles for Durable Extractive Contracts*. Comments received will inform any further revisions for purposes of the finalisation of the *Guiding Principles* by the OECD Development Centre, supported by the Friends of the Negotiation Support Forum.

## Invitation to contribute

Government, business and civil society representatives, international organisations, and the general public are invited to contribute comments to the advanced draft of the *Guiding Principles*. **Comments should be sent to [DEV.NaturalResources@oecd.org](mailto:DEV.NaturalResources@oecd.org) by 30 March 2018.**

Field Code Changed

To find out more about OECD work on natural resource-based development, please visit <http://www.oecd.org/dev/natural-resources.htm>

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## GUIDING PRINCIPLES FOR DURABLE EXTRACTIVE CONTRACTS

*(Advanced draft for public consultation)*

### ***Preamble***

Recognising the value of balanced and therefore more durable extractive exploration and production contracts, these guiding principles have the objective of providing a framework for the content and negotiation of such balanced and durable contracts. The purpose of these principles is to assist host governments and investors using them to (i) structure their on-going relationship in an integrated manner to promote long term sustainable development, while attracting and sustaining investment; (ii) foster alignment of expectations and convergence towards agreed objectives; (iii) provide mechanisms that can accommodate and respond in a predictable manner to potentially significant changes in circumstances; (iv) build trust to strengthen mutual confidence and reduce risk for both parties; (v) and obtain full value from resource development through equitable, sustainable and mutually beneficial contracts and operations,

Recognising the importance for developing countries to adopt policy, legislative and regulatory frameworks setting out conditions of general application for extractive operations,

Considering that there exists a variety of systems to award oil, gas, and mining exploration and production rights, these principles are without prejudice to the choice of the preferred allocation mechanism nor do they imply a preference for contractual regimes versus legal systems providing for non-negotiable provisions,

Recognising that even in jurisdictions where well-developed legal regimes govern the relationship between host governments and investors and regulate the great majority if not all aspects of oil and gas, and mineral exploration and production, the domestic legal framework may still leave room for negotiable elements,

Recognising that in most countries the domestic legal framework for oil and gas, and mineral exploration and production may leave room for some negotiations, the Negotiation Support Forum, hosted by the OECD Policy Dialogue on Natural Resource-based Development, has developed the following non-binding principles through inclusive multi-stakeholder dialogues between December 2015 and November 2017. The Principles and supporting commentary aim to provide guidance for the content and negotiation of mutually beneficial, sustainable and therefore enduring extractive contracts and thus reduce or eliminate the risk of disputes and renegotiation of contract terms over time,

Recognising the trend towards increased transparency and reporting in the extractives sector (e.g. disclosure of payments made by extractive companies to governments, publication of signed contracts, and disclosure of beneficial ownership information), the parties are encouraged to ensure that the contract terms are robust and able to withstand public and commercial scrutiny. During the negotiation process, the parties should anticipate that, consistent with domestic law, host governments may publish all or parts of

their signed contracts, with due regard taken [to adhering to contractual and/or legal obligations and](#) to protecting proprietary [and/or](#) commercially sensitive information.<sup>1</sup>

Emphasising the complementarity between these guiding principles and the policy tools developed as part of the OECD Policy Dialogue on Natural Resource-based Development to foster collaborative strategies for in-country shared value creation, including through mutually beneficial agreements<sup>2</sup>, to identify, prevent and address heightened corruption risk, where mineral, oil and gas rights are awarded through negotiated deals<sup>3</sup>; and to enable effective government engagement in contract negotiations, including through access to specialist expertise and advice<sup>4</sup>;

The Negotiation Support Forum calls upon States, investors, negotiation support providers, bilateral and multilateral institutions to consider the following principles, and actively promote their application in the negotiations of extractive contracts.

### Guiding Principles

- I. Durable extractive contracts are aligned with the long-term vision and strategy, defined by the host government on how the extractive sector can fit into and contribute to broader sustainable development objectives.
- II. Durable extractive contracts are anchored in a transparent, quality, long-term relationship and operational partnership between host governments, investors and communities, to fulfil agreed and understood objectives based on shared and realistic expectations that are managed throughout the lifecycle of the project.
- III. Durable ~~extractive~~ ~~contracts~~ ~~balance~~ the legitimate interests of host governments, investors, and communities, with due account taken, where relevant, of the specific rights of indigenous peoples recognised under applicable ~~international and national~~ law.
- IV. Durable extractive contracts seek to maximise overall value, including economic, social and environmental outcomes to be drawn from the development of the host country's resources. To the extent not covered by the applicable law, durable ~~extractive~~ ~~contracts~~ provide for the identification and management of potential adverse environmental, health, safety and social impacts of the extractive project and establish clear roles and responsibilities for the host government and the investor for the prevention, mitigation and remediation of those impacts, in consultation with affected communities.
- V. Durable extractive contracts are ~~negotiated and~~ based on continual sharing of key financial and technical data to build a common understanding of the performance and of the main risks and opportunities of the project throughout its life-cycle.
- VI. Durable extractive contracts operate in a sound investment and business climate and should be underpinned by a fair, non-discriminatory, transparent and clear legal and regulatory framework.
- VII. Durable extractive contracts are consistent with applicable laws, and anticipate that host governments may introduce laws, regulations or policies that: (a) are not arbitrary; (b) reflect internationally recognised standards and/or good practices generally accepted from time to time in the industry; with due regard taken of the consequences of any substantive adverse impact on the performance of the project.

**Comment [EL4]:** This is superfluous... "applicable law" is inclusive of all laws that may apply, whether international or national

**Comment [EL5]:** Durable contracts should be based on continual sharing of relevant technical and financial data throughout the life of the contract, not just during negotiations. Also, note that in open tender rounds, which are becoming more prevalent for Oil & Gas, model contracts are typically used with little to no room for negotiations

**Comment [EL6]:** As discussed during the 9<sup>th</sup> session in Paris, it is important that all investors, both foreign and domestic, be treated equally

VIII. Durable extractive contracts are underpinned by a fiscal system that provides for a fair sharing of economic rent (i.e. total revenues minus total costs) between the investor and the host government, taking into consideration the risks and potential rewards. A regime with ~~automatic adjustments~~ responsive fiscal terms pre-defined to adjust allocation of production or revenue for the government take ~~to~~ amongst host government and investors based on prevailing market conditions and/or project performance (e.g. variable with commodity price, production volume, resource quality, or project profitability) reduces the incentives for either party to seek re-negotiations of terms. Due regard should be given to providing assurance of fiscal receipts/revenue to the host government for each year of commercial resource production.

**Comment [EL7]:** As evidenced during the 9th session in Paris, “economic rent” can be subject to various interpretations. We therefore suggest to define it in the guidelines

**Comment [EL8]:** Note that “automatic” can be subject to interpretation and does not adequately convey that the responsive fiscal regime should be pre-defined

**Comment [EL9]:** The text in parenthesis provides examples of market conditions AND project performance typically used to structure fiscal terms

**Comment [EL10]:** Host government entities can receive revenue through multiple mechanisms, incl. taxes, royalties, share of production and investment participation (e.g. via their NOCs), rather than just fiscal receipts

These principles are not presented in hierarchical order. They interact with each other and should be considered together. They are high-level in nature and should be read in conjunction with relevant detailed international guidance on specific topics. They can serve as a common reference for extractive contract negotiations, in accordance with applicable laws and international commitments, and taking into account national, and broader, sustainable development objectives and priorities.

These principles will be reviewed by the Negotiation Support Forum every three years based on experience with their use in actual negotiations to ensure their continuous relevance and broad uptake and strengthen their effectiveness over time.

#### COMMENTARY ON GUIDING PRINCIPLE I

**Durable extractive contracts are aligned with the long-term vision and strategy, defined by the host government on how the extractive sector can fit into and contribute to broader sustainable development objectives.**

1. Host governments need first to determine what they want to achieve with their natural resource endowments (the vision) and how they wish to achieve such goals (the strategy). Host governments have the responsibility to develop, through an inclusive participatory process a long-term strategic vision for extractive industries in terms of their contribution to economic and social development, with due regard for the environmental and environmental development. While ownership of the vision should reside in government to ensure clear accountability, the governance for the development of the strategy should be more inclusive and involve government as well as non-government stakeholders, including investors, with the objective of getting the buy-in of all stakeholders involved and an in-depth understanding of their interests and needs
2. It is recognised that industry and market dynamics that are relevant to attracting investment and to shaping the strategic goals for the development of a nation’s natural resource endowment may not be fully understood by all stakeholders. Without prejudice to the government’s sole responsibility for setting the vision, the involvement of non-governmental stakeholders in the process will may help deploy a strategy that achieves the strongest positive result for all parties.
3. It is recognised that in practice, depending on their investment horizon and/or strategic interests, some investors may or may not buy-in to the long-term vision and strategy of the government. At a minimum, investors should endeavour to understand the government’s long-term vision and strategy, which needs to be properly reflected in the terms and conditions of the contract under which the investor will operate.<sup>5</sup>
4. Durable extractive contracts reflect a workable balance between the host government’s long-term vision and the legitimate interests of investors and communities. The goals of the long-term vision should inform the government’s objectives in the negotiations to help long-term interests prevail

**Comment [EL11]:** Not clear what “environmental development” would refer to?

**Comment [EL12]:** One should be mindful not to convey more certainty than one can reasonably expect here

over short-term interests. Pressure for short-term gains that may arise from both the government and investors' side needs to be carefully handled.

5. Host governments have the responsibility to ensure a coherent, comprehensive interdepartmental approach to the implementation of the long-term vision, by reconciling any potentially conflicting internal objectives and being conscious of potential trade-offs. It is the role of host governments to foster investor and community understanding of the strategy and the means through which the long-term vision will be implemented.

## COMMENTARY ON GUIDING PRINCIPLE II

**Durable extractive contracts are anchored in a transparent, quality long-term relationship and operational partnership between host governments, investors and communities, to fulfil agreed and understood objectives based on shared and realistic expectations that are managed throughout the lifecycle of the project.**

6. Extractive contracts are just the starting point of a long-term partnership between the host governments and investors, requiring mutual engagement and accountability, clear articulation of respective roles responsibilities and transparent relationships to achieve common objectives. Durable extractive contracts recognise that community engagement is vital to ensuring the contract's long-term durability. The relationship between host governments, investors and communities should be based, from the beginning, on mutual respect, understanding of their respective interests and needs, and on-going management of expectations. Governments, investors and communities may enter their relationships with assumed understandings and expectations of each other which are not necessarily well informed or aligned. While investors are concerned with the long-term operability of the contract, and profit and return to compensate for risks taken and contributions made, host governments are concerned by the need to achieve broader national development objectives. It is the responsibility of the government to ensure that community interests are protected. Communities, including indigenous peoples, youth, and women, expect that their interests are considered and that benefits are shared at the local level through the participation in potential socio-economic development opportunities (jobs, infrastructure, business opportunities, and community development). It is the host government's role to integrate as appropriate local socio-economic development objectives with the wider agenda for regional and national development plans and policies.
7. Unrealistic or too high expectations on the fiscal, social and economic development benefits of a project need to be managed and alignment achieved. Understanding and managing expectations is particularly important in the exploration phase of a project because (a) it is during and sometimes even before the initial phase that many expectations can, rightly or wrongly become established, and (b) exploration activities may not result in commercial discoveries and production.<sup>6</sup> Host governments and investors have a shared responsibility to clearly communicate along with economic and commercial issues, the potential benefits that can realistically be achieved, the contingency of them, and their sustainability, or not, throughout the project's life cycle and the consequent potential impacts on affected communities.
8. Disappointment may arise because expectations are not met or even discussed. To prevent this, host governments have a role to play in (a) themselves setting realistic expectations, and (b) creating the enabling conditions, including through a regulatory environment providing for open and effective communication, consultation and participatory processes with stakeholders that help achieve widely held expectations and understanding and pave the way for mutually beneficial outcomes (see Principle VI and related commentary)

9. Effective engagement can help to foster the trust of local communities, which is a vital foundation for achieving realistic expectations and understanding. It can identify any misalignment; promote mutual understanding of different positions, interests, and needs; clarify and manage expectations; prevent conflicts and litigation, overcome distrust and strengthen collaboration. In particular, before and during the negotiation, communication with the community and information sharing between governments and investors regarding community concerns (e.g. site location involving the resettlement of local communities, especially if indigenous peoples are affected, or involving environmental impacts or health and safety concerns) and interests emerging from initial engagement efforts (through exploration, feasibility or due diligence studies) are crucial to inform the design of effective community engagement plans through the life cycle of the contract.
10. Attaining and retaining a social licence to operate throughout the project cycle entails for investors to agree with affected communities host governments on an engagement and consultation process tailored to the characteristics and interests of affected communities. For example, where indigenous peoples are affected, applicable law may require working towards seeking free, prior and informed consent (FPIC) as soon as possible during project planning, before activities for which consent should be sought are commenced or are authorised, and the time required for a meaningful informed consultation and participation process needs to be factored into the contract terms.<sup>7</sup> Such engagement plans, developed in accordance with domestic and international standards, can help understand priorities on many of the critical social and economic development issues, clarify what can be realistically achieved<sup>8</sup>, including the identification of realistic opportunities for maximising benefits and mitigating risks, and ensure a coherent result that the community can support.<sup>9</sup>
11. The contract should provide a mechanism to ensure that the views and concerns of affected communities in relation to planning and decision making for projects that may significantly impact them are taken into account. Lack of broad community support can threaten the economic viability of the project and heighten corporate and industry reputational risk.

**Comment [EL13]:** Host governments have the primary responsibility for establishing the regulatory framework and representing community interests, particularly in negotiations. Investors will usually engage communities once contracts are in place and community engagement plans have been agreed with Governments

### COMMENTARY ON GUIDING PRINCIPLE III

**Durable extractive contracts balance the legitimate interests of host governments, investors, and communities, with due account taken, where relevant, of the specific rights of indigenous peoples recognised under applicable law.**

12. The extraction of non-renewable resources is a process of asset depletion. Both host governments and investors have a common objective to maximise the overall value that can be obtained from the exploitation of finite resources. But, beyond obtaining revenues and getting a fair share of the financial benefits to secure a reward for ownership of resources, host governments pursue multi-layered objectives aimed to secure broader benefits to support the achievement of development priorities for the national economy.
13. Communities are interested in benefitting from potential opportunities through employment, providing services and supplies, access to infrastructure, and other community development outcomes.
14. Investors, beyond financial contributions remunerated by return on capital (cost of equity and debt), also seek to be rewarded for the contributions made in terms of commitment (against alternatives) of capital, technical and managerial expertise, proprietary technology, operational experience and integrated solutions, all of which require significant development costs, and the risks taken and enduring over time to explore, develop, produce and commercialise the resource.



15. A balanced situation that recognises all of (a) the host countries' interest to develop its resources in pursuit of many-layered development objectives; (b) communities' interest to optimise local benefits, and (c) investors' need to be rewarded for the risks incurred and the allocation of capital and organisational resources is essential for extractives contracts to be sustainable in the long-term.
16. Durable contracts maintain an alignment of interests throughout the life-cycle of the project. The framework for operation should be a balance of risks and rewards over the economic and financial returns for the investor. The outcome is then mutually beneficial, with governments, investors and communities sharing the risks and rewards and enjoying a more sustainable long-term relationship.
17. When considering the feasibility of a project, narrow financial modelling generally neither accounts for the additional costs linked to adverse social or environmental impacts of the project, nor for the costs and benefits associated with the optimisation of socio-economic benefits through suitable means<sup>10</sup>. It is critical to ensure that fiscal and non-fiscal elements are integrated into the negotiations and reflected in the agreement.
18. Risk is present at all stages of an extractive project's life cycle. The nature and degree of risks are different at different times during the life cycle of an investment (exploration, development, production, processing and marketing, decommissioning and rehabilitation) and are context dependent, industry and project specific.
19. Furthermore, perceptions of risk and opportunities by different stakeholders may, before a common understanding is achieved, initially vary between them and do so again at different stages of the project. It is therefore very important that common understanding is built and maintained so that risks and opportunities are recognised and fully appreciated.
20. Resource projects are subject to considerable risk and uncertainty at all stages of an extractive project's life cycle, from exploration through development to extraction and decommissioning/closure. There is uncertainty about geological potential, in terms of quantity, quality, accessibility of the resource and the costs of extracting it. Exposure to geological risk diminishes as more information is acquired. The access to geological and geophysical data by host governments can reduce perception of risk. In mature areas where there is greater geological knowledge and there is an established industry with on-going production, risk exposure is, is less though it is far from eliminated. By the time production starts, sunk costs associated with substantial capital investment expose investors to political (expropriation and unilateral regulatory changes) and economic risks, given the long payback period before revenues are generated and the initial investment recovered. Meanwhile, uncertainties inherent in the economics of resource extraction (recovery factor, reservoir or deposit performance, project cost, price) persist. While expropriation, tax and other policy changes are under government control, many risks are outside of either party's control (risk that resources are not present, uncertainty regarding the volume and technical quality of any discoveries and market risks related to price and costs, including initial capital costs of development).
21. Social risk is as important as other risks. If there is not a clear perception of 'felt' social benefit at the national and community level, irrespective of expected or actual financial benefits, the project may be at risk. Social risk is influenced by many factors, including the operating environment, project footprint and may be higher in mining and large-scale on-shore oil and gas investments, than off-shore oil and gas.

## COMMENTARY ON GUIDING PRINCIPLES IV

**Durable extractive contracts seek to maximise overall value, including economic, social and environmental outcomes to be drawn from the development of the host country's resources. To the extent not covered by the applicable law, durable extractive contracts provide for the identification and management of potential adverse environmental, health, safety and social impacts of the extractive project and establish clear roles and responsibilities for the host government and the investor for the prevention, mitigation and remediation of those impacts, in consultation with affected communities.**

22. From a sustainable development perspective, the notion of full value (the “size of the pie”) is understood as encompassing a wide range of important elements that can positively or negatively affect the economic viability of the investment. These include: (1) the maximisation of the economic value from the resource base; (2) creation of opportunities for positive socio-economic outcomes, by leveraging, so far as economically practicable, in favour of the host country, region and communities the project's demand and expenditures on goods, services and infrastructure requirements (roads, ports, railways, power plants, pipelines, telecommunications, water, warehouses, and logistics terminals) that are necessary for the viability of the project, and local purchasing and employment, and for the shared use of infrastructure (whilst recognising the vital contribution to economic viability that is made by the global sourcing of many inputs for the quality, timeliness, reliability and cost such sourcing achieves)<sup>11</sup>.
23. Affirmative efforts are necessary to establish these linkages and optimise infrastructure design through appropriate planning. However, at the same time governments need to realise what the trade-offs are, as incremental costs may result in reduced revenues, unless these costs are taken up by the host government, development banks or donors. It is recognised that it may not always be possible to fully maximise economic, social and environmental benefits all at the same time. Rather, a host government may have to make trade-offs in order to meet prioritised policy objectives and attract investment. That said, the incremental costs can on occasions be small compared to the significant benefits that may accrue from the project – though for some extractive projects the cost and net present value impact of such incremental costs can make the difference between being able to achieve investment viability or not.
24. Alongside positive contributions, actual and potential direct adverse impacts need to be identified, prevented and mitigated across the full lifecycle of the project (including decommissioning, abandonment or rehabilitation of the site). Social and environmental impacts of extractive projects may be related to: land use and rights; water use; displacement and resettlement of local communities and the specific rights of indigenous peoples-; **infrastructure and resource needs;** management and implementation of security; **disaster management;** health and safety risks ~~that can arise from extractive projects~~; use of labour force; environmental degradation; closure/decommissioning. Host governments, in their permitting and regulatory capacity, have the primary responsibility to ensure that potential environmental and social impacts are identified and appropriately addressed. National laws and regulations often prescribe that social and environmental impact assessments are carried out either by enterprises or by the government and that they are conducted in a specific manner. The risks and impacts identification should take account of the outcome of early engagement with affected communities as appropriate, based on disclosure of relevant environmental and social information<sup>12</sup> and community participatory involvement in the formulation of environmental management plans and social impact management plans<sup>13</sup>, with due regard to the prioritisation of those most severely impacted (e.g. indigenous peoples, women, and children).<sup>14</sup> Sharing critical information about the potential risks of the project and engaging with the community to understand and address their concerns to find appropriate solutions is essential to build a trustful relationship and ensure the social licence to operate for both governments and investors. Sufficient time and

**Comment [EL14]:** Additional examples of the type of important activities with potential impacts

**Comment [EL15]:** Unclear what “disaster management” refers to here

**Comment [EL16]:** Redundant phrase since this entire sentence is already focused on “social and environmental impacts of extractive projects...”

resources need to be allocated for an effective process of community engagement, which should be designed and implemented in accordance with good practice principles of stakeholder engagement<sup>15</sup>. Beyond compliance with domestic laws and regulations, host governments and investors can agree to incorporate into the extractive contract requirements consistent with international standards or good practice employed in the international industry under similar circumstances to facilitate the prevention, mitigation and remedy of adverse impact throughout the project's life cycle<sup>16</sup>. Requirements that are appropriate to the local context can help to: 1) fill any gaps in domestic laws, policies or capacity to monitor compliance<sup>17</sup>; 2) create common expectations and benchmarks on aspects that are not adequately covered by domestic requirements; 3) clarify the roles and responsibilities of the parties to the contract. To the extent not covered by national laws, the extractive contract "should delineate responsibility for: (a) periodically assessing actual and potential adverse [...] impact; (b) devising and carrying out a prevention and mitigation plan for potential negative impact"<sup>18</sup>; and (c) ensuring appropriate and transparent financial arrangements are in place to ~~guarantee-ensure~~ that ~~adequate-sufficient funds resources~~ are available ~~to-ensurefor~~ the execution of prevention, mitigation plans and remediation responses (e.g., use of escrow accounts, special funds for decommissioning, bank or company guarantees).

**Comment [EL17]:** Guarantees issued by financially strong banks and/or investing companies can provide adequate assurances that sufficient funds are available to pay for remediation, decommissioning

25. In particular, to the extent not covered by domestic laws, contractual provisions may be needed for the parties to agree on a set of social and environmental baseline studies (prepared by the government, the investor or a third party) approved by the government before operations begin, against which implementation and compliance can later be measured, ~~also to and which can~~ inform the development of requirements for continual improvement and remediation for any harm caused by the ~~activities~~extractive project operations.

#### COMMENTARY ON GUIDING PRINCIPLE V

**Durable extractive contracts are ~~negotiated and~~ based on continuing sharing of key financial and technical data to build a common understanding of the performance and of the main risks and opportunities of the project throughout its life-cycle.**

26. Absence or limited availability of information on the value of the resources (quantity, quality, price, and costs) affects the ability to determine ~~the resource rent and~~ the size of possible ~~revenue~~ economic rent available to be shared between that may be generated by the project for both host governments and investors. It is recognised that during negotiations the final financial outcome is not known by any party, because there is both risk and uncertainty on the presence, size and quality of the resources, as well as their potential production levels, extraction and development costs, and future market prices. However, at the pre- negotiation stage there may be qualified ~~estimated-estimates~~ of possible outcomes.
27. Investors will have better information on the value of the intangibles they have developed (e.g. intellectual property related to new ways or the design of new machinery extraction or otherwise bringing the resources to market). Host governments may rely on the investor's estimates with the assumption that they will provide objective information at the exploration, development and extraction stage. However, financial and feasibility studies carried out by investors to assess the viability of the investment do not contain definitive data, but rather qualified estimates about geological contingencies, input costs, the volume and quality of the resources to be developed, and cost of compliance with local requirements.
28. Given the uncertainty surrounding the true value of the resources until they are found, produced and sold, these datasets are projections that remain subject to multiple vagaries that are liable to affect the financial balance of the contract with potentially significant implications for the distribution of the economic benefits and/or costs originally envisaged. In these circumstances and

**Comment [EL18]:** Recommend avoiding the use of "resource rent" in the guidelines to avoid confusion with "economic rent"

~~in order to best serve their interests (e.g. manage their tax liability), investors may not share information on their best estimates.~~

**Comment [EL19]:** The intent and value of this statement is highly questionable...

29. In oil and gas, many contracts are signed following a tender process where investors place bids in accordance with bidding criteria set out in legislation or regulation. These criteria can set out the required information that needs to be made available to the government. Well-designed auctions induce competitive bidding. In mining, bid rounds are much less common and consequently, there are less established mechanisms to share information up front.
30. For this reason, host governments may wish to undertake their own independent valuations and develop their own financial models to identify multiple scenarios and possible outcomes under different circumstances (fluctuations of commodity prices, quality, costs, etc.).
31. Sharing of information between host governments and investors on qualified estimates of the resources, development scenarios and production profiles ~~is critical to can help~~ build a shared understanding around the assumptions for defining the economic equilibrium of the contract as well as in the design of the revenue allocation mechanism to sustain the viability of the project throughout its lifecycle (see also Principle VIII and related commentary). The information provided by investors should be at least of a similar frequency, detail, and quality to the information that is made available to financial lenders. Working from the same assumptions and economic and financial models, leveraging third party macro-economic data where appropriate, ~~will may~~ help build trust between the parties, foster alignment of interests, and build a true long-term partnership. In line with Principle IV, the adoption of a holistic and integrated approach is recommended to capture not only financial and economic aspects, but also performance on safety, environmental, social and community issues.

**Comment [EL20]:** Use of third party data can remove some subjectivity and help facilitate alignment on assumptions

## COMMENTARY ON GUIDING PRINCIPLE VI

**Durable extractive contracts operate in a sound investment and business climate and should be underpinned by a fair, non-discriminatory, transparent and clear legal and regulatory framework.**

32. A sound investment and business climate is critical for successful investment in the extractive industry. The development of mineral, oil and gas resources requires heavy upfront investments before production and is characterised by long lead times, high risk and uncertainty (see commentary to Principle III). The extractive sector is characterised by long payback periods where initial investments are recouped after many years of production. Securing a fair rate of return commensurate with the risk borne by the investor occurs over a long time horizon whilst being subject to volatility in prevailing market conditions.
33. When evaluating the investment potential in a host country, investors will consider whether a solid legal framework is in place, which allows investors to ascertain obligations (fiscal, environmental, social and others) that affect the ability to determine the project's possible economic outcome. Transparency of the legal framework provides an important safeguard for foreign investors and should help ensure effective use of the resources for public benefit. Laws, regulations or contracts may include provisions that give accounting and reporting procedures for investors to provide reliable information to host governments for purposes of reporting to the public on resource revenue receipts and spending and may require the publication of signed contracts.
34. Governments can help reduce both uncertainty and risk by having institutions that uphold the rule of law, with transparency and integrity, and by providing fair, transparent and clear regulations, without unnecessarily high costs of compliance. As recognised by the *OECD Policy Framework for Investment*, "well-crafted regulations can improve the investment climate by creating an

**Comment [EL21]:** Host government entities and investors are typically the only parties to an extractive contract, consequently investors' reporting obligations are generally to host governments, rather than the public

**Comment [EL22]:** Decision or requirement regarding such publication generally reside with host governments, rather than investors who are typically subject to confidentiality obligations contained in contracts and/or law

efficient framework and ensuring high standards of rule of law. Good regulation does not necessarily mean less regulation. Rather, it suggests that administrative burdens should be streamlined where necessary and that the objectives of regulations should be transparent and their effectiveness regularly monitored and evaluated”<sup>19</sup>.

35. Governments need to provide assurance on contract enforcement and property rights, and the fairness, predictability, impartiality and efficiency of the dispute resolution process, so that investors have confidence that their investment will not be unfairly taken or impaired.<sup>20</sup> Red tape, bureaucratic burdens and excessive complexity and other constraints such as those identified in the World Bank’s reports on ease of doing business raise business costs and can also lead to corruption. Administration transparency, integrity, coherence and consistency are critical to attract quality investment and ensure the continuity of extractive projects.
36. Strengthening the security of tenure (including on the conditions and process for land acquisition and requirements for land use fees, compensation and resettlement)<sup>21</sup>, ensuring clarity of administrative procedures (applying objective criteria in making decisions on whether or not to grant applications and reducing the time for obtaining all necessary clearances, licenses, permits and certificates), and effectively coordinating activities among different ministries and agencies as well as between the central and local governments promote investment. Investors are also attracted by a strong investment climate which provides for open trade policy, and political and macroeconomic stability.

#### COMMENTARY ON GUIDING PRINCIPLE VII

**Durable extractive contracts are consistent with applicable laws, and anticipate that host governments may introduce laws, regulations or policies that: (a) are not arbitrary; (b) reflect internationally recognised standards and/or good practices generally accepted from time to time in the industry; with due regard taken of the economic consequences of any substantive adverse impact on the project.**

37. ~~Recognising that c~~Contracts need to be implemented and interpreted in accordance with applicable laws,  durable contracts provide contractual parties with rights and obligations that should be honored. Unilateral change in law is a political risk over which the investor does not have control. Investors take into account this regulatory risk when deciding whether to invest: the higher the perceived risk, the higher the investor’s risk premium or the less likely an investor is to invest, and the lower the assessed viability of the project and its profit potential. Transparency and stakeholder consultations are best practice when policy reforms are considered.
38. Where regulatory changes are expropriative, or are objectively arbitrary, compensation should be provided to the investor. Under customary international law foreign property may not be expropriated except for: (i) a public purpose; (ii) on a non-discriminatory basis; (iii) in accordance with due process of law; and (iv) against prompt, adequate and effective compensation. Whether or not a change in law amounts to a direct or indirect expropriation, giving rise to a right of full compensation is a matter that needs to be determined on a case-by-case basis.<sup>22</sup>
39. Durable contracts recognise that regulatory regimes evolve over time, and so do the expectations and requirements that extractive projects must meet for the protection of public health, safety, security and the environment consistent with internationally recognised standards or good practices generally accepted from time to time in the industry in similar circumstances, and that are applied on a non-arbitrary basis<sup>23</sup>. In line with the OECD Guidelines for Multinational Enterprises, investors should refrain from seeking or accepting exemptions not contemplated in the statutory

**Comment [EL23]:** The universal expectation that parties to a contract must honor rights and obligations granted under the contract, must be incorporated in the commentary to ensure the full legal / contractual framework is considered as part of principle VII

or regulatory framework related to human rights, environmental, health, safety, labour, taxation, financial incentives, or other issues<sup>24</sup>, unless the constitution of the host country provides its citizens the right to advocate for changes in legislation.

**Comment [EL24]:** This statement may be inconsistent with the constitutional right of citizens to advocate for changes in legislation

40. Durable extractive contracts take into due consideration the economic consequences of changes in law as a result of which the investor incurs substantive additional costs and/or is unable to perform any of his rights or obligations. In such limited circumstances, the parties to the contract can integrate a number of mechanisms, ~~—other than including~~ stabilisation clauses, ~~—~~ to manage the economic and/or operational consequences of changes in the law. These may include procedures to facilitate the efficient and effective resolution of issues as they arise and requirements for the parties to negotiate in good faith regarding mitigating any substantive adverse impact of changes in the law.<sup>25</sup>

**Comment [EL25]:** It is important to also consider the operational consequences that can result from changes in law

41. A change in law includes changes in the interpretation or application of applicable laws. ~~One of the key challenges for host governments is to protect the revenue base and administer effectively rules on abusive transfer pricing<sup>26</sup>, thin capitalisation, and controlled foreign corporation rules, consistent with internationally recognised tax standards. For example, the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations provide methods for determining arm's length prices. Furthermore, the OECD Guidelines for Multinational Enterprises provide that enterprises should reasonably believe that the transaction is structured in a way that gives a tax result for the enterprise which is not contrary to the intentions of the legislature.~~

**Comment [EL26]:** This recent addition to commentary 41 seems out of scope and not relevant to this principle VII. It may better belong in another section of the guidelines

42. Mitigation of regulatory risk related to changes in fiscal laws to cope with fluctuations in market conditions (mainly prices) is addressed in Principle VIII and its commentary.

#### COMMENTARY ON GUIDING PRINCIPLE VIII

Durable extractive contracts are underpinned by a fiscal system that provides a fair sharing of economic rent (i.e. total revenues minus total costs) between the investor and the host government, taking into consideration the risks and potential rewards. A regime with responsive fiscal terms pre-defined to adjust allocation of production or revenue automatic adjustments amongst host government and investors based on for the government take to prevailing market conditions and/or project performance (e.g. variable with commodity price, production volume, resource quality, or project profitability) reduces the incentives for either party to seek re-negotiation of terms. Depending on context specific conditions, due regard should be given to providing assurance of fiscal receipts/revenue to the host government for each year of commercial resource production.

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43. Durable extractive contracts are underpinned by a fiscal regime that provides for equitable sharing of value through all stages of the project life cycle and across a range of outcomes and market conditions. Having self-adjusting fiscal terms defined in advance that anticipate change and respond by equitably rebalancing the revenue sharing can contribute to the durability of the contract and lessen the need of renegotiations, by balancing the interests of host governments and investors in times of both boom and bust and cope with fluctuations in market conditions (price, cost and volume). This structure can also help governments deal with political pressures to renegotiate or introduce unilateral changes while maintaining the competitiveness of the contract. In fact, in this arrangement “the government take tends to vary with project profitability so that the government may be less likely to adjust fiscal settings in response to major changes in market conditions”<sup>27</sup>. The outcome is then mutually beneficial, with both the government and investors sharing the rewards and enjoying a more sustainable long-term relationship. For example, some countries have introduced a progressive element in royalties by having them depend on the level of production or in some cases oil price. This is known as a sliding scale royalty, where the royalty rate is low when production or oil price is low and vice versa, thereby decreasing the possibility of negative cash flows when production or oil prices are low.



44. Fiscal instability is a risk factor that is under direct government control. It is one of the many items considered by investors, besides geologic, political, and development risks, which influence an investor's view of the overall investment climate and their assessment of the attractiveness of the opportunity. The real challenge for the government is to optimise revenue collection by striking a delicate balance between ensuring an adequate share of revenues for governments whilst maintaining the competitiveness of the fiscal regime under a range of outcomes to provide sufficient incentives for investors to pursue exploration, development and production for optimal resource recovery.
45. Pressures for changes in fiscal terms may arise from governments and investors for different reasons. Without price responsive fiscal terms, governments often modify fiscal terms when commodity prices rise in an attempt to capture the windfall. When prices are low two distinct approaches can be observed depending on the country's financial circumstances: (1) those governments who rely heavily on revenues from [the extractives industry](#) for their budgets find themselves in a situation where they need to revise fiscal terms to receive more revenue to fund public spending; (2) those governments who wish to encourage continued investment in the extractives industry and increase production levels take action to improve fiscal terms for the investor. Extractive projects are likely to operate through several economic cycles and they are likely to experience booms, but also periods of economic stress or even loss. If governments frequently change fiscal terms and structures when prices rise under the assumption that higher prices translate into unjustifiable higher returns to investors, this creates additional fiscal risk that investors will be either unwilling to accept or they will require expected higher project returns to compensate that risk, with a consequential reduction of the resource ~~rent~~ [revenue](#) for host governments. The same problem exists in a scenario of sharp decline in commodity prices where the driver ~~is~~ may be less on maximizing the capture of resource ~~rents~~ [revenue](#) than on sustaining investor commitments to existing projects and encouraging them to sustain investment in risky exploration ventures". [In either circumstance, investors require inclusion of fiscal stabilisation clauses in the extractive contract to reduce fiscal risk. Host governments may not need to offer or accept to include stabilisation clauses, if they could still attract the required investment. Where necessary to attract investment in high-risk environments and reduce investor risk premium, fiscal stabilisation clauses can be designed to minimise the general tax policy impact, by limiting their scope to specific key fiscal terms \(not all fiscal terms\) for a specific period of time \(not indefinitely\).](#)
46. Chasing the price of commodities is neither efficient, given that price volatility tends to be cyclical and is a structural characteristic of the market, nor it is productive as experience shows that this resulted in strained relationships between host governments and investors<sup>28</sup>, leading to renegotiation of agreements or unilateral imposition of new fiscal terms by governments. Host governments [and investors](#) should aim to structure a credible fiscal system that does not distort production decisions, is responsive to price changes, and allows both governments and investors to reduce risk and adequately deal with imperfect information at the time of the signature of the contract.
47. Depending on context and regardless of the type of fiscal system adopted by a host government, it may be appropriate to ensure a minimum flow of revenues to the host government for each year of commercial production, coupled with the variable component which is linked to profitability, to help align interests of the government and investor. In a concessionary or tax-royalty system, early government revenue can be achieved through a production-based royalty payment while in a production sharing contract the same result can be achieved by imposing an annual recovery ceiling that is less than 100% of revenue in each year or alternatively via a modest royalty element. With these terms included, as long as there is production, the government will receive some benefit early in the project life cycle.

**Comment [EL27]:** As stated earlier, we suggest not using the term "resource rent" to avoid confusion

**Comment [EL28]:** Unclear where this is quoted from...

48. Early revenue is of particular importance to governments with newly developing extractive industries to bolster their budgets and whose population is expecting to realise some immediate benefits from its resource development. The rationale is that whatever the price of the commodity, the mere fact of extraction triggers a revenue payment. If the project was not economically justified, there will not be commercial production going on. If the project was attractive for investment and therefore there is commercial production, the government should benefit from it because the investor is doing it for a profitable reason. The proposed approach can be particularly useful for host governments with a large resource endowment, yet limited access to capital markets and a limited portfolio of projects. Under these circumstances, ensuring that the host government gets an early revenue stream as soon as production starts and whenever production occurs may be desirable – though revenue generation may start before production begins where signature and discovery bonuses are in place. There could be circumstances where output-based royalties may not be desirable if the additional production cost imposed by the royalty makes the difference between acceptable and unacceptable profitability. Royalties may discourage incremental investments in mature high cost deposits for full recovery of the resources and lead to a premature abandonment of the field, because they can cause operating income to become negative even when gross revenues exceed extraction costs. The level of royalty will be of critical importance to the investor.
49. Governments that have a wide portfolio of projects may not necessarily need nor desire to receive a payment in every year of production from every single project and may be able to withstand fluctuations through diversifying risk and optimizing revenue across the wide range of production through macro-economic management.
50. Governments need to decide what combination of fiscal elements will be appropriate for their individual circumstances – those circumstances not being just how much the government wants to raise and spend, but how competitive the government wishes to be to attract investment. So, the optimal level of flexibility is likely to involve trading this off against the associated costs of risk-bearing. A risk-averse government may legitimately opt for greater certainty of the percentage of revenue flows it will receive and forego the prospect of exceptional revenues to reduce the risk of very poor outcomes, though the flip side of this may be a greater risk of reduced investment. A fiscal system where revenue is not responsive to changes in future market conditions reduces the risk of fiscal loss, but also does not adequately manage the risk of fiscal gain and participation in the upside when exceptional profits materialise. This scenario should be avoided to ease political economy pressures to renege on initial agreements, which leads to unilateral changes of fiscal terms or renegotiation that often prompt investors to require stabilisation clauses. Durable contracts should have some provisions that allow for the government's revenue share to increase when resource prices rise and also readjust downward when resource prices fall.
51. Beyond attitudes towards risk, the government's limited administrative capacity and performance in managing variable revenues, may point to heavier reliance on royalties than elsewhere.<sup>29</sup>
52. A fiscal system that provides for a combination of reasonable revenue certainty and is responsive to market conditions and project outcomes will be perceived as more durable as it will reduce the likelihood that a change of fiscal terms would be imposed unilaterally, ~~and~~ consequently reducing the perception of risk, which in turn can translate into a higher level of investment or potentially a reduced investment hurdle rate and therefore an increase in the size of the total economic resource—rent available for both host governments and investor.



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- <sup>1</sup> IMF (2007), *Guide on Resource Revenue Transparency*, p.17, available at <https://www.imf.org/external/np/pp/2007/eng/051507g.pdf>; UN (2015), *Principles for responsible contracts*, p.32, available at [http://www.ohchr.org/Documents/Publications/Principles\\_ResponsibleContracts\\_HR\\_PUB\\_15\\_1\\_EN.pdf](http://www.ohchr.org/Documents/Publications/Principles_ResponsibleContracts_HR_PUB_15_1_EN.pdf); International Bar Association (2011), *Model Mining Development agreement*, p.130, [http://www.mmdaproject.org/presentations/MMDA1\\_0\\_110404Bookletv3.pdf](http://www.mmdaproject.org/presentations/MMDA1_0_110404Bookletv3.pdf); Extractive Industries Transparency Initiative (2016), *The EITI Standard*, p.20, available at [https://eiti.org/sites/default/files/migrated\\_files/english\\_eiti\\_standard\\_0.pdf](https://eiti.org/sites/default/files/migrated_files/english_eiti_standard_0.pdf)
- <sup>2</sup> OECD (2016), *Collaborative Strategies for In-Country Shared Value Creation: Framework for Extractive Projects*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264257702-en>.
- <sup>3</sup> OECD (2016), *Corruption in the Extractive Value Chain: Typology of Risks, Mitigation Measures and Incentives*, OECD Development Policy Tools, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264256569-en>.
- <sup>4</sup> OECD (2017), *Guidance to Assemble and Manage Multidisciplinary Teams for Extractive Contract Negotiations*, OECD Development Policy Tools, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264274914-en>.
- <sup>5</sup> OECD (2017), *Guidance to Assemble and Manage Multidisciplinary Teams for Extractive Contract Negotiations*, OECD Development Policy Tools, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264274914-en> at 16 recommends host governments to conduct a thorough due diligence of the investor’s business history, operational model and strategic interests in the global industry.
- <sup>6</sup> OECD (2017), *OECD Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractive Sector*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264252462-en>, p. 74: “This is a particularly salient problem for exploration enterprises, which may be understood to be operational [mining] enterprises although they may lack the same resources and generally do not discover commercially viable deposits”. To respond to this challenge, the *OECD Due Diligence Guidance* encourage stakeholders throughout engagement “to share their expectations and likewise share expectations of the enterprise regarding the operation to identify any misalignment and to ensure that all sides understand one another’s positions. Transparency regarding the operation and commitments can also be helpful in managing expectations. For example, disclosing contracts and reporting revenues and tax payments can help to provide stakeholders with a realistic understanding of the operation. Provide needed support for stakeholders to understand the operational realities of the project.”
- <sup>7</sup> “Irrespective of regulatory or operational requirements, throughout their project planning enterprises should anticipate that indigenous peoples may expect consultation seeking FPIC and that risks may be generated if such expectations are not met. In countries where FPIC is not mandated, enterprises should consider local expectations, the risks posed to indigenous peoples<sup>6</sup> and operations as result of local opposition. They should pursue an engagement strategy that meets the legitimate expectations of indigenous peoples to the extent that it does not place them in violation of domestic law”. OECD (2017), *OECD Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractive Sector*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264252462-en>, pp.96-97).
- <sup>8</sup> The level of expectations for benefits should be in keeping with the specific characteristics of the project.
- <sup>9</sup> OECD (2017), *OECD Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractive Sector*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264252462-en>. For detailed guidance on stakeholder engagement and how to develop effective community engagement plans, with particular attention to indigenous groups, see: United Nations, *Principles for responsible contracts: Integrating the management of human rights risks into State–investor contract negotiations – Guidance for negotiators* (A/HRC/17/31/Add.3), United Nations publication, Sales No. 13.XIV.5, Principle 7; IFC, *Performance Standards* 1 and 7.

**Comment [EL29]:** We suggest including literature as a bibliography rather than endnotes. A reference to the literature in endnotes implies acceptance of the guidance. A bibliography simply refers the reader to additional literature for consideration

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- <sup>10</sup> Through community development agreements or other suitable means, investors, the community and the government (central and local) should work together to identify where the project can make positive contributions to the social and economic development of the local community. The *OECD Framework on Collaborative Strategies for In-Country Shared Value Creation* provides practical guidance on how opportunities for local employment, procurement and shared use of infrastructure can be identified, articulating the respective roles and responsibilities of governments, investors and civil society.
- <sup>11</sup> Leveraging demand for goods and services, and infrastructure built for projects and that would not have been constructed or expanded if the project did not exist and without which the project would not be viable should not be confused with the different scenario in which investors may be required to provide services that are unrelated to their business venture, their project objectives and their expertise.
- <sup>12</sup> See *IFC Performance Standards 1, Stakeholder engagement, Disclosure of Information* at para. 29: “Disclosure of relevant project information helps Affected Communities and other stakeholders understand the risks, impacts and opportunities of the project. The client will provide Affected Communities with access to relevant information on: (i) the purpose, nature, and scale of the project; (ii) the duration of proposed project activities; (iii) any risks to and potential impacts on such communities and relevant mitigation measures; (iv) the envisaged stakeholder engagement process; and (v) the grievance mechanism”. Relevant information is defined as follows: Depending on the scale of the project and significance of the risks and impacts, relevant document(s) could range from full Environmental and Social Assessments and Action Plans (i.e., Stakeholder Engagement Plan, Resettlement Action Plans, Biodiversity Action Plans, Hazardous Materials Management Plans, Emergency Preparedness and Response Plans, Community Health and Safety Plans, Ecosystem Restoration Plans, and Indigenous Peoples Development Plans, etc.) to easy-to-understand summaries of key issues and commitments. These documents could also include the client’s environmental and social policy and any supplemental measures and actions defined as a result of independent due diligence conducted by financiers.
- <sup>13</sup> IFC Performance Standards 1, Stakeholder engagement, Consultation, at para 30: “When Affected Communities are subject to identified risks and adverse impacts from a project, the client will undertake a process of consultation in a manner that provides the Affected Communities with opportunities to express their views on project risks, impacts and mitigation measures, and allows the client to consider and respond to them. The extent and degree of engagement required by the consultation process should be commensurate with the project’s risks and adverse impacts and with the concerns raised by the Affected Communities. See also *OECD Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractive Sector*, at p. 18: “Stakeholders themselves can contribute important knowledge to help identify potential or actual impacts on themselves or their surroundings. The values and priorities of impacted stakeholders are vital considerations in evaluating impacts and identifying appropriate avoidance or mitigation steps”.
- <sup>14</sup> Regardless of the requirements in law, meaningful stakeholder engagement is critical to avoiding some of the potential adverse impacts of extractive operations
- <sup>15</sup> OECD (2017), *OECD Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractive Sector*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264252462-en>; International Finance Corporation (IFC) (2007), *Stakeholder Engagement: A Good Practice Handbook for Companies Doing Business in Emerging Markets*, Washington D.C., available at [http://www.ifc.org/wps/wcm/connect/938f1a0048855805beacfe6a6515bb18/IFC\\_StakeholderEngagement.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/938f1a0048855805beacfe6a6515bb18/IFC_StakeholderEngagement.pdf?MOD=AJPERES).
- <sup>16</sup> See *IFC Performance Standards*; OECD (2011), *OECD Guidelines for Multinational Enterprises*, OECD Publishing. <http://dx.doi.org/10.1787/9789264115415-en>, Chapter I General Policies, A Enterprises should: “[...] 10. carry out risk-based due diligence, for example by incorporating it into their enterprise risk management systems, to identify, prevent and mitigate actual and potential adverse impacts as described in paragraphs 11 and 12, and account for how these impacts are addressed. The nature and extent of due diligence depend on the circumstances of a particular situation. 11: Avoid causing or contributing to adverse impacts on matters covered by the Guidelines, through their own activities, and address such

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impacts when they occur”. Consistent with the *OECD Guidelines for Multinational Enterprises*, the *OECD Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractive Sector* proposes provides recommendations to enterprises on applying the due diligence framework for meaningful stakeholder engagement to identify and manage risks to stakeholders impacted by extractive sector operations and specifically to indigenous peoples, women, workers and artisanal and small-scale miners.

- <sup>17</sup> United Nations, Office of the High Commissioner on Human Rights, *Principles for responsible contracts: Integrating the management of human rights risks into State–investor contract negotiations – Guidance for negotiators* (A/HRC/17/31/Add.3), United Nations publication, Sales No. 13.XIV.5, Principle 2, at p. 14: “If the State currently lacks monitoring capacity [for verifying compliance with the full range of referenced standards], the contract should provide for alternatives, at least temporarily, such as self-reporting or external credible verification”.
- <sup>18</sup> United Nations, Office of the High Commissioner on Human Rights, *Principles for responsible contracts: Integrating the management of human rights risks into State–investor contract negotiations – Guidance for negotiators* (A/HRC/17/31/Add.3), United Nations publication, Sales No. 13.XIV.5, Principle 2, at pp. 11-12.
- <sup>19</sup> OECD (2015), *Policy Framework for Investment 2015 Edition*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264208667-en>. The *Framework* is a tool, providing a checklist of key policy issues for consideration by any government interested in creating an enabling environment for all types of investment and in enhancing the development benefits of investment to society. The *Framework* looks at 12 different policy areas affecting investment: investment policy; investment promotion and facilitation; competition; trade; taxation; corporate governance; finance; infrastructure; policies to promote responsible business conduct and investment in support of green growth; and lastly broader issues of public governance. These areas affect the investment climate through various channels, influencing the risks, returns and costs faced by investors. But while the *Framework* looks at policies from an investor perspective, its aim is to maximise the broader development impact from investment and not simply to raise corporate profitability.
- <sup>20</sup> OECD (2015), *Policy Framework for Investment 2015 Edition*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264208667-en>, p. 23: “Uncertainty about the enforceability of lawful rights and obligations raises the cost of capital.”
- <sup>21</sup> OECD (2015), *Policy Framework for Investment 2015 Edition*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264208667-en>, pp. 25-26: “Investors need to be confident that their land rights are properly recognised and protected and that they are protected against forced evictions without compensation. [...] In order to provide for secure land tenure rights, the land administration should be accessible, reliable and transparent. The responsibilities of the central government versus local authorities should be clearly defined to promote efficiency, reduce corruption, and enhance law implementation and enforcement. [...] The land administration should actively contribute to land use planning in order to ensure sustainable investment and balanced territorial development and help reconcile the different objectives of land use. Land use plans should be developed at all government levels and updated regularly through wide public participation to minimise the risks of land disputes and to ensure that the priorities and interests of local communities are reflected”.
- <sup>22</sup> OECD (2015), *Policy Framework for Investment 2015 Edition*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264208667-en>, p. 25: “[t]he concept of expropriation includes direct expropriation where the state obtains a formal transfer of title or outright physical seizure and indirect expropriation where a state interferes in the use of a property or in the enjoyment of its benefits even where the property is not seized and the legal title to the property is not affected. The degree of protection against indirect expropriation under domestic laws varies significantly across countries, including OECD members. Determining whether a regulation may constitute an indirect expropriation for which compensation should be paid is made on a case-by-case basis. It is not enough that a regulation adversely affects profits for it automatically to be regarded as an act of expropriation. Some legislation provides that,

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except in rare circumstances, non-discriminatory regulatory actions to protect legitimate public welfare objectives, such as public health, safety and the environment, are not considered to constitute expropriation”.

<sup>23</sup> On the notion of arbitrariness, see Institute of International Law (2013), *Legal Aspects of Recourse to Arbitration by an Investor Against the Authorities of the Host State under Inter-State Treaties* (Report), Yearbook of Institute of International Law, Tokyo Session, Draft Works, Paris, Pédone, available at [http://www.idi-jil.org/app/uploads/2017/06/Question3\\_travaux.pdf](http://www.idi-jil.org/app/uploads/2017/06/Question3_travaux.pdf), p. 66, para 133: “The principle of non-discrimination/arbitrariness was affirmed by the ICJ in the Elettronica Sicula (ELSI) case (United States v. Italy, 20 July 1989) “Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law ... It is a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety” (para. 128). [...]. As to arbitrariness, in the same case Lemire v. Ukraine, the Tribunal confirmed that (para. 262) “Arbitrariness has been described as ‘founded on prejudice or preference rather than on reason or fact’; ‘...contrary to the law because...[it] shocks, or at least surprises, a sense of juridical propriety’; or ‘wilful disregard of due process of law, an act which shocks, or at least surprises a sense of judicial propriety’; or conduct which ‘manifestly violate[s] the requirements of consistency, transparency, even-handedness and non-discrimination’”. The Tribunal also made reference to the definition of “arbitrary” measure given by Schreuer (who acted as expert in the ICSID Case EDF (Services) Limited v. Romania (cf. above para. 71), and was quoted by the Tribunal at para. 262 of the Award): “a. a measure that inflicts damage on the investor without serving any apparent legitimate purpose; b. a measure that is not based on legal standards but on discretion, prejudice or personal preference; c. a measure taken for reasons that are different from those put forward by the decision maker; d. a measure taken in wilful disregard of due process and proper procedure.” The Tribunal then affirmed that (para. 263): “Summing up, the underlying notion of arbitrariness is that prejudice, preference or bias is substituted for the rule of law”.

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<sup>24</sup> See OECD (2011), *OECD Guidelines for Multinational Enterprises*, OECD Publishing, <http://dx.doi.org/10.1787/9789264115415-en>, Chapter II, General Policies, para. 5.

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<sup>25</sup> United Nations, Office of the High Commissioner on Human Rights, *Principles for responsible contracts: Integrating the management of human rights risks into State–investor contract negotiations – Guidance for negotiators* (A/HRC/17/31/Add.3), United Nations publication, Sales No. 13.XIV.5, Principle 2, p. 18.

<sup>26</sup> Examples of abusive transfer pricing in the extractive sector include: claiming excessive fees for managerial and technical services shared by a company’s international operations; licensing of intellectual property in low tax jurisdictions; and providing capital goods and machinery in leasing arrangements at above-market costs.

<sup>27</sup> L. Hogan and B. Goldsworthy, *International mineral taxation: experience and issues*, in P. Daniel, M. Keen, and C. McPherson (2010), London and New York, Routledge, International Monetary Fund, at p. 133.

<sup>28</sup> P. van Meurs (2016), *Government Fiscal Strategies under Low Oil Prices and Climate Change*, Discussion paper for submission to the 3rd Government Oil and Gas Summit (May 17-18, 2016, London, UK), <http://www.cwcschool.com/report-fiscal-strategies-under-low-oil-prices-and-climate-change/>.

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<sup>29</sup> R. Boadway and M. Keen, *Theoretical perspectives on resource tax design*, in P. Daniel, M. Keen, and C. McPherson (2010), London and New York, Routledge, International Monetary Fund, at p. 62.