Chapter 1

Background and Rationale
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There is growing recognition that sound investment contracts between foreign investors and host states can play an important role in helping countries meet the Sustainable Development Goals (SDGs), and ensure that valuable benefits accrue for society and the environment. At the same time, many current investment relationships are understood to lack fairness and balance. While economic and financial considerations can go a long way in righting this relationship, a more comprehensive treatment of environmental, social and economic development aspects in investment contracts is also necessary to help the contracting parties achieve a relationship that minimises harm and maximises benefits to the host state, people and the environment.

Unfortunately, for government practitioners who wish to draft investment contracts to support sustainable development in a fair and balanced investment relationship, adequate reference sources are scarce, and what is available tends to focus on traditional contract approaches and not on how the investment can maximise its sustainability benefits by fully integrating these issues into the contract development process.\(^1\) Similarly, despite a vast literature on international investment treaties and sustainable development,\(^2\) there is a surprising vacuum in the academic literature on investment contracts and sustainable development.

This Resource is intended to help government drafters and reviewers of investment contracts achieve the requisite fairness and balance in investment relationships with respect to environmental, social and economic development matters. In so doing, it will also highlight issues concerning the relationship between domestic law and investment contracts, and the need for these two legal elements governing investments to be developed in a symbiotic way.

1.1 How this Resource came about

This Resource was informed by several interrelated elements. The results of a 2019 questionnaire issued to Commonwealth Attorney-General departments by the Commonwealth Secretariat,
and the outcome document of a subsequent consultation meeting in Johannesburg in June 2019 captured the challenges that government lawyers face in drafting and negotiating investment contracts, and provided valuable insights into the necessary focus of this Resource.

The specific guidance proposed in this Resource was also informed by available literature, including guides and materials from international organisations and development banks and other relevant general or sector-specific standards and practices. In addition, an extensive review of clauses from publicly available contracts in the extractive (oil, gas and mining), agriculture, and infrastructure sectors was undertaken. Key sources here included publicly disclosed infrastructure contracts and model contracts by certain jurisdictions identified by the law firm of Foley Hoag LLP, as well as those in the large contracts databases maintained by the Columbia Center on Sustainable Investment (CCSI). This research is discussed in more depth in Chapter 2.

Finally, the Resource was supplemented by the authors’ combined decades of practical experience and perspectives gained from negotiating and drafting investment contracts, model agreements and laws, International Investment Agreements (IIAs), and international standards on sustainable development used in investment activities.

### 1.2 The scope of the Resource

The Resource focuses on investment contracts between host states and investors. Known also as investor–state contracts, they are, for many governments, a common tool for establishing and managing foreign investments into their countries. These
contracts are not international investment agreements or investment treaties that are concluded between two or more states, but contracts directly between the investor and the host state government. This reflects the very different nature of these instruments, and the critical need of governments for support in the contracting process.

The Resource focuses on the environmental, social and economic development dimensions of an investment contract. These three dimensions of sustainable development should be a part of every investment contract. The approach taken here is to suggest ways to fully incorporate these dimensions into contracts, rather than to treat them as piecemeal add-ons to traditionally designed contracts that often considered these issues to be outside their scope. Maximising the value of investments for sustainable development requires clear formulations of the social, economic and environmental obligations of each party to the contract that are designed to achieve this end.

The environmental, social and economic sustainability dimensions are one group of issues in any contract. This resource is limited to these issues. Moreover, in the context of ‘economic’ issues, we address only those related to the economic contributions of the investment project to the local and national economy in terms of ‘spinoffs’: labour, upstream and downstream supply chain relationships, skills and know-how transfers and so on, that stimulate local economic activity and social development. In other words, we focus on the direct economic impacts of the project in the local community and region of the investment. What we do not include here are issues relating to overall business and economic structures of the investment, such as financing, taxation or general risk allocation. The financial and fiscal issues between the government and investor, which we acknowledge are often central to the economic sustainability of a business for the investor, are not included here.

The Resource is intended to be most relevant for investments in large-scale and long-term projects, such as infrastructure, natural resource extraction (oil and gas, mining, forestry), and agricultural projects. While this is the target, it is anticipated that the Resource will be relevant for smaller projects as well.

The Resource does not propose a model contract – instead it suggests practical guidance for drafters, informed by existing
good practice and lessons learned. Each contract will differ based on the precise investment proposed, the country, the legal system, the scope of domestic law in relation to the project, and other factors. It is thus hoped that principle-based guidance will be more useful across these differences than specific language that might apply in more limited circumstances.

As this Resource is broadly based and not sector-specific, it will be important for government users to ensure they have access to sector-specific expertise in negotiating any given investment contract. It is essential for government negotiators to be able to match the level of expertise of the investor who is proposing the project, and this can only be done on a sector-by-sector basis.

1.3 Key audiences

The key audiences for this Resource are government contract negotiators and their negotiating teams.

Ensuring that legal advice informs the goals of a government in a negotiation, and in the actual negotiation itself, emerged as a significant issue during the Commonwealth Secretariat consultations with member governments in 2019. This Resource takes the position that lawyers for the government should be involved in the development of negotiating positions as early as possible in the process. Unfortunately, this is often not the case. In many instances, lawyers are not involved in the development of negotiating positions, the initial drafting of the contract, and often even the contract negotiations with the investor. This leads to poor drafting, the creation of conflicts between domestic law and contracts, or other difficulties that cause a lack of clarity in the operating environment of the investment. Lawyers can identify such issues when they arise and help avoid them. They can also understand provisions that might create excessive liabilities for governments, or create other imbalances in the contract, including building an understanding of what issues should be addressed through the applicable domestic law and what should be in the contract (see the discussion in Chapter 3). These and other reasons suggest strongly that government lawyers should be part of the negotiating team at all times.

At times, governments may need outside legal expertise, which is not a sign of internal failure but a good investment in their capacity. The fact is that few governments have the level of
expertise needed to negotiate contracts across a full range of sectors and issues. Bringing in the needed expertise is therefore an investment in the long-term future and maximising the benefits of the potential investment. Nonetheless, government lawyers provide a backstop and expertise that is essential for fully understanding the contract, the responsibilities and liabilities governments are assuming, and how the contract fits with other applicable law. Getting these issues right from the beginning of a contract is critical.

The audience for this Resource extends beyond government lawyers to all government officials working on developing government negotiating positions and those who participate in government negotiating teams. It is vitally important that government officials who participate in the contract process have an understanding of what is legitimately possible for governments to seek in that negotiation. Of course, not every contract will include every element set out below: some may not be relevant to a given context and others may be fully reflected in domestic law and need not be in a contract. But understanding the scope of what governments can expect as their legitimate right in return for an investor's benefits of its investment is crucial. This Resource is based on the view that the host state has the legitimate right to expect good outcomes on environmental, social and economic development issues in relation to an investment.

In many cases, government officials, and especially Ministers, see achieving a contract as an end point in itself. Ministers may be satisfied to have achieved a contract, often knowing there will be another Minister in that position if something goes awry down the road. But this distorts the reality that a contract is the starting point of a relationship between the government, investor and local community, not an end point. The contract must, therefore, set the stage properly for the project to meet the goals of all stakeholders over the longer period of time. The lawyer's role in making this happen can be invaluable.

Notes

Development Provisions in Investment Contracts


3 Agriculture can also be understood as an extractive sector, extracting water as its principal resource. However, for present purposes, we have stayed with more commonly used categorisations here. See Smaller, Carin and Mann, Howard (2009), A Thirst for Distant Lands: Foreign investment in agricultural land and water, IISD, available at: https://www.iisd.org/publications/thirst-distant-lands-foreign-investment-agricultural-land-and-water