Re: Natural Resource Governance Institute Comments on Guiding Principles for Durable Extractive Contracts

The Natural Resource Governance Institute (NRGI) is pleased to provide the comments below regarding the draft Guiding Principles for Durable Extractive Contracts (hereinafter the “Guiding Principles”) presented for public consultation by the OECD Development Centre.

The comments on the Guiding Principles pertain to the following in particular:

A. Transparency of contracts (Preamble and Guiding Principle VI)
B. Contractual assurances of legal stability (Guiding Principles VII and VII)
C. Avoiding tax holidays and bespoke incentives (Guiding Principle VIII)
D. Miscellaneous: contractual regimes vs. legal regimes and renegotiation issues

NRGI’s engagement with the development of the Guiding Principles and the associated “Negotiation Support Forum” and “friends of” grouping has been limited. While NRGI has not been a formal member of these groupings, we did previously provide limited inputs to the OECD Development Centre on particular issues such as contract transparency. We appreciate the openness of the OECD Development Centre to these prior inputs notwithstanding our limited role in the overall process and hope that the present inputs will also be constructive.

NRGI’s past and present inputs do not imply an endorsement of the Guiding Principles nor of a view that the Guiding Principles represent a consensus or convergence view of different stakeholders, including organizations such as NRGI. Our focusing of these comments on a few issues also does not constitute approval of the remaining content of the Guiding Principles. We further hope that the next steps in the development of the Guiding Principles will be transparent and accessible and that concerns regarding ensuring a sufficiently inclusive process are taken on board.

A. Transparency of contracts (Preamble and Guiding Principle VI)

NRGI reviewed an early draft of the Guiding Principles in 2017 and noted the lack of any direct mention of the principle of contract transparency. Accordingly, in July 2017 we coordinated with other organizations on a letter to the OECD Development Centre to flag the issue. We were encouraged to see that subsequent drafts included reference to contract transparency. We are therefore disappointed to see that the relevant text ultimately included in the draft for public consultation (copied below for reference) falls short on several grounds.

Preamble: 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

1 For more information on NRGI, please see “About the Natural Resource Governance Institute” at the end of this document.
should anticipate that, consistent with domestic law, host governments may publish all or parts of their signed contracts, with due regard taken to protecting proprietary or commercially sensitive information.

Commentary on Guiding Principle VI (paragraph 33): ... Laws, regulations or contracts may include provisions that give accounting and reporting procedures to provide reliable information to the public on resource revenue receipts and spending and require the publication of signed contracts. ...

While the draft now references contract disclosure and importantly recognizes the trend in this respect, it fails to explicitly endorse or encourage the practice and in this sense falls short of international good practice. As noted in our July 2017 letter, a failure to endorse the practice of contract disclosure puts the Guiding Principles out of sync with the policies and practice of many host governments, international organizations and companies. In February 2018 Total the French oil “supermajor” became the latest company to make a policy statement in support of contract transparency and advocating for host states to disclose their petroleum contracts and licenses. The failure to endorse contract transparency in the Guiding Principles is particularly problematic because contract transparency is recognized as fundamental to the purported focus of the Guiding Principles, namely the durability of extractive sector contracts. For example, the IMF has stated that a general rule favoring publication of negotiated outcomes (i.e. contracts) is “more likely to produce an outcome that is sustainable and in the mutual interests of host country and companies.” Accordingly, rather than the current approach of simply presenting contract transparency as a possibility (e.g., see uses of “may” in above excerpts), the Guiding Principles should endorse or explicitly encourage contract transparency so as to proactively promote the very robustness and durability of contracts which are the core objectives of the document.

It is disappointing to see that the draft of the Guiding Principles submitted for public comment has taken a step backward as compared to previous drafts we have seen. The November 2017 draft for example recognized that encouraging contract transparency could motivate more durable contracts

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2 There are now over 39 countries that have disclosed extractive industry contracts, and 22 with laws requiring disclosure. See Hubert and Pitman (2017), Past the Tipping Point? Contract Disclosure within EITI, p.2 and p.27, available at https://resourcegovernance.org/sites/default/files/documents/past-the-tipping-point-contract-disclosure-within-eitiweb.pdf. The practice is endorsed by the IMF Guide on Resource Revenue Transparency, the UN Principles for Responsible Contracts, the International Bar Association’s Model Mining Development Agreement and encouraged by the Extractive Industries Transparency Initiative Standard. The International Finance Corporation requires that all their oil, gas and mining financings disclose the “principal contract with government that sets out the key terms and conditions under which a resource will be exploited”. The European Bank for Reconstruction and Development has similar requirements for hydrocarbon projects. Contract disclosure was recently recommended in the OECD Secretary-General’s High-Level Advisory Group (HLAG) Report on Anti-Corruption and Integrity. Companies, such as Kosmos Energy, Tullow Oil and Rio Tinto, have made public statements in support of the contract disclosure and several more make disclosures in stock exchange filings in their home countries.


by stating (in the Preamble) that, “... in accordance with international good practice, the parties are encouraged to anticipate during the negotiation process the public disclosure of signed contracts ... as a means to negotiate a good deal and to ensure that its terms are robust and able to withstand public and commercial scrutiny.” In addition, that draft correctly recognized (in the commentary in Principle VI) that insofar as contracts are used in a given country, they constitute a part of the country’s legal framework for extractives, and so requiring transparency of contracts is essential for transparency of the legal framework, the stated aim of Guiding Principle VI.5

The Guiding Principles should not regress on issues such as contract transparency. Rather than taking a “lowest common denominator” approach based on comments submitted by different stakeholders, the Guiding Principles should represent a principled leadership approach in line with international good practice developments on the issue of contract transparency.

**B. Contractual assurances of legal stability (Guiding Principles VII and VII)**

As per previous comments to the OECD Development Centre (in our email of November 27, 2017) on the Guiding Principles, given the sensitivity and complexity of the issue of stabilization, it is important that the Guiding Principles be in sync with international good practice on the issue.

In this sense, we are encouraged to see that Guiding Principle VII partially incorporates some of our earlier comments based on the Natural Resource Charter6 and the African Mining Legal Atlas Guiding Template7, namely:

- Recognition that governments may not offer stabilization at all, depending on their ability to attract investment
- Acknowledgment that where stabilization is offered, governments can minimize the impact by limiting the scope (e.g. specific fiscal terms) and duration (e.g. not indefinite) of stabilization

The Guiding Principles remain nevertheless problematic in their treatment of a few of the elements related to stabilization.

First, the Guiding Principles remain somewhat ambiguous as to the treatment of stabilization when it comes to areas other than fiscal terms. The Guiding Principles should make clear that even where granted, contractual assurances of stability should not contemplate compensation for changes in law (e.g. through economic equilibrium style stabilization clauses on matters related to the public interest such as human rights, environmental controls, health and safety, security and labor. Per the Natural Resource Charter (Precept 11), companies should not ask for, expect, or accept provisions for exemptions or compensation (emphasis added) for changes in the legal framework related to the

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5 The relevant excerpt from the November 2017 draft: Transparency of the legal framework provides an important safeguard for foreign investors and should help ensure effective use of the resources for public benefit. This includes the establishment of laws and regulations that ... require the publication of signed contracts.

6 The Natural Resource Charter is a set of principles to guide governments’ and societies’ use of natural resources. See more here: [http://resourcegovernance.org/approach/natural-resource-charter](http://resourcegovernance.org/approach/natural-resource-charter)

7 The African Mining Legal Atlas Guiding Template is a reference tool providing guidance on the drafting of various elements and issues likely to be covered in an African mining law based on Africa’s present realities. Development of the AMLA Guiding Template was supported by the World Bank, the African Legal Support Facility and the African Commission and involved various institutions including NRGI. Available at: [https://www.a-mla.org/guidingtemplate](https://www.a-mla.org/guidingtemplate)
above areas. Government assurances to companies should be limited to nondiscriminatory treatment and the protections otherwise afforded by national and international investment law.

Part of the present ambiguity in the Guiding Principles stems from whether Guiding Principle VII is limited to non-fiscal elements. Separating the positions taken regarding stabilization of fiscal and non-fiscal elements is an important distinction, but the Guiding Principles should be clearer on the position taken regarding stabilization of non-fiscal elements, especially insofar as Guiding Principle VII is limited to these elements. While paragraph 39 contains references to the state’s ability to continue to legislate and regulate in the referenced non-fiscal areas, the Guiding Principles also contain problematic wording on the same issues. Specifically, the reference in Principle VII to “due regard taken of the economic consequences” of changes in law and paragraph 40 to taking into “due consideration the economic consequences of changes in law “, give the impression that the Guiding Principles are contemplating economic equilibrium style stabilization clauses even for the non-fiscal areas covered by Guiding Principle VII. In order to avoid this ambiguity, in addition to the reference in paragraph 40 to the relevant mechanisms being “other than stabilization clauses”, the Guiding Principles should, in line with international good practice documents such as the UN Principles for Responsible Contracts, expressly make clear that contract clauses should not seek to limit non-discriminatory changes of law in these non-fiscal areas or apply economic penalties to the state as a result of such changes in law.  

Second, Guiding Principle VII should be clearer in its description of the types of new laws, regulations or policies that are contemplated as not being problematic. Specifically the benchmark should not be “good practices generally accepted from time to time in the industry” as this is more of a commercial industry formulation than an appropriate benchmark for state regulatory action. The international obligations of the host country could instead be used as an additional benchmark (as suggested in the Ninth Meeting of the Policy Dialogue), though this should remain as an additional alternative to the broader “internationally recognised standards” and not a replacement. The formulation of “international standards, benchmarks or recognized good practices” used in the UN Principles for Responsible Contracts could also be appropriate. 

Third, with respect to stabilization of fiscal terms, the Guiding Principles can go further to provide a more nuanced picture of international good practice thinking on the issue. It is important that the Guiding Principles now reference that governments may not need to offer fiscal stabilization clauses. As the IMF has stated, stability and credibility of the fiscal regime for the extractive industries do not necessarily require a contractual assurance of fiscal stability. Governments’ non-discriminatory treatment and practically demonstrating a commitment to predictability in the process by which a fiscal regime is modified may be sufficient to attract and maintain investment. In this sense, the Guiding Principles would be well served to also point out that stabilization is relatively rare in OECD countries. Furthermore, in addition to the important recent addition to the Guiding Principles

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9 Ibid.

10 International Monetary Fund (2012), p. 36.

11 For example, per the PWC 2017 Mining Taxes Data Tool, none of the 7 OECD countries included in the tool offer fiscal stability agreements, whereas 11 of the 17 non-OECD countries included do. Available at: https://www.pwc.com/gx/en/industries/energy-utilities-resources/publications/compare-mining-taxes-data-tool.html. Regarding the disparity between OECD and non-OECD country contracts on stabilization, see also:
regarding limiting the scope and duration of fiscal stabilization, the Guiding Principles could reference the approach taken by some countries (e.g. Chile and Peru at certain times) of offering investors the option of standardized (i.e. non-negotiated) terms for fiscal stabilization in exchange for additional payment by the investor.12

C. Avoiding tax holidays and bespoke incentives (Guiding Principle VIII)

Guiding Principle VIII attempts to maintain a balanced approach on fiscal issues as between the interests of host governments and investors with an eye to promoting the durability of the arrangements made for extractive projects. One relevant element in this respect which the Guiding Principles’ section on fiscal matters unfortunately omits is the issue of tax holidays and financial incentives often sought by and provided to investors. These holidays and incentives can subsequently become the source of frustration on the part of host governments and societies and can generate political pressures for renegotiation in much the same way as the non-progressive fiscal regimes referenced in the Guiding Principles.

It is therefore important for the commentary on Guiding Principle VIII to specifically address the issue. The commentary for Guiding Principle VII (paragraph 39) references the OECD Guidelines for Multinational Enterprises which mention the need to refrain from exemptions related to, among other areas, taxation and financial incentives, but a more explicit mention as part of the section on tax (Guiding Principle VIII) would also be warranted. The Natural Resource Charter (Precept four) includes the following which may be useful in this respect:

“Investors often request that governments with potential or newly discovered resources provide special incentives in the form of tax holidays, accelerated recovery of capital expenses, or reduced royalty or profit rates. A government should resist offering such incentives. If a project cannot bear the royalty or a normal tax on equity investment, the investment is unlikely to be a good deal for the country. Changing circumstances —higher commodities prices or new technology, for example — frequently result in projects that were once deemed uneconomical becoming feasible without the benefit of government subsidies. Not all resources have to be developed at any given time …”

D. Miscellaneous: contractual regimes vs. legal regimes and renegotiation issues

The Guiding Principles specify in the Preamble that they are not meant to “imply a preference for contractual regimes versus legal systems providing for non-negotiable provisions.” It is important that such a caveat is included. The existence and significance of natural resource contracts for many countries also justifies the attention paid to them in documents such as the Guiding Principles. Nevertheless, the approach of the Guiding Principles can be problematic insofar as it leaves readers without any reference to the significant line of thinking that recommends favoring a non-negotiable legal regime over a contractual regime. Generally a legal framework with comprehensive laws and regulations and less (or no) detail up for negotiation in individual contracts provides a stronger


foundation for a country to manage its extractive industries.\textsuperscript{13} Contract-focused systems can create numerous risks from a governance perspective, namely lack of capacity and corruption in negotiation, highly variable agreements significantly complicating administration, and potentially less transparency and public input. Institutions such as the IMF have recognized this preference of general legislation versus negotiation by contract and have stated that legislating terms applicable to all extractive projects (rather than case-by-case negotiation) could reduce “administrative costs, political difficulties, and, probably, investors’ perceived risk”.\textsuperscript{14} The advantages of a law-focused system over a contract-focused system, or at least referencing the view that there are advantages, could be briefly acknowledged in the Guiding Principles without taking away from the document’s important focus of presenting good practices for when contracts are used.

The Guiding Principles focus on the goal of reducing the likelihood of renegotiation. While this is an understandable goal, it would be worth clarifying that in some cases it is impossible and potentially inappropriate to eliminate renegotiation altogether. Institutions such as the IMF have acknowledged this:

\textit{While the obligation to respect contracts is vital, renegotiations do and sometimes should occur. Renegotiation can be warranted when terms have become egregiously out of line with international practice, or with terms in comparable circumstances: no contract can anticipate all conceivable outcomes. When this happens through consultation, or by mutual agreement, the investment climate may be strengthened rather than weakened.}\textsuperscript{15}

In light of the above, references in the Guiding Principles to eliminating, rather than just reducing, renegotiation may not be appropriate, especially insofar as the drivers for renegotiation can involve exogenous factors outside the government’s control.

Separately, the Guiding Principles could more consistently acknowledge that renegotiation is not only prompted by government and that under certain circumstances investors also seek renegotiation with governments, in much the same way that a company may seek to renegotiate a commercial contract with another company.

\textsuperscript{14} International Monetary Fund (2012), p. 36.
\textsuperscript{15} Ibid.
About the Natural Resource Governance Institute

The Natural Resource Governance Institute (NRGI) is an international non-profit policy institute and grant-making organization whose focus and expertise is the responsible management of oil, gas and mineral resources for the public good. Our work promotes transparency and governance standards for the management of natural resources and resource revenues by governments, as well as the associated activities of companies, lenders and investors active in the extractive industries. We work in resource-rich countries in Africa, the Middle East, Eurasia, Latin America, South East Asia and the Pacific.

We also work at the international level to inform and implement best practice standards for extractive industry governance, and have played a central role in the establishment of the Natural Resource Charter (NRC), the Extractive Industries Transparency Initiative (EITI) and the Publish What You Pay (PWYP) coalition. NRGI additionally publishes the Resource Governance Index (RGI), which measures the quality of governance of oil, gas and mining sectors across 58 countries producing 85 percent of the world's petroleum, 90 percent of diamonds and 80 percent of copper, generating trillions of dollars in annual profits. Please find more information on NRGI at: www.resourcegovernance.org.