OECD Development Policy Tools

# Guiding Principles for Durable Extractive Contracts




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**Please cite this publication as:**
OECD (2020), *Guiding Principles for Durable Extractive Contracts*, OECD Development Policy Tools, OECD Publishing, Paris, *https://doi.org/10.1787/55c19888-en*.

ISBN 978-92-64-92264-8 (pdf)

OECD Development Policy Tools
ISSN 2518-6248 (print)
ISSN 2518-3702 (online)

Corrigenda to publications may be found on line at: *www.oecd.org/about/publishing/corrigenda.htm*.

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# *Foreword*

The Guiding Principles set out eight principles that provide guidance on how resource projects can be developed to reflect the balance of risks and rewards, which underpins durable contracts, while also taking into account, from the very beginning, community interests and concerns. They also aim at assisting host governments and investors in explaining the content of the contract to the public, thereby helping to overcome tensions between stakeholders.

The Guiding Principles are the result of an open, intense, enriching process that included multi-stakeholder consultations hosted by the Development Centre between December 2015 and June 2019. The Guiding Principles are an output of the OECD Policy Dialogue on Natural Resource-based Development's Work Stream 3 on "Getting Better Deals".

An initial draft of the Guiding Principles was prepared by the Development Centre, serving as Secretariat of the Policy Dialogue on Natural Resource-based Development, and was discussed during the Seventh Plenary 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 Development Centre and benefited from input received from interested stakeholders who met via teleconference to review subsequent drafts on 31 January, 28 March and 2 May 2017.

The multi-stakeholder consultation process involved subject matter experts from government, the private sector, civil society and international organisations. As part of the consultation process, an informal multi-stakeholder 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 Consultation of the Eighth Plenary 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.

Meanwhile, at its 4th High Level Meeting held on 3 October 2017, the Governing Board of the OECD Development Centre encouraged the Development Centre to: "develop, through an open and inclusive participatory process, and building on the experience of relevant international initiatives, guiding principles for durable extractive contracts, so that host governments and investors can have a common reference to shape durable, equitable and mutually beneficial relationships".[1]

An advanced draft of the Guiding Principles was discussed at the Ninth Plenary Meeting of the Policy Dialogue on Natural Resource-based Development held on 31 January-1 February 2018 and simultaneously submitted for on-line public consultation during the period January-March 2018. All comments received at the Ninth Plenary Meeting and during the public consultation period were collectively reviewed and addressed during two multi-stakeholder expert workshops held on 26 June and 11 December 2018, followed by four teleconferences held on 20 February, 20 March, 17 April, and 22 May 2019.

Following the collective review of all comments from the public consultation and additional input from stakeholders, the Guiding Principles were presented and endorsed at the Twelfth Plenary Meeting of the Policy Dialogue on Natural Resource-based Development on 20-21 June 2019.

Participants in the Twelfth Plenary Meeting of the Policy Dialogue on Natural Resource-based Development strongly welcomed the Guiding Principles, emphasising their great value-added and the timeliness of their finalisation to support the implementation of the new Extractive Industries Transparency Initiative's (EITI's) requirement for contractual disclosure and to reduce disputes that can lead to investor-state arbitration.

Negotiations' support providers, such as CONNEX, the African Legal Support Facility and the Commonwealth Secretariat, agreed to utilise the Guiding Principles in their ongoing support and programmes in developing countries, and recognised how these principles can reduce the asymmetry of information and can build the capacity of governments in negotiating contracts.

On 10 February 2020, the Governing Board of the OECD Development Centre:

I. **ENDORSED** the Guiding Principles for Durable Extractive Contracts developed by the Development Centre's Policy Dialogue on Natural Resource-based Development;

II. **NOTED WITH SATISFACTION** the vital role of tripartite engagement, through multi-stakeholder dialogue, experience-sharing, and the good faith in the negotiations among host governments, industry and civil society, as useful means to promote mutual understanding, build trust, strengthen mutual confidence, and work towards mutually beneficial solutions and improved development outcomes;

III. **INVITED** the Policy Dialogue on Natural Resource-Based Development to support the Guiding Principles, including by:
   i. actively promoting the Guiding Principles, particularly in the negotiation of extractive contracts;
   ii. sharing best practices and innovative approaches in the negotiation of balanced extractive contracts;
   iii. collaborating, as appropriate, with partner organisations on the use of the Guiding Principles; and
   iv. reviewing the experience with the Guiding Principles and considering possible adjustments.

# *Editorial*

The *Guiding Principles for Durable Extractive Contracts* mark an important achievement for the OECD Development Centre, and the development community as a whole, for three main reasons.

First, they address the difficult question of how to negotiate a fair deal for governments, investors, *and* communities. Unbalanced contracts are not sustainable: they create strained relationships between governments and investors and are often a source of social conflicts around extractive projects. Contracts can facilitate good development outcomes if they ensure a fair sharing of benefits between governments, investors and communities throughout the project life-cycle and across a range of outcomes and market conditions. The Guiding Principles provide guidance on how to do this.

Second, the Guiding Principles, with the endorsement by the Development Centre's Governing Board, are an unprecedented tool, reflecting the common ground reached by its 56 members, of which 27 are OECD countries and 29 are developing and emerging economies. They show how the Development Centre, with its unique membership, provides a policy forum with equal participation from a diversity of countries not only to discuss issues of mutual interest, but to also build consensus and develop innovative approaches to development challenges.

Third, the Guiding Principles are the product of a collaborative effort by governments, industry, civil society, experts and international organisations. The multi-stakeholder process is an achievement in itself, as each actor came to the table with different and sometimes diverging perspectives. At the beginning of the process, there was a trust deficit between stakeholders. The Development Centre, acting as a facilitator, played a crucial role in bridging the divide between different positions. Through an open and transparent dialogue, participants made genuine efforts to understand the motivations and positions of each other and to work towards shared solutions.

Far from settling on the lowest common denominator, the Guiding Principles are forward-looking. They aim to facilitate a common understanding between the parties to the contract about how to approach difficult aspects of their relationship, showing how tensions can be overcome and contentious issues dealt with during the negotiations. The recommended approaches are intended to maintain an alignment of interests throughout the life-cycle of the extractive project, reflecting a balance of risks and rewards shared by governments, investors and communities.

By endorsing the Guiding Principles, the Governing Board recognised the importance, relevance and early impact of this tool, expressing its political support for their use in the negotiation of durable extractive contracts.

As Chair of the Governing Board, let me express the wish that the Guiding Principles will become a common reference for the negotiation of enduring and sustainable extractive contracts leading to improved development outcomes.

*Ambassador Manuel Escudero*

*Chair of the Governing Board, OECD Development Centre*

# *Acknowledgements*

This work originated from the suggestion made by South Africa to identify the key attributes of durable extractive contracts and the preliminary analysis of contractual practice carried out by the OECD Development Centre in 2015.

The initial draft of the *Guiding Principles* were prepared by the Development Centre, serving as Secretariat (Dr. Lahra Liberti, Head of Unit, Natural Resources for Development Unit, with support from Elliot Smith, Legal Analyst, Natural Resources for Development Unit). Subsequent drafts of the *Guiding Principles* were prepared by the Secretariat and benefited from the contributions received during the multi-stakeholder consultation process between December 2015 and June 2019.

The Development Centre would like to express its deep appreciation and gratitude to all those who have inspired and contributed to this collective achievement, by engaging in good faith discussions and by contributing with relentless efforts to this complex, but highly rewarding exercise. In particular, the Development Centre would like to acknowledge the constructive engagement, high quality and valuable inputs received from: Mr Anozie Awambu, Crestle Zanders Legal Practitioners; Mr Joseph Bell, International Senior Lawyers Project (ISLP); Mr David Bertoch, Exxon Mobil; Ms Charlotte Bisley, Social Clarity; Mr Peter Cameron, University of Dundee; Mr Ian Coles, Mayer Brown LLP; Mr Philip Daniel, University of Dundee; Mr Natty Davis, Devin Corporation; Mr Daniel Devlin, International Monetary Fund (IMF), formerly at the OECD Centre for Tax Policy and Administration; Mr Boris Dolgonos, Jones Day; Ms Katerina Drisi, International Senior Lawyers Project (ISLP); Mr Darryl Egbert, Exxon Mobil; Mr Laurent Elizabe, Exxon Mobil; Ms Alache Fisho, Commonwealth Secretariat; Mr Marc Frilet, French Institute of International Legal Experts (IFEJI); Mr Ken Haddow, Kenneth Haddow Associates LTD; Mr Doug Kerins, Exxon Mobil; Ms Christina Konvicka, Exxon Mobil; Ms Laura Logan, Exxon Mobil; Mr Herbert M'Cleod, International Growth Centre, Sierra Leone; Mr Mosa Mabuza, Department of Mineral Resources, South Africa; Dr Howard Mann, International Institute for Sustainable Development (IISD) / Inter-Governmental Forum on Mining Minerals and Metals for Sustainable Development (IGF); Ms Lizelle Marwick, AngloGold Ashanti; Mr Serge Matesco, Matesco and Partners; Ms Katherine Mulhern, formerly at International Senior Lawyers Project (ISLP); Dr Carole Nakhle, Crystol Energy; Ms Paula Norman, Exxon Mobil; Dr Timothy Okon, Ministry of Petroleum Resources, Federal Republic of Nigeria; Prof. Fabien N'kot, Republic of Cameroon; Mr Günther Nooke, BMZ, Federal Republic of Germany; Ms Naadira Ogeer, Commonwealth Secretariat; Mr Robert Pitman, Natural Resource Governance Institute (NRGI); Dr Oral Rainford, Ministry of Transport and Mining, Jamaica; Mr James Reynolds, International Senior Lawyers Project (ISLP); Mr Sam Russ, formerly at Ministry of Lands, Mines and Energy, Republic of Liberia; Mr Mandakhbat Sereenov, Ministry of Foreign Affairs, Mongolia; Mr Amir Shafaie, Natural Resource Governance Institute (NRGI); Mr Amir Shaikh, African Legal Support Facility (ASLF); Mr Iain Steel, Overseas Development Institute (ODI); Ms Salli Anne Swartz, Artus Wise LLP; Mr Nava Touré, Ministry of Mines, Republic of Guinea; Ms Anna Theeuwes, Shell International; Ms Perrine Toledano, Columbia Center on Sustainable Investment (CCSI); Prof. Louis Wells, Harvard Business School; Ms Juliane Weymann, Extractives for Development, GIZ, Federal Republic of Germany; and Mr Joseph Williams, Natural Resource Governance Institute (NRGI).

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## Background

These *Guiding Principles* were developed by the OECD Development Centre to provide resource-rich developing countries and investors negotiating extractive contracts with a common reference to shape durable, equitable and mutually beneficial relationships. The *Guiding Principles* are the result of a process that included multi-stakeholder consultations hosted by the Development Centre between December 2015 and June 2019.

There is clear value in balanced and therefore more durable extractive exploration and production contracts. The *Guiding Principles* aim to provide guidance for the content and negotiation of mutually beneficial, sustainable and therefore enduring extractive exploration and production contracts and thus reduce the risk of disputes and demands for contract renegotiation by either party over time. The *Guiding Principles* are intended to assist host governments and investors 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; and

v. ensure a fair share of the benefits of the development of the resources for all parties to the contract and optimise the value from resource development through equitable, sustainable and mutually beneficial contracts and operations.

The *Guiding Principles* are grounded on the principle of permanent sovereignty over natural resources, as recognised in the United Nations General Assembly resolution 1803 (XVII) of 14 December 1962.

It is recognised that a robust legal framework with comprehensive laws and regulations, setting out conditions of general application for extractive operations and non-discriminatory treatment of investors under like circumstances, and limiting the scope for project-specific negotiated terms, provides a stronger foundation upon which a country can manage its extractive industries according to national priorities, thus increasing transparency and accountability by strengthening institutional checks and balances, reducing administrative costs and possibly investors' perceived risks.

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.

In practice, negotiated agreements are more commonly used in countries where legal systems are not yet comprehensively developed. Even in jurisdictions where well-developed legal regimes govern the relationship between host governments and investors and regulate the majority of extractive exploration and production contracts, the domestic legal framework may still leave room for negotiable elements, especially for large investments and complex projects.

There are instances in which renegotiation may be warranted to avoid issues escalating into a dispute as contracts cannot anticipate all possible outcomes and consequences at the time they are negotiated. These Principles aim to provide guidance for the content and negotiation of mutually beneficial, sustainable and therefore enduring extractive contracts and thus reduce the risk of disputes and demands for contract renegotiation by either party over time.

Recognising the benefits of transparency and reporting in the extractives sector, the parties should anticipate during the negotiation process the public disclosure of their future signed contracts in accordance with international good practice, with due regard taken to both protecting proprietary or commercially sensitive information and the public interest in transparency. Agreeing to publish contracts adds an important dimension of *ex post* accountability to negotiation processes. This means that the parties are likely to negotiate and draft in a manner to ensure that terms are able to withstand public and commercial scrutiny.

There is complementarity between these 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. These include tools to identify, prevent and address heightened corruption risk, where mineral, oil and gas rights are awarded through negotiated deals; and to enable effective government engagement in contract negotiations, including through access to specialist expertise and advice. These Guiding Principles further recognise the importance of the principles on responsible business conduct, as reflected in the OECD Guidelines for Multinational Enterprises and the OECD Due Diligence Guidance for Responsible Business Conduct.

These *Guiding 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.

The *Guiding Principles* do not purport to be an authoritative statement of domestic and international law relevant to the contract. Rather, they are intended to facilitate a common understanding between the parties to the contract about how they will approach certain aspects of their contractual relationship to ensure that the contract is as durable as possible, to the benefit of all parties. They can serve as a common reference for extractive contract negotiations, in accordance with applicable international and/or national laws and international commitments, and taking into account national, and broader, sustainable development objectives and priorities.

## 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 strategies and national and local development objectives they want to achieve with their natural resource endowments (the vision) and how they wish to achieve such goals (the strategy). Host governments should develop, through an inclusive participatory process by all identifiable actors a long-term strategic vision for extractive industries in terms of their contribution to sustainable development, including economic, social, and environmental dimensions. 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 national and local government as well as non-governmental stakeholders, including local communities and 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 sustainable development of a nation's natural resource endowment may not be fully understood by all stakeholders. Without prejudice to the government's unique role in setting the vision, the involvement of non-governmental stakeholders in the process may help deploy a strategy that achieves the strongest positive result for all parties.

3. It is recognised that in practice there may not be full alignment between the investment horizon and/or investors' strategic interests and the long-term vision and strategy of the host government. At a minimum, investors should endeavour to understand the government's long-term vision and strategy. 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.

4. Host governments should 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. Recognising that host governments may not approve all projects as proposed, they should ensure that project proposals are consistent with their long-term vision and strategy for sustainable development.

5. The goals of the long-term vision should inform the government's objectives in the negotiations and need to be properly reflected in the terms and conditions of the contract under which the investor will operate to help long-term interests prevail over short-term interests. Pressure for short-term gains that may arise from both the government and investors' respective sides needs to be carefully handled. In order to be durable, extractive contracts should reflect an equitable balance between the host government's long-term vision, integrating the concerns of local communities, and the legitimate interests of investors.

## Guiding Principle II

*Durable extractive contracts are anchored in a transparent, constructive long-term commercial 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 life-cycle of the project.*

6. The negotiation and signature of extractive contracts are just the starting point of a long-term relationship between the host governments and investors, requiring mutual engagement, transparency and accountability, and clear articulation of respective roles and responsibilities to achieve common objectives. 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 trust, mutual respect, and complete understanding of expectations are of utmost importance. While investors are concerned with the long-term operability of the contract, profit and return on investment to compensate for risks taken and contributions made, host governments are concerned with the need to achieve broader national development objectives and secure a fair share of the benefits derived from the development of their resources. It is the responsibility of the host government to ensure that community interests are protected. Communities 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, access to 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 or expansive expectations concerning the fiscal, social and economic development benefits of a project for local communities and the host government need to be managed and alignment sought. 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 and the negotiations of the contract that many expectations can, rightly or wrongly, become established, and (b) exploration activities may not result in commercial discoveries and production. 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, their contingency, and their sustainability, or not, throughout the project's life-cycle and the consequent potential impacts on affected communities.

8. Disappointment, frustration and even anger may arise because expectations are not met or even discussed. To prevent this, host governments and investors have a role to play in (a) themselves setting realistic expectations, by identifying context-specific issues that are likely to arise at different stages of the project life-cycle; and (b) creating the enabling conditions, including through the host government establishing an appropriate legal and regulatory environment, to provide for open and effective communication, consultation and participatory processes with stakeholders that help manage widely held expectations, achieve understanding and pave the way for mutually beneficial outcomes (see Principle VI).

9. Community engagement is crucial to ensuring the contract's long-term durability. Effective engagement and constructive consultations can help to foster the trust of local communities and indigenous peoples, which is a vital foundation for achieving realistic expectations and understanding. They can help to 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 life-cycle entails for investors to agree with host governments and affected communities on an engagement and consultation process tailored to the characteristics and interests of affected communities. For example, where indigenous peoples or local communities are affected, applicable international and/or national law may require under specific circumstances working towards and obtaining 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 negotiations and the contract terms. Such engagement plans, developed in accordance with applicable national and/or international standards, can help understand priorities on many of the critical social and economic development issues, clarify what can be realistically achieved, including the identification of realistic opportunities for maximising benefits and mitigating risks, and ensure a coherent result that the community can support.

11. Consistent with applicable international and/or national law, the contract should provide a mechanism to ensure meaningful involvement in the process of affected communities so that their views and concerns can be taken into account, and adequately integrated into planning and decision making, especially for projects that may significantly

impact them. Lack of broad community support can threaten the economic viability of the project and heighten corporate and industry reputational risk.

## 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 affected indigenous peoples recognised under applicable international and/or national 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. Local communities should benefit from opportunities which arise through extractive projects such as employment, provision of services and supplies, access to infrastructure, and other community development outcomes.

14. Investors should 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 investments, 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 multi-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 financial and organisational resources is essential for extractives contracts to be sustainable in the long term.

16. Contracts that maintain an alignment of interests throughout the life-cycle of the project are more likely to be durable. The framework for a successful project should reflect a balance of risks and rewards for the parties. 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. The feasibility of a project should account for the additional costs linked to adverse social or environmental impacts over the life-cycle of that project, and for the costs associated with the optimisation of socio-economic benefits through suitable means agreed by the parties. It is critical to ensure the social and environmental elements are integrated into the negotiations and reflected in the agreement.

18. Uncertainty and actual or perceived risks are present at all stages of an extractive project's life-cycle, from exploration through development to production, processing and marketing, decommissioning/closure and rehabilitation. The nature and degree of risks vary at different times during the life-cycle of the project and are context dependent, industry and project specific. Uncertainty on the geological potential diminishes as more information is acquired on the quantity, quality, accessibility of the resource and the costs of extracting it by host governments and investors. Risks 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, are outside of either party's control. There is also uncertainty about the future economics, markets, and politics

that will affect the project. By the time production starts, sunk costs associated with substantial capital investment expose investors to political (expropriation, tax and other policy changes) and economic risks, given the long payback period before revenues are generated and the investment recovered. Meanwhile, uncertainties inherent in the economics of resource extraction (recovery factor, reservoir or deposit performance, project cost, price) persist. Actual or perceived environmental and social risks are as important as other risks and are influenced by many factors, including the operating environment and local community context. If there is not a clear recognition of the need to ensure actual social benefits at the national and community level, irrespective of expected or actual financial benefits, the project may be at risk.

19. Perceptions of risk and opportunities by different stakeholders may 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. Sharing critical information about the actual and perceived 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.

## Guiding Principle IV

*Durable extractive contracts seek to optimise full value from resource development for all stakeholders, including economic, social and environmental outcomes.*

*To the extent not covered by applicable international and/or national 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.*

20. 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 optimisation of the economic value from resource development, taking into account any adverse environmental or social impacts; (2) creation of opportunities for positive socio-economic outcomes, by leveraging, so far as economically practicable, in favour of the host country, and its communities the project's demand for 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, as well as local purchasing and employment, and 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); and (3) the potential for value added processing of resources, where economically feasible, recognising that this may require a separate contract.

21. 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 for the host government, 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 financial, economic, social and environmental benefits in the same timeframe, but all benefits should be incorporated into the objectives of the project

over its life-cycle. At each stage of a project, a host government may have to make trade-offs in order to meet prioritised policy objectives and attract investment. That said, the incremental costs for governments may be small compared to the significant benefits and goodwill 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.

22. Alongside positive contributions, actual and potential direct adverse impacts need to be identified, prevented and, if they cannot be totally prevented, mitigated across the full life-cycle of the project (including decommissioning, abandonment or rehabilitation of the site). It is understood that some negative impacts may make proposed projects non-viable. 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; management and implementation of security; health and safety risks that can arise from extractive projects; use of labour force; environmental degradation, including disaster management; and closure/decommissioning. Host governments, through their permitting and regulatory capacity, have the responsibility to ensure that potential environmental and social impacts are identified as early as feasible and appropriately addressed and monitored through the life-cycle of the project. Investors share in this responsibility, particularly where host governments' law may be insufficient. In all cases, investors should comply with relevant internationally recognised standards. National laws and regulations should prescribe that social and environmental impact assessments are carried out either by experts engaged by the government or the investor and that they are conducted in a specific and transparent manner. These assessments must be completed before conducting activities with a potential adverse impact. 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 and community participatory involvement in the formulation of environmental management plans and social impact management plans, with due regard to the prioritisation of all those who may be impacted, particularly indigenous peoples, women, and children. Sufficient time and 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, as described under paragraph 10 under Guiding Principle II. Beyond compliance with relevant domestic and international law requirements, regulations and standards, host governments and investors can agree to incorporate into the extractive contract requirements consistent with internationally recognised standards and good practice to facilitate the prevention, mitigation and remedy of adverse impacts throughout the project's life-cycle. Requirements that are appropriate to the local context can help to: 1) fill any gaps in domestic laws, policies or capacity to monitor compliance; 2) create common expectations and benchmarks on aspects that are not adequately covered by national and/or internationally recognised standards; 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; and (c) ensuring appropriate and transparent financial arrangements are in place to ensure that sufficient funds are available for the execution of prevention, mitigation plans and remediation responses (e.g. use of escrow accounts, special funds for decommissioning, bank or company guarantees).

23. In particular, to the extent not covered by domestic laws, contractual provisions 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 may be beneficial, and can inform the development of requirements for continual improvement and remediation for any harm caused by the extractive project operations.

## Guiding Principle V

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

24. Absence or limited availability of information on the value of the resources (quantity, quality, price, and costs) affects the ability to determine the size of possible benefits to be shared between 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, development, closure/decommissioning costs, and future market prices. However, at the pre-negotiation stage there may be qualified estimates of possible outcomes.

25. Investors will have better information on the level of capital investment required, the actual operating costs, as well as the value of the intangibles they have developed (e.g. intellectual property related to the design of bespoke equipment and/or new extraction methods 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 time of exploration, development and extraction stages. Host governments should recognise that the financial and feasibility studies carried out by investors to assess the viability of the investment do not normally 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 national laws and internationally recognised standards.

26. 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.

27. 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.), while recognising that they may need to protect strategic and industry-sensitive information.

28. 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 to respond to tenders.

29. Sharing of information between host governments and investors on qualified estimates of the resources, development costs and scenarios, production profiles, and closure/decommissioning liabilities 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 life-cycle (see also Principle VIII). 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 and for their own internal decision-making purposes. Working from the same assumptions and economic and financial models, leveraging third party macro-economic data where appropriate 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 obligations and internationally recognised standards.

## Guiding Principle VI

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

30. 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 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.

31. When evaluating the investment potential in a host country, investors will consider whether a reliable 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. This includes the establishment of laws, regulations and contracts that give accounting and reporting procedures to provide reliable and consistent, coherent information to the public on resource revenue receipts and other obligations, and provide for the publication of signed extractive contracts.

32. 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 unnecessary high costs of compliance. As recognised by the OECD Policy Framework for Investment, "well-crafted regulations can improve the investment climate by creating an 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".

33. 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 unlawfully

expropriated or otherwise impaired. Red tape, bureaucratic burdens and excessive complexity and other constraints such as some of 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. Government should ensure the clarity of administrative procedures, including by effectively co-ordinating activities among different ministries and agencies as well as between the central and local governments.

## Guiding Principle VII

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

*If such changes in law and/or applicable regulations result in the investor's inability to perform its material obligations under the contract or if they lead to a material adverse change that undermines the economic viability of the project, durable extractive contracts require the parties to engage in good faith discussions which might eventually lead the parties to agree to renegotiate the terms of the contract.*

34. Contracts need to be respected and they must be implemented and interpreted in accordance with applicable laws.

35. Extractive contracts that 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, the environment and communities, are more likely to be durable. In line with the OECD Guidelines for Multinational Enterprises, investors "should refrain from seeking or accepting exemptions not contemplated in the statutory or regulatory framework related to human rights, environmental, health, safety, labour, taxation, financial incentives, or other issues". Mitigation of regulatory risk related to changes in fiscal laws to cope with fluctuations in market and project performance conditions is addressed in Principle VIII.

36. Transparency and stakeholder consultations are best practice when policy and regulatory reforms are considered.

37. Negotiating in good faith implies that non-arbitrary implementation of existing laws that have been passed but are not yet in force or that provide for subsidiary or implementing regulations to be put in place should be anticipated.

38. A proper assessment of the legal and regulatory framework and socio-political context will help investors to anticipate the foreseeable development of laws and regulations to meet evolving practices in respect of health, safety, social, labour, human rights and environmental protections.

39. Without prejudice to other measures designed to pursue legitimate public interest objectives, it is presumed that bona fide non-fiscal changes in law that are consistent with

relevant internationally recognised standards and best practices should not be regarded as arbitrary or discriminatory.

40. Investors take into account regulatory risk when deciding whether to invest in a project or in a country: the higher the perceived risk, the higher the investor's risk premium or the less likely an investor is willing to invest, and the lower the assessed viability of the project and its profit potential.

41. Changes in law or regulations that are expropriatory, whether direct or indirect, are subject to the following rules. Foreign property cannot be expropriated unless the following conditions are met: (i) for public purposes, (ii) on a non-discriminatory basis, (iii) in accordance with due process of law, and (iv) against compensation.

42. The costs of compliance with changes in non-fiscal laws wholly and necessarily incurred in the pursuit of a specific project should be considered as any other project costs for purposes of tax deductibility. In oil and gas production sharing agreements, these additional costs would be recoverable from the allocation of "cost oil" or "cost gas". In mining contracts, these additional costs would be treated as deductible expenses in both income taxes and rent taxes.

43. When introducing changes in non-fiscal laws, governments should consider that such changes may increase the project costs and make the project less profitable. A responsive fiscal regime, as recommended in Guiding Principle VIII, incorporates project costs, including any additional costs resulting from non-fiscal changes in law and helps to achieve an equitable sharing of financial benefits between the parties.

44. Extractive contracts should provide for procedures to facilitate the efficient and effective resolution of issues as they arise when changes in non-fiscal law and/or applicable regulations result in the investor's inability to perform its material obligations under the contract or if they lead to a material adverse change that undermines economic viability.

45. In such circumstances, contractual provisions that require the parties to engage in good faith discussions to achieve an agreed solution and which might eventually lead to renegotiate the terms of the contract, where agreed between the parties, can help maintain mutual trust and support a continuous beneficial, long-term relationships.

## Guiding Principle VIII

*Durable extractive contracts are underpinned by a fiscal system that is consistent with the governments' overall economic and fiscal objectives and provides a fair sharing of financial benefits between the investor and the host government, taking into consideration the potential risks, rewards, and country circumstances. As there is no one ideal fiscal regime, each host government needs to identify the optimal mix of fiscal instruments and terms to meet its objectives.*

*A predictable fiscal regime that includes responsive terms defined in legislation and/or the contract to adjust the allocation of overall financial benefits between host governments and investors to variables that affect project profitability (such as variance in commodity prices, costs, production volume, or resource quality) contributes to the long-term sustainability of extractive contracts and reduces the incentives for either party to seek renegotiation of terms.*

*Host governments need to generate financial benefits from the extraction of their resources. Durable extractive contracts avoid sustained periods of commercial production with little or no revenue flows to the government.*

46. In the extractive sector, the fiscal system refers to the combination of general tax law, a sector-specific law, and project-specific contractual agreements, such as: (1) concession agreements, common to both mining and petroleum with the primary instruments being royalty and taxes; (2) production sharing contracts, characteristic of petroleum regimes which share the production between the state and the investor (in some instances, there may also be royalty and taxes imposed); or (3) risk service agreements, sometimes used for petroleum resources, where the host government pays the investor a service fee. When using multiple legislative and contractual instruments, host governments should consider how they interact with each other and with the general tax legislation. Recognising that the specificities of the extractive sector and the need to attract investment result in some variation between the standard tax regime and the extractive fiscal regime, limiting such variations can help to avoid fragmentation and minimise the burden of administration and ensure overall coherence of the fiscal system.

47. Governments decide what combination of fiscal instruments and terms will be appropriate for their individual circumstances. These circumstances include how much the government wants to raise and spend, but also how competitive the government wishes to be to attract investment and encourage resource exploration, development, and production for optimal resource recovery. It is important to devise an optimal mix of fiscal instruments and terms for the given set of country circumstances, knowing that each instrument has its own trade-offs and there is no one ideal fiscal regime.

48. The choice of fiscal instruments and terms may be influenced by the capacity of a particular country to implement them. Close, ongoing co-ordination among different governmental agencies, including Ministries of Energy and Mining, Environment, Finance, Tax Policy and Administration, is important to achieve the right policy balance and successful implementation.

49. Without prejudice to the applicable revenue-sharing arrangements between federal and sub-national governments, extractive contracts that are underpinned by a responsive fiscal regime that provides for the fair sharing of value through all stages of the project life-cycle and across a range of outcomes and ongoing market conditions are more likely to be durable. Extractive projects are likely to operate through several economic cycles and they are likely to experience booms, but also periods of economic stress and loss. Host governments should aim to structure a credible fiscal system that minimises distortions to production decisions, is responsive to price changes, and allows both governments and investors to reduce risk and adequately deal with incomplete information at the time of the negotiation and signature of the contract.

50. Responsive fiscal terms defined in legislation and/or the contract, anticipate multiple profitability scenarios (whether influenced by price, cost, volume, quality, etc.) and equitably rebalance the sharing of financial benefits, foster fiscal stability and contribute to the durability of the contract. The meaning of responsive in this context is that the government share of financial benefits automatically increases when profitability is high, and conversely decreases when profitability is low.

51. This structure can also help governments deal with political pressures which could minimise the likelihood to renegotiate or introduce changes while maintaining the predictability of the contract. Chasing the price of commodities through repeated

renegotiation is neither efficient (given that price volatility tends to be a structural characteristic of the industry), nor it is productive as experience shows that this results in strained relationships between host governments and investors.

52. Without responsive fiscal instruments and terms defined in legislation and/or the contract, pressures for changes in fiscal terms may arise from governments and investors for different reasons. For example, without responsive fiscal instruments and terms, when commodity prices rise, there is often the presumption of a perceived windfall wherein all upside accrues to investors. This creates an incentive for governments to modify fiscal instruments and terms in an attempt to address this imbalance – whether real or perceived. For investors, when prices fall and there are not responsive fiscal instruments and terms it may result in projects becoming uneconomic. This creates an incentive for investors to approach host governments to seek more favourable terms to enable continued activity and production.

53. Fiscal instability is one of the key risks considered by investors, in addition to geologic, political, technical and non-technical risks, which influence an investor's view of the overall investment climate and their assessment of the attractiveness of the investment opportunity. For example, if governments frequently change fiscal instruments and terms when prices rise, this creates additional fiscal risk for investors. In response, investors may require higher project returns to compensate for that risk, or simply not undertake projects. The result is likely to be a consequential reduction of investment and revenues for host governments, if the government fiscal framework is deemed by investors to be unstable.

54. In cases where investors perceive there to be high fiscal or political instability, they may seek the inclusion of fiscal stabilisation clauses to reduce these risks. Host governments may not need to offer or accept to include stabilisation clauses, as they could still attract the required investment through strong constructive negotiations and open competitive bidding involving technically and financially capable investors. Where governments decide they are necessary, fiscal stabilisation provisions can be designed to minimise the general tax policy impact, by limiting its scope to specific key fiscal terms (not all fiscal terms), such as agreed rates, for a specific period of time (not indefinitely), and possibly by applying a stability premium on tax rates. Commensurately, for extractive contracts to be durable, they should contain clear obligations on investors to pay their full share of taxes under the contract and applicable law and the clear rights of the host governments to enforce those obligations. The adoption of bona fide anti-avoidance measures or the interpretation of existing laws by host governments to protect the revenue base against tax base erosion and profit-shifting (e.g. on interest deduction limitations and transfer pricing) and consistent with internationally recognised tax practices should not be considered a change in law constrained by stabilisation clauses.

55. There are various mechanisms available to governments to design responsive regimes. It is worth considering that responsive regimes may increase the burden of administration. The government's limited administrative capacity and performance in managing variable revenues, may point to heavier reliance on less responsive instruments and terms that are easier to administer.

56. The overall government benefits from the development of its natural resources are broader than the fiscal take and can include the development of new infrastructure, employment creation, training, local procurement of goods and services, and community projects. However, if there are sustained periods of production with little or no revenue flows, the contract may not be sustainable as host governments need to demonstrate that the country is benefitting financially from the development of its finite resources.

57. Depending on context, it may be appropriate to ensure a minimum share of revenues to the host government for each year of commercial production. Governments that have a diversified economy and/or wide revenue base may not necessarily need nor desire to receive a payment in every year of production from every single project. For host governments with limited revenue, access to capital markets and project portfolio, the assurance of a minimum level of revenue is important. In addition, for governments with newly developing extractive industries, early revenue flows are important to bolster budgets in light of the population's expectation of realising some immediate benefits from its resource development.

58. Ensuring a minimum share of government revenue can be achieved through a royalty and/or cost recovery ceilings in a production-sharing contract. It should also be noted that these fiscal instruments are regressive and may discourage incremental investments in marginal projects.

59. A fiscal system that includes both regressive and progressive instruments, and that is progressive overall will help to align the interests of the host government and the investor.

## Note

[1] OECD Development Centre, *Policy Statement on Natural Resource-based Development,* 4th High-level Meeting of the Governing Board, 3 October 2017 (http://www.oecd.org/dev/POLICY_STATEMENT_NATURAL_RESOURCES.pdf) .

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OECD Development Policy Tools

# Guiding Principles for Durable Extractive Contracts

The *Guiding Principles for Durable Extractive Contracts* (the Guiding Principles) provide guidance on how resource projects can be developed to reflect the balance of risks and rewards that underpins durable contracts, while taking into account community interests and concerns since the very beginning. The Guiding Principles offer a blueprint for the content and negotiation of durable extractive contracts that can reduce the drivers of renegotiation and can provide adaptive and flexible provisions that, for example, can automatically adjust to prevailing market conditions. They also aim to assist host governments and investors in explaining the content of the contract to the public, thereby helping to overcome tensions between stakeholders. The Guiding Principles set out eight principles and supporting commentary that host governments and investors, as well as negotiation support providers and legal practitioners, can use as a common reference for future negotiations of enduring, sustainable and mutually beneficial extractive contracts.

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**PDF ISBN 978-92-64-92264-8**