Guidance Note on the Tax Aspects of Negotiation and Renegotiation of Contracts[1]

Executive Summary/Purpose

The purpose of this note is to provide an overview of some of the tax and fiscal related issues developing countries face in the negotiation and possible renegotiation of long term natural resource contracts. It will also provide some additional perspective on the negotiation and renegotiation process. This is intended to help developing country policy makers and administrators, and to provide information to other stakeholders, on both substantive and procedural approaches to agreements between such countries and the investors they seek to attract in the development of their potential oil, gas, and mineral resources. Background contained in this note will provide a broader context for options and approaches available in negotiating long term contracts.

Status of the Note

This note is for guidance only. It is intended to identify tax and fiscal related issues in the negotiation and renegotiation of extractive industries contracts, address several of the most significant ones in short form, help build awareness, and ultimately, along with the additional specific issue guidance notes, help those faced with these issues make policy and administration decisions in relation to them.

Background

Developing countries offer prospects for major extractive industry investments over the next several decades. It has been estimated that, in the energy sector alone, some $48[2] trillion of investment will be needed over the next 25 years, with the bulk of that being in emerging economies. How countries attract outside investment while balancing their economic, environmental, and social needs is a major challenge, requiring careful upfront planning and priority setting. In some countries, laws are independently enacted governing the framework for investments in resources, and investors must determine whether they will invest based upon those prescribed rules.[3] In many developing countries, however, where resource development is beginning, a fully developed, detailed sector specific framework may not exist, and thus many of the fiscal elements governing a natural resource development project may be established by negotiations

[1] This guidance note was prepared by the Subcommittee on Extractives Industries Taxation Issues for Developing Countries with help from the Secretariat.
[2] International Energy Agency, World Energy Investment Outlook 2014, p. 32, available at https://www.iea.org/publications/freepublications/publication/WEIO2014.pdf.
[3] Some countries might also have prescribed rules for the mining sector, but which may not be entirely appropriate for the oil and gas sector, and vice versa.

between an investor and the government. It is generally beneficial to define as many of the natural resource development rules as possible, including fiscal terms, in legislation, leaving to negotiation only limited matters. This ensures consistency and transparency, while allowing for flexibility to address some project specific considerations. However, in early stages of resource development, where the rules are evolving, countries may in practice rely on project specific contract negotiations for many items governing natural resource development, including key fiscal terms.

This note will review various considerations and concerns of governments and investors involved in a natural resource contract negotiation, or possible renegotiation as circumstances or parties involved change, with particular attention to tax and fiscal issues. While the most common tax issues will relate to the provisions directly affecting government take, such as royalties, income and additional profit taxes, withholding taxes, VAT, and export taxes, other contractual terms (e.g., decommissioning or requirements to fund infrastructure), and even the procedures in negotiations, can have tax implications. Some of those more important concerns are also addressed in this note.

The ultimate objective for both the government and the investor in a natural resource development project is success over a very long term. The nature of the original agreement terms should provide a structure that maximizes chances to achieve results beneficial to government and investor alike. It should also promote an arrangement where, as differences of view arise over the course of the 20-30+ year relationship, the parties agree to work together to resolve those differences in a mutually satisfactory way.[4]

Interrelationship with other guidance notes

Where other guidance notes cover particular issues more directly, they will be referenced in this note. To avoid duplication, the reader is invited to review those more specific notes. In particular, the Overview Note provides a context for understanding the nature of the Oil and Gas and Mining industries, including the various phases in the lifespan of natural resource projects (i.e., exploration, development, production, processing, and decommissioning). The Overview Note also summarizes the types of

[4] Two very helpful resources covering a wide range of issues in natural resource contracts are: "Mining Contracts--how to read and understand them" [hereafter "Mining Contracts"] and "Oil Contracts--how to read and understand them" [hereafter "Oil Contracts"]. These sources contain a wealth of information, examples, and considerations related to understanding and negotiating long term natural resource contracts, as well as basic information about the mining and oil and gas industries. They each also contain extensive and helpful glossaries of mining and oil terms, and are available free for download at (1): https://s3.amazonaws.com/s3.documentcloud.org/documents/1279596/mining-contracts-how-to-read-and-understand-them.pdf (for mining contracts) and at (2) http://openoil.net/understanding-oil-contracts/ (for oil (and gas) contracts). In addition, the International Institute for Sustainable Development has published a Handbook on Mining Contract Negotiations for Developing Countries, Volume One: Preparing for Success (April 2015) available at http://www.iisd.org/sites/default/files/publications/iisd-handbook-mining-contract-negotiations-for-developing-countries-volume-1.pdf [hereafter "IISD Handbook"] with legal background on contract negotiations as well as negotiating preparation and implementation procedures and practices.

fiscal regimes that generally apply in these industries, while the Fiscal Terms Note provides additional important detail on the elements of such regimes. Together, they provide additional context for the issues reviewed in this note.

Negotiation Background: Country Perspectives

Balancing investment attractiveness with obtaining resource value

In designing a fiscal plan for developing resources, one key objective is maximizing the present value of government revenues. Other important objectives also exist, such as employment creation, training, local content, infrastructure requirements, and environmental concerns.[5] When seeking an investor to bear some or all of these costs, and the other risks associated with developing resources, a country will also need to consider what terms are required to provide investors an adequate return for the risks they take.

A country may address these issues in its statutory provisions related to resource activities, or it may address them on a project by project basis via contractual negotiations. These may be based upon a model contract, but in practice, such a model tends to be a guideline, or a country's "opening position" in what becomes a more specific negotiation, taking account of the specific characteristics of the particular resource to be developed.

Ideally, whether in a statutory or contractual mechanism, the terms and conditions for natural resource projects should be flexible to meet government and investor objectives over an extended period of time, and under different and changing price and cost environments. This can be advanced via a choice of various fiscal tools, but in many cases, in more extreme circumstances, the agreement of the parties to re-open or renegotiate certain provisions is included in contracts.

Priority setting

As suggested in the Overview Note, a key starting point in establishing a fiscal regime, via a general statutory approach or in a particular contract negotiation, is for the country (and the investor) to identify its principles, priorities, and objectives to be achieved.[6] This can take a fair degree of time, and involve input from multiple stakeholders in the planning process.[7] Once a set of objectives is determined, the ongoing design of the

[5] See Fiscal Regimes for Extractive Industries: Design and Implementation, IMF Fiscal Affairs Division Paper, at https://www.imf.org/external/np/pp/eng/2012/081512.pdf, p. 13.
[6] See Overview Note, Background.

[7] See for example the extensive work done in developing the Mozambique Natural Gas Development Plan (http://www.ppiaf.org/sites/ppiaf.org/files/publication/Mozambique-Gas-Master-Plan-executive-summary.pdf); Uganda's Vision 2040 covering overall country development, but noting the importance of contributions to be made by the Oil and Gas and Mining sectors, at http://npa.ug/wp-content/themes/npatheme/documents/vision2040.pdf, pp. 47-51; specifically for mining see the African Mining Vision and "Building a sustainable future for Africa's extractive industry: From vision to action" and particularly the Key tenets of the Vision and programme clusters at http://pages.au.int/sites/default/files/Action%20Plan%20Final%20Version%20Jan%202012%20%282%29.

fiscal regime and other key statutory or contractual conditions should be tested against their impacts on achieving the base objectives.

One of the benefits of relying on a statutory approach for fiscal regimes is that it can embody the agreed upon objectives and ensure consistency among projects.[8] Where more of the terms are left to negotiations, the risks increase that the ultimate contract will not be as fully consistent with the country's agreed upon priorities.

> "Experts increasingly suggest that the model with more detailed laws and regulations …creates a stronger foundation upon which a country can manage its extractive industries according to national priorities. In addition to helping investors to feel like they are being treated equally across deals, consistent terms across projects can streamline monitoring for government institutions. A robust legislative framework may also result in greater public input because the public can more easily participate in the legislative process than in individual contract negotiations."[9]

Where some of the fiscal regime provisions are included in statutes while others are negotiated, the negotiations present the very real risk that conflicts may arise between statutory rules and the contract provisions. This is addressed more fully below in the context of having tax and customs representatives involved in fiscal terms negotiations to ensure enforceability of the contract terms and their conformity with the statutory provisions in place.[10]

Parties involved from Country standpoint (Internal and External Stakeholders)

A key factor that distinguishes natural resource development from many other investments is that they involve "exhaustible" resources, considered country assets, the benefit of which should belong to the people of the country. In addition, considerations of how those benefits are shared between current and future generations are also involved. Finally, while the benefits are often viewed as inuring to the entire country, the disruptions that naturally occur in development activities can disproportionately be borne

---

pdf, page 9. Also see the Natural Resources Charter Principle One, e.g., "Effective and sustainable resource management requires an inclusive and comprehensive national strategy. To achieve this, the government must make a series of key decisions that will affect different groups and set choices extending far into the future. To avoid making decisions in a piecemeal fashion and to build a shared sense of direction, governments should, in dialogue with stakeholders, use a national strategy process to guide extractive resource management decisions." http://resourcegovernance.org/approach/natural-resource-charter/precept-1-strategy-consultation-and-institutions#; and IISD Handbook, section 4.5.1, pp. 49-50.

[8] Consistency among investors and projects can be important from a non-discrimination and anti-corruption perspective. A further benefit to consistency in terms and terminology that a statutory approach provides is the facilitation of administration and compliance enforcement.

[9] "Legal Framework: Navigating the Web of Laws and Contracts Governing Extractive Industries," Natural Resources Governance Institute, NRGI Reader, March 2015, p.6. at http://www.resourcegovernance.org/analysis-tools/publications/primer-legal-framework

[10] Where a statutory rule is no longer realistic, or is not sufficiently flexible to accommodate projects that country negotiators wish to have developed, it is arguably better to adjust the statutory rules themselves than to seek to override or modify them via a contract. An attempted "override" may simply be unenforceable, and lead to conflicts and ambiguities that only increase risk and uncertainty.

by the region or locations where most of the activities are conducted. Thus, special consideration for such localities must be taken into account.

National Government representatives[11]

The establishment of a country's taxation and fiscal regime is a complex exercise, given the many issues involved and, in terms of governmental responsibilities, the numerous agencies or departments involved or affected. Thus, wide range collaboration is essential. Benefits of establishing a regime under a statutory approach, in addition to those already noted, include the likelihood of this wide range of input being obtained, and a higher degree of transparency being achieved. When a country determines its regime under a contractual, project by project, approach to resource development, the challenges of appropriate and full participation are greater. Even in this case, however, establishing a "Model Contract" can be a productive exercise and a means of obtaining input from as wide a group within government as possible.[12]

Further, in light of the long lead times in generating production and, following that, net revenues after cost recoveries, clear descriptions of project results, and their timing, should be communicated. This will help to anchor expectations, particularly with respect to the timing of anticipated benefits, in a realistic context.

Finance Ministry/Planning Ministry

Given the key importance of taxation in contract negotiation, (including all forms of government take), it is essential that the Ministry of Finance be included in development of objectives, in statutory regime structuring, and specific contract negotiations, as the case may be. The further involvement, in collaboration with the Finance Ministry, of the Tax Administration, as well as the Customs Administration, is essential.

Ministry of Finance and tax representatives bring skills to the negotiating team that are particularly important, including the likelihood of being able to conduct economic and financial modeling of the impact of various negotiation proposals and a knowledge of tax

[11] While this note is addressed particularly at taxation issues, and thus the following subsections focus on Finance and Resources (Petroleum and Minerals) Ministries, there are of course many other national level ministries (or organizations) that need to be included, such as ministries overseeing health, safety, and environment, labor and employment, and of course any national mining or oil company. Even when the focus is on taxation and other more purely fiscal terms, involvement of these other representatives is often important since they will provide valuable input into the underlying objectives in their areas. Similarly, even when non-tax or fiscal terms are discussed, inclusion of tax representatives is important since decisions in those areas will no doubt have tax impacts that should be understood and carefully considered. See e.g., Mining Contracts, pp. 22-24. Generally, the parties involved should be largely symmetric as between the government and the investor.

[12] See e.g. Liberia Model Production Sharing Contract at http://www.eisourcebook.org/cms/Liberian%20Production%20Sharing%20Contract.pdf; Tanzania Model Production Sharing Agreement at https://www.google.com/webhp?sourceid=chrome-instant&ion=1&espv=2&ie=UTF-8#q=tanzanian+model+psa; Mexico's National Hydrocarbons Commission documents at http://www.gob.mx/cnh/#documentos; and Timor Leste Model Production Sharing Contract at http://archive.resourcegovernance.org/sites/default/files/Model%20Production%20Sharing%20Contract.pdf

policy and practice to assist in determining and evaluating the composition and approach of which fiscal tools to use.

Further, involvement of tax representatives in the negotiation process creates a better understanding of how the provisions are intended to operate in practice and ensures that they can in fact be implemented as intended. Many examples exist where without involvement of the tax (and customs) administrations, a negotiation will result in provisions that are contrary to the tax laws (including tax treaties) in existence, or may use terms that have different definitions under such tax provisions than the "negotiators" may intend, creating immediate ambiguities, if not outright conflicts, in the interpretation of the agreement and its enforceability under the other statutory requirements in place.[13] In a recent African Tax Administration Forum (ATAF) meeting, one country representative noted that its Tax Administration, which had not been involved in a negotiated contract, found itself unable to implement the terms of a negotiated contract since they were in conflict with the specific tax laws of the country. This forced a renegotiation of a contract that the investor and the government negotiators had signed (and thought was finalized).This result can be largely eliminated by ensuring participation and inclusion of tax and customs administrations in the negotiation process.[14]

Such participation can be achieved by having representatives of the affected agencies on the negotiating team or, at a minimum, available to and regularly consulted by the team throughout the process. It is equally important that investors work with the negotiating parties to clarify that such involvement and consultation is undertaken.

Uncertainties that may exist in implementation of any aspect of the agreement will simply increase the risks the investor will see, and will therefore affect the terms of the negotiations. Reducing these types of risks is beneficial to all.

[13] See e.g., a recent Parliamentary Briefing issued by the Natural Resource Governance Institute noting, "Through their oversight role, parliamentarians should…[e]nsure that all legislation affecting the fiscal elements of oil, gas and mining projects are coherent. Some countries have wrestled with inconsistencies between pieces of legislation." Getting a Good Deal from Oil, Gas and Mining Parliamentary Briefing January 2015 FISCAL REGIMES FOR OIL, GAS AND MINERALS, in http://resourcegovernance.org/sites/default/files/documents/nrgi_fiscalregime_20150311.pdf, p. 4. While ambiguities in statutory interpretations can occur, generally providing for as many of the fiscal terms as possible in statutes, and minimizing the terms that are agreed to via separate contracts, will help to reduce ambiguities. Ghana presents an interesting dichotomy here given that it has traditionally provided the fiscal terms in the mining sector on a negotiated contract basis, while it is generally standardizing terms in the oil and gas sector by means of statutory requirements.
Further, the language differences of negotiators, and differences between the language in which the negotiations are conducted and the ultimate contract language, can affect how agreements are understood by the parties, and is another area that can generate ambiguities.

[14] Another example of conflicts between contracts and statutes involved a country where separate contracts negotiated with a number of mining companies specified different periods for the carryforward of losses for tax purposes. In some cases the contracted period was longer than the country's statutory one, while in other cases it was shorter. Each of these presented issues of interaction between the contract and the existing tax law, and provided outcomes that could be much different from what the negotiators intended.

Full inclusion in the negotiating process may sometimes be harder to achieve in very limited negotiations, and is one reason to avoid those processes. Where that is not possible, it is again in both the country's and the investor's interest to minimize risk through consultations with tax and customs representatives.

Resource (Petroleum and Mining) Ministries

The Petroleum or Mining Ministries will clearly be involved in contract negotiation and in some, if not all, of the fiscal (government take) structuring. They are most likely to know the asset characteristics (e.g., the geology, market, and needed infrastructure) that are key elements in understanding and estimating the value of the resource itself. Again, however, given the clear overlap with numerous tax issues, the Resource Ministries should coordinate closely with the Finance Ministry (and Tax and Customs Administrations) to ensure full enforceability of the arrangements and complete understanding of their economic effects.

In the fiscal regime planning stage, it is important to have robust economic (including tax) modeling tools to evaluate the impacts of the various options and fiscal tools which ultimately will form the overall fiscal regime. Similarly, where some or a large portion of that regime is developed under a project negotiation, having project based economic modeling tools is essential. Those with knowledge of the resource need to combine efforts with those with the financial and economic evaluation skills to understand the predicted outcomes under numerous scenarios such that they are fully prepared for how the negotiations will transpire and can provide key information to the ultimate decision makers.

Before finalizing an agreement, an important "best practice" is again to work through all of the proposed fiscal terms under several development and production scenarios, and with input and computations developed or reviewed by the agencies responsible for each particular item of significance (i.e., customs agencies on duties, tax administrations on various taxes involved, natural resource and finance ministries for royalties and other financial payments, etc.) Doing this in as much detail as possible can ensure alignment and understanding within the government, and between the government and investor, of how the terms are intended to operate in practice and can provide the opportunity to revise or clarify provisions where ambiguities are found.

> To achieve full benefit from the concession contracts it negotiates, the Government will have to effectively monitor, and ensure compliance with, the terms of its negotiated agreements.[15]

Thus, having a complete and agreed understanding of what the negotiators meant the agreement terms to mean is a clear prerequisite to ongoing successful implementation, monitoring, and enforcement.

[15] Raja Kaul *and* Antoine Heuty *with* Alvina Norman, Getting a Better Deal from the Extractive Sector--Concession Negotiation in Liberia, 2006-2008; A report to the Liberian Reconstruction and Development Committee Office of the President, Republic of Liberia, Revenue Watch Institute, 2009, p. 77.[hereafter Liberian Renegotiation Report].

Regional and Local counterparts

In addition to ensuring that all relevant governmental concerns at a federal level are addressed, it is also very important to involve regional and local governments—i.e., those where the operations will take place-- in the planning stages (i.e., before an area is opened up for exploration or for bidding, and before activities commence) and in the negotiation process. While this is a clear issue in terms of how the project will actually be physically implemented (with roads, port expansions, and other infrastructure directly impacting local and regional areas), the actual mechanism by which a fair sharing of government revenues occurs is a critical issue which should be covered by statute or a negotiated contract. Failure to address this issue adequately-- both at the planning stage and during the negotiations--can lead to project delays, inefficiencies, and disruptions as a result of local dissatisfaction.

Negotiation team participation

The makeup of the country negotiating team is a key issue. While the team conducting the actual negotiations with potential investors cannot practically include all interested (and important) members, a mechanism to ensure their input is critical to the success of the negotiation.

> "There is no one structure for government negotiating teams. Practice is diverse across the globe.... It should be noted that bigger is not necessarily better when it comes to seats at the table. A single negotiator or 3-4 negotiators may be much more efficient than a group of 15. Confusion, distraction, and divide-and-conquer techniques can be employed for large negotiating teams."[16]

One framework to consider is having a relatively small core negotiating group that conducts the formal negotiations, with a larger team of negotiation advisors who provide relevant input before and throughout the negotiation process on issues consistent with their expertise. In addition, when particular negotiating sessions focus on certain specific issues, it may be appropriate to include in the session the subject matter expert. For example, if there are specific taxation issues that are to be negotiated, a government tax representative could be included in that session even if otherwise financial issues are handled by the Finance Ministry.

How the political dimension of a negotiation is handled, including interaction with the negotiating team, is a critical issue. The Liberian renegotiation study noted the benefit of strong and engaged leadership:

> President Sirleaf's leadership in the ArcelorMittal and Firestone negotiations was key to the success Liberia achieved. From the beginning of the process, the President managed the negotiating process and allowed a direct reporting line from the Chairman of the negotiating team to herself. Among other things, President Sirleaf…clearly communicated a vision of national priorities to the nation and investors….

[16] Mining Contracts, pp.22-24. See also "Building the winning negotiating team", in Thompson, The Truth About Negotiations (FT Press, Upper Saddle River, N.J.), 2008, pp. 169-171.

> The President's leadership… displayed her consistency, integrity (the negotiation team knew they could count on her backing if needed), and involvement. She sought updates, listened to the negotiating team and its advisors, was accessible, was a consensus builder, held people accountable, had substantive knowledge of the issues being negotiated, and was decisive."[17]

Communication protocols

A mechanism to ensure robust communication among the negotiating team and advisors is important to achieving a successful outcome, and an agreement that can be implemented as intended. For example, almost all issues have a tax implication, whether it be income, VAT, excise, customs, withholding, or individual taxation matters, (and including where applicable tax treaty issues). It is therefore always helpful to ensure tax issues are understood by the negotiators. To illustrate, the termination provisions of a contract will likely provide some requirement to reclaim and restore the mining or oil and gas production sites. The issue of who will bear this cost, and how those costs are addressed under the country's tax law (or, if the negotiators wish to provide tax treatment under the contract) are key to the economics of the deal. Negotiators not expert in tax matters may not immediately appreciate the tax implications of various options for addressing this issue. Having an effective communication procedure in place with advisors will ensure the negotiators understand and account for the tax effects of various proposals. See the Guidance Note on Decommissioning Costs for additional detail on this specific issue.

When negotiations are at certain critical stages, there may be concerns about information sharing outside a relatively small group. Again, however, that group should ensure that it has a full understanding of the tax implications of the decisions being considered. The best way to ensure this is to include a tax representative within that group; failing that, having a consultation with the tax representative and fully explaining what is being proposed is the next best approach. In this context, the tax representative needs to be entrusted to understand the full context of the issue—in some cases, country tax representatives have noted that they have been asked "hypothetical" or "piecemeal" questions, and this can lead to responses that are different from what would apply if the full context of the facts involved were known.

Model issue notes

One way to provide input where individual involvement may not be practical is via written issue notes on items of importance. For example, a tax administration note outlining some of the basic rules in the tax law applicable to resource investments could further highlight that if the negotiators desire to deviate from statutory rules, they will need to obtain legislative amendments or the tax administration will be unable to implement

[17] Liberian Renegotiation Report, p. 9. See also the IISD Handbook, Section 4.4.5, p. 45: "The role of the Minister or President in any negotiation is critical. It can be extremely constructive when Ministers are fully onside with the negotiating strategy, and very destructive to longer-term national goals when short-term personal or political goals are at the forefront of their individual objectives."

them. In addition to model issue notes that may be provided as background within a negotiating team, explanatory notes may also be helpful, and exchanged, with the opposite negotiating team. This can help negotiators from both sides to have the same understanding of how tax provisions important to each side operate in practice. When creating issue notes, either meant only for one's own team members or to be exchanged, making a record of the note, and its transmission details, is a best practice.

Other stakeholders and constituents

Consultation with non-governmental stakeholders in the planning and implementation of awarding resource contracts, or in structuring a statutory regime covering resource development, is important to generate trust in the process, and the outcome, of such activities. Community engagement prior to any negotiations, and during the process itself, can be a key factor in gaining community support. Such consultations and ongoing input also need to be appropriately managed in terms of time frame and subject matter. As noted in the the context of the Liberian contract renegotiations:

> A majority of government officials—including the President—are favorable to consultations with non-governmental stakeholders as long as they are time-bound and focused. Consultations with non-governmental stakeholders should take place early in the concession award process as part of the bid tender, evaluation, or award process. If there have been no consultations as part of the process to select the concessionaire, then a time-bound and focused consultation at the outset of the contract review phase is advisable.
>
> Some in the Government have pointed out that soliciting third-parties' input during the concession negotiation phase runs the risk of breaching the confidentiality required during negotiations. The development of a non-governmental stakeholder consultation mechanism should be done….Prior to finalizing such a mechanism, input should be sought from non-governmental groups such as community representatives and labor unions.
>
> Consultations with stakeholders should occur as part of the concession bid tender, evaluation and award process. If this is not possible, then consultation with non-governmental stakeholders should occur as part of the contract review process. In adopting rules for consultations with stakeholders, the Government should require that such consultations occur early in the negotiation process (i.e., during the contract review process *and* prior to the development of a draft term sheet); as part of a formal public process; and in a time-bound and focused manner.[18]

Some outside groups push for inclusion on the negotiating team but this is usually not accommodated. The more common practice appears to be consultation prior to and at appropriate times during the negotiations, plus review of the draft final contract. Each country will have to determine the best balanced approach to this issue.

There are often times during the negotiations when confidentiality is important. There may be proposals and counterproposals on important negotiating points, including proposed trade-offs among various terms. Negotiations conducted "publically" on these

[18] Liberian Renegotiation Report, p. 61.

positions are far less likely to be successful.[19] Nevertheless, the final product, including explanations of the various trade-offs embodied within it, should be available for review and comment. Negotiators should also be prepared to explain their final positions taken in concluding the overall agreement.

Outside Advisor Resources

It is often stated that investors negotiating natural resource development agreements possess asymmetric information and skills, given their technical expertise and greater experience in such matters. There are several ways to address this issue, depending on time and resources available.

First and foremost is to identify the information and skills the government needs (e.g. valuation of the resource or project, overall market analysis, legal or other negotiation skills, environmental expertise, and economic modeling) and then identify which of these can be adequately covered from within the government itself. In many cases, countries do in fact have the knowledge and skills required and should take full advantage of these resources. Where it is determined that gaps exist, or where additional augmentation is desirable, identifying options and putting together a plan for dealing with these is the next step. A number of possible approaches exist.

One option is to hire outside advisors as needed to meet the country's needs. While a great number of organizations are available to provide natural resource project support, some on a pro-bono basis and others on a partial or full funding approach, when a country is preparing to embark on serious, substantive negotiations, there is no substitute for hiring technical, legal, and financial advisors from the private sector for pre-negotiation planning and negotiation support. In some cases, funding support for this may be available, but even where that is not the case, given the overall size and significance of natural resource projects, and the amount of potential revenues involved, the immediate and consistent availability of dedicated service support is worth the cost. Even with all of the expertise that investors have, they often also hire outside assistance. To equalize negotiating strength, it is strongly recommended that where dedicated, longer term, project negotiating support is required, countries should seriously consider going to the private sector and hiring such high-level support.[20]

[19] The substantive renegotiation by Liberia of the ArcelorMittal iron ore and associated minerals concession contract was begun in New York for several reasons, including the consideration that, "…[h]aving the discussions in New York also increased the Government's chances of maintaining confidentiality around the negotiations. The Government and its technical advisors felt that strict confidentiality at this stage of the process was absolutely necessary if Liberia was to succeed in its bid to renegotiate the MDA [Mineral Development Agreement]. Everyone acknowledged that negotiations conducted through the press would make it harder if not impossible for the Government to reach agreement with ArcelorMittal." Liberian Renegotiation Report, pp. 33-4.

[20] See, e.g., Federal Ministry for Economic Cooperation and Development, Natural Resource Contracts as a Tool for Managing the Mining Sector, 2015, pp. 54-56 in support of this point and for a general discussion of the role of outside advisors and the "Question of External Assistance," available at https://www.bmz.de/g7/includes/Downloadarchiv/Natural_Resource_Contracts.pdf . See also IISD Handbook, section 4.4.4, "Outside Expertise: Capacity provision and capacity building", pp. 47-49. In addition, when a country does decide to hire outside support, a robust and transparent process for

Many organizations are available to provide overall background to a country beginning or enhancing its education on important natural resource development issues. These include well known international and regional financial and development organizations, assistance organizations supported by one or a small number of countries or other organizations, and numerous non-governmental organizations dedicated to providing support with respect to natural resource matters. These can be quite helpful in providing basic information, more general in nature, rather than specific technical support for a particular project or contract.

In addition to more generalized information and support, specific project related negotiations support is also provided by several organizations. An excellent window into the array of advisors, technical assistance programs, and other advisory and support tools for negotiations is the "Negotiations Portal for Host Country Governments."[21] The Portal, operated by the Columbia Center on Sustainable Investment (CCSI), is part of the G7's 2014 CONNEX Initiative to address the need for contract negotiation assistance by:

> …Strengthening Assistance for Complex Contract Negotiations (CONNEX) to provide developing country partners with extended and concrete expertise for negotiating complex commercial contracts. G7 Summit Communiqué, June 5, 2014.

The Code of Conduct for the CONNEX[22] initiative states:

> … the objective of the initiative is to strengthen advisory support to low-income country governments in negotiation of complex commercial contracts – to make the support that is available more comprehensive and more responsive to government's needs and to contribute to fairer, more sustainable investment deals. This includes not only the provision of information and capacity building, but also the improvement of advisory services involved directly in contract negotiations.

The CONNEX initiative is especially directed to natural resources.[23]

The CCSI has compiled a helpful database of significant negotiation support organizations, with background and contact information for each of the organizations listed.[24]

A country utilizing pro-bono support, or even fee-based support when the fees are paid by others, needs to assure itself as to the quality of the expertise being provided, including that the donor organization's technical support provider is sufficiently experienced in the particular area where advice is being sought. For example, one would not expect to obtain top level tax law advice from other than a tax specialist, and

identifying and hiring advisors is essential. It would be doubly harmful to incur the costs for an outside advisor that fails to provide the level of technical, financial, or legal assistance needed.

[21] http://negotiationsupport.org/

[22] http://www.bmz.de/g7/includes/Downloadarchiv/150505_CONNEX_Code_of_Conduct_final.pdf

[23] http://www.bmz.de/g7/en/Entwicklungspolitische_Schwerpunkte/Connex/index.html

[24]see http://negotiationsupport.org/providers a list of specific organizations that provide support, together with the nature of such support, during the planning, preparation, negotiation, monitoring, and implementation stages of natural resource projects,

thus a securities or contract lawyer should not be utilized to provide the level of technical tax support that might be sought. In addition, a country considering reliance on outside organizations for support should assure itself that the support needed will be timely, and sustained, throughout the negotiation process.[25]

Outside legal advisors

In addition to resources available through organizations such as the International Senior Lawyers Project,[26] and others included in the Negotiations Portal for Host Country Governments list of support organizations, some major law firms make their partners available from time to time to assist countries in negotiating activities. See the Liberia Renegotiation Report summary noting that certain law firms provided valuable assistance to the Liberian negotiating team.

Project forecast models

The IMF has developed and issued a Fiscal Analysis of Resource Industries (FARI) tool[27] which can model project level cash flows for both petroleum and mining projects. A technical explanation of the model is also available.[28] The FARI model has been successfully utilized in a number of Asian and African countries, and the IMF is available to consult and assist in the implementation in appropriate circumstances by longer-term FARI training to government officials, and hands-on modeling workshops, and remote assistance from D.C.

Other investment advisors with modeling capability can be accessed, and the Negotiations Portal for Host Country Governments list of support organizations referenced above can be consulted for some of these additional providers.

As previously noted, economic modelling capability is crucial for governments. The benefits of contract/project based economic models are summarized:

> Governments can use models to experiment with various policy options and measure their impact. They can use them to assess the impact of modification of fiscal terms proposed in contract negotiations in a range of alternative price, cost, and production level scenarios. Companies generally use economic models to assess natural resource tax regimes and for contract negotiation, and governments are at a serious disadvantage if they do not have the same tools at their disposal.[29]

Sample contracts

---

[25] For some of the sensitivities countries should consider in relying on outside support organizations, see Federal Ministry for Economic Cooperation and Development, Natural Resource Contracts as a Tool for Managing the Mining Sector, 2015, pp. 54-56, available at https://www.bmz.de/g7/includes/Downloadarchiv/Natural_Resource_Contracts.pdf .

[26] http://islp.org/

[27] http://www.imf.org/external/np/fad/fari/index.htm#2

[28] http://www.imf.org/external/pubs/ft/tnm/2016/tnm1601.pdf

[29] Calder, Jack, Administering Fiscal Regimes for Extractive Industries: A Handbook (International Monetary Fund: Washington, D.C.) 2014, p. 95.

A number of sample contracts are available from various sources, including the Extractive Industries Source Book,[30] Open Oil,[31] and Resource Contracts.[32] As of 2013, Open Oil suggested that either model or actual signed contracts were publically available for: Afghanistan, Angola, Azerbaijan, Bangladesh, Brazil, Burkina Faso, Cambodia, Colombia, Congo, Cyprus, DRC, Ecuador, Equatorial Guinea, Ethiopia, Ghana, India, Iraq, Jordan, Kenya, Liberia, Libya, Mauritania, Mexico, Mongolia, Mozambique, Nicaragua, Peru, Senegal, Sierra Leone, Tanzania, East Timor, Trinidad and Tobago, Turkmenistan, and Uganda.[33]

Sample mining agreements and models/examples of mining contract provisions are available under the Model Mining Development Agreement Project.[34]

In its directory of Petroleum and Mineral Contracts, Resource Contracts has at least one contract (model or actual) for 89 countries.[35]

Negotiation Background: Investor Perspectives

Understand country priorities

Just as it is important for a country to critically evaluate its priorities and key objectives in developing its resources, it is basic to a successful negotiation that the investor dialogue with the country to ensure a full understanding of the country's goals. Ideally the initial discussions can be at a high level where basic principles, objectives, and obligations are articulated and debated. Seeking to understand the underlying interests that the parties have can often lead to solutions to positions that might otherwise appear to be intractable.[36]

Look for long term relationships

Investors will explain one of their basic objectives is to develop a long term, mutually beneficial relationship with the country. Agreements that are overly favorable to one side are not likely to be lasting ones and certainly will not operate to maximize the value of the resources to be developed. If overly favorable to the investor, the country will

[30] http://www.eisourcebook.org/676_58ContractNegotiationsandDisputeSettlement.html
[31] http://repository.openoil.net/wiki/Downloads
[32] http://www.resourcecontracts.org/ In addition, over 40 Production Sharing Contracts entered into by the Kurdistan Regional Government are available at http://cabinet.gov.krd/p/p.aspx?l=12&p=1

[33] http://openoil.net/2013/10/07/openoil-is-looking-for-partners-to-analyse-oil-contracts-around-the-world/
[34] http://www.mmdaproject.org/
[35] http://www.resourcecontracts.org/
[36] "Negotiators too often state their positions as opposed to their underlying interests. For example, an IMC [International Mining Company] will state that it will not pay income tax above a certain rate and it will not agree to a cap of deductible costs. Meanwhile the government will state that a large front-end payment is mandatory and that taxes are payable on the date of a commercial discovery. If they were talking about their respective interests, the IMC would explain that it needs a minimum Internal Rate of Return (IRR) on its capital to get approval from its Board of Directors, failing which its investment committee will not approve the project. The government would state that it needs income as fast as possible, or it could face mounting political pressures. When interests are clearly expressed, it is easier to see where the parties can compromise." Mining Contracts, pp. 184-5. See also "Focus on Interests, Not Positions" in Fisher and Ury, Getting to Yes (Penguin Books, New York), 1983, pp. 41-57.

press to renegotiate or simply impose new terms. If overly favorable to the country, the investor will likely terminate the contract at the first opportunity, and development of the resource itself may be jeopardized. Agreements that provide a balance of interests, and which provide some degree of flexibility in case of material and substantial changes in circumstances, can create an underlying contractual structure most supportive of a successful long term partnership.

Articulation of investor needs and investor risks[37]

The extractives industries are unique in many ways: The sector is shaped by high sunk costs in the form of substantial investments that often cannot be recouped if a project is unsuccessful, long lead times from initial investment to project start-up, fluctuating costs and prices that in turn influence the profitability of exploration, development and extraction, volatile demand, very long production/project lives, and substantially greater environmental impacts to address, including ultimately 'decommissioning' or reclamation responsibilities.[38] An investor committing to the substantial outlays required for these investments will look for a satisfactory return taking into account all of the risks the investor bears. This is one reason why it is difficult to compare fiscal regimes and general return levels across countries, since the degree of geologic, political, and economic risks varies country by country and even project by project.

One key consideration that can benefit a country in its negotiations is that the more a country can reduce investor risks, the lower the return the investor will need, and hence the more it will be willing to pay. Investors themselves further seek to reduce risks given the large, and usually upfront, amounts they make, and hence generally see benefits in stability and predictability of laws and fiscal arrangements.

[37] For a more complete list of the risk factors investors face, see "Table 1.4 Categories of risk facing an energy investment project", International Energy Agency, World Energy Investment Outlook 2014, p. 32, available at https://www.iea.org/publications/freepublications/publication/WEIO2014.pdf.

[38] It is important to assess the risks at the time they are undertaken. A simple example illustrates this point. Assume A offers to sell to B a right to receive $1000 if B can toss a coin and get heads 5 times in a row. The odds of this occurring are one in 32 (i.e., 0.5^5). The risk weighted value of this is 1/32 x $1000 or just over $31. This is therefore what A can expect B to pay for this contract right. Suppose after B has obtained 4 heads in a row, it wishes to "cash out" and offers to sell its rights to C. The odds at this point of realizing the $1000 payment have increased from 1/32 to one in two, and the value of the "contract" has increased from $31 to $500. To say that B is being "overcompensated" since he paid only $31 for the contract rights which now have a $500 value is simply not correct since it ignores all of the risks taken by B up to that point. A was fairly compensated for its sale and B is now fairly compensated as well. One can change this example to add a feature to the original contract such that, in the event B does obtain 5 heads in a row, in addition to the $1000 it will receive, it will have a chance to receive an additional $10,000 by rolling a die and it coming up as a 6. The odds of getting the additional $10,000—at the outset--are 1/192 (1/32 x 1/6). The additional price B would pay A for this significant "upside", at the outset, would be $52. But after B had achieved four heads in a row, the odds of the significant upside become 1/12, with an expected value of $833. This latter example could be viewed as similar to a case where an unexpected, or low probability but sustained upside in resource prices occurs well after the original contract date. The underlying economics of the contract would have built this in to the original expected value (as well as offsetting unexpected downsides).

> "It's all about risk and reward. If you can help reduce the IOCs' [International Oil Companies'] perception of risk they will be prepared to give you an even bigger share of the reward. OR, to put it another way: Offering a stable, consistent and predictable tax environment, with a fair, transparent, timely and reliable appeals process is very valuable to IOCs. If you can convince them that you will provide this they will accept a higher government take.[39]

Stability clauses[40]

Investors frequently seek provisions in contracts that operate to limit the changes that can be made over time, most especially to the fiscal terms. This is because the projects generally involve substantial upfront capital and the project lives are expected to last for long periods. As noted, investors seek to reduce risks as much as possible, and given that government policies and officials will almost certainly change over time, a way to provide some degree of stability against such changes is often sought. "Stability" or "stabilization" provisions are common in natural resource contracts and are one of the mechanisms used to reduce political and legislative risks.

Stability clauses have themselves evolved over time. Most of the early clauses generally froze the important aspects of the fiscal and legal regime applicable to the particular project to what was in effect at the time the contract was agreed upon. This provided investors with a higher degree of confidence that the important fiscal and other legal provisions upon which their economics were based would last throughout the project. A criticism of such "freezing" clauses is that they infringed on a country's sovereignty to change its laws over time. In reality, such clauses did not technically freeze the government from enacting changes, but instead provided a contract right to the investors that, should such changes be made, a contractual payment for "damages" would be due.

Nevertheless, clauses have generally evolved from the "freezing" type of provisions to ones more of an economic equivalence approach—hence many clauses now provide that should certain governmental changes occur (e.g., an increase in the tax rate), the parties agree to negotiate changes to the contract to place the investor back in the

[39] Bill Page, "Petroleum Tax Administration in EAC Countries: A Private Sector Perspective," presentation made at Fiscal Management of Oil and Natural Gas in East Africa-- East African Community and International Monetary Fund Workshop, January 15 – 17, 2014 Arusha, Tanzania, workshop materials available at https://www.imf.org/external/np/seminars/eng/2014/eac/pdf/031514.pdf, pp. 132, 137.

[40] A number of helpful articles and sources deal with stability clauses and related issues. For example, see Polkinghorn, Michael, STABILIZATION CLAUSES AND PERIODIC REVIEW OUTLINE at http://www.energycharter.org/fileadmin/DocumentsMedia/Events/CCNG_2015_Michael_Polkinghorne.pdf; Nahkle, Carole, Fiscal Stabilization in Oil and Gas Contracts – Evidence and Implications, at https://www.oxfordenergy.org/publications/fiscal-stabilization-in-oil-and-gas-contracts-evidence-and-implications/; Tade Oyewunmi, Renegotiation and Stabilisation of International Oil and Gas Contracts (2016) available at http://www.slideshare.net/TadeOyewunmi/renegotiation-and-stabilisation-of-international-oil-and-gas-contracts; and Philip Daniel and Emil M. Sunley, Contractual assurances of fiscal stability, in P. Daniel, M. Keen and C. McPherson (eds.), The Taxation of Petroleum and Minerals: Principles, Problems and Practice, (Routledge, New York 2010), Chapter 14 at p. 405.

general economic position it would have experienced had the particular law change not occurred. If the parties cannot successfully negotiate a change in the overall contract, in certain circumstances an investor may nevertheless be able to seek compensation based on the economic equivalence provision.

In some cases, the law itself can actually contain stability related provisions. For example, in South Africa, fiscal stability is viewed as an important tool to facilitate future oil and gas investment (given the high costs of capital investment, combined with high risk and delayed potential profit). Current income tax law grants the Minister of Finance the power to enter into binding fiscal stability agreements with oil and gas companies. The predetermined terms were developed in a legislative process which allowed all interested parties to provide input and comments (including presentations to the Parliamentary Committee on Finance) and required written responses by the National Treasury.

A fiscal stability agreement concluded between the South African Minister of Finance and an oil and gas company in respect of an oil and gas right guarantees that the provisions of the Tenth Schedule to the Income Tax Act of 1962[41], on the date of

---

[41] The fiscal stability provisions set out in paragraph 8 of the Tenth Schedule to the Income Tax Act of 1962 are as follows:

> "FISCAL STABILITY
>
> 8.(1) (*a*) The Minister may enter into a binding agreement with any oil and gas company in respect of an oil and gas right held by that company, and that agreement so entered into must guarantee that the provisions of this Schedule (as at the date on which the agreement was concluded) apply in respect of that right as long as the right is held by the oil and gas company.
>
> (*b*) …
>
> *(c)* …
>
> (2) (*a*) In the case of a disposal of an exploration right, …, an oil and gas company that has concluded an agreement as contemplated in subparagraph (1) in respect of that right may… assign all of its fiscal stability rights in terms of that agreement relating to the exploration right disposed of to any other oil and gas company.
>
> (*b*) In the case of a disposal of a production right,… an oil and gas company that has concluded an agreement as contemplated in subparagraph (1) in respect of that right disposed of may… assign all its fiscal stability rights in terms of that agreement relating to the production right disposed of to another company if that other company is a company within the same group of companies as the oil and gas company transferring the fiscal stability right at the time the agreement is concluded.
>
> (3) ,,,
>
> (4) An oil and gas company that has concluded an agreement contemplated in subparagraph (1) in respect of an oil and gas right may at any time unilaterally terminate the agreement in respect of that oil and gas right so held with effect from the commencement of the year of assessment immediately following the notification date of the termination.

conclusion of the agreement, will continue to apply to the oil and gas right as long as the right is held by the oil and gas company. However, an oil and gas company may unilaterally terminate the agreement if so desired. The reason for termination could be that subsequent tax changes are more taxpayer favorable than the tax rates, deductions and rules applying on disposal of oil and gas rights, provided for in the Tenth Schedule on the date of conclusion of the agreement.

It is likely that an investor will seek some form of a stabilization agreement, and each country must decide whether, and the degree to which, it is willing to provide such stability. Countries like South Africa and The Netherlands[42] have considered this issue and determined to provide some aspects of stability by means of its statutes. When implemented on a negotiated contract basis, the trend appears to be toward using economic equivalence type of provisions requiring a good faith negotiation between the parties. One other important technique that provides stability with respect to income or profits based taxes is a “pay on behalf” approach. Egypt provides a clear example of this since, under its Production Sharing Agreement provisions, the governmental entity that is a party to the PSA makes income tax payments to the government on behalf of the contractor.[43] The contractor, however, is still subject to the Egyptian income tax and continues to file own tax return. Under the “pay on behalf” approach, the government effectively withholds amounts due to the contractor equal to the contractor’s tax liability and remits such amounts to the government, since these amounts are treated as additional taxable income to the contractor that must be reported on its Egyptian income tax return. Nevertheless, this contractual approach effectively insulates the investor from changes in the income tax laws with respect to the project.[44]

---

(5) …

(6) If the State fails to comply with the terms of the agreement contemplated in subparagraph (1) and that failure has a material adverse economic impact on the taxation of income or profits of the oil and gas company that is party to that agreement, that oil and gas company is entitled to compensation for the loss of market value caused by that failure (and interest at the prescribed rate calculated on the compensation from the date of non-compliance) or to an alternative remedy that otherwise eliminates the full impact of that failure.

[42] See article 55 of the Netherlands Mining Act [more precise cite to follow].
[43] Egypt actually enacts into law each Production Sharing Agreement, and thus the entire contract has the force of law and cannot be changed except with the approval of the Minister of Petroleum and the Parliament.
See Production Sharing Agreements: An Overview in Egypt Oil and Gas Web Portal (March 2015), at http://www.egyptoil-gas.com/publications/production-sharing-agreements-overview/.
[44] Ernst and Young Global Oil and Gas Tax Guide (2015), available at http://www.ey.com/Publication/vwLUAssets/EY-2015-Global-oil-and-gas-tax-guide/$FILE/EY-2015-Global-oil-and-gas-tax-guide.pdf; see also Understanding Egypt: Production Sharing Contracts and Tax Barrels, Apache Corporation (2014), at http://files.shareholder.com/downloads/APA/0x0x728759/af4015b8-478d-4506-a57c-7558d74b1a0a/Apache_Understanding_Egypt_20140226.pdf.

As noted, contractual stabilization provisions have to be evaluated in terms of their interrelationship with general statutory rules in existence (or which are later enacted). The effect of such stabilization provisions may generally be more effective, and more supportable, as they apply to fiscal terms, versus human rights or other social issues, since they do not have to override the law (i.e., payments to the government can be made consistent with new rules followed by a contractual "reimbursement").[45] Stabilization rules that apply to other conduct may not be as easily addressed, although in theory a monetary cost of the new rules or standards compared with those in effect at the date of the contract could be calculated, and thus compliance with the new standards would be achieved, but monetary offsets would be contractually provided, just as in the fiscal term example above. Nevertheless, many countries restrict the scope of stabilization provisions to fiscal matters, to avoid any concerns about their ability to change non-fiscal related rules, and/or limit their duration.[46]

In administering stabilization provisions, it will be necessary to clearly understand how the parties view their operation in practice. For example, if the negotiators view the tax rules in effect at the time of the contract to be the ones that will govern actual payments to the government over the life of the project, this can place the tax administration in a clear conflict position. If the contract does not have the force of law in the country (sufficient to override other conflicting tax laws), tax administrators will be hard pressed to accept payments not based on the statute. The negotiators—on both sides--need to understand that they may not be able to "compel" this result, and in such cases, should mutually agree that they will address the financial impact of the changes by means of a contractual adjustment.[47]

Finally, if the stabilization provision operates to actually change or fix the law with respect to the project, the country will need to understand whether this may trigger non-discrimination provisions elsewhere in the country's laws or treaties.

Parties involved from an investors standpoint

---

[45] Regarding clauses that extend into areas of human rights, the UN Principles for Responsible Contracts provides: "Contractual stabilization clauses, if used, should be carefully drafted so that any protections for investors against future changes in law do not interfere with the State's bona fide efforts to implement laws, regulations or policies, in a nondiscriminatory manner, in order to meet its human rights obligations." https://business-humanrights.org/sites/default/files/media/documents/ruggie/report-principles-for-responsible-contracts-25-may-2011.pdf

[46] "Legal Framework: Navigating the Web of Laws and Contracts Governing Extractive Industries," Natural Resources Governance Institute, NRGI Reader, March 2015, p.6. at http://www.resourcegovernance.org/analysis-tools/publications/primer-legal-framework

[47] Of course complicating this even further is the tax treatment of such an adjustment. If taxable itself under the country laws, the amount of the adjustment should be clarified as to whether it is to be "before" or "after" any country tax due.

In the mining industry, typically one investor is involved, while in the oil and gas industry it is common to have joint ventures, where several oil and gas companies participate. Where multiple investors are involved, they will usually nominate one as the lead negotiator, but all major participants are generally present, and even with those not present, or with other members of their teams, there is frequent and detailed consultation and communication. Whether one or multiple investors, the “investor” team will typically be led by their exploration and/or project development personnel, and will be supported by geologists, engineers, and other technical personnel. Other key participants will include financial (including tax) and legal representatives of the investor(s), both in-house and oftentimes outside advisors. Other support personnel may be either included on the teams or consulted with on a regular basis (e.g., government and public affairs, safety, health, and environmental, or marketing groups). Prior to and during negotiations, project planning (reserves, mining/drilling plans, infrastructure needs, etc.) and financial (costs, prices, markets, etc.) assumptions will be modeled and project economics will be developed on the basis of a number of scenarios. As negotiations proceed, investors generally re-run cases as new information becomes available or assumptions change. These economic evaluations, along with overall strategic and business judgement, are used to assist in the negotiations and in the ultimate determination of whether the investor will agree to undertake a particular project. Typically, investors have multiple investment opportunities and must evaluate each one on its own risk and return levels as well as in comparison with the other competing projects being considered.

Given the usually large commitments that are at stake, it is not uncommon for companies to use outside consultants to assist on a number of issues prior to and during the negotiations. This can be viewed as placing the country negotiators at a “knowledge” disadvantage, and approaches to dealing with this are suggested above under Negotiation Background: Country Perspectives.

Investment Phases

Exploration

In the exploration phase, minerals or oil and gas will generally be sought out by reconnaissance and seismic surveys. Contracts covering exploration will generally provide for a certain work plan, over a certain time frame and geographic area. The contractor will generally have the right to exploit the resource, if found in commercial quantities, subject to submission and approval of a development plan.

Development

After a feasibility study following exploration efforts, a development plan will generally be proposed and relevant government approvals will be required. In a contractual arrangement, the actual terms (including fiscal terms) may be negotiated in a context where the investor sets forth what it believes will be necessary for a commercial project to be viable, and the government will seek to maximize its benefits, consistent with a project going forward.

> If there is the opportunity to negotiate a lower tax or royalty rate or any other payment to government, any rational company would take it. If there is an argument that the proposed arrangements in the model agreement are uneconomic, then a company would not be irrational to negotiate terms that made the mine economic under even the worst scenarios (though a forward-looking miner might be cautious about signing a deal that is "too good to be true", anticipating government dissatisfaction and potential conflict down the road). The company will want to make sure its …mine is still profitable after it has incurred the costs of getting the gold out of the ground, to market, and paid the government its shares.
>
> But the government will want to be sure of some things as well. Its job is not to bend over backwards, but to maximize the total benefit to the country. Correction, the total NET benefit. This is a key concept. Mining comes at a cost.[48]

Production/operations

Once the facilities have been constructed or developed, including production, processing, and other infrastructure requirements, production operations will begin and production levels will be ramped up until production amounts set forth in the development plan are achieved (or levels are re-adjusted based on further agreement). The contract may call for some levels of minimum production to be required.

Expansions

Project expansions may be either envisioned in the contract itself, such as development in prescribed phases, or may be acknowledged as possibilities in the contract, and subject to approvals and possible expansion plan negotiations. Even where expansions have been envisioned, and where the expansion development plans have been set forth, it is possible that terms may need to be renegotiated to take into account new circumstances which either make a possible expansion uneconomic—such that it will not occur without modification—or make the terms to government unacceptable given changes in assumptions upon which the original terms were set.

End of project obligations

The contract will also need to address the obligations of the contracting parties upon termination of the project. It is standard practice for contracts to require contractors, once mining or petroleum operations are no longer economic, to restore the affected properties to a suitable condition, e.g., removing production and processing structures and equipment and restoring the production site to an environmentally and ecologically

[48] Mining Contracts, p. 50.

stable and acceptable state. The general outline of the requirements for "decommissioning" are typically covered in the contract (or licensing) terms.

Some Practical Aspects of Successful Negotiations[49]

> "Preparing for negotiations is a time-consuming process. Getting the negotiating process right is also time consuming. Both are essential, however, if the result is to be constructive." [50]

The following is a brief summary of some major practical considerations that can help achieve success:

1. Preparation, and development of policy objectives before negotiations commence.
2. Consider the long term relationship and seek a result that is positive for the government, the community, and the investor.
3. Prepare by understanding the value of the resource and the economic development goals to be sought, including revenues, employment, infrastructure, downstream opportunities, local content, environmental stewardship, education and training.
4. Build a negotiating team with interdepartmental representation and strong communication and decision making protocols.
5. Carefully design mechanisms to ensure public outreach and involvement.
6. Understand investor needs and objectives in order to identify and negotiate upon common interests.
7. Get agreement on how to negotiate (place, language, timing, duration).
8. Get agreement on what to negotiate (overall and in each session).
9. Stay focused on objectives and avoid "distractions."
10. Develop strong team leadership and team discipline.
11. Have political support for negotiating team including the ability to discontinue negotiations.
12. Provide for public information and for community development agreement.
13. Assume transparency of ultimate contract as means of ensuring community support and long term relationship focus.

Other Contract Negotiation Issues

Due Diligence in Pre-Negotiation Research

[49] For additional background on this section, see generally the IISD Handbook, Parts 3 and 4, pp. 19-56.
[50] IISD Handbook, p. 56.

Before any negotiations begin, both the investor and the government will do research on one another, with the investors seeking to understand the goals and backgrounds of the governmental negotiators and information about the country and countries equally seeking to understand the nature of the potential investor and its negotiators.

> “The term "due diligence" generally refers to an investigation carried out by a party to learn and verify the full background, history and current situation of the other party(ies) with which it may contract. Due diligence takes time and is expensive, but thorough due diligence will prevent and/or mitigate unwelcome surprises down the road. It is an essential tool in the decision making process of any investor, financial institution or government.
>
> Potential mineral investors will do due diligence on governments, to ascertain the stability of the government, and its political institutions to determine the political and economic risk of doing business in the country. Investors will also look at the stability and independence of the judicial system, the economic (debt) situation, the electoral situation, the human rights situation, and any other issues that could affect the profitability of an investment and the reputation of the investor.
>
> Governments should do similar due diligence of potential investors to ascertain financial stability, expertise, experience, track record on environmental and human rights practices, history of disputes and the like. Not all investors are equal. One would expect a government to do much less due diligence on a well-known international company with public financial statements and a long track record than it would on a little known, privately held company….[I]nvestigators will look for potential risks which could affect the company’s ability to perform its obligations, such as the company’s financial capacity to fund the mining project, its level of expertise and experience and its capacity to reimburse financing. Red flag items could be large unfunded reserves for potential losses, outstanding mass litigation such as asbestos or other product liability issues, ongoing criminal investigations concerning corruption, money laundering or other alleged crimes, allegations of human rights abuses or environmental neglect, and other reputational, financial or legal issues. If a red flag issue is identified, permission will often be requested to interview the company management, auditors and lawyers.”[51]

The fiscal system of the country where the investor is located can have an impact on its negotiation positions. For example, companies resident in a country where relief from double taxation is granted by means of a foreign tax credit may have requirements for certain fiscal term characteristics that are different from those of companies resident in a country operating an exemption system. The investor’s head office country of residence also determines whether such a company is able to claim the benefits of a treaty concluded between the country of source of income and the country of residence. Different tax treaty applicability can affect the relative positions of various investors. Finally, even greater differences may apply in the case of a state owned investor competing against a private investor. Thus, based on these and other considerations, the economics of a transaction may look quite different between potential investors.

A final aspect of due diligence is understanding the nature of the contracting parties. The contracting party on the investor side may be a subsidiary of the investor which is incorporated in the host country, or a company incorporated elsewhere and doing business in the host country via a branch. The country should seek to understand the nature of the investor, and the

[51] Mining Contracts, pp. 179-80.

ownership chain up to the ultimate owner(s). This is particularly important when some type of performance guarantee may be required by the country from a company higher up in the chain of ownership. Investors will want to understand who the contracting party will be on behalf of the country, i.e., is it a Ministry of the country, a government owned natural resources company, or a combination of both.

Transparency

In countries that specify their natural resource rules by statute, e.g., the U.S. with respect to federal lands, the terms governing natural resource exploration and development are specified in law and regulations available to all, and successful bids are public. In these regimes, transparency regarding contract terms is complete, and applicable to all investors.

In countries that license resources via private negotiations, the rules vary. In some countries, the law requires negotiated contracts to be approved by a legislative body, and hence the contract is generally, though not always, available. In other countries, the law requires that contracts (even if not subject to legislative approval) need to be made public as well.

However, a number of countries do not have requirements to make contracts available to the public, and while some may be, or become, public, this outcome is inconsistent. In some cases, the contracts are explicitly confidential and terms are not generally available to the public.

Increasingly there is a movement to publicize contracts, and organizations like the IMF, World Bank, OECD and the EITI are generally in agreement that a best practice in promoting overall transparency, in addition to publishing financial information and payments made, is that final contracts relating to the extractive industries should be made publically available.[52]

As noted earlier, a country will generally want to involve, via consultation at a minimum, outside groups at various stages of the negotiation process. This is an important element in obtaining support for the process and the ultimate contract award, and ultimately can be viewed as increasing the overall "stability" of the contract itself (see below).

> Contracts negotiated by the Government often have tremendous impact on the life of communities affected by the operation of these agreements. In many developing countries, concession agreements also have nation-wide economic and social implications and can even affect state security…. Recognizing the impact of these concession agreements on Liberia, the Government committed to transparency by making the ArcelorMittal and Firestone agreements public documents. Contract

[52] http://www.resourcegovernance.org/blog/takeaways-eiti-2016-contract-transparency-becoming-norm

> transparency is in the best interest of the government, private investors and citizens. The disclosure of contracts expresses the public ownership of the exploited natural resources. Transparency also ensures that expectations from communities affected by the contracts are managed and realistic. Public disclosure of the terms of concession agreements provides a safeguard for private investors to ensure contract stability and avoid abuse in contract implementation…[53]

Investors may prefer confidentiality to protect proprietary and competitive information, and likely to streamline the process of finalizing an agreement, but their main objective appears to be that the rules be applied uniformly. Thus, rules that may apply only to certain types of investors (e.g., publically traded companies), and thus treat competitors differently, can inappropriately provide a competitive advantage to some at the expense of others.

Dispute Resolution under a Specific Contract[54]

Given the number of issues that can arise under natural resource contracts, and the long timeframes of the projects governed by such contracts, it is almost certain that disagreements on both the meaning of the contract terms and the compliance with the contract obligations (by either party) will arise. The contract itself generally provides mechanisms for resolving such disputes, with the ultimate resolution mechanism usually being litigation. However, there are often several steps that may be followed in resolving disputes other than by going to court, such as:

1. Seeking to settle the dispute among the parties themselves;
2. Referring the issue to a technical expert[55], whose conclusion may be binding or simply advisory;
3. Referring the issue for mediation (usually non-binding); and
4. Referring the issue for arbitration (which may be binding or non-binding).

[53] Liberian Renegotiation Report, p. 62.

[54] Generally a country will have established resolution procedures for tax disputes under its laws. However, a negotiated contract may provide for mechanisms to resolve other disputes that may arise in the interpretation of that contract. Where such contractual dispute resolution procedures cover items that are otherwise covered in a country's statutes, they raise the same issues as discussed earlier with respect to possible conflicts which need to be clearly understood and addressed.

[55] "Certain disputes that are of a more objective nature may lend themselves to expert determination, for example around the valuation of oil, where clear data are available from markets, and other accounting matters." Oil Contracts, p.182.

In the context of reducing risks, investors often seek as the ultimate dispute resolution mechanism a binding arbitration approach under international arbitration rules.[56] A number of different international arbitration rules exist, under various international arbitration organizations, such as the UNCITRAL, London Court of International Arbitration, the International Chamber of Commerce, and the International Centre for Settlement of Investment Disputes.

It is important to note that even where international arbitration is invoked, and even if it is conducted outside the resource country, the governing substantive law under which the contract is to be interpreted, and which the arbitrators must apply, is most often the law of the resource country.

Where arbitration is not binding, the ultimate step for dispute resolution remains litigation, and generally under the courts of the resource country or a country agreed upon by the parties which otherwise may have jurisdictional rights.

Dispute resolution that extends beyond the parties themselves tends to be expensive and time consuming. Each party takes the "dispute resolution risk" regarding the ultimate outcome. Hence, by far the preferred dispute resolution mechanism is for the parties to settle the issue or issues via mutual agreement.

Applicable Law—Domestic and International Agreements

Whether in arbitration or litigation, the law to be applied in resolving a particular conflict is most often the law of the resource country.[57] But the laws of the resource country, in addition to including any constitutional provisions and other statutory or similar laws applicable to the investor(s) and the project operations, may also include bilateral or multilateral tax and/or investment treaties. How such treaties interact with the other laws of the country can be very important, since they can in effect limit or even override what otherwise is the domestic law. Further, in the negotiation of such tax or investment treaties, just as in the negotiation of resource contracts, again all affected departments within the government should be involved to avoid overriding domestic law without full consideration of the consequences. In some cases, it has been noted that those negotiating investment treaties have sought to use that mechanism to alter tax laws (including tax treaties) and practices, contrary to the policies and positions of the tax administrations. One example of this is where tax disputes are to be resolved by administrative review, and ultimately litigation, under domestic law, but an international investment treaty changes this to an arbitration approach.

[56] "Whilst host country citizens may find the suggestion that their courts are not impartial or fair insulting, the reality is that in many jurisdictions the court process may not be independent, or may be slow, and international investors generally…prefer not to take that risk." Oil Contracts, p. 183.

[57] In purely contractual arrangements, it may be possible for the contract rights to be adjudicated based on laws other than the resource country, assuming all parties agree. Further, it would be possible, in an agreement with the country, and ratified or passed by the body that has legal authority to make law within the country, to adopt laws governing the particular contract arrangement based on laws of other countries.

****

GETTING A GOOD DEAL FROM OIL, GAS, AND MINING: FISCAL REGIMES FOR OIL, GAS AND MINERALS—AN NGO'S PERSPECTIVE[58]

When designing or assessing fiscal regimes for oil, gas, and mining, government officials should take into account the following goals:

• **Fiscal regimes need to create sufficient incentives for private companies to invest**. Extractive projects have large upfront exploration and development costs and long production timelines. <u>The fiscal regime must assure companies that the rules will not be unduly changed once investments are made. Stable fiscal regimes that provide a fair return to both investors and the state[59] under a variety of circumstances will be less likely to attract pressure for renegotiation.</u>

• **Fiscal regimes should divide risk appropriately between the investor and the state**. Uncertainty is inherent in the extractive sector. <u>The fiscal regime should ensure that the state does not end up bearing a share of risk disproportionate to its expected return.</u>

• **The state should be compensated for the loss of resources, regardless of the profitability of a given operation.** This is because oil, gas and mineral resources are finite. Fiscal instruments such as baseline royalties provide a guaranteed return for the state even if a project runs losses.

• **Fiscal regimes should be progressive**. Extractive projects can generate substantial rents. Rents (sometimes called "windfalls") are the financial returns above those a company requires to make the investment profitable. <u>Mechanisms to measure and tax a share of windfalls can enhance state returns in times of high profits and adjust to allow for adequate company returns during times of low profits.</u>

• **Countries should set fiscal instruments through laws rather than individual contracts.** <u>Negotiated rather than standardized fiscal regimes are prevalent in the extractive sector. Setting fiscal regimes through laws increases transparency and accountability, because contracts are more likely to be kept secret. Also, negotiations bring additional opportunities for corruption or manipulation. Additionally, if the applicable fiscal regime varies from contract to contract, it can make monitoring onerous and frustrate the efforts of policymakers to carry out policy reforms.</u>

• **Transparency and consistency can help strengthen the state's position.** <u>The extractive industries are characterized by significant asymmetries between states and private actors. Companies often have more information about the specific parameters of</u>

---

[58] Natural Resource Governance Institute, Parliamentary Briefing, http://www.resourcegovernance.org/sites/default/files/nrgi_FiscalRegime_20150311.pdf, 2015. Underlined provisions have direct relationship to negotiation of contracts.

[59] For clarity purposes, note that references in this document to "state" are to the overall country involved rather than to any regional or local subdivision.

extractive projects and are more sophisticated in tax planning, which can give them the upper hand in negotiations.
****
****

Contract Renegotiation Issues

Background

Ideally, contract or licensing rules applicable to long term natural resource projects will be flexible enough to "self-adjust" as circumstances change.[60] For example, in times of increased prices, fiscal terms which automatically adjust the amount of government take per a prescribed formula can ensure a fair revenue sharing occurs, even as total revenues increase. Conversely, in times of very low prices or increased costs, ideally the terms will adjust to promote continued operation of the project rather than making it even less economic. Thinking through items (or assumptions) that may change significantly over time, and providing flexibility in contract term design that address such potential changes may automatically be accounted for in the contract can obviate the need for a "renegotiation" to occur.

Prior sections noted the use of stability clauses to address law or government policy changes. The more modern stability clauses call for the parties to enter into good faith negotiations to place the investor in a similar economic position as if the rules had not changed. This can be viewed as a means of acknowledging the right of the government to change its laws over time, while still protecting the economic interests of the investor and reducing its risks. This also, however, provides an obligation in effect to renegotiate terms in good faith.

In addition to renegotiations that may be implicated as a result of stability clauses, contracts also may have renegotiation clauses per se, that can be invoked under circumstances specifically or more generally described in the clause. For example, an exploration and development agreement that covers oil may sometimes not cover natural gas, and thus may explicitly require that in the event that commercial quantities of natural gas are found, a new negotiation will take place regarding the terms of its development. More generally, some contracts may provide for "re-opening" certain provisions in the event of exceptional, unforeseeable, or profound changes in circumstances. For example, an oil contract from Liberia provides:

[60] As noted, in addition those providing for self-adjustment mechanisms, agreements that from the outset also reflect a fair balance of interests are less likely to generate a need for renegotiation.

> The State and the Contractor shall meet if the State or the Contractor gives at least forty-five (45) days' Notice to the other that it reasonably considers a Profound Change in Circumstances to have occurred. At the meeting, the State and the Contractor shall review the relevant facts and circumstances and determine whether or not a Profound Change in Circumstances has occurred. To the extent that a Profound Change in Circumstances has occurred, the State and the Contractor shall enter into good faith discussions to consider and shall make such modifications to this Contract as they may through good faith discussions propose as necessary or appropriate to restore the economic, fiscal and financial balance of the Contract… [61]

Increasingly, clauses explicitly recognizing the right to renegotiate contracts have become more prevalent. Given the long term nature and complexity of issues involved in these contracts, it is highly likely that significant changes in circumstances will occur sometime during their existence. Assuming adjustments have not been built into the contract to cover these particular changes, the parties can address these in a number of ways:

1. The investor or the government can argue that a contract is sacrosanct, and the other party (the one seeking a modification) has no recourse but to abide by the original contract terms;
2. The government (but not the investor) can impose changes on a take it or leave it basis, which in the worst case scenario can lead to an expropriation if the investor does not agree; or
3. The parties can come together, recognize that under certain circumstances some modifications to the original contract may be appropriate, and negotiate in good faith to achieve an agreed solution.

Obviously, approach number 3 is best in terms of achieving an ongoing, mutually beneficial relationship. But political changes, public perception pressures, or even prior history can force an outcome under items 1 or 2 above. Special circumstances calling for renegotiation of contracts can occur in post-conflict situations, where of course the nature and level of risks accepted at the time of the original agreement have changed substantially.[62]

The consequences of an item 1 choice are obviously not helpful to a long term sustained relationship. What may be an advantage taken by one party (e.g., where the investor fails to work with the government in times of unexpectedly favorable conditions) can later become a disadvantage (e.g., where costs rise or prices drop for a prolonged period), and there will be little "sympathy" given the prior position taken.

---

[61] Jacky Mandelbaum, Salli Anne Swartz and John Hauert,"Periodic review in natural resource contracts", Columbia Center for Sustainable Investment Briefing Note 1, June 2014, p.10 available at http://ccsi.columbia.edu/files/2014/08/Periodic-review-in-natural-resource-contracts-Briefing-Note-FINAL-8.11.pdf.

[62] P. Le Billon. 2012. Contract renegotiation and asset recovery in post-conflict settings. In *High-Value Natural Resources and Peacebuilding,* ed. P. Lujala and S. A. Rustad. London: Earthscan. Available online at

Where the government has the upper hand, choosing either 1 or 2 can lead to an outcome where the resource becomes unproductive and the project is either mothballed or terminated prematurely. For example, where conditions change to the detriment of the investor, such as long term decrease in prices or highly escalating costs of meeting commitments, it may seek some relief from the government.[63] Where relief is not provided, the investor will nevertheless be obligated to fulfill its contract terms. But if the project is early on, one could expect the investor to do the minimum required under the project terms, or even exercise a contract right to terminate. This may not be in the best interests of either party, and hence it is usually better to find some way to make adjustments—as long as they are reasonable and balanced. An investor requesting a delay in meeting drilling commitments (to mitigate a spike in drilling costs), could perhaps be granted that by the government in return for a small delay payment. Thus, a true negotiation, with each side giving and getting something, takes place.

On the other hand, when the government approaches an investor to renegotiate contract terms, the investor who is likewise interested in promoting and growing a long term relationship, should likewise be open to a negotiation where each side gives, and gets, something. For example, an investor might agree on the renegotiation of a particular fiscal term sought by the government in return for a modification to the duration of the contract.

Some illustrations[64]

Case A: As referenced earlier in this note, extensive analysis has been done of Liberia's renegotiation of a number of resource contracts following the end of the civil war in 2003. Following her government coming to power in 2006, President Ellen Johnson Sirleaf ordered a review of all concession agreements, with priority given to the two largest, one with ArcelorMittal and the other with Firestone.[65]

> When approached pragmatically, contract reviews and concession negotiation can benefit both government and industry. The amended Liberian contracts offer significant gains for the state and for the communities where Firestone and ArcelorMittal operate. The new agreements also pose no threat to the companies' profitability, and pave the

[63] It is not only countries that desire to renegotiate contracts; investors also seek modifications.

[64] Case A is based upon Liberia's post conflict contract renegotiations. Cases B, C, and D are not country specific, but reflect factual elements in each case that were present in several countries.

[65] For an extensive report on the negotiations process and results, see Raja Kaul *and* Antoine Heuty *with* Alvina Norman, Getting a Better Deal from the Extractive Sector--Concession Negotiation in Liberia, 2006-2008; A report to the Liberian Reconstruction and Development Committee Office of the President, Republic of Liberia, Revenue Watch Institute, 2009. It is worth emphasizing this case as a post-conflict transition to a democratic regime and that given the history involved and the vast changes in circumstances both inside the country and in the overall markets, the likelihood for a successful renegotiation was increased. Further, renegotiation in a transitional context may receive greater support from a country's "international partners" which can have a significant impact.

> way for a more stable partnership between the companies and the Liberian government. ArcelorMittal's decision to increase investment in Liberia by half a billion dollars shows plainly that better contractual terms and heightened investor interest can in fact go hand in hand.
> The ArcelorMittal amended agreement had some 30 improvements over the original contract; the Firestone amendment had nearly 40 improvements….The Government has widely cited the re-negotiations of the ArcelorMittal and Firestone contracts as proof of investor confidence that Liberia is "re-opened for business."
> Liberia's successful negotiations with ArcelorMittal and Firestone have caught the attention of other African governments seeking to maximize value from concession agreements covering their natural resources."[66]

The report provides extensive background on how the negotiations were conducted, and the give and take that ensued, ultimately arriving at agreements accepted by the parties. It shows how a principled approach to renegotiations, coupled with a sound justification underpinning them, with strong preparation, technical assistance, and political support, led to a successful result.

Case B: In several countries, major natural resource discoveries have been made but development agreements and terms have yet to be finalized.

Prior oil related contracts in place were renegotiated when natural gas was discovered to reflect the different economic and infrastructure requirements for that resource. Disputes have arisen as to whether the country negotiated sound revised contracts. Even where independent evaluations of the revised supported the contract terms, given higher costs and risks associated with new production, public opposition continued.

Given the uncertainties with respect to the renegotiated arrangements, as well as additional negotiations for new projects, finalization of terms continues to be delayed. An additional delay in all contracts is caused by the fact that several of the contracts have different terms, and there is now a desire to conform them all. In the meantime, investments that could have been started are on hold.

This case illustrates two important issues. First is the need to address public expectations and for the negotiators to explain the contracts they negotiate and defend their provisions.[67] With that, there will no doubt still be some opposition, but without that, the opposition can be based on inaccuracies and speculation.

The second issue is how negotiating separate terms for separate contracts can become a problem. In this case, after the fact the country has determined in some cases to try to combine parts of the projects and seeks to conform the terms now. This of course effectively creates a renegotiation of several contracts, further delaying progress.

[66] Liberian Renegotiation Report, pp. 1-2.

[67] This underscores the importance of involving the public via consultations and dialogue throughout the process and providing for appropriate regional and local support in the agreement or in separate agreements (such as community development agreements).

Case C: A country's reaction to dissatisfaction with the amount and pace of revenues coming into the government during years of large price increases led to new taxes being imposed on the industry, and the obligation of existing contract holders either to sign new contracts or face expropriation.

A key element of the government's approach was, despite the threat of expropriation, to offer attractive terms even after its new rules were imposed. In the end, most investors did in fact sign new agreements. Showing its flexibility, in light of a subsequent downturn in prices and the need for additional investment, the government relaxed some rules and announced some new investment incentives for domestic and foreign investors.

This case illustrates that even in a rather extreme case—involving the threat of expropriation-- that in the actual renegotiation process, negotiating on a basis that still provided investors with what they needed, i.e., an attractive return based on the risks they had taken, resulted in most staying, and even re-investing in the country. One factor that assisted in this outcome was that both parties benefitted from higher commodity prices following the renegotiations. But when prices dropped, the country understood future investment would be hampered by the changed circumstances, and reacted accordingly.

Case D: In some cases, the results of expropriation threats or actions do not end as well as in Case C, and more companies decide not to renegotiate. In this case, while some important investors did renegotiate, other significant investors did not and the amount of new investment decreased. Further nationalizations were undertaken. Finally, after a number of years and in order to stem the investment declines, more favorable terms were provided and some new investment began to be committed.

This case illustrates that where a government appears to "overshoot" the balance and imposes terms that may be too onerous; there is an increased risk that it could be counterproductive to its long term goals. In the end, promoting policies and an atmosphere that suggest the desire for, and support the possibility of, a long term relationship between investors and the country has a higher chance of attracting, and sustaining, the investments that are critical to natural resource developments.

Each of the cases above, except for Case B, which is still in essence a "work in progress", involved a degree of unilateralism on the part of the government. But in Case A, a true re-negotiation took place and the basis for the renegotiation was a substantial change in circumstances compared with those underlying the original contracts. In Case C, fair compensation and a desire for an ongoing relationship (coupled with the fortuitous timing of the events which allowed both parties to gain from the significant price increases following the changes) provided confidence that ongoing investments were still justified. In Case D, the terms of the renegotiations, coupled with additional nationalizations in other industries, resulted in a real aversion to continued investments.

One might conclude that renegotiations (even ones in the context of a partial ownership level change) if based upon real changes in circumstances and in an environment where the government makes it clear it still desires a positive, though changed, ongoing relationship, can be successful and can avoid or at least reduce collateral downside effects. But where done in a less constructive manner, they can stifle ongoing investment and ultimately be counterproductive.

Consequences on Specific Project—unilateral or negotiated adjustments

If all or a part of a particular project is "expropriated" or nationalized, there can be obvious implications on continuing project investments and operations. Where the private investors are completely removed, the government must be comfortable that it can take over the management and operations, and provide the funding necessary for capital and operating needs. If the government feels there are benefits to continuing outside investor participation, e.g., to provide funding or technical expertise, it will need to consider this in how it effects its changes. If changes are unilaterally imposed, it is likely that investors (whether the original or replacements) will be more cautious, or seek additional new protections, before investing, since they will perceive the risks as having increased. This can lead to significant delays in project development. In addition, there are potential direct financial implications to the government, such as where an investor invokes an arbitration provision. Where changes are negotiated, and some "give and take" is provided, even where on an overall basis the terms become more favorable to the government, there is a strong likelihood that the relationship will not be unduly harmed, and that a positive and mutually reinforcing partnership can result.

Similarly, an investor who is faced with a unilateral, or negotiated, contract change to a project needs to determine its long term goals and act accordingly. If it also seeks a positive, long term relationship, it needs to negotiate (or in a unilateral change---react) in a positive and constructive manner. If it concludes that the best It can achieve is an exit, with compensation, then it needs to be prepared for a prolonged dispute over valuation, likely in a highly adversary context.

Consequences on other investments—unilateral or negotiated adjustments

The actions of a government with respect to one project can have spillover effects on other existing, or proposed, projects and investments. Thus, other current and prospective investors will be keenly interested in, and will closely follow, how any particular contract renegotiation (or nationalization) proceeds. Just as with respect to the project itself, the ability to achieve long term private sector investment will be impacted by how the government approaches any specific project renegotiation. Where changes are unilaterally imposed, without consultation or ongoing discussion, other investors will view events with apprehension, which could reduce or delay additional investments in the natural resources sector or more broadly within the country. Further, the costs of future projects may increase due to a perception of an overall increase in country related risks. Conversely, where the renegotiation is principles based, and proceeds fairly, such factors can greatly mitigate the otherwise negative collateral effects of a project renegotiation.

Changes in overall tax law in license or contract countries

Finally, while this note has focused on negotiations and renegotiations of natural resource contracts, many countries rules are set forth in law and licensing procedures, rather than being individually negotiated. In this context, unilateral changes are equally possible, by a mere change in the laws themselves. For example, countries like the UK and Norway put new excess profit taxes in place back in the 1970's in light of increased crude oil prices.

While there is almost always some degree of consultation with affected taxpayers at the time new legislation is proposed, the ultimate decision is a unilateral one. Just as in contract situations, investors take note of these changes and react accordingly. In some cases, there may be effective date relief or legislated "stability" clause provisions that may be helpful. But more frequently, the law changes are imposed and investors change behavior by adjusting their operations and future investments, given that their economics have been altered. Maximizing consultation, and perhaps providing some offsetting relief to the investors, can help to build, or maintain, an environment of mutual trust.

Ideally, as with contract situations, statutory provisions that will govern the large investments of the natural resources sector should be developed by anticipating, and reflecting, as many conditions as can reasonably be envisioned. If, for example, an excess profit tax is envisioned in high price environments, having one in place, even if current conditions do not trigger it, is by far a better course than imposing it later, after the fact.

Conclusions

Some countries govern the development of their natural resources via published law and licensing rules. The licensing provisions will cover the terms of making resources available for exploration and development, and will normally also provide for full life cycle obligations that a licensee accepts, including decommissioning at the termination of the project life. Tax rules may be covered under the general tax laws, or specific laws or provisions applicable to natural resources.

Other countries govern the development of their natural resources on a project by project negotiated basis. Where this occurs, there may be published "model" agreements covering the host of issues and obligations in a natural resource project. However, the final negotiations on a particular project may deviate from the model in a number of areas, including the fiscal terms and possibly some stability provisions.

Irrespective of whether a country uses a statutory or negotiated contract approach in structuring long term natural resource investments, it is key that up-front and continuous involvement of the tax authorities be present. In designing statutory rules, tax policy and administration experts are essential participants in ensuring the tax rules ultimately adopted are consistent with sound tax policy and the priorities of the country, and are enforceable. Similarly, when fiscal rules are set in a negotiated contract approach, tax professionals should also be involved to ensure provisions of the contract do not conflict with existing laws or regulations, that the provisions are clearly understood by all, and that they can be implemented as intended.

Given their long term nature, economic and political conditions are bound to change over the course of natural resource projects. A best practice is to address, in some form or another, as many of these possibilities as can be envisioned at the beginning of the investment relationship. Some can be handled by designing laws and licensing rules, or specific negotiated contracts, with as much flexibility and as many self-executing adjustments as can be developed to minimize disputes.

Nevertheless, it is not likely that all of the possible scenarios that may arise can be anticipated, and thus mechanisms to deal with such circumstances will need to be developed. Appropriately structured stability clauses may be one way to deal with changes in circumstances, but they tend to cover only some of the possible events. Re-opener or renegotiation clauses can be useful, and they can at least provide some general conditions that serve as trigger events for either party to seek contract adjustments. Since these may provide at most an agreement to negotiate in good faith, they do not in themselves compel or guarantee a result, but they can provide an expectation and a framework supportive of a mutually beneficial, long term, relationship.

A final note on confidentiality and transparency. It is clear that openness and engagement of the entire community can help achieve buy-in and support for the ultimate contract negotiated. But this must be managed with care. At times, particularly when contract negotiations are proceeding and proposals (and counter proposals) are being reviewed, confidentiality is crucial to the integrity and effectiveness of the process. When the negotiations are complete, however, it is incumbent on the negotiators to explain and defend the bases for their results. This is clearly the case when such agreements are subject to final review by outside groups or other governmental bodies before becoming effective. But even when that is not the case, presentations explaining the agreement terms and answering questions about them are equally important in order to gain public confidence and longer term support, which benefit both governments and investors interested in positive, long term relationships.

For more information……

"Mining Contracts--how to read and understand them" available at https://s3.amazonaws.com/s3.documentcloud.org/documents/1279596/mining-contracts-how-to-read-and-understand-them.pdf

"Oil Contracts--how to read and understand them" available at http://openoil.net/understanding-oil-contracts/

Handbook on Mining Contract Negotiations for Developing Countries, Volume One: Preparing for Success (April 2015), International Institute for Sustainable Development, available at http://www.iisd.org/sites/default/files/publications/iisd-handbook-mining-contract-negotiations-for-developing-countries-volume-1.pdf

"Legal Framework: Navigating the Web of Laws and Contracts Governing Extractive Industries," Natural Resources Governance Institute, NRGI Reader, March 2015, available at: http://www.resourcegovernance.org/analysis-tools/publications/primer-legal-framework

"The Uproar Surrounding Petroleum Contract Renegotiations" George Kahale, III, OXFORD ENERGY FORUM AUGUST 2010 available at: http://www.curtis.com/siteFiles/AttorneyFiles/Oxford_Energy_Forum.pdf

EI SourceBook, available at http://www.eisourcebook.org/ and particularly see http://www.eisourcebook.org/642_5PolicyLegalandContractualFramework.html

IMF, Fiscal Regimes for Extractive Industries: Design and Implementation (2012), available at https://www.imf.org/external/np/pp/eng/2012/081512.pdf.

Natural Resource Contracts: A Practical Guide, Environmental Law Alliance Worldwide, 2013, available at https://www.elaw.org/system/files/Natural_Resource_Contracts_Guide.pdf

Natural Resource Contracts as a Tool for Managing the Mining Sector, Federal Ministry for Economic Cooperation and Development, 2015, available at https://www.bmz.de/g7/includes/Downloadarchiv/Natural_Resource_Contracts.pdf

"Impacts of Fiscal Reforms on Country Attractiveness: Learning from the Facts:, Lisa E. Sachs, Perrine Toledano, Jacky Mandelbaum, with James Otto, available at: http://ccsi.columbia.edu/files/2013/11/Impacts_of_Fiscal_Reforms_on_country_attractivness-_Website1.pdf