

# CONTRACTS VS LEGISLATION



## Supporting Inclusive Resource Development (SIRD) East Africa TRAINING PROGRAM 2019



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# Objectives of legal frameworks

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- Defines the terms of the investment project, commits parties to certain rights & obligations
- Allocates risks, costs, benefits & responsibilities
- Sets standards for social, health & safety & environmental impacts & performance
- Aids in ensuring investment provides opportunities for jobs and services
- Allocates responsibilities for regulating, auditing, monitoring & enforcing rights & obligations
- Provides details on which information is shared, with whom and how.



# Scope of the framework

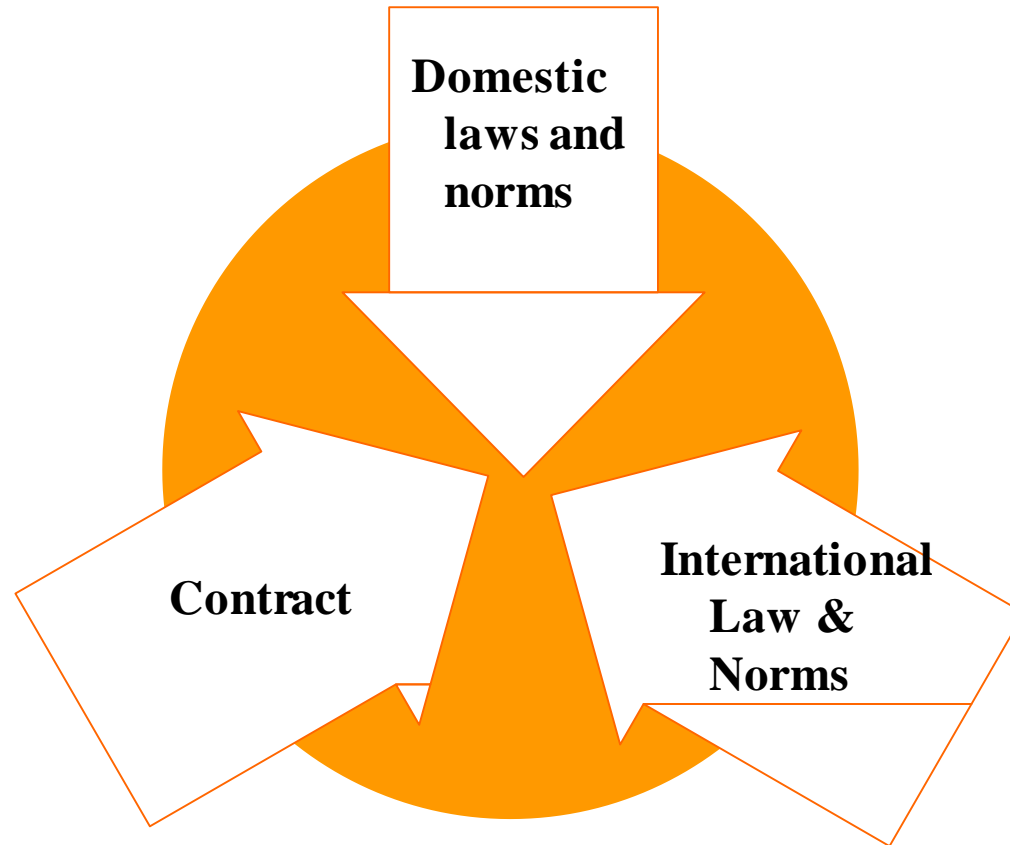
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- Governs the activities, rights and obligations of numerous actors e.g.
  1. Investors
  2. Lenders and Insurers
  3. Contractors
  4. Suppliers
  5. Host Govt. agencies
  6. Landowners and affected communities
- Covers a non-exhaustive list of issues e.g.
  1. Allocation of rights
  2. Land title
  3. Resettlement & compensation
  4. Taxes, royalties, equity, profit share
  5. Accounting practices
  6. Minority shareholder rights
  7. Dispute Resolution mechanisms
  8. Stabilization clauses
  9. Transparency & Disclosure



# Forces governing extractive projects

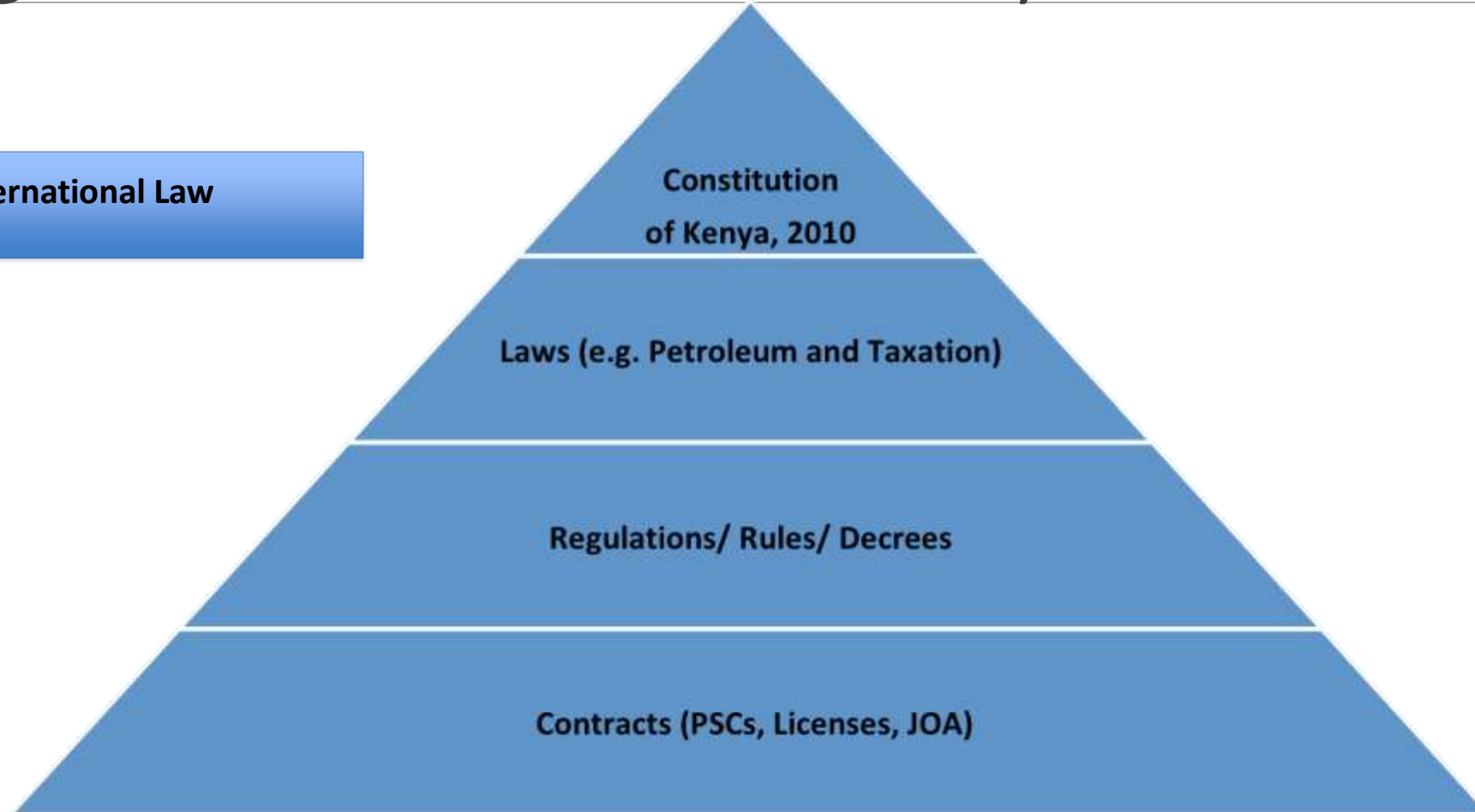
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# Legal Structure & Hierarchy of Laws

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**International Law**



# Legal Instruments in the Extractive Sector

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## ❖ Constitution

- Ownership of the resources
- Basic structure of government (incl. roles of different actors, degree of centralization)
- Rights of citizens
- Durable & reigns supreme

## ❖ Legislation/statutes

- Passed by Parliament
- Can cover land rights, mining or petroleum codes, taxation, revenue sharing and management, environmental protection, community development agreement requirements, etc.

## ❖ Regulations

- Establish systems and procedures that operationalize statutory requirements
- Typically established by executive bodies (e.g. ministries, regulatory agencies)
- Statute sets out the bounds of what can be included in Regulations



# Legal Instruments – Cont.

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## ❖ Contracts

- Distinct agreement between two or more parties
- Binding on named parties only though party rights are implicated
  - Little (or usually no) room for investment of non-parties in the negotiation
- Allows more specificity to a particular project
- Changing the terms requires agreement between the parties
- At least four basic types of investor-state contracts:
  - Concession or License agreement
  - Joint Venture
  - production sharing agreement
  - Service agreement
- Often confidential.



# Network of Contracts

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More than 100 contracts may govern one particular investment:

-**Concession contracts between the government and the investor** (or consortium) regulating exploration and development

-Agreements between the investor and the government(s) regulating the **construction**

**and operation of transport** (pipelines, rail, ports) –and in some cases, intergovernmental agreements

-**Shareholder agreements** among consortium members

-**Lending agreements**, regulating the financing of the project

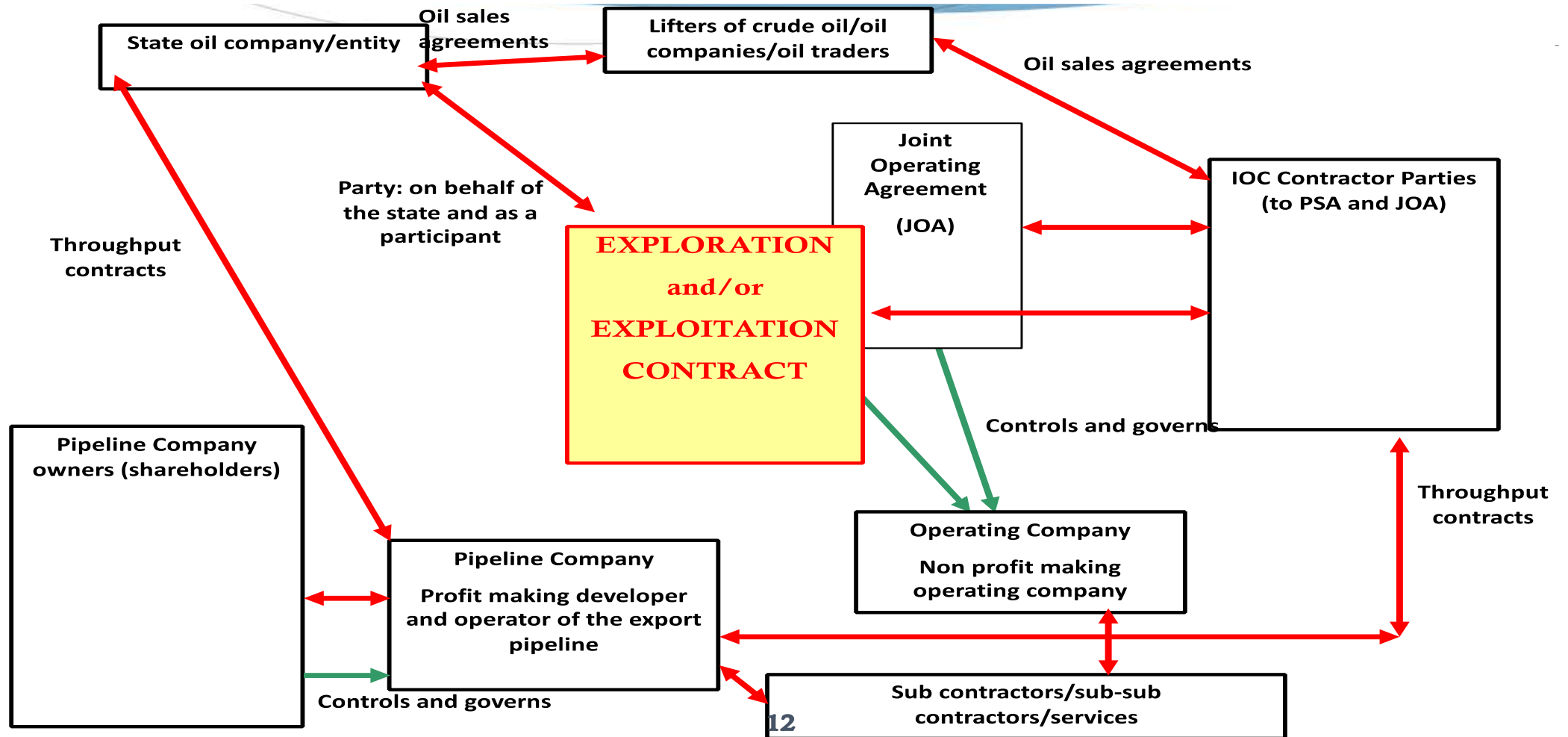
-**Sales and off-take agreements**

-**Community development agreements**





# Network of contracts e.g. Oil Sector



# National Law

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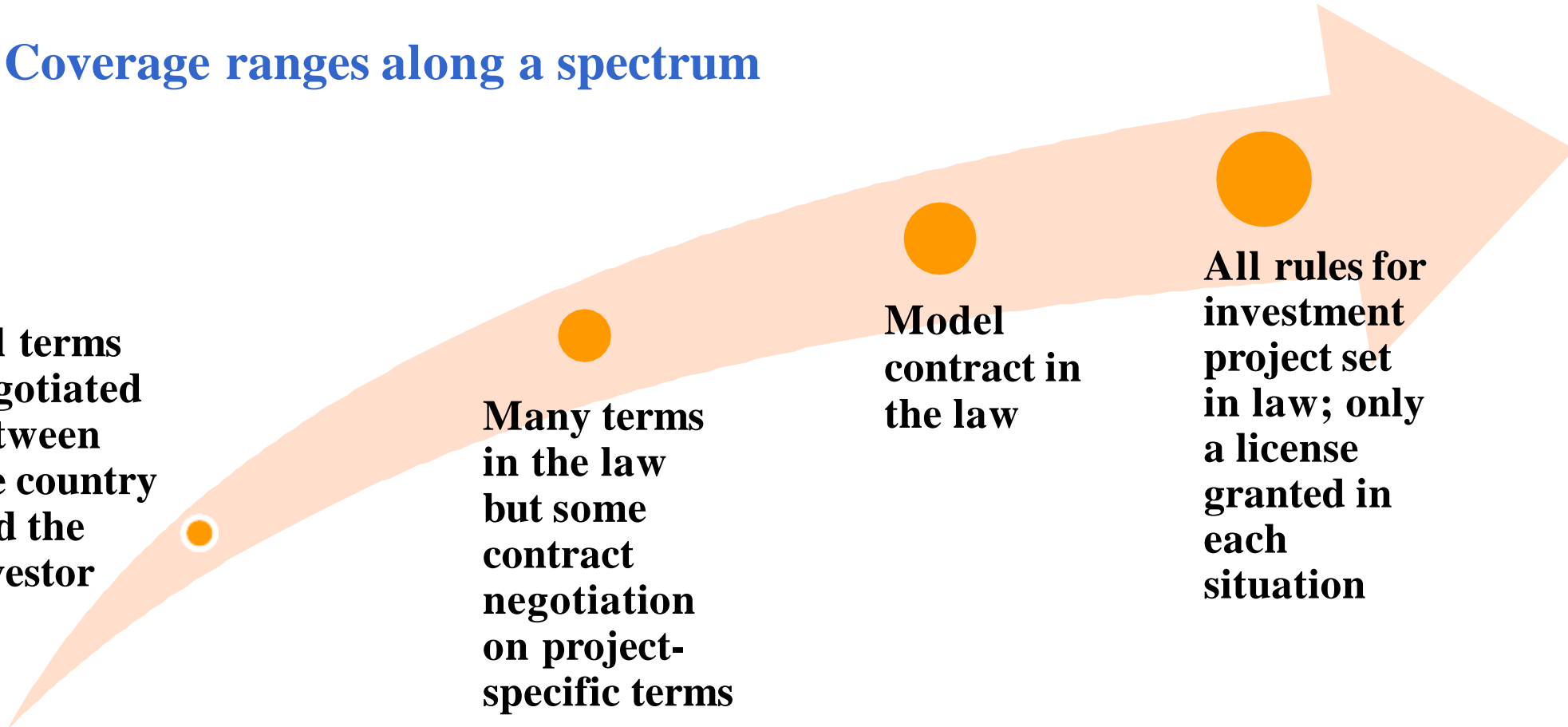
Coverage ranges along a spectrum

**All terms negotiated between the country and the investor**

**Many terms in the law but some contract negotiation on project-specific terms**

**Model contract in the law**

**All rules for investment project set in law; only a license granted in each situation**



# Legal instruments cont.

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## Implications of including the terms of the deal in contracts

- Ability to change the terms requires agreement between the parties
- Little (or usually no) room for involvement of non-parties in the negotiation
- Asymmetry of resources, knowledge, experience between the parties
- May be confidential
- Creates a web of different terms, arrangements, etc.– very difficult to monitor and enforce



In many instances, the “rules” will be found in a combination of the laws, regulations and contracts (example from Sierra Leone

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| <b>Provision</b>                               | <b>Where Located</b>                                     |
|--|--|
| Work Programme/Feasibility Studies             | Mines and Minerals Act, Regulations, Contract            |
| Prospecting/Exploration/Mining Licenses        | Mines and Minerals Act, Regulations, Contract            |
| Rights to Additional Minerals                  | Mines and Minerals Act, Regulations, Contract            |
| Use of Water on or Adjacent to Concession Area | Mines and Minerals Act, Regulations (dredging), Contract |
| Construction of Infrastructure                 | Mines and Minerals Act, Regulations, Contract            |
| Training of Local Workers                      | Mines and Minerals Act, Regulations, Contract            |
| Reporting Requirements                         | Mines and Minerals Act, Regulations, Contract            |
| Surrender of Lands at End of License           | Mines and Minerals Act, Contract                         |

# Example: where contract reinforces law

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Contract between China National Offshore Oil Corp and Primeline China (2012)

## **Article 20**

### **Taxation**

20.1 The Contractor shall pay taxes to the Government of the People's Republic of China subject to the tax laws and regulations of the People's Republic of China.

# Example: where contract trumps certain aspects of the law

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## **Contract between Afghan Krystal Natural Resources Co and the Ministry of Mines of Afghanistan (2011)**

27(2). Any future changes to existing Mineral Laws shall have no bearing on the terms, conditions or validity of this contract, unless incorporated within a jointly agreed addendum.

27(3). Subject to notification by the MoM, AKNR agrees to observe any changes to Mineral Laws and ministerial procedures that are designed to improve health and safety.

# Example 3: Contract vs Law

## *Mining Law superseding the Contract:*

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*This Agreement shall be governed by, interpreted, and construed in accordance with the Laws of (Country), as such Laws are set forth in duly adopted and published legislation, and supplemented by the standards, customs, and usage generally applied in the international mining industry for those matters not covered by (Country) Laws and as may be applicable. If there are conflicts between this Agreement and the Mining Proclamation or Mining Tax Proclamation, including definitions, then the Mining Proclamation and the Mining Tax Proclamation shall govern.*

## *Contract superseding the Law:*

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*The (Government) declares that this Agreement is authorized by (Country) law. It is expressly understood that, for the entire period of its validity, the present Agreement shall constitute the law applicable between the Parties.*

*Consequently, domestic law of the (Government), as in force and effect on the date of signature of this Agreement, shall be applicable in the interpretation of this Agreement, as a complementary tool, only to the extent that this Agreement does not exhaustively govern the issue.*

Guyana Esso Exploration and Production Guyana Ltd, CNOOC Nexen  
Petroleum Guyana Ltd, Hess Guyana Exploration Ltd, PSA, 2016

EXAMPLE 4

If at any time after the signing of this Agreement there is a change in the laws of Guyana whether through the amendment of existing laws (including the hydrocarbons law, the customs code or tax code) or the enactment of new laws or a change having the force of law in the interpretation, implementation or application thereof (whether the change is specific to the Agreement, the Contractor or of general application) and such change has a materially adverse effect on the economic benefits, including those resulting from the fiscal regime provided by this Agreement, accruing to the Contractor hereunder during the term of this Agreement, the Government shall promptly take any and all affirmative actions to restore the lost or impaired economic benefits to Contractor, so that Contractor receives the same economic benefit under the Agreement that it would have received prior to the change in law or its interpretation, application, or implementation. The foregoing obligation shall include the obligation to resolve promptly by whatever means may be necessary any conflict or anomaly between this Agreement and any such new or amended legislation, including by way of exemption, legislation, decree and/or other authoritative acts.





**BENEFITS**

**COSTS**

## If more terms in **legislation**:

- Increased flexibility of government to amend the rules over time
- Helps to address asymmetry of bargaining power (less room for negotiation)
- Maintains the role of the legislature/parliament, in overseeing regulation of the sector
- Limited discretion (and risk of corruption) of negotiators
- Reduces the chance that interests of one agency/ministry prevail over interests of others
- Time and cash-flow pressures of contract negotiations may make it more difficult to strengthen the protection of local or public interests, including through public consultation/input
- Fragmented legal system with disparate and potentially conflicting contracts and laws is more challenging to monitor and enforce
- Typically, greater transparency of terms

## If more terms in **contract**:

- Allows room for tailoring to particular circumstances.
- May be more easily enforced.
- Can use it to supplement provisions in the law, or to reinforce the law and make them contractually binding.

# Better in law or contract?

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- Fiscal Terms
- CSR Commitments
- Environmental and social obligations
- Labor Obligations
- Work program obligations
- Resettlement
- Infrastructure arrangements
- Local Content
- Revenue Management arrangements
- Community engagement and development obligations (including the definition of the “Local Community”)

# Sometimes there's need to adapt to changing circumstances

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Why are reforms/re negotiations likely in extractive industries?

1. Long duration of agreements
2. Some contracts entered into with corrupt, transition or incompetent governments
3. Volatility of the sector and major price changes over time have changed underlying economics
4. Asymmetry of negotiating capacity, knowledge, reference tools etc. This means that the original deal may be imbalanced.
5. Environmental, labor, health, safety and human rights standards are still evolving in many countries that are developing their legal regimes

# Adapting to changing circumstances

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## Investors Response: Stabilization

- Sought by investors to prevent the govt. from changing the conditions or the investment environment within which a contract was negotiated
  - Ranges along a spectrum of limitations on govt. actions
  - Many lenders insist on this “stability” as a fundamental aspect of the bankability of an investment
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- Does “freezing” terms in a contract achieve stability?
    - To an extent yes:
      - May make govt.’s think twice about such changes
      - May be able to sue govt.’s that breach a stabilization agreement and at least get compensated
      - Gives investors leverage to negotiate a lesser degree of or a delay in implementation
    - But to an extent no:
      - Consider that many renegotiations take place even when there are stabilization clauses

# A legal framework that reconciles competing needs for flexibility and predictability

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## **A fair deal to begin with should be more robust**

- Requires addressing the asymmetry of resources, information, capacity, etc.

## **Legislation rather than contracts?**

- In developed economies, governments adjust their tax systems regularly and investors comply. Companies invest with a perception that the fiscal and regulatory regime will be adjusted “reasonably.”
- Including terms in legislation rather than confidential contracts can also minimize distrust and therefore calls from the public for renegotiation.

## **Build in internal mechanisms in the contract to rebalance interests in changed circumstances**

- Progressive fiscal regimes
- Limiting stabilization clauses; exclude compliance with international standards or “non-discriminatory” legislation concerning the protection of health, safety, labor and the environment.

## **Review periods**