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## 5.9 Contract Negotiations

As the list of topics in **Chapter 5.5** above suggests, contracts and licenses contain a diverse subject matter. As a result, their negotiation, probably on the basis of a model, will require considerable expertise. Often this will cross disciplines, involving law, geology, engineering and economics skills. Before any negotiations start, the government side needs to give some thought to at least four features of EI contract negotiations in a modern setting:

1. **Legacy matters.** Negotiations will rarely take place in a context that has no prior history of negotiating with international companies. The country's history of dealing with investors, and investors' track record in dealing with the country, including any deals struck that appear in retrospect to have been made on bad terms for the state, will influence any negotiation, for the good or not;
2. **Extractives differ.** Negotiations on oil exploration or mining exploration and their possible development will differ from each other, sometimes involving complex issues of infrastructure development. If gas development is envisaged, this requires discussion of gas pricing, transportation and marketing;
3. **Capacity limits can be managed.** In the face of capacity shortages, a government will usually have no difficulty in obtaining offers of outside help. The challenge will be to identify which is the best source among those on offer. 'Best' will mean the ideal fit with the government's objectives and needs, rather than a rapid response.; and
4. **Technology helps.** The idea that negotiations always require face-to-face meetings does not fit well with the context of computers, internet connections and video-conferencing. This should influence the tasks of preparation, research and reduce the number of on-site meetings of all of the parties.

In general, negotiating procedures tend to be complex and lengthy, covering potential investments for long-term projects in conditions of considerable uncertainty. Negotiations will have different phases, from formulating strategic policies and regulatory frameworks, to preparing for and carrying out negotiations for particular projects, and monitoring and enforcing contracts. They will typically address the sharing of economic rent between the investor and the host government and will have significant economic development, environmental and

social impacts. The government will seek to carry out due diligence on its potential partners in what may be a long term relationship.

**What is Required.** Negotiations require special skills, and particularly a grasp of both legal and economic issues, such as fiscal modelling, to explore the impacts of various fiscal options prior to making a choice. In this respect, a **major problem** for most resource-abundant countries is the lack of capacity (specialized know-how, technical expertise and negotiating experience) to negotiate the necessary agreements with well-resourced and experienced foreign investors, suppliers and contractors. This is often due partly to difficulties in attracting or retaining qualified and experienced staff as a result of salary differentials compared with the private sector and a high staff turnover. As more countries make commercially viable discoveries, the demand for negotiating capacity (and support from third parties outside the country) increases. The abundance of suppliers of such skills among development organizations goes some way towards mitigating this problem however[1].

**Given the complexity of the issues involved and their consequences in terms of revenue and other benefits, governments should place a premium on the development of internal negotiation capacity and access to knowledgeable external expertise. This is especially important given the considerable information, skills, and resources generally available to those on the other side of the negotiating table.**

Two helpful tools are: the availability of model contracts to the government side (**Chapter 5.5.2**); and the potential role of a state resource company. Such companies can "sustain a cadre of trained personnel with skills that can be deployed effectively in negotiations. By comparison, sector ministries are often ill-equipped to contend with the challenges of contract negotiations".[2]

**Governance issues** These can play a role in negotiations. In some cases, governments will reject or fail to seek support in negotiations in spite of internal capacity shortcomings. The reasons may be attributable to a lack of coordination, a lack of resources, distrust, internal disagreements or corruption. One study of ministry behaviour noted that "some ministries may want ownership over particular deals, and may therefore be reluctant to coordinate and collaborate with other ministries". Alternatively, the authority of a particular ministry within government or of a state resources company to manage the negotiations and approve the final

[1] A very useful start in this process is the website resource organized by the Columbia Centre for Sustainable Investment: http://www.negotiationsupport.org/matrix/columbia-center-sustainable-investment (last visited 16 March, 2016)

[2] Bryan Land, 'Capturing a fair share of fiscal benefits in the extractive industry', Transnational Corporations, Vol. 18, No.1 (April 2009), UNCTAD, p.170.

terms may well be uncertain. Government officials may also seek quick, short-term solutions for political reasons. Where corruption is prevalent, officials will prefer to retain maximum discretionary authority throughout the decision-making process. In such contexts, it is useful for the other organs of government such as parliament (and also civil society) to be aware of contract negotiation issues to function more effectively as a source of checks and balances in the domestic system. Governments may then be held accountable for the deals they have negotiated.

**Renegotiation** is a highly sensitive topic. Gas sales contracts typically contain price review clauses but it is rare for a hydrocarbons or mining contract to envisage a renegotiation of the basic terms in a comparable way.

Inevitably, in a long-term relationship one of the parties may come to view the terms of the original contract as unfair, poorly drafted or inappropriate to changed circumstances. For the government side, an insistence upon renegotiation (however justified it may see this action) will usually carry a high reputational cost and risk triggering international arbitration. Irrespective of any short-term benefits in a particular case, the impact on future investment may be negative and if formal arbitration results, the outcome in terms of legal costs, time spent and reputational damage can be significant, even if the host state 'wins' the case. A much more common approach in such circumstances is to seek discussions on an amicable basis with the investor(s), seeking a resolution away from the glare of publicity and minimizing its adversarial character. The investor too may seek to revisit its contractual obligations, perhaps seeking to reduce its work program in the light of unfavourable early results, or a major change in the overall commercial environment.

Sometimes it has been claimed that renegotiations have taken place under duress[3]. The expression, 'forced renegotiations' has been commonly used in media descriptions of investor-state negotiations in Latin America and some other regions. It underlines the importance of following good practice in any such negotiations. If such duress has occurred, the outcomes are likely to be deemed null and void.

In the *Aminoil* case[4], the investor argued that it was threatened with a shut-down of its operations if it failed to agree on new terms offered by the Kuwaiti Government after a significant oil price increase; obtaining its consent in such circumstances rendered it invalid since it was obtained under duress. The Tribunal did not accept

[3] Some early examples are recounted by T Waelde and A Kolo in 'Renegotiation and Contract Adaptation in International Investment Projects: Applicable Legal Principles and Industry Practice', 1 *Journal of World Investment* (2000) 1-58 at 14-18, and see the authorities cited at Footnote 38.

[4] The Government of the State of Kuwait v American Independent Oil Co (Aminoil), Award, 21 ILM 976 (1982) ("*Aminoil*").

this claim[5]. It set out four principles that should be followed if the negotiations were to be deemed fair: they had to be conducted in good faith; there had to be a sustained upkeep of the negotiations over a period appropriate to the circumstances; an awareness of the interests of the other party and a persevering quest for an acceptable compromise[6]. If the investor was under financial pressure, this did not necessarily mean that an agreement reached between the parties was done so under duress. There had to be some evidence of abuse by the other contracting party.

[5] *Aminoil*, paragraph 40 et seq.

[6] *Aminoil*, 1014; but see also Klaus-Peter Berger's list of 19 requirements that should govern the parties' conduct during a contract renegotiation: Berger, 'Renegotiation and Adaptation of International Investment Contracts: the Role of Contract Drafters and Arbitrators', 36 *Vanderbilt J Transnat'l L*, 1347 (2003), 1365-66.