



Foreign investment, law and sustainable development

A handbook on agriculture
and extractive industries

Lorenzo Cotula

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Acronyms

ACHPR	African Charter on Human and Peoples' Rights
ACHR	American Convention on Human Rights
ATS	Alien Tort Statute (United States)
BIT	Bilateral investment treaty
CAO	Compliance Advisor/Ombudsman, International Finance Corporation
CBD	Convention on Biological Diversity
CEDAW	Convention on the Elimination of All Forms of Discrimination against Women
CIT	Corporate income tax
COMESA	Common Market for Eastern and Southern Africa
DTT	Double taxation treaty
ECHR	European Convention for the Protection of Human Rights and Fundamental Freedoms
ECOWAS	Economic Community of West African States
EIA	Environmental impact assessment
EITI	Extractive Industries Transparency Initiative
ESIA	Environmental and social impact assessment
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FOI	Freedom of information
FPIC	Free, prior and informed consent
GATS	General Agreement on Trade in Services
ICCPR	International Covenant on Civil and Political Rights
ICERD	International Convention on the Elimination of All Forms of Racial Discrimination
ICESCR	International Covenant on Economic, Social and Cultural Rights
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
IFC	International Finance Corporation
IIED	International Institute for Environment and Development
ILO	International Labour Organization
IPIECA	'IPIECA, the global oil and gas industry association for environmental and social issues' (the full title which the acronym originally stood for is no longer in use)
NAFTA	North American Free Trade Agreement
NCP	National Contact Point
OECD	Organisation for Economic Co-operation and Development
PSA	Production sharing agreement
PTA	Preferential trade agreement
RSB	Roundtable on Sustainable Biomaterials
RSPO	Roundtable on Sustainable Palm Oil
TRIMs	Agreement on Trade-Related Investment Measures
UDHR	Universal Declaration of Human Rights
UK	United Kingdom
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCLOS	United Nations Convention on the Law of the Sea
UNCTAD	United Nations Conference on Trade and Development
US	United States
VAT	Value added tax
WTO	World Trade Organization

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Executive summary

Why law matters

Sustainable development, broadly defined, is a process that improves people's lives while respecting the environment. As countries strive to promote foreign investments in agriculture and extractive industries, the effective use of legal tools, by government and citizens alike, has become an important ingredient of public efforts to ensure that foreign investment contributes to sustainable development.

Indeed, legal norms influence many aspects of investment processes. Take the case of a foreign investment project to develop a sugarcane plantation and processing facility in a low-income country. Treaties that liberalise trade may have been an important driver of the project, particularly if the venture targets export markets. Who owns the land will affect who has legal authority to allocate land to the project, and through what process.

Tax rules – including arrangements to fight tax avoidance – will influence the amount and distribution of the public revenues contributed by the project. The ability of different groups to have their concerns taken into account will partly depend on the effectiveness of any legal remedies available to them, and many people affected by investments have taken their case to national courts and international bodies.

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Of course, law is only a part of the story. Policy instruments outside the legal sphere can also influence investment patterns and outcomes (for example, macroeconomic policy). Legal norms are often not properly enforced due to vested interests, power imbalances or resource constraints. And even well-implemented legislation may produce unintended consequences. But if governments and citizens fail to harness the potential of law for sustainable development, they will miss out on important levers for change.

About this handbook

This handbook is about how to use law to make foreign investment work for sustainable development. It aims to provide a rigorous yet accessible analysis of the law regulating foreign investment in low and middle-income countries – what this law is, how it works, and how to use it most effectively.

The main target audience is government and civil society in low and middle-income countries. The ambition is to provide a resource that can assist government efforts to ensure that foreign investment contributes to sustainable development, and civil society efforts to influence decisions and hold government and investors to account. The handbook may also be of use to investment lawyers interested in sustainable development.

Some of the issues discussed here are relevant to all sectors of the economy but the focus is on agriculture and extractive industries. These sectors account for a large share of investment flows to many low and middle-income countries. Investment in agriculture and extractives can exacerbate pressures on natural resources, in contexts where the livelihoods and culture of rural people crucially depend on those resources.

Because several legal arenas are relevant to any given investment project, the handbook takes an integrated approach that cuts across areas of law typically treated in separate literatures and by different communities of practice – including investment treaties, extractive industry legislation, land tenure, human rights norms, environmental legislation and tax law. For both government and civil society, strategic use of a variety of legal tools is critical in harnessing the full potential of law.

Harnessing law for sustainable development

Using legal tools to make foreign investment work for sustainable development involves government and civil society action in four interlinked areas:

■ Aligning public policies and decisions on investment with a strategic vision of sustainable development based on local and national aspirations

Sustainable development involves placing people at the centre of the development process. This means ensuring that, in any given country, public policies and decisions on investment respond to a bottom-up, strategic vision of sustainable development. Developing and implementing a strategic vision of a country's future often involves struggle and contestation, and is a function of the political space.

Public participation in decision making can be facilitated by effective engagement with the law. This includes government protection and citizen exercise of political rights for collective action, such as freedom of assembly and association; government promotion of public participation in the elaboration of policy-setting legislation, and civil society leveraging of these processes to catalyse public mobilisation on strategic policy choices; through to transparency requirements in both host and home countries, and effective legal remedies at national, international and transnational levels.

■ Getting a fair economic deal

It is widely held that private investment can help promote economic development. But much depends on the 'economic deal' that underpins investment projects. This economic deal is influenced by the norms that enable the government to get a handle on corporate structures; the fiscal regime applicable to the project, including arrangements to fight tax avoidance; and instruments to promote inclusiveness of investment and positive linkages with the local economy.

Governments are chiefly responsible for regulating and monitoring the economic deal. Well-drafted legislation and effective administration systems are key, for example in tax matters or industrial policy. But civil society can play an important role too by ‘naming and shaming’ tax avoiders; advocating for tighter tax laws, including in home countries; and monitoring compliance with any performance requirements.

■ **Taking social and environmental considerations seriously**

A sustainable development perspective entails balancing the social, economic and environmental considerations at stake in the investment process. This means going beyond getting the best possible economic deal and taking social and environmental considerations seriously. This requires well-drafted and enforced national legislation to regulate impact assessments, secure local land rights, uphold labour rights, protect the environment, provide for effective monitoring powers and establish legal liabilities and remedies – among other things.

Making this legislation work requires well-resourced and properly mandated government institutions. It also requires effective civil society action. For example, civil society can use legal tools to scrutinise social and environmental impact assessments, by demanding disclosure of documentation, participating in public hearings, making written comments and seeking administrative or judicial review of government decisions.

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■ **Balancing investment protection with competing policy goals**

Action in the previous three areas can improve a country’s investment preparedness – that is, the extent to which people and institutions can identify the right types of investment, fully harness the benefits of that investment and minimise its risks. A sustainable development perspective also has implications for investment promotion.

The investment protection regime is a case in point. Many argue that legal protection of foreign investment is important in promoting investment flows to countries where political risk is perceived to be high. But ill-drafted investment protection standards can constrain the ability of host states to take measures in the public interest, if those measures adversely affect protected investments. A sustainable development perspective requires careful balancing of multiple policy concerns in the formulation of investment protection standards, and in the working of systems to settle disputes between investors and states.

Governments pushing for change in these directions can harness recent developments in investment treaties and arbitration, as well as growing guidance from United Nations agencies and think tanks. Civil society can take advantage of emerging opportunities to scrutinise the negotiation of investment treaties and the conduct of investor-state arbitration.

Addressing capacity challenges

Harnessing the law requires not only savvy law making, but also effective institutions in both governmental and non-governmental sectors. This ranges from government agencies responsible for collecting taxes, ensuring compliance with environmental regulation or managing investor-state arbitration through to law units established by civil society or producer organisations to handle public interest litigation.

Where capacity gaps exist, governments may consider options for strengthening their own capacity. These include, first and foremost, effective arrangements for mobilising expertise available within the country, for instance in private practice and academia. Where external support is appropriate, multiple channels may be possible: technical co-operation projects, partnerships with leading universities, professional advice on a *pro bono* (voluntary) basis, pooling of experience and expertise among countries, and staff secondments.

The issue of capacity is not limited to government. Non-governmental organisations, parliamentarians and the media need to be in a position to scrutinise government action and hold decision makers to account. National organisations of rural producers and workers need to be properly equipped to help their members to have a strong voice. Legal avenues alone are not enough: collective action and political mobilisation can help to give real leverage to legal rights.

Capacity support in the non-governmental sector may harness existing capacity, for instance through documenting success stories and sharing lessons from experience. It may also involve strategic local-to-global alliances between organisations that can contribute complementary capacities – for example, legal and technical expertise, skills and channels for outreach and campaigning, and capacity to mobilise vocal constituencies.

Long-term vision and citizen action

The law regulating natural resource investments involves highly technical legal issues. Detail and specialised expertise are therefore critical. This handbook discusses some of these technical issues. But harnessing the law to ensure that investments contribute to sustainable development is not just about dealing with technical aspects concerning specific legal instruments.

Sustainable development calls for taking a big-picture view of the multiple legal arenas involved, and of how these arenas relate to the power relations that characterise investment flows in low and middle-income countries. It calls for a vision for the formulation and implementation of the law in light of real-life trajectories towards sustainable development. Politics are essential to this process, and use of the tools discussed in the handbook would reflect political choices – for example, on taxation, land ownership and the balance between investment promotion and policy space.

Therefore harnessing the law to make investment work for sustainable development is not a task for government regulators or legal advisors alone. It also requires vibrant civil society organisations and social movements to advocate, scrutinise, challenge and influence. Perhaps most importantly, it requires citizens themselves to be able to appropriate and wield legal tools in their efforts to shape their own future.

Introduction

1.1 About this handbook

Topic and target audience

This handbook is about how to use the law to make foreign investment work for sustainable development. It aims to provide a rigorous yet accessible analysis of the law regulating foreign investment in low and middle-income countries – what the law is, how it works, and how to use it most effectively. It aims to identify issues and map options, rather than provide solutions, and is no replacement for expert advice.

The primary target audience is government and civil society in low and middle-income countries. Civil society, broadly defined, includes a wide range of non-governmental organisations and membership-based associations. The ambition is to provide a resource that can assist government efforts to ensure that foreign investment contributes to sustainable development, and civil society efforts to influence public decisions and hold government and investors to account. The handbook may also be of use to investment lawyers interested in sustainable development.

Government and civil society tend to have different positions on a number of the sustainable development issues discussed in this handbook, such as transparency. Even within these categories there may be actors with different and even conflicting interests. For example, within governments, national oil companies and environmental protection agencies have different concerns. In distilling the practical implications from the analysis, this handbook seeks to cater for these diverse target groups.

The handbook covers complex issues. In the interest of accessibility much detail had to be glossed over, but the text is inevitably fairly technical. Making the most of it should not require specialised legal expertise, but it does assume a degree of familiarity with investment policy issues.

Scope and focus

While foreign and domestic investments raise many similar issues, this handbook focuses on foreign investment. This choice is justified on legal grounds: as will be discussed, international investment law specifically protects foreign investment. In low-income countries where domestic sources of capital are limited, there may also be a correlation between the scale of investment and its impacts on the one hand, and the involvement of foreign capital on the other.

Some of the issues discussed are relevant to all sectors of the economy. For example, the chapter dealing with investment treaties and arbitration is relevant to foreign investment in sectors as diverse as natural resources, banking,

telecommunications and manufacturing. On the whole, however, this handbook focuses on foreign investment in agriculture and extractive industries, where agricultural investment is defined as including production and/or processing activities, but excluding the acquisition of farmland for speculation.

The focus on agriculture and extractive industries reflects the importance of these sectors in investment flows to many low and middle-income countries. Investments in agriculture and extractives also raise particular issues. For example, they can exacerbate pressures on natural resources in contexts where the livelihoods and culture of rural people crucially depend on those resources, and where competition for resources may already be intensifying as a result of demographic pressures and socio-economic change (Box 1).

Although investor-state contracts can be very important in setting the terms of investment in natural resource sectors, this handbook focuses on the wider legal frameworks. The relationship between investor-state contracts and sustainable development has been discussed in earlier IIED work (for example Ayine *et al.*, 2005; Cotula, 2010, 2011; Ahmadov *et al.*, 2012; Cotula and Tienhaara, 2013).

Rationale and value added

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There is growing demand for learning materials on how to align the law regulating foreign investment with the pursuit of sustainable development. This demand is increasing among government regulators and negotiators, and among civil society organisations working to democratise investment decision making.

Recent developments have fuelled this demand. Ambitious investment treaties are currently being negotiated, and several investor-state arbitrations have raised important sustainable development issues. These include access to water, protection of local land rights and the management of environmental risks. Tighter public finances have promoted increased scrutiny of tax avoidance. Reports of negative social and environmental outcomes from investment have encouraged civil society organisations to use legal tools, and strengthened government resolve to regulate more effectively.

There is already an extensive academic literature on international investment law¹ and the regulation of transnational corporations.² The United Nations Conference on Trade and Development (UNCTAD) has developed an Investment Policy Framework for Sustainable Development that presents guidelines and options for national and international investment policy in pursuit of sustainable development (Box 2). UNCTAD has also published numerous reports on specific aspects of investment law.³

1. See for example the textbooks by Sornarajah (2004), Muchlinski *et al.* (2008), Subedi (2008), Newcombe and Paradell (2009) and Dolzer and Schreuer (2012), and a growing number of monographs and journal articles.

2. See for example Muchlinski (2007), Faundez and Tan (2010), Picciotto (2011) and the many articles in the journal *Transnational Corporations*.

3. See UNCTAD's Investment Policy Hub: <http://investmentpolicyhub.unctad.org/Default.aspx>.

Think tanks have written guides and reports on international investment law (for example Mann *et al.*, 2005; Bernasconi-Osterwalder and Johnson, 2011; Cotula, 2007). Civil society organisations have produced guides and toolkits on tax justice (for example Christian Aid and SOMO, 2011), and on ways to protect land rights affected by natural resource investments (for example Colchester and Ferrari, 2007; Oxfam Australia, 2010). There is a vast and growing literature on the ‘business and human rights’ agenda.

This handbook complements this literature through a holistic discussion of the national, international and transnational law that regulates investment in low and middle-income countries. Because multiple sites of regulation are relevant to any given investment project, the handbook takes an integrated approach that cuts across areas of law typically treated in separate literatures and by different communities of practice – including investment treaties, extractive industry legislation, land tenure, human rights norms, environmental legislation and tax law. For both government and civil society, strategic use of multiple legal tools is critical in harnessing the full potential of law.

This handbook also differs from many of the existing materials on the law regulating foreign investment in its non-academic audience, its focus on agriculture and extractive industries, and its emphasis on practical approaches.

What this handbook is not

This handbook is not a thorough, comprehensive legal analysis of applicable norms, nor a source of legal advice. The areas of law covered are too vast and complex for that and contexts too diverse. The topics discussed are inevitably selective, and the treatment of issues succinct. Neither is this handbook an advocacy-oriented critique of investment law. Many such critiques have been produced by civil society organisations in recent years (for example Varghese Buchholz, 2013). Finally, this handbook is not a training manual, although it could provide background information for materials more explicitly oriented towards the delivery of training courses.

1.2 Quality investment and sustainable development

Investment quality, not just quantity

Foreign investment in agriculture, mining or petroleum can have both positive and negative social, environmental and economic outcomes in recipient countries. By contributing capital, know-how and market links, foreign investment can help to promote economic development, generate public revenues, develop infrastructure and create employment in countries with limited alternative options for development. But foreign investment may fail to create enough positive linkages with the local economy, for instance in the form of employment and opportunities for local businesses. It may even crowd out or out-compete local producers.

Box 1. Extractives and agriculture – some differences and commonalities

Investments in petroleum, mining and agriculture share some common characteristics. They typically involve the allocation of long-term rights to land and/or natural resources in exchange for revenues and development contributions. These investments often involve contracts with the host government, because states usually own subsoil resources and, in many low and middle-income countries, large amounts of land too.

Investments in agriculture and extractive industries can have major impacts on the land and resource rights of farmers, herders and foragers. This has implications for the law: it is particularly important that rules and institutions can mediate between competing resource claims, and can safeguard the rights of vulnerable groups.

Natural resource investments tend to require high capital costs up front, for example to build an oil pipeline or an agro-processing facility. They will typically take a long time to recover costs and make a profit. Once the investment has been made, the investor cannot exit the project without incurring major losses. Therefore, negotiating power tends to shift from the investor to the government (Vernon, 1971). Commodity price fluctuations are often accompanied by renegotiations and disputes (Wälde, 2008). These features also have implications for the law, because investors tend to require legal safeguards to protect their investment from adverse government interference.

At the same time, there are differences between these sectors. Petroleum, mining and agriculture raise different legal issues – ownership of subsoil resources in extractive industries, for example, versus irrigation rights in agriculture. They also raise different sustainable development questions. For example, petroleum operations typically involve large-scale investments. Key issues may include whether or not petroleum operations should proceed in given contexts, the place of the sector in the overall development strategy, the regulation of investments including in social and environmental matters, and the management of public revenues.

Agricultural production, on the other hand, can be undertaken by farms of various sizes and using different cultivation methods. Globally, small-scale farmers are the main source of private investment in agricultural production (FAO, 2012). Foreign investment in agriculture does not necessarily involve large plantations. It can be of different scales and forms, including small-scale agro-processing facilities that source produce from local farmers. So a key challenge in agriculture is to define the types of investment that best respond to local and national aspirations.

Foreign investment can bring cleaner technologies and better management practices, but many large natural resource projects have degraded the environment. Increased investment can create new livelihood opportunities that help reduce poverty, but if it is not done properly, it can also dispossess poor people of their land and natural resources.

Given the potential for both positive and negative outcomes, it is increasingly accepted that investment quality is critical in ensuring that foreign investment contributes to sustainable development (UNDP and UNEP, 2011).

Sustainable development: an evolving concept

Different people define sustainable development in different ways – there is no universally accepted definition. In foreign investment projects, investors and affected people often put forward competing visions of what constitutes sustainable development (Fortin and Maconachie, 2013). International instruments adopted over the past three decades do provide some useful guidance, however.

This handbook defines sustainable development very broadly, as a process that improves people's lives while respecting the environment.⁴ In this perspective, promoting investment is not an end in itself, but a means to an end. While for the investor the main concern is usually about generating commercial returns, for host countries and communities the main aim is (or should be) to mobilise assets and capabilities to promote sustainable development. This perspective has implications for two key aspects of investment processes: placing people centre stage in investment decision making; and balancing social, environmental and economic considerations.

Placing people centre stage

Principle 1 of the 1992 Rio Declaration on Environment and Development places people at the centre of the development process. Giving real meaning to this concept requires more than just managing the social and environmental risks of prevailing investment patterns. It requires, more fundamentally, ensuring that public policies and decisions on investment respond to a strategic, long-term vision of sustainable development, based on local and national aspirations.

This recognition has far-reaching implications. It means that countries have 'the sovereign right to exploit their own resources pursuant to their own environmental and developmental policies' (Principle 2 of the Rio Declaration). Placing people at the centre of the development process also has implications for the ways in which a government manages resources on behalf of its citizens: it involves empowering people to have greater control over the decisions and processes that affect their lives (see Principle 10 of the Rio Declaration).

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Such an approach entails a fundamental shift away from treating people as passive recipients of investment flows, who at best are able to react through local consultation exercises. Instead, it places their aspirations centre stage in defining what types of investment to promote, where and how.⁵

Balancing social, environmental and economic considerations

Sustainable development entails a careful balancing of the social, environmental and economic considerations at stake in any investment process. A few provisions of the Rio Declaration can help illustrate these issues.

Economic considerations are an important part of sustainable development. Principle 3 of the Rio Declaration refers to the right to development. Realising this right may require promoting private investment.⁶ But it also involves maximising the economic benefits to the host country and communities from those investments – for example, public revenues, capital contributions, employment, business opportunities, technology transfer and infrastructure development.

4. Principle 1 of the Rio Declaration states that human beings 'are entitled to a healthy and productive life in harmony with nature'.

5. On some of the complexities involved, see Section 5.1.

6. See for example the Plan of Implementation of the 2002 World Summit on Sustainable Development, Paragraph 84; and the Outcome Document of the Rio+20 summit of 2012, 'The Future We Want', Paragraphs 46 and 56-74.

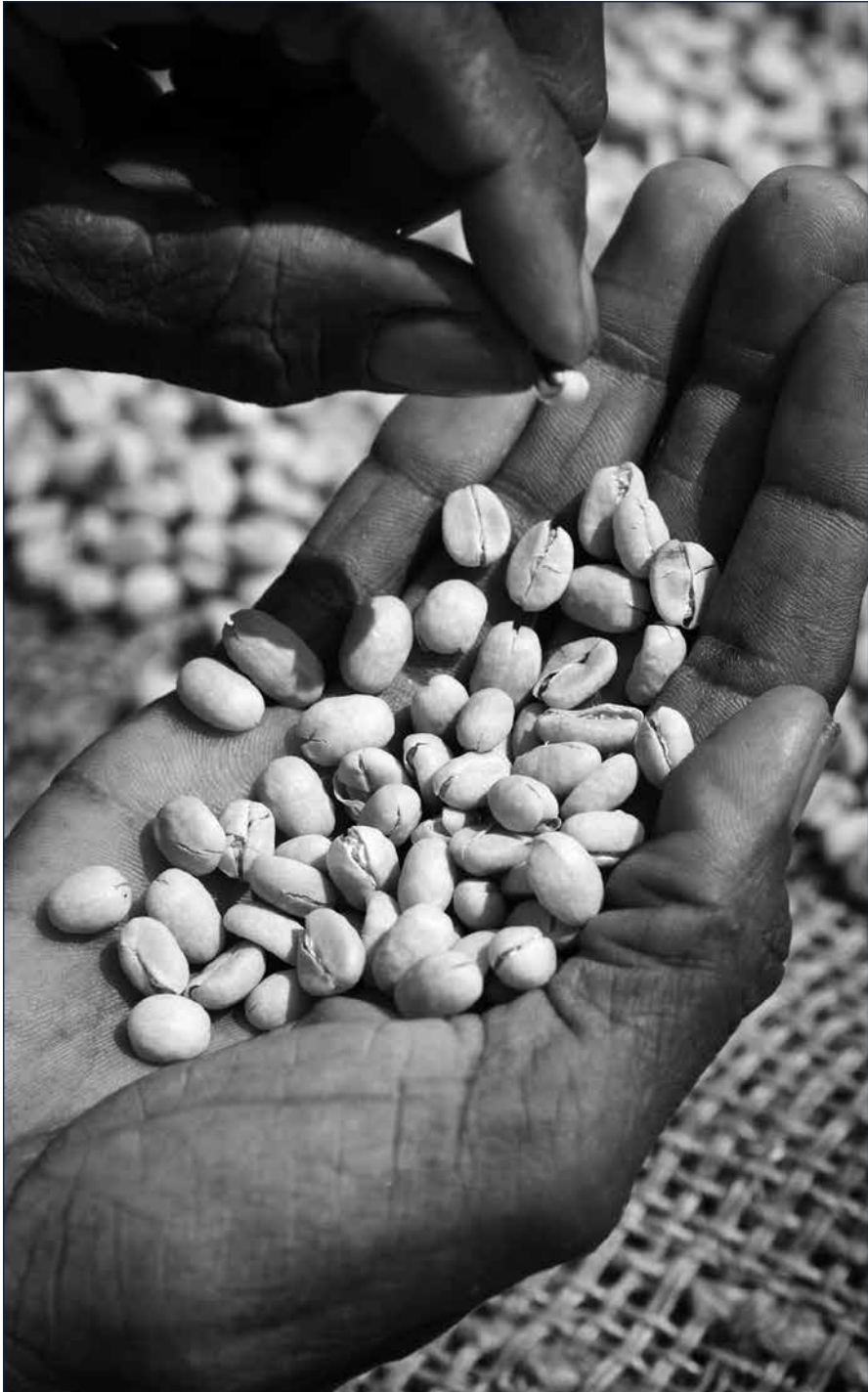


Photo: Sven Torfinn / Panos Pictures

Sustainable development requires the careful handling of the social, environmental and economic considerations at stake in investment processes

With regard to environmental considerations, Principle 4 of the Rio Declaration states that ‘environmental protection shall constitute an integral part of the development process’. Building on concepts developed by the Brundtland Report, the Rio Declaration also states that the right to development must be fulfilled ‘so as to equitably meet developmental and environmental needs of present and future generations’ (Principle 3). This principle of inter-generational equity has important implications in terms of safeguarding the environment for future generations.

Environmental considerations affect multiple aspects of the investment process – from minimising negative impacts on the environment, for instance water abstraction or resource degradation, to clearly allocating responsibility for environmental damage and remediation, through to actively promoting environmental benefits, for instance through investment in low-carbon technologies.

When it comes to social considerations, the Rio Declaration makes poverty eradication ‘an indispensable requirement for sustainable development’ (Principle 5). It also calls on states to support the interest of indigenous peoples and communities (Principle 22). And while the Rio Declaration placed much emphasis on balancing economic development and environmental sustainability, subsequent summits have more fully recognised the importance of social aspects in sustainable development.⁷

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Taking social considerations seriously means that even an investment that is economically beneficial to the country as a whole (for example in terms of gross domestic product or public revenues) cannot promote sustainable development if affected people are arbitrarily dispossessed of their land, if they are oppressed by security forces, if they do not benefit from the deal, or if they have no mechanism to voice their grievances.

1.3 Why the law matters

The law influences key aspects of investment quality

Most people with experience of legal processes will know the ‘limits of law’ (Allott, 1980) first hand. Laws are often not properly enforced due to vested interests, power imbalances or resource constraints. Legislation may protect human rights, land rights or labour rights, but often remains a dead letter. Tax laws may be circumvented, and tax payments are not always easy to collect. Some contracts for natural resource investments have been awarded in violation of prescribed procedures or substantive rules.

Implementation may take legal norms in unexpected directions, often reflecting power relations between those who stand to gain or to lose from competing interpretations of the law. Even well-implemented legislation may produce unintended consequences. Whether affected groups are well organised for collective action may have greater impact than the legal rights they formally hold.

7. For example, the Plan of Implementation of the 2002 World Summit on Sustainable Development contains language on poverty, hunger, health, energy, water and sanitation, and corporate social accountability.

Despite these limitations, multiple sources of regulation, from local to global, play an important role in determining the terms and conditions applicable to investment flows. Also, as foreign investments in agriculture and extractive industries increase pressures on land and natural resources in low and middle-income countries, the law is an important vehicle through which competing claims are mediated. So legal norms can influence the quality of investments, which is critical to the pursuit of sustainable development.

Take the case of a foreign investment project to develop a sugarcane plantation and processing facility in a low-income country. The national law of the host state will regulate who owns the land needed for the project, who can participate in decisions affecting that land, the rights that the investor will be able to acquire over the land, and the protection available to villagers who may be using the land for farming, herding or foraging.

Sugarcane being a thirsty crop, national law will also regulate the allocation of water rights for irrigation, and balance competing water demands. In addition, national law in principle determines the amount and distribution of tax revenues that the project will contribute, it regulates labour relations, and it determines the applicable environmental safeguards and liabilities.

International law will also define key terms of the sugarcane project. Global or regional trade treaties may enable the company to export its produce, or allow the government to grant tariff protection to that produce if the venture targets the national market. In addition, an investment treaty – or a preferential trade agreement containing an investment chapter – may protect the agribusiness venture from adverse host state interference. For instance, the treaty may require the host government to accord ‘fair and equitable treatment’ to the venture, and it may enable the agribusiness company to bring disputes with the host government to international arbitration.

International law also facilitates co-operation between states on issues like tax matters or the management of shared natural resources – for instance, if the sugarcane venture abstracts water from a cross-border watercourse. Importantly, international law protects the human rights of people who may be displaced or otherwise affected by the venture, and the basic labour rights of those employed by it.

Transnational legal relations – that is, relations that straddle multiple national jurisdictions – are another recurrent feature of foreign investment. Because foreign investment projects bring into contact players and assets located in multiple jurisdictions, the law of several countries beyond the host state may be relevant to important aspects of the project. This will influence the rights and obligations of the parties and the recourse mechanisms available to them.

For example, if affected people feel wronged by the venture and distrust local courts, depending on the jurisdiction they might be able to sue the parent company of the agribusiness firm in its home country. Also, if the agribusiness firm takes the host government to investor-state arbitration, the national law of a large number of countries may be relevant to the enforcement of the arbitral ruling.

A complex web of contracts among the investor, the host state, lenders, insurers, suppliers and contractors will define the rights and obligations of these multiple parties. For example, the contract between the investor (that is, the agribusiness firm in the sugarcane venture example) and the host government will allocate resource rights, set the terms for the investment, define how returns will be shared between investor and state, and specify social and environmental safeguards. The contract between the investor and the host government is loosely termed here as the 'investment contract', though in practice multiple contracts between the two parties may be involved.⁸

Finally, international guidelines and standards may raise the bar beyond what is required under applicable law. Guidance has been developed by United Nations (UN) agencies, other international organisations such as the Organisation for Economic Co-operation and Development (OECD), lenders and multi-stakeholder certification schemes. Certification schemes relevant to sugarcane include the Roundtable on Sustainable Biomaterials (RSB),⁹ if the venture is for ethanol, and the Better Sugarcane Initiative ('Bonsucro').¹⁰

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Guidelines and standards are not legally binding but they can still have legal consequences. For instance, legislation or project contracts may require the venture to comply with specific standards. In the European Union, the Renewable Energy Directive of 2009 gives indirect legal weight to approved sustainability standards, including RSB certification.

Even where international guidance or standards have no legal value, the institutional arrangements associated with them can still create effective incentives for companies to comply, including grievance mechanisms and reputational damage in case of non-compliance.

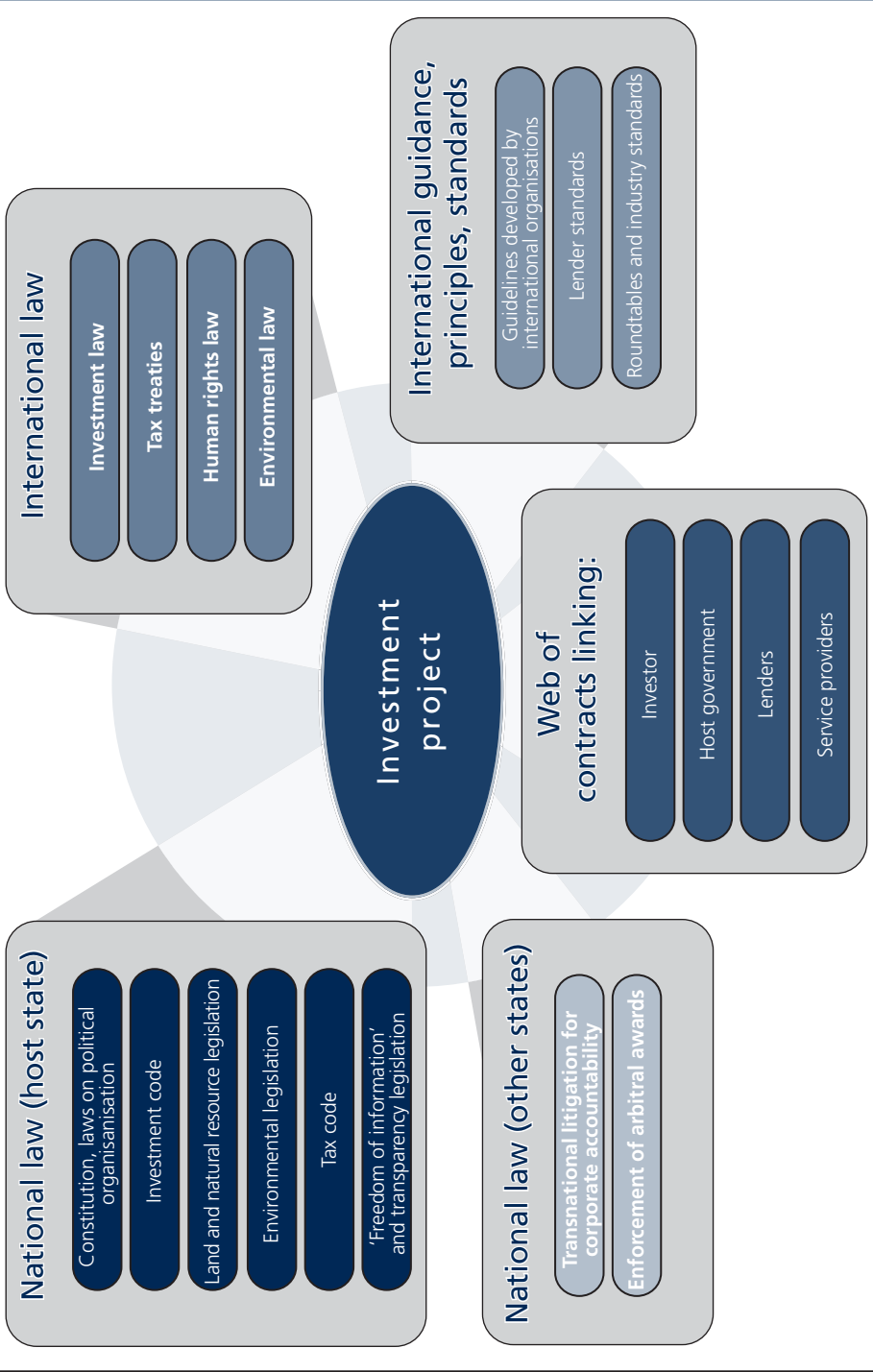
These multiple sources of regulation and guidance are interconnected: international law may influence the development of national legislation, investment contracts may require a project to comply with international standards and affected people may seek to enforce the rights affirmed by international law through recourse to national courts (Figure 1).

8. In the sugarcane venture example, the company and the government may at different stages sign a memorandum of understanding, an establishment convention, a land lease and a water rights convention.

9. <http://rsb.org/>.

10. <http://www.bonsucro.com/>.

Figure 1. Multiple sources of regulation and guidance - some examples



The interplay among these multiple sources of regulation and guidance influences key aspects of investment quality – in relation both to balancing social, environmental and economic considerations, and to placing people at the centre of investment processes. Indeed, the law defines the rights and obligations of the different parties involved; it affects the way the costs, risks and benefits of investments are shared among these parties; and it provides space for contestation and negotiation. It also shapes the rights and recourse mechanisms that affected people hold in their capacity as citizens, landholders, workers or unlawfully wronged persons.

Of course, law is only a part of the story. Policy instruments outside the legal sphere can also influence investment patterns and outcomes (for example, macroeconomic policy). Shortcomings in implementation mean that investment processes typically reflect a spectrum of situations between law and practice, between the normative and the experienced, in which multiple norms with varying degrees of implementation have both intended and unintended consequences for real-life processes.

But given the role of law in framing the terms and conditions of investment, effective use of legal tools by government and citizens alike is an important ingredient of public efforts to ensure that foreign investment contributes to sustainable development.

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Three additional reasons for engaging with law

There are three additional reasons to engage with the law. The law has a role in influencing patterns of investment flows; the law regulating foreign investment can affect options for public action in other domains; and people affected by the investment process increasingly demand effective use of legal tools.

Reason 1: laws can influence investment flows. The law can create incentives that influence whether a type of investment occurs in the first place. For instance, treaties that liberalise trade may facilitate export-oriented investments. The international investment protection regime is premised on the assumption that legal safeguards are important for attracting foreign investment.

Renewed interest in Africa's mineral resources since the 1990s reflects shifts in global supply and demand. But it is also a response to legislative reforms that have made mining more attractive in several African countries (Campbell, 2004, 2009). In agriculture, extensive government land ownership and powers to expropriate private land in many parts of Africa allow companies to acquire large areas of land, and favour plantation agriculture over investment models that source from local farmers (Anseeuw *et al.*, 2012).

To ensure that investment promotion is aligned with sustainable development, it is important to have a good grasp of how legal frameworks shape the incentives for different types of investment.

Box 3. Seizing the prince's plane: how arbitral rulings are enforced

The ability of investment treaties to affect policy is largely linked to the effectiveness of international investor-state arbitration. This refers to the settlement of disputes between an investor and a host government through an international arbitral tribunal that issues a binding award (effectively, a document similar to a court judgment). Investment treaties typically allow investors to take disputes to these tribunals.

Legal arrangements ensure that the arbitration proceeds even if the government refuses to take part. If a government does not pay the damages awarded by these tribunals, widely ratified multilateral treaties allow investors to cash in their compensation payments by seizing assets that the host state may hold overseas. These arrangements, and their limitations, are further discussed in Chapter 2.

In 2011, these enforcement mechanisms made the headlines as an international construction firm seeking to enforce an arbitral ruling against the Thai government seized the plane used by the Thai crown prince after it landed in Germany (Jolly and Fuller, 2011). The plane was only released after the Thai government offered a substantial bank guarantee (Isermann, 2011).

Because in a globalised world virtually all states hold assets overseas, this type of legal action tends to provide an effective enforcement mechanism. In addition, governments are often under pressure to honour arbitral rulings in order to keep attracting investment.

Reason 2: the law regulating foreign investment can affect policy options in other domains. Some norms are backed up by effective enforcement mechanisms, and must therefore be taken very seriously. They can affect the ability of governments to take action on a wide range of social, environmental and economic issues. Investment treaties have proved particularly effective in disciplining the exercise of state sovereignty. Governments can adopt measures that violate investment treaties but they may have to pay steep bills in compensation to investors. Mechanisms to enforce treaty commitments are quite effective, particularly through international investor-state arbitration (see Box 3).

For example, the government of New Zealand recently suspended the adoption of legislation to discourage smoking in order to wait for the outcome of a lawsuit brought by an investor to challenge similar legislation adopted in Australia (Peterson, 2013; see Box 6 in Chapter 2). Restrictions on policy space are more acute in poorer countries, where budget constraints are tighter and the capacity of government to compensate investors is more limited.

Reason 3: grassroots demand for effective use of legal tools. Some activists are sceptical about the emancipatory potential of legal tools. But as competition for natural resources intensifies, villagers, federations of producer associations and non-governmental organisations in many low and middle-income countries have resorted to legal action to contest large investment projects (for example Polack *et al.*, 2013; Dhliwayo, 2013). In many cases, legal avenues form part of a wider advocacy strategy that combines legal recourse with collective action and political mobilisation.

These trends show that effective use of legal tools is not just a prerogative of government – it is part and parcel of active citizenship, broadly taken to mean ‘the act of any person taking part in public affairs’ (Gaventa, 2002:3). They also suggest that there is strong grassroots demand for effective use of legal tools.

1.4 Outline of the handbook

The remainder of this handbook is structured as follows. Chapter 2 discusses the law promoting investment flows, with a focus on investment treaties and arbitration. It explains key concepts and trends, and examines their sustainable development implications.

Chapter 3 explores selected issues concerning the economic deal – from corporate structure to the fiscal regime, through to promoting positive linkages with the local economy, such as employment and business opportunities.

Chapter 4 discusses social and environmental considerations. While these considerations cover a wide range of diverse issues, the focus of the chapter is on impact assessment, land rights and acquisition, labour rights, and environmental protection. The chapter discusses social and environmental aspects together because some legal processes, such as impact assessments, aim to cover both sets of considerations.

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Chapter 5 examines selected issues concerning investment decision making: inclusive deliberation, transparency, anti-corruption measures and legal remedies. These topics reflect diverse pathways to greater local control and accountability in investment processes. They are key to placing people at the centre of sustainable development.

In each chapter, the main text discusses the relevant law, while ‘top tip’ boxes distil key pointers for government and civil society. At the end of each chapter, a few resources for further reading are suggested. Given the handbook’s non-academic target audience, these lists prioritise resources that are available online.

There is significant overlap between the issues discussed in the different chapters. For example, job creation is an important ingredient of the economic deal (Chapter 3) and a key ‘social’ issue (Chapter 4). Community engagement is important in shaping public participation and accountability in investment decision making (Chapter 5) and also, more specifically, in impact assessment and land acquisition processes (Chapter 4).

While Chapters 2 to 5 focus on practical issues and options, Chapter 6 draws out some deeper, more analytical reflections about the relationship between foreign investment, law and sustainable development.

Investment preparedness and promotion

2.1 Preparedness, not just promotion

Investment preparedness refers to the extent to which people and institutions in the host country can identify the right types of investment, fully harness the benefits of that investment and minimise its risks. Many investment policies focus on promoting investment. But preparedness in the host country is critical to ensuring that investments contribute to sustainable development in that country.

Investment preparedness has much to do with issues outside the legal sphere. For example, countries need to have a strategic vision of national development, and of the types of investment that are best suited to advance that vision (see UNCTAD's Investment Policy Framework for Sustainable Development, Box 2 in Chapter 1). They also need effective institutions and the capacity to manage investment processes, competitive domestic producers that can seize the new business opportunities created by incoming investment, and a vibrant civil society with the capacity to hold government and business to account.

The law provides tools to ensure that investments are in line with local and national development aspirations, and to enable the host country to get the best possible deal for sustainable development. This legal dimension of investment preparedness could include publicly debated framework legislation that sets strategic orientations for sectoral development (see Box 30 in Chapter 5 on Mali's Agricultural Orientation Act of 2006). It could also include properly enforced legislation requiring effective community engagement in the early stages of project design, robust social and environmental impact assessment requirements, and mechanisms to minimise tax avoidance.

In many countries, recent legislation has created new opportunities that could increase investment preparedness. For example, environmental legislation was embryonic in many low and middle-income countries until the mid-1990s. But several states have more recently adopted comprehensive framework legislation to regulate environmental matters. This trend is being driven by factors such as civil society scrutiny, donor pressures and a more widespread recognition that greater investment does not automatically translate into positive sustainable development outcomes.

Yet much remains to be done to reform laws and properly implement them. The overriding policy imperative to attract as much investment as possible has often hampered efforts to improve preparedness. This is particularly the case where concerns were raised that too tight a regulatory framework might deter investors.

TOP TIP 1

Prepare for investment

- If investment is to contribute to sustainable development, preparing for investment needs to be a key part of investment policy making, and investment promotion needs to be based on a clear strategic vision of national development.
- A strategic vision can help governments make effective decisions about what types of investment to promote, where and how – rather than responding to investor proposals on an *ad hoc* basis.
- In legal terms, improving investment preparedness involves action by governments, citizens, civil society and socio-professional organisations to leverage a wide range of legal tools to promote the emergence of a long-term, bottom-up vision (Chapter 5), get the best economic deal (Chapter 3), and take social and environmental considerations seriously (Chapter 4).

Broadly speaking, investment promotion involves measures aimed at attracting investment. It is widely recognised that private investment can play an important role in pursuing sustainable development. This role was explicitly recognised at the 1992 Rio Conference on Environment and Development and at follow-up events. The role of foreign investment is particularly relevant in poorer countries, where domestic capital resources are often constrained.

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Over the past two decades, governments in most low and middle-income countries have taken steps to attract foreign investment, including in the natural resource sector. For example, many countries have established investment promotion agencies that provide prospective investors with information and guidance, and help investors to navigate administrative procedures.

Investment promotion measures have also included reforms to national law, and international treaties. Governments have pursued a number of different approaches but law making to promote investment typically involves a combination of three main types of measure, to varying degrees: investment liberalisation and facilitation, including the easing of restrictions on cross-border investments; investment protection, because it is widely believed that legal safeguards are needed to attract investments in contexts where political risk is perceived to be high; and tax incentives. International investment law plays a particularly important role in the protection of cross-border investments (Box 4). Tax incentives are covered in Chapter 3.

In many ways, it would make sense for this handbook to discuss investment preparedness first, and investment promotion after. Logic would require a country to first think through the models of investment it wants to promote and tighten up the necessary safeguards, and then to take steps to promote those investments. In practice, policy making does not always work in this way. Existing investment protection measures can have far-reaching implications for a country's

Box 4. International investment law

International investment law is the body of international law that protects foreign investments from adverse host state interference. It has undergone rapid change and exponential growth over the past two decades.

International investment law is based on customary international law and international treaties. Customary law is created through state practice accompanied by *opinio juris* – that is, the belief of states that their practice reflects an international legal obligation. International treaties account for the bulk of the norms of investment law. They include a web of over 3000 investment treaties, mostly bilateral investment treaties (BITs) but also, increasingly, regional or bilateral preferential trade agreements (PTAs) that contain an investment chapter (UNCTAD, 2012b). The number of investment treaties has increased sharply since the early 1990s, when neo-liberal thinking became prevalent. But the extent to which governments have signed up to these treaties varies considerably across countries.

Investment treaties aim to promote investment flows between the states which are party to them. They pursue this goal by establishing obligations about how investments by nationals of one state in the territory of the other state will be admitted and treated. The evidence on whether investment treaties actually make a difference in promoting investment is mixed (Section 2.3). Because international investment law is dominated by bilateral and regional treaties, the legal protection available to different investments varies depending on the host and home states.

Most investment treaties allow investors to bring disputes with the host state to international arbitration (investor-state arbitration). These disputes are settled by arbitral tribunals that issue binding rulings called arbitral awards. Arbitral tribunals are not bound by the interpretations contained in earlier awards and there is no centralised system for appeals against them. So different tribunals have often followed different approaches although tribunals usually do refer to earlier awards to support their reasoning.

Investment-related norms are also included in treaties relating to the World Trade Organization (WTO), particularly the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Investment Measures (TRIMs). These agreements are binding on the over 150 states that have joined the WTO, and are enforced through an effective inter-state dispute settlement system at the international level.

ability to take measures that could strengthen preparedness. For example, WTO norms and some investment treaties restrict the use of legal requirements on investors to source goods and services locally.

By discussing investment promotion first, this chapter introduces key concepts about investment treaties and arbitration that will be referred to while examining aspects of investment preparedness (Chapters 3 to 5).

Government regulators and negotiators play a central role in drafting and implementing investment treaties and legislation, and in the conduct of investor-state arbitration. Therefore, many of the ‘top tips’ in this chapter relate to government action. However civil society has been increasingly active in scrutinising investment law making (see Box 5) and arbitration (see Chapter 5).

Box 5. Civil society scrutiny of treaty negotiations: experience from Thailand

For organisations to provide effective advocacy on investment treaties, they need a good understanding of how treaties are concluded, and how they might have some input into the process. Treaties are commonly negotiated between government officials, but in some countries, parliament may be empowered to provide guidance to government negotiators, and to ‘ratify’ (effectively, approve) treaties signed by the government.

At the ratification stage, the content of a treaty usually cannot be amended – it can only be approved or rejected. It is therefore important to provide input early in the negotiation but information and opportunities for influence may not be available at that stage. Civil society action can open up space for debate, however.

In Thailand, Article 190(3) of the constitution requires parliamentary approval, disclosure of information and a public hearing for the negotiation of major economic treaties. In 2012, a civil society coalition invoked this provision to call for open debate on the negotiation of a preferential trade agreement with the European Union (Ashayagachat, 2012; Polack *et al.*, forthcoming).

The campaign raised public awareness about the negotiation. Politicians later suggested amending Article 190, however, arguing that the provision could prevent Thailand from concluding important treaties (Thepphajorn, 2013).

2.2 Admitting foreign investment (‘entry’)

Trends in admission policy

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Under customary international law, states have the sovereign right to regulate the admission of foreign investment within their territory. Investment treaties mainly concern the treatment of foreign investment after its entry into the territory of the host state. Most treaties do not oblige the host state to admit foreign investment. Many merely require compliance with the admission rules contained in the national law of the host state – although some call on the state parties to create ‘favourable conditions’ for investment from nationals of the other state party (Newcombe and Paradell, 2009).

As a result, countries have ‘a free choice as to the degree of open admission’ of foreign investment: they can restrict entry or place conditions on it, or they can liberalise it through unilateral measures or international treaties (Muchlinski, 2008a:20). Admission policy largely depends on national law. Restrictions tend to have diverse motivations, including national security and protectionism.

For a long time, many states imposed controls on entry. Commonly used controls included bans on foreign investment in specific sectors, screening processes that admitted foreign investment only on government authorisation, restrictions on foreign ownership of businesses or strategic assets and performance requirements such as the need to source goods or services from local producers (Muchlinski, 2007).

In the 1990s and early 2000s, however, most low and middle-income countries took measures to liberalise and facilitate inward investment, including in the natural resource sector. These measures involved far-reaching reforms in national law, and much international treaty making.

Many countries have revised their mining, petroleum and investment codes to partly or fully liberalise the admission of foreign investment. Some countries have also reformed their land legislation to allow market transactions and enable foreign investors to acquire more secure land rights. Some have introduced facilitation measures such as the establishment of an investment promotion agency to provide investors with information, consider investment applications, issue relevant administrative certificates and help investors to liaise with other government departments. Some countries have established 'land banks': inventories of land deemed unused and ready for allocation to prospective investors.

More recently, the economic crisis in the West has given renewed momentum to government intervention in the economy, and some governments have taken new steps to screen and regulate foreign investment (UNCTAD, 2012b). A commodity boom in the late 2000s triggered a wave of 'resource nationalism', with host countries renegotiating extractive industry projects to seek not only higher taxation, but also, in some cases, greater government control on the business venture itself.¹¹ Overall, however, low-income countries still seem to have an overriding concern to attract foreign investment.

Depending on the country, national legislation may still impose controls on investment, ranging from restrictions in particularly sensitive industries to various forms of regulation. For example, some countries require that proposed investments be screened and approved by a government authority, or that foreign investors operate through a local subsidiary incorporated in the host country.

Restrictions on the type of land rights that foreigners can acquire remain widespread, and some laws also restrict how land acquisitions by foreign nationals can be used. For instance, land and investment legislation in Tanzania only allows foreigners to acquire land rights for the purposes of investment projects, while Uganda's legislation restricts foreign investors from undertaking certain types of land use.

'Pre-establishment' investment treaties

Some investment treaties create enforceable obligations regarding the entry of foreign investment. In these 'pre-establishment' models, the investment treaty requires governments not to discriminate against the admission of investment from the other state party. Specifically, these treaties usually provide that the host state must treat foreign investors no less favourably than its own nationals ('national treatment') and/or than nationals of other states ('most-favoured-nation treatment') in relation to the establishment, acquisition or expansion of an investment.

This pre-establishment approach is particularly common in the treaties concluded by Canada, Japan and the United States, while European investment treaties tend not to feature such provisions. It is also common in treaties that protect investment as part of wider preferential trade agreements.

11. On resource nationalism and sustainable development, see Ward (2009).

The obligation not to discriminate against foreign investors does not constitute, in itself, full liberalisation of investment flows. For example, government authorisations may still be required as a pre-condition for investment if they are applied in a non-discriminatory way (Newcome and Paradell, 2009). But pre-establishment models restrict options for national policy. The requirement not to discriminate between nationals and non-nationals means that foreign investors are, in principle, entitled to the same treatment provided to nationals. And as will be discussed (Section 3.4), investment treaties following the pre-establishment model may restrict the ability of governments to impose performance requirements as a condition for the admission of foreign investment.

The norms of the World Trade Organization (WTO) also have implications for the admission of foreign investment in certain sectors or aspects. Most states today are either members of the WTO, or are in the process of joining. The WTO General Agreement on Trade in Services (GATS) requires these states, among other things, not to discriminate against foreign service providers in the establishment of branch offices within their territory – though this only applies to the service sectors for which each state has agreed to be bound in this way. The WTO Agreement on Trade-Related Investment Measures restricts use of performance requirements (Section 3.4).

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Some governments may be prepared to agree to limit the future exercise of their sovereign powers in order to attract investment. But it is important to bear in mind that pre-establishment provisions in international treaties can significantly erode the host state's control over the admission of foreign investment into its territory. Before signing up to such commitments, it would be prudent for governments to fully appreciate the ramifications that these commitments can have, and to negotiate appropriate exemptions if pre-establishment provisions are used.

For example, pre-establishment clauses commonly exclude existing measures, meaning that the non-discrimination requirement only applies to future measures. In addition, governments may want to consider 'positive listing' – whereby pre-establishment obligations only apply to the sectors or measures that are specifically mentioned in the treaty. The 'positive listing' model is in line with the approach followed by the GATS.

On the other hand, if commitments are formulated in general terms, the treaty may feature a list of exceptions that exclude the application of non-discrimination requirements to particular sectors or measures ('negative listing'). For instance, the Benin-Canada BIT of 2013 excludes from the application of a pre-establishment national treatment provision the residency requirements applicable to landowners that are in force in Benin.

Pre-establishment obligations are not the only way to reassure investors about the way they will be treated at the admission stage. States can also make less intrusive commitments on admission. For example, a treaty provision stating

that investments must be admitted in accordance with the national laws of the host state would preserve the ability of the host state to impose entry controls and change laws over time. But it would also protect investors against arbitrary government decisions that conflict with national law (UNCTAD, 2012a).

TOP TIP 2

Before signing up to pre-establishment obligations in investment treaties, carefully consider their full implications and the range of possible alternatives

- States have the sovereign right to regulate admission of foreign investment in their territory.
- Before entering into any binding commitments on the admission of foreign investment, governments should fully appreciate the ramifications that these commitments can have.
- If governments are prepared to enter into such commitments, treaty provisions can be formulated so that the commitments only apply to specified sectors or measures ('positive listing').
- On the other hand, if commitments are formulated in general terms, it is prudent to negotiate appropriate exemptions for certain sectors or measures ('negative listing').
- Stating that investments must be admitted in accordance with national law gives more freedom to host country regulators, while also providing reassurances to investors against arbitrary refusals.

2.3 Legal protection of foreign investment ('treatment')

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Standards of investment protection

In order to promote foreign investment, many countries have adopted national legislation and ratified international treaties that protect investment from measures that may adversely affect the business venture.

Investment protection is designed to mitigate political risk. Once an investment is made – for example, after the irrigation infrastructure or processing plant has been constructed – the investor becomes vulnerable to host government measures that can undermine the project. Legal safeguards to protect investment aim to reassure investors that adverse government action will not prevent them from reaping the rewards of their economic activities. As such, these safeguards are widely thought to be an important ingredient of investment promotion.

In practice, the empirical evidence on whether legal protection instruments like investment treaties do promote investment is mixed.¹² It is widely recognised, for example, that investment treaties only 'play a complementary role among many determinants that drive firms' investment decisions', not least because investment treaties alone 'cannot turn a bad domestic investment climate into a good one' (UNCTAD, 2012b:133).

12. For a collection of studies about the relationship between investment treaties and investment flows, see Sauvart and Sachs (2009).

In many countries, investment codes restrict the power of the government to expropriate investments. Examples include Article 9 of Cambodia's Investment Act of 2006, Article 6 of Guatemala's Foreign Investment Act of 1998 and Article 22 of the Tanzania Investment Act of 1997. Many investment codes also prohibit discrimination between national and foreign investors, and some allow investors to bring disputes to international arbitration. But it is international treaties that play a particularly important role in this area – not least because, unlike safeguards in national investment codes, treaties cannot be easily overturned by subsequent legislation.

So what legal safeguards do investment treaties provide? 'Treatment' provisions usually include:

- National treatment and most-favoured-nation clauses require the host state to treat foreign investments no less favourably than investments in the same circumstances by its own nationals (national treatment) or by nationals of other states (most-favoured-nation treatment).
- Fair and equitable treatment clauses require the host state to treat foreign investment according to a minimum standard of fairness, irrespective of the rules it applies to domestic investment under its national law.
- Full protection and security clauses require the host state to take steps to protect foreign investment from harm caused by third parties (for example in the arbitral award *Asian Agricultural Products v. Sri Lanka*, by armed militias).
- Clauses that restrict the expropriation of foreign investments require that they be for a public purpose and non-discriminatory, and that states must follow due process and pay compensation determined according to specified standards.
- 'Umbrella' clauses require the host state to honour the commitments it may have entered into, for example through contracts, which would enable a foreign investor to seek redress under the treaty for government violations of an investment contract.
- Provisions on currency convertibility and profit repatriation allow investors to repatriate returns from their activities.

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National treatment and most-favoured-nation provisions are relative standards: they only require the state not to discriminate against protected foreign investors and investments. In contrast, the other standards of treatment are absolute standards: they establish minimum standards of treatment applicable to protected foreign investment irrespective of the treatment applicable to other investments.

These treatment provisions feature in the vast majority of investment treaties. But while investment treaties tend to have broadly comparable terms, their wording can vary considerably. For example, standards of compensation for expropriation vary, with treaties using diverse formulae such as 'full', 'adequate' or 'fair' compensation. Similarly, the formulation of 'fair and equitable treatment' clauses varies, with some treaties explicitly restricting this standard to the treatment already required by customary international law. As a result, the protection that investors are entitled to will vary depending on the wording of the treaty.



Photo: Chris Stowers / Panos Pictures

Investment treaties require a careful balancing act between investment protection and policy space for public action

Most-favoured-nation clauses tend to level the playing field upwards, by extending to an investment the protection accorded to other foreign investments under another more favourable investment treaty. Therefore, in order to fully understand the implications of an investment treaty, it is necessary to examine other treaties that the host state may have entered into.

From a sustainable development perspective, investment treaties raise a number of issues including: balancing investment protection and policy space for public action in the public interest, and balancing investor rights and obligations.

Investment protection vs policy space

Broadly speaking, 'policy space' refers to the ability of one country 'to calibrate national policies to local conditions and needs' (Akyüz, 2008:i). All international economic treaties limit national policy space: governments may be legally required to take some measures, and may no longer be allowed to take other measures. Therefore, the negotiation of investment treaties involves a delicate balancing act between committing to protect foreign investment on the one hand and preserving policy space on the other.

Insofar as investment protection promotes investments that produce positive social, environmental and economic outcomes, it is an important ingredient of efforts to promote sustainable development. But if not carefully framed, investment protection can significantly restrict policy space in host countries. While much depends on how a government uses the policy space it enjoys (Mayer, 2009), excessive restrictions on policy space can undermine the ability of the host state to adopt measures in pursuit of sustainable development.

A recurrent feature of investment treaties is that the language used is often unspecific, and lends itself to multiple interpretations. When called upon to adjudicate investment disputes, several arbitral tribunals have interpreted the standards of investment protection in expansive ways.

Take the case of ‘fair and equitable treatment’ – a standard that has been relied on in ‘almost all claims brought to date by investors against States’ (UNCTAD, 2012b:147). Few would disagree with the notion that investors should be treated fairly. But establishing what is fair or equitable is not always straightforward. In practice, several arbitral tribunals have interpreted this standard expansively, and have ordered governments to pay large amounts in compensation to investors whose business prospects had been adversely affected by government action. A central requirement of the fair and equitable treatment standard is considered to be respect for the legitimate expectations that the investor had when making the investment.¹³ This requirement has been held to include, for example, consistency and transparency of government conduct,¹⁴ and stability and predictability of the regulatory framework.¹⁵

Many of the government measures that have been found to be in violation of fair and equitable treatment did involve arbitrary conduct (Cosbey *et al.*, 2004). But some commentators have raised concerns that, if these legal requirements are applied too rigidly, the broad interpretation of fair and equitable treatment and other standards of investment protection, coupled with the effective enforcement mechanisms that assist investment treaties, can also constrain the ability of governments to pursue desirable economic policies, protect their country’s environment or public health, or improve labour standards where doing so adversely affects commercial investments. Governments can still adopt these measures but they may have to pay steep compensation bills if they wish to regulate in violation of a treaty obligation (Box 6).

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However, some arbitral tribunals have interpreted fair and equitable treatment in ways that place greater emphasis on the right of governments to regulate. For example, the tribunal in *Saluka Investments BV v. Czech Republic* stated that ‘[n]o investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged’, and that ‘the host State’s legitimate right [...] to regulate domestic matters in the public interest must be taken into consideration.’¹⁶ But arbitral practice is diverse, and recent awards feature examples of both restrictive¹⁷ and expansive¹⁸ approaches to interpreting ‘fair and equitable treatment’.

13. See the arbitral rulings *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*; *LG&E Energy Corp. v. Argentina*; *Parkerings v. Lithuania*; *Saluka Investments B.V. v. The Czech Republic*; and *El Paso Energy International Company v. The Argentine Republic*.

14. *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*.

15. *CMS Gas Transmission Company v. The Argentine Republic*; *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic (Decision on Liability)*.

16. *Saluka Investments BV v. Czech Republic (Partial Award)*, para. 305. See also *Alex Genin, Eastern Credit Limited Inc. and A.S. Baltoil v. Estonia (Award)*.

17. *El Paso Energy International Company v. The Argentine Republic*.

18. *Merrill & Ring Forestry L.P. v. Canada (Award)*, where the tribunal defined fair and equitable treatment as ‘protect[ing] against all such acts or behavior that might infringe a sense of fairness, equity and reasonableness’ (para. 210).

Box 6. Restrictions on policy space: cigarette marketing legislation in Australia and Uruguay

Restrictions on policy space flowing from investment treaties are not limited to low-income countries. In recent years, for example, a major tobacco company filed arbitrations to challenge legislation aimed at discouraging smoking in Australia and Uruguay.

The company argued that the measures violated the standard of fair and equitable treatment affirmed in applicable investment treaties, and sought compensation.

Governments are likely to take account of liability risks before adopting legislation that could adversely affect companies. Even if companies lose a case, the host governments may still face costly legal bills. The government of New Zealand recently announced that it would wait to see the outcome of the arbitration against Australia before introducing similar anti-smoking legislation in New Zealand.

Sources: *Philip Morris Asia Limited v. Australia (Notice of Arbitration)*; *Philip Morris Brands Sarl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay (Request for Arbitration)*; Peterson, 2013.

There have been evolutions in some treaty practice too. A number of recent investment treaties provide clarifications that circumscribe the scope of investment protection standards. For example, the new model investment treaties developed by Canada and the United States clarify that fair and equitable treatment is restricted to the international minimum standard of treatment required under customary international law. The governments of Canada and the US use these model treaties as a basis for the negotiation of bilateral or regional treaties.

The customary law standard of treatment is typically interpreted relatively narrowly, as referring to conduct that is 'arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory [...] or involves a lack of due process'.¹⁹ Equating fair and equitable treatment to the customary standard should restrict the scope of investment protection, and preserve greater space for national policy.

Some recent awards, however, have suggested that the customary standard is itself evolving, and have adopted broader interpretations of that standard.²⁰ There is uncertainty about the precise contours of the international minimum standard of treatment required under customary law. So the extent to which the more restrictive treaty formulations can help remains to be seen. Equally, some countries have continued to conclude treaties that feature unqualified fair and equitable treatment clauses.

Similar considerations may be developed with regard to other standards of investment protection, such as 'full protection and security', or the notion of 'indirect expropriation'. The latter concerns regulation that adversely affects an investment to such an extent that it is treated as an expropriation – thereby requiring the government to compensate the investor for losses suffered.

Expansive arbitral interpretations combined with concerns about excessive restrictions on national policy spaces have resulted in shifts towards a more careful

19. *Waste Management II – Waste Management Inc. v. Mexico (Award)*, para. 98.

20. See for instance *Railroad Development Corporation (RDC) v. Republic of Guatemala*.

definition of the balance between investment protection and regulatory powers in both arbitral jurisprudence and some treaty practice. For example, recent US investment treaties include an annex that clarifies that non-discriminatory regulation in pursuit of legitimate public welfare objectives does not in principle constitute expropriation that would require the payment of compensation. Other recent investment treaties do not feature this clarification, however.

Before concluding a new investment treaty, it is prudent for governments to fully appreciate the real costs and benefits of that treaty, including the far-reaching implications that investment protection commitments can have for regulation in pursuit of sustainable development. Not concluding a treaty may be preferable to signing up to unfavourable commitments. Also, there is growing guidance on how to formulate treaties in ways that balance investment protection and policy space for sustainable development (e.g. Mann *et al.*, 2005; UNCTAD, 2012a; VanDuzer *et al.*, 2012).

For example, UNCTAD (2012a) outlines a wide range of possible drafting options with regard to 'fair and equitable treatment'. An unqualified fair and equitable treatment standard provides maximum investment protection and may be welcome by prospective investors, but it can expose the government to legal liabilities that may be difficult to fully foresee (UNCTAD, 2012a).

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Alternative options include providing an exhaustive list of more specific state obligations (such as the obligation not to deny justice in judicial or administrative proceedings, or not to subject the investor to unjustified harassment), so as to more clearly determine the boundaries of investment protection. Treaties can also clarify that the standard does not preclude good faith regulation, and that the investor's conduct must be taken into account when determining whether fair and equitable treatment has been breached. Treaties can even omit the fair and equitable treatment standard altogether (UNCTAD, 2012a).

In addition to influencing the formulation of new treaties, states can also take steps to influence how their existing investment treaties are interpreted (Box 7).

Balancing investor rights and obligations

Investment treaties establish rights for investors, but most do not create any obligations. For instance, most treaties say little or nothing about obligations on foreign investors in relation to human rights or environmental standards. This is because investment protection has traditionally been the main focus of investment treaties.

Many commentators have argued that aligning investment law with the pursuit of sustainable development would require investment treaties to specify investor obligations as well as rights (for example Mann *et al.*, 2005). This would help arbitral tribunals to consider investor misconduct in proceedings brought by an investor against the host government.

Box 7. How governments can influence the interpretation of investment treaties

When an investor-state dispute is pending, the interpretation of an investment treaty for the purposes of settling that dispute is ultimately in the hands of the arbitral tribunal. But states can pursue several avenues to influence the interpretation of the treaties they have concluded (UNCTAD, 2013c).

First, state parties to an investment treaty can issue joint, authoritative interpretations of treaty provisions. For example, following arbitral jurisprudence that interpreted fair and equitable treatment in expansive terms, the inter-governmental Free Trade Commission established under the North American Free Trade Agreement (NAFTA) issued an interpretive note that restricted fair and equitable treatment under NAFTA to the narrower standards of protection already prescribed by customary international law. The NAFTA treaty clarifies that interpretations by this commission are legally binding.

Second, a state can initiate international arbitration against another state (state-to-state arbitration). The pending arbitration *The Republic of Ecuador v. The United States of America* is a case in point. A US investor had initiated an investor-state arbitration against Ecuador. The arbitral tribunal in that case interpreted a norm of the Ecuador-US BIT of 1993. Concerned about the implications of the tribunal's interpretation, the government of Ecuador initiated an arbitration against the US government to clarify the meaning of the treaty.

Third, a state could make submissions in an arbitral proceeding between two other states and initiated under a treaty ratified by the non-party state. These submissions would enable a state that is not a party to the dispute to articulate its position on the interpretation of treaty provisions. For example, the governments of Costa Rica and the United States made such submissions in *Pac Rim Cayman LLC v. El Salvador*, and the arbitral tribunal engaged with arguments included in these submissions.

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For example, investor obligations may relate to thoroughly assessing the social and environmental impacts of proposed activities, respecting local land rights, supervising the work of security forces, upholding labour standards and taking measures to protect the environment. National law typically regulates these matters, although several international guidelines and principles raise the bar above national requirements (Chapter 4).

There are two ways for an investment treaty to establish obligations for investors, directly or indirectly. Some treaties define protected investment as an investment made in compliance with applicable law, including the national law of the host state ('legality requirement'). For host countries, this approach has the benefit of depriving investors of legal protection in relation to investments made in violation of applicable law – for example, because the transaction is tainted by corruption, because the corporate structure circumvents applicable regulations, or because the project was initiated without the necessary social and environmental impact assessment.

Where a legality requirement applies and the investor is deemed to have breached national law (beyond 'minor errors': *Tokios Tokeles v. Ukraine*), arbitral tribunals have declined jurisdiction to hear the case (*Inceysa v. El Salvador*; *Fraport v. Philippines*), or otherwise dismissed the investor's claim (*Plama v. Bulgaria*). Some arbitral tribunals held that a legality requirement applies even if there is

no express language in the definition of investment;²¹ expressly stating it in the treaty, however, would increase legal certainty.

The limitation of this approach is that it focuses on the way an investment is made. Investor conduct after that initial moment is not covered. So another approach is for the investment treaty to spell out the obligations that investors must comply with in the conduct of their activities. One difficulty with this approach is that treaties usually create obligations for the states that ratify them, not for the private entities making the investment.

Some recent treaties include provisions requiring the states parties to 'encourage' their investors to comply with internationally recognised standards of corporate social responsibility.²² These 'best efforts' clauses can send a signal to investors (Lévesque and Newcombe, 2013), but they are not enough to create a legally binding obligation for investors to comply with specified standards (Dumberry, 2013).

Similar provisions could be formulated in mandatory terms, and establish explicit references to specific international guidance – for example, the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights. It is important to bear in mind, however, that different international standards may apply to investors from the different states.

2.4 The settlement of investment disputes: investor-state arbitration

Investor-state arbitration in outline

Effective mechanisms for the settlement of disputes between investors and states are widely considered to be an important element of investment protection. If such a dispute arises, the default rule is that investors must bring their case to national courts in the host state. However, states may allow investors to bring disputes to international arbitration instead of (or in addition to) national courts.

International investor-state arbitration refers to the settlement of a dispute between the investor and the host state by an international arbitral tribunal. By taking a dispute to arbitration, the investor will seek to enforce a commitment that the government has entered into through a treaty, law or contract. The investor will typically allege that the government has taken action that violates that commitment – or failed to take action where it was required to.

The decision of the arbitral tribunals is referred to as an arbitral award. The award is binding for the parties. If the arbitral tribunal decides in favour of the investor, the award usually orders payment of compensation. Arbitrators are not bound by

21. *Gustav F.W. Hamster GmbH & Co KG v. Republic of Ghana*.

22. For example the preferential trade agreements concluded in 2008 between Canada and Peru and between Canada and Colombia.

TOP TIP 3

Understand the implications of investment treaties' standards of protection – and carefully think through their scope

- To fully understand the implications of an investment treaty, it is necessary to examine other treaties that the state may have entered into.
- It is prudent to formulate standards in precise terms. Vague and broadly interpreted standards of investment protection can significantly restrict the ability of host government to take measures in pursuit of sustainable development.
- For example, 'fair and equitable treatment' clauses can be clarified by means of an exhaustive list of more specific state obligations, to ensure the standard does not preclude good faith regulation.
- Clarifying the obligations that investors must comply with, including in social and environmental matters, can help align investment treaties with sustainable development goals.
- Legality requirements, whereby an investment treaty only protects investments made in accordance with applicable law, enable governments to deny legal protection to investments that violate rules – including rules aimed at promoting sustainable development.
- Treaties can also require investors to comply with applicable law in the conduct of their activities, and refer to internationally accepted standards of corporate social responsibility.

precedent, that is by previous judgments or arbitral awards. But in practice they do tend to take account of, and refer to, previous arbitral decisions.

International arbitration is today a commonly used dispute settlement mechanism, with a boom in the number of investment arbitrations having been registered since the late 1990s. By the end of 2012, there were 514 known cases of international arbitration under investment treaties (UNCTAD, 2013c); up to the year 2000, this number was below 50 (UNCTAD, 2012b). Given the limited transparency that still prevails in international arbitration, it is likely that many more cases exist that are not publicly known. Natural resource investment features heavily in the overall case load. For example, 25 per cent of arbitrations administered by the International Centre for Settlement of Investment Disputes (ICSID) relate to extractive industries, and an additional five per cent relate to agriculture, fishing and forestry (ICSID, 2013).

The boom in the number of investor-state arbitrations reflects the widespread practice of states consenting to settling disputes through arbitral proceedings. Investment treaties commonly include provisions that enable investors to bring investment disputes to arbitration. Most treaties do not require investors to pursue the dispute through the domestic courts before filing a notice of arbitration, although some do. Other treaties feature different requirements – for instance, by asking investors to attempt amicable settlement or domestic litigation for a given period of time. In yet other cases, investors can choose between international arbitration and national litigation – but once they have chosen, the other option is precluded ('fork-in-the-road' clauses).

National laws and investment contracts may also allow the investor to bring disputes to arbitration, in which case the arbitral tribunal would apply the contract and relevant law (rather than treaty standards). However, many national investment codes do not contain an arbitration clause, and some countries have recently dropped reference to arbitration in their investment codes.

There are several systems of investment arbitration. The World Bank-hosted ICSID is one prominent example. It was established through a multilateral treaty in 1965 specifically to administer investor-state arbitrations. It has gained much currency since the 1990s.

For an ICSID arbitral tribunal to have jurisdiction, both home and host states must be parties to the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention). However, the ICSID Additional Facility Arbitration Rules allow cases to be taken to ICSID where either the host state or the home state is not a party to the convention.

Other arbitration systems are administered by private bodies like the International Chamber of Commerce, the London Court of International Arbitration and the Stockholm Chamber of Commerce. These private arbitration institutions were primarily designed for business disputes between private parties, but they are also used for investor-state disputes. Each of these systems has its own set of procedural rules.

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Arbitrations can also be carried out outside any standing institutions (so-called '*ad hoc* arbitration'). *Ad hoc* arbitrations typically follow the Arbitration Rules adopted by the United Nations Commission on International Trade Law (UNCITRAL), though it may also be possible to include modifications to these established rules.

Under most arbitration rules, disputes are typically settled by a panel of three arbitrators appointed by the parties. Often, one arbitrator will be appointed by each party and the chair appointed by the two party-appointed arbitrators. Rules provide for the appointment of arbitrators where the host state refuses to co-operate, so arbitral proceedings can continue even if the government does not take part.

Despite important variations, arbitral proceedings typically involve 'the commencement of the arbitration, the constitution of the tribunal, the submission of pleadings and evidence, an oral hearing and further written submissions in some cases, possible settlement discussions, the issuance of an award, and, if necessary, challenge to or enforcement of the award' (Delaney and Barstow Magraw, 2008:728-729).

In contrast to the judgments of domestic courts, the enforcement of arbitral awards is specifically regulated by global treaties. The 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards requires

states parties to recognise awards as binding and to enforce them within their jurisdiction. However, the convention allows states to refuse enforcement if major defects affected the arbitral proceedings, or where enforcement would be contrary to the public policy of the country.

The latter exception refers to the fact that in many jurisdictions some issues may not form the object of arbitral proceedings (for example, criminal matters), and that the substance of a decision may in some cases be in conflict with public policy. The New York Convention has been ratified by more than 140 states. This widespread ratification makes arbitral awards easier to enforce than court judgements.

Similarly, the ICSID Convention commits states parties to recognise awards issued by an ICSID tribunal as binding and to enforce them within their jurisdiction as if they were final judgements issued by their own courts. The ICSID Convention does not contain an exception like the New York Convention. But it does provide some narrowly defined grounds for the annulment of an ICSID award through a special procedure before an *'ad hoc committee'*.

On the basis of these conventions, if the host state fails to comply with an award, the investor may seek to enforce the ruling in the national courts of a third country where the host state holds interests, for instance through seizing goods or freezing bank accounts, provided that the third state is party to the relevant convention (see Box 3 in Chapter 1). Rules protecting the immunity of assets held by states in their sovereign capacity may hinder these enforcement strategies, however.

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Overall, mechanisms to enforce arbitral awards appear to have proved effective, although reliable systematic data on government compliance with arbitral awards is hard to come by. There have been a number of cases where governments have challenged the award rendered or have otherwise refused to pay the compensation awarded to investors (Box 8).

But the evidence suggests that states tend to pay up – both because of the legal arrangements backing up enforcement, and because of concerns that a failure to comply may discourage prospective investors. These circumstances make it all the more important to get the balance of government and investor rights and obligations right, because any violations of investor rights may expose the host state to significant legal liabilities.

How to prevent and manage investor-state arbitrations

Investors tend to value international arbitration. Arbitration offers an alternative to resolving disputes in the courts of the host state where, depending on the country, there may be risks of political interference in the judicial process or cumbersome and lengthy procedures.

On the other hand, arbitration can expose the host government to major liabilities. The damages awarded can involve very large amounts of money, and may be

Box 8. Effective dispute settlement, or legal saga? Difficulties enforcing arbitral awards

Countries including Argentina and Russia have refused to pay arbitral awards, causing much debate in specialist circles. It can also be difficult to enforce awards against low-income countries.

In 2009, an arbitral tribunal ordered the government of Laos to pay US\$56 million in compensation to a Thai investor. The dispute centred on the government's termination of two contracts relating to a high-profile mining project. The arbitral tribunal was established according to UNCITRAL Arbitration Rules under an investment contract rather than a treaty. Despite the major compensation award, the investor has not yet received any money.

After the award was issued, the investor initiated enforcement actions in a number of jurisdictions, including France, the United Kingdom and the United States. The award was upheld by courts in the United States, which authorised the investor to obtain information about the location of assets that could be seized, and in the United Kingdom, which ordered the government of Laos to deposit the amount sought.

The Lao government sought annulment of the award before national courts in Malaysia, which was the country where the arbitration was seated. In late 2012, a Malaysian court reportedly annulled the arbitral award, but the legal battle continues.

Sources: *Thai-Lao Lignite (Thailand) Co. Ltd. and Hongsa Lignite (Lao PDR) Co. Ltd v. Government of the Lao People's Democratic Republic (Award)*; Carbera, 2011; Hepburn and Peterson, 2012; IAREporter, 2013.

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substantially higher than those awarded by domestic courts. In the case *Occidental Petroleum Corporation v. The Republic of Ecuador*, for example, the investor was awarded the record amount of US\$1.7 billion plus interest. The costs of the arbitration proceedings can themselves be very high, and are often split between the parties. In *PSEG Global Inc. v. Republic of Turkey*, the host government was ordered to pay 65 per cent of arbitration costs that totalled over US\$20 million.

For these reasons, governments may want to limit their exposure to investor-state arbitration. This would require governments to give proper thought to the advantages and disadvantages of including arbitration clauses in their treaties. In recent years, some countries have taken more cautious approaches to investor-state arbitration. For example, the government of Australia recently announced that it would not include investor-state arbitration clauses in future investment treaties. Some Latin American countries (Bolivia, Ecuador and Venezuela) have withdrawn from the ICSID Convention.

Other options would include subjecting access to arbitration to pursuit of domestic litigation or conciliation for specified periods of time, or even to exhaustion of domestic remedies. Countries with effective and independent judiciaries would have less to lose from more cautious approaches to arbitration, because investors may be more prepared to trust national courts. Where investor-state arbitration is applicable, well thought-out national legislation and institutions can help governments to minimise exposure to lawsuits, and handle the case effectively where arbitration cannot be avoided (Box 9).

It is also prudent for governments to think through investment treaty provisions that can affect the conditions for access to international arbitration.

Box 9. Institutional preparedness to handle arbitration: lessons from Peru

Peru passed legislation to establish a 'response system' to deal with international arbitration. The system involves an inter-ministerial commission and technical secretariat that represent the state in investment disputes, early alerts to identify disputes and reach settlement before escalation, and the allocation of funds for legal costs and specialised advice. The system is perceived to have increased the effectiveness of government action in preventing arbitration and handling cases.

The system also allows the government to allocate the costs created by the arbitration to the public bodies that adopted the challenged measures. This may deter entities outside the control of the central government such as local government bodies from taking actions that can create liabilities for the state. However, it could also expose under-resourced government bodies to substantial liabilities.

Source: UNCTAD, 2011, with additions.

For example, some arbitral tribunals have applied most-favoured-nation clauses to dispute resolution as well as to the substantive rights agreed in the treaty. This gives investors the same access to international arbitration as provided by other investment treaties concluded by the host state.

In *Emilio Agustín Maffezini v. Spain (Decision on Jurisdiction)*, the arbitral tribunal accepted that the most-favoured-nation clause in the applicable Argentina-Spain BIT allowed the investor to access international arbitration without first pursuing the case before domestic courts for 18 months, as required by that treaty. Spain had concluded treaties with other states that did not contain a similar requirement, opening itself up to this ruling. This approach has been followed by other tribunals, and would undermine the effectiveness of more cautious treaty formulations on access to arbitration.

The extension of most-favoured-nation treatment to dispute settlement has proved controversial, however. Other arbitral tribunals have come to different conclusions, partly as a result of differences in the wording of investment treaties.

For example, in *Gas Natural SDG S.A. v. Argentina (Decision on Jurisdiction)*, the arbitral tribunal held that the most-favoured-nation clause should be deemed to apply to dispute settlement unless the treaty explicitly states otherwise while the arbitral tribunals in *Telenor Mobile Communications A.S. v. Hungary (Award)* and in *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Jordan (Decision on Jurisdiction)* ruled that most-favoured-nation treatment only applies to substantive rights, not to dispute settlement, unless the investment treaty specifically provides otherwise (Newcombe and Paradell, 2009).

In light of this controversy, it is prudent for investment treaties to explicitly clarify whether the most-favoured-nation clause extends to the terms and conditions of arbitration. A restrictive clarification that excludes dispute settlement from most-favoured-nation treatment would tend to reduce a government's exposure to arbitration claims. So-called 'denial of benefits' clauses can also help, and are discussed in Chapter 3.

Reducing uncertainties in the scope and interpretation of the investment protection standards featured in investment treaties is also critical to limiting exposure to arbitration. This consideration reinforces the strong case for clearly defining the meaning of investment protection standards like ‘fair and equitable treatment’, discussed above.

Aligning investor-state arbitration with sustainable development

Concerns about the functioning of prevailing international arbitration systems have been widely debated. These include the emergence of a restricted club of arbitrators, potential conflicts of interests (for example where an individual serves as arbitrator in one case, and as legal counsel in another suit that may deal with similar issues of law), inadequate mechanisms to challenge arbitral awards (there is no appeal system and arbitration rules usually allow for awards to be reviewed only on very narrowly defined grounds), and the high costs involved (van Harten, 2007; UNCTAD, 2012b).

Addressing these concerns would help align investor-state arbitration with sustainable development. Legal specialists have put forward suggestions for reforming the investor-state arbitration system, including the creation of a standing court or at least the creation of an appeal mechanism that can remedy errors of law and promote more uniform interpretation of treaty standards (van Harten, 2007). Investment treaties can make provision for an appeal system. Investment treaties can also establish basic principles of integrity and independence, either directly or through reference to an external code of conduct (e.g. to deal with conflicts of interest).

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In addition, it is crucial for sustainable development that dispute settlement mechanisms adequately address all the interests involved in investment disputes – including both commercial and non-commercial concerns. In many arbitrations, there is much more at stake than purely commercial matters. This is not simply because awards need to be paid from the public purse but also because public policy and third-party interests may be directly affected – as is the case in many arbitrations concerning natural resource investments. Indeed, investment disputes can arise from action taken by the host state to protect the interests of local groups that may be adversely affected by an investment project (Box 10).

In recent years, international arbitrators have become increasingly sensitive to concerns about respecting national policy space. In order to take these wider interests into account in an effective way, arbitral tribunals need to have expertise in all the relevant branches of law, including investment, environmental and human rights law. The most experienced arbitrators, however, tend to come from a commercial or investment law background, although one arbitrator in a recent arbitral tribunal was a human rights expert (*Grand River Enterprises Six Nations Ltd and Others v. United States*).

Box 10. Civil society submissions in investor-state arbitration: the case of a mining dispute in El Salvador

A company carried out mining prospecting in El Salvador. It then applied for the environmental permits necessary to initiate mining operations. But government agencies did not issue the permits. In 2009, the company took the case to international arbitration, seeking compensation from the government for the frustration of its business prospects.

In 2011, a group of local, national and international civil society organisations made a written submission to the arbitral tribunal. The submission pointed to reports of environmental risks, particularly relating to water, and local opposition to the project. It developed legal arguments calling on the tribunal to rule that it lacked jurisdiction to hear the case – an objection also raised by the host government.

In 2012, the arbitral tribunal issued a decision that declined jurisdiction to hear important aspects of the investor's claim. The decision explicitly referred to the civil society submission, although the tribunal also distanced itself from some of the arguments contained in that submission.

Sources: *Pac Rim Cayman LLC v. The Republic of El Salvador (Application for Permission to Proceed as Amici Curiae)*; and *Pac Rim Cayman LLC v. The Republic of El Salvador (Decision on the Respondent's Jurisdictional Objections)*.

While some recent treaties set norms as to who can be selected as arbitrator, it is ultimately up to the parties to appoint arbitrators and ensure that the expertise on the arbitral tribunal is well balanced. Host governments are therefore able to play a key role in shaping the composition of the tribunal – not only by appointing the right state-appointed arbitrator but also by scrutinising the arbitrator appointed by the other party. Reading about an arbitrator's earlier awards or academic publications may provide useful insights into their professional profile.

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Transparency, public scrutiny and civil society submissions in arbitral proceedings are critical in ensuring that sustainable development considerations are taken seriously in investment arbitration. Box 10 provides one example, and these issues are further discussed in Section 5.2.

To sum up

Aligning investment protection with sustainable development has implications not only for the substantive standards of protection, discussed in Section 2.3, but also for the systems established to settle investor-state disputes. In order to ensure sustainable development considerations are properly reflected in investor-state arbitration, there needs to be:

- Effective national institutions for handling arbitrations.
- Procedural fairness and propriety.
- The promotion of balanced expertise in the arbitral tribunal.
- Transparency, public scrutiny and civil society participation in arbitral proceedings.
- Proper thought given to acceptable levels of exposure to legal liabilities from investor-state arbitration.

TOP TIP 4

Mainstream sustainable development considerations in investor-state arbitration

- In order to align investment protection with the pursuit of sustainable development, governments need to mainstream sustainable development considerations into the systems established to settle investor-state disputes.
- Reflecting sustainable development considerations in investor-state arbitration would involve ensuring procedural fairness and propriety; promoting balanced expertise in the arbitral tribunal so as to consider the commercial and sustainable development issues at stake; considering options for an appeals system; and enabling transparency, public scrutiny and civil society participation.
- Proper thought should be given to acceptable levels of host government exposure to legal liabilities from investor-state arbitration. 'Exhaustion of domestic remedies' and 'fork-in-the-road' clauses can limit governments' exposure to arbitration under investment treaties. Treaties can also exclude dispute settlement from any most-favoured-nation treatment.
- Effective national institutions can help governments to minimise exposure to arbitration and handle the case effectively where arbitration cannot be avoided.

2.5 The evolving political economy of investment law: new opportunities for sustainable development

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Recent trends in international investment law have created new opportunities to integrate a wider range of sustainable development considerations into investment treaty making. Key developments include:

- The shifting balance of global economic power (from west to east and north to south) is altering the political economy of investment treaty making (UNCTAD, 2012b; Schill and Jacob, 2013a). Countries that have traditionally approached investment treaties from the point of view of capital exporters now have to consider the implications of those treaties as capital importers too. High-income countries including the United States and Canada have seen their own public action challenged by foreign investors relying on generous investment protection regimes. While in the past these countries promoted robust standards of investment protection, they have now developed model investment treaties that seek to balance investment protection with other policy considerations, including in social and environmental matters.
- Some low and middle-income countries are becoming more assertive in investment treaty-making. Following a long-standing Latin American tradition of engaging with and contesting international investment rules, for example, Bolivia, Ecuador and Venezuela have recently terminated some BITs and withdrawn from the ICSID Convention.
- Many African countries have in the past simply signed up to treaties developed by major capital exporters. Recently, African regional integration organisations such as the Common Market for Eastern and Southern Africa (COMESA) and

the Southern African Development Community (SADC) have developed model investment treaties for their member states that seek to balance investment protection with other sustainable development goals.

- In the European Union (EU), the 2009 Lisbon Treaty gives the European Commission exclusive competence to negotiate investment treaties. Over time, the EU will negotiate new treaties to replace over 1200 treaties that member states have signed with non-EU countries. Most of these existing treaties focus on investment protection and pay scant attention to other policy goals. In theory, the post-Lisbon process opens the possibility of integrating sustainable development concerns in a new generation of EU treaties. This is particularly so given that, in its relations with the wider world, the EU must contribute to ‘the sustainable development of the Earth’ and to the protection of human rights.²³
- Governments are under increasing pressure from civil society to take fuller account of sustainable development considerations in the elaboration of investment treaties. Some governments are also more mindful of sustainable development considerations in treaty negotiations: a growing number of investment treaties feature provisions that integrate concerns about transparency, environmental protection and labour rights, for example (UNCTAD, 2013c).
- Many investment treaties have a sunset clause, whereby the treaty can be unilaterally terminated after a specified period of time, often 10 years. Some 1300 of the world’s 3000 investment treaties were signed in the 1990s, and could now be renegotiated or terminated (UNCTAD, 2013a and 2013c). This provides opportunities for promoting the emergence of a new generation of investment treaties that would be more aligned with sustainable development (UNCTAD, 2013c). It is worth noting, however, that most treaties have a ‘survival clause’ that continues to protect existing investment after termination for a further period specified in the treaty, often another 10 years.

Shifts in the political economy of investment treaty making create new opportunities better to align investment law with the pursuit of sustainable development. Effective harnessing of the politics can enable government and civil society in low and middle-income countries to push for a better deal.

It is important to keep these developments in perspective, however. Compared to the existing stock of investment treaties, only a very small minority include provisions that seek to balance investment protection with other policy goals. Most treaties currently in force were signed many years ago, and are framed as short, unspecific agreements focused on investment protection. Even today, much treaty making is still based on succinct models that exclusively focus on investment protection (Schill and Jacob, 2013a). These treaties make no mention of sustainable development considerations.

23. Article 3(5) of the Treaty on European Union (Consolidated Version of 2012).

There is also uncertainty on the future direction of investment treaty making. For example, fast-growing economies in Asia such as China and India are playing an increasingly active role in investment treaty making, and will influence future developments in investment law in ways that are still difficult to fully predict (Schill and Jacob, 2013a).

Most treaty making in low and middle-income countries remains sheltered from public deliberation, and many treaties are not even publicly available. Given that the 1992 Rio Declaration places people at the centre of sustainable development (see Chapters 1 and 5), democratising investment treaty-making is a key challenge ahead.

Useful online resources

A4ID. 2008. *At a Glance Guide to Arbitration*. Advocates for International Development (A4ID), London.

<http://www.a4id.org/sites/default/files/user/documents/arbitration.pdf>.

APEC-UNCTAD. 2013. *APEC-UNCTAD Handbook for Negotiators of International Investment Agreements*. United Nations Conference on Trade and Development, Geneva and New York.

http://investmentpolicyhub.unctad.org/Upload/Documents/UNCTAD_APEC%20Handbook.pdf.

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Bilaterals.org: an open-publishing website on bilateral trade and investment treaties from a civil society perspective. <http://www.bilaterals.org/>.

Investment Arbitration Reporter (IAReporter): an electronic news service tracking international arbitrations between foreign investors and their host governments. Requires subscription. <http://www.iareporter.com/>.

Investment Treaty Arbitration (ita): a resource for professionals and researchers on investment treaty law and arbitration, providing access to publicly available investment treaty awards and to other materials relating to investment treaties and arbitration. <http://italaw.com/>.

Mann, H., von Moltke, K., Peterson, L.E., Cosbey, A. 2005. *Model International Agreement on Investment for Sustainable Development: Negotiators' handbook*, 2nd edition. International Institute for Sustainable Development (IISD), Winnipeg, MB. <http://www.iisd.org/publications/pub.aspx?pno=686>.

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Getting a fair economic deal

3.1 Economic deal and sustainable development

It is widely held that poorer countries need economic development to sustain efforts to reduce poverty and improve living standards. The 1992 Rio Declaration mentions the right to development, though it also states that this right must be fulfilled so as to equitably meet the needs of present and future generations (Principle 3). It is widely recognised that private investment can help to promote economic development. But much depends on the 'economic deal' regulating investment projects.

While the issues discussed in Chapter 2 are relevant to a wide range of industries (from banking to manufacturing, through to telecommunications), the nature of the economic deal varies significantly across different industries. This chapter focuses on natural resource investments, covering agriculture, mining and petroleum.

Despite much diversity between countries and between sectors, the basic deal underpinning natural resource investments typically involves the allocation of rights to exploit natural resources for commercial operations on the one hand, and public revenues, livelihood opportunities and other development contributions on the other. Because states tend to own or otherwise control natural resources within their jurisdiction, natural resource projects tend to involve contracts with the host state (Box 11).

Box 11. Sovereignty, ownership and contracts

Under international law, states have permanent sovereignty over natural resources within their jurisdiction. This principle was affirmed in UN General Assembly Resolution 1803 of 1962 and is widely considered to be a rule of customary international law. An important corollary is that states have the right to regulate economic activities that exploit natural resources within their jurisdiction.

International law also governs the exercise of sovereign rights in areas beyond a country's territory. The United Nations Convention on the Law of the Sea (UNCLOS) defines criteria for the delimitation of the continental shelf, which affects the ability of a state to allocate rights for offshore petroleum projects.

International law also restricts the exercise of state sovereignty over natural resources. Externally, states must ensure that activities within their jurisdiction do not cause harm to the environment of other states or of areas beyond the limits of national jurisdiction (Principle 2 of the Rio Declaration). Internally, states must exercise their sovereignty over natural resources in the interest of the 'well-being of the people' (General Assembly Resolution 1803 of 1962, Paragraph 1). International human rights institutions have held that the failure of governments to protect local interests affected by natural resource investments can violate human rights (for example *SERAC and CESR v. Nigeria*).

In the exercise of their sovereign rights, states enact national legislation regulating ownership of natural resources within their jurisdiction. In most countries, subsoil resources are owned

by the state, and the government has the legal authority to allocate rights to commercial operators. Mining and petroleum projects therefore typically involve contracts with the host government or, in the petroleum sector, a state-owned entity such as a national oil company.

Patterns of land ownership are much more diverse. In many low and middle-income countries, national law vests land ownership with the state. As a result, many large agricultural investments involve leases or concessions granted by the host government. In other jurisdictions, however, much of the land is owned by private landholders. In Ghana, for example, customary chiefdoms, families and individuals own the greater part of the land. In these cases, land leases may be signed with local landholders or customary authorities representing them.

Government ownership of natural resources can create tensions where the allocation of resource rights to commercial operators impinges on rights claimed by local groups or individuals. Equally, accountability problems can arise where the land is administered by customary chiefs. Effective legal arrangements for inclusive deliberation and public accountability are crucial, and are discussed in Chapter 5.

Despite this common underlying arrangement, natural resource investments display a great diversity of investment models. This is particularly pronounced in agriculture, where investments can take many forms. In some, companies invest in processing facilities and source the produce, in whole or in part, from local farmers. In contrast, in recent years business operators have shown a growing interest in large-scale land concessions for plantation farming, triggering concerns about 'land grabbing' (Box 12). Choices between these different models of agricultural investment can have far-reaching repercussions for development pathways. Legal tools can be used to promote more inclusive investment models (see Box 12, and Sections 3.3, 4.3 and 5.2).

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In addition to making strategic choices about investment models, host countries wishing to maximise the economic benefits for themselves and for local communities must address at least three core aspects of investment preparedness when it comes to the economic deal:

- Legal arrangements enabling the host government to get a handle on transnational corporate structures (Section 3.2).
- Legislation regulating taxation and how public revenues are managed and shared by different levels of government (Section 3.3).
- Legal instruments to maximise positive linkages with the local economy (Section 3.4).

3.2 Corporate structure

Foreign investment projects in agriculture, mining and petroleum often involve complex transnational corporate structures. A parent company listed on a stock exchange in New York, London, Johannesburg or Singapore may be owned by a large number of shareholders worldwide, including pension funds, rich individuals or even governments.

The parent company may operate an investment project in Africa, Latin America or Asia through a local subsidiary incorporated in the host country. Shares in the

Box 12. 'Land grabbing' and inclusiveness in agricultural investment

There is growing acceptance of the criteria for assessing inclusiveness of agricultural investments – such as free, prior and informed consent; inclusion of local communities and producers as suppliers and possibly shareholders; fair labour relations; and gender equity (Chan, 2013).

Recent years have witnessed rising interest among businesses in acquiring long-term land leases in Africa, Asia and Latin America for the production of food, biofuels and timber products. These investments have triggered lively media debates and civil society campaigns on 'land grabbing'.

Several plantations established as part of this trend have failed due to financing difficulties, insufficient soil fertility or underestimating the challenges of greenfield investments in tropical agriculture. Even where investments are profitable, many commentators have questioned the extent to which these projects can contribute to poverty reduction. Villagers are losing the land, water and natural resources that have supported their livelihoods for generations (Cotula *et al.*, 2009; Deininger *et al.*, 2011; Oxfam, 2011; Anseeuw *et al.*, 2012).

Highly mechanised farms create only limited numbers of jobs, and shifts from family farming to large-scale plantations rarely create jobs for all those that were working the land before the project (Li, 2011). This problem is particularly acute because alternative livelihood options are scarce in many low-income countries. Small-scale farming tends to be more labour intensive, and investments that support small-scale farming could generate more broad-based employment (Wiggins *et al.*, 2010).

Alternative models of agricultural investment focus on agro-processing and source agricultural produce from local farmers, based on direct contracts between investor and farmers. In some of these models, farmer associations own shares in the company they collaborate with, which gives them monetary benefits and greater say in business decisions. For example, a Zambian company supplies sugarcane to a major national sugar mill through both a plantation estate and contracts with outgrowers; the outgrowers' co-operative owns 13 per cent of the company, while another 25 per cent is owned by a district-level cane farmer association (Mujenja and Wonani, 2012).

Collaborative models between investors and local farmers present features of inclusiveness but they can also create significant risks. Some projects have been linked to farmer indebtedness and unfair pricing arrangements, and questions have been raised about the extent to which local groups genuinely have a voice. Inclusion in global supply chains may only reach the most commercially oriented small-scale farmers, while the landless poor might benefit more from supplying local markets or from new wage labour opportunities (Vorley, 2002).

Any discussion of different models of agricultural investment goes well beyond purely legal matters and raises fundamental issues about models of development and policy choices. But many low and middle-income countries have incentives that favour large over small-scale farming, and law reforms could reverse that – for example, by strengthening local land rights (see Sections 4.3 and 5.2) or reframing tax incentives (see Section 3.3) (Vorley *et al.*, 2012).

National law can also regulate contractual relations between companies and local farmers, defining key terms and setting minimum parameters. Some countries have adopted – or are in the process of adopting – legislation to regulate contract farming.

subsidiary may be held by one or more intermediate holding companies, perhaps located in a tax haven to minimise tax liabilities, and/or in a country that has signed a robust investment treaty with the host state so as to ensure effective legal protection.

Important project activities – such as construction or management services – may be run by other companies that are part of the same business group ('affiliates') but are incorporated in third countries. It may make sense for a large business group to centralise certain capabilities (such as construction services for oil and gas projects), and for the local subsidiary to contract these specialised units to run operations requiring those capabilities. Other third-country affiliates may buy the output produced by the local subsidiary ('off-takers').

There will also be financial flows within the group, linked to the corporate structure. These flows include capital injections from the holding company to the subsidiary to operate the project (in the form of equity or loans), the repatriation of profits from the subsidiary to the holding company, and payments between affiliates for transactions involving the supply of goods and services or the off-take of produce.

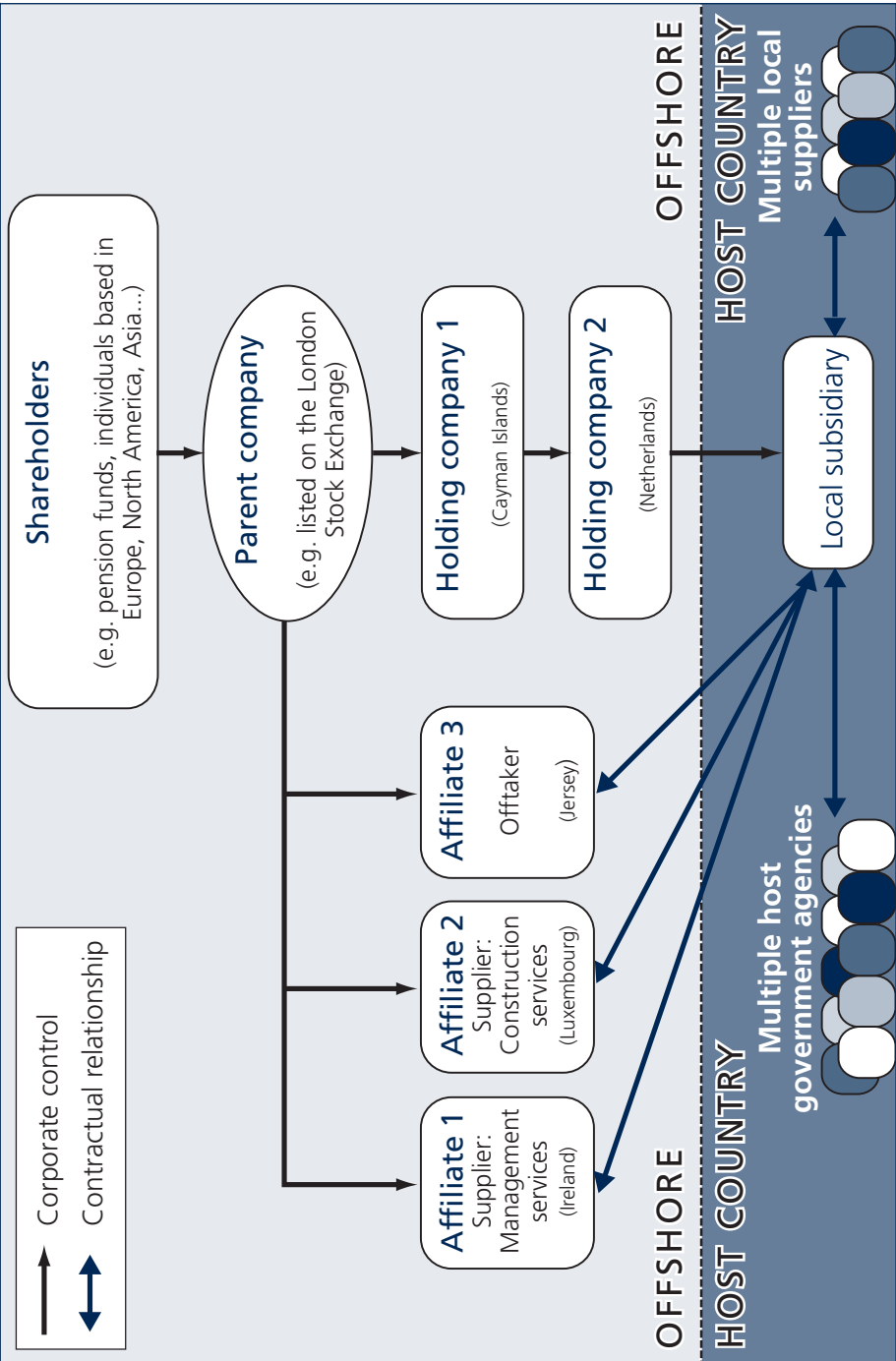
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Figure 2 shows a simplified diagram of a corporate structure – real-life ventures typically involve substantially more complex structures. They can also be extremely diverse. For example, the parent company in Figure 2 is listed on a stock exchange – but many companies are not listed and are privately owned. Also, many oil and gas projects involve joint ventures between different international oil companies, and in some cases with the host government too. While Figure 2 emphasises vertical relations in the corporate structure, joint ventures involve horizontal as well as vertical relations.

These complex corporate structures raise important sustainable development issues for the host country. The host government has a direct interest in ensuring that an investor has the capabilities needed to implement a project, that taxes are paid and other project liabilities honoured, and that the national policy space is not unduly constrained. Yet investors could exploit complex structures to sell the investment project to another company that may lack the required experience, avoid paying taxes through manipulating the terms of transactions between affiliates, or use third-country holding companies to benefit from the protection of investment treaties that would otherwise not be applicable.

Because of these issues, establishing systems to scrutinise the corporate structure is an important part of investment preparedness. This section discusses capitalisation levels, assignments of rights and 'denial of benefits'. Taxation aspects are discussed more fully in Section 3.3. Arrangements to hold the parent accountable for damage caused by its foreign subsidiaries are discussed in Chapter 5.

Figure 2. Corporate structure of a hypothetical business



Source: Adapted from Gilchrist, 2012.
 Note: Real-life corporate structures can be extremely complex, and the figure above is only designed as a schematic illustration.

Ensuring that the venture is properly resourced

Broadly speaking, 'capitalisation' refers to the amount of money that a company has for its operations. Investors often operate by establishing a local subsidiary in the host country. In some cases, the financing of this subsidiary involves high levels of debt compared with the equity invested. This can raise many issues including solvency risks and the ability of the subsidiary to honour the obligations and liabilities created by project implementation.

Capitalisation and debt levels also have important implications for taxation. High levels of debt tend to involve high levels of interest payments. While the payment of dividends to shareholders is usually subject to taxation, interest payments are a cost to the investor's local subsidiary. As such, in many jurisdictions they can be deducted from taxable income for corporate income tax purposes.

This situation is open to abuse: investors could structure the investment so that the holding company injects little capital into the local subsidiary, and provides much of the financing as a loan instead. The holding company may be incorporated in a tax haven, and be subject to little taxation. The investor could then manipulate the terms of the loan between the holding company and the local subsidiary: inflated interest rates would shift profits from the latter to the former. This practice would reduce corporate income taxes paid by the subsidiary to the host government, and is a specific instance of manipulation of transfer pricing (discussed in Section 3.3).

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National legislation and/or individual investment contracts can deal with these issues. With the exception of some particularly sensitive sectors such as banking, few national laws require minimum levels of capitalisation, or minimum ratios of debt to equity, in absolute terms. Legislation in some countries requires minimum levels of capitalisation for certain types of limited liability companies. It is also not uncommon for investment contracts to set maximum debt-to-equity ratios on a project-by-project basis.

In several countries, national legislation contains 'thin capitalisation' rules for tax purposes. These rules limit the amount of debt on which interest payments can be deducted for tax purposes, for example through a debt-to-equity ratio. Alternatively, they define a maximum amount of interest that can be deducted (Gilchrist, 2012).

These rules allow subsidiaries to contract debt over the specified ratio, or to pay interest over the maximum allowed. But, for tax purposes, excessive debt or interest payments over the limit cannot be deducted. This affects the calculation of profit of the local subsidiary, and thus the tax it must pay.

'Withholding taxes' can also be used to deal with the tax dimension of thin capitalisation. These are levied by the host country on interest payments made by the subsidiary to entities located offshore. Transfer pricing rules can also be used to ensure that the interest rate charged between affiliates reflects market conditions (see Section 3.3).

Ensuring that the company has the necessary capabilities: investor identity and assignments of rights

In complex projects that require significant capital and know-how, it is important for the host government to know who the investor is. A company's experience and track record are often important considerations in government decisions about the allocation of resource rights especially where multiple companies compete for the same project. Well-advised governments conduct thorough scrutiny of a company before awarding contracts.

Yet, it is not uncommon for an investment project to change ownership over its duration as a result of the investor transferring ('assigning') its rights to another company. The investor may wish to exit the venture following changes in expected returns or corporate strategy. For example, a small oil company which led an exploration project may decide to transfer its stake to a larger company with greater capabilities after making a commercially viable discovery, instead of operating the venture directly. Similarly, a company developing an agricultural plantation may transfer the project to a larger operator once the land has been acquired and the venture is up and running.

Such project transferability may be necessary if a project depends on loans, to offer guarantees to the lender that the debt will be repaid – or, in default, that the lender will be able to take over the project and sell it on. There is a risk, however, that an investor transfers the project to a company that lacks the necessary capabilities. Also, unrestricted transferability can encourage speculative acquisitions of land and resource rights by companies that merely aim to make a profit from transferring the project to third parties.

To address these issues, many governments make such assignments of rights subject to authorisation by the relevant government agency. For these restrictions to be effective, they need to cover both direct and indirect transfers. Otherwise, a parent company can easily circumvent restrictions on transferability by selling its shares in the local subsidiary or the holding company (Gilchrist, 2012).

Investment contracts may contain a clause that explicitly subjects both direct and indirect transfers to host government approval. They may also feature an annex detailing the corporate structure at the time of the contract signing, so as to provide information about the chain of shareholding at least up to the parent company (Gilchrist, 2012). Finally, the contract may clarify the sanctions available to the government in case of violation, including termination of the contract.

National legislation (such as a country's petroleum or mining code) may also require assignments of rights to be subject to government authorisation. These provisions would be reinforced if any applicable investment treaties contain a 'legality requirement' (excluding investments made in violation of applicable law from legal protection – see Chapter 2) formulated so as to cover not only the making of an investment, but also its subsequent acquisition by third parties.

If the government sanctions unauthorised transfers by terminating the contract, the investor could challenge the government's action under applicable investment treaties. Arbitral tribunals have not upheld these claims if the government has complied with clearly spelled out rules and procedures (Box 13). But the host government could be liable if it is found to be in breach of the principle of fair and equitable treatment and of proportionality in terminating investment contracts (see the award *Occidental Petroleum Corporation v. The Republic of Ecuador*).

Box 13. Unauthorised transfer loses investor both contract and legal challenge

Assignments of rights have come up in investment arbitrations. In the 2013 award *Vannessa Ventures v. Venezuela*, the claimant acquired interests in a Venezuelan mine from a company that in 1991 had entered into a joint venture with a government entity in Venezuela. In deciding to award the contract to the original operator, the host government gave significant weight to the technical and financial capability of that operator. In 2001, the original investor sold its stake in the project to the claimant because it deemed that low gold prices made the project uneconomic.

The Venezuelan government reacted by terminating the contract, taking over the mine and re-allocating it to another mining company. The company that had bought the project filed arbitration against the government, alleging expropriation of its investment as well as breach of 'fair and equitable treatment' and 'full protection and security' under an applicable investment treaty.

The arbitral tribunal dismissed the investor's claims. It recognised that the technical and financial capacity and the extensive experience in mining of the original operator had been important considerations when the host government awarded the contract. The tribunal found that the transfer of shares did not comply with contractual requirements. Among other things, the joint venture contract with the government entity barred the parties from transferring 'in any manner' the rights created by the contract unless the other party consented.

In transferring its shares in the project company, the original investor did not obtain authorisation from the Venezuelan government. Although the case concerned the sale of shares in the company, rather than an assignment of the contractual rights, the restriction was deemed to be formulated broadly enough ('in any manner') for indirect transfers to be covered.

The contract also gave the joint venture partners a preferential right to purchase shares if the other partner wished to sell – a right that had not been respected in the transaction. As a result, the tribunal held that the government measures were lawful steps taken to remedy the investor's violations of contract terms, and refused to award compensation to the investor.

Source: *Vannessa Ventures v. Venezuela* (Award).

Legality requirements and denial of benefits

Investors could organise their activities to circumvent national rules on corporate structure, or to benefit from the protection of investment treaties that would otherwise not apply. Host states may want to keep these practices in check, not least in order to limit their exposure to arbitration claims. To this effect, the host country may seek to negotiate 'legality requirements' and 'denial of benefits' clauses in the investment treaties that it concludes.

As discussed in Chapter 2, legality requirement clauses exclude investments made in violation of applicable law from legal protection under the investment treaty.

These requirements can help host states to avoid legal liabilities if the investor violates national rules on corporate structure and then takes the government to international arbitration.

For example, the Germany-Philippines BIT of 1998 defines investment as ‘any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State’ (Article 1(1) of the treaty). In one arbitration brought under this treaty, the host state obtained an award declining jurisdiction on grounds that national law restrictions on foreign ownership had been breached, although this award was later annulled.²⁴

Similarly, investment treaties typically protect investments that a company incorporated in one state makes in the other state where both are parties to the treaty. By referring to the country of incorporation to determine nationality, rather than, say, the country where the management of the company is actually located, these treaties effectively allow the practice of ‘treaty shopping’: a company based in one country and investing in another country can benefit from the protection accorded by an investment treaty concluded between the host country and a third country by channelling the investment through a subsidiary incorporated in the third country – even if the company has no real connection with that country (Hébert, 2013).

The company may want to do this because the host country has no treaty with its home country, or because the investment treaty between host and home countries provides less robust standards of protection. Many companies do this type of ‘corporate planning’ before the investment is made or acquired. But there have also been arbitrations where companies restructured their investment to benefit from a more favourable investment treaty after the dispute with the host state has arisen (Hébert, 2013).

Arbitral tribunals have tended to interpret corporate nationality in formalistic terms: if the treaty refers to the country of incorporation as the sole criterion for determining the nationality of a company, as is commonly the case, most arbitral tribunals have considered the investor to be a national of the country of incorporation – even if that company is controlled by nationals of other countries, or by nationals of the host country.²⁵

In cases involving corporate restructuring after the dispute had arisen, a few arbitral tribunals have declined to uphold the investor’s claims for breach of an implicit investor obligation to act in ‘good faith’.²⁶ However, some tribunals have not followed this approach,²⁷ and much depends on the facts of each case.

24. *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*, later annulled.

25. See e.g. *Tokios Tokelés v. Ukraine (Decision on Jurisdiction)*; *Saluka Investments B.V. v. The Czech Republic (Partial Award)*; *Romp petrol v. Romania (Decision on Respondent’s Preliminary Objections on Jurisdiction and Admissibility)*. All these cases involved corporate planning before the dispute had arisen.

26. *Phoenix Action v. Czech Republic (Award)*.

27. *Saba Fakes v. Turkey (Award)*.

To prevent abuses and reduce uncertainty, an investment treaty can be formulated in ways that reduce room for treaty shopping. For example, the treaty may define the investor's corporate nationality with regard to the country where the company has its main seat, or where the company has real economic activities.²⁸

Another option is for the state parties to include a 'denial of benefits' clause in the investment treaty, as recent US and Canadian treaties have done. Under this clause, each party has the right to deny the benefits of the treaty to a shell company that has no substantial business activities in the country under whose laws it is legally constituted. The formulations used for denial of benefits clauses vary, and arbitral tribunals have taken different approaches to their application.

One arbitral tribunal has recently declined jurisdiction to hear treaty-based claims brought by a mining company against El Salvador (see Box 10 in Chapter 2). The relevant investment treaty featured a 'denial of benefits' clause. The United States was a party to this treaty, but Canada was not. A holding company based in the United States owned shares in the local subsidiary. In turn, the holding company was owned by Canadian nationals. The tribunal found that the holding company was a shell company with no substantial business activities in the United States, and declined jurisdiction to hear the claim under the investment treaty.²⁹

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However, some arbitral awards have cast doubt on the effectiveness of denial of benefits clauses that grant governments discretionary power to deny treaty protection to an investor. In *Plama Consortium Ltd v. Republic of Bulgaria (Decision on Jurisdiction)*, the tribunal held that reliance by a state on a denial of benefits clause during an arbitration can only affect subsequent claims by the investor – not the claims made through the pending arbitration.

This interpretation conflicts with the approach taken by some earlier tribunals (such as *Generation Ukraine v. Ukraine*), but has been followed by some later awards. Therefore, some commentators have suggested formulating denial of benefits clauses in mandatory terms (for example benefits '...shall be denied...'; Hébert, 2013).

To sum up

Even before discussing the specifics of the economic deal, there are certain issues that can have important implications for the economic deal – and, more generally, for the pursuit of sustainable development. They relate to:

- Scrutinising the level of capitalisation of the local subsidiary, so as to ensure that the project is duly resourced and taxes are paid.
- Scrutinising transfers of rights, so as to ensure that the company has the necessary resources and capabilities.
- Minimising treaty shopping by investors, to limit the host government's exposure to legal liabilities towards companies that have violated the law, or structured the investment in opportunistic ways.

28. *Alps Finance and Trade AG v. Slovak Republic (Award)*, based on a treaty that uses these two criteria in conjunction with the traditional incorporation criterion (Hébert, 2013).

29. *Pac Rim Cayman LLC v. The Republic of El Salvador (Decision on the Respondent's Jurisdictional Objections)*.

Understand corporate structures and regulate transfers of ownership

- To regulate investment flows effectively, governments need to understand the transnational corporate structures of their investors.
- Effective arrangements to review the capacity of the operating company and its partners are critical not only before awarding any contracts, but also in the event of any transfer of ownership. Any transfers could affect applicable investment treaties, and consequently the balance of rights and obligations between the investor and the host state.
- National law can make any assignments of rights conditional on government authorisation, and empower government to scrutinise transactions. For this legislation to be effective, it must cover both direct and indirect transfers.
- Investment treaty protections can be restricted to companies that have a genuine business connection with states parties to the relevant treaty. Treaties can also deny protection to companies that circumvent rules on corporate structure.

3.3 Taxation

Law, taxation and sustainable development

Public revenues are an important way in which the host country can benefit from a natural resource investment. Yet low and middle-income countries have often faced challenges in effectively taxing agribusiness and extractive industry ventures. As a result, investment projects may generate considerable profits but contribute relatively little public revenue. This can adversely affect the ability of a government to provide public services to its citizens, support poverty reduction initiatives and pursue sustainable development.

In recent years, economic hardship in some high-income countries has heightened public concerns about fairness in taxation, increased scrutiny of corporate tax practices and made taxation a higher priority in international policy agendas. In 2013, taxation received considerable attention at the summits of the Group of 8 (G8) and the Group of 20 (G20). Organisations campaigning to fight world poverty have stepped up their advocacy for 'tax justice', in order to help developing countries reap a fair share of the benefits generated by economic activities within their jurisdiction.

Legal norms critically influence tax issues. The norms regulating taxation are often referred to as the fiscal regime and define the government take of the revenues generated by an investment project. In principle, the fiscal regime is determined by generally applicable law, including the tax code, the investment code and sector-specific legislation like the mining or petroleum code. However, many countries, especially in the developing world, allow the investment contract to define aspects of the fiscal regime, deviating from generally applicable law (Sachs *et al.*, 2013).

The OECD Guidelines for Multinational Enterprises state that enterprises should '[r]efrain from seeking or accepting exemptions not contemplated in the statutory or regulatory framework related to [...] taxation, financial incentives, or other

issues' (Paragraph II(A)(5)). In other words, tax provisions in contracts should not involve tax exemptions that are not contemplated in generally applicable law.

Public revenues

Depending on the jurisdiction, natural resource investments would be subject to a range of different taxes under general tax law.³⁰ One key distinction is between direct and indirect taxes. So-called 'indirect taxes' are charged when certain transactions occur, for example, a value added tax (VAT) applied when goods or services are bought and sold, or customs duties applied when goods are imported or exported. Indirect taxes are not linked to company profits.

On the other hand, direct taxes are paid by the company to the government based on the income generated by the company. The main example is corporate income tax (CIT) or profit tax, which is charged on the company's net income (that is, its profit). Many countries also charge withholding tax, which is a tax deducted from payments made by the company to other persons located outside the country (for example dividends to shareholders or royalties for intellectual property rights).

Some revenue streams are specific to, or particularly prominent in, a given industry. Land rental fees and water fees may be important sources of revenue in agriculture projects. In extractive industries, royalties are common revenue streams. Royalties can be periodic payments based on the value of production (*ad valorem* royalties based on gross revenues), or more rarely on production volume ('specific' royalties). They can also be based on profit or on output price. Royalties may be calculated on the basis of fixed rates or on a sliding scale that depends on factors like production levels or profitability. Bonuses to the government are commonly used in the oil and gas sector, including one-off payments (for example at contract signature or commercial oil discovery) and regular, fixed payments (for example after production reaches specified levels).

Many oil and gas projects in low and middle-income countries are based on production sharing agreements (PSAs). These contracts are concluded between the investor and the host state or a state-owned oil company (in which oil ownership is vested). While there are many different variants of PSA, the investor generally provides financial and technical services to the state-owned company, for example funding exploration, development and production. In return, it receives a share of the oil or gas to recover costs and make a profit (Ahmadov *et al.*, 2012).

In production sharing agreements, the government's share of 'profit oil', (that is, oil net of costs), whether in cash or in kind, can be an important source of public revenue. It may be calculated on the basis of a fixed share of production or, more commonly, on sliding scales based on changing output levels or rates of return.

30. See also the many materials developed by the Revenue Watch Institute on public revenues in extractive industries (<http://www.revenuwatch.org>).

The fiscal regime for an investment may also involve other types of public revenues. Government agencies may charge application fees for licences, contract renewals and other procedures. If the project involves a joint venture with the host government, the government would also receive dividends – the share of profits that is not reinvested into the joint-venture company but distributed to the joint-venture parties. Finally, in investments that create large numbers of jobs, income tax paid by the workers can constitute a very substantial share of the public revenues contributed – even if wages, and therefore individual tax contributions, are low.

Sector-specific rules may modify the application of general tax law. In some jurisdictions, oil profits are taxed at higher rates than mainstream CIT rates. Another common practice is ring-fencing. Under general tax law, CIT would be charged on a company's taxable net profit. Corporate profit would be affected by the operation of all the investment projects that a company may run in a given country. In some jurisdictions, however, individual projects are ring-fenced, so CIT is charged on the profit generated by each project. This means that profits made through one project cannot be offset by losses made in another project.

Ring-fencing is particularly important in capital-intensive industries like petroleum or mining. Without ring-fencing, the tax liabilities of an oil company may be significantly reduced if the company starts a new project in the country, because extractive industry projects typically involve significant losses until sunk costs have been recovered.³¹

Towards optimal taxation for sustainable development

There is no magic bullet when it comes to designing tax laws. Industries and jurisdictions are very different, and tax regimes reflect this diversity. A recurring challenge in designing fiscal regimes for natural resource investments is maximising revenue to the state, while also making the tax deal attractive to investors: if tax rates are too low, the host country will miss out on public revenues that could have been used to provide public services and reduce poverty; but if the rates are too high, companies may be deterred from investing in the country, and overall public revenues may suffer as a result (Otto *et al.*, 2006).

While it is important to get the tax rates right, the design of tax legislation raises many other challenges. Different combinations of revenue streams may lead to different results in terms of distribution of public revenues over time, sharing of risk between the parties, incentives for economic (in)efficiencies, or ease of tax collection. These trade-offs need to be addressed in relation to specific contexts and based on government policy (Otto *et al.*, 2006).

For example, royalties based on gross sales and corporate income tax are both influenced by production levels and sale prices but their revenue implications are very different. Income tax is only due when the project becomes profitable,

31. The discussion of ring-fencing is based on Tordo (2007).

while royalties are due irrespective of profitability. A fiscal regime that emphasises income taxation over royalties may generate lower levels of public revenues in the early stages of the project until it becomes profitable enough to generate income tax. Profit-based taxes are also harder to administer than some other revenue streams such as bonuses or royalties, so regimes that emphasise income taxation need to have the capacity to administer it.

From a sustainable development perspective, taxation is not just a source of government revenue – it is also a public policy tool that may be used to regulate social and environment matters. In environmental policy, some recent legislation has emphasised an incentive-based approach, whereby behaviour is promoted or discouraged through tax incentives such as higher taxes or tax breaks rather than prohibitions and sanctions. For example, carbon taxation (an environmental tax on emissions of carbon dioxide) may be used as a tool to promote use of cleaner technologies.

Similarly, a sustainable development perspective would call for tax regimes to be assessed on the basis on their ability to promote, or discourage, more inclusive and sustainable investment models. This issue is touched upon in the discussion of tax incentives below.

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TOP TIP 6

Create a robust tax regime – and a well-resourced tax administration

- Well-drafted legislation and a well-resourced tax administration are crucial to the effective implementation of a tax regime. This would include appropriate rules and institutions to deal with any disputes.
- Understanding revenue streams over a project's life cycle through such means as financial modelling can give host countries insight into an investment's viability and its likely contribution to sustainable development.
- The design of a fiscal regime implies clear and well thought-out policy choices to address trade-offs between competing objectives and considerations.
- Taxation is not just a source of government revenue – it is also a public policy tool that may be used to regulate social and environment matters.

Tax incentives: a race to the bottom?

Tax incentives are 'any incentives that reduce the tax burden of enterprises in order to induce them to invest in particular projects or sectors' (UNCTAD, 2000:12). They have been widely used as a tool to improve the competitive advantage of a country, and to promote investment for a variety of policy objectives – from promoting growth in the national economy to channelling investment into deprived regions within the country, through to promoting investment in some sectors such as renewable energy.

Tax incentives may be embodied in the tax law, the investment code, sector-specific legislation such as mining codes or decrees and regulations adopted by the government. There are many different types of tax incentives (see Boxes 14 and 15).

Box 14. Types of tax incentives

Incentives may affect direct and indirect taxation. Direct tax incentives commonly relate to corporate income tax (CIT). They include tax holidays, whereby CIT is not due for specified periods of time, and preferential CIT rates, whereby profits are taxed at a lower rate than specified in generally applicable legislation.

Tax holidays are relatively easy to administer, and for this reason they are very popular in low-income countries. But they can greatly reduce and defer revenues. Time-bound tax holidays require safeguards to prevent abuse. For example, investors might reincorporate or restructure to benefit from a new tax holiday period.

Direct tax incentives can also operate through deductions, which affect the tax base (that is the taxable income), rather than the tax rate. For example, capital allowances enable companies to deduct a share of the cost of machinery and equipment (depreciation) from their taxable income. Accelerated depreciation is an accounting practice that allows companies to calculate higher rates of asset depreciation in early years. For example, accelerated depreciation of an asset worth US\$5000 with a lifespan of 10 years may involve calculating annual depreciations of US\$1000 for the first five years only, rather than US\$500 over ten years. This practice has the effect of shifting tax liabilities to later years.

Tax credits involve deducting a percentage of capital costs from CIT liabilities – that is from the amount of tax due rather than from taxable income. Tax credits differ from capital allowances in that the value of the incentive to the investor is not affected by variations in the tax rate.

Subsidies involve payments from the government. They are problematic because they can create major costs to the state for projects that may not prove viable. While CIT incentives only have an effect once the project is profitable, subsidies involve forgoing public revenues up front.

Indirect tax incentives relate to a company's transactions, rather than its profits. Examples include tax breaks applied to taxes on the importation of capital goods (exemptions from import duties) and on the sale of final products (VAT exemptions).

Sources: UNCTAD (2000); Zee *et al.* (2002).

Box 15. Tax incentives in Tanzania

Tanzania's tax law features a number of tax incentives for investors. For example, all agribusiness companies holding a 'certificate of incentives' issued by the Tanzania Investment Centre are entitled to duty-free importation of capital equipment for agriculture and farm inputs, exemption from VAT on agricultural inputs such as fertilisers and pesticides, and capital allowances for certain types of capital expenditure.

Additional tax incentives are available to investors operating in export processing zones and in special economic zones, while companies investing more than US\$20 million are granted 'strategic investor' status and can negotiate tailored fiscal regimes.

Source: FAO, 2012.

Tax incentives have formed the subject of much controversy. Economists have argued that they are generally ineffective in attracting investment, because they are secondary to more fundamental determinants concerning access to raw materials or availability of skilled labour, for instance (UNCTAD, 2000; Zee *et al.*, 2002). Economists have also raised concerns that, by favouring some investments over others, tax incentives can distort decision making and favour inefficient resource allocation (Zee *et al.*, 2002).

Tax incentives may also favour certain investment models over others. For example, low or absent land fees, or exemptions from the payment of land fees for specified periods of time, create incentives for agribusiness to lease large areas of land for plantation agriculture or even for speculation, rather than sourcing from local farmers (Vorley *et al.*, 2012).

Campaigning groups have pointed to the high cost of tax incentives in terms of forgone public revenues that could have been used to fund public services and poverty reduction programmes (OSI *et al.*, 2009; Christian Aid, 2009). Where investments would occur even without tax incentives, an incentive effectively constitutes a gift to the investor from the public treasury (Zee *et al.*, 2002). And where tax incentives are used to attract foreign investment, they may place national competitors at a disadvantage (ActionAid, 2013).

By reducing public revenues, tax incentives can undermine one of the main contributions to sustainable development that natural resource investments could provide. If a project pays little tax and creates few jobs, macroeconomic indicators such as economic growth and foreign reserves may improve, but few people in the host country would feel the benefit.

It has been argued that tax incentives can play a useful role to promote activities that present positive externalities – in other words, activities that benefit the wider economy but that commercial operators have little economic incentive to pay for (UNCTAD, 2000; Zee *et al.*, 2002). But there is a strong case for thoroughly scrutinising legislation that involves tax incentives (Moran, 2006; ActionAid, 2013). The rules of the World Trade Organization restrict the use of some tax incentives, for example in connection with local content requirements, discussed in Section 3.4, and export performance.³²

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Concerted action could help countries to reduce tax incentives without losing out on investment. Regional or sub-regional efforts could enable low and middle-income countries to harmonise their tax legislation, at least in specific sectors, and to have greater negotiating power with regard to prospective investors. For example, the Economic Community of West African States (ECOWAS) is currently developing a harmonised mining code. On the other hand, as tax incentives are likely to continue being widely used, there is also a case for ensuring that whatever incentives are provided they are properly thought out, and for maximising transparency and public scrutiny (Zee *et al.*, 2002).

Assessing the effectiveness of different types of tax incentives is difficult, not least because the same type of incentive can have different outcomes in different socio-economic contexts (Zee *et al.*, 2002). Overall, however, the evidence suggests that tax incentives involving faster recovery of investment costs such as

32. Under the Agreement on Trade-Related Investment Measures and the Agreement on Subsidies and Countervailing Measures, respectively.

capital allowances, accelerated depreciation or tax credits tend to be more cost-effective than tax holidays or reductions in the tax rate (Zee *et al.*, 2002).

It is important for governments to ensure that tax incentives do not favour exclusionary investment models: for example, this may require governments to avoid land fee exemptions and appropriately price land in agricultural investments (Vorley *et al.*, 2012). Periodic review of tax incentives by government authorities can help eliminate unnecessary tax breaks, and better fine-tune continuing incentives – although as investors value predictability, frequent changes to the tax regime may prove counterproductive (UNCTAD, 2000).

Transparency and accountability are critical in the management of tax incentives. Wherever access to tax incentives is subject to the discretionary power of government officials, there are opportunities for corruption. This calls for legislation to grant tax incentives on the basis of clearly specified objective criteria. Embodying tax incentives in general tax law, instead of decrees or contracts, increases transparency and reduces the risk of inconsistencies (Zee *et al.*, 2002). This fits with the OECD Guidelines for Multinational Enterprises, which state that investment contracts should not grant investors tax incentives that are not contemplated in applicable national law.

TOP TIP 7

Scrutinise your tax incentives

- There is a strong case for thoroughly scrutinising any legislation that involves tax incentives.
- Where tax incentives continue to be used, there is also a case for ensuring that they are properly thought out, and for maximising transparency and public scrutiny.
- Periodic review of tax incentives can help eliminate unnecessary tax breaks and fine-tune any continuing incentives.
- Concerted action with other countries in the region, for instance to harmonise tax legislation, could help reduce tax incentives without losing out on investment.

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Progressive taxation and windfall taxes

A 'progressive' fiscal regime is one where 'the [g]overnment "take" would rise or fall to correspond to changes in the levels of profitability' (Land, 2009:161). Natural resource investments are often long term, sometimes spanning several decades. If the deal is negotiated at a time of low commodity prices and price hikes occur once the project is operational, higher profitability may translate into higher public revenues – but not necessarily to the level hoped for by the government.

In such situations, the company may make profits well above the rate of return that would have made the investment commercially attractive. Progressive tax regimes aim to enable the host government to participate more fully in the financial benefits brought by higher commodity prices: when commodity prices and investment returns increase, so does the tax rate (Land, 2009).

There is great diversity of possible legislative models. The simplest model is centred on progressive profit taxes, whereby corporate income tax is charged at escalating rates. In other words, the tax rate increases with rises in taxable income (Land, 2009). Escalating rates may also be applied to royalties, rather than taxes on profits: 'sliding-scale' royalties are calculated on the basis of rates that increase beyond specified thresholds (Land, 2009).

These models can be particularly onerous for large-scale investments, for which absolute profits (but not necessarily profit-to-capital ratios) are usually higher because of the larger amount of capital involved. For this reason, many systems determine thresholds for higher tax rates or for windfall taxes on the basis of a profit ratio, instead of absolute profits (Land, 2009). For example, a country may charge a 'resource rent tax' at a specified rate (say, 40 per cent), and apply this tax to profits that accrue beyond a specified rate of return on the investment (for instance, 20 per cent), after corporate income tax has been paid (Bell, 2012).

Yet another model is centred on windfall taxes based on commodity prices. Rather than measuring the profitability of an investment, this model assumes that higher commodity prices will result in greater profitability, and it triggers higher tax rates if commodity prices reach specified thresholds (Land, 2009).

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The advantage of price-based models is that they are easier to administer: profitability is often difficult to ascertain, while price indices for many commodities are readily available. The drawback is that profitability also depends on many factors other than commodity prices, particularly in relation to production costs. So a price-based windfall tax may increase the tax burden on ventures that are not as profitable as they are assumed to be (Land, 2009).

Despite the advantages of progressive tax regimes, these regimes are not widely used in low-income countries (Land, 2009). One reason is that progressive regimes tend to be more difficult to administer.

Some countries have sought to renegotiate tax rules following changes in market conditions, for instance by applying new windfall taxes to ongoing projects at times of high commodity prices. This approach is different to applying a progressive fiscal regime from the beginning, whereby unchanged rules would automatically increase the government take over project duration if commodity prices increase.

The introduction of new taxes on 'excess profits' during the implementation of a project may generate more revenues but it is likely to be opposed by investors. Industry operators tend to value fiscal stability. They also tend to feel that high returns are justified by the high risks involved in natural resource projects: many mineral explorations are unsuccessful, and successful projects must provide high-enough returns to cover the costs of the unsuccessful ventures (Box 16).

Box 16. Contract renegotiation in Zambia's mining sector

In 2008, the Zambian government introduced a new Zambia Mines and Minerals Development Act that significantly revised the fiscal regime applicable to ongoing and future mining projects. The new tax regime introduced a new windfall profit tax based on the price of copper. But the reform was partly reversed following opposition from the mining industry, and the windfall tax was abolished in 2009.

Source: Sachs *et al.*, 2013.

Windfall taxes in violation of legal commitments may expose the host government to liabilities through international investor-state arbitration, although host governments will not necessarily lose the case. In *Burlington Resources v. Ecuador*, the arbitral tribunal found that even a windfall profit tax taking 99% of profits above a specified threshold did not constitute expropriation: for an expropriation to occur, there must be substantial deprivation of the investment itself while a windfall profit tax, no matter how dramatic, is by definition only limited to windfall profits.

But one of the three arbitrators in that case dissented, and argued that a 99 per cent windfall profit tax amounts to expropriation. Future tribunals may feel the same, and the facts of each case will probably matter a great deal. Even if expropriation is not at stake, windfall profit taxes have been held to breach other standards of investment protection, particularly fair and equitable treatment (discussed in Chapter 2).³³

To minimise the legal liabilities that may be linked to investor-state arbitrations involving challenges to unilateral contract renegotiations, it is prudent to include a periodic review clause in the contract or in national law, which allows the parties to periodically revise key terms. Where investors require fiscal stability, the host country may charge a premium for it, for example in the form of higher tax rates – as is done in Chile under the Foreign Investment Statute of 1974 (Sachs *et al.*, 2013). Some high-income jurisdictions, such as Norway, charge high but stable oil tax rates.

TOP TIP 8

Maximise benefits from rising commodity prices

- Progressive tax regimes can provide more revenue when commodity prices increase – but they tend to be more difficult to administer than flat rate taxes or royalties.
- Periodic review clauses in investment contracts can enable the parties to review key terms over project duration.

33. See e.g. *Occidental Petroleum Corporation v. The Republic of Ecuador*, concerning the same Ecuadorian tax legislation at stake in *Burlington Resources v. Ecuador*. An important reason for the different outcomes of the two cases is that, in *Burlington Resources*, the arbitral tribunal ruled that it has no jurisdiction to hear the investor's claim relating to fair and equitable treatment. The *Sergei Paushok v. Mongolia* award found that a windfall profit tax on mining did not violate investment treaty obligations.

Minimising tax avoidance

Natural resource investments often involve corporate structures that span multiple countries raising significant challenges over taxation. Because holding companies and subsidiaries are distinct legal entities, under prevailing tax regimes each is responsible for their own taxation (Muchlinski, 2007). These companies are typically located in different jurisdictions, so they have to comply with different tax requirements.

There is huge diversity in national approaches to taxation and the tax burden itself. In some countries, the law imposes little or no income tax, and transparency is very limited. These countries are often referred to as 'tax havens'. The rules that establish the jurisdiction of a country to impose taxation also vary greatly.

For tax purposes, the country of residence is the country where the investor is based (the home country, in investment terms) while the country of source is where returns on investment are generated, namely the host country. Many countries tax residents on all worldwide income, and non-residents only on income from sources within the territory (Eden, 2001; Picciotto, 2011; O'Brien and Brooks, 2013).

This situation creates the risk that the same income will be taxed twice – an outcome that the investor will be eager to avoid. To address this problem, many tax treaties and laws provide that business profits should be first taxed by the source country. The residence country can also impose taxation, but this must usually take account of taxes paid in the source country – typically through tax credits (Eden, 2001).

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Multinationals with a number of related companies incorporated in different jurisdictions, each with a diversity of applicable tax rules, are able to structure their business in ways that take advantage of beneficial tax rules in different countries. In other words they have opportunities for tax avoidance, the practice of minimising tax payments without formally breaking tax rules (Box 17). For example, investors can minimise their tax liabilities by shifting profits to tax havens ('profit shifting'). Tax avoidance can deprive host countries of large amounts of public revenues. Many countries, not just low and middle-income ones, are struggling to tax globally mobile profits.

Transfer pricing is a key concept in relation to tax avoidance.³⁴ It refers to pricing in transactions that occur between companies belonging to the same business group ('affiliates' – see Figure 2). Transactions may include the sale of goods such as inputs or produce; the supply of services such as construction, management or marketing; the licensing of intellectual property rights such as patented technology; or loans between the local subsidiary and other companies belonging to the same business group.

In large groups with many subsidiaries, these intra-corporate transactions are part of ordinary business life. But transfer pricing offers major opportunities for tax

34. On tax avoidance and transfer pricing, see UNCTAD (1999), Eden (2001), Muchlinski (2007) and Picciotto (2011).

Box 17. Tax avoidance and tax justice: civil society advocacy

Recent research has highlighted that many companies claiming to be good 'corporate citizens' by virtue of their corporate philanthropy make extensive use of tax avoidance. As a result, they pay little tax in the countries where they do business (Jenkins and Newell, 2013).

Over the past few years, civil society organisations have launched increasingly vocal campaigns to promote tax justice. This includes campaigns by ActionAid (<http://www.actionaid.org.uk/tax-justice>) and Christian Aid (<http://www.christianaid.org.uk/ActNow/trace-the-tax/>), as well as international networks and alliances (such as the Tax Justice Network, <http://www.taxjustice.net/>). Non-governmental organisations have also produced toolkits for civil society advocacy (for example Christian Aid and SOMO, 2011).

Civil society can play an important role in exposing and fighting tax avoidance. It can increase pressure for governments to reform their tax regimes, and 'name and shame' companies into paying their fair share.

ActionAid recently published a report claiming that a global sugar producer ultimately controlled by a UK company reduced its tax liabilities in relation to its farming and processing operations in Zambia (ActionAid, 2013). According to the report, transactions between companies within the same business group, involving payments for management, marketing and other services, effectively shifted profits to low-tax jurisdictions in Europe (Ireland, Jersey) and Africa (Mauritius). The company emphatically denied the allegations.

Based on the report's findings, ActionAid has been advocating for change in the company's practices and in tax policy in Zambia and the United Kingdom.

avoidance. By manipulating prices for goods, fees for services, royalties on patents, or interests on loans, the investor can shift profits to jurisdictions where taxation is lower ('manipulation of transfer pricing'; Eden, 2001).

For example, if the subsidiary incorporated in the host country pays inflated prices to affiliates located in a tax haven, its profits, and thus the profit taxes paid to the host government, will be reduced. The investor will pay less tax to the host country, which will lose public revenues.

Virtually all countries have developed legislation to deal with tax avoidance. Governments have also signed a network of double taxation treaties (DTTs), now estimated to total some 3000 treaties worldwide (Picciotto, 2011; O'Brien and Brooks, 2013; Box 18). International guidance has promoted the harmonisation of approaches. The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the OECD Transfer Pricing Guidelines), first released in 1995 and revised in 2010, are a commonly used instrument.

To deal with manipulation of transfer pricing, the national law of most jurisdictions, most DTTs and the OECD Transfer Pricing Guidelines apply the so-called 'arm's length principle'. The arm's length principle means that affiliates are free to apply the price they choose, but for tax purposes their taxable profits are determined to be those that would have arisen if the transaction had taken place between two unrelated parties (Muchlinski, 2007). In other words, the host government scrutinises the prices applied in transactions between affiliates, and if need be recalculates profits on the basis of arm's length transactions.

For transfer pricing legislation to work, it must require companies to keep contemporary documentation of their transactions with affiliates, including information about the rationale for the transaction and about the ways in which prices were determined. Such documentation allows tax authorities to scrutinise intra-corporate transactions effectively.

In addition, transfer pricing legislation may place the burden of demonstrating that intra-corporate transactions comply with the arm's length principle on investors, and provide for spot checks by internal and international auditors (ICMM and Commonwealth Secretariat, 2009). Some governments also charge penalties if they have to make transfer pricing adjustments on profits declared by tax payers (Muchlinski, 2007).

In practice, applying the arm's length principle is often difficult. For transactions involving commodities, international commodity price indices may be available that offer a straightforward price comparator. Interest rates for comparable loans may also be available. But services provided are rarely identical, while intellectual property rights are by definition unique. It may be difficult to determine arm's length prices in these transactions (Muchlinski, 2007). Most low and middle-income countries lack the resources to administer the arm's length principle effectively.

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Difficulties with applying the arm's length principle have led some experts to call for the application of a radically different method (Picciotto 2011, 2012). Under the 'formulary apportionment' or 'unitary taxation' system, the tax base is determined with regard to the whole business group, rather than its individual subsidiaries. Profits and losses are then allocated to different affiliates based on a formula reflecting effective business presence (for instance, the location of sales, assets and staff), ignoring intra-corporate transactions altogether. So a business would mainly pay tax in the countries where it genuinely operates, rather than at very low rates in tax havens.

There is experience with formulary apportionment in some jurisdictions, particularly federal states where the system is used to apportion the income of companies whose operations straddle several sub-national jurisdictions (in the United States, for example). Applying unitary taxation at the international level also presents challenges, however. Politically, the issue has proved controversial for a long time, and powerful vested interests are opposed to unitary taxation. There are technical challenges too, not least because formulary apportionment is likely to result in the same income being taxed twice unless all jurisdictions agree to switch to the new system, possibly on the basis of a widely ratified international treaty.³⁵

It is worth noting that transfer pricing issues can also arise when apportioning income between different economic activities carried out within the same jurisdiction, particularly where those activities are taxed differently. This may be the case, for example, where some activities, such as oil production, are subject to a higher CIT rate than others, or because some activities, such as farming, enjoy tax incentives not available to others.

35. The discussion of unitary taxation draws on Picciotto (2012).

Box 18. Double taxation treaties

Double taxation treaties allocate income for taxation purposes between source and residence countries. They aim to avoid both double taxation and tax avoidance – although in fact some tax treaty provisions can enable tax avoidance practices. Many double taxation treaties also establish standards of treatment such as prohibiting discrimination against foreign investors in tax matters and promote inter-state co-operation in tax matters through such means as exchanges of information. DTTs are mainly concerned with direct taxation, though they may have implications for indirect taxation too.

Both the OECD and the United Nations have developed model DTTs. The UN Model Double Taxation Convention between Developed and Developing Countries is seen as being more favourable to capital-importing countries, because it allows more scope for taxation by the source country; but it is the OECD Model Tax Convention on Income and Capital that has been more widely used, mainly because of the stronger negotiating position of capital-exporting countries in DTT negotiations (Salter, 2010).

Some leading tax experts have cautioned low and middle-income country governments against signing up to DTTs because of the provisions these treaties contain.³⁶ For example, many DTTs limit the ability of the source country to impose ‘withholding taxes’ – that is, taxes on payments made by the local subsidiary to other persons located outside the source country. These payments could include dividends to shareholders, royalties for intellectual property rights, interests on loans and fees for management, marketing or other services. This means that companies can more easily siphon off profits through manipulation of transfer pricing, because they would pay no tax in the source country on amounts they transfer to affiliates located overseas.

As in the case of investment treaties, the vast network of DTTs provides investors with opportunities for treaty shopping: many investors channel their investment through a shell company incorporated in a third country that has concluded advantageous DTTs, for example one that restricts the right of the government to apply withholding taxes.

Some DTTs do feature a ‘denial of benefits’ clause, however, that enables the host state to deny the benefits of the DTT to a company that is controlled by third-country nationals and has no genuine business connection to its country of incorporation (O’Brien and Brooks, 2013). Renegotiating the many DTTs that do not contain such provisions would take time. Therefore, some commentators have also suggested integrating anti-abuse mechanisms into national law (Picciotto, 2011).

Where they apply, the OECD Guidelines for Multinational Enterprises discuss the responsibility of enterprises to pay their tax liabilities. ‘It is important that enterprises contribute to the public finances of host countries by making timely payment of their tax liabilities. In particular, enterprises should comply with both the letter and spirit of the tax laws and regulations of the countries in which they operate’ (Paragraph XI(1)). The Commentary to this provision clarifies: ‘Transactions should not be structured in a way that will have tax results that are inconsistent with the underlying economic consequences of the transaction unless there exists specific legislation designed to give that result’.

Co-operation between national tax authorities is critical in tackling tax avoidance. The Convention on Mutual Administrative Assistance in Tax Matters, adopted in 1988 and revised in 2010, provides a framework for tax co-operation. States that have not done so yet may consider ratifying this convention and complementing

36. See the lecture by tax specialist Lee A. Sheppard (video at <http://www.youtube.com/watch?v=3SrlgzGVbt8>, transcript at <http://taxjustice.blogspot.nl/2013/05/lee-sheppard-dont-sign-oecd-model-tax.html>).

it with instruments providing greater detail, for example on the information which should be exchanged (Picciotto, 2011). Greater transparency in tax payments, for instance through the Extractive Industries Transparency Initiative (Chapter 5), can also help ensure that companies pay their fair share (Picciotto, 2011).

TOP TIP 9

Minimise tax avoidance by strengthening tax rules and administration

- Putting in place effective systems to minimise tax avoidance is a key element of investment preparedness.
- International co-operation and co-ordination, including exchange of information among tax authorities, are essential to minimise tax avoidance.
- Making systems to minimise tax avoidance more effective requires closing loopholes in tax laws and treaties, creating clear accounting standards, requiring companies to keep contemporaneous documentation, scrutinising intra-corporate transactions, and sanctioning non-compliance.
- The arm's length principle is the most widely used approach to tackle transfer pricing, but its application can be difficult. Unitary taxation would change the game in tax avoidance, but raises technical and political challenges.
- 'Denial of benefits' clauses in double taxation treaties can reduce treaty shopping by denying treaty benefits to a company that has no genuine business connection to its country of incorporation.
- Foreign investors will have access to the best tax and legal advice available. Host governments may consider options for strengthening the capacity of the tax administration, including through external support such as technical co-operation projects, partnerships with universities or secondments of staff from other tax jurisdictions.

Revenue management and sharing for sustainable development

Optimising the government take through well thought-out tax regimes will do little to promote sustainable development if the revenues are not used wisely. Decisions about revenue use are quintessentially a matter for national sovereignty. Different governments will have different priorities in spending decisions. But international law provides important pointers.

UN General Assembly Resolution 1803 of 1962, which is widely considered to reflect customary international law, requires states to exercise their sovereignty over natural resources in the interest of the 'well-being of the people' (Paragraph 1). Arguably, the notion of the well-being of the people should be interpreted in light of the international human rights treaties that states have ratified. These rights include the economic, social and cultural rights recognised by the widely ratified International Covenant on Economic, Social and Cultural Rights (ICESCR). The covenant recognises, for example, the rights to education, to health and to food.

The ICESCR commits each state party 'to take steps, [...] to the maximum of its available resources, with a view to achieving progressively the full realization of the

rights recognized in the present Covenant by all appropriate means [...]’ (Article 2). In other words, the Covenant requires states to ‘take steps’ but recognises that economic, social and cultural rights may be realised over time given resource constraints.

But while in practice states enjoy wide discretion in public spending, references to ‘the maximum of [...] available resources’ and ‘all appropriate means’ create review standards for national courts and international human rights bodies, and also for civil society. Where resources are constrained, the reference to the maximum of available resources effectively requires states to prioritise the progressive realisation of human rights. This interpretation was endorsed by the Committee on Economic, Social and Cultural Rights, which is the UN body responsible for overseeing implementation of the ICESCR (General Comment No. 3 of 1990, Paragraph 10).

It is widely recognised that robust revenue management systems, and transparency and public scrutiny in revenue management, are critical to ensuring wise use of public revenues. They are therefore important ingredients of investment preparedness. Some countries have explicitly entrenched transparency requirements in law. This experience is discussed in Chapter 5.

Some countries have also set up public funds to manage the revenues generated by natural resource projects. These funds include ‘stabilisation funds’, which aim to shelter the national economy from fluctuations in mineral revenues; and ‘future generations’ funds, which aim to save revenues for future use (Box 19).

Box 19. Managing oil revenues through public funds: Chad and Ghana compared

A well-known if ultimately unsuccessful example of national legislation to regulate the management of oil revenues in Africa concerns Chad’s Petroleum Revenue Management Act of 1999. This law was adopted as a condition for World Bank lending to the Chad-Cameroon oil development and pipeline project. The project involved oil development in southern Chad, and the construction and operation of a pipeline to transport oil to the coast of Cameroon.

In its original version, the law provided for the majority of the project’s oil revenues to be spent on health, education, infrastructure, rural development, the environment and water. It also provided for 10 per cent of oil revenues to be placed in a future generations fund, which was supposed to be spent on projects to support livelihoods once the oil reserves had run out. In addition, the law established mechanisms for transparency and public oversight, which are discussed in Chapter 5.

However, the government of Chad subsequently amended the law, adding ‘security’ to the list of priority sectors for use of oil revenues and abandoning the future generations fund. This experience highlights that real change must come from, and be sustained by, grassroots pressure, rather than external sources alone.

A more promising example is provided by Ghana’s Petroleum Revenue Management Act of 2011. This law was passed following extensive civil society input. It establishes a Petroleum Holding Fund to receive and disburse all petroleum revenues. Of these revenues, 70 per cent is allocated to the government budget, 21 per cent to a Stabilisation Fund, and 9 per cent to a Heritage Fund (effectively, a future generations fund). The legislation contains extensive provisions to promote transparency in revenue management, also discussed in Chapter 5.

National legislation can also require that a proportion of project revenue be devolved to local government bodies in the project implementation area. There is experience with this approach, for example in the mining sector (ICMM and Commonwealth Secretariat, 2009). In several jurisdictions (for example Ghana and Indonesia), mining legislation allocates a share of certain mining revenues collected by the central government to lower levels of local government (revenue sharing). In other cases, particularly in federal systems, local government bodies have autonomous power to impose certain taxes. And in yet other instances, for example Papua New Guinea, legislation allows the company to deduct its contributions to a community development fund from the corporate income tax due to the central government (ICCM and Commonwealth Secretariat, 2009).

Devolving a share of the revenues to local government bodies enables affected people to benefit from the investment, while also allowing the central government to redistribute part of the wealth nationally including to more deprived and less resource-rich areas. Revenue sharing is particularly important given the negative social and environmental impacts that affected people may suffer.

In practice, however, revenue sharing has produced mixed results. In several cases, benefits have been captured by local elites, inequalities between neighbouring municipalities have been exacerbated, and locally administered monies have not always been used wisely (ICMM and Commonwealth Secretariat, 2009). Without effective checks and balances, revenues managed by the central government can also be misused, and benefits captured by national elites.

TOP TIP 10**Manage and share investment revenue effectively**

- Governments are obliged to prioritise the realisation of human rights in public spending decisions under international human rights treaties.
- National legislation can identify priority sectors for public spending, but genuine political commitment and robust public scrutiny are key to making this legislation work.
- Effective and transparent revenue-management institutions, and effective checks and balances, can help a country to take a long-term perspective to managing public revenues.
- Devolving a share of the revenues to local government bodies would enable affected people to benefit from the investment.

3.4 Maximising positive economic linkages

A recurring problem with many natural resource investments is that they fail to create enough positive linkages with the local economy. Capital-intensive extractive industries and mechanised farming often create only limited numbers of jobs. Opportunities for local businesses may also be few, especially where there is insufficient business capacity. As a result, investments may contribute to the national economy at the macro level, in terms of economic growth, export promotion or foreign reserves, yet have limited impact on poverty reduction.

Measures to maximise positive linkages with the local economy are an important ingredient of investment preparedness. Depending on how they are designed, policy measures can promote, or discourage, more inclusive investment models. In agriculture, for example, sourcing from local farmers may support many more livelihoods than highly mechanised, large-scale plantations (Box 12). Countries can reverse the incentives favouring large land deals by strengthening the land rights of small-scale farmers, and rethinking tax incentives on large land deals (see Sections 3.3 and 4.3).

Some countries have enacted legislation that specifically promotes positive economic linkages, for instance through the introduction of performance requirements. These are 'stipulations, imposed on investors, requiring them to meet certain specified goals with respect to their operations in the host country' (UNCTAD, 2003:2). They are typically motivated by a concern to maximise the economic benefit of investment for the host country (Muchlinski, 2008a). The requirements may be included in sector-specific legislation, such as that regulating the oil and gas sector; investment legislation; or contracts between the investor and the government.

Performance requirements can cover a wide range of issues linked to a company's operations – from 'local content' requirements for the company to source goods and services from local businesses, through to requirements linked to employment creation, exports, technology transfer or research and development. While traditionally these requirements were imposed as a condition for admission into the host country, they are now often non-mandatory and associated with financial incentives instead.

Both developed and developing countries have made extensive use of performance requirements (Muchlinski, 2008a). Evidence on the effectiveness of these requirements is mixed (UNCTAD, 2003; Beviglia Zampetti and Fredriksson, 2003; Moran, 2011). Some evidence suggests that export performance requirements have been effective in increasing export orientation, for example in Brazil, Chile, Japan, Malaysia, Thailand and the United States (UNCTAD, 2003).

On the other hand, performance requirements on local content or research and development tend to have little effect in the absence of adequate local capacity to take up the business opportunities created. Some commentators also argue that performance requirements may lead to inefficiencies due to their inherently protectionist nature (Moran, 2011). Improving the competitiveness of local businesses is critical to promoting positive economic linkages, whether performance requirements are used or not.

Performance requirements may impact on other parts of the economic deal, particularly the fiscal regime. In countries with limited local business capacity, there may also be trade-offs between requirements to source goods and services locally on the one hand, and promoting higher safety, social, and environmental

standards on the other. Managing these trade-offs is a matter for public policy. Finally, a government's ability to introduce performance requirements may be restricted by international free trade or investment treaties (Box 20).

Following economic liberalisation in the 1990s, use of performance requirements declined, not least because of the need for WTO member states to comply with WTO norms (UNCTAD, 2003). In manufacturing, competition for foreign investment has also contributed to the decline of performance requirements. In the natural resource sector, however, the host government may enjoy stronger negotiating power because of the location dependency of natural resource ventures. As a result, performance requirements are still relatively common, and are often associated with resource nationalism (Ward, 2009).

For example, the spike in oil prices in 2007-08, and the associated wave of resource nationalism and renegotiations triggered by the price hike, have resulted in the adoption of several local content laws, for example in Nigeria and Kazakhstan (Osanova, 2010; Wilson and Kuszewski, 2011).

The Nigerian Oil and Gas Industry Content Development Act of 2010 requires oil companies to submit a 'Nigerian Content Plan' as part of the bidding process, and allows local content to be considered in the selection process where bids are within one per cent of each other. The law also establishes tax incentives for companies that establish processing facilities in Nigeria, restricts junior and intermediate jobs to Nigerians, sets a five per cent ceiling for expatriates in management positions, and establishes company reporting requirements to monitor compliance.³⁷

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As already noted, in the absence of local business capacity to meet the project's demand for goods and services, however, performance requirements remain a dead letter. Taking steps to strengthen local business capacity is therefore essential. Some recent investor-state contracts require the investor to restructure procurement over time in order to make local provision of goods and services more feasible and to contribute to strengthening local business capacities in critical service and supply areas.

As investment projects often involve long chains of contractors and sub-contractors, best practice clarifies that performance requirements apply to economic activities run by contractors and sub-contractors, and extends reporting requirements to these operators as well.

37. On local content requirements in Nigeria, see the Nigerian Content Development and Monitoring Board (<http://www.ncdmb.gov.ng/>), 'Nigerian Local Content' on the Nigeria Oil & Gas website (http://www.nigeria-oil-gas.com/nigerian_local_content-26-10-2-art.html) and 'Nigeria' on the Menas Local Content Online website (<http://www.menas.co.uk/localcontent/home.aspx?country=77>).

Box 20. Legal restrictions on performance requirements

The WTO Agreement on Trade-Related Investment Measures (TRIMs Agreement) prohibits measures that are inconsistent with state commitments not to discriminate against non-nationals in trade in goods, and to remove quantitative restrictions on imports of goods. The TRIMs Agreement lists examples of prohibited measures. Performance requirements concerning trade in goods are explicitly prohibited under these norms. In contrast, requirements on employment or research and development would be outside the scope of the TRIMs Agreement. The vast majority of countries in the world are now members of the WTO and are bound by these provisions, although least developed countries have benefited from special transitional periods.

Most investment treaties do not contain provisions restricting performance requirements. Some treaties do, however. This is particularly the case of those investment treaties that take a pre-establishment approach – in other words, those that create host state obligations on the admission of foreign investment (see Chapter 2). Investment treaties that follow this approach may place more wide-ranging restrictions on performance requirements than those flowing from WTO norms. For example, some treaties restrict performance requirements concerning employment or research and development. Incentive-based provisions, however, which tie performance requirements to financial or other advantages rather than imposing them, are not necessarily restricted by investment treaties.

Remedies for violations differ between the WTO and investment treaties. The WTO focuses on disputes between states: a challenge to a prohibited performance requirement would need to be brought by the investor's home state. In contrast, investment treaties and some preferential trade agreements give investors direct access to international remedies through investor-state arbitration (see Section 2.3).

Published arbitral awards concerning restrictions on performance requirements are still rare, partly because many investment treaties do not restrict performance requirements. Yet, there is a small but growing number of cases where tribunals have found that performance requirements violated an investment treaty (e.g. *Mobil Investments Canada Inc. and Murphy Oil Corporation v. Government of Canada*), or where they found the specific measure at stake not to violate a treaty commitment (e.g. *ADF Group Inc. v. United States of America*).

TOP TIP 11

If you use performance requirements, structure them effectively

- Performance requirements raise complex trade-offs between different policy goals.
- Performance requirements are only effective if local businesses have the capacity to seize the opportunity.
- Before adopting performance requirements, governments should consider any restrictions stemming from international treaties, and the legal liabilities they may incur if they violate them.
- Requiring companies to regularly report on progress, extending the application of performance requirements to subcontractors and structuring procurement in ways that facilitate inclusion of local suppliers can all increase the effectiveness of performance requirements.

Civil society scrutiny of the economic deal

Civil society organisations can play an important role in monitoring the economic deal, for example by 'naming and shaming' tax avoiders; advocating for tighter tax laws, including in home countries; shedding light on questionable corporate structures; and monitoring compliance with any performance requirements.

To sum up

This chapter has covered some key issues affecting the economic deal at stake in natural resource investments – from promoting inclusive investment models to getting a handle on corporate structure, through to taxation and maximising positive linkages with the local economy. While getting a fair economic deal is a key part of ensuring that foreign investment contributes to sustainable development, it is not the whole story. Social and environmental considerations are also important, and they are discussed in the next chapter.

Useful online resources

Eden, L. 2001. Taxes, transfer pricing and the multinational enterprise. In Rugman, A.M. and Brewer, T.L. (eds). *The Oxford Handbook of International Business*, Oxford University Press, Oxford.

<http://www.voxprof.com/eden/Publications/EDEN-OHIB-CHAPTER-12102552.pdf>.

Land, B. 2009. Capturing a fair share of fiscal benefits in the extractive industry. *Transnational Corporations* 18(1) 157-173.

http://unctad.org/en/docs/diaeiia20097a7_en.pdf.

Menas Local Content Online – an online resource on the legal and practical issues relating to local content requirements:

<http://www.menas.co.uk/localcontent/home.aspx>.

Otto, J. *et al.* 2006. *Mining Royalties: A global study of their impact on investors, government, and civil society*. World Bank, Washington DC.

<http://siteresources.worldbank.org/INTOGMC/Resources/336099-1156955107170/miningroyaltiespublication.pdf>.

Revenue Watch Institute has published extensive materials on revenue management in extractive industries:

<http://www.revenuewatch.org/publications>.

UNCTAD. 2003. *Foreign Direct Investment and Performance Requirements: New evidence from selected countries*. United Nations Conference on Trade and Development, Geneva and New York.

http://unctad.org/en/Docs/iteiia20037_en.pdf.

UNCTAD. 2000. *Tax Incentives and Foreign Direct Investment: A global survey*, ASIT Advisory Studies No. 16. United Nations Conference on Trade and Development, Geneva and New York.

http://unctad.org/en/Docs/iteipcmisc3_en.pdf.

UNCTAD. 1999. *Transfer Pricing*. United Nations Conference on Trade and Development, Geneva and New York.

<http://unctad.org/en/Docs/psiteiitd11v1.en.pdf>.

Taking social and environmental considerations seriously

4.1 Setting the scene

Sustainable development and human rights

Even a deal that is economically beneficial to the country as a whole can be bad news if social and environmental considerations are not properly factored in. Large natural resource investments can bring significant environmental impacts, including water pollution, deforestation and soil degradation. They can also raise major social concerns, such as managing land acquisitions, ensuring continued local food security for affected people, ensuring the project benefits are widely shared, regulating the conduct of security forces and establishing effective grievance mechanisms.

As discussed in Chapter 1, balancing social, environmental and economic considerations is central to the concept of sustainable development. Principle 4 of the 1992 Rio Declaration on Environment and Development states that ‘environmental protection shall constitute an integral part of the development process’, while Principle 5 considers poverty eradication as ‘an indispensable requirement for sustainable development’. These principles have made their way into some international rulings. For example, the International Court of Justice has referred to the ‘need to reconcile economic development with protection of the environment[, a need that] is aptly expressed in the concept of sustainable development’.³⁸

Many social and environmental considerations are closely linked to the realisation of fundamental human rights (Box 21). The relevance of human rights is evident in social matters. For example, land acquisition processes can affect the internationally recognised human rights to property, to food and to housing. Labour standards can also raise human rights issues.

But human rights are also directly relevant to environmental protection. Environmental degradation can impact on widely recognised human rights, including the right to health. Some international treaties also affirm the human right to a clean environment (for example Article 24 of the African Charter on Human and Peoples’ Rights).

Over the past two decades, human rights and sustainable development organisations have become very involved with advocacy on foreign investment projects in low and middle-income countries. Today, many large investments in the extractive industries and agriculture are accompanied by thorough public scrutiny. As a result, companies are under increasing pressures to uphold effective social and environmental standards.

38. *Case Concerning the Gabčíkovo-Nagymaros Dam*, at 140.

Many companies have also taken a more proactive role in making social and environmental considerations a mainstream part of their business operations. The 'business and human rights' agenda (Box 22) enjoys strong support in many parts of the private sector. Despite the protracted recession in the West, business concern about sustainable development and human rights is not fading. In fact, it is set to grow in importance as pressures on resources increase and social and environmental challenges intensify.

In practice, balancing social, environmental and economic considerations is often complex, not least because there is no consensus on how to address important trade-offs, and because the balancing act is inherently context specific and evolves over time. The sustainability of any development can look very different at different levels: a decision that seems to promote sustainable development at the national level may be unsustainable at the local level.

Box 21. International human rights law

International human rights law affirms the fundamental rights to which all human beings are entitled. It aims to protect human dignity. Global human rights law is centred on international treaties and authoritative declarations linked to the United Nations system. This includes the 1948 Universal Declaration of Human Rights (UDHR), the 1966 International Covenant on Civil and Political Rights (ICCPR), the 1966 International Covenant on Economic, Social and Cultural Rights (ICESCR), the 1965 International Convention on the Elimination of All Forms of Racial Discrimination (ICERD) and the 1979 Convention on the Elimination of All Forms of Discrimination Against Women (CEDAW).

Human rights are also protected by regional systems. In Europe, for example, there is the 1950 European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR) and its protocols; in the Americas, the 1969 American Convention on Human Rights (ACHR); and in Africa, the 1981 African Charter on Human and Peoples' Rights (ACHPR) and its protocols.

International human rights law has been further developed through authoritative treaty interpretations provided by the United Nations bodies established to monitor the implementation of given treaties. States have also negotiated guidelines, including the 2004 Voluntary Guidelines to Support the Progressive Realization of the Right to Adequate Food in the Context of National Food Security. The United Nations has appointed Special Rapporteurs to develop specific rights or deal with specific issues or countries, including the UN Special Rapporteur on the Right to Food, Olivier De Schutter (see <http://www.srfood.org/en/>).

Some human rights treaties establish international courts or bodies to promote compliance by states with their treaty obligations. These legal recourse mechanisms are discussed in Section 5.5.

Can international standards fill gaps in the law?

There is much international guidance on ways to tackle social and environmental issues in investment processes. Principles, guidelines and standards have been developed by a variety of different types of bodies:

- International agencies, for example the OECD Guidelines for Multinational Enterprises.
- Global and regional multilateral lenders, for example the Performance Standards on Environmental and Social Sustainability of the International Finance Corporation (IFC), and equivalent documents adopted by the African

Box 22. The UN Guiding Principles on Business and Human Rights

The UN Guiding Principles on Business and Human Rights were unanimously endorsed by the UN Human Rights Council in 2011. They are intended to clarify the human rights duties of states and the responsibilities of companies in the context of business activities. The principles were developed through an international consultation process led by the then Special Representative of the Secretary General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, John Ruggie.

The UN Guiding Principles rest on three pillars: protect, respect and remedy. States have a duty to protect human rights against third-party interference, including interference from business actors (protect). Businesses have a corporate responsibility to act with due diligence to avoid infringing on human rights and to address adverse impacts that may arise from their activities (respect). Finally there need to be effective remedies, including judicial fora and non-judicial grievance mechanisms (remedy).

The state duty to protect 'requires taking appropriate steps to prevent, investigate, punish and redress [human rights violations] through effective policies, legislation, regulations and adjudication' (Principle 1). In other words, states should enact and enforce laws, issue guidance and provide effective remedies.

The responsibility of business to respect human rights requires that enterprises:
'(a) Avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur;
(b) Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts' (Principle 13).

The Guiding Principles are accompanied by annexes, including the Principles for Responsible Contracts: Integrating the Management of Human Rights Risks into State-Investor Contract Negotiations.

While not legally binding, the Guiding Principles have received wide acceptance and support, and some of their main implications are now reflected in other international instruments (such as the OECD Guidelines for Multinational Enterprises and the International Finance Corporation's Performance Standards on Environmental and Social Sustainability, both revised in 2011).

Development Bank, the Asian Development Bank and the Inter-American Development Bank.

- Inter-governmental negotiation processes, for example the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security.
- Commercial lenders, for example the Equator Principles – a voluntary 'baseline and framework' developed by commercial lenders as a benchmark for their own internal social and environmental policies, procedures and standards.³⁹
- Multi-stakeholder roundtables and certification schemes, such as those established for industries and commodities as diverse as palm oil, soy, sugar and biofuels.

39. Following a revision in 2012, the Equator Principles apply to operations financed through certain types of project-based lending that meet specified criteria, including: project-finance transactions with total project capital costs of US\$10 million or more and project-related corporate loans meeting specified criteria (for instance a total aggregate loan amount of US\$100 million or more). Project finance is a method of funding in which the lender looks primarily to the revenues generated by a single project both as the source of repayment and as security for the exposure.

A group of governments, extractive industry companies and civil society organisations have adopted the Voluntary Principles on Security and Human Rights, which have become an international benchmark in matters relating to the operation of security forces (Box 23).

While all these international standards are not legally enforceable in themselves, many of them are backed up by grievance mechanisms – for example, the IFC Compliance Advisor / Ombudsman, and the National Contact Points established in countries that subscribe to the OECD Guidelines for Multinational Enterprises.

Box 23. The Voluntary Principles on Security and Human Rights

The Voluntary Principles on Security and Human Rights were developed in 2000 by some governments, extractive industry companies and non-governmental organisations. They offer guidance to companies on how to protect the security of their operations while ensuring respect for human rights.

The principles provide guidance on risk assessment, whereby companies should assess security risks and the potential for human rights abuses. They also cover how companies should engage with public security providers (police, military) in a way that promotes the protection of human rights; and with private security providers (that is, contracted security) in a way that respects human rights.

Source: IPIECA, 2012a.

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International standards may go considerably beyond national legal requirements. Some investment contracts require projects to comply with international social and environmental standards. Where national law does not provide effective regulation, this approach may help to fill gaps – but only if governments are equipped to monitor compliance with standards they may not be familiar with.

Reference to international standards can also have drawbacks. In democratic countries, national legislation reflects the balance of social, economic and environmental considerations chosen by the people. National law thus has greater legitimacy than international standards. The application of different national and international standards to different projects under different contracts can also create inequalities among people in the same country, and challenges for the government agencies that monitor compliance.

International standards can provide a benchmark for national law making, however. In some countries, legislation has been used to effectively incorporate the content of specified international standards into national law (see Section 4.3).

Chapter outline

This chapter covers some recurring social and environmental concerns and the chief means used to address them: impact assessments, land rights and acquisition, labour rights, and environmental standards and liability. It does not cover everything: promotion of local development is another important issue, and while revenue sharing and job creation are discussed in Sections 3.3 and 3.4, local consultation issues are touched upon in Chapter 5.

Given the important role played by international standards in efforts to address social and environmental concerns, this chapter refers to some widely used standards, although there is not enough space to discuss all the relevant guidance. For instance, with regard to multilateral lenders, the chapter discusses the IFC Performance Standards, which have global relevance and are cross-referenced in the Equator Principles. It may be argued, however, that the standards developed by regional development banks may be more suitable in some cases insofar as they are tailored to specific regional contexts.

4.2 Environmental and social impact assessment

Key concepts

Environmental and social impact assessments (ESIAs) aim to assess the likely or potential impacts of a proposed project before the project is approved. They also identify alternatives to the option proposed and consider preventative or mitigating actions to minimise any impact identified.

Impact assessments are typically carried out in the early stages of the project cycle. They should result in the formulation of social and environmental management plans to be applied throughout project duration. Management plans identify how particular risks, such as an oil spill, would be dealt with during the project.

Legal requirements for impact assessments

Several environmental treaties require states to ensure that an environmental impact assessment is conducted before authorising activities that are likely to have significant environmental impact. For example, Article 14 of the Convention on Biological Diversity (CBD) commits states to introduce, 'as far as possible and as appropriate', 'procedures requiring environmental impact assessment of [...] proposed projects that are likely to have significant adverse effects on biological diversity'. The CBD has been ratified by virtually all countries in the world, with the notable exception of the United States (Morgera, 2013).

Some treaties specifically require or regulate impact assessments for projects that are likely to have an impact on the environment in other states or in areas beyond national jurisdiction. This includes the 1991 Espoo Convention on Environmental Impact Assessment in a Transboundary Context, which has been ratified by a number of countries in the northern hemisphere, and numerous treaties regulating shared watercourses.

It is worth noting that, even where these treaties do not apply, customary international law still requires all states to demand an environmental impact assessment for activities within their jurisdiction that are likely to cause environmental harm to other states. In the case *Pulp Mills on the River Uruguay (Argentina v. Uruguay)*, the International Court of Justice (ICJ) held that 'it may now be considered a requirement under general international law to undertake

an environmental impact assessment where there is a risk that the proposed industrial activity may have a significant adverse impact in a transboundary context', even if no treaty explicitly requires this.⁴⁰ Treaty provisions may still be useful to clarify specifics and procedures.

Impact assessments may also be required under international human rights law. In *Saramaka People v. Suriname*, the Inter-American Court of Human Rights found that the collective right to property of a tribal people had been violated because, among other things, the state had awarded timber and mining concessions without prior environmental and social impact assessment.

International environmental law tends to focus on environmental impact, while human rights law requirements have implications for both social and environmental impact assessments. Requirements in some environmental treaties have been interpreted broadly to also include the social impact, however. For example, the Conference of the Parties of the Convention on Biological Diversity has issued guidelines on how to carry out impact assessments where proposed projects affect indigenous peoples. These guidelines explicitly cover social and cultural as well as environmental impacts (Box 24). Social impacts are also likely to be of direct relevance to 'human rights due diligence', one of the core elements of the business responsibility to respect featured in the 2011 UN Guiding Principles on Business and Human Rights (see Boxes 22 and 25).

Box 24. Impact assessments and indigenous peoples: the Akwé: Kon Guidelines

In 2004, the Conference of the Parties of the Convention on Biological Diversity adopted the Akwé: Kon Voluntary Guidelines for the Conduct of Cultural, Environmental and Social Impact Assessment Regarding Developments Proposed to Take Place on, or Which are Likely to Impact on, Sacred Sites and on Lands and Waters Traditionally Occupied or Used by Indigenous and Local Communities.

The Akwé: Kon Guidelines provide guidance for states in the development of cultural, environmental and social impact assessment regimes where proposed projects affect indigenous peoples (Akwé: Kon Guidelines, Paragraph 1). They cover several important aspects of impact assessments. For instance, they provide that information should be disclosed in local languages and through means other than written materials.

The guidelines broaden the conventional scope of impact assessments to explicitly cover the cultural impact. This is defined as the 'process of evaluating the likely impacts of a proposed development on the way of life of a particular group or community of people, with full involvement of this group or community of people and possibly undertaken by this group or community of people' (Paragraph 6(a)).

The guidelines are not legally binding, but they could be used as evidence of best practice in legal or other proceedings. In the United Kingdom, authorities hearing complaints for alleged non-compliance with the OECD Guidelines for Multinational Enterprises (the 'National Contact Point' for the United Kingdom) have used the Akwé: Kon Guidelines as an international benchmark in a dispute involving indigenous people affected by mining operations in India (Morgera, 2013).

40. *Pulp Mills on the River Uruguay (Argentina v. Uruguay)*, para. 204.

Box 25. Human rights due diligence

According to the 2011 UN Guiding Principles, human rights due diligence is the process through which companies 'identify, prevent, mitigate and account for how they address their adverse human rights impacts' (Principle 17). The process 'should include assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses, and communicating how impacts are addressed'.

The human rights due diligence '[w]ill vary in complexity with the size of the business enterprise, the risk of severe human rights impacts, and the nature and context of its operations' (Principle 17). The commentary to the UN Guiding Principles clarifies that human rights due diligence can be included within broader enterprise risk-management systems, including impact assessment processes.

There is an increasing amount of guidance available on how to carry out human rights due diligence, for example in the petroleum industry (IPIECA, 2012b). Commentators have emphasised that the credibility of human rights due diligence depends on transparency and public scrutiny of company processes and claims (Harrison, 2013).

Since the early 1990s, many low and middle-income countries have adopted national legislation on environmental protection. In Africa these include Ghana's Environmental Protection Agency Act of 1994, Mozambique's Environment Act of 1997, Cameroon's Framework Law on Environmental Protection of 1996, and Senegal's Environment Code of 2001. These laws usually require an environmental impact assessment (EIA) for proposed projects that may have significant effects on the environment.

Sector-specific laws may also require impact assessments for all activities carried out under their provisions. For instance, Mali's Mining Code of 1999 and Cameroon's Petroleum Code of 1999 both require impact assessments for mining and petroleum-related activities, respectively. Where government authorities approve an impact assessment, they issue the environmental permits or licences needed to implement the project.

In many cases, national legislation still formally limits its requirements to the environmental rather than the social impact of activities. However, the scope of the impact assessments has been increasingly expanded, particularly to cover social impacts. As discussed in Chapter 2, investment treaties can include 'legality requirements' that would strengthen the effectiveness of national legislation prescribing impact assessments: investments made without carrying out a legally required impact assessment would not be protected by the investment treaty.

International guidance and standards

There are multiple sources of international guidance and standards on how to conduct social and environmental impact assessments. For example, Performance Standard No. 1 of the International Finance Corporation (IFC) deals with the 'Assessment and Management of Environmental and Social Risks and Impacts'. This standard applies to all IFC-financed projects that have environmental and social risks and impacts. It provides guidance on the integrated assessment of a project's social

and environmental impacts and risks, effective community engagement through disclosure of project information and local consultation, and the management of environmental and social performance throughout the life of the project.

Compliance with the IFC performance standard is also indirectly relevant to projects financed by lenders that have subscribed to the Equator Principles. This is because the Equator Principles effectively extend the application of IFC Performance Standard No. 1 to signatory banks (Equator Principles, Principle 3).

Where they apply, the OECD Guidelines for Multinational Enterprises call on enterprises to develop environmental management systems to assess and control their environmental impacts, integrate environmental considerations into their business operations and progressively raise the level of environmental performance in all parts of their operations (Chapter VI of the OECD Guidelines).

Making impact assessments work

In practice, the implementation of impact assessment requirements is often marred by difficulties. The involvement of multilateral lenders or of well-established companies tends to be a force for good in impact assessment processes. On the other hand, there have been many reports of shortcomings in impact assessments, including flagrant violations of legal requirements, for example in relation to large-scale land acquisitions for agricultural investments (see Box 12 in Chapter 3).

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Recurring problems include inadequate company systems and expertise, lack of institutional capacity in the government agencies that scrutinise impact studies and subsequently monitor compliance with management plans, and weak negotiating power of environmental agencies with other ministries when it comes to investment decision making.

While methodologies for environmental impact assessments are increasingly robust, social impact assessments are newer and less established, although growing amounts of guidance is becoming available (for example Interorganizational Committee on Guidelines and Principles for Social Impact Assessment, 1994; Dalal-Clayton and Sadler, 2012).

The right accountability and incentive structures are critical to effective assessments. Impact studies are often financed by the investor, creating potential conflicts of interest. Government authorities can ensure rigorous impact assessments by scrutinising drafts submitted by the investor and also by demanding use of internationally recognised experts. Having multilateral lenders finance impact assessments can also help to increase the independence of the exercise.

Investments in agriculture and extractive industries are typically implemented over a long timeframe. It is important that any permits or licenses issued reflect the recommendations included in impact assessment studies or in separate

management plans based on those studies. Best-practice permits can include detailed conditions (for instance, to safeguard groundwater resources or regulate waste management), either directly or through reference to the management plans.

It is important that government authorities have the power to monitor compliance and withdraw or suspend permits in case of non-compliance (see Section 4.5). It is also important that the government agency mandated with approving impact assessments and monitoring compliance during project implementation is properly resourced, equipped with the full range of skills needed (including to deal with social impacts), and backed up by strong political support at the highest level of government.

If affected people and concerned citizens can participate meaningfully in the ESIA process, it can help to ensure that the impact assessment identifies and addresses all relevant issues. National law may explicitly require local consultation and public participation in ESIA exercises, and public disclosure of ESIA documentation. Citizens and civil society can also play an important role in scrutinising impact studies (Box 26), and in monitoring subsequent compliance with social and environmental management plans.

Box 26. Legal tools for civil society scrutiny of impact assessments

Depending on the country context, EIA/ESIA legislation may provide important opportunities for civil society scrutiny and participation. The earlier civil society gets involved, the more effective its participation will be – ideally, even at the screening stage.

Many laws require draft EIA/ESIA documentation to be made available for public review, and allow the public to make written comments and participate in public hearings. Citizens should feel comfortable insisting that documentation be made accessible, including any documents that are cited in the EIA/ESIA. Usually, comments must be provided within a specified timeframe – although for complex EIA/ESIAs civil society might be able to obtain an extension from competent government authorities.

Submitting comments and attending public hearings provide opportunities to raise concerns. Such actions can also strengthen the case of a civil society organisation that subsequently decides to seek administrative or judicial review of the final EIA/ESIA, because that organisation can prove that it had raised its concerns when given an opportunity to do so.

If the government agency approves the EIA/ESIA and issues environmental permits, dissatisfied citizens could seek administrative review of the decision. Administrative review involves bringing the matter to higher-level government bodies, for example to claim that the process was flawed or some impacts were not duly considered. This process can be simpler than judicial review, but it can also be frustrating if corruption or other improper behaviour at a higher level were involved.

Citizens may also seek judicial review of the decision to issue permits if the national law allows. This means taking the case to court. The courts would establish whether the EIA/ESIA complied with legal requirements. Practical and legal barriers may constrain this route. For example, in some countries civil society organisations are not deemed to have ‘standing’ (sufficient legal interest) to bring the case, though some national laws explicitly allow civil society to bring cases in the public interest.

Source: ELAW, 2010.

Ensure that impact assessments have teeth

Both governments and civil society organisations have a role to play in making sure impact assessments are effective. Governments can:

- Require thorough social and environmental impact assessments of proposed investments when all options are still open, based on local consultation and public participation.
- Add legal bite to national legislation by negotiating 'legality requirements' in investment treaties, thus restricting legal protection to investments made in compliance with national law.
- Establish institutions mandated with scrutinising impact assessments and monitoring compliance during project implementation. For these institutions to be effective, they must be properly resourced and backed up by strong political support.
- Push for rigorous impact assessments by demanding use of internationally recognised experts, involving multilateral lenders in the financing of the deal and scrutinising drafts submitted by the company.
- Ensure that any permits reflect the recommendations of the impact assessments, and empower the authorities to monitor compliance and withdraw or suspend the permit in case of non-compliance.

Civil society organisations can:

- Remind governments of their legal duty to require the conduct of impact assessments.
- Scrutinise social and environmental impact assessments by demanding disclosure of documentation, participating in public hearings, making written comments and seeking administrative or judicial review of government decisions. Monitor subsequent compliance with the recommendations embodied in impact studies.
- Hold businesses to account, including for their responsibility to respect human rights, and including by benchmarking business practice against the extensive international guidance on how to handle social and environmental issues.

4.3 Land rights and acquisition

Why land rights matter

Land acquisition is a major bone of contention in many natural resource investments. Taking land to enable project implementation can have a devastating impact on people, particularly where they depend on land for their livelihoods. In many countries, land also has strong cultural and spiritual connotations, and it provides the basis for social identity. Issues concerning land acquisition tend to arise in the early stages of project implementation, at the land clearance and construction stages. But new land issues may arise later, for example if the project area is extended.

Where agriculture or extractive industry projects involve the acquisition of local land rights, fundamental human rights may be at stake. The taking of land may trigger the application of the legal safeguards protecting the human right to property. This right is recognised by Article 17 of the UDHR, Article 21 of the ACHR and Article 14 of the ACHPR. Depending on applicable law, these safeguards include due process, non-discrimination, public purpose and compensation.

Indeed, the Inter-American Court of Human Rights and the African Commission on Human and Peoples' Rights have consistently held that the collective, customary land rights of indigenous and tribal peoples are protected by the right to property – even in the absence of formal titles or legal recognition under national law.⁴¹ States must ensure that any interference with these rights comply with the safeguards attached to the right to property.

Other human rights are also at stake. Where people depend on land for their food security, for example, they cannot realise their right to food without effective protection of their land rights. The right to food is recognised by Article 25 of the UDHR and Article 11 of the ICESCR.⁴² The International Labour Organization's Convention No. 169 of 1989 Concerning Indigenous and Tribal Peoples in Independent Countries protects the land and resource rights of indigenous and tribal peoples (see Section 5.2).

International guidance also points to the need to protect land rights affected by investment projects. The Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security, endorsed by the FAO Committee on World Food Security in 2012, call for the protection of all legitimate tenure rights that may be affected by decisions about large-scale agricultural investments (Article 12).

It is important to factor in land issues in the early stages of a project because project design can substantially affect the nature and extent of land acquisition. In agriculture, for example, large-scale land acquisitions for plantation farming have triggered much debate about 'land grabbing'. Designing agricultural projects so that the investment focuses on processing and sources produce from local farmers would minimise land acquisition, though these models may also raise other challenges (see Box 12 in Chapter 3).

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Improving legal recognition of local land rights

In many low and middle-income countries, legislation vests land ownership with the state, and grants the government legal authority to allocate land to investors. Many farmers, herders and foragers access land through 'customary' or other local systems of land tenure. National law may formally protect these local land rights but they are often construed as conditional use rights, rather than ownership.

Depending on the jurisdiction, the land rights held by people affected by natural resource investments may be undermined by legal and practical factors. For example, legal protection of local land use rights is often subject to evidence that the land is being used productively. This can undermine local claims to

41. See for example *Mayagna (Sumo) Awas Tingni Community v. Nicaragua*, *Saramaka People v. Suriname*, and *Centre for Minority Rights Development and Minority Rights Group International on behalf of Endorois Welfare Council v. Kenya*.

42. On the implications of the right to food for large-scale agricultural investments, see 'Large-Scale Land Acquisitions and Leases: A Set of Minimum Principles and Measures to Address the Human Rights Challenge', developed in 2009 by the UN Special Rapporteur on the Right to Food.

rangelands, hunting-gathering grounds or sacred sites, which often account for a large share of local landholdings (Alden Wily, 2011).

Legal protection of local land rights is also often weakened by wide powers of eminent domain, whereby commercial investments are considered to be for a public purpose. This enables the government to acquire land even against the will of landholders ('compulsory acquisition').

In many low and middle-income countries, few rural people hold formal documentation for their land. Much land is not titled, and land titles may only have been issued to local or national elites, who have the information, resources and relations necessary to navigate often cumbersome administrative procedures (see for example Djiré, 2007, writing on Mali). So it may be difficult for affected people to prove that a piece of land is theirs.

Finally, legal protection may be undermined by inadequate social impact or local consultation requirements, and by weak compensation requirements. For example, compensation may be limited to 'improvements' such as trees and crops, to the exclusion of land values.

This legal context is a recurring source of tensions in natural resource investments. Weak land rights expose local groups to the risk of dispossession and investors to contestation and conflict. Affected people may mobilise against a project even if the investor has complied with applicable rules and was lawfully granted land rights by the government.

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For both government and investors, recognising local land claims is critical to preventing conflict and promoting local support for the project. Depending on the country, this may require legal reform to strengthen local rights, and more effective enforcement of existing laws.

Indeed, the implementation of land legislation is very limited in many low and middle-income countries, particularly in rural areas. This may be due to government agencies lacking financial resources and institutional capacity, lack of legal awareness among the rural population, formal or informal socio-political deals between the state and customary authorities, and, often, a lack of perceived legitimacy of official rules and institutions.

Law reform and implementation can go hand in hand. Legislation that protects local land rights can be drafted in ways that facilitate its implementation. For example, recognising that many rural people will continue to access land on the basis of undocumented customary rights and that national law can only work if it builds on local practice, some innovative land laws protect customary land rights even if they are not formally registered, and grant customary rights the same legal protection available to land rights issued by the state. Examples of these include the Land Act of 1997 in Mozambique and the Village Land Act of 1999 in Tanzania (Knight, 2011).

Strengthening safeguards against compulsory acquisition

Legal safeguards against compulsory acquisition are particularly important in the context of natural resource investments. FAO (2008) provides detailed guidance on these safeguards. Governments and civil society can demand that social impact assessments (see Section 4.2) include a thorough analysis of the impacts that any land acquisition would have, and of options to minimise land acquisition (FAO, 2008). Legislation can require that impact assessments be undertaken with the participation of affected landholders (FAO, 2008).

Safeguards can also be strengthened through tighter requirements that clearly define the notion of ‘public purpose’ and that enable judicial review of government decisions (FAO, 2008). Use of compulsory acquisition to make land available for commercial investments requires particular public scrutiny (FAO, 2008), and Section 5.2 below discusses the principle of ‘free, prior and informed consent’ as a basis for land acquisition.

Safeguards against land acquisition need to cover all land and resource rights perceived to be legitimate in a given context, including rights falling short of formal ownership. Where land is held communally, safeguards are also needed to ensure that compensation packages are distributed fairly within the group and reach all the people affected by the project.

There is a difference between compensating for lost assets and restoring livelihoods to pre-project levels (Cernea, 1997). Cash compensation based on market value may achieve the former, but not necessarily the latter. Assets critical to local livelihoods may have low monetary value, and compensation may not enable people to restore their livelihoods due to market imperfections.

Therefore, in line with the approach taken by some lender policies (Box 27), national law can require authorities to minimise compulsory acquisition, and link cash payments or in-kind compensation (such as the provision of alternative land) to what is needed to restore the livelihoods of affected people to a position that is better than their position pre-acquisition, or at least equivalent to it.

In Laos, for example, Decree No. 192 of 2005 effectively integrates into Lao law the key tenets of IFC Performance Standard No. 5 (Box 27), with some variants, although there have been shortcomings in the implementation. This is one way international standards can provide a benchmark for national law making.

Under international human rights law, evictions must be carried out lawfully; should only take place in exceptional circumstances; must be based on due process, genuine consultation and adequate compensation; and must be in full accordance with applicable international law. There is a strong presumption that forced evictions violate human rights law.⁴³ Finally, it is essential that people who feel wronged by land acquisition have access to effective appeal systems (FAO, 2008).

43. These principles are stated in General Comment No. 7 of 1997 on The Right to Adequate Housing: Forced Evictions, developed by the UN Committee on Economic, Social and Cultural Rights; and the Basic Principles and Guidelines on Development-based Evictions and Displacement, developed in 2007 by the UN Special Rapporteur on the Right to Housing.

Box 27. Minimising resettlement and linking compensation packages to livelihood restoration: IFC Performance Standard No. 5

IFC Performance Standard No. 5 on Land Acquisition and Involuntary Resettlement calls for the minimisation of involuntary resettlement, with preference to be given to negotiated settlements over compulsory takings. Resettlement is defined very broadly to cover both physical and economic displacement, including land acquisition and restrictions on land access or resource use.

The standard also calls for the improvement or at least restoration of the livelihoods of the affected people to pre-project levels, through compensation at full replacement cost and additional assistance as required, and for suitable systems to deal with grievances.

Source: IFC Performance Standards on Environmental and Social Sustainability.

Action by governments and civil society

The government plays a central role in establishing the systems and processes discussed in the previous section. But civil society action can also make a difference. Many civil society organisations are helping affected people to defend land rights squeezed by natural resource investments, through means such as awareness raising via rural radios (Goïta and Coulibaly, 2012), legal literacy trainings for community 'paralegals' (Knight *et al.*, 2012; Box 28), participatory land use mapping (Nguiffo and Djeukam, 2008) and public interest litigation to challenge resettlement or compensation packages (Dhliwayo, 2013).

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Civil society organisations can also help villagers to use existing grievance mechanisms, and they can 'help to identify viable, cost-effective alternatives to the project that avoid or minimise disruption to the community' (FAO, 2008:51).

Box 28. 'Barefoot lawyers' in the Philippines: using community paralegals to help protect the land rights of people affected by mining

In 1995, a new Mining Act in the Philippines made the national context more attractive for mining companies. For example, the law allowed 100 per cent foreign ownership of operating companies. This triggered renewed momentum in mining operations, exacerbating a squeeze on local land rights. Progressive legislation protects the land rights of indigenous peoples, but implementation faces challenges (see Box 31).

Civil society organisations have been supporting communities affected by mining. One approach to protect local land rights is to train community paralegals. Paralegals are literate community members trained in basic aspects of the law (such as the constitution, human rights, land law and indigenous peoples' rights) and in the use of legal and advocacy tools.

Paralegals work in a number of ways: disseminating information in their communities, supporting the creation of community petitions against mining operations, and liaising with government agencies to obtain documents and make inquiries. Their work appears to have prevented evictions and enabled local landholders to have more of a voice.

Source: Rebuta *et al.*, 2012.

Provide strong legal protection for land rights

- Factor land issues into the early stages of a project because the project design can substantially affect the nature and extent of land acquisition.
- Failure to deal with land issues properly can expose investment projects to protracted contestation – even if the project benefits the national economy. This means that strong legal protection of local land rights will not necessarily deter investors, as many prefer to deal with people who have clear and uncontested title.
- Protect local land rights, including customary rights, irrespective of their formal registration, to help secure land rights where access to official procedures is constrained.
- Ensure that social impact assessments include a thorough, participatory analysis of the impacts that any land acquisition would have, and options to minimise land acquisition.
- Ensure that safeguards against land acquisition cover all land and resource rights perceived to be legitimate in a given context including rights falling short of formal ownership. They should also feature strong public purpose, due process, consultation and compensation requirements; ensure that compensation packages are distributed fairly and reach affected people; and provide effective systems for appeals and judicial reviews.
- National legislation can establish rules requiring authorities to minimise compulsory acquisition, and link compensation to what is needed to improve livelihoods or at least restore them to pre-project levels, rather than simple cash compensation.
- Civil society organisations can help to secure local land rights by using rural radios, paralegals, public interest litigation and access to international human rights bodies. They can also help to identify alternatives to the project that would avoid or minimise land acquisition.

4.4 Labour rights

Jobs are often one of the most prominent benefits that companies and governments promise when they sign contracts for investments in agriculture and extractive industries. Section 3.4 touched on performance requirements, including those promoting employment creation. But jobs can only be beneficial if labour standards are upheld. While land issues primarily arise in the construction phase, labour issues are relevant throughout the duration of an investment project.

Labour rights under national law

Labour rights are mainly regulated by national law. For example, many constitutions protect the right of freedom of association, and some make explicit reference to the right of workers to form or join a trade union of their choosing. Many constitutions also affirm fundamental rights concerning employment conditions.

Natural resource investments raise specific labour issues, and they may be excluded from the application of general labour legislation. For example, temporary, seasonal or casual workers tend to account for a large share of the agricultural labour force. These workers often face legal and practical challenges in joining trade unions or exercising labour rights. In fact, some national laws still exclude agriculture from the application of legislation on freedom of association

and collective bargaining (International Labour Office, 2008). Outgrowers – independent farmers contracted to supply the company – are also usually outside the protection of labour law, although some countries have adopted or announced legislation specifically aimed at protecting the rights of contract farmers.

Harnessing international labour standards

International treaties oblige states to bring their legislation in line with minimum international standards. The International Labour Organization (ILO) has developed many international treaties (called conventions) that cover a wide range of issues – from freedom of association and collective bargaining to child labour or discrimination, through to health and safety, working time and social security.

Some conventions regulate specific industries or economic activities (such as the poorly ratified Plantations Convention), or protect the rights of particularly vulnerable groups such as migrant labourers. ILO member states must submit regular reports on implementation to the ILO Committee of Experts on the Application of Conventions and Recommendations.

ILO conventions are binding on the states that have ratified them. In addition, the 1998 ILO Declaration on Fundamental Principles and Rights at Work affirms the core principles and rights that all ILO member states must observe by virtue of their membership – irrespective of whether they have ratified the relevant conventions. These core principles and rights include:

- Freedom of association and the effective recognition of the right to collective bargaining (see ILO Conventions No. 87 of 1948 and 98 of 1949, which affirm the right of workers to establish and join trade unions of their own choosing, prohibit anti-union discrimination and interference, and promote collective bargaining to determine employment conditions).
- Elimination of all forms of forced or compulsory labour (see ILO Conventions No. 29 of 1930 and 105 of 1957).
- The effective abolition of child labour (see ILO Conventions No. 138 of 1973 and 182 of 1999).
- The elimination of discrimination in respect of employment and occupation (see ILO Conventions No. 100 of 1951 and 111 of 1958, which require states to eliminate discrimination in access to employment and in employment conditions on the basis of race, colour, sex, religion, political opinion, national extraction and social origin).

However, while the declaration refers to an ‘obligation’ for all member states to respect, promote and realise these rights, there are no legal mechanisms to enforce compliance. Rather, follow-up is centred on periodic reports submitted by governments to the ILO Committee of Independent Expert Advisers.

In addition to its implications for all ILO member states, the ILO Declaration is explicitly referred to in the UN Guiding Principles on Business and Human Rights (Box 22) as being part of the internationally recognised human rights which the business has a responsibility to respect.

Leveraging the OECD Guidelines for Multinational Enterprises

Where they apply, the OECD Guidelines for Multinational Enterprises provide guidance on labour relations. Chapter V echoes the 1998 ILO Declaration, calling on companies to uphold the four core principles and rights enshrined in the declaration. But the OECD Guidelines also go beyond the scope of the 1998 ILO Declaration.

Indeed, the OECD Guidelines contain provisions on employment conditions, for example calling on companies to provide ‘the best possible wages, benefits and conditions of work [...] related to the economic position of the enterprise [...but...] at least adequate to satisfy the basic needs of the workers and their families’ (Paragraph V(4)(b)). The guidelines also call on companies to employ and train local labourers ‘to the greatest extent practicable’, and to provide ‘reasonable notice’ for changes that entail collective dismissals (Paragraphs V(5) and (6)).

Trade unions and non-governmental organisations have brought complaints to the National Contact Points established to oversee compliance with the OECD Guidelines, as a way of promoting compliance with the guidelines (Box 29).

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Box 29. Taking labour issues to OECD National Contact Points

On several occasions, trade unions and non-governmental organisations have taken alleged violations of labour standards to the National Contact Points (NCPs), which are the national institutions that oversee compliance with the OECD Guidelines for Multinational Enterprises. Complaints can be filed with the NCP in the host country, or in the investor’s (or the buyer’s) home country. In at least one case, the company was a downstream buyer (a major cotton trader), rather than the producer directly engaged in the alleged violations.

Complaints typically allege non-compliance with the provisions of the guidelines that deal with labour standards. In at least one case, the NCP complaint followed unsuccessful court litigation in the host country (Malaysia).

In several cases, the complaint led to conciliation between company and complainants and the complainants dropped the complaint after having been satisfied by the company’s handling of their concerns.

Where conciliation failed, NCPs investigated the merits of the allegations. Where they found breaches of the OECD guidelines, they made recommendations on ways to address the shortcomings and required follow-up reporting.

Source: Statements by National Contact Points for the OECD Guidelines for Multinational Enterprises. OECD website. <http://www.oecd.org/daf/inv/mne/ncpstatements.htm>.



Photo: Mikkel Ostergaard / Panos Pictures

Do not drop labour standards – the benefit of new jobs is negligible if labour rights are not upheld

Dealing with labour issues in investment treaties

Some recent investment treaties have responded to concerns in richer countries about companies moving overseas in search for lower labour standards by including references to labour standards. For example, the most recent model investment treaty of the United States reaffirms the parties' commitment to the ILO Declaration on Fundamental Principles and Rights at Work. The US model investment treaty also requires each party to ensure that it will not derogate from, or fail to enforce, its labour laws as part of efforts to attract foreign investment. However, this obligation only applies to non-derogable labour rights – namely, those affirmed in the ILO Declaration, and the right to acceptable conditions of work.

Creating effective enforcement mechanisms for these investment treaty provisions is problematic. Because the norms are not designed to benefit foreign investors, they are unlikely to be enforced through the investor-state arbitration system (Section 2.4). In addition, the US model investment treaty provides that state-to-state arbitration does not apply to matters arising from the provision on labour standards. Where a state party deems a violation to have occurred, it can only seek consultations with the other state party.

4.5 Environmental protection

Environmental standards, agencies and liability

Large natural resource projects are often associated with major environmental impacts, for example through forest clearances, the use of fertiliser in agriculture or cyanide in mining. It is therefore important that legal arrangements are in place to prevent and remedy environmental harm.⁴⁴

The 1992 Rio Declaration on Environment and Development calls on states to adopt 'effective environmental legislation' (Principle 11), including legislation to regulate liability and compensation (Principle 13). Section 4.2 covered the requirement for the investor to conduct an environmental impact assessment before project approval. National law will also define the environmental rules that an investment project must comply with, such as restrictions on the use of certain chemicals or requirements for certain working methods or techniques to be used. Special rules may apply in environmentally sensitive areas. Further specific conditions applicable to an individual project may also be defined in the project's permit or licence.

Government institutions responsible for adopting regulatory measures are equally important. These issue environmental permits, monitor compliance and sanction non-compliance. Depending on the country, this could be a ministerial department or an independent environmental protection agency.

For environmental agencies to be effective, they must be equipped with wide-ranging powers of inspection and investigation, including the power to enter premises, access records, take samples and measurements, and seize evidence. They must also be empowered to issue warnings and mandatory orders to prevent, stop or remedy damage, backed up by credible administrative and criminal sanctions.

The rules regulating legal liability are particularly important in preventing and remedying environmental harm. Some international treaties regulate liability for environmental harm in specific contexts. For example, rules on liability for oil pollution are set by the 1992 International Convention on Civil Liability for Oil Pollution Damage, the 1992 International Convention on the Establishment of an International Fund for Compensation for Oil Pollution Damage, and the 2001 International Convention on Civil Liability for Bunker Oil Pollution Damage.

In most situations, however, the terms of liability are determined by national law. The Rio Declaration affirms the 'prevention' principle, which requires avoiding or minimising adverse environmental impacts (do no harm), and the 'polluter pays' principle, which requires that the costs of environmental degradation should be borne by the operator responsible for it (see Principle 16 of the Rio Declaration).

44. On environmental protection in natural resource projects, see Tienhaara (2009, 2011).



Photo: Paul Smith / Panos Pictures

Environmental impacts are best assessed before a project is approved, with management plans then drawn up and applied accordingly

A corollary of the prevention principle is the existence of legal arrangements that empower government authorities to require the investor to take preventative measures in case of imminent threat of environmental damage. It is also important that legislation empowers authorities to require remedial action if environmental harm has already occurred. This could include, for example, doing works, treating land, removing contaminants or planting trees.

In line with the polluter pays principle, national law can require the investor to bear the costs of preventative or remedial measures – either because the investor executes the measures directly, or, failing that, because authorities take measures and recover costs from the investor. National law may require companies to obtain insurance for environmentally risky activities.

Citizens and civil society can bring environmental threats or harm to the attention of government authorities, and invite authorities to investigate and take action. Legislation can grant citizens and civil society the right to seek judicial review if the government refuses to act, and also the power directly to seek injunctions and damages in the public interest against the investor if the government fails to do so.

Private parties that have been adversely affected by environmental harm may also be able to bring claims ('civil liability'). This may include, for example, people whose property, health or livelihoods have been adversely affected by water pollution, fumes or other environmental degradation. National law may allow private parties to seek preventative injunctions, restoration orders and compensation.

A key issue is whether companies are liable only for environmental harm caused by their negligence (fault-based liability), or whether strict liability applies. Under a strict liability regime, the investor is liable for any environmental harm caused by its activities, even if there is no evidence that the investor acted negligently. The investor could only escape liability if it could prove that a defence specified in the legislation applies, such as damage caused by an armed conflict or natural disaster.

Proving negligence is often very difficult for both environmental agencies and affected people. Therefore, a strict liability regime makes it easier for authorities to enforce remedial action and for third parties to obtain compensation, though for the same reason it can also increase business costs.

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In some jurisdictions, legislation applies strict liability for specified hazardous activities such as the disposal of extractive industry waste, and fault-based liability for other activities. Different standards of liability may apply to enforcement actions by regulatory authorities and to civil liability activated by private parties.

In natural resource investments, the management of environmental issues is not limited to the duration of the project. After it ends, materials in the project site may be a continuing source of pollution. In some cases, such as open-cast mining, the very nature of the project can require action to restore the environment to its pre-project state once activities have been completed. Legislation or the authorities may set rules for managing project closure ('decommissioning'). Environmental permits may include restoration conditions and require the investor to provide securities as a guarantee in case of environmental harm.

Environmental protection in investment treaties

If not properly thought through, environmental measures by administrative or judicial authorities can expose the host government to legal liabilities. Some recent investor-state arbitrations have ultimately been rooted in action taken by national courts or government agencies over alleged environmental violations (Tienhaara, 2009).

For example, a complex and high-profile dispute between a US oil company and the government of Ecuador has involved lawsuits before multiple national and international bodies. These include a class action by people claiming to have been adversely affected by environmental damage caused by the project (an action brought against the company first in the United States and then in Ecuador) and an investment arbitration filed by the company against the host state, arguing that the court judgment awarding substantial damages to the Ecuadorian plaintiffs violated Ecuador's obligations under an applicable investment treaty (*Chevron and Texaco v. Ecuador*).

Some recent investment treaties contain explicit references to environmental standards. For example, some treaties that prohibit performance requirements (see Section 3.4) nonetheless allow requirements for investors to use technology that meets environmental specifications, provided that these 'environmental performance requirements' are not applied in an arbitrary manner.⁴⁵ These requirements could be included in national law or an environmental permit, for example.

Some investment treaties also contain provisions responding to concerns in richer countries that companies may move overseas in search for lower environmental standards. Some of these provisions are framed as 'best efforts' clauses that do not create legal obligations. For example, recent treaties signed by Canada state that the parties 'should' not derogate from environmental measures to attract investment.⁴⁶ As can be seen, the language of this provision is not mandatory.

Other provisions are formulated in mandatory terms. For example, the most recent US model investment treaty provides that each party 'shall' ensure that it does not derogate from, or fail to enforce, its environmental laws as part of efforts to attract foreign investment. Even so, as with labour standards provisions, enforcement is centred on consultations and 'mutually satisfactory' solutions among the parties.

Indeed, as with all norms which are not designed to benefit foreign investors, such environmental provisions are unlikely to be enforced through the investor-state arbitration system. The US model investment treaty provides that state-to-state arbitration does not apply to matters arising from the provision on environmental standards. Where a state party deems a violation to have occurred, it can only seek consultations with the other parties.

Importantly, the US model investment treaty also recognises the discretion of government authorities in relation to 'regulatory, compliance, investigatory, and prosecutorial matters' relating to the environment. This provision can help to shelter states from investor claims that government action discriminated against them (Johnson, 2012).

45. See for instance Article 8(3)(c) of the US-Uruguay BIT of 2005.

46. See for instance Article 15 of the Benin-Canada BIT of 2013.

Ensure that labour and environmental standards are upheld

There is much that governments and civil society can do to ensure that natural resource investments uphold labour and environmental standards. Governments can:

- Enact and enforce labour and environmental laws to ensure compliance with international obligations, to manage environmental risks and to promote respect for rights affecting labour relations and employment conditions.
- Regulate labour and environmental issues arising over the entire duration of investment projects – from inception to decommissioning.
- Establish, resource and empower government agencies to monitor compliance and sanction non-compliance. Effective institutions need appropriate powers of inspection, investigation and sanction, and strong political support at the highest level of government.
- Protect the diverse labour rights of multiple groups, for example permanent and temporary workers, and in agriculture the rights of contract farmers and their labourers.
- Give government agencies powers to prevent environmental damage and to take or require remedial action if damage occurs. Establish clear and robust liability rules for environmental damage.
- Ensure that investment treaties allow policy space for public action to promote and enforce labour and environmental standards.

Civil society can:

- Harness international treaties and instruments in their advocacy to push for higher labour and environmental standards.
- Monitor compliance, bring violations to the attention of government agencies, and where appropriate seek judicial review if government refuses to act.
- Use national and international recourse mechanisms to denounce violations and help affected people obtain redress (Section 5.5).

Useful online resources

- ELAW. 2010. *Guidebook for Evaluating Mining Project EIAs*. Environmental Law Alliance Worldwide (ELAW), Eugene.
<http://www.elaw.org/files/mining-eia-guidebook/Full-Guidebook.pdf>.
- FAO. 2008. *Compulsory Acquisition of Land and Compensation*. Food and Agriculture Organization of the United Nations (FAO), Rome.
<http://www.fao.org/docrep/011/i0506e/i0506e00.htm>.
- ICMM. 2012. *Human Rights, Social Development and the Mining and Metals Industry*. International Council on Mining and Minerals (ICMM).
<http://www.icmm.com/human-rights-social-development-and-the-mining-and-metals-industry>.
- Interorganizational Committee on Guidelines and Principles for Social Impact Assessment. 1994. *Guidelines and Principles for Social Impact Assessment*. U.S. Department of Commerce National Oceanic and Atmospheric Administration, National Marine Fisheries Service.
http://www.nmfs.noaa.gov/sfa/social_impact_guide.htm.
- IPIECA. 2012a. *Voluntary Principles on Security and Human Rights: Implementation guidance tools*. International Petroleum Industry Environmental Conservation Association (IPIECA), London.
<http://www.ipieca.org/publication/voluntary-principles-security-and-human-rights-implementation-guidance-tools>.
- IPIECA. 2012b. *Human Rights Due Diligence Process: A practical guide to implementation for oil and gas companies*. IPIECA, London.
<http://www.ipieca.org/publication/human-rights-due-diligence-process-practical-guide-implementation-oil-and-gas-companies>.
- IPIECA. 2004. *A Guide to Social Impact Assessment in the Oil and Gas Industry*. IPIECA, London. <http://www.ipieca.org/publication/guide-social-impact-assessment-oil-and-gas-industry>.

Placing people at the centre of investment processes

5.1 A fundamental shift in perspective

Principle 1 of the 1992 Rio Declaration on Environment and Development places people at the centre of the development process. Giving real meaning to this statement requires more than just managing the risks of prevailing investment patterns. Fundamentally, it means ensuring that public decisions on investment respond to a bottom-up, strategic vision of sustainable development, based on local and national aspirations. In other words, it requires democratising the processes governing investment flows and strengthening the governance and effectiveness of these processes.⁴⁷

Most of the discussion about investment is framed in macro-level, top-down terms. Many governments treat as a given the need to attract as much investment as possible, and do not question current patterns of investment. In progressive circles, the question is usually how to ensure that local people benefit from those investment flows. Better practice in agricultural and extractive industry investments involves the consultation of affected people before implementing a project. But time pressures and power imbalances tend to affect the quality of consultations for individual projects (Polack *et al.*, 2013).

The technical discussion in Chapters 2 to 4 aims to support government and citizens in getting the best possible deal in these circumstances. But top-down investment that trumps local and national aspirations is bad news even if it embodies a generous fiscal regime, or if it applies decent social and environmental standards.

In order to consider investment quality rather than quantity, policy makers need to depart from top-down approaches, and place people at the centre of investment processes. People should not have to wait until an investment project comes in before they are enabled to have their say. Rather, inclusive deliberation should be part and parcel of the development process, and it should form the basis for public decisions on investment (Polack *et al.*, 2013).

In agriculture, for example, key questions for inclusive deliberation at both local and national levels would include:

- What sort of agricultural development do people aspire to pursue, including what balance between small, medium and large-scale farming?

47. On the nexus between democracy and sustainable development, see the work of the Foundation for Democracy and Sustainable Development – particularly its Manifesto for Democracy and Sustainability, which was launched in March 2013 (FDSD, 2013).

- What assets and capabilities can people build on to pursue that vision, and what are the main constraints?
- Can commercial operators help to address these constraints, and what types of investment would best respond to the shared development vision?
- What measures are needed to promote and regulate these investments?

This bottom-up approach involves a fundamental shift from treating people as passive recipients of investment flows, or at best negotiators reacting to local consultation exercises, and instead places their aspirations centre stage. Such an approach would not only promote investment models that reflect local and national aspirations, it would also increase the legitimacy of investment processes locally. Some countries have adopted policies and framework laws that incorporate elements of this bottom-up approach (Box 30).

Multiple tensions and complexities are involved. Local ‘communities’ are typically highly diverse with different interests, power and aspirations. Any decision-making process would need to develop ways to balance and mediate competing local voices. Managing relations between the local and the national often involves trade-offs between respecting the rights and voices of those who are likely to be directly affected by investment processes on the one hand, and the imperative for government to pursue national development strategies that also consider the needs of other less well-endowed parts of the country, on the other.

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Very importantly, any given country is likely to have competing visions of development, reflecting different worldviews and interests, and held by diverse social groups and opposing political forces. A country’s long-term development trajectory can be the object of much contestation and struggle. The positions of government and civil society may not be aligned – and in countries where government is authoritarian and political space restricted, opposition to top-down decision-making can expose civil society to repression (Polack *et al.*, forthcoming).

Legal tools can help governments to show leadership by facilitating the emergence of a bottom-up vision of national or sectoral development. Citizens can exercise their legal rights to help shape their country’s future. Producer organisations and trade unions can use legal tools to help their members to have a strong voice in the process. And non-governmental organisations can use legal tools to scrutinise and influence strategic choices, and support weaker groups.

This chapter discusses the use of legal tools to democratise investment processes. It concentrates on the legal tools for inclusive deliberation, transparency and public scrutiny, anti-corruption measures, and remedies for redress and accountability. Although the chapter focuses on the relevant laws, this is not to suggest that legal norms are the only or even the most important factor in a democratic process. The nature of the government, how much political space there is for opinion and dissent, and the capacity of citizens to mobilise and take collective action in often difficult political terrains typically matter more than

poorly implemented legislation – although effective legal tools can increase the leverage of well-organised citizens.

5.2 Legal tools for inclusive deliberation

Rights of democratic participation

A large number of legal norms influence the space for inclusive deliberation on investment issues – many more than it is possible to review here. A country's constitution determines the formal rules for public participation in decision making, including the mechanisms for choosing legislators and the instruments for holding decision makers to account (such as in the relationship between government and parliament, and between government and parliamentarians, on the one hand, and citizens, on the other). The constitution also determines the degree of protection of the human rights which are indispensable to the exercise of active citizenship, including freedom of expression, assembly and association.

In many low and middle-income countries, new democratic constitutions adopted since the early 1990s have provided new openings for public participation in decision making. In practice, however, the degree of political openness varies significantly between jurisdictions, even in countries that formally have democratic constitutions.

International human rights treaties affirm fundamental rights that are relevant to public participation – including the right of citizens to vote and, in addition, 'to take part in the conduct of public affairs, directly or through freely chosen representatives' (Article 25 of the International Covenant on Civil and Political Rights).⁴⁸ The UN Human Rights Committee, which oversees implementation of the covenant, has clarified that this right 'covers all aspects of public administration, and the formulation and implementation of policy at international, national, regional and local levels' (General Comment No. 25 of 1996, Paragraph 5).

The UN Human Rights Committee also clarified that, in addition to voting rights, citizens can take part in public affairs in other ways, including 'by exerting influence through public debate and dialogue with their representatives or through their capacity to organize themselves. This participation is supported by ensuring freedom of expression, assembly and association' (Paragraph 8 of General Comment No. 25).

Under environmental law, so-called 'procedural rights' can give the public opportunities to influence decision making. These rights are usually defined to include access to information, public participation in government decision making and legal remedies against adverse decisions (Principle 10 of the 1992 Rio Declaration). National law typically regulates opportunities for citizens to participate in environmental decision making. Some international treaties also affirm procedural rights, and are binding for the states that have ratified them.

48. See also Article 23 of the American Convention on Human Rights and Article 13 of the African Charter on Human and Peoples' Rights.

For instance, the 1998 Aarhus Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters affirms the right of ‘the public concerned’ (that is, those likely to be affected by a decision) to be informed about proposed projects that are likely to have a significant effect on the environment. The ‘public concerned’ also have the right to participate in decision making ‘when all options are open’, and expect decision makers to take these views into ‘due account’ (Article 6).

The Aarhus Convention also affirms the public’s right to obtain access to environmental information, although exceptions can be granted on grounds including confidentiality of commercial and industrial information. These grounds are to be interpreted in a restrictive way (Article 4). Finally, the Aarhus Convention affirms the right of ‘the public concerned’ with a ‘sufficient interest’ (which explicitly includes non-governmental organisations) to access judicial review procedures to challenge the legality of decisions, acts or omissions (Article 9). This convention applies to ratifying states in the northern hemisphere, and specifically deals with environmental information.

Framework laws, resource tenure and decentralised natural resource management

Governments and civil society can use the process of drafting framework legislation that sets key directions for a given sector in order to catalyse public debate on strategic development choices (Box 30).

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Box 30. Public debate on Mali’s Agricultural Orientation Act of 2006

In Mali, the elaboration of the Agricultural Orientation Act of 2006 was accompanied by the active participation of national federations of rural producer organisations. The law embodies a vision for agricultural development in the country. It recognises the role of both large and small-scale producers in agricultural ‘modernisation’.

Subsequently, however, the government signed many large land deals for plantation agriculture. Some activists felt that this betrayed the spirit of the new law. Even after the adoption of a framework law, public mobilisation is essential to ensure that subsequent legislation and administrative action is consistent with its policy directives.

Source: Djiré, 2008, and Djiré *et al.*, 2012, with additions.

In natural resource projects, resource tenure can influence the inclusiveness of decision-making. In many African countries, for example, the state claims ownership or control of much of the land. Villagers may have claimed or used the land for generations, but under national law they may have only qualified use rights (see Section 4.3).

As a result, it is the government, not landholders, that has the legal authority to allocate land to commercial operators. In many large agricultural projects, land allocations have been decided over the heads of landholders (Vermeulen and Cotula, 2010b). Granting villagers stronger rights over land and natural resources can help to increase their leverage in negotiations with government and investors.

Decentralised natural resource management can also increase local control over decision making. In Senegal, legislation vests land management responsibilities with elected rural councils (Article 195 of the Local Government Code of 1996). In Tanzania, the Village Land Act of 1999 designates village councils as the collective manager of 'village land'. Village councils are the lowest level of local government in Tanzania and are elected by the village population. Village land is estimated to account for some 70 per cent of national land. Tanzania's land law provides a framework for village-level land use planning, which can provide the basis for the development of a local vision on how to use natural resources within the village.

However, decentralisation alone is not sufficient to secure inclusive decision making. Local government bodies in low and middle-income countries may lack the human, economic and other resources that are necessary to exercise government responsibilities fairly and effectively. Local politics may also get in the way of long-term thinking about sustainable development.

Democratic processes, including non-discriminatory universal suffrage and accountability mechanisms, are supposed to provide checks and balances against the capture of local elected government bodies by local elites. Despite these checks and balances, elite capture may nonetheless take place, with many elected councils dominated by a few families with higher status under customary law, greater capacity to mobilise resources from the outside world, or access to greater economic resources. In both Senegal and Tanzania, as in many other countries, the central government also retains considerable powers and can compulsorily acquire land for a public purpose when large investments are at stake.

Local consultation and consent requirements

The norms discussed so far create opportunities for inclusive deliberation before any individual project enters a local arena. Once a given investment project is under consideration, there are other sources of guidance and regulation to facilitate community engagement. It is widely recognised that effective engagement in the early stages of project design is essential not only to respect local rights, but also to establish a company's 'social license to operate'.

International guidance calls for local consultation before investment approval, including the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security. The guidelines also call for the negotiation of partnerships with local tenure right holders (Article 12).

The OECD Guidelines for Multinational Enterprises refer to 'adequate and timely communication and consultation with the communities directly affected by the environmental, health and safety policies of the enterprise' (Paragraph VI(2) (b)). In an interesting example of cross-fertilisation between different bodies of international guidance, the United Kingdom's National Contact Point for the OECD Guidelines has interpreted the consultation provisions contained in these guidelines

in light of the CBD Akwé: Kon Guidelines, discussed above (see Box 24 in Chapter 4). The UK National Contact Point found that a mining company operating in India had not used local language and non-written forms of communication in consulting indigenous people, as called for in the Akwé: Kon Guidelines.⁴⁹

Where indigenous and tribal peoples are involved, international legal requirements on local consultation or consent may also apply. States that have ratified the ILO Convention No. 169 of 1989 Concerning Indigenous and Tribal Peoples in Independent Countries must comply with specific legal obligations. Article 6 of the convention requires governments to consult indigenous and tribal peoples 'in good faith', 'with the objective of achieving agreement or consent to the proposed measures'.

Article 15(2) requires local consultation before issuing extractive industry rights in ancestral lands. Article 16(2) requires the 'free and informed consent' of indigenous and tribal peoples for investment projects that involve relocation of those people. If consent cannot be obtained, however, this provision requires compliance with procedures established by national law that allow for the 'effective representation' of the peoples concerned. Some 20 countries have ratified this convention to date, mainly in Latin America.

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The UN Declaration on the Rights of Indigenous Peoples of 2007 goes further by stating that '[n]o relocation shall take place without the free, prior and informed consent of the indigenous peoples concerned' (Article 10). The declaration also calls for good-faith consultation with indigenous peoples in order to obtain their free, prior and informed consent (FPIC) before states can adopt legislative or administrative measures that may affect those people (Article 19). The declaration is an authoritative but not legally binding document. FPIC requirements have been progressively interpreted in international human rights jurisprudence relating to the collective right to property of indigenous or tribal peoples.⁵⁰

The involvement of indigenous peoples may also trigger the application of special lender policies. For example, IFC Performance Standard No. 7 on Indigenous Peoples requires IFC clients to seek free, prior and informed consent for projects that involve relocation of indigenous peoples, that impact on lands and resources subject to traditional ownership or customary use, or that may significantly impact on critical cultural heritage. The performance standard clarifies that 'FPIC does not necessarily require unanimity and may be achieved even when individuals or groups within the community explicitly disagree' (Paragraph 12).

The concept of FPIC has emerged in relation to indigenous peoples but it has been recently applied to protect all people that may be adversely affected by large development projects. For example, the Directive on the Harmonisation

49. *Survival International Complaint against Vedanta Resources Plc (Final Statement)*. On this case, see Morgera (2013).

50. For example, in *Saramaka People v. Suriname and Centre for Minority Rights Development and Minority Rights Group International on behalf of Endorois Welfare Council v. Kenya*.

of Guiding Principles and Policies in the Mining Sector, adopted by ECOWAS in 2009, requires companies to obtain the free, prior and informed consent of 'local communities' before initiating mining operations (Article 16(3)). The wording of this provision does not restrict the term 'local communities' to indigenous and tribal peoples. Similarly, some third-party certification schemes, such as the Roundtable on Sustainable Biomaterials (RSB) require FPIC in relation to all landholders, not just indigenous peoples.⁵¹

Legislation can play an important role in translating international guidance and obligations into legal requirements under national law. Many countries have enacted legislation that makes local consultation or consent a legal requirement as part of investment approval processes. For example, Mozambique's Land Act of 1997 requires the consultation of legally defined 'local communities' before a land lease can be allocated to an investor (Article 13(3)). Legislation in the Philippines explicitly requires free, prior and informed consent for developments affecting the ancestral lands of indigenous peoples (Box 31).

Implementation of these consultation or consent requirements has often fallen short of expectations, however, not least due to the major asymmetries in information, capacity and negotiating power that affect relations between companies, governments and affected people. The outcome of a consultation is often not a legally binding agreement between the community and the company. This limits the ability of communities to hold investors to account in case of non-compliance (Nhantumbo and Salomão, 2010).

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Consent requirements have tended to cause concern among governments and companies, particularly out of fear that enabling local groups to 'veto' proposed projects may make it more difficult for governments to pursue the interest of the country as a whole, and for projects to go ahead. The implementation of FPIC processes is also typically constrained by difficult practical challenges – including, often, divisions within local communities.

However, a growing body of experience, evidence and guidance provides insights on how to implement FPIC processes (see for example Colchester and Ferrari, 2007; Colchester, 2010; Oxfam Australia, 2010; Buxton and Wilson, 2013; IPIECA, undated). The World Bank is currently reviewing its safeguard policies, in part because of the FPIC challenge.

51. See RSB Principle 12, Criterion 12.b and the Minimum Requirements under this Criterion (<http://rsb.org/sustainability/rsb-sustainability-standards/>).

Box 31. Free, prior and informed consent in the Philippines

Giving effect to constitutional provisions, the Indigenous Peoples Rights Act of 1997 recognises indigenous peoples' right to self-determination, to the legal protection and collective titling of 'ancestral domains', and to the application of customary rules in the management of land and natural resources. At the same time, this law guarantees gender equality and the human rights of indigenous women, balancing the recognition of indigenous peoples' autonomy with the protection of universal human rights.

The law recognises the right of indigenous peoples to express their free, prior and informed consent on proposed development projects (Articles 7(c) and 59). FPIC is defined as meaning 'the consensus of all members of the [indigenous people] to be determined in accordance with their respective customary laws and practices, free from any external manipulation, interference and coercion, and obtained after fully disclosing the intent and scope of the activity, in a language and process understandable to the community' (Article 3(g)).

But the implementation of FPIC requirements, for example in mining projects, has faced major challenges. Research suggests that in many cases the required procedures were not respected, the information disclosed was biased, and consent was effectively orchestrated (Co, 2008; Cariño, 2005; Corpuz, 2010). These problems result from power imbalances, but also from the lack of the necessary resources and community facilitation skills in relevant government departments (Co, 2008).

Comparative analysis of experience in the Philippines and Canada suggests that the quality and attitude of institutions can have greater impact than formal legal requirements. In contrast to the Philippines, Canadian legislation does not formally require FPIC. But in practice the institutional structures for consultation and decision making appear to go a long way towards reflecting the 'spirit' of FPIC (Buxton, 2012).

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TOP TIP 16

Promote inclusive deliberation at local and national levels

- Placing people at the centre of the development process requires ensuring that public decisions on investment respond to a bottom-up, strategic vision of sustainable development, based on local and national aspirations.
- Effective engagement with law making and implementation can facilitate the emergence of this bottom-up vision, and ensure that this vision guides public decision making.
- This includes government protection and citizen exercise of fundamental human rights such as freedom of expression, assembly and association, and the various rights for public participation in decision making.
- It also includes government promotion of public participation in the elaboration of framework and ordinary legislation, and civil society leveraging of these processes to catalyse public mobilisation on strategic policy choices.
- Decentralisation and rights of public participation in decision making offer wider opportunities for the public to participate and influence the process – so long as local governments are downwardly accountable and properly empowered, staffed and resourced, and civil society is equipped to seize opportunities.
- Laws that grant villagers stronger rights over land and natural resources can increase their leverage in negotiations with government and investors. Making such legislation work in the face of major power imbalances requires sustained capacity support for local organisations.
- Strict local consultation or consent requirements can open space for local negotiation, but the quality and attitude of the institutions overseeing these processes can have greater impact than formal legal requirements.

5.3 Transparency and public scrutiny

Why transparency matters

Transparent investment processes are a crucial precondition both for meaningful local deliberation and for public scrutiny of governments and investors. Lack of transparency facilitates corruption and investments that do not pursue what is in the public's best interest. Requirements for, and commitment to, transparency in the contracting process would send a signal that attracts 'quality' investors, and add pressure for fair terms.

Greater transparency is also a public good in itself. Citizens have a right to know how their government is managing the natural resources it owns on behalf of the nation (Rosenblum and Maples, 2009). Access to information and public participation in decision making are key pillars in the concept of sustainable development (Principle 10 of the 1992 Rio Declaration on Environment and Development).

Yet transparency often provides an arena for confrontation between opposing camps, not least because government and civil society may have different positions on transparency: many civil society organisations push for greater transparency, but governments have often refused to disclose information.

Transparency in investment contracting

Legislative instruments to improve transparency can work at different levels. One important level relates to contracting – the process of developing and administering investment contracts. Most contracts for natural resource investments are negotiated behind closed doors, and few are in the public domain.

But pressure is mounting to open up the contracting process to greater public scrutiny. International guidance mandates the disclosure of contract terms unless compelling reasons require otherwise. Examples include the recently revised International Finance Corporation's Performance Standards on Environmental and Social Sustainability, and the UN Principles on Responsible Contracts. A new Open Contracting initiative promotes transparency in public contracting, including extractives and agriculture.⁵²

Some governments have disclosed their extractive industry contracts. In Liberia, disclosure is a legal requirement under the Liberia Extractive Industries Transparency Initiative Act of 2009. This law was developed to establish the national process relating to the Extractive Industry Transparency Initiative. But its scope was also broadened to include agriculture and forestry (Box 32).

Contract disclosure can only improve accountability if the people affected and the public at large can use the information disclosed in effective ways. This is a function of political space and, depending on the context, it may require sustained investment in capacity building.

52. See the Open Contracting website, <http://www.open-contracting.org>.

Box 32. What governments can do to promote transparency: lessons from Liberia

In Liberia, petroleum, agriculture and forestry contracts are approved by parliament and are publicly available online. This situation has much to do with Liberia's recent history.

In 2003, a peace agreement put an end to more than a decade of conflict. A transitional government came to power that signed several large investment contracts, including for mining and agriculture. There were allegations of corruption. When some of the contracts were leaked, some commentators felt that the government had agreed to terms that were not in the best interests of the citizens of Liberia.

In 2006, a democratically elected government took office. The new government wanted to signal a clear break with past practices. It made it a priority to renegotiate the contracts awarded by earlier governments. In addition, parliament passed the Liberia Extractive Industries Transparency Initiative Act in 2009. This law provides that investment contracts for agriculture, mining, petroleum and forestry operations must be made publicly available. Contracts for natural resource investments in Liberia can now be downloaded from the official Liberia Extractive Industries Transparency Initiative website, see www.leiti.org.lr.

Source: Ford and Tienhaara, 2010, with additions.

Waiting until the investment contract has been agreed may be too late. It is also essential to increase the transparency of the decision-making process before a final contract is approved, disclosing project information and offering opportunities for public consultation at important stages on the way. Increasing transparency before a contract is signed must take into account the needs of the different sectors. It is common for petroleum contracts to be awarded through public auction. So a key issue is how to increase transparency in the bidding process. On the other hand, open tendering is more rare in mining and agriculture. In these sectors, requiring disclosure of project information in the early stages of community engagement is key.

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Freedom of information laws and human rights instruments

Depending on the jurisdiction, freedom of information (FOI) legislation grants members of the public the right to obtain information held by public bodies. Public bodies have a legal obligation to disclose the information. FOI legislation usually contains exceptions, which commonly include trade and commercial secrets. In other words, the public body holding the information can refuse disclosure if it can show that disclosure would damage trade and commercial secrets.

Depending on the national legal system, for this exception to be applicable it may need to be shown that the information is not already in the public domain. This is an important caveat because information not available to civil society may be known in industry circles and as such deemed to be in the public domain (Rosenblum and Maples, 2009).

In recent years, civil society organisations have used FOI legislation to seek access to unpublished, government-held information concerning investments (Box 33). In many low-income countries, however, FOI legislation does not exist or is ineffective.

Box 33. Leveraging freedom of information legislation to access arbitral awards in Poland

In 2012, an arbitral tribunal ruled on a dispute brought by a French investor against the government of Poland under the France-Poland BIT of 1989. The ruling was not made public. So a Polish civil society organisation submitted a FOI application for the Polish government to disclose the award. But the government refused to consider the claim, arguing that Poland's FOI law did not apply to the relevant government body.

The civil society organisation challenged this decision in the Polish administrative courts. The district administrative court dismissed the government's arguments and ordered the release of the award. In October 2013, the government released a redacted copy of the award.

Source: Hepburn and Balcerzak, 2013, with additions.

Civil society organisations have also used human rights instruments to increase transparency and public oversight. The Inter-American Court of Human Rights has affirmed that access to government-held information is a human right in the case *Reyes and Others v. Chile*. The case was about a civil society request for information, including contracts, relating to a contested investment project. The government refused to disclose the information sought, and activists took the case to court.

The Inter-American Court noted that the right to freedom of thought and expression, recognised by Article 13 of the American Convention on Human Rights, includes 'not only the right and freedom to express one's own thoughts, but also the right and freedom to *seek, receive and impart* information and ideas of all kinds' (emphasis added).

The court ruled that restrictions are only possible if they are established by law, they are for a purpose allowed by the American Convention on Human Rights, and they are justified by and proportional to a compelling public interest. The court found that the refusal by the government, without written justification, to provide information requested by civil society violated Article 13 of the convention.

International guidelines also favour transparency. Where they apply, the OECD Guidelines for Multinational Enterprises call on companies to disclose 'timely, regular, reliable and relevant information [...] regarding their activities, structure, financial situation and performance'. They also provide guidance on how to implement corporate disclosure (OECD Guidelines, Chapter III).

Transparency in revenue management

One area where greater transparency and public scrutiny are particularly important concerns the management of public revenues flowing from natural resource investments. The social, economic and environmental outcomes of these investments will depend on whether their revenues are used to promote sustainable development or to enrich well-connected individuals. By increasing opportunities for accountability, transparency in revenue management can improve decisions about the use of public revenues.

The Extractive Industries Transparency Initiative (EITI) aims to address this issue in the mining, oil and gas sectors. It was launched in 2002 and involves governments, the private sector and civil society. The EITI Principles and Criteria require companies to disclose payments made to the government, and governments to disclose revenues received, in relation to extractive industry activities. These payments and revenues are then checked against each other for any discrepancies.⁵³

Disclosure of public revenues provides civil society with an effective weapon to hold governments to account for the way they spend public money. Some countries have passed legislation to ensure compliance with EITI requirements, or more generally to promote transparency in revenue management. Examples include the Nigeria Extractive Industries Transparency Initiative Act of 2007 and the Liberia Extractive Industries Transparency Initiative Act of 2009 (Box 32).

Adoption of such legislation may be necessary in order to establish the institutions needed to facilitate compliance with EITI. It may also remove or neuter legal or contractual obstacles to transparency, such as contractual confidentiality clauses restricting disclosure of information (Gormley, 2013).

An early (pre-EITI) example of national legislation in Africa, if ultimately unsuccessful, was Chad's Petroleum Revenue Management Act of 1999 (see Box 19 in Chapter 3). This law was adopted as a condition for World Bank lending to the Chad-Cameroon oil development and pipeline project. The law established an oversight committee, which included two representatives of civil society organisations. The committee was responsible for supervising the implementation of the legislation.

However, implementation was riddled with difficulties, not least because the committee lacked the necessary resources. This experience highlights the limitations of approaches that rely on external sources, rather than grassroots pressure, to impose legal reform.

A more promising example is provided by Ghana's Petroleum Revenue Management Act of 2011, which was passed following extensive civil society input. It establishes funds to receive, manage and disburse petroleum revenues. The Bank of Ghana and the Auditor-General both have the power to conduct audits of these petroleum funds.

Various provisions of this law promote transparency in revenue management, including through the publication of records of petroleum receipts in the media; through parliamentary oversight; and through independent oversight by a Public Interest and Accountability Committee. This committee is composed of members selected by independent think tanks, civil society organisations and a range of other interests including trade unions, customary chiefs, bar association, journalists and the chamber of commerce.

53. <http://eiti.org/eiti/principles>. Goldwyn (2008), Gormley (2013) and O'Sullivan (2013) offer excellent starting points on the EITI.

Legislation in the investors' home countries can also help to improve transparency of public revenues. In the United States, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 requires disclosure of payments made to the US or foreign governments by oil, gas and mining companies listed on US stock exchanges (Section 1504, also known as the Cardin-Lugar amendment).

Failure by the US Securities and Exchange Commission to adopt the necessary implementing regulations within deadline led to a lawsuit brought by Oxfam America before US district courts. When the commission passed the regulations, industry bodies challenged their legality, leading US courts to strike the regulations down.

In 2013, the European Union adopted new Accounting and Transparency Directives that feature similar disclosure requirements for companies listed on EU-regulated stock exchanges, and also for unlisted companies that meet certain size criteria (turnover, total assets or number of employees). This European legislation applies not only to extractive industry companies, but also to logging firms. It requires companies to disclose all government payments above a minimum threshold (€100,000).

Regulations in Hong Kong also require disclosure of payments to governments made by extractive industry companies listed on the Hong Kong stock exchange (Gormley, 2013).

Transparency and public scrutiny in investment treaties and arbitration

Most investment treaties do not mention anything about transparency but some recent treaties contain provisions that require host governments to ensure transparency of the regulatory framework with regard to investors. These include publishing laws and regulations, publishing proposed measures and seeking comments in advance, or ensuring transparency in administrative proceedings (for some examples, see UNCTAD, 2013b). In addition, international arbitral tribunals have deemed transparency of government conduct with regard to the investor to be an important part of the 'fair and equitable treatment' standard.⁵⁴

The settlement of investment disputes that may arise between the company and the host government also needs to be open to public scrutiny. International arbitration proceedings (see Section 2.4) can raise important issues of public interest. Public scrutiny and participation in these proceedings are important to ensure that broader interests are properly taken into account.

Such proceedings are mainly private, however. In several cases, procedural rules ban public access to oral hearings, the dissemination of information concerning the dispute and the publication of the arbitral award. There may also be restrictions on the ability of civil society organisations and other groups that are not directly

54. For instance, in *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States and Saluka Investments BV v. The Czech Republic*. See Section 2.3 above.

a party to the dispute to make submissions and draw the tribunal's attention to matters of public policy (these actions are called *amicus curiae* submissions).

However, different arbitration systems vary considerably in this respect, and have evolved significantly. Recent years have witnessed a trend towards greater transparency and public scrutiny in investor-state arbitration. The ICSID Arbitration Rules were amended in 2006 in ways that have increased opportunities for public scrutiny. For example, the amended rules empower tribunals to accept written submissions by civil society organisations, after consulting the parties to the dispute (Arbitration Rule 37(2)). A civil society submission is likely to be accepted if it would assist the tribunal to decide on a legal or factual issue, if it is within scope and if the civil society organisation has a significant interest in the dispute.

Restrictions nonetheless remain. In practice, ICSID tribunals enjoy considerable latitude, and have sometimes reached different conclusions (Box 34). Access to hearings remains subject to the parties' consent (ICSID Arbitration Rule 32(2)), and was denied in several cases (for instance, *Bewater v. Tanzania*). Consent of the parties is also required for the publication of the award. ICSID is empowered to publish excerpts (Arbitration Rule 48), however, and awards are commonly published on the ICSID website (<http://icsid.worldbank.org/ICSID/Index.jsp>).

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In July 2013, the United Nations Commission on International Trade Law (UNCITRAL) adopted new Rules on Transparency that aim to increase transparency in investor-state arbitrations. These rules provide for disclosure of key case documents; they empower arbitral tribunals to allow written submissions by 'third persons' (which would include civil society organisations); and they require hearings to be open, subject to exceptions.⁵⁵

The Rules on Transparency apply to investor-state arbitrations brought under investment treaties and conducted under the UNCITRAL Arbitration Rules. They can also be applied to investor-state arbitrations conducted under other arbitration rules. However, the new UNCITRAL rules only apply to arbitrations filed under investment treaties concluded after 1 April 2014 – unless the parties to a dispute (investor and state), or two states parties to a pre-2014 investment treaty, explicitly 'opt into' the new rules.

This means that, as a default position, the UNCITRAL Rules on Transparency do not apply to arbitrations based on the over 3000 investment treaties currently in force worldwide. Governments committed to transparency and public scrutiny can issue unilateral statements for opting in. The statement would take effect if the investor makes a similar statement when filing an arbitration (CIEL *et al.*, 2013).

55. For a commentary on the new UNCITRAL Rules on Transparency, see CIEL *et al.* (2013).

States parties to a pre-2014 treaty can also opt in by revising the treaty, or by issuing an 'interpretive statement' that clarifies that reference to the UNCITRAL Arbitration Rules in the treaty must be taken to include the new UNCITRAL Rules on Transparency (CIEL *et al.*, 2013). A multilateral convention to apply the new rules to arbitrations under pre-2014 treaties is now being prepared. Civil society organisations can increase pressure for governments and investors to opt in.

Box 34. Civil society submissions under the International Centre for Settlement of Investment Disputes (ICSID)

Civil society organisations have been able to make submissions in several ICSID cases where a matter of public interest was directly at stake. For example, arbitral tribunals have accepted civil society submissions in disputes relating to contracts for the management of water and sewage services,⁵⁶ investor challenges to legislation designed to reverse historical injustices,⁵⁷ and contestation about mining projects.⁵⁸

On the other hand, some ICSID tribunals have followed a narrower interpretation of the ICSID rules and denied submissions raising human rights issues that were deemed not to be relevant to the dispute, or submissions coming from organisations of doubtful neutrality.⁵⁹ This approach contrasts with the line taken by the more liberal tribunals, which have allowed submissions even from organisations that had openly campaigned against the investment project.⁶⁰

Where submissions are allowed, civil society organisations may still be denied access to the case documentation they need to prepare an informed submission. This is because ICSID rules require the consent of the parties for disclosure of case documents.⁶¹

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Some recent investment treaties also provide for transparency in investor-state arbitration, and they allow *amicus curiae* submissions where specified criteria are met. Some of these treaties require hearings to be open to the public and documents to be made available to the public, though they often feature exceptions for confidential information. These rules would apply independently of the chosen set of arbitration rules.

Arbitral tribunals have paid varying degrees of attention to civil society submissions, but some awards have made explicit reference to arguments developed in those submissions (for example *Methanex v. United States of America*). Anecdotal evidence also suggests that in some cases the arguments brought by non-parties influenced the tribunal's thinking. Even if it appears that there is no significant impact on the arbitration process, civil society submissions can still be useful in improving public awareness and catalysing popular mobilisation.

56. E.g. *Aguas Argentinas, S.A., Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. Argentina* (Order in Response to a Petition for Transparency and Participation as Amicus Curiae), decided before the change in ICSID Rules that allowed non-party submissions; and *Biwater v. Tanzania* (Procedural Order No. 5), decided on the basis of the new ICSID Rules.

57. *Piero Foresti, Laura de Carli and Others v. Republic of South Africa* (ICSID Letter Regarding Non-Disputing Party).

58. *Pac Rim Cayman LLC v. El Salvador* (Procedural Order No. 8).

59. See the joined cases *Bernhard von Pezold and Others v. Republic of Zimbabwe* and *Border Timbers Limited, Border Timbers International (Private) Limited and Hangani Development Co. (Private) Ltd v. Republic of Zimbabwe*.

60. For example in *Pac Rim Cayman LLC v. El Salvador* (Procedural Order No. 8).

61. *Biwater v. Tanzania* (Procedural Order No. 5).

Civil society submissions – and, more generally, public scrutiny of investor-state arbitrations – can therefore be a powerful tool to ensure that sustainable development considerations are properly taken into account (see Box 10 in Chapter 2). As arbitration is an eminently legal process, submissions are more effective if they stick to professional legal arguments and strategies, avoid general political statements, and comply with prescribed procedures (A4ID, 2012).

Transparency in other important aspects of investment decision making has already been discussed elsewhere – for instance, with regard to admission decisions (Chapter 2) or to the administration of tax incentives (Chapter 3).

TOP TIP 17

Promote transparency and public scrutiny

Transparency in investment processes is a crucial precondition both for meaningful local deliberation and for public scrutiny of governments and investors. Both governments and civil society organisations can play a role.

Governments can:

- Disclose contract terms unless compelling reasons require otherwise, bearing in mind that contract disclosure can only improve accountability if affected people and the public at large can get organised and use the information disclosed in effective ways.
- Promote transparency through such means as disclosure in investment contracting, ‘freedom of information’ legislation that gives citizens a right to obtain information held by government bodies, and legislation designed to implement the Extractive Industries Transparency Initiative.
- Support openness in investor-state arbitral proceedings, including through ‘opting into’ the new UNCITRAL Rules on Transparency and favouring more open and transparent arbitration systems.

Civil society organisations can:

- Use freedom of information legislation to obtain information held by public bodies and challenge government refusals to disclose information before national courts or international human rights bodies.
- Exploit the opportunities to access information created by transparency legislation in investors’ home countries.
- Use the increasing opportunities for scrutinising investor-state arbitration proceedings and make written submissions. Press for more open proceedings where these opportunities are restricted.

5.4 Anti-corruption measures

Corruption can significantly distort decision making about natural resource investments in ways that run counter to the public interest. An unworthy project may receive the necessary approvals and government support, or a company without the necessary resources and track record may be favoured over more deserving competitors (Moran, 2006).

Corruption in natural resource projects has become increasingly sophisticated. Research from Indonesia has shed light on complex deals whereby the investor pre-finances the acquisition of an equity stake in the project company by a relative or close associate of a high-level decision maker; the company then never claims back the loan, and interest payments are deducted from dividends. As a result, the local partner actually does not pay for the equity stake, which can be sold for cash (Moran, 2006). Greater sophistication makes it harder for anti-corruption authorities to enforce legislation but a number of measures can help to fight corruption.

Mechanisms to increase transparency and public oversight can mitigate the risk of corruption. Effective anti-corruption legislation, institutions and sanctions are also critical. This is, first and foremost, a matter for the legal and institutional framework in the host country. The involvement of transnational corporate entities, however, also creates the need and the opportunity for anti-corruption measures at international and transnational levels.

Regulatory efforts started in the United States, where legislation adopted in the 1970s criminalises the bribing of foreign public officials by US-based companies (Foreign Corrupt Practices Act of 1977). Since then, the US government has pushed for comparable legislation at the international level and in major industrialised countries, so as to avoid placing US companies at a disadvantage.

Progress has been slow but a range of global and regional treaties are now in force, and major industrialised countries have adopted legislation that criminalises corruption in activities overseas. International treaties include the 1997 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the widely ratified 2003 United Nations Convention against Corruption. At the regional level, relevant treaties include the 2003 African Union Convention on Preventing and Combating Corruption, the 1996 Inter-American Convention against Corruption, and the 1999 Council of Europe Criminal Law Convention on Corruption.

All these treaties require states to enact legislation that criminalises the bribing of government officials. A number of countries have adopted national legislation to implement international treaties (for example the UK Bribery Act of 2010, adopted to implement the OECD Convention). The scope and terms of the treaties vary considerably, however. For example, the OECD Convention specifically concerns certain types of corruption of foreign government officials

while the UN Convention is much more comprehensive, because it applies to a wider set of public and private-sector officials. It also requires states to criminalise solicitation or acceptance of bribes, it covers forms of corruption that are not addressed in the OECD Convention (such as trading in influence or abuse of function), and it establishes mechanisms for the international recovery of assets obtained through corruption.

Despite much national and international law making, many loopholes remain. For example, the OECD Convention does not prohibit the funding of foreign political parties (unlike the Foreign Corrupt Practices Act), it does not include non-cash gifts (such as shares or trips) in the definition of bribery and it does not make companies responsible for corruption that their subsidiaries engage in (Hawley, 2000). Also, enforcement of anti-corruption legislation in the investors' home countries has been very limited, because significant economic interests are often at stake.

There is growing experience with transnational litigation spearheaded by governments from low and middle-income countries to recover assets held overseas by former political leaders. These efforts have had varying degrees of success (Davis, 2010; for a practical guide, see Brun *et al.*, 2011).

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At the national level, effective, independent and well-resourced anti-corruption agencies are key. But civil society can also play an important role – as is explicitly recognised by the UN Convention. This may include public scrutiny in the host country, but also providing information to authorities in the investor's home country (for example, in the US, to the Department of Justice, which investigates violations of the Foreign Corrupt Practices Act).

In international investor-state arbitrations, there have been cases where governments have managed to get lawsuits dismissed because the contract providing the basis for the arbitration was tainted by corruption. However, corruption allegations in investment arbitrations (and elsewhere) typically involve an onerous burden of proof. In at least one arbitration the tribunal found that the government had failed to provide clear and convincing evidence. So it may be difficult for the government to have a case thrown out due to corruption.

Arbitral awards involving corruption are quite rare, not least because governments may not have much incentive to raise the issue, and because – if evidence of corruption surfaces during the arbitral proceeding – the parties may prefer settling the case to avoid an award that makes public the instance of corruption.



Photo: Robin Hammond / Panos Pictures

There is growing recognition that transparency and public scrutiny are an important part of contractual and arbitration processes

5.5 Remedies

Legal norms and rights would be of little use if they were not backed up by effective remedies. In any given investment project, multiple sets of remedies affect different relationships. Government agencies may be legally empowered to impose sanctions on an investment project, or even cancel it altogether, if certain breaches occur (for example, see Section 3.3 in the case of tax avoidance; and Section 4.5 in the case of environmental liability). Investors too can use remedies if the government adversely affects their investment. These remedies are provided by national courts and, where applicable, international arbitration (see Section 2.4).

Legal remedies are also available to people adversely affected by natural resource investments, and to civil society organisations supporting them (Polack *et al.*, 2013, forthcoming). This section briefly reviews some of these remedies. Depending on the applicable legal system, those who bring a legal action are called plaintiffs, claimants or petitioners.

National courts

The courts in the host country are usually the first port of call for a wide range of situations – from challenging the legality of adverse decisions through to seeking compensation for harm suffered. For example, villagers or civil society may challenge the legality of an investment project, arguing that no adequate consultation or impact assessment was carried out as may be legally required, or that the decision-making process otherwise did not comply with prescribed procedures (see Box 26 in Chapter 4).

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In other cases, affected people or civil society organisations supporting them might allege damage to health, crops or the environment. Depending on the jurisdiction, lawsuits involving such claims against a company for damages could be filed under the law of torts – the norms whereby any person who wrongfully harms others must bear responsibility for the actions, including by paying compensation as appropriate.

Where human rights are at stake, national courts are typically empowered to hear cases involving alleged violations of the constitution or, in some countries, of international treaties. In many jurisdictions, national human rights commissions are specifically competent to investigate complaints of human rights violations. And in many countries, constitutional courts have the power to strike down legislation or government measures found to violate the national constitution, particularly any ‘bill of rights’ that constitutions typically include.

In practice, affected people may find it difficult to take cases to court, especially if no external support is available – though good institutions can make a difference (Box 35). Apart from the practical impediments that often limit access to court for people affected by investment projects, legal constraints under national law may include requirements on standing, that is who is able to sue. For instance, community-based organisations may not be recognised as a legal entity.

The burden of proof (proving causation between activity and damage, and negligence on the part of the investor if this is required to establish liability) may be too high and statutes of limitation (whereby lawsuits can only be brought and heard within a short timeframe, relative to the time it may take to overcome lack of resources and legal awareness) may be too short. Where projects are perceived to be in the national interest, the availability of injunctions may be limited and even where there is a successful claim, levels of compensation may be low.

Box 35. Facilitating access to courts: lessons from Indonesia

Good strategy and effective institutions can help to overcome constraints on access to courts. The Indonesian Peasants Union – a national federation of peasant organisations – has established a legal unit that handles legal advocacy, public interest litigation and constitutionality challenges.

One of the actions led by the unit was a constitutionality challenge to aspects of the Investment Act of 2007. The legal case was taken to the Constitutional Court as part of wider mobilisation by a civil society coalition, of which the Indonesian Peasants Union is a member and hosts the secretariat.

The case led to some aspects of the law being struck down, particularly provisions that enabled investors to acquire very long-term land rights. During the consultations that preceded the filing of the lawsuit, members of the Indonesian Peasants Union had raised concerns that these provisions could pave the way to ‘land grabbing’ for plantation agriculture, to the detriment of small-scale farmers.

Source: Fathoni, forthcoming.

International human rights remedies

Where legal routes under national law fail, remedies may be available under international human rights law at both regional and global levels (see Box 21 in Chapter 4). As discussed, the 2011 UN Guiding Principles on Business and Human Rights affirm the corporate responsibility of business to respect human rights (Box 22 in Chapter 4). But the duty bearer under international human rights law is the state. So claims brought under international human rights law would usually be made against governments, rather than companies.

Several human rights treaties create remedies that involve combinations of legal and political pressure. Victims of violations, or civil society organisations supporting them, can take the matter to regional human rights courts where these exist and the host state has ratified relevant treaties. In Europe and the Americas, for example, victims of alleged human rights violations can take their case to the European Court of Human Rights and the Inter-American Court of Human Rights, respectively.

In Africa, liberal rules on legal standing (that is, the need to show a direct connection to the dispute) have allowed many civil society organisations to bring alleged violations to the African Commission on Human and Peoples’ Rights. About half of the African states have ratified the 1998 African Court Protocol, which entered into force in 2004 and established the African Court of Human and Peoples’ Rights.

Disputes against those states that have ratified the African Court Protocol can be taken to the African Court on Human and Peoples' Rights, though usually petitioners must first go to the African Commission on Human and Peoples' Rights. While the commission only issues non-binding recommendations, the court delivers binding judgments, though enforcement against determined state opposition ultimately relies on political pressure.

There is no global human rights court. Some global human rights treaties allow victims to bring disputes to quasi-judicial bodies. For example, the First Optional Protocol to the International Covenant on Civil and Political Rights (ICCPR), adopted in 1966, established an individual complaint mechanism for alleged violations of the covenant. Complaints can be filed with the Human Rights Committee, which is the United Nations body responsible for overseeing the implementation of the covenant.

Similarly, the Optional Protocol to the International Covenant on Economic, Social and Cultural Rights (ICESCR), adopted in 2008, has established a mechanism for complaints from individuals or groups alleging violations of economic, social and cultural rights, including the right to food, labour rights and the right to health. This protocol entered into force in 2013, but has had very few ratifications to date.

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In both the ICCPR and the ICESCR complaint procedures, and under most regional human rights systems, those bringing a case must first exhaust legal avenues under national law ('exhaustion of domestic remedies'). This may involve protracted proceedings and multiple degrees of appeal.

Global human rights treaties also offer less direct avenues for raising human rights complaints. For example, governments must periodically submit reports to the United Nations bodies that monitor compliance with the human rights treaties ratified by those governments. Examples of such bodies include the Human Rights Committee for the ICCPR, the Committee on Economic, Social and Cultural Rights for the ICESCR, and the Committee on the Elimination of Racial Discrimination for the ICERD.

Civil society organisations can submit 'shadow reports' to bring violations to the attention of the relevant UN committee. The committee then issues recommendations on how to address the problem. The recommendations are not binding, but governments tend not to like being put on the spot in this way. Determined non-compliance from the state can mainly be challenged through political pressure and continued civil society campaigning.

Civil society can also make use of the Special Rapporteurs appointed by the UN Human Rights Council to follow specific rights, themes or countries. Where the host government allows it, a Special Rapporteur could visit contested project sites and make recommendations, which would add authority to messaging from civil society.

Some environmental treaties also offer opportunities for international complaints. With Decision I/7 of 2002, the Meeting of the Parties to the 1998 Aarhus Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters (see Section 5.2) established a compliance committee that can consider, among other things, submissions made by states parties with regard to alleged non-compliance by other states.

The committee can also consider communications submitted by the public, unless the relevant country has explicitly opted out of this procedure. The committee reports to the Meeting of the Parties, which may make recommendations, provide advice, issue declarations of non-compliance and suspend the rights of the relevant state under the convention.

Transnational litigation for corporate accountability

In addition to remedies offered by international law, there is growing experience with transnational litigation for corporate accountability. This involves suing a parent company in its home country, or in a third country, over damage caused by its foreign subsidiaries. The justification for this type of litigation is that the parent company ought to be directly liable for harm caused by its subsidiaries if that harm is the result of the parent's own acts or omissions. Transnational lawsuits may also be brought against other companies related to the local subsidiary, including affiliates belonging to the same business group.

There are many practical reasons why claimants may want to litigate in the home country of the parent company, or in a third country, instead of their own country. Claimants may have little faith in the independence or effectiveness of their national courts. They may have inadequate legal support in their country. Claimants may also be able to obtain higher damages and more easily enforceable judgements in the parent's home country, or in a third country – for instance, if the local subsidiary is thinly capitalised (see Section 3.2) and enforcement overseas is therefore required. Courts abroad will not necessarily recognise and enforce a judgment issued by courts in the host state.

In short, the need for transnational litigation arises out of shortcomings in the legal remedies available in the host country, and at international level. There is also symbolic value in bringing a case against a parent company in a highly visible public arena.

Opportunities for transnational litigation depend on the jurisdiction. In the United States, the Alien Tort Statute (ATS) of 1789 empowers US federal courts to hear civil lawsuits filed by foreigners alleging violations of customary international law. This statute was mainly intended to fight piracy, and remained an obscure and little-used law for centuries. In 1980, however, a Paraguayan national successfully brought litigation against a Paraguayan government official for alleged human rights violations that took place in Paraguay (*Filártiga v. Peña-Irala*). This changed the relevance of the statute, because US courts held that they had jurisdiction to hear cases involving conduct with no or minimal connection to US territory.

The *Filártiga* case opened the door to a flurry of transnational litigation against companies accused of complicity with foreign governments in violating human rights overseas, whether they were based in the United States or not. Over the years, US courts have heard cases brought by victims of alleged human rights violations in different parts of the world – even where all the relevant conduct took place outside the United States and where neither the plaintiff nor the defendant were directly related to the United States.⁶²

In recent years, however, US courts have clarified the boundaries of the ATS. The overall trend is towards restricting the application of the ATS. A recent significant judgment of the US Supreme Court restricted the extraterritorial reach of the statute, holding that a connection with the United States is required for US courts to have jurisdiction (*Kiobel v. Royal Dutch Petroleum*). Based on this interpretation, many pending cases filed under the ATS against companies with tenuous US links are now likely to be dismissed.

Recent decisions by lower courts have applied the principles stated in the *Kiobel* ruling even more restrictively (O'Brian, 2013). Limited options for transnational litigation for corporate accountability in the United States still remain, for example before state courts based on general tort law (rather than under human rights law; O'Brian, 2013). As discussed, the law of tort regulates legal responsibility for harm caused by wrongful acts or omissions.

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Opportunities for transnational litigation for corporate accountability under the law of tort also exist in other jurisdictions, including England, France and the Netherlands. Although the United Kingdom has no legislation comparable to the US Alien Tort Statute, the English courts have ruled that they had jurisdiction, under specified circumstances, to hear cases brought by people who claimed to have suffered damage as a result of actions committed by British-controlled companies operating overseas. Several such lawsuits have led to payment of compensation based on out-of-court settlements (see for example *Connelly v. RTZ Corp plc*; *Lubbe and Others v. Cape plc*; *Yao Essaie Motto & Others v. Trafigura Ltd and Trafigura Beheer BV*).

Major legal barriers constrain opportunities for this type of transnational litigation. Parent and subsidiary companies are distinct legal entities. Judges are usually not prepared to 'pierce the corporate veil' and allow claimants to sue the parent company. Usually, the plaintiffs would need to show that, because of the particular functions that the parent company performed, the parent company directly owed the plaintiff a duty of care, and breached it.⁶³

62. For some examples, see the Business and Human Rights Resource Centre website, <http://www.business-humanrights.org/Categories/Lawlawsuits/Lawsuitsregulatoryaction/AlienTortClaimsActUSA>.

63. See the case *David Brian Chandler v. Cape plc*, concerning a dispute where both parent company and subsidiary were based in the United Kingdom.

Another important legal hurdle in transnational litigation concerns jurisdiction – because in many countries the courts of the parent company’s home state would have no jurisdiction to hear claims concerning plaintiffs, companies, activities and damage located overseas. Also, some Anglophone jurisdictions apply the *forum non conveniens* doctrine, whereby a court can refuse to hear a case where there is some other available forum in which the case may be tried more suitably. In this type of litigation, the most obvious forum to hear the dispute is the courts of the host country, where the investment and the alleged violations took place. Only in rare circumstances have English courts found it possible to set aside this doctrine – for example, where substantial justice will not be done in the alternative forum.⁶⁴

There are many practical barriers too, and in most cases only effective external support can make these lawsuits possible. Civil society organisations can help facilitate contact between people affected by natural resource investments and specialised law firms overseas. They can also facilitate ongoing communication, especially in lawsuits that involve a large number of plaintiffs. Financing is a major challenge, particularly as legal aid budgets are being cut in several countries. Where ‘no win, no fee’ arrangements are allowed, they enable the law firm to pre-finance the lawsuit, and receive payment if the claim is successful (Meeran, 2013).

Developments with transnational litigation for corporate accountability have so far mainly concerned national courts in Europe and North America. But the landscape of international investment flows is changing, and a growing share of outward investment now comes from emerging economies. There have been some innovative legal developments in some of these contexts.

In Thailand, the National Human Rights Commission has been prepared to hear complaints involving natural resource investments (such as the building of dams or agricultural plantations) made by Thai companies operating in Myanmar, Laos and Cambodia (Box 36). Also, plaintiffs have adapted their legal strategies to leverage opportunities for litigation in the West, even where the business is owned by companies located elsewhere – for example, by suing a buyer rather than the parent company (Box 36).

Complaint mechanisms

In addition to formal legal processes, a wide range of complaint mechanisms can also provide opportunities for redress. In countries adhering to the OECD Guidelines for Multinational Enterprises, complaints of non-compliance with the guidelines may be brought to the relevant National Contact Point (see Box 29 in Chapter 4, and Box 36). The relevant National Contact Point is that of the country where the alleged violation has occurred, or the country where the investor, a buyer or other relevant project stakeholder is based.

64. *Connelly v. RTZ Corp plc; Lubbe and Others v. Cape plc.*

Box 36. Transnational litigation against land concessions in Cambodia

In recent years, the government of Cambodia has signed many 'economic land concessions' for agricultural projects (see the Open Development Cambodia website, <http://www.opendevdevelopmentcambodia.net/>), although the government has more recently issued a moratorium on new concessions. Civil society organisations have used a variety of transnational avenues to promote accountability.

For example, national non-governmental organisations have filed lawsuits with Cambodian courts and, in cases involving Thai companies, with the Thai National Human Rights Commission. In 2012, the Thai National Human Rights Commission found that it had jurisdiction to examine one complaint (<http://www.business-humanrights.org/Links/Repository/1013888>). In 2013, villagers filed a lawsuit based on Cambodian property law against a UK buyer before the courts of England and Wales. A mediation procedure (now closed) was also initiated vis-à-vis a US buyer before the US National Contact Point responsible for overseeing compliance with the OECD Guidelines for Multinational Enterprises. All the companies involved deny any wrongdoing.

Civil society organisations have taken concerns about land concessions for sugarcane production in Cambodia to the attention of the European Commission. The sugar produced in Cambodia is exported to the European Union under a preferential trade arrangement for least developed countries called 'Everything But Arms'. Under this trade scheme, imports from least developed countries are free of duties and quotas, with the sole exception of armaments. EU legislation empowers the European Commission to suspend these preferences, in whole or in part, including in cases where an investigation documents 'serious and systematic violations' of internationally recognised human rights.

Civil society organisations have called on the European Commission to carry out an investigation and suspend trade preferences for sugar imports from Cambodia. The European Parliament called on the European Commission to investigate the Cambodian government's practice of issuing economic land concessions, and to suspend EU trade benefits to Cambodian firms currently exporting sugar to Europe should human rights abuses be found. The Commission has raised the matter with Cambodian authorities at the highest level but has so far refrained from initiating a full investigation.

This case illustrates the variety of transnational mechanisms that affected people and civil society can use to seek redress.

Sources: websites cited, various personal communications and additional research on this case by Emma Blackmore.

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Where multilateral lenders like the World Bank, the IFC or regional development banks are involved, they typically provide grievance procedures to deal with complaints that the lender has not complied with its own institutional policies or performance standards. For instance, the Chad-Cameroon pipeline project resulted in the establishment of two World Bank Inspection Panels, one for Chad and one for Cameroon, and a complaint to the IFC Compliance Advisor/Ombudsman (CAO).

Complaints to the IFC CAO have also been made in relation to a wide range of natural resource investments – including the financing of palm oil processing facilities that sourced biodiesel from contested plantations (Box 37). Commodity-based, multi-stakeholder platforms like the Roundtable on Sustainable Palm Oil (RSPO) also provide grievance mechanisms.

Companies may also establish their own grievance mechanisms as an avenue to address local grievances that may arise in connection with project implementation (for guidance on effective grievance mechanisms, see Wilson and Blackmore, 2013). Establishing grievance mechanisms is an explicit requirement under the Equator Principles, an international benchmark adopted by lenders to determine, assess and manage environmental and social risk in project finance transactions.

Access to remedy is one of the three fundamental pillars of the UN Guiding Principles on Business and Human Rights (see Box 22 in Chapter 4). These principles provide guidance on remedies for alleged human rights violations, including formal courts and human rights commissions, and also grievance mechanisms established by companies.

The UN Guiding Principles include a number of criteria to ensure effectiveness of non-judicial remedies. Namely, these remedies must be legitimate, accessible, predictable, equitable, transparent, rights-compatible, a source of continuous learning, and based on engagement and dialogue (Principle 31).

Box 37. Use of IFC complaint mechanisms leads to land return in Indonesia

Palm oil expansion in Indonesia has been linked to deforestation and land dispossession. In July 2007, a group of community organisations and non-governmental organisations led by the Forest Peoples Programme, Sawit Watch and Serikat Petani Kelapa Sawit lodged a complaint with the IFC CAO. The complaint raised concerns about adverse environmental and social impacts of the oil palm operations in Indonesia.

The IFC was not directly involved in the plantations but it made investments in trading and processing ventures that sourced palm oil from the Indonesian plantations. Companies belonging to the same business group also owned plantations and palm oil trading and processing facilities.

The civil society complainants alleged that the enterprise had cleared land without appropriate community approvals, legally required permits or EIA processes. They argued that this conduct violated national law, RSPO standards and IFC procedures.

In 2008, the CAO facilitated a settlement agreement between the enterprise and some 1000 community members. The agreement provided for the return of some 1700 hectares of community land, compensation for households who lost land and enhanced community funds. A joint monitoring and evaluation team was established to follow the implementation of this agreement.

In 2009, the CAO also released an audit report which concluded that the IFC had failed to apply its own standards. The report found that the IFC had misclassified the project's social and environmental risks because it only assessed risks in relation to the trading and processing operations, without considering risks in the palm oil supply chain.

Following this case, the IFC developed a new strategy for investment in the palm oil sector and changed its approach to classifying risk in its investment – recognising that supply chain risks must be considered when investing in downstream operations.

Source: Case documentation available at http://www.cao-ombudsman.org/cases/case_detail.aspx?id=76.

Help affected people obtain remedy

Civil society organisations can:

- Bring lawsuits to national courts to challenge the legality of the investor-state contract or the impact assessment.
- Seek injunctions and judgments to change government or investor conduct and/or to obtain compensation for affected people.
- Challenge the constitutionality of legislation or government measures.
- Take cases to regional or human rights bodies.
- Involve a UN Special Rapporteur, or submit 'shadow reports' to provide information to UN bodies monitoring compliance with human rights treaties.
- Help affected people to sue the parent company or affiliates in their home country, or in other countries.
- Provide information to anti-corruption authorities, including in the investor's home country.
- Bring cases to the National Contact Point that monitors compliance with the OECD Guidelines for Multinational Enterprises.
- File complaints with grievance mechanisms established by the investor, lenders or multi-stakeholder bodies.

Useful online resources

- A4ID. 2012. *Amicus Curiae & Investment Arbitrations*, Part One. Advocates for International Development (A4ID), London. <http://a4id.org/sites/default/files/user/Amicus%20Curiae%20Legal%20Guide%20Part%20One%20LG.pdf>.
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Looking at the bigger picture

The previous chapters have raised issues and mapped practical options for using the law to make foreign investment work for sustainable development. This final chapter reflects on the fundamental questions about the interface between foreign investment, law and sustainable development.

These reflections provide important pointers for government and civil society. The pointers go beyond the specific tips outlined in the previous chapters. They raise systemic questions about applicable law, and may prompt a rethink of fundamental aspects of the design and implementation of legal norms.

A systemic approach to investment law: harnessing multiple, inter-linked legal arenas

Over the past few decades, economic globalisation has been accompanied by extensive developments in the national and international law that regulates cross-border economic activities. Compared to the norms that governed international trade and investment just a few decades ago, this 'law of the global economy' (Ortino and Ortino, 2008) now includes many more rules, regulates a wider range of situations and is far more effective in shaping the behaviour of states and economic actors (Faundez, 2010).

The law regulating foreign investment has developed as part of these wider evolutions. Today, foreign investments in agriculture and extractive industries take place in a fast-evolving, highly polycentric legal environment. Diverse sites of regulation enact norms, oversee their implementation and provide dispute settlement fora – thereby establishing national, international and transnational 'legal arenas' where competing claims intersect and come into contest.

These legal arenas are framed by a wide range of norms well beyond legal instruments that bear an explicit 'investment' label, such as investment treaties and codes. To fully understand the terms applicable to an investment project, it may be necessary to examine everything from a country's petroleum code, environmental legislation, tax code and labour law to investment treaties, double taxation agreements and human rights treaties, through to a wide range of international standards and guidelines.

The legal arenas are populated by actors who wield different and possibly competing legal claims.⁶⁵ Investors, governments, affected people and civil society organisations can take disputes arising from an investment project to international arbitral tribunals, national and international human rights bodies, national courts in the host state and, under specified circumstances, in other countries, and grievance mechanisms established by lenders, companies and multi-stakeholder bodies.

65. The language of actors and arenas is inspired by the work of Le Meur (2011).

Different legal arenas reflect different values, historical trajectories and normative content. For example, international human rights and investment law both protect private rights from arbitrary government action but they have different aims: protecting human dignity and promoting secure cross-border investment flows, respectively. These different aims inform prevailing discourses in dispute settlement fora, including the arguments of the parties and the reasoning of international bodies.

In any given investment project, these two sets of international norms may protect the competing claims of investors and affected people, and reflect different ways of conceptualising land and natural resources – as commercial assets, under international investment law, and as a basis for local livelihoods, traditional lifestyles and social identity, under international human rights law.

There is also diversity in approaches within each body of law, and some features of legal frameworks tend to promote greater diversity. One example is the central place of bilateral and regional treaties in the development of international investment law, coupled with the fact that states have followed different approaches to treaty drafting. As a result, standards of investment protection can vary within the same country, because different investment treaties may apply to different investments. In addition, arbitral tribunals have on several occasions reached conflicting conclusions in disputes that raised similar issues (Chapter 2).

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In contrast, some legal arrangements tend to promote convergence within and between legal arenas. Under international investment law, for example, most-favoured-nation clauses in investment treaties would tend to level the playing field upwards (Schill and Jacob, 2013a). The authorities called upon to apply norms and guidance have also facilitated cross-fertilisation within and between arenas: international arbitrators have cited each other's awards and, in some cases, human rights jurisprudence; international human rights courts and bodies have cross-referenced each other's work; and, outside the realm of hard law, one OECD National Contact Point has referred to guidance developed under the Convention on Biological Diversity (Box 24).

Different legal arenas may be closely interconnected, and each actor may straddle multiple arenas. For example, the boundaries between national and international law are increasingly fluid (Picciotto, 2011; Tan, 2013). Indeed, international law may influence the development of national legislation, investors may rely on investment treaties to challenge national measures, investment contracts may require a project to comply with international standards, and affected people may seek to enforce the rights affirmed by international law through recourse to national courts. Also, transnational networks of experts facilitate the replication of regulatory models across different national jurisdictions, even where international law does not require national authorities to harmonise their legislation (Tan, 2013). Opportunities for transnational litigation blur geographic boundaries for the exercise of active citizenship (Polack *et al.*, 2013).



Photo: Robin Hammond / Panos Pictures

Negotiating multiple levels of governance is critical in ensuring that foreign investment contributes to sustainable development

This interplay among multiple actors engaged in different legal arenas influences the content of the law as well as its implementation. Indeed, a legal norm is shaped not just by written words, but also by their interpretation. For example, the standard of fair and equitable treatment included in many investment treaties acquires concrete meaning through interpretation by arbitral tribunals, which address arguments developed by investors and governments (Section 2.3). Similarly, judges in some countries have interpreted old laws in ways that open new opportunities to hold parent companies to account for damage caused by their foreign subsidiaries (Section 5.5).

As a result, the law that regulates foreign investment has not been developed as a monolithic body of norms codified and handed down by a rational, benevolent law maker. Rather, it is highly dynamic, and features inherent tensions and contradictions. It is the product of negotiation and contestation among different actors: for example, between the governments that make law through negotiating investment and tax treaties, contesting the content of customary international law and developing national regulation; between law makers and those called upon to interpret and apply the law – a tension illustrated by the way in which some government have refined the wording of their investment treaties as a response to broad interpretations by arbitral tribunals (Section 2.3); and between competing claimants who push the boundaries of their legal rights.

The latter group would include investors whose lawyers develop sophisticated legal arguments to make the most of the investment protection regime – an important intellectual engine of the expansive interpretation of treaty standards by arbitral tribunals. It would also include people affected by investment projects,

and civil society organisations that work to change the law through precedent-setting legal action. For example, affected people, and the lawyers assisting them, have pioneered new legal strategies of transnational litigation for corporate accountability (Section 5.5). Also, the now widely accepted practice of *amicus curiae* submissions in investor-state arbitration was initiated by pioneering civil society work (Section 5.2).

Given these features of the law regulating foreign investment, harnessing of the multiple legal arenas in a strategic way is essential to using the law to its full potential. In order to increase space for inclusive deliberation, for example, citizens and civil society organisations may mobilise the national constitution, international human rights treaties, labour rights, legislation on decentralisation, ‘procedural rights’ of access to information and public participation, transparency requirements in home and host countries, and local consultation or consent requirements (Section 5.2).

And in order to regulate investment effectively, governments have a diverse array of legal levers they can use, for example under investment, tax or environmental law. Because of the interconnectedness of the multiple bodies of law, and of the way in which claims under different bodies of law may come into contest, it is important for law makers to move away from *ad hoc* approaches to treaty negotiation and legislative drafting, and to legislate instead in a more systemic, strategic way.

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This would require improving co-ordination between departments responsible for different areas of regulation. It would also involve considering how each new legal instrument would affect, and fit within, the wider balance of legal claims established under applicable law – recognising, for example, that strengthening investment protection without also strengthening the social and environmental safeguards can lead to lopsided legal frameworks that are unlikely to promote sustainable development.

Addressing the implementation challenge

Implementation and enforcement are paramount for the law to matter in real life. Without proper implementation, any discussion of law is useless. Much progressive law remains a dead letter, particularly in low and middle-income countries where the practical barriers to implementation are often more acute.

Enforcement issues are rife with conceptual as well as practical challenges. For example, much ink has been spilled in legal scholarship to distinguish ‘hard’ from ‘soft’ law – that is, binding norms from non-binding guidance.⁶⁶ Conceptually, it is important to separate what an actor must do as a matter of legal obligation from conduct that is merely encouraged or promoted.

66. For scholarly writing that critically considers the traditional distinction between ‘hard’ and ‘soft’ law at the international level, see for example Dupuy (1991), Abbott and Snidal (2000), Bjorklund and Reinisch (2012) and Tan (2013).

But a binary opposition between hard and soft law, between binding and non-binding norms, tends to mask the extreme diversity of the instruments grouped under the notion of 'soft law'. These range from technical or lender standards to guidelines developed by international agencies, from industry-based certification schemes through to solemn international declarations.

These instruments have diverse legal status and consequences. While lender standards are not in themselves legally binding, for example, compliance with these standards may be required by binding contracts between lender and investor, or between investor and host government.

The binary opposition between hard and soft law also tends to mask the fact that, within binding law, some norms are backed up by more effective enforcement arrangements than others. For example, both investment and human rights treaties are legally binding for the states that ratify them but investor-state arbitration provides more effective enforcement mechanisms than most international human rights systems (Sections 2.4 and 5.5).

Indeed, unlike much investor-state arbitration, human rights law usually requires petitioners to take their case to national courts before accessing international remedies. Decisions issued by human rights bodies are not always binding and even binding decisions are not backed up by the transnational enforcement mechanisms that assist investor-state arbitration.

In practice, the effectiveness of enforcement mechanisms can have greater impact than whether an instrument is considered to be legally binding or not (Picciotto, 2011). Compliance also largely depends on real-life incentives, of which legal enforcement routes are only one source. Under certain circumstances, 'soft' standards backed up by reliable grievance mechanisms may provide more effective recourse than 'hard' law embodied in treaties that have little legal bite.

So rather than a black and white opposition between hard and soft law, the regulation of natural resource investments presents multiple shades of grey in the nature and effectiveness of enforcement arrangements. This recognition raises far-reaching conceptual questions about what 'law' is, but it also points to important practical implications – because it calls for focusing efforts on establishing effective mechanisms to induce compliance, rather than just on the formal nature of an instrument (binding or non-binding).

In other words, the most promising route for taking social and environmental considerations seriously involves not just entrenching these considerations into binding law, but also establishing compliance-inducing mechanisms that are as effective as those assisting the investment protection regime.

In addition, effective institutions are essential in making good use of both hard and soft law. This point is illustrated by many situations discussed in the

handbook – from Peru’s ‘response system’ to international arbitration (Box 9), to the importance of effective government agencies in collecting taxes (Section 3.3) or ensuring compliance with environmental regulation (Sections 4.2 and 4.5), through to the law unit that handles public interest litigation on behalf of the Indonesian National Peasant Union (Box 35).

Finally, the formulation of norms and standards also influences how easy it is to implement them. For example, legislation that requires costly administrative machinery in resource-constrained countries is bound to face implementation challenges. On the other hand, protecting local land rights irrespective of whether they are formally registered, as is done in some jurisdictions (see Section 4.3), is a way of recognising that, realistically, getting formal documentation is very difficult for most rural people.

Between right and might: navigating the interface between law and power

Natural resource investments in low and middle-income countries bring into play competing claims underpinned by unequal power relations – from transnational companies to host governments, through to affected people. Law making itself is an inherently political process, and as such it is influenced by power relations. Depending on whose rights the law protects, power relations can also significantly ease, or constrain, implementation.

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Any effective engagement with legal processes must come to terms with the relationship between the legal sphere and real-life power relations. Navigating the political economy of legal processes can facilitate important advances on how to use legal tools for sustainable development.

This issue has a number of dimensions. First are the power relations between the government, the investor and affected people in a given investment project. In natural resource projects, the balance of negotiating power tends to shift over the duration of a project. The investor’s negotiating power vis-à-vis the host government is diminished after the bulk of the investment has been made, because the investor cannot exit the project without incurring major losses (Vernon, 1971).

Changes in commodity prices over the duration of an investment project tend to be reflected in shifts in legal and contractual arrangements between economic liberalism and resource nationalism (Wälde, 2008). These evolving political economies have enabled some states to unilaterally revise tax legislation or investment contracts. Investors can accept, negotiate or resist these legal changes, including through mobilising the legal arenas (international arbitration, for example).

The balance of power in relations between companies and government, on the one hand, and affected people, on the other, is typically unfavourable to the latter, reflecting enormous differences in access to resources, capabilities, relations, influence and coercion. But local groups may still be able to exercise a degree of



Photo: Oliviero Olivieri / Robert Harding

When people are put at the centre of investment processes, all sorts of innovations are possible

countervailing power – for example, where the investment project is vulnerable to sabotage or reputational risk. These power imbalances affect the ability of actors to use legal tools. Effective use of legal tools can also challenge powerful vested interests, however, especially where it is combined with collective action to increase countervailing power.

The second dimension of the interface between law and power relates to national legal systems. Political space influences the type of legal tools that can be used in a national context, and how (Polack *et al.*, forthcoming). Also, the political economy of the state and of natural resource relations shapes the legislation that governs the management of natural resources.

For example, features of national law such as government ownership of land and natural resources, weak local land rights, and legal arrangements for government agencies to allocate natural resources to commercial operators facilitate access to resources for foreign investors. At one level, these features reflect the policy imperative to attract investment. But in many low and middle-income countries, these features have been shaped by the experience of colonial domination, the way those countries are integrated into the world economy mainly as providers of commodities, and the political deal among social groups that underpins the national state. Understanding the political economy of vested interests and power relations in national societies can help identify opportunities and alliances for law reform and implementation.

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The third dimension of the relationship between law and power concerns inter-state relations and international law. Despite the rise of non-state actors in international law making, states remain the primary actor in the creation of international law. Power relations among states are therefore inevitably reflected in international legal developments.

For example, the shifting balance of global economic power, and the increasingly blurred divides between capital exporting and capital importing countries, underpin the new opportunities for integrating sustainable development considerations in investment treaty making (see Section 2.5). A good understanding of these dynamics can help both government and civil society to harness the politics necessary for effective legal strategies in the negotiation and application of investment treaties.

Law and the global resource squeeze: an imbalanced legal framework

Foreign investments in agriculture and extractive industries can compound pressures on natural resources. These pressures are increasing in many parts of the world as a result of population growth, urbanisation, shifting consumption patterns and economic development in emerging economies.

As part of these trends, petroleum and minerals are being extracted in previously marginal sites. The agricultural frontier is also advancing and in many places the pace of land clearances is accelerating, forests are giving ground to monoculture, and pressures on aquifers are increasing. On current trajectories, the global economy will demand more resources, not less, and pressures on resources in low and middle-income countries are projected to continue growing in future.

These trends raise major environmental concerns but also important social issues. This is because increased pressures on resources can exacerbate competition between multiple resource users – from indigenous peoples to transnational corporations. Intertwined with growing pressures on the environment is a ‘resource squeeze’ that, if not properly managed, can deprive some of the world’s poorest people of the resources they depend on for their livelihoods.⁶⁷

Where agriculture or extractive industry projects bring competing natural resource claims into conflict, whose rights are protected, how and to what extent matters a great deal – for example, where an investor and affected people bring disputes about the same investment to international arbitration and human rights bodies, respectively.

The multiple legal arenas, blurred boundaries between law and guidance, and complex relations between law and power, discussed above, foster complexity, diversity, fluidity and contestation in the development and implementation of law. Overall, however, the legal frameworks that regulate natural resource investments in low and middle-income countries tend to present major imbalances.

On the one hand, investment treaties, national law reforms and investor-state arbitration have gone a long way towards strengthening the legal protection of foreign investment and imposing discipline on the exercise of state sovereignty. Openings created by tax treaties and laws allow companies to shift profits to lower-tax jurisdictions, thereby capturing wealth generated from natural resources.

On the other hand, efforts to improve the preparedness of legal frameworks to regulate investment for sustainable development have made slower progress. Advances in international human rights law have not kept pace with the legal safeguards that international law offers foreign investment – as illustrated by the differences in the effectiveness of enforcement mechanisms already discussed.

This is not to deny that the law does provide opportunities for protecting local rights and holding decision makers to account. In many jurisdictions, national law reforms following democratisation in the early 1990s have augmented opportunities for citizen participation in decision making, strengthened the recognition of local land rights or devolved natural resource management responsibilities to local government bodies, for example (Polack *et al.*, 2013).

67. The notion of a ‘resource squeeze’ is developed in IIED (2009). See also Lee *et al.* (2012).

New human rights treaties have been adopted, existing treaties have been more widely ratified and growing international jurisprudence has clarified the normative content of human rights law.

In practice, however, the legal options available to people affected by natural resource investments are often limited, or else their effectiveness is constrained by poor implementation. In many contexts, national law empowers the government to allocate land to a company with little consultation and transparency, without social impact assessment and with small compensation payments for affected people.

In many contexts, it is perfectly legal for companies to pay little tax in the host country. In social and environmental matters, much is still left to norms, standards and guidelines that remain difficult to enforce. Legal and practical barriers restrict the outreach of breakthroughs in transnational litigation.

The overall result is a legal regime that is geared more towards enabling secure transnational investment flows than it is towards ensuring that these flows respond to local and national aspirations and benefit people in recipient countries. In other words, the law is geared more towards investment promotion than investment preparedness and more towards investment quantity than investment quality.

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In this way, the imbalances in legal rights compound the existing power imbalances that characterise the encounters between transnational corporations, government authorities and affected people. The imbalances in rights have far-reaching implications for the ways in which the social, environmental and economic costs, risks and benefits of investments in agriculture and extractive industries are internalised. As pressures on the world's natural resources increase, poorer groups in low and middle-income countries risk losing out.

Rethinking the law, addressing capacity challenges

This analysis has direct implications for law makers committed to ensuring that increased investment flows respond to a national vision of sustainable development as well as to commercial considerations, and to ensuring that increased investment results in positive social, environmental and economic outcomes at local and national levels. These law makers will be interested in strengthening investment preparedness so as to manage competition for natural resources and improve the quality of investment.

The different legal arenas mapped in this handbook offer law makers opportunities to intervene on the multiple pressure points that can influence investment processes. Law makers can introduce or strengthen FPIC and ESIA requirements, tighten up norms to minimise room for tax avoidance, all the way up to rethinking important aspects of investment treaties.

Law reform may occur through formal law-making processes at both national and international levels. Governments can negotiate treaties, or enact legislation. Enacting laws is a notoriously difficult and slow political process, however, and strong vested interests often get in the way. Power asymmetries in treaty negotiations may make it difficult for low and middle-income countries to meet their objectives. Very importantly, fast-evolving investment landscapes mean that, in many contexts, there is not enough time for the complex legal reforms that would be required.

But advances can also be made through pushing the boundaries of existing law. International human rights institutions have not shied away from progressive interpretations of existing human rights norms, even though these interpretations are not always backed up by effective enforcement. Some national legislation establishes progressive legal tools that could be used more effectively than they currently are – including, for example, local consultation and impact assessment requirements. Legal provisions regulating land ownership often leave significant room for interpretation, and political and judicial acceptance of progressive interpretation could shift the balance of legal rights without formally altering the legislation.⁶⁸

Importantly, this is not just a job for government. The variety of legal arenas offers many opportunities for civil society to push for change and redress through action at local, national, international and transnational levels. No single legal tool can bring change but the strategic harnessing of multiple tools can make a real difference to the design and implementation of natural resource investments.

Making law work in practice calls for sustained investment in capacity building at a number of levels. Government agencies need to be in a position to manage investment effectively. They need to be able to fulfil their international obligations and properly implement national legislation. Foreign investors will have access to the best tax and legal advice available so it is often difficult for governments effectively to regulate economic activities within their jurisdiction. This is the case in high-income countries, and even more so in low and middle-income countries. Capacity asymmetries also affect negotiations between high and low-income country governments, for example for investment protection or double taxation treaties.

Host governments in low and middle-income countries may consider options for strengthening their own capacity. This may include effective arrangements for mobilising the expertise available within the country. In some jurisdictions, private practice and academia may offer expertise that governments could tap into. The arrangements for harnessing this expertise when it is most needed should be put in place if they are not already due to gaps in information, communication or resourcing.

68. This point is based on conversations with Malian jurist Moussa Djiré.



Photo: Jez Coulson / Panos Pictures

Civil society can play an important role in shedding light and raising awareness on developments in investment law

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External support, where appropriate, could come through a number of channels. These could include technical co-operation projects funded through development aid, partnerships with leading universities, provision of legal and technical advice from global firms on a *pro bono* (voluntary) basis, pooling of experience and expertise among countries, and secondments of staff from the private sector or from government agencies in other jurisdictions.

The issue of capacity is not limited to government. Non-governmental organisations, parliamentarians and the media need to be in a position to scrutinise government action effectively and hold decision makers to account. National associations protecting the interests of rural producers and of workers must be properly equipped to have a strong voice, and to help their most vulnerable constituents to exercise their legal rights as a basis for pursuing their development aspirations. And legal avenues alone are typically not enough: collective action and political mobilisation can help to give real leverage to legal rights.

Options for augmenting capacity in the non-governmental sector may include better harnessing of existing internal capacity – for instance, through documenting success stories and sharing lessons from experience. It may also involve strategic local-to-global alliances between organisations that can contribute complementary capacities – for example, technical and legal expertise, skills and channels for outreach and campaigning, and capacity to mobilise politically vocal constituencies.

Long-term vision and citizen action

The law regulating natural resource investments involves highly technical legal issues. Detail and specialised expertise are therefore critical. Many discussions about investment law focus on the wording of treaties, or the interpretive approaches taken by arbitral tribunals. The handbook has discussed some of these technical issues, although in order to keep the text accessible more complex matters have had to be simplified.

Yet, at a time when jurists are under growing pressure to specialise in ever narrower fields, harnessing the law in a strategic way calls for legal professionals to be able to take a 'big-picture' view of the multiple legal arenas involved and how these arenas interconnect. The increasingly fluid boundaries between national and international law, and between hard and soft law, reinforce this need for more holistic approaches to understanding and using legal tools.

Also, the fact that legal norms are embedded in complex social processes highlights the limitations of conventional, formalistic approaches to the law (Perry-Kessaris, 2013; Tan, 2013). Using the law effectively is not just about word-smithing or legal plumbing – fixing the flows and connections amongst applicable norms. Legal specialists working on investment and sustainable development need to understand how best to adapt legal categories to the wide diversity of social contexts and investment models, and how legal options are affected by the shifting power relations that characterise investment flows in low and middle-income countries.

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More fundamentally, harnessing the law to ensure that investments contribute to sustainable development is not just about dealing with technical aspects. It calls for developing a vision for the development and implementation of the law in light of real-life trajectories towards sustainable development. Politics are essential to this process. The regulation of foreign investment is an eminently political issue, as is the governance of land and natural resources. Different approaches to law making in these fields assume important political choices about the extent and nature of government intervention in the economy.

Use of the tools discussed in this handbook in itself would reflect political choices: few would argue that investment projects should not undergo effective impact assessment processes but there are major political considerations involved in policy choices concerning taxation, the balance between investment promotion and policy space, the use of performance requirements, and land ownership, to name just a few examples.

This is why this handbook has placed so much emphasis on the political rights citizens can leverage to influence public decisions. Harnessing the law to make investment work for sustainable development is not a task for government regulators or legal advisors alone. It also requires vibrant civil society organisations and social movements to advocate, scrutinise, challenge and influence. Perhaps most importantly, it requires citizens themselves to be able to appropriate and wield legal tools in their efforts to shape their own future.

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2. International treaties and instruments

Trade and investment treaties (by date of signature/adoption, most recent top)

- Benin-Canada BIT of 2013: Agreement between the Government of Canada and the Government of the Republic of Benin for the Promotion and Reciprocal Protection of Investments, signed on 8 January 2013, not yet in force. <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/benin-text.aspx?lang=eng>.
- US-Uruguay BIT of 2005: Treaty between the United States of America and the Oriental Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment, signed 4 November 2005, into force 1 November 2006. http://www.ustr.gov/sites/default/files/uploads/agreements/bit/asset_upload_file748_9005.pdf.
- Germany-Philippines BIT of 1998: Agreement between the Federal Republic of Germany and the Republic of the Philippines for the Promotion and Reciprocal Protection of Investments, signed 18 April 1997, into force 24 July 1998.
- General Agreement on Trade in Services (GATS), Annex IB to the Agreement Establishing the World Trade Organization, signed in Marrakesh on 15 April 1994, into force 1 January 1995. http://www.wto.org/english/docs_e/legal_e/26-gats.pdf.

- Agreement on Trade-Related Investment Measures (TRIMs). Annex to the Agreement Establishing the World Trade Organization, signed in Marrakesh on 15 April 1994, into force 1 January 1995. http://www.wto.org/english/docs_e/legal_e/18-trims.pdf.
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- ICSID Arbitration Rules: Rules of Procedure for Arbitration Proceedings (Arbitration Rules), adopted by the Administrative Council of the International Centre for Settlement of Investment Disputes. <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=RulesMain>.
- ICSID Arbitration (Additional Facility) Rules, adopted by the Administrative Council of the International Centre for Settlement of Investment Disputes. <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=AdditionalFacilityRules>.
- UNCITRAL Arbitration Rules (as revised in 2010). United Nations Commission on International Trade Law. Resolution adopted by the United Nations General Assembly, 6 December 2010, <http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules-revised/arb-rules-revised-2010-e.pdf>.
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