



## **Columbia FDI Perspectives**

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### **The importance of negotiating good contracts\***

by

Karl P. Sauvant\*\*

Complex contracts between governments and foreign investors, covering large-scale projects especially in natural resources, agriculture and infrastructure, define the long-term relationship between the parties. It is therefore important that they are negotiated with a view to the allocation of benefits and responsibilities for years to come. Well-defined regulatory frameworks establishing clear parameters are crucial, but even then developing countries and economies in transition (“emerging markets”) often need to undertake fine-tuning negotiations. Moreover, they depend on mobilizing their limited assets to reach the Sustainable Development Goals (SDGs).

Negotiating such contracts is a challenge under any circumstances. Take minerals as an example: geologists need to ascertain the quality of a deposit; industry specialists assess market conditions, investors’ strategies and prices; financial analysts model trade-offs between, say, royalties and income taxes; other specialists evaluate environmental and social impacts; and, naturally, host countries need experienced lawyers to negotiate the terms of contracts (including renegotiation provisions) with the world-class advisors typically available to large foreign investors. Governments face challenges from lack of expertise, an imbalance of financial resources, time pressure, and the potential for corruption.

Many emerging markets negotiating with foreign investors simply do not have the human and financial resources to negotiate the best possible deals.<sup>1</sup>

Bad contracts eventually lead host countries to become dissatisfied, particularly if not receiving a fair share of the economic benefits of a project. This can result in conflicts that negatively affect both the credibility of future government commitments and the operations of existing investors. Good contracts are therefore beneficial for both host countries and investors.

Conflicts, furthermore, can escalate into costly international arbitrations under dispute-settlement clauses in the contracts themselves, host country legislation or investment treaties. The International Centre for Settlement of Investment Disputes had registered 597 disputes by the end of 2016; of these, 29% involved extractive industries and agriculture and 44% infrastructure (electrical power and other energy; water, sanitation flood protection; construction; transportation; information; communication)<sup>2</sup> – typically large-scale projects. Arbitration costs are normally high (especially in extractive industries), awards can be in the hundreds of million dollars and countries’ reputations can be damaged – and all this in addition to possible disruptions to the projects themselves.

What to do to arrive at good contracts that are more likely to last?

Providing information to negotiators of emerging markets helps. At least for natural resources, CCSI has established a Negotiation Support Portal that provides useful information to negotiators. It “aims to address the information-sharing and coordination gap by improving the accessibility and visibility of useful tools & resources and technical support available to assist governments in the investment process.”<sup>3</sup>

But, in the end, good contracts depend on the ability of host countries to field experienced negotiation teams.

No institution currently provides governments with comprehensive, multidisciplinary negotiation support on short notice (if need be) regardless of economic sector or geographic region. Only partial support is available for resource-constrained host countries, for example, through the African Legal Support Facility and the International Senior Lawyers Project.

Importantly, therefore, Germany established the CONNEX Support Unit early 2017 “to provide assistance to governments of developing as well as transition countries in negotiating, renegotiating or implementing large-scale, complex investment contracts.... It aims to provide rapid, independent, high-quality, and multidisciplinary support” to requesting governments, “...to arrive at stable contracts that are commercially viable and contribute as much as possible to the sustainable development of host countries”.<sup>4</sup> The Support Unit has begun to assist in identifying experts, funding their work and exercising quality control. It is a facilitator.

The challenge is making this ambitious facility an effective and credible institution that gains the trust of potential clients and builds a record of success that demonstrates its utility. It should not become a large unit nor house its own experts. Rather, it should rely on top-level external experts and the cooperation of other institutions with such expertise. It needs to concentrate on its core competence of assisting in actual negotiations. Its success depends on being administratively agile and independent of influence by investors and their home country governments. Its experts must be able to help prepare negotiating positions and advise on options for decision-making by host country governments (including that it may be advisable not to conclude a given contract), but

they must not see themselves as decision-makers. On-the-job training of local staff should be explored to help build local capacity, including for monitoring the contracts negotiated.

Negotiation parties need to arrive at mutually beneficial, durable contracts that are commercially viable and help mobilize the domestic resources host countries require to achieve the SDGs. Any assistance host countries can get from any facilitator to arrive at good contracts is very desirable.

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<sup>1</sup> Even developed countries at times lack the in-house human resources to negotiate large-scale contracts, but they have the financial resources to hire the expertise required.

<sup>2</sup> See [https://icsid.worldbank.org/en/Documents/resources/ICSID%20Web%20Stats%202017-1%20\(English\)%20Final.pdf](https://icsid.worldbank.org/en/Documents/resources/ICSID%20Web%20Stats%202017-1%20(English)%20Final.pdf), chart 7.

<sup>3</sup> See <http://negotiationsupport.org/about>.

<sup>4</sup> See <http://connex-unit.org/mandate-2-2/>. The establishment of CONNEX by Germany's BMZ is the outcome of a process that began some 20 years ago at UNCTAD, continued in 2006 at Columbia University, subsequently involved, importantly, the Humboldt-VIADRINA School of Governance (Peter Eigen), and was introduced into the G7 in 2014.

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