Chapter Ten: Respect for Human Rights in Investor-State Relationships

Overview

Brief overview of investor-state relationships

States enter into a variety of contracts with companies, for example through procuring goods and services or entering into public-private partnerships or for natural resources concessions. This chapter focuses on investment relationships between a company and a state, including contracts signed between national governments and investors (sometimes referred to as investment contracts, government agreements or host government agreements (HGAs)). An investor-state contract is a legal agreement between an investor (often a foreign investor) and a governmental entity that defines the responsibilities of each party, typically with respect to the development, construction and operation of a project by the investor. They are particularly common for large agricultural projects, large infrastructure projects (to construct roads, railways, ports, official buildings, dams, etc.), and exploration and exploitation of natural resources (oil, gas, minerals, water, forestry resources). The contracts for extractive projects often take the form of a license, concession, or production-sharing agreement granting exploration and/or production rights.

Contract terms typically address issues that are uniquely in a government's power to grant or regulate. These may include indemnifications, authorisations, taxation, protections from expropriation, local content requirements, and granting access to land. Such contracts may also contain clauses that provide companies with subsidies, exemptions, or remedies (such as compensation if the value of their investment is adversely affected by changes in the national or sub-national regulatory regime). Such clauses are often called "stabilisation clauses". Investment contracts set out arrangements and venues for dispute resolution, which can include referral to international arbitration. More recent investment agreements may also address investor compliance with national laws and regulations on environmental and social issues.

Human rights and investor-state relationships

Businesses may consider human rights impacts for a number of reasons when entering into contracts with states. For example:

- Projects covered by investor-state contracts often have a large physical footprint. Because of their scale, they may be associated with significant human rights risks. Governments are expected to incorporate requirements related to their duty to protect human rights into the contracts they conclude.[97] As a result, investor-state contracts should include content that would not otherwise be included in purely private contracts. Examples include stabilisation clauses (discussed further below), human rights requirements regarding the provision of public services, and requirements to protect cultural sites. Provisions addressing human rights issues in these contracts are

97 Guiding Principles 4-6.

likely to continue to evolve. Equally, citizens and civil society have higher expectations for transparency around such contracts because their government is directly involved in what are often large projects that are significant to the national economy. For companies, this may have important implications not only regarding transparency but also communication, grievance management and remedy, and consultation and participation.

- Contracting with a government (even when the contract limits the relationship to a single project) associates the company with the government for that project, and in the public mind, often beyond the project. Even when a company is the operator and able to control the project's performance standards, by association it may be linked to a government's poor human rights record or corruption elsewhere. In some circumstances, for example because sanctions are in place, it may be clear that it is not appropriate to work with a government. In many others, a difficult balancing of considerations is required.
- Companies may be obliged to contract with the government on a range of services that pose human rights risks and over which they may have limited control. These include land acquisition, resettlement, public consultation, and provision of security. A company must often be creative, display persistence and employ many forms of leverage to respect human rights and overcome official resistance to doing so. The Guiding Principles make clear that companies are required to act responsibly, and to respect human rights, even if the governments with which they cooperate do not.

The UN SRSG's Work on Investor-State Contract Negotiations

The UN SRSG's *Principles for Responsible Contracts: Integrating The Management of Human Rights Risks Into State-Investor Contract Negotiations: Guidance for Negotiators*[98] sets out the steps and considerations that parties to investor-state contracts can consider and how such issues can be reflected in contracts.

Contract negotiations provide an important opportunity to identify, avoid and mitigate human rights risks at the earliest stages of an investor-state venture. The Principles note that states fulfil their human rights obligations in part by taking legislative measures to address a broad range of human rights issues, including health, safety, labour, environment, security and non-discrimination. Where stabilisation clauses are adopted, states must retain the latitude to adopt and fully implement such measures.

The document sets out ten principles. A commentary explains each principle's content, context and implications, and a recommended checklist for negotiations.

98 At: http://www.business-humanrights.org/media/documents/ruggie/report-principles-for-responsible-contracts-25-may-2011.pdf. The Principles built on the SRSG's earlier work on stabilisation clauses and their potential adverse impacts on human rights.

The principles cover:

1. Early preparations for negotiating the project.
2. Identification of responsibilities for preventing and mitigating the project's potentially adverse human rights impacts.
3. The project's operating standards.
4. Use of contract stabilisation clauses.
5. Use of 'additional goods and services provisions'.
6. Physical security for the project.
7. Community engagement.
8. Project monitoring and compliance.
9. Grievance mechanisms for non-contractual harms to third parties
10. Transparency of contract terms and conditions.

The Business Relationship Cycle

Selecting and Starting the Relationship

Setting expectations and communicating them to business partners

Investor-state contracts provide opportunities for private partners to proactively improve uptake of the Guiding Principles by their state business partners and level the playing field amongst public and private businesses.

Through investor-state contracts, companies can raise their state business partner's awareness of the Guiding Principles and promote their implementation. Respondents acknowledged this requires concerted effort and frank dialogue about operating standards, because few governments have yet to reflect their duty to protect into their negotiations or contracts. Where the agreements involve state-owned enterprises (SOEs), respondents noted in particular that levelling the playing field with public sector competitors and partners is especially important in moving forward with global implementation of the Guiding Principles. As one respondent remarked, both private companies and SOEs have a responsibility to respect human rights and both should therefore compete on the same terms, including adherence to international standards and expectations.

Understanding the issues – Assessing human rights impacts in investor-state relationships

Business relationships with governments can magnify real or perceived involvement with states' human rights abuses.

Respondents noted that entering into a business relationship with a government involved in human rights abuses unrelated to the business relationship nonetheless risks criticism for doing business with the government. As one participant noted, it is an issue of proximity

– there is a real likelihood that if issues with the government arise the company would likely be criticised. The test should be whether the actions of the government are "directly linked" in any way to the business relationship. In sectors where relations with government are integral to doing business (such as the extractives, infrastructure, and to a lesser extent, telecommunications sectors), the perception of "directly linked to" may be far wider than is actually the case. It requires careful planning and management to enter and structure a relationship with a government to minimise linkage and even more importantly, impacts.

State-Owned Enterprises (SOEs) inexperienced in human rights management can bring risks and challenges for their private partners.
Recognising the wide variations in size and scale of SOEs, respondents noted that it is difficult to generalise about the attitudes of these companies to human rights or their capacity to respect them. However, smaller SOEs (which governments often impose on private companies as business partners) are generally regarded as higher risk and lack awareness of their human rights responsibilities and associated due diligence measures. At the same time, participants regarded some larger SOEs as increasingly open to learning, gaining experience and obtaining insights from international companies, for example, through the use of their private partner's or industry association's resources on issues such as health and safety, impact assessments and local community relations.

Assessing country risk is a standard consideration.
All participants carry out some form of country risk assessment within their due diligence processes, especially when dealing with a government as a business partner. Assessments of this kind generally draw on publicly available third party research such as country reports by the US State Department, Amnesty International, Human Rights Watch, the Business and Human Rights Resource Centre's country portal, and Transparency International's Corruption Perceptions Index, amongst others. Some of the participant companies also commission risk assessments and bespoke research from private consultancies. Most also require their own local staff to prepare regular or periodic briefings to headquarters of the situation 'on the ground'. A company's country risk assessment tends to become more detailed over time as it accumulates project and design information, experience in working with the government, and this information becomes incorporated into its impact assessment.

Participants noted that they often take account of particular country contexts, including:

- **Weak, absent, or unenforced law.** Some companies apply formal criteria to decide when and whether to enter or exit a country, while others identified this as a gap which they planned to address as they moved forward on implementation of their responsibility to respect.
- **Conflicts between domestic law and international human rights standards.** All respondents were versed in the objective of seeking to honour the principles of internationally recognised human rights standards in the face of silent or conflicting domestic law. Some more systematically addressed the conflict of laws dilemma than

others, such as by providing formal guidance to staff potentially faced with such situations, agreeing methods at the point of contracting for ensuring compliance with relevant international and third party standards, and ensuring flexibility in the project's governance framework for evolving standards.

- **Conflict or potential conflict.** In general, the risk that companies may become linked with state abuses of human rights – and potentially the most serious forms of abuse – rises sharply wherever conflict occurs. Internal or international armed conflicts often bring principles of international humanitarian law into play, and require heightened human rights due diligence processes and procedures.

Developing processes to assess governments as business partners is still a work in progress.

The Guiding Principles note that a potential business partner's track record on human rights is a relevant consideration that should be factored in when setting up a relationship. Most companies can readily establish whether a government business partner is subject to international or national sanctions; and most can evaluate broader country risks. Expertise in assessing states or state agencies as business partners is less well developed, however, than for private sector partners.

In certain sectors, notably the extractive industries, companies may be given little choice about who they can partner with. Respondents noted a number of problems where governments or SOEs do not give human rights serious attention. Companies often try to increase their operational control in these circumstances.

National authorities or international financial agencies may require stakeholders to be consulted on large projects and respondents often feel well placed to lead this process.

Governments may require potentially affected groups to be consulted on large projects that are subject to investor-state agreements. The Guiding Principles also emphasise the importance of consulting potentially affected stakeholders, particularly in circumstances where the operating context poses risks of severe human rights impacts. As a matter of standard practice, companies are undertaking preliminary socio-economic baseline studies before beginning any activity, enabling them to identify relevant stakeholders to engage. Levels of government involvement and support for consultation processes vary considerably, from those that are well developed and government-led to those with no formal government involvement. Companies put their own consultations in place when not supported by the government, including in cases when they must find pragmatic ways to obtain information about perceptions and impacts.

Several respondents noted that they prefer to lead on consultation processes involving relocations and compensation, rather than leaving the process entirely to government, to ensure that consultations are carried out in accordance with international standards and expectations.

Formalising the Relationship

Host states are not always equipped or willing to accommodate international and public expectations on human rights when negotiating agreements.
Participants noted that there is very little standardisation globally of contract terms for investor-state contracts. Governments tend to develop agreements according to their particular country context and history. Respondents added that investment contracts do not generally refer to human rights issues specifically. They may however refer to international standards more broadly. They may also contain provisions on employment law, health and safety of employees, local content requirements, environmental and social considerations, and sometimes international conventions.

Several respondents noted that when attempting to include additional social and environmental clauses in investment contracts during negotiations, their government partner had resisted their inclusion. Respondents explained that they will often be presented with a pre-drafted agreement in which they have little capacity to add clauses. In some cases, respondents said they had been pressed to adopt text that referred to national law rather than to international standards, because the state concerned did not wish to reveal deficiencies in its domestic law.

In some instances, companies have successfully included their own environmental, labour, and land negotiation standards and processes that do not rely on national requirements in investment contracts. Contracts may also sometimes include references to the performance standards established by the IFC or the Equator Principles (references that are mandatory when securing financing from those institutions). In this way, investment contracts can form the basis for establishing higher standards of social and environmental performance.

At the same time, respondents recognised that it is not sufficient to simply insert references to human rights in contracts; on their own, contracts will not shape government behaviour. It is necessary to operationalise human rights standards and due diligence in the governance of the partnership, supported by training and awareness-raising, as well as on-going monitoring of the commitments according to the particular context.

Companies and external stakeholders often have different perceptions about the extent to which companies exert leverage with governments.
Respondents noted that NGOs and civil society organisations commonly assume that private companies have more influence over government partners than company officials feel they may have in reality. Respondents described the different roles governments can play within investment activities, for example as legislator and regulator, judicial authority, business partner (such as a JV member), and provider of basic services. Governments also have many tools at their disposal to control inward investment: they can pass laws, restrict foreign shareholdings in national companies, curtail foreign ownership in privatised companies, and regulate joint ventures between foreign and local enterprises.

The respondents observed that a company's leverage with government changes, sometimes dramatically, after committing large up-front investments. Thereafter the investment is potentially vulnerable should disputes arise with the host government threatening termination or expropriation. Companies suggested that, for this reason, the negotiation of contracts remains a crucial phase. It provides the opportunity to lay down minimum standards and establish robust mitigation measures to reduce risks posed by business partners and the operating context, such as through specific organisational roles, assurances, as well as proactive training and education (often mandated) of local business partners. The UN SRSG's *Principles for Responsible Contracts* affirm the early opportunity investor-state contracts provide in establishing minimum standards and setting clear expectations during negotiation to the benefit of the project and partnership throughout the relationship cycle.

Projects covered by investor-state contracts often require provision of public security. This raises challenges around state sovereignty and the duty to protect. Respondents agreed that the recruitment and management of government security forces is a particular challenge. It is often necessary to provide security for operations that are covered by investor-state contracts, and host governments will frequently offer or require that its police force or military is employed to protect projects, especially jointly owned assets. Yet, some participants noted, human rights risks are far higher with government forces, because companies have less leverage over them than over security providers they contract privately. Security negotiations with states are therefore doubly sensitive. Companies prefer to hire private security, because they are better able to control human rights and reputational risks; but governments tend to view security as a state responsibility, implicating its sovereignty. As such, participants reported that when they had proposed to provide private security for the project or operation, government negotiators would sometimes refuse the offer. In such circumstances, one respondent reported the practice of ensuring clear communication of company expectations to the government partner. Each partner's expectations and responsibilities around security provision would ideally be reflected in the contract itself, or a Memorandum of Understanding (MOU), followed by ongoing dialogue to ensure such expectations and responsibilities were reflected in day-to-day business and operations.

Referring to MSIs can provide an avenue to reinforce human rights in investor-state agreements.
Inserting references to multistakeholder initiatives in contracts can be a credible and effective way of building in human rights protections. Several participants noted that the Extractives Industries Transparency Initiative (EITI) (a coalition of governments, companies, investors, civil society and international organisations set up to promote transparency in oil, gas and mining) provided clear guidance and metrics useful to both companies and states. The Voluntary Principles on Security and Human Rights (VPs) initiative was similarly seen to provide an authoritative process for implementing their responsibility to respect in high-risk countries where enforcement of law was weak. One respondent consistently seeks to include an explicit reference to the VPs in MOUs covering public security forces with governments in high-risk areas.

Managing the Relationship

Perceptions of the benefits from (and motives for) local content requirements are mixed.
Governments frequently impose local content requirements within foreign direct investment regulation as a way to promote national employment and technology transfer. Participants considered that such requirements are an inevitable feature of the investment landscape, but differed in their assessment of the benefits. Some work closely with local business partners because they feel it is in their strategic interest to build and strengthen local firms' capacities on key compliance issues such as standards of production, worker safety, training and security. This was described by one respondent as a reverse incentive: companies had to bring local partners up to standard because of the restraints to recruiting outside expertise. Others considered local content requirements as beneficial because they promote the national and local industrial base and the skills of national and local partners. Quite a few of the participants who have international production also noted efforts around water use and conservation, agriculture and farming in order to build up the local skills base for more local sourcing. Some of the companies include such elements in their bid packages. In one case, after a five-year capacity-building period, one company was sourcing 95% of its inputs from local businesses.

"Additional goods and services" provisions can be seen to contribute positively to local development or inappropriately displace government's responsibility.
States can require investors to provide non-commercial services or infrastructure (such as schools, healthcare facilities or roads) that are unrelated to its core project activity. Participants' had different views on the issue. Some run and finance various supplementary community projects, in association with local NGOs, on education, medical and agricultural projects. Others were hesitant to become involved with such arrangements out of concern of raising community or civil society expectations about their operational responsibilities or developing a potential reliance by the state for the private sector to deliver certain public services. The UN SRSG's *Principles for Responsible Contracts* notes that private provision of public goods and services can blur the roles, responsibilities and accountability of businesses and government, and emphasises that both parties retain their respective responsibility to respect and duty to protect human rights.

Contractual transparency expectations increase when working with governments.
Contracts with governments may be subject to additional disclosure and reporting requirements, presenting a key difference as compared to contracting with purely private sector partners. Participants have observed a trend in some countries to make contracts public, particularly in the extractives sector, and publicise project and investment

agreements, for example in national parliaments and official gazettes.[99] Such disclosure is viewed as a means of decreasing corruption and improving good governance. Some states, however, prohibit the publication of contracts, putting companies in a difficult position on how to meet contrasting international expectations, and even opposing home and host state laws, on disclosure and transparency. As one participant remarked, this is "the dilemma of choice about which country's jail the CEO ends up in".

Scrutiny of Investor-State Contracts is Increasing

- **The UN: the SRSG's work on investor-state contract negotiations**
  The UN SRSG's *Principles for Responsible Contracts* notes that "[c]ontract terms, with exceptions for compelling justifications, should be disclosed in an accessible manner and seen as part of the community engagement plan for the project"[100] (see box on page 130: The UN SRSG's work on investor-state contract negotiations for further background on the Principles' aims and content).[101]

- **The World Bank Group: the International Finance Corporation**
  The 2011 revision of the IFC Policy on Environmental and Social Sustainability[102] includes new provisions on sector-specific governance and disclosure. Until 2013, the IFC will encourage governments and corporations to make extractive industry contracts public; thereafter it will require publication of the principal contract with government that sets out the key terms and conditions under which a resource will be exploited, and any significant amendments to that contract. When the IFC invests in infrastructure projects that involve the final delivery of essential services to the general public under monopoly conditions (such as retail distribution of water, electricity, piped gas, and telecommunications), it encourages the public disclosure of information relating to household tariffs and tariff adjustment mechanisms, service standards, investment obligations, and the form and extent of any ongoing government support.

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99 In addition to OECD states, the governments that publish their contracts with extractive companies include Peru, Liberia, and Timor-Leste; several more governments are moving in the same direction. Niger's new constitution requires that all oil and mineral contracts are published in the official gazette. Sierra Leone passed a new petroleum act that requires publication of all oil contracts. Guinea passed a new mining code in 2011 that requires the publication of all contracts in the official gazette and on the government website. In Iraq, the Kurdish Regional Government publishes all its petroleum-sharing agreements with oil and gas companies.

100 At: http://www.business-humanrights.org/media/documents/ruggie/report-principles-for-responsible-contracts-25-may-2011.pdf.

101 The Principles were presented alongside the UN SRSG's final report on the UN Guiding Principles but were not in the package of documents that was unanimously endorsed by the UN Human Rights Council.

102 At: http://www1.ifc.org/wps/wcm/connect/7540778049a792dcb87efaa8c6a8312a/SP_English_2012.pdf?MOD=AJPERES.

- **Civil society: work on investor-state contracts**
  Civil society organisations are increasingly focusing on contracts, recognising that they shape business relationships and their impacts on local communities. For example:
  - **Global Witness** investigates, campaigns and lobbies on natural resource-related conflict and corruption. Its contract analyses aim to build a body of knowledge that governments and communities can use during contract negotiations.
  - **The International Institute for Environment and Development** works extensively on investor-state contracts and their implications for sustainable development.
  - **The International Institute for Sustainability and Development**, amongst other work on the issue, has developed a toolkit on international investment agreements for country negotiators. It includes a model standard form agreement with provisions on contract and revenue transparency.[103]
  - **Revenue Watch** undertakes research on disclosure and confidentiality in extractive industry contracts.

Demands for public reporting of revenue are also increasing.
Participants noted that civil society organisations (such as the Publish What You Pay Coalition), but also international financial institutions such as the IFC,[104] are calling on companies to publicly report on and disclose information regarding their revenues and payments to host governments. They cited various new global and regional financial transparency laws, including the forthcoming EU country-by-country financial reporting requirements[105] (which require extractive and logging companies to declare taxes, royalties and bonuses paid to host countries, and will potentially be extended to the banking, telecoms and construction sectors) and the US Dodd-Frank Wall Street Reform and Consumer Protection Act[106] (which requires extractive companies to disclose their payments to foreign governments annually to the US Securities and Exchange

103 At: http://www.iisd.org/pdf/2005/investment_model_int_handbook.pdf.

104 IFC Policy on Environmental and Social Sustainability (2012) – Infrastructure Projects 49 states: "When IFC invests in projects involving the final delivery of essential services, such as the retail distribution of water, electricity, piped gas, and telecommunications, to the general public under monopoly conditions, IFC encourages the public disclosure of information relating to household tariffs and tariff adjustment mechanisms, service standards, investment obligations, and the form and extent of any ongoing government support. If IFC is financing the privatization of such distribution services, IFC also encourages the public disclosure of concession fees or privatization proceeds. Such disclosures may be made by the responsible government entity (such as the relevant regulatory authority) or by the client." See: http://www1.ifc.org/wps/wcm/connect/7540778049a792dcb87efaa8c6a8312a/SP_English_2012.pdf?MOD=AJPERES.

105 At: http://europa.eu/rapid/press-release_IP-11-1238_en.htm?locale=en.

106 At: http://www.sec.gov/rules/final/2012/34-67717.pdf.

Commission.[107] Respondents commonly felt that such legislative measures were often narrowly conceived, and could have unintended impacts on those who were expected to benefit. They considered MSIs like EITI (see box below) to be far more effective in increasing transparency and improving the governance and benefits of natural resources exploitation to foster growth and reduce poverty.

Reporting on Revenue Transparency

The **Extractive Industries Transparency Initiative** (EITI) is a coalition of governments, companies, civil society groups, investors and international organisations. All countries implementing the EITI standard publish reports that disclose how much revenue governments receive from the extraction of natural resources, while companies disclose what they have paid in taxes, royalties and other fees. These two sets of figures are compiled and reconciled by an independent reconciler, making transparent for citizens and other stakeholders, often for the first time, what their government receives for their country's natural resources.

The EITI 2012 *Extracting Data Report*[108] is an overview of six years of EITI reports. It compiles key information, including total government revenues and company payments for 30 countries and data from more than 900 companies. Most reports cover the oil, gas and mining sectors, though some countries have included forestry and agriculture. Certain EITI reports go beyond revenue and payment information, with those on Ghana, Mongolia and Peru for example including data on extractive sector flows to local governments.

Company operational level grievance mechanisms can provide a competitive advantage when working with government.

One participant noted the advantage their human rights due diligence and remediation processes offered when working with governments. In one instance the application of company resettlement requirements lead to the resolution of previously unaddressed resettlement issues in the area. This contributed to the award of a license, as the host government aligned with the company's priorities and standards around resettlement issues and procedures.

107 The American Petroleum Institute, the International Chamber of Commerce and two other industry associations challenged the rule before the US courts. http://www.csrandthelaw.com/.

108 At: http://eiti.org/document/extracting-data.

Ending or Renewing the Relationship

After a change of government, companies may have to build their relationships all over again.

When the political party in power changes, companies may have to renew their relationships with government. Participants noted that new administrations would not necessarily be willing to agree to a relationship on the same terms or expedite negotiations as a result of previous dealings, no matter how positive they had been. One respondent pointed out, however, that because it had managed its reputational legacy carefully, the incoming government welcomed its subsequent return to the country. Many companies participating in the research agreed that companies must be prepared to forge relationships and agreements with states on a case-by-case basis.

Legacy, and its reputational consequences, are highly correlated with country context.

Respondents noted that at times they are met with strong pressure to disinvest from countries that have a poor human rights record. They agreed that numerous factors must be weighed when taking such a decision. In addition to considering longer-term prospects for political change and related social and economic factors, a company has a duty to take into account the fate of staff left behind and the identity and reputation of those who might take over its projects. Several participants observed that the incidence of human rights abuses tends to rise when a government or a government-favoured company takes over in such situations. All participants recognised this is a difficult dilemma, which generates reputational risks.