

# IISD Handbook on Mining Contract Negotiations for Developing Countries

## VOLUME I: PREPARING FOR SUCCESS

Howard Mann  
IISD Senior International Law Advisor

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April 2015

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## About the Author

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## ACKNOWLEDGEMENTS

The present text reflects the contributions to learning of dozens of people, many unknowingly, some even unwittingly. Over several years I have been privileged to work on the issue of mining and sustainable development with giants in the field. Trying to distill their experience, wisdom, practical advice and understandings on the issues at hand is a daunting goal.

Firstly, I would like to thank the other members of the gang of four I was so fortunate to work so closely with on the drafting of the International Bar Association's Model Mine Development Agreement, Luke Danielson, Peter Leon and Bob Basset. They are an incredible group of people who displayed the highest level of professionalism, courtesy and true effort to build something better than was there before. And they succeeded. It was truly an honour to be involved, and to have that process as a basis to build upon.

The MMDA process was my introduction to the myriad details of mining law. Since then, I have been fortunate to participate in conferences, consultations and training sessions around the world on mining and sustainable development. The many participants in those meetings are far too numerous to mention. But many of those on the front side of the lectern can be noted: Luke Danielson, Peter Leon, Bob Basset, Kristi Disney, Suzy Nikiema, Carin Smaller, Joe Zhang, Laura Baretto, Adriano Trindade, Jerry Cormick, Carlos Vilhena, Ousmane Deme, Ciata Bishop, Benjamin Aryee, Coumba Ngalani, and Elizabeth Bastida.

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And to my colleagues at IISD, in particular: Aaron Cosbey, my co-conspirator for some 17 years now, Nathalie Bernasconi, and Mark Halle, and for specific contributions to this volume including editing and suggestions for improvement: Aaron Cosbey, Carin Smaller, Martin Brauch and Oshani Perera, Tom Penner and Kathy Clark for copy edit and design, and Flavia Thome for project and author management, thank you all so much.

The diverse inputs of all of these people do not entail their responsibility for its failings. I alone take responsibility for those.

And to Julie, for reigniting all the colours of the rainbow, thank you my love.

## PREFACE

The IISD Handbook on Mining Contract Negotiations for Developing Countries builds on the experience of the author and colleagues in developing and delivering training programs, curricula, model contracts, and reviews of international best practice in developing countries in Africa, Asia and Latin America and with international institutions active in this field. The result is thus the collected distillation of the learning I have been the beneficiary of from colleagues engaged in these processes, and from those who have participated in the courses as students and observers.

Among the key sessions were public consultations on the development of the International Bar Association's Model Mine Development Agreement (MMDA) in April 2010 in Toronto, and December 2010 in Beijing; and at the International Bar Association Annual Meeting in Vancouver in October 2010; courses in Mozambique led by Luke Danielson and the Sustainable Development Strategies Group in December 2012; training sessions in Ouagadougou, Burkina Faso in September 2013 by IISD; the Intergovernmental Forum on Mining, Minerals and Sustainable Development Annual Meeting in October 2013 with colleagues from the African Legal Support Facility and World Bank Institute; training undertaken by IISD in Laos for local government personnel and in Thailand for ASEAN regional representatives, both in 2014; in the Dominican Republic in 2014 as well; and in Arusha, Tanzania and Ouagadougou for anglophone and francophone African government officials in June and October 2014, with Sustainable Development Strategies Group, African Legal Support Facility and the World Bank.

In each case, parts of earlier drafts of this handbook and/or the MMDA on which many elements are based were used as part of the session design and material. The feedback from colleagues on both sides of the lectern has led to multiple improvements in content and design. The author is most grateful for the collective learning and experience sharing of all of these and other events. The handbook is not meant to be an end product in itself. Rather, it is hoped it will be part of an ongoing process for developing country governments and communities in setting out their own needs and approaches to maximizing the sustainable development benefits of mining in their states.

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# PART 1: INTRODUCTION





# PART 1: INTRODUCTION

This *IISD Handbook on Mining Contract Negotiations for Developing Countries* fills a need for a self-contained tool to help guide developing countries through the process of negotiating investment contracts with mining companies. Unlike some guides or model contracts that seek to provide a one-size-fits-all solution, this handbook seeks to assist government officials to first identify their needs and goals, and then to prepare themselves in a manner that will enable more effective negotiating by government negotiators and those behind the scenes who assist them.

In this sense, the guide does not replace the active engagement and responsibility of the government officials and representatives. Rather, it relies upon this engagement and responsibility. It is not an “off the shelf” document to use as a model contract, though it may help guide officials in the creation of a model contract if they wish to do so. Primarily, it is intended to be a tool to help officials particularize the issues and specific contents of a contract negotiation to their needs and goals.

This IISD handbook is not necessarily limited to contract negotiations: permitting, licensing and other types of legal processes relating to the initiation of mining projects all involve several negotiated elements today. In addition, all of the negotiations must be fit into the context of other laws applicable in the state. Thus, the handbook can be of equal value in our view in the context of preparing for these various negotiations, all of which should, today, have the same goal of creating maximum shared value from mining for mineral-rich developing countries.

## 1.1 Orientation of the Handbook: Mining and sustainable development

The handbook takes its orientation from a clear purpose and approach: the role mining can play in supporting and promoting sustainable development in a developing country context. It is inspired in this sense by documents and processes like the Africa Mining Vision, which note the need for integrated understandings of the social, economic and environmental dimensions of sustainable development (African Union, 2009; see also Hobbs, 2005). The handbook thus recognizes the need for governments to maximize the value and value added of their resource base in general terms, and seeks to provide support in doing this in the concrete context of a specific negotiation.

At the same time, neither foreign nor domestic investors can be compelled to invest. If the expectation of a fair rate of return is not available, the investment will not take place. However, different investors will have different views of what a reasonable return is, and may value resources differently at different times during the inevitable cycles of metal and mineral prices. Governments must therefore continuously evaluate the benefits of a potential project prior to and during a negotiation. While it is often important to compromise, it is always important to be prepared to say no and wait for the next investor with an interest in that resource who is prepared to ensure greater benefits to the country and local communities (see, for example, Barberis, 2001).

The result of a successful negotiation will balance these interests in a fair, equitable and long-term way. It will reflect the interests of both the investor and the government, and of the communities surrounding the mine site. This handbook focuses on achieving this win-win-win result.

## 1.2 Structure of the Handbook

The handbook is divided into five main sections in two volumes. Volume 1, *Preparing for Success*, begins with a discussion of the legal context in which mining contracts between governments and investors



sit. It then turns to the need to shift negotiating contexts from win-lose to interest-based negotiations. Volume 1 concludes with a review of the pre-negotiation phase, and its special importance for success in this area. Understanding all of these together create a sound foundation for a successful negotiation.

Part 2 of Volume 1, on legal context, has two main goals. The first is to note how mining contracts fit into the investment law environment created by the combination of domestic law, investment treaties and investment contracts. The second goal is to set out how this handbook relates to the recently concluded Model Mining Development Agreement (MMDA) of the International Bar Association, the contents of which form the basis for much of the work in Volume 2.

Part 3, on shifting from win-lose to win-win-win negotiating paradigms will address a range of changing assumptions in relation to mining contract negotiations. In practical terms, these changes in negotiating paradigms reflect the rapidly changing relationships between investors, government and communities. Among the fundamental shifts are the recognition of the need for a social license to operate for companies (and increasingly for governments) and the legitimacy of community needs and objectives. Most critical is the shifting view within developing country governments, from being beggars for foreign investment to being owners of the world's critical resources, making the sovereign control over natural resources an implementable right as opposed to a distant dream.

Part 4 sets out a number of key steps to prepare properly for any mining investment negotiation, even when the context is a permitting process rather than a separate contract. The importance of this critical preparatory phase cannot be overstated, and paying careful attention to it is an absolute precursor to success in any negotiation. The practical reality is that many negotiations are lost by governments before they even begin, due to the lack of preparations. While we are aware that not all governments will be able to do everything discussed in every instance, the approach set out is not all or nothing. The more that can be done, the better the negotiating results will be. Part of the preparation process will be to set priorities based on the needs of a specific negotiation.

While the number is impossible to determine, the likely reality is that perhaps 90 per cent of negotiations are not won or lost during the negotiations, but before the negotiations even begin. The negotiations are like putting the coat of paint on a new home: if the foundations are not straight, the walls have gaps in the framing, and the windows are not set right, the home will not last no matter how nice the paint looks when it is done. Conversely, when negotiations are well prepared, the negotiators have a chance to succeed due to the strong foundations created during the preparation process.

Part 4 of the handbook addresses a number of issues to help build that strong foundation, including:

- Understanding the full economic value of the resource and the proposed project.
- Identifying the needs and opportunities of the developing country as they relate to the specific project.
- Clarifying the role of domestic law in relation to the contract and carefully scoping out the negotiations.
- Preparing internally for the negotiations: strategy, objectives, goals.
- Identifying and ensuring the negotiating team capacity needs are present.
- Managing the negotiating process with the company.
- Managing the political side.

The content of the legal negotiations, discussed in Volume 2 (Part 5), will be determined in large part by the effective implementation of the pre-negotiation phase, including a clear understanding of the desired relationship between the contract and domestic law. When negotiations are underway, the handbook provides a careful review for use by negotiators of different options and directions. The need to consider the implications of one section on the other sections is highlighted, and the interplay with domestic law is a continuing theme. The content sections in Volume 2 are set out in a thematic approach, so that critical issues can be considered in a holistic and dynamic way, leading to progressive and clear results from both the state and sustainable development perspectives.

The post-negotiation phase, also in Volume 2 (Part 6), includes consideration of how to monitor and enforce the contract, how to ensure ongoing community engagement, and how to ensure periodic reviews can proceed in a non-politicized environment. Some of the capacity issues involved here may also help define the results of the negotiations on certain issues in order to ensure that those results can, in fact, be properly monitored and enforced.

When combined, these five substantive parts in two volumes provide a holistic approach, yet one that is designed to work with the interests of developing countries rather than pre-determine what those interests are. As already noted, this is an approach that does not replace the engagement and responsibility of government officials, but seeks to support that engagement and responsibility in a coherent and comprehensive manner.





# PART 2: LEGAL CONTEXT



## PART 2: LEGAL CONTEXT

The legal context, the subject of this section, is one element that negotiators and other officials must understand in order to achieve their goals. Other contexts are equally critical: the economic context, the opportunity to achieve development objectives, and the environmental context of any given project will all loom large. These elements are all addressed in subsequent sections.

### 2.1 Three Sources of Law for Mining Investments: Investment Contracts, Domestic Law and International Investment Treaties

A critical context for any mining contract negotiation is the fuller legal setting of which a contract will be a part. In many if not most cases, there are three sources of law: the domestic law, the mining contract, and potentially an international investment treaty. In addition to the content of each of these, the relationship between them is also important.<sup>1</sup>

#### 2.1.1 Domestic Law

In general terms, all investments in mining or any other sector are covered by a series of domestic laws. These may include the constitution, environmental laws, health and safety laws, consumer protection laws, labour laws, human rights protections, tax laws and so on. Where a significant investment in the extractive sector is involved, additional issues related to infrastructure development (energy, road, rail, ports) may be involved. In addition, many governments have specific laws relating to foreign investments that would apply to a foreign mining company seeking to make an investment. In addition to such legislation and regulation, the general civil law or common law regime will apply, and in many instances tribal law or customary law will be applicable as well. In short, all investments are potentially subject to a vast array of domestic laws.

In many states, the domestic law is highly developed and covers all aspects of a mining project, from initial staking to exploration to its operation and closure. All the legal elements are found in the domestic law regime and its associated permitting processes. In other states, the domestic law framework may be much less developed, leaving gaps or coverage that falls below international standards. Many states that use contracts fall into this category, often relying on the contract to fill in these gaps. Unfortunately, this strategy has not always worked well.

#### 2.1.2 Mining Contracts

“Mining contracts,” as the term is used in this handbook, refer to the contracts between the investor and the host state government. When the investor is a foreign investor, as is often the case for developing countries, the mining contract will take on an international dimension that raises additional issues.

Generally, mining contracts fit within the law of the host state where the investment is located, and are subject to that overall body of law. Although situated within domestic law, a contract with a foreign investor is understood to be an international contract between the government and the foreign investors. This internationalization is seen as taking the contract out of the ambit of common private law and adding a public law element to it. Often, this will mean having the contract governed by the law of another state or, increasingly, by international law as the basis for interpreting the contract. In addition, contracts now often have international dispute settlement provisions that alter the usual recourse to resolving contract disputes in the domestic courts.

<sup>1</sup> A comprehensive discussion of this area can be found in Salacuse (2013).



The scope of issues that can be covered or referenced in mining contracts varies greatly from jurisdiction to jurisdiction. In some instances, the contracts are very narrow, covering only the locations in question and duration of the mining investment, and any specific financial issues related to the project. In other cases, the contract can become a fully contained code for that investment, replacing all other sources of domestic law. Most contracts fall in between these two poles.

In addition, mining contracts may cover one or more of the phases of a mining development: exploration, exploitation, and closure. Indeed, many contracts will straddle these phases. Most critical here is the situation where a contract covers exploration and exploitation. When this transition point is regulated by a contract, it is extremely important that the rules and obligations for this transition to be made are clear and precise.

For example, what role does an environmental assessment play in the transition, and can the exploitation phase commence without it being approved by the government? Must the government approve it or does it maintain the same discretion as under the general environmental impact assessment law to impose conditions or reject the project completely? These types of transition point issues are now the subject of several international arbitrations worth hundreds of millions or even a few billions of dollars.<sup>2</sup> Clarity in intent and drafting is essential to avoid such litigation.

## Sequencing

In subsequent sections we will refer to this as an issue of “sequencing,” making sure that the right sequence of legal rights and obligations is set out between the domestic law and the contract. When the rights and obligations of the investor and the government are out of sequence, the investor will be able to circumvent the normal legal requirements by relying on its rights in the contract. Conversely, when the legal sequencing is correct, the investor will have to comply with all the legal requirements under the law relating to this transition point. For present purposes, it suffices to note that this is an extremely important issue and one that now lies at the bottom of multiple international arbitrations relating to mining.

Closely related to the preceding issue is a highly controversial provision found in many contracts, especially in sub-Saharan African mining contracts,<sup>3</sup> known as a stabilization provision. This type of provision, described in detail in section 2.2.4, freezes the law applicable to the investment at the time the investment is made, or otherwise requires the government to compensate the company for complying with a new law. Many observers now believe these provisions are detrimental to the achievement of the potential sustainable development benefits of mining, placing constraints on the ability of government to modernize labour, environmental, health and safety, human rights and other social and economic development measures. The potential impact of these provisions is discussed in section 2.2.4 below. The technical legal detail is then considered in detail in Part 5 in Volume 2.

### 2.1.3 International Investment Treaties

Finally, where a foreign investor is involved in a mining project, international investment treaties can become the third source of relevant law. The first such treaty was signed in 1959 by Germany and

<sup>2</sup> See, for example, *Corona Materials LLC v. Dominican Republic*, ICSID Case No. ARB(AF)/14/3 (the claimant asks for at least US\$100 million in compensation for denial of environmental approval of a mining exploitation concession), and *South American Silver Limited v. Bolivia*, PCA Case No. 2013-15 (the claimant requests US\$385.7 million in compensation or US\$176.4 million in restitution for expropriation, allegedly due to the withdrawal of environmental permits, among other reasons).

<sup>3</sup> Sub-Saharan Africa is apparently the region where the highest percentage of mining contracts contain stabilization provisions. See Shemberg (2009).



Pakistan. There are about 3,000 international investment treaties in force today—with more still being signed and ratified every year. These agreements come in the form of bilateral or regional investment treaties, and as chapters in bilateral or regional free trade agreements or economic partnership agreements. While they are formal treaties between states, they establish rights for foreign investors. These rights can include:

- The right to make an investment on national treatment terms (i.e., on the same terms as a domestic investor).
- National treatment after the investment is made.
- Most-favoured-nation treatment when compared to investors of any other foreign state.
- No expropriation without compensation.
- The notion of fair and equitable treatment, which takes on a wider or narrower meaning depending on precise drafting and who the arbitrators are in any given dispute.
- Free movement of capital, and, inevitably today.
- An investor–state arbitration provision for the enforcement of the treaty rights directly by the investor.

A key feature, as noted, is the availability of a direct right for investors to initiate an international arbitration against the host state to enforce their rights. At the time of writing, approximately 650 such arbitrations have been commenced by investors since the first one in 1987. The great majority of these have been initiated in the last 10 years, making this so-called Investor–State Dispute Settlement (ISDS) system the most used international dispute settlement process ever. And this number now grows by approximately 50 arbitrations every year (UNCTAD, 2014). Mining, oil and gas cases constitute about 25 per cent of these arbitrations today, split almost 50–50 between the mining sector and oil and gas sector. As a result, it is very clear that investment treaties are becoming an ever more important element as a source of law relating to mining investments.

## 2.2 The Relationship Between the Three Sources of Law

### 2.2.1 General Approach

The relationship between these three sources of law is important to understand, two key elements in particular. First, where there is a conflict between the domestic law and the international law obligations, international law will prevail, in particular when international dispute settlement processes such as ISDS are used by an investor.

The basis for this general principle of international law is quite simple: if all a state has to do to avoid complying with international law obligations is have a domestic law that is inconsistent with them, states would easily be able to avoid all of their obligations. International law would then essentially have no real meaning. So this general rule is in place to prevent such an easy route to nullify international obligations. This is not unique to the mining sector, but applies across all of international law.

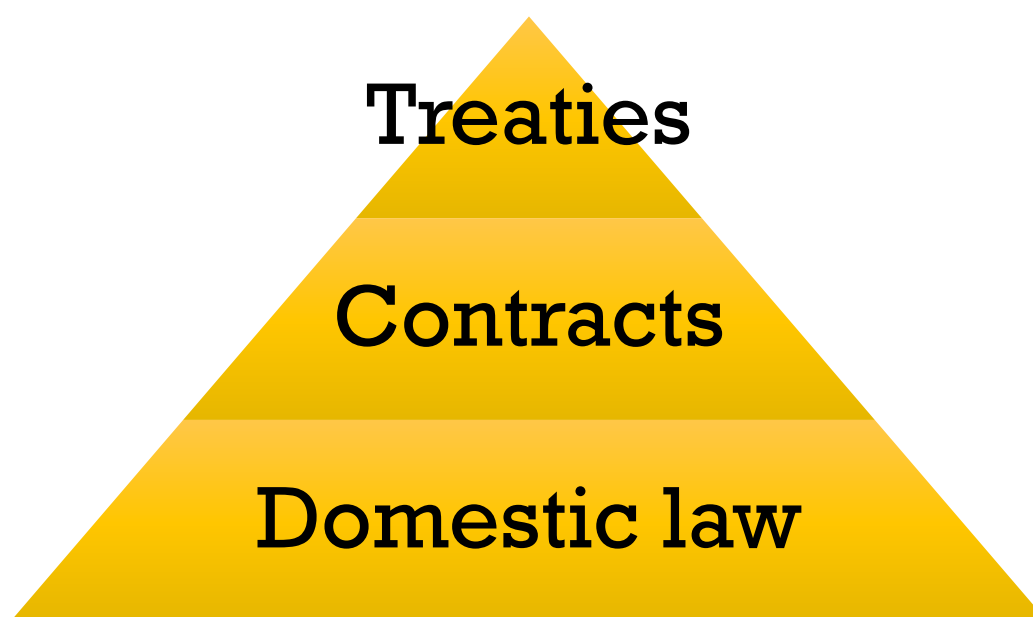
The second key element to understand is that when the dispute settlement forum is shifted from the domestic courts to the international level, as generally happens under mining contracts and investment treaties, the international mining contracts and treaties will generally be used to fill in gaps in domestic law. It is here that the importance of the relationship between these different sources of law truly begins to crystallize: these contracts and treaties can fill in the gaps in domestic law in favour of either

the investor or the host state, or in a properly balanced way. If the treaties and contracts have been drafted in a way that is only related to security of tenure or only related to the rights of the investor, the ability for those gaps to be filled in a balanced way becomes very limited and the balance of rights can easily become distorted in favour of the investor.

### 2.2.2 The Hierarchy Illustrated

The relationships can be illustrated with the two pyramids below. In a well-functioning set of legal relationships, the state will have a broad base of domestic law (Pyramid 1). The base of the pyramid will be domestic law, through which the great majority of the factors relating to any investment will be regulated. The contracts will come on top of that, and identify a narrower number of issues, very specific to an investment: it might be the size of an investment, the lease rates or the concession rates, site-specific environmental assessment or management issues, community-related issues, or the particular aspects of a public-private partnership, as examples. Most critically, the scope of the contract will not be such as to alter the domestic law. It is simply to particularize the arrangement between the contracting parties as it relates to matters not covered by the domestic law or where domestic law leaves some discretion for particular applications of the law.

In this same well-functioning relationship, one may find investment treaties that come at the top of the pyramid, and deal essentially with egregious violations of the treaty provisions or specific breaches of the treaty, such as an expropriation without any compensation. But one does not, in this setting, have the treaty in and of itself being used to read in significant elements to manage the operation of the investment.

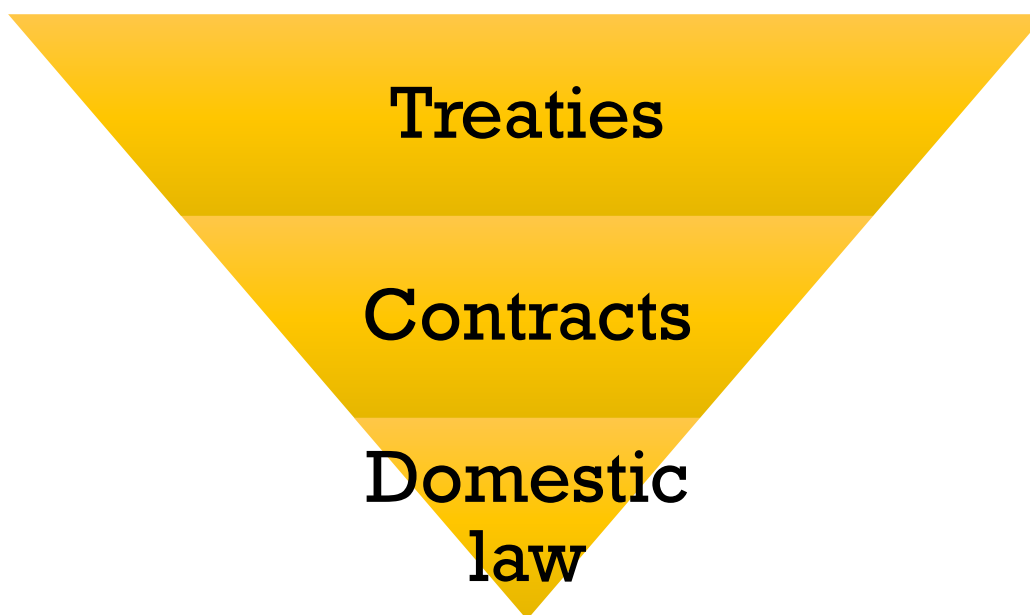


PYRAMID 1: A WELL-FUNCTIONING RELATIONSHIP

However, in many areas where the large foreign investments in developing countries in mining are going, one still finds a situation more closely resembling the opposite structure, an inverted legal pyramid (Pyramid 2). The domestic law is more likely to be the smallest part of the pyramid. In many cases, sufficient domestic law and enforcement does not exist, such as for environmental, human health and worker safety, economic development requirements and linkages, and others. Hence, one may find a largely weak or very narrow domestic law base upon which the contracts then come into play.

In these circumstances, one can easily see a result where a contract has a broader legal reach than the underlying law does. It is thus essential that the contract be fully balanced and reflective of all of the necessary sustainable development linkages of the project, for both the state and the local community. If the contract is not balanced, but reflects the predominant interests of the investor, or is silent on key issues, the balance in the legal relationship can be easily tilted in its favour.

The treaties may then come into play, and because they have generally focused solely on the rights of the investor, there are very few mechanisms within them to read in obligations of the investor or rights of the host state to regulate in order subsequently to fill in gaps in the domestic law. This can leave a clear balance of contract and treaty law being applied in favour of the investor.



PYRAMID 2: A POORLY FUNCTIONING RELATIONSHIP

And it is precisely in these circumstances that one finds the largest range of two key contract clauses: provisions that allow the contract to deviate from domestic law and stabilization provisions. These are discussed in the next subsection.

Let us use a hypothetical example to illustrate the results of the above illustrations. Assume that a mining contract is made in a jurisdiction with strong environmental laws versus one with weak environmental laws. Where the laws are strong, it is unlikely the government will allow deviations for individual projects. Neither the public nor the courts would likely be receptive in most cases. The project, before being approved, will therefore have to have an approved environmental assessment and an approved management plan. It will have to meet all applicable environmental standards. Where the laws are weak, however, one often finds additional “clarifications” in the contract. These may allow the project to be approved prior to the EIA being done, which is actually a common result of many combined exploration and exploitation contracts or permits. One contract the author has seen “clarified” that the mining company only had to make “best efforts” to comply with environmental laws, rather than had to comply with them; and included a right to dispose of all tailings in the only local river. As odious as this may sound today, it would be enforceable under international arbitration clauses in the contract or an investment treaty. The contract would override the domestic law.

Assume the same situation for water usage in the mining process, a requirement for all mining operations. A well-structured legal system will ensure an apportionment of water under law when



there are severe shortages. Where this is not set out in the law, and the contract is silent, the result may well be an assumption that the mine is legally entitled to the water levels needed for its full operation, even if this means other users are deprived of water. Silence in the law and the contract can thus create a presumption in favour of the company.

Given these dynamics, one is likely to find an imbalanced result between a legal system that is well-developed and constructed, and the much less-developed legal systems where so many of the large-scale mining investments go today. It is therefore increasingly important today for developing countries to ensure the ongoing development of their domestic law, which is the best legal mechanism to ensure a strong reflection of the national interest in relation to mining developments. Contracts in this respect are not the first best option. However, they are a significant option and one that continues to play a major role in managing government-investor-community relationships. In this respect, the approach of the MMDA, reflected in this handbook, is to be comprehensive in initial outline, while deferring to domestic law on those issues where it exists. This reduces the risk of conflicting obligations and provides the best opportunity to fully reflect the national interest.

### 2.2.3 Choosing Which Law Will Prevail

When a contract is used as part of the legal matrix for establishing and managing a mining investment, it is important for governments to determine with precision the rules that will prevail in the event of divergence or conflict with the generally applicable law. The issue is not academic or benign: in many instances, it is common for investors to seek special legal regimes that provide specific advantages to them, in the form of exceptions to the generally applicable law, or special rights to tax or other financial benefits. It is also increasingly common for these types of contracts to lead to conflicts between states and investors, including numerous international arbitrations pursuant to the contracts and international treaties. The issue is, therefore real and critical for states to address.

#### **Is this right?**

In 2010 the present author was part of a review for finance purposes of a contract negotiated in 2010 with a West African government. The investor sought and received an exemption from compliance with environmental laws, and a stated right to dispose of its mine tailings in the local waterways. These provisions were completely at odds with the generally applicable environmental law. Is this an appropriate demand for an investor? Was it, in 2010, appropriate for a government to agree to?

While creating divergences from domestic law has been a common practice in the past, it is increasingly frowned upon today. It creates various levels of inconsistencies and divergences that become increasingly difficult to monitor and enforce; often creates losses to the treasury of external costs to society; and promotes corruption for favours received. It also promotes secret dealmaking and non-transparent governance, neither of which promotes the form of transparent investment environment quality investors seek today.

Given these issues, we strongly suggest the adoption of a clear policy on the maintenance of the generally applicable law. Where there is a contract put in place, it is advisable to include a provision that makes it clear that,

1. In the event of any inconsistencies, the generally applicable law will prevail over the contract; and
2. The contract is to be interpreted and applied in accordance with the law of the state in which the mine will operate.

Where an exception is to be made for whatever reason, it is essential for the contract to be adopted by the legislature as an amendment to the applicable law. Otherwise, political leaders are given the discretion to alter the generally applicable law, overriding the role of the legislature. This requirement therefore provides a key control over political decision-makers, and an essential element in the transparency of government.

The specific text of provisions in this regard is set out in Volume 2.

#### 2.2.4 Stabilization Provisions

Closely related to the issue of what law will prevail is the issue of stabilization provisions. These are provisions included in a contract (and occasionally in domestic law) that limit the ability of a government to change the law applicable to the mining company after the investment has been authorized, whether by permit, contract, license or whatever other process. In essence, the law to be applied to the mining company is made “stable” for the full period of the operations or for a defined period of time set out in the stabilization provisions.

These provisions stabilize the law in one of two ways.<sup>4</sup> One is fully freezing the law applied to the investment. Under this approach, any new laws simply are not applicable to the investment. The company is under no obligations to comply with them. These are known as freezing clauses. These in turn can be full freezing—covering all laws, or partial freezing—covering certain types of laws specified in the provisions.

The second approach would see the changes in law or new laws applying to the company, but the company would be legally entitled to compensation for the costs of complying with them if costs were incurred. Thus, the investor’s costs of complying with the domestic law remain capped at what they were when the investment is made. This is known as the economic equilibrium model of stabilization provisions.

The idea of stabilization provisions was conceived to provide legal assurance to companies against political uncertainty that might lead to changes in the law. Following the period of nationalization of mines in the immediate post-colonial period, the re-privatization of mining was seen as equally subject to reversal, as was the risk of other forms of legal measures having high costs for the companies. Further, the 1980s saw the period of deregulation gaining favour, and the stabilization provisions were seen as a way of creating a barrier to new regulations.

In addition to these motives of investors, for governments the increased popularity of the provisions came during the period when developing countries, especially in sub-Saharan Africa where these provisions are most prevalent, were persuaded they had to roll out the red carpet for investors. Indeed, the perception, and in some cases reality, of competition between governments to attract investment was often intense. However, over time, these provisions have become seen as brakes on legitimate development goals, including all of the economic, social and environmental dimensions of sustainable development. There has also been considerable disquiet for the implications of these provisions from a broad human rights perspective.

<sup>4</sup> See Shemberg (2009). A great deal of this section uses this work as a reference, including the development of the notions of freezing clauses and economic equilibrium clauses.

In addition, stabilization provisions in contracts (and in domestic law) have an impact on how investment treaty provisions are interpreted and applied. Several arbitration tribunals have altered the “normal” interpretation of provisions on expropriation and fair and equitable treatment, for example, to much stricter readings, when the investor has a stabilization provision to turn to. Thus, these states have faced higher levels of obligations under the investment treaties.

### **What role do stabilization provisions really fulfill?**

What role do stabilization provisions really fulfill?: In part, these provisions are cost-freezing mechanisms, in part political risk insurance, in part they are perceived as a positive element in the investment environment for foreign investors. But with leading organizations such as the UN Special Representative on Business and Human Rights and the International Council on Mining and Metals suggesting they may do more harm than good for mining companies by creating false legal certainties, is that really the role they play? Does any business, no matter how it operates, expect the law that applies to it never to change? Do any lawyers see no changes in law as a legitimate objective? Or, do lawyers who drive the inclusion of these provisions really just seek a big stick for companies to use in any negotiations with a government that might arise after an investment has begun? And if this is the case, is it reasonable for governments to give investors this big stick?

Finally, we note the difference between fiscal stabilization and non-fiscal stabilization. The former relates to the fiscal regime that applies to the mine, whether under the contract or domestic law. Here, there may be a higher level of legitimacy for a specified and limited degree of fiscal stabilization to improve the bankability of a project. No such rationale applies, however for non-fiscal issues, which chiefly include things like the environment, human health, labour laws, human rights, etc. Consequently, there is a growing sense of the need to distinguish these two areas, and look at the merits of each differently.

Today, there is a strong move away from stabilization provisions, though companies will often still propose their inclusion in mining contracts, as a negotiating tactic if nothing else. It should be noted that governments are not somehow required to include such provisions. Alternatives have also been developed. For fiscal issues, time-bound and subject-bound stabilization provisions have been articulated that are much more limited than full fiscal stabilization. They address the issues of bankability and finance, without putting in place comprehensive blocks to future equitable development of fiscal regimes. There are also approaches that seek to build flexibility into the fiscal regimes, rather than a permanent single rate of taxation. These approaches rely on the predictability of tax levels at different commodity prices as the way for governments and investors to be able to manage the fiscal regimes (Mann, 2011; Mann, Danielson, Disney, Phillips, & Zubkova, 2012).

For non-fiscal issues, again alternatives are available. In the context of the MMDA, an alternative was forged that created protections against discriminatory and arbitrary measures by governments. These forms of protections distinguish *bona fide* legal measures from those that are not *bona fide*, and provide remedies for the latter while protecting governments when enacting the former. For developing country governments, this approach is seen as far more balanced. These alternatives are highlighted in the drafting sections in Volume 2 of this handbook.



## 2.3 The Role of the MMDA

A great deal of the approach to the content of contract negotiations in Part 4 is drawn from the process and results of the International Bar Association's Model Mining Development Agreement (MMDA) (International Bar Association (IBA) (2011, Apr. 4) (Mann et al., 2012). The Model Agreement was developed over almost three years under the auspices of the International Bar Association's Mining Law Committee. Sustainable development expertise was brought into the work through representatives of IISD and the Sustainable Development Strategies Group. After multiple public consultations, a web-based consultation process and international on-site visits from Beijing to Addis Ababa, the MMDA was released in April 2011.<sup>5</sup>

The MMDA is the first comprehensive model agreement in the field to take a fully integrated sustainable development starting point. Moreover, it deliberately supports an approach to negotiations that shifts from a zero-sum win-lose negotiation paradigm to a win-win-win negotiating paradigm. This triple win is identified as state, community and company. This approach is described in more detail in Part 3.

The MMDA is a significant contribution to the capacity of developing countries to negotiate mining contracts, but it is not a panacea in this regard. It has limitations. For one, the document is based largely on precedent, so options for new approaches were not canvassed in a significant way. Second, and flowing from the last point, the MMDA still reflects many elements of a traditional contract model based on a concession contract that gives the company ownership or leaseholder rights over the land in question and ownership of the minerals produced with a right to all the profits therefrom, save what is expressly allowed to governments as royalties, taxes or other charges. Other models, such as production-sharing or management contracts more often seen in the oil and gas and water sectors were not canvassed or considered. Third, the MMDA provides a lead option and then several other options in most cases, leaving negotiations more open-ended in some areas.

Despite these limitations, the MMDA is an important milestone and resource. First and foremost, the drafters of the MMDA reset the starting point by asking, quite purposefully: What would a mine development agreement look like if we started from a sustainable development perspective? As a result, the MMDA provides a comprehensive document, with all the elements of a sustainable development perspective placed on the same legal footing. This is an enormous change from previous approaches that highlight a "core" agreement with some SD-related elements tacked on as ancillary, hortatory or voluntary provisions. The MMDA addresses all the relevant linkages between mining operations and sustainable development in a forward-looking, equally binding, manner.

The MMDA also recognizes the need for the transparent and effective inclusion of communities. This is done in several ways, all of which focus on long-term solutions to achieving win-win-win results.

Because of this comprehensiveness, one of the most important features of the MMDA is the table of contents. This is a part of the document that is of universal application. This is not because every contract must include every provision noted in the table of contents. Rather, it is because it provides an entry point for analyzing what needs to be in the contract, what is covered by domestic law, what might be covered by a related community development agreement, and what is simply not appropriate for the circumstances. In short, the table of contents can be used in the pre-negotiation phase by governments to assess what the scope of the negotiation should be (as discussed further below) and to assist the negotiating parties in agreeing on the scope of the negotiations. Its comprehensive nature

<sup>5</sup> The full history and process and the final product is available at [www.mmdaproject.org](http://www.mmdaproject.org). IISD was represented by Howard Mann, author of the present handbook, and SDGS by Luke Danielson and Kristi Disney. See also Danielson & Phillips (2012).

makes it an excellent tool in itself for this purpose. The table of contents can also be used, quite by design, to help set out a checklist for what should be in revised mining laws or codes, whether or not the jurisdiction in question uses mining contracts.

The MMDA thus provides a menu for negotiators and officials to consider and a set of options set out in a non-case specific context. This handbook seeks to help governments particularize the results of the MMDA for its specific needs and in the context of a specific negotiation.



# PART 3: CHANGING THE NEGOTIATING DYNAMIC





## PART 3: CHANGING THE NEGOTIATING DYNAMIC: TOWARD A NEW STARTING POINT FOR GOVERNMENTS

### 3.1 From Win-Lose to Win-Win-Win

A critical element of any negotiation is the context in which it takes place. It has been noted above that one of the underlying concepts of the MMDA was to shift the negotiating dynamic from one of a win-lose zero-sum game to a win-win-win dynamic. The win-lose scenario is very simple:

- For a mining company, it is “My money or your money, and I’d rather it be my money. So everything I can get, I will take. Then I will back it up with a stabilization provision.”
- For a government: “I want all the upfront money and promises of jobs I can get because what happens later is some other Minister’s problem, not mine.”

Of course, both of these have a high level of caricature to them to highlight the point. But the essence is not far off: short-term thinking about money and temporary gains, rather than long-term thinking about the conditions that define a successful project in this century as opposed to previous centuries.

By contrast, a win-win-win scenario starts from a different perspective. It recognizes that the social license to operate can no longer be taken for granted by either the investor or the national government. Rather, the social license to operate must be negotiated among the key interests—investor, government and local communities. This shift recognizes that the result sought is one of long-term stability for the company and the community based on a balanced and equitable result. It recognizes that there is no one size that fits all, and each situation may require its own creative solutions. Yet the principles of fairness and equity can still remain as the key touchstones.

The shift can be stated in a different way: moving away from a rents-based negotiation to an interests-based negotiation. A rents-based negotiation refers to the money and only the money. But what are these interests in an interest-based negotiation? In broad terms they can be understood as:

<b>Company</b>	<ul style="list-style-type: none"> <li>▪ A stable economic and social environment for the full period of operations</li> <li>▪ Good long-term relations with the community and government</li> <li>▪ An ongoing rate of return that ensures reasonable profits</li> </ul>
<b>Government</b>	<ul style="list-style-type: none"> <li>▪ A steady and fair return on national resources</li> <li>▪ Ongoing development benefits from the resources</li> <li>▪ The maintenance of a sustainable environment for future generations</li> </ul>
<b>Community</b>	<ul style="list-style-type: none"> <li>▪ Social and economic development opportunities; while preserving the environment and enhancing opportunities for the sustainable use of environmental resources</li> <li>▪ Legitimization and promotion of the human rights of all citizens in the area</li> <li>▪ An ongoing recognition of its right to be heard on matters of direct and immediate interest to the community and its members</li> </ul>

A win-win-win negotiating paradigm will break down these elements and then integrate them in a fair, balanced and equitable manner. What the MMDA did that was new was ensure that all of these interests were equally reflected in the body of the agreement, rather than as add-ons in ancillary agreements or in a non-binding corporate social responsibility context.

By moving from a rents-based approach to an interests-based approach, there is much more room to negotiate constructive results that contribute to the achievement of all the interests, rather than the win-lose context of a rents-based negotiation. This does not mean rents are unimportant. Rather, it means other interests are also important, sometimes more important, and need the same type of attention.

## **Is the MMDA pro-business or pro-government? A personal reflection**

Shortly after the publication of the MMDA, the present author was asked, “Is the MMDA pro-business or pro-government?” The answer was “yes.” The follow-up question was obvious: “Yes, pro-business or yes, pro-government?” The answer again was “yes.” “It is pro-business AND pro-government.”

The objective of the MMDA process had been to develop a product that reflected the needs and interests of all stakeholders. It sought to put mining development into a proper sustainable development context, rather than a winner versus loser, pro- one or the other result. If the MMDA succeeded in doing this, then the proper answer to the question posed is it is both pro-business and pro-government, and that the two should not be seen in opposition to each other.

Closely associated with this approach are the notions of inclusiveness in the negotiations and transparency of the result. Inclusiveness is not simply a notion of consultation with local communities. The MMDA goes on to recognize the need for enforceable community-based agreements, either as part of the principle contract or related to it to ensure enforceability.

### **3.2 Putting Government Negotiations on a Business Footing**

Negotiations with investors are a business proposition. The investor is well prepared with its knowledge of the value of the resource, its business plan, its profit objectives, its financing, its social plan, and so on. By the time the company is prepared to negotiate, it will have spent three to five years—at a minimum—investigating the potential of the resources, the cost of harvesting them, and the market value over several price fluctuation scenarios. The government in a developing country, on the other hand, will often have little awareness of these same issues. The government, is, in effect, playing catch up, and often doing so at a severe human resource deficit.

Given this, governments still get the result they negotiate for, not the result they think they should get, or even are entitled to, because they are government. Despite the human resource deficit, experience tells us that developing countries can and do get good deals. The key element is to take the time necessary to prepare to negotiate properly. When this is done, good results can be achieved. When this is not done, the result will almost inevitably be sub-optimal.

### **Negotiating as an informed partner**

The simplest example of being well prepared is understanding the value of the resource itself. Governments in developing countries often rely today on the investor’s valuation of the resource. They assume the investor providing objective and “true” information. Should they do so? In an arbitration between the government of a developing middle-income country and an investor over a major infrastructure project, the company valuation expert was asked by lawyers for the state to address the valuation of the investment he had set out on date X, prior to the investment taking place. The expert asked the lawyer, “Which valuation of that date?” The lawyer, somewhat surprised, asked how many valuations there were. “Two” said the expert: “one that we gave the government and the other that we used for our own internal purposes.”

While we talk about win-win-win solutions, negotiations will still lead to a business result. If the negotiations are not prepared, the business end will be inadequate to meet government objectives. Indeed, it is an open question whether government negotiators will even be fully aware of the potential for the mine and hence what the objectives should be. Companies will negotiate to achieve a balanced result today, this is clear. But they will not do so when not compelled to because the negotiating partner is ill-informed and ill-prepared.

Distilled to its essence, governments will get out of a negotiation what they put into it. If they do not act in a business-like manner, they cannot expect the result to achieve their own objectives: fiscal, developmental or otherwise.

## When are negotiations not business-like?

These statements are true statements made by government negotiators:

- “The company lawyers are coming tomorrow, please begin negotiations with them in the afternoon after I meet them.”  
(Minister to lawyer)
- “It does not matter really what we do, we can always renegotiate” (Negotiator to observer)
- “We are beggars, we have to take what we are told to take, we have no choice.”  
(Government official at SADC regional meeting)

These statements reflect a rejection of a business-like approach—built-in excuses for failing rather than a process for succeeding.

In many instances, it appears that developing country governments conflate negotiating a contract (or a permit or license) with a policy-making exercise. Doing so would be misdirected, however. Negotiations are not, or at least should not be, an exercise in policy-making. Rather, they should, indeed must, reflect the pre-established goals and policies of the government so that these can be incorporated into the objectives for the government to achieve in the negotiations. Negotiators should not be making up policy during the negotiations.

In Part 4, on the pre-negotiating environment, we set out the critical steps for governments to prepare for a negotiation. Here, the critical need to prepare is what is focused on. Two points are central in concluding this discussion:

- Governments as a whole, and not just one ministry, must take responsibility for the negotiating process, rather than shed responsibility as the above quotes illustrate.
- Governments, in order to achieve a positive result, have to invest in the negotiations.

The second point is perhaps most difficult. In many cases, if not most, developing country governments will have few resources to invest. This issue is dealt with in some detail in Part 4 on preparing to negotiate. It is clear that there is no easy answer. But there are answers if governments are prepared to slow the negotiating process down to a speed that allows them to become properly informed. This need not be a long-term delay. However, governments do have to realize that major negotiations will take time: leading government negotiators in Africa and elsewhere have suggested a period of 12-24 months to negotiate a contract is the norm, and other governments should not be prepared to short-circuit this norm. Sacrificing quality of result for speed of result will not produce a long-term win for the government or its citizens.

### 3.3 From “Beggar” to Responsible Resource Owner

A further issue in terms of changing the negotiating dynamic is understanding and embracing the shift from government as “beggar” for investment (as reflected above) at any cost to government as a responsible owner of valuable natural resources.

For over two decades developing countries were told by the Organisation for Economic Co-operation and Development (OECD), World Bank and other organizations that they essentially had to provide incentives, extraordinary legal recourses and other elements in order to attract investment. Moreover, it was driven home that developing countries were competing with each other for scarce investment dollars. Essentially, developing countries were directed by major international organizations to act as beggars for investment, ready to do almost anything for whatever investment would come their way. The contribution of that investment, in particular after the incentives were accounted for, was not a key concern: just get as much as you can in a highly competitive environment.

There is no doubt that a positive investment environment creates more opportunities to receive foreign investment. But there is also little doubt now that the quality of that investment is equally and generally more important than the quantity. The pursuit of quantity of investment at all costs has simply not produced positive results from a sustainable development perspective (UNCTAD, 2012).

At the same time, for those states with a rich natural resource endowment, the value of those resources overall continues to grow. This reflects growing overall demand over time, scarcer resources in many cases, higher costs of production in other instances, and so on. In the mining sector, it is axiomatic that mining companies must go where the minerals and metals are. To stay in business, mining companies must find and develop mining properties. This alters the balance of power in a negotiating environment, at least to the point of creating an equal footing.

And here is also where one finds market forces exerting their balancing effect: companies cannot be compelled to invest. Yet these same companies need the resources to maintain and expand their businesses. At what level the equilibrium will be found from a sustainable development perspective is a part of the negotiation. If governments start from the perspective of being a beggar for an investment, that level will be very much in favour of the investor. If governments start from an understanding of the real value of the resource, and the real needs of the community, then the result can be balanced and equitable.

At the end of 2014, mining investments were widely seen to be at the bottom of their cycle (Medina, 2014; Williams, 2014; Roberts, 2014). New mine construction in 2014 was low. Market saturation for many commodities reflected a combination of lower global demand and the number of mines opened in the previous five years. For governments, this presents an enormous challenge: the sense of chasing fewer and fewer investments can be very real. At the same time, chasing those investments at any cost leaves governments vulnerable to international arbitrations when the market reverses and governments seek corrections in the terms of the deals negotiated out of a sense of foreboding. Again, Part 4 on preparing for negotiations helps to address this issue.



### 3.4 The Contract Is not an End Point but a Starting Point

Short-term perspectives often lead governments, or parts of a government, to conclude that the completion of negotiations on a mining contract is the end point of their work. In fact, it is the starting point of establishing a long-term relationship between the government, investor and community. Indeed, it is the starting point for relationships that may last 30 or 40, even 50 years. This long-term view is essential for success.

Negotiators should have this critical factor in mind. Political leaders also need to consider this fact, despite the often short-term interests associated with elections and other political processes. Responding to this fact leads to making long-term interests the key factor, and processes to protect and nurture them become much easier to envisage. A negotiation that adopts this view is much more likely to lead to a successful long-term relationship than one that simply takes the completion of the negotiations as the goal.

The problem is that governments are often caught up in short-term goals, which tend to make the completion of the negotiation the end goal rather than the long-term success of the project. Part of this drive may come from the sense of competition for any investments. Another part of it may come from the shorter-term political ambitions of Ministers or other government leaders. For many such leaders, achieving a final contract brings positive political results: the ability to achieve results, to add jobs, to corral often difficult-to-get investments all bring positive political results. And in many cases, given that any problems may not emerge for five or more years, one can often safely assume that the problems that may arise will fall to another Minister or leader to solve.

These are issues of human nature. In all countries, north and south, small and large, these tensions are seen. Setting and reaching long-term national goals can sometimes be at odds with short-term goals and perceptions of success. Human nature and human welfare do not, unfortunately, always coincide.

There are tools to overcome some of these issues, to help long-term interests prevail over short-term interests. Model contracts can be one such tool. Well-prepared negotiations are another. Transparency of contracts is a third tool that tends to enhance the need to put broader interests ahead of personal ones (Fülöp & Kiss, 2002; Rosenblum & Maples, 2009); These and other options are discussed in Part 4, below.

### 3.5 Know Your Investor

A key part is the process of identifying good investment partners. When the government is entrusting the sustainable development of its natural resources (and the achievement of related social and economic development goals) to private sector partners, it has a right and, indeed, a responsibility to its citizens, to know the type of company and company leadership it may enter into this partnership with. In other words the government should play a direct and informed role in choosing its investing partners.

Screening investors prior to commencing negotiations will help government find high-quality investors and determine whether the investor has the necessary technical experience, financial resources to make the project operational. It is not in the interests of the host government to accept any investor on any terms. Given the stakes at issue, it is worth spending some resources to conduct a thorough due diligence of the investor's business history and operational model before entering into negotiations.

This could include an assessment of:

- The financial capacity of the investor (including cash flow and available funds).
- The experience and technical expertise of the investors.
- Investor experience dealing with local communities and conducting social and economic impact assessments and establishing related management plans (including the budget to finance these activities).
- The track record in supporting development benefits from its operations.
- Its record of resolving disputes when they arise (early resort to international arbitration, use of local mechanisms, efforts at mediation, use of local reporting and grievance mechanisms, etc.).

Knowing the investor will be important for governments for another reason: the local community will certainly do its own research in this regard, and come well prepared to any community meetings or events. Governments should be well equipped to address issues in a clear way (beyond “don’t worry, we will not let that happen here”) in order to develop positive working relationships with the communities as well.

Identifying which ministries and government representatives can be involved in screening the investor is crucial: if only the investment promotion agency is involved it may not be overly inclined to find many red flags. If there is no capacity within the government then it is advisable to use an independent third party.

In the end this issue feeds directly into the next one: is this investor one who responds positively to the requirements today to obtain a social license to operate?

## 3.6 The Social License to Operate

Finally, we turn to the growing recognition of the concept of the social license to operate. It is a concept that can be difficult to define, yet it is essential to grasp. In essence, the social license to operate is the complement to the legal license to operate, but it is received from the community, as opposed to the government. But the concept is also evolving and expanding (Business for Social Responsibility, 2003; Pike, 2012; Yates & Horvath, 2013). In the two subsections below, we look at the concept in its original form as the social license of business to operate, and its increasing relevance to governments as well.

### 3.6.1 The Social License of Business

*“The social license to operate can no longer be taken for granted”*

Prof. John Ruggie, UNSRSG on Business and Human Rights

The most common perception is that the social license to operate is a concept that applies between the community and the investor. This is the basis of the growing literature in this field and the public perception of the concept. It is most certainly one component.

Broadly speaking, this social license between community and company must be negotiated. The result must be balanced, measurable and implemented. And, because every mine is different and every community is different, there is no one-size-fits-all prescription. But the parameters are now well established: the company must be prepared to use its resources to support the social, economic

and environmental development of the community in order to earn the support of the community for the operation of the mine. Benefits, including economic benefits, must be shared (Wall & Pelon, 2011).

This does not mean the company is expected to or should seek to become an alternative local government. That is not, and should not be, its role. Rather, the company should be able to identify, with the community (including local government), where it can make legitimate contributions to the social and economic development of the local community. The relationship between the company, community and local government should be clearly delineated, transparent and accountable on all sides. But the role of the company should not be confused with the role of the government.

There are difficulties in achieving and maintaining the social license to operate. Who does the company negotiate with? Who represents the community? What are the legitimate expectations of the community versus inflated or unrealistic expectations? How does the social license to operate get renewed? And how often must it be renewed?

There are no easy answers. Fundamentally, however, the idea of the social license to operate requires the same deliberate consideration as achieving the legal license to mine the metals or minerals. Where a company may spend four to six years exploring the mining potential, it must spend the same time understanding the local communities, their needs, their political structures and social and economic constitution. Negotiations with the community should be as important as those with the government. A company that fails to take this time risks the very viability of the project today.

But why is this risk so high? The answer lies, at least in part, with the idea that the national government can no longer simply do anything it wishes just by making its deal with the company.

### **3.6.2 *The Social License of Government***

The concept of the social license to operate is now expanding to governments as well. Governance is changing today. The process of democratization is working at different levels today, internal and external. International laws are becoming more effective, in broad terms, in defining limits on government relationships with its citizens. This is seen in broad human rights instruments, and more narrowly defined instruments such as the IFC Performance Standard on Land Acquisition and Involuntary Resettlement. Neither the government nor the company can simply impose its will by force over a community today as might easily have been done two or three decades ago. Central or provincial government constitutional authority is no longer seen as an authority to ignore community interests. Governments that attempt to do so in an age of increasing bottom-up democratization processes and international standards do so at their own peril.

The relevance of the social license to operate begins with the negotiation to establish a mine, if not before. It requires engagement between all the major stakeholders, not just two of them. And because a contract (or permit or license) is the beginning of a long-term relationship, not an end point, the social license to operate must also be seen as a long-term endeavour that must be nourished and supported to be maintained.

## The little device with a big impact:

Globalization has brought many technological changes. Oftentimes globalization is thought of purely in economic terms. But technology has also brought incredible opportunities to reach people at a social level all over the world. Today, no matter where one is in the world, someone has a cell phone and that phone has a camera. Few governments have the capacity to regulate the basic reality: if there is violence at a mine, and miners are injured or killed by the police, army or private security, someone is filming it and that video will be uploaded to the world in a matter of minutes. For governments, this means that their reputation domestically and internationally is open to risk every day. Governments can no longer impose their will by force or stand idly by as company security agents use force unless they are prepared to take these large reputational risks. The social license for government does not come simply by virtue of a national election, and most certainly it does not come at the end of a gun. Rather, it too increasingly comes as a result of dialogue and agreement.

Part 6, on post-negotiation mechanisms, sets out several mechanisms to promote this approach. These include annual compliance reporting, ongoing consultative processes, grievance mechanisms, common committees to promote job training and access to company purchasing processes, and so on. In essence, all of these lead to a process of defining *common* objectives and *common* means to achieve them. Win-lose approaches cannot support the social license to operate.



# PART 4: GETTING READY TO NEGOTIATE



## PART 4: GETTING READY TO NEGOTIATE

### 4.1 Introduction

Many of the issues raised above can be most effectively addressed before negotiations begin. This section sets out several elements for consideration to ensure a high-quality preparatory process. The steps are not necessarily sequential. Several may go on at the same time. We hope they will provide important guidance for governments as they strive to achieve the control over their resources that they and their citizens expect.

The broader context for this part is the placing of mine planning and operations firmly in a sustainable development context. In our understanding, this includes issues of poverty alleviation, inclusive growth, social and environmental issues, and respect for human rights, etc. This adds complexity to the process, but is essential to maximizing the development benefits and minimizing the environmental and social costs. The complexity is reflected in the need to consider a very broad range of issues that go far beyond taxes, royalties and environmental protection:

- Revenues from the mining operation
- Economic linkages from the purchase of goods and services by the company
- Building capacity in local firms for the supply of goods and services
- Training for more highly skilled employment and technology training
- Downstream valued-added work and production
- Gender equity and equal opportunity issues
- Health considerations in the community
- Education considerations in the community
- Water security
- Energy security
- Environmental protection and while enhancing the sustainable use of environmental resources for local livelihoods, and
- Food security

Each individual situation will add its own variations or new elements to this list.

Assessing the government's needs and objectives is not a static process, but rather must be geared to the size and location of the proposed mine. As noted above, governments must also be careful not to make mining companies into local governments in lieu of properly constituted governments. Likewise, specific environmental concerns need to be identified and addressed.

Presumed in the above is the ability to identify and assess the needs and objectives. Yet, in reality, this may not always exist. This issue of capacity is addressed below.

The sustainable development paradigm for a negotiation can be broad. Setting priorities in a realistic manner is important. Again, the negotiation takes place in a commercial context, governed by market rules on investment. Demands that price all investors out of the market may be short-sighted, unless the government is prepared to enter the sector itself as developer and operator. At the same time, governments should not be unduly shy in seeking a proper level of social and economic benefits from the project.



## Can governments say “No”?

Governments should not be held hostage to a “take-it-or-leave-it” proposition that does not meet their objectives. It is important for the government to know the alternatives before a negotiation starts. What other potential investors may there be? Is the mining cycle at a low point so that investors will be prepared to give more when it begins to move back up? What other options are available now? Is the resource likely to increase in value over time so that future options will improve revenues? These types of issues will help establish the true context for a negotiation. Saying “no” to one investor at one moment in time does not mean the resource will not be developed.

Setting out the negotiating goals and objectives of the government will also require a careful consideration of what is set out in the law and what should be in the contract. This issue has been described above and will be discussed below as well.

In the next sections of this part, we discuss, in turn:

- 4.2 The value of the resource
- 4.3 The negotiating team
- 4.4 The negotiating process

### 4.2 The Value of the Resource: Economic development goals

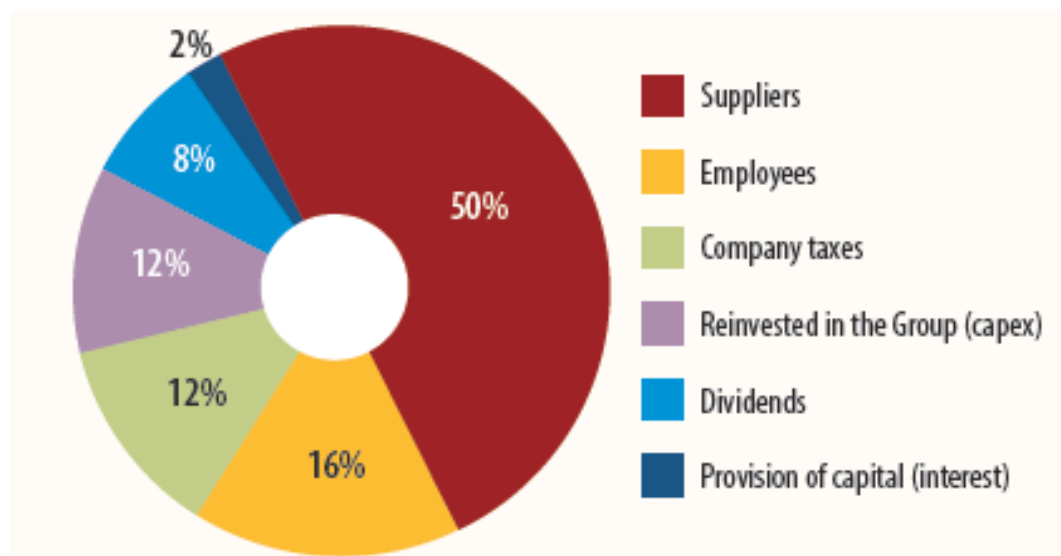
The pre-negotiation phase is largely about gathering, organizing and identifying how to use information. Foremost among this information is the value of the resource. It is understood today that many developing countries do not know the full value of the resource they are planning to have developed. As previously noted, in many instances governments rely on the company’s evaluation as the basis for its own view of the value of the resource. Yet this is a national resource, and achieving full value for allowing it to be harvested is a vital component of stewardship in the national interest. It is a misplaced trust for governments to expect a potential investor to declare the full value of the resource. Companies negotiate rates of return with governments, and will often minimize the true value (and hence expected profit) from the resource to maximize the rates of return and incentives they receive. It is up to the government to ensure it has a sound, fact-based knowledge of the value of the resource under negotiation.

But how does one value a resource today? This is indeed a complex question. From the investor’s perspective, it is basically the estimated quantity of the resource times world market prices, minus the cost of development.<sup>6</sup> Yet from the host country’s perspective there are other elements to the valuation as well: the fiscal value to governments of taxes and royalties, the potential for local purchasing and employment, and potential benefits from downstream value-added processing and labour. In addition, there is an issue of whether governments should take an ownership share as a way to enhance the governments income from the project through dividends. These issues are developed in more detail below.

<sup>6</sup> While the firm’s valuation will build on this basic formula, the actual calculation is complex, and involves taking into account such variables as the time to expiration of its option on the resource; variance in the value of the resource; the risk-free (money market) interest rate; the rate of time preference (discount rate), some assumption about the uncertainty in the estimate of the reserve size, and others.

### 4.2.1 The Value Pie Chart

The objective of ensuring that mining makes a substantial contribution to poverty alleviation, inclusive growth and social development can be understood in relation to the following chart.<sup>7</sup> This chart is an average of a mining company's outlays of money in relation to a mine, i.e., how much it spends on the different key components of its development and operations. It is illustrative rather than intended to be prescriptive of desired or expected levels of expenditure.



Traditionally, governments and mining companies have focused on two parts of the pie chart: company taxes and dividends when an equity stake is also discussed. Company taxes have been the primary focus for governments, in the form of income tax, royalties and other taxes. For some governments, dividends derived through share ownership in the mine have also been a key element of the financial benefits to governments. We emphasize the notion of governments here, as communities traditionally were not part of the equation in negotiating mining agreements and permits. The impact of this approach was that the zero-sum negotiation between companies and governments focused on the 12 per cent of the pie relating to the monies paid out by mining companies in taxes. In some cases, there was also a portion (usually 10–25 per cent) of the additional 8 per cent paid in dividends, so somewhere in the neighborhood of 0.8–2 per cent of the total company expenditures pie.

Achieving better development results requires mining companies, governments and communities to examine how concepts of poverty alleviation, inclusive growth and social development can be applied to, at least, company expenditures on supplies of goods and services, and employment.<sup>8</sup>

#### Can common development goals be set?

The result of this expanded view: instead of 12–15 per cent of the company expenditure pie being the subject of negotiation, up to 80 per cent of the company's expenditures become the legitimate subject of collective consideration by governments, companies and communities. Turning this level of expenditure to the goal of sustainable development through mining—which is common to the company, the community and the government—can lead to substantial benefits.

<sup>7</sup> Based on an Anglo Gold-Ashanti review of distribution of monies spent in relation to its mining operations.

<sup>8</sup> See Pedro (n.d.).



This transition is essential from a sustainable development viewpoint, and for many companies it is already well underway. It is not new and not an obstruction to contract negotiations for investors who see their role as partners in development.<sup>9</sup> Indeed, serious mining companies will have plans and processes in place for these issues prior to entering into any negotiation. What has traditionally been missing is the government readiness to enter these discussions as a condition of a contract (or permit, etc.) and legalize the results.

But the value assessment does not end here. In addition, there are options for downstream uses in-country that many states are exploring. These options raise issues of capacity for downstream uses, as well as economic trade-offs between exports and domestic uses. These may be complex issues, but there are certainly examples where mandatory downstream processing or other value addition requirements have provided economic development benefits to developing countries, making this an important assessment for governments to consider.

Given this, the full value of a resource today requires consideration of:<sup>10</sup>

- The basic market value of the resource.
- The potential fiscal benefits to government (less any incentives provided).
- The potential for dividends from share ownership.
- The potential benefits of other forms of equity arrangements.
- The potential for local purchasing of goods and services by the company.
- The maximization of employment opportunities and human resource skills development.
- The possible benefits from downstream processing or other value-addition requirements.

#### 4.2.2 *The Basic Market Value of the Resource*

The basic market value of the resource is the key consideration of every mining company: how much can it sell the product for? This number will determine, in large part, the rate of return on the investment and the ability of a company to finance the project.

The market value of the resource is also key to the ability of the government to understand and assess the scope of the possible benefits from the mine, in particular the fiscal benefits and the economic benefits that might be associated with the mine. The value of the mine will also relate to such factors as employment levels to be expected and the related degree of local purchasing.

**A key element in relation to the value of the mine is also the ability to set the right level of expectation for social and economic development benefits. Not all mines are the same, and not all will produce a single set of pre-defined benefits. So it is important for the level of expectations for benefits to be in keeping with the size and nature of the mine. Community leaders, government and the company all have a responsibility here, one that hinges largely on the ability of government to have a sound understanding of the mine's value.**

Achieving a valuation requires an understanding of commodity values, fluctuations, grades, mining costs, and so on. Economists with special training in the field are often needed. Where this capacity is not present within government, or at a regional level, the options become relying on whatever

<sup>9</sup> For example, the World Gold Council advocates this type of approach to mining and sustainable development and documents member company performance towards this end. See World Gold Council (2014).

<sup>10</sup> See Alba (2009).

investor's valuation they choose to provide, or getting external support. Because reliance on the investor's valuation is very risky, seeking outside support is critical. Several options for this may be available, from paid to development assistance-supported experts. Below we note some of the general issues in obtaining external support. Here, it suffices to note the need for expertise on valuation.

#### 4.2.3 *The Potential Fiscal Benefits to Government (Less Any Incentives Provided)*

The total of fiscal benefits to the government will be taxes on income and royalties.<sup>11</sup> From this total, one must subtract the cost of fiscal incentives provided by the government.

To obtain the maximum benefits, the government must know the comparative market rates for taxes and royalties, and the basis on which they are charged. Governments do not need to have the lowest rates to attract investment, but understanding the global comparisons is important to setting a realistic rate that makes the country competitive. The global picture will help set out the range for negotiating, *if* the taxes and royalties are not fixed in law. This is one area where governments must make a clear decision: to apply rates set out in the domestic laws and regulations, or to negotiate individual rates for each company. In either case, investors will almost always also seek a stabilization provision. Decisions on this issue must also be made before negotiations begin.

Incentives, especially when done through broad tax holidays, can be very expensive for governments, and rarely achieve long-term benefits.<sup>12</sup> Yet some government still use them. When doing so, it is important to fully cost out the incentives to government. This can become quite complex and requires a full understanding of applicable tax laws. Will expenses be carried forward to the post-tax-holiday period? Will companies be able to book current and past years' expenses against revenues at the same time? These types of issues determine the actual costs to government of incentives and the actual revenues to be expected at any given time.

It is also important to plan for commodity price fluctuations, which have led to windfall profits becoming an ongoing issue between companies and governments. How should they be accounted for? Here we return to the idea of predictability rather than stabilization. Is it possible for governments and companies to plan out windfall profit taxes, based on rates of return set out in the business plan approved for the initiation of the investment? Having a planned division of windfall profits can help avoid disputes and alleviate the risks of stringent stabilization or other contract provisions.

The government may also seek an upfront payment due when the contract is signed. This may be used to guarantee performance or simply as an upfront payment to the government, a contract signing bonus.

Government tax experts should have the capacity to understand and plan for all these issues. External support may be useful for more complex or long-term planning. But in doing this planning, what is essential is that the cost of incentives be as well understood and accounted for as the expected tax and royalty revenues.

In relation to these and the other fiscal and non-fiscal economic benefits for governments from mining, few effective models exist, and none that look at the issues in a holistic, integrated manner. IISD is developing such a model, but at the time of writing this is not yet available. This of course makes it difficult to get into details of how to make the necessary assessment for each of the areas

<sup>11</sup> See International Mining for Development Centre (2012); Commonwealth Secretariat, & International Council on Mining and Metals (2009, Feb.); Otto et al. (2006).

<sup>12</sup> See a general discussion in Thomas (2011); James (2010). For a treatment of empirical evidence, see Klemm and Van Parys (2009).

canvassed here. Nonetheless, we believe that government economists, perhaps with external support, can particularize many of the issues within a specific national and community context with a sufficient degree of accuracy to make better informed choices.

#### 4.2.4 *The Potential for Dividends From Share Ownership*

One of the key areas government are now looking to in order to increase the long-term value of mining investments are share ownership arrangements. Often called free carry shares, the arrangement is usually one where the company assigns a specified percentage of shares to the government. Another variation is to have a portion of a company's shares held by the state development banks that finance them. Through equity ownership, the government may gain two elements: a revenue stream in terms of dividends, and a seat or two on the board of directors in order to have an input into the governance and direction of the investment.

The idea of a government equity stake reflects political as well as fiscal issues. These include the need to be seen to capture greater benefits from mining, and having a greater opportunity to maximize development benefits and minimize environmental damages through participation in decision making. The practice is growing, with very different levels of equity stakes being seen today:<sup>13</sup>

- In 1953, Liberia took a 50 per cent stake in the LAMCO iron ore mine in exchange for no taxation. This trade-off was seen to fail and is no longer the practice in Liberia, though taking free carry shares at a lower percentage level with no tax adjustment on taxes is in use there again.
- The Democratic Republic of the Congo imposed a 5 per cent equity requirement in 2002 but is expected to increase this to 15 per cent in the near future.
- Kenya, in its 2012 mining regulations, brought in a 35 per cent requirement, but is expected to reduce this somewhat, toward 15 per cent.

The issue of who benefits most from this, the government or the investor, is far from clear. On the one hand, government gets an ownership share without being responsible for the operations costs. However, one should note that they usually do not have the right to sell the shares, and so may not be able to realize any capital gains from the ownership stake. This is consistent with the dividend-related interests.

Government stakes are often open to easy use by investors for their own purposes. By creating a stake in dividends, investors can use this as leverage against government measures that will increase costs and thus, presumably, lower profits and by extension reduce dividends. This can relate to regulations for environmental, human health, minimum wage or other public welfare issues, creating a push-pull within government that may not otherwise exist. Indeed, one recent article identifies free carry shares as a tool for risk management by the company, suggesting a range of 21–30 per cent as optimal for the company risk-management purposes.<sup>14</sup>

This type of “capture” of the utility of the free carry share can be enhanced by the company's ability to control its issuing of dividends. Companies can easily manipulate dividends by stripping cash, having investment equity in debt with high interest rates from affiliates, lending cash to affiliates at low interest rates, and using transfer pricing techniques and other methods to move money within the company that reduces profits and dividends. And they can simply decide not to pay dividends in any given year. Situations of these types are better controlled by government through the tax system than

<sup>13</sup> For other examples of African countries that have adopted share ownership arrangements, see Webber Wentzel (2014).

<sup>14</sup> James & Vaaler (2013).

through a seat on the board.<sup>15</sup> And when earnings are reinvested in the operations instead of being paid as dividends (a desirable process) it means that the government is in practice investing in the company by diminishing its revenues, diluting the notion of “free carry” of the shares. Finally, because there is more opportunity for companies to control dividends in times of rising prices, revenues may not increase as predictably or efficiently as a well-structured royalty regime when commodity prices increase.

Consequently, it is important to ask what is being given up if a government takes a share of ownership. Will government gain more from the dividends revenues despite little ability to control factors relating to decisions on dividends? Or will it gain more through taxes, which it can manage more effectively in most cases? Can the government, through an effective provision in the law or contract, prevent the dilution of the shareholding through subsequent issue of more shares in which it does not participate? Can national development banks be used to have more influence when they are part of the funding mix? Can it maintain a steady dividend? Even having a vote on the board may not be enough to do so, as information and power asymmetries can remain very large and bar effective participation by governments. In addition, a government vote on the board will always be a minority vote compared to the company appointed directors.

Of course well-structured taxes and royalties may also co-exist with a free carry share requirement. But achieving the anticipated benefits is simply not automatic, and thus a realistic assessment of costs and benefits must be made. If a negotiation comes down to a choice between them, a careful calculation is needed.

#### 4.2.5 *The Potential for Other Forms of Equity Arrangements*

The preceding section raises a serious question about the goals of equity ownership, especially when one considers the broader context of sustainable development and mining. For example, goals related to the following areas may not be well served by free carry shares for government:<sup>16</sup>

- Technology transfer
- Human resource development
- Creating national champions
- Building competitive capacity and technological capacity
- Improved management practices
- Access to global marketing channels
- Improved gender equity
- Poverty alleviation
- Reducing income gaps between rich and poor
- Economic empowerment programs for disadvantaged groups.

Indeed, given this diversity of possible goals, a range of alternatives can be considered. Among these are joint-venture requirements with a state-owned enterprise, joint-venture requirements with a private sector company, and minimum levels of equity for nationals of the host state. All of these may raise issues of trade law and investment treaty application.<sup>17</sup> But aside from this, it is important

<sup>15</sup> Much of this section is drawn from Wells (2014).

<sup>16</sup> On the range of goals and possible tools, see Cosby & Mann (2014).

<sup>17</sup> Cosby & Mann (2014).



to remove the relatively easy potential for them to be used for purposes other than those ascribed to them for these tools to succeed in.

For example, state-owned enterprises can become international players in global markets and strong national champions, as Chile's CODELCO has in copper and several companies have in the oil sector. But they can also lead to their own forms of corruption and political capture, leaving many companies inefficient and ineffective in national or global contexts. There is a constant temptation for governments to use SOE revenues as government revenue by dictating high levels of dividends, leaving the enterprises unable to make necessary reinvestments, and weakening long-term competitiveness. Governance is a critical issue.

Private sector joint-venture requirements can similarly distribute skills and technologies in the sector and increase participation in shared value when the local partner is an active company in the sector, or they can be captured by a very small number of politically well-connected companies, often in capitals and rarely in areas where the mines are located. As noted above, this can easily lead to the investor capturing the benefits of this requirement instead of the government. Minimum national equity levels can similarly favour well-connected people and lead to greater concentrations of wealth rather than greater dispersion of wealth.

Additional options for local equity ownership can also be considered. These include trade unions associated with the proposed project, and local communities themselves.

Any of these tools can achieve good results, but in no case are results guaranteed. Partnerships that are captured purely for the investor's political protection will not yield the desired results. Domestic partners without the necessary sectoral or marketing expertise likewise will fail to capture the benefits. Mandatory partnerships with incompetent partners can create distrust and the opposite impacts, such as, for example, the use of old technology to prevent theft of newer technology.

In short, without appropriate flanking and governance policies, mandatory national ownership requirements are more likely to fail to form a broad development perspective, or to be used as part of a political process.<sup>18</sup> Thus, in preparing to negotiate or regulate requirements in these areas, governments must consider carefully their goals, whether there are appropriate policies in place for the tools to work, and the governance structures that must be involved.

#### **4.2.6 *The Potential for Local Purchasing of Goods and Services***

The notion of purchasing local goods and services as inputs into the mine construction and mining operations has now become a central element in looking at mining from a sustainable development perspective.<sup>19</sup> The pie chart in section 4.2.1 shows the potential benefits from a development perspective, with some 50 per cent of a mining company's expenditures on a mine being on the purchase of goods and services. Tapping into this can improve the economic multiplier effects of a mine many times over. In addition, it can improve technical skills, manufacturing capacity, marketing skills, and help establish businesses that can expand beyond the focus of the mine itself. It can be an essential part of helping prepare for the post-mining life of the community as well.

At the same time, companies have reasonable requirements to ensure they can obtain the goods and services they need in the quantity and quality they need, and in a timely manner. To meet those requirements while procuring locally will often involve an ongoing process of capacity building, opportunity building, and business mentoring. In addition, expectations should be in keeping with

<sup>18</sup> See especially Part 1 of Cosby & Mann (2014).

<sup>19</sup> See, for example, World Bank (2012a).

the size and nature of the mine, and the capacity of businesses in the community to deliver. It is often reasonable to have levels of purchasing increase over time to allow for the interactive capacity-building processes to work.

Two related issues should be noted. One is the granting of import duty concessions to foreign mining companies for equipment and supplies. This can create a price disincentive for the purchase of local goods, especially when some of the component elements of the final product have been imported by a supplier that does have to pay import duties. Care must be taken not to build in barriers to local purchasing in this way. Second, it is important to ensure that local purchasing is done from actual local companies, not shell companies set up to look like domestic suppliers.

Specific details are addressed in Volume 2, Part 5. In terms of preparing, it is important for the government to understand the size and nature of the mine, the value of the resource, and—most importantly—the existing capacity and latent potential of domestic suppliers to meet the requirements of the investor in order to understand the potential for local purchasing. It is also important to identify what types of processes will be most useful in improving opportunities in this regard, in conjunction with the company. As noted above, domestic firms may need considerable support in upgrading to meet investor needs, and, while the investors themselves need to play a major role in that support, there is also a role for government in training, financing, linking to existing educational institutions and so on.

In essence, what we see here is a very concrete application of the idea of creating common interests among the community, company and government. When a process for doing this over the longer term is established, the focus moves from immediate issues of compliance with a number to establishing a process that seeks to continuously improve the levels of local purchasing. Short-term failures can be addressed together, and successes replicated. Specific and quantifiable obligations are still important, but establishing the longer-term common interest is more important.

#### 4.2.7 Infrastructure

The need for associated infrastructure when a new mine is being developed creates additional opportunities for host states to benefit from the new mine project. However, it is again by no means guaranteed that benefits will accrue: this depends on appropriately planning and managing the process.

This issue should be the subject of a completely separate guide that would address almost all of the same issues from the infrastructure construction and operations perspectives. As such, all we can do here is note some of the key issues.

First, of course, is identifying what infrastructure is needed: roads, ports, railroads, energy, telecommunications, water management, and others may all be involved in one way or another.

Second, who will be responsible for building the infrastructure? The government, the project proponent, the home government of the project proponent as an aid project, a purpose-built public-private partnership (PPP)? Each may have advantages and disadvantages.

Third, who will pay for the infrastructure? Again, will it be the proponent? The home government of the investors as aid? Development banks may be actors in this field as well. And of course other sources of private financing may be involved in a PPP-type approach. How will development of the infrastructure relate to obtaining the right to mine is another important question that arises in some

cases where development of infrastructure has essentially been used to purchase the right to mine a particular resource.<sup>20</sup>

Who will use the infrastructure is another issue that relates very closely to the benefits of its building. If only the mining company is allowed to use it, development benefits will be limited. If all persons in the country or community can use it, the size or other construction variables may be very different.

Ongoing maintenance and upkeep of infrastructure once it is built is another issue that must be considered for benefits to properly accrue to the states and the community.

Then, all of the questions concerning employment, training, local purchasing, and others applicable to capturing the full value of the mine also apply to capturing the full value of the infrastructure components of the project.

These issues must be fully considered in the design, building and contracting of infrastructure projects associated with developing a new mine. In addition, the environmental and social impact assessments and management plans must be developed, and other regulatory measures respected. In some cases, for example, river dredging and port construction may be the most environmentally impacting components of a mine development, and could equally impact local fishing and agricultural livelihoods in the local communities. Project impact assessments need to consider both the specific impacts of each component of a project as well as the cumulative impacts.

Short-term and long-term understandings of costs and benefits are important for sound decisions. Indeed, the recent World Bank report on access for infrastructure shows the difficulties many governments have experienced in getting value from infrastructure for access-type arrangements, despite their attractiveness.<sup>21</sup> This serves to highlight the need to properly address these issues. However, providing more detail here would expand the scope of this guide beyond its reasonable limits.<sup>22</sup>

#### **4.2.8 Maximization of Employment Opportunities**

Maximizing employment opportunities is a key element of the development process. Going back to the pie chart in section 4.2.1, we see that about 16 per cent of the total expenses for a mine relate to employment. Maximizing the local revenues from that share is important. Equally important are the opportunities to maximize skills development in the local community and the country as a whole, including higher technology levels and management skills. The development of all of these skills adds value not just for immediate disposable incomes and tax revenues, but also for application outside the mining context by mobile employees, and post-mining economic development.

There are several issues for governments to prepare here:

- How big is the mine going to be?
- How many jobs in what phases: construction, initial operation, full operation, closure?
- What types of jobs: unskilled, skilled, management, professional?
- What skills does the labour pool have in the region of the mine, and more broadly across the country, and how well do they match with investor needs?
- What type of skills development can reasonably be done by the company, government and community working together?

<sup>20</sup> This is an issue more hidden in the political sphere, and little discussed in the literature.

<sup>21</sup> Halland, Beardsworth, Land, & Schmidt (2014).

<sup>22</sup> See, for example, Columbia Center on Sustainable Development (2015), Vale Columbia Center on Sustainable International Investment (2014), International Finance Corporation (IFC) (2013), Center for Sustainability in Mining and Industry (CSMI) of the University of Witwatersrand (2010).

As seen in relation to local purchasing, governments should consider actual and measurable numbers at different levels of employment and different phases of operations. But they should equally be seeking ongoing processes that work on the basis of common interests to continually enhance the opportunities for local employees. This longer-term view is important to build into negotiating goals.

**Creative processes can work:** In a mine in the Canadian arctic, where education and skill levels can be low, a commitment to local employment was seen to be difficult to implement due to a very rapid turnover of employees—as high as 75 per cent per year for the first two years. This benefited neither the local population nor the company, even though they were in technical compliance with the numerical obligations. As a result, the company and community established a joint committee to understand the rapid turnover problem. They found that employees were dissatisfied with the lack of career development opportunities and left quickly. The company then established a career development and mentoring program. The next year turnover dropped from 75 per cent to 25 per cent. Compliance was not the issue: the common commitment to skills development over the longer term was the common goal.

#### 4.2.9 *The Possible Downstream Use Benefits*

The final piece we address here concerns the government need to assess available downstream benefits from further processing of the commodity in country. Botswana's in-country diamond processing is one well-known success story in this regard, having achieved not just in-country processing of its own raw stones, but the import of stones from Europe for finishing as well, and the creation of an infant diamond jewelry industry.<sup>23</sup>

Governments may seek to achieve several related things in promoting downstream use of the resources. These include:

- Additional jobs, in particular higher-skill and value jobs
- Technology development and related skills development
- Increased manufacturing base
- Access to markets for higher value products.

Governments must, however, be realistic in what they seek in terms of downstream value added. Not every country can process every commodity produced in its territory, and certainly not in a manner that is economically efficient, competitive and environmentally sustainable. Diamond processing, for example, is neither water- nor energy-intensive, two factors that will often limit downstream processing opportunities. Thus, sound economic and industrial analysis is needed.

One element of this analysis is the integration of downstream processing into a broader industrial policy design, so that a multiplier effect can be achieved. Where opportunities are new, integrated planning to maximize the benefits needs to take place.<sup>24</sup> One-off opportunities may be useful, but opportunities integrated into a broader development strategy will achieve more. This would also help in prioritizing realistic opportunities when human resources, capital, energy and water may be scarce.

For downstream processing to be economically viable, there must be some economic advantage other than just the presence of the resource itself. This may be cheap energy, where processing is energy-

<sup>23</sup> See Mbayi (2011).

<sup>24</sup> Bond (2013).



intensive (e.g., aluminum), or good transport infrastructure and proximity to final markets where shipping costs are high, or existing expertise and skills that can be used in the processing sector.

As well, building a downstream processing sector is best done in deliberate and strategic collaboration with private sector firms already operating in this space, who can contribute the necessary marketing connections and expertise. Successful localization of processing requires much more from government than simply the directive that requires it to be done; it is a difficult exercise in industrial policy, and requires active support to successfully launch and nurture through to the point of self-sustaining global competitiveness.

Governance is also important: do the means exist to prevent cronyism and corruption? Are transparent governance regimes in place? Will the new processing facility be structured in a way for the investor to avoid any profits and thus eliminate possible tax revenues? How will it be structured to maximize benefits—owned by the investor? A joint venture? Partly owned by government? None of these questions pose ultimate barriers, but the government must consider these issues if seeking a requirement for downstream processing.

And, once again, demands must be realistic so as not to scare off an otherwise good investor. Here, as in other instances, we return to the idea of creating a common objective. How can the proposed downstream requirements also benefit the investor, rather than simply limit its export opportunities? What additional profits or other benefits will it achieve so that it will make sense to be a partner in pursuing the success of the downstream design? At a lesser level, what approaches will at least ensure that downstream processing does not cost the investor anything so that supporting it is not a cost factor?

The downstream use issue is also one fraught with political posturing. It is an easy issue for political leaders to take hold of for political purposes. For negotiators, however, the issues need to be concrete and specific. Is there enough energy available? Is there enough water? Are the human resources available? In the context of a specific proposed investment, downstream beneficiation is not a political slogan but a detailed part of an often complex negotiation. Success depends on planning and realistic assessments of the opportunities and on building a partnership rather than a command-centered approach.

### 4.3 Social and Environmental Pillars of Sustainable Development

In addition to maximizing the economic benefits of a potential mining project, it is equally important to identify, understand and maximize the social and environmental benefits. In practice, this requires engaging with local communities and developing ongoing processes between the company planning to make the investment, the community and the government. The precise parameters and composition of these interactions will depend on the specifics of each instance, but the basic point should hold across all instances.

Social issues can cover a wide range of factors. These might include large-scale issues like resettlement, accommodations for artisanal miners, addressing water and electricity needs, and managing the social changes and health risks that can come with large-scale investments, and protecting human rights. And they might include more limited issues like building health clinics, schools or libraries. Environmental issues begin, but do not end, with compliance with locally applicable law. The contract should never undercut this bedrock minimum. As noted previously, this is one of the most contentious

issues in the relationships between mining contracts and domestic law, especially when an investment process spans the exploration and exploitation phases of a project.

In this section, we highlight a few of the key issues in the social and environmental areas that require clear attention in the lead up to a negotiation. More specific details follow in the drafting sections of Part 5 and 6.

### 4.3.1 *Community Engagement*

As previously discussed, the long-term success of an investment project depends on the local community's acceptance of the terms of the deal. Achieving success here is tied closely to the contract negotiation and to a sense in the community that its interests are taken seriously throughout the process.

The relationship between the investor and the local community is of paramount importance to the chances of long-term success of the project. Given this, real engagement with the community is important before and during the negotiation process. While the investor should have the primary responsibility for establishing and managing its relationship with the local community, the relationship between the government and community is also important. Indeed, in most instances, part of the government negotiators' mandate is to assist the community to achieve its own objectives, whether this is reflected in the principal contract or permit between the government and investor or through a Community Development Agreement, or both. This cannot be done without clear communication with the community before and during the negotiations.

There are many challenges in such discussions, including whom to consult with, when, through what processes, etc. These are all legitimate issues, but issues that generally need to be worked through as part of the consultation process. The preparatory period for the company prior to beginning negotiations will be several years. This also provides a window for the government to gather its basic information and establish an effective consultation process.

There are several guides to promoting good community consultations.<sup>25</sup> For example, in the Principles for Responsible Contracts, the UN Special Representative on Business and Human Rights proposes an effective community engagement plan through the project's life cycle, starting at the earliest stages (Principle 7).<sup>26</sup> This includes:

- An inclusive consultations plan with clear lines of responsibility and accountability.
- Consultation with affected communities and individuals before the finalization of the contract (We suggest well before commencing the negotiations).
- Disclosure of information about the project and its impacts as part of meaningful community engagement.
- Knowledge about the history of any previous engagement efforts carried out by the investor with the local community regarding the investment project.
- Community engagement plans aligned at a minimum to the requirements of domestic and international standards (For example, free prior informed consent is now seen as a minimum global standard for consultations with indigenous peoples).

<sup>25</sup> See ICMC (2012a), ICMC (2009) and Anguelovski (2008).

<sup>26</sup> UN Human Rights Council, *Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*, U.N. Doc. A/HRC/17/31 (Mar. 21, 2011). Retrieved from [http://www.ohchr.org/Documents/Issues/Business/A-HRC-17-31\\_AEV.pdf](http://www.ohchr.org/Documents/Issues/Business/A-HRC-17-31_AEV.pdf)

### 4.3.2 *Land Tenure, Resettlement and Artisanal Mining*

Secure land tenure is a requirement for any mining project, whether in the form of ownership of land (rare) or a long-term lease for the duration of commercial operations. This is covered in detail in the more technical sections in Part 5. For governments, a critical issue is understanding with precision the extent to which the land requirements of the company will impact land use and occupation by its citizens. Will the project require moving communities, farms, small businesses? Will it dislocate people, and, if so, how many? What are the opportunities for resettlement in such cases?<sup>27</sup>

As will be seen in Part 5 on specific content in a contract, IISD supports the view that the company is responsible to pay for, compensate for and undertake any relocation needed. The government should not take on this responsibility. However, to effectively manage the tripartite relationship between company, community and government, the government cannot avoid this issue. Critically important is that the expectations on the company to meet international standards for relocation is clear from the beginning, and that the community is aware of these standards, even when the international standards are higher than the existing domestic law requirements. Ensuring open communication is a key part of the government role here. The International Finance Corporation's Performance Standard 5 on Land Acquisition and Involuntary Resettlement is widely accepted as the key international standard in this area and forms a key element in addressing this issue as a baseline standard in Part 5.<sup>28</sup> Government officials should be well versed in this performance standard as a basis for engaging with the local communities and the company.

For mining, the relationship of a proposed project to artisanal mining is also critical. This is tied to relocation issues because the concept of relocation also covers impacted livelihoods, not just actual living spaces. If artisanal mining has to be terminated for safety reasons, alternative livelihoods must be provided for. This is an issue rife with problems that can easily lead to extended delays in construction, mine shutdowns when operating, and even localized armed incidents. It is therefore critical to address this issue in any negotiations, and thus important for the government and community to work with the company to find solutions based on sound information that can only be obtained through government-community cooperation.<sup>29</sup>

A large concern in many countries is that land rights are not always recognized in ways similar to Western legal forms. In many countries, land rights are based on traditional community rights, tribal rights and other customary mechanisms. It is important for these rights to be fully recognized by the company, and governments may have an important role to play in this regard. This includes not just traditional title rights but also traditional use rights for pastoralists, use of forests resources, use of water resources, etc. Where the government has not mapped these rights and interests, it is the responsibility of the company to ensure it knows and understands them, in consultation with the communities.

### 4.3.3 *Gender Equity and Equal Opportunity Issues*

In many communities, gender is a major development issue. It is important for governments and the company to ensure that women have an equal opportunity to benefit from the mine. This may mean taking a leadership role and promoting training for women in both mining and mine-related job opportunities. Ensuring equal wages for men and women is important when these jobs are provided.

<sup>27</sup> On the issue of displacement and resettlement, see Downing (2002).

<sup>28</sup> International Finance Corporation (IFC) (2012).

<sup>29</sup> The issue is often very complex. Some resources can be found at: Communities and Small-Scale Mining (CASM), International Finance Corporation and World Bank's Oil, Gas and Mining Sustainable Community Development Fund (IFC CommDev) and International Council on Mining and Metals (ICMM) (2010); Buxton (2013); and Hentschel, Hruschka and Priester (2003).

**Making sure all voices are heard; A key issue in promoting gender equality is making sure that women have a full chance to be heard in community consultations. Over and over, one experience that stands out is the need for separate consultation sessions to be held with women in the community. This enables the participants to speak openly, and express issues that the men in the community may not be supportive of hearing. These women-only sessions are often the only way to ensure all voices are truly heard.**

Being heard is of course of little value if it is not followed by actions. Issues identified in the consultations must be reflected in the design of the social and economic development provisions of the contract, and in any Community Development Agreement between the company and the community. In many instances, ensuring that women are specifically represented not just in initial consultations, but in ongoing consultations between the government, company and community, and on the management committees for these processes, will be central to long-term success in addressing the identified issues. Governments have a special leadership role to play in this regard.<sup>30</sup>

#### **4.3.4 Health Considerations in the Community**

It is important for governments to understand health issues in the community, and to use the mining development as a path to new health care improvement opportunities. Precisely what these will be depends on the size of the community, its location, its proximity to other services, and other factors. As every large-scale mine will have some form of health clinic and emergency services, there often are opportunities to assist in community care as well, even at smaller scales of investment.

Many companies will offer to build local clinics in the community, and in some cases even hospitals. Understanding the needs of the communities and governments, and their capacity to manage and operationalize such facilities with and without ongoing support is critical in responding to such issues.<sup>31</sup> Companies should not be making decisions on needs that are properly the role of the local community and government, but assisting in meeting these needs when this is appropriate. Here, as in the area of education and some other issues, the relationship between government, community and company must be clear.

#### **4.3.5 Education Considerations in the Community**

Very similar issues arise in relation to education. What role can the company play in supporting government efforts in relation to education? Will boys and girls be treated equally? Will barriers such as uniform requirements have an impact on access? Will the community and government be able to operationalize facilities if the company builds them? What about adult literacy or other education or skills training programs?

As noted previously, the company role is not to replace the local government in providing health and education services, but to assist and enhance opportunities when needed and useful. Creating successful partnerships is based on understanding needs and opportunities from the ground up.

#### **4.3.6 Energy Security**

Energy security is a major issue in many developing countries, and governments must be prepared to address it. This has two aspects in relation to mining. One is the potential for the mine to take up

<sup>30</sup> See Centre for Women in Politics and Public Leadership (2012) and Oxfam Australia (2009).

<sup>31</sup> See ICMM (2013b); and Shandro, Veiga, Shoveller, Scoble and Koehoorn (2011).



too much power and thus deprive other users or create high risks of blackouts or brownouts. The second is the potential for the company to contribute energy to the community. This can arise when the company is developing its own source of electricity or expanding access to a national or regional grid in a way that can also assist the community. In addition, as mining companies increasingly turn to renewable energy sources, this can provide opportunities for local communities to access renewable energy options, as well as the skills for installing and maintaining them, at costs that make them affordable. Incremental costs can often be taken up by development banks.

Which of these is going to be most relevant, if either is, will be determined by the specifics of the situation. As energy supply and security is a key development issue, governments should consider the above types of issues before approving a mine project.

### **Seize the moment**

On one mission in Western Africa, a delegation of UN post-conflict experts met with mining company officials and World Bank officials separately. The mining company had built and owned the then-largest electricity production source in the country. When asked if they would be able to provide power to the community a few kilometers away, they said yes, there was plenty to spare. But they said they would not want to be responsible legally for the distribution systems needed. The World Bank country representative was later asked if it would be prepared to help fund and establish a local distribution system as an independent legal entity so the company would have no liability. The immediate answer was yes. When asked why this did not already exist, the answer was simple: no one ever asked before.

#### **4.3.7 Environmental Issues**

Environmental protection in the area of the mine and in the area impacted by the mine is, of course, a critical expectation of any government today. But there is more to the environmental issue than simply protection. The few topics discussed below exemplify the range of issues that governments must be able to consider when evaluating an environmental impact assessment and management plan. They also give a sense of the issues that the government must be able to consider in an informed way with the community and the company. Indeed, to address them properly, it is important to consider not just environmental science but the interaction of the community, and other users, with the environmental resources.<sup>32</sup>

#### **Environmental Quality**

The quality of the environment before the beginning of any mining operation sets the baseline for measuring the impacts of the mine. Compliance with the applicable law will be one element required of the company to maintain the quality, but may not be enough. The company's environmental management plan should include commitments not to harm the environment, and to mitigate any harm that may be essential. This may include proper rehabilitation planning at or before closure, or it may include other requirements for continual improvement of environmental performance of the operations as required by most international standards on environmental management. The baseline date for measuring these issues has to be established before the mine operations begin. This may be done by the government, by the company in preparing the environmental assessment, or by a third party. Either of the last two options will require review and acceptance by the government.

<sup>32</sup> See ICMM (2006), Environment Canada (2009), Environmental Law Alliance Worldwide (2010) and Deshaies (2011).

## Environmental Uses and Services

In all rural environments, local communities and people will have a high degree of dependence on the local environment for making a living. Whether it is farming, fishing, forestry, use of local energy sources (wood or other biomass), or simply harvesting local foods and water, the environment is almost always a critical part of rural livelihoods. Impacts on the environment will thus have the potential for a significant economic impact on the community. These need to be assessed in the social component of the assessment processes, and accounted for by government as it reviews the assessments. Understanding the economic and social relationships with the environment is thus essential.

The environmental resources also provide ecosystem services like soil protection, water filtration, CO<sub>2</sub> removal, support for biodiversity, prevention of landslides in mountain areas, and so on. Understanding these services is also important in properly understanding the potential impacts of project development and operations. Thus, specialized expertise in environmental services is important, just as the specialized capacity in relation to the economic benefits of the project is within the government. Interdepartmental coordination of input into community consultations, and reviewing environmental assessments and management plans is almost always going to be necessary as well.

Finally, it is important to raise an alternative potential in the relationship between the company and the environment. The traditional view is always as expressed above: reduce or eliminate damage to the environment from mining. IISD believes<sup>33</sup> it is time to conceive of the next step: to use the mine to improve the environment. The approach here is to find how to use the expertise and research capacity of the mining company in a way not only to reduce and eliminate damage from the mine development itself, but also to provide analysis and tools to improve the quality of the environment and increase the opportunities for enhanced and sustainable use of environmental resources. Governments can facilitate this approach to employing new expertise in a positive government-community-company context.

## Water Resources

One of the most contentious issues in mining is the use of water and the risks of water pollution from daily uses and from major emergencies. Water-quantity issues must be understood in order to protect all water users and not allow one user—the company—to be able to legally preempt the rights of other users. Water-quality issues can impact the local communities' ability to use surface and groundwater resources for daily needs, agriculture and other commercial uses.

Managing water resources—both the quantity and quality issues—usually requires following a water basin management approach, defining the rights and responsibilities of different actors having in mind the different uses of water. The group of water users may be diverse, and it may include not only domestic but also international partners in the case of shared water basins. Just as in the case of land users, water users may include both those with formal legal rights and traditional or customary indigenous water rights. It is important to map carefully the range of potentially affected parties and take into account their perspectives as early as possible in the consultations with the community.

Assessing water quality and quantity is not as complex as one might imagine. Water models can be developed using easily accessible metering equipment. At the same time, advances in access to information from satellites are making this work easier and cheaper to conduct in poorer countries. Capacities within water ministries vary greatly from country to country, but consultants and researchers

<sup>33</sup> IISD Mining and Sustainable Development Initiative, at <http://www.iisd.org/sites/default/files/publications/iisd-mining-sustainable-development-initiative-brochure.pdf>.

should be available everywhere. There are also regional research institutes that can take on or facilitate this type of work. Completing these steps will create a baseline for water use.

In 2011 IISD was contracted with a team of hydrologists from the University of Niamey to develop a watershed model for a wetland complex in central Niger at a cost of US\$40,000. The work was done in around four months. In the Dominican Republic, IISD commissioned the Stockholm Environment Institute and the Dominican Hydraulic Institute to apply their Water Evaluation and Planning system for a water basin at a cost of around US\$35,000.

It is important for the government to work with potential investors and the community to establish a clear protocol for water allocation priorities under periods of water stress, to ensure that minimum safe water supply standards for the local population can be met. In the same way, provisions may be needed for dealing with excess water, which could be due to flooding. Finding collaborative responses to these challenges is important, and necessary to avoid later claims by a company that it has an implied right under any circumstances to all the water resources it needs to operate.

Finally, governments must consider the water issues in the context of growing threats to water security due to climate change. Given growing fluctuations and changes in water flows, companies must take proactive steps in reducing water uses (quantity) and impacts on water (quality). This is an important policy issue for governments to consider. Minimum obligations on governments would mean compliance with existing and future laws. However, a more forward-looking approach would require additional research and development work to develop alternative processes to reduce water use and impacts. This approach is, in fact, part of many environmental management models.<sup>34</sup> But it takes a deliberate choice of governments to move this from a voluntary management approach to a specific obligation of the investor.

## Climate Change Impacts

Climate change poses material risks to all economic actors today. Few areas on the planet will escape any impacts under projected patterns of climate change. For companies making large-scale, long-term investments it is important to understand the risks of climate change impacts in the area of the investment to ensure that adaptability and emergency responses to large weather events are built into operational plans. Climate risk assessments will help governments and investors understand relevant climate hazards, the exposure to hazards, sensitivity to climate impacts, and the capacity to adapt when events arise. This form of adaptation has nothing to do with positions in international negotiations or national climate plans. It has everything to do with ensuring the ability of large investments to plan for climate change-related impacts that are going to happen, and thus build in a large degree of resilience when the events do occur.<sup>35</sup>

A second issue is, of course, reducing CO<sub>2</sub> emissions. Whatever the specific commitments today or anticipated in the next years, projects being planned now and in the future are intended to last for several decades, long after current negotiating periods. It is thus prudent for governments to consider addressing carbon dioxide emissions from new facilities before major new sources are created. Again, this is an area where government policy should be clear. Options include compliance with existing laws

<sup>34</sup> ICMM (2014); ICMM (2012b); Global Water Partnership (GWP) and International Network of Basin Organizations (INBO) (2009); GWP and INBO (2012).

<sup>35</sup> IISD is now working with industry and communities on joint projects for climate change adaptation. The goal is to improve resilience to climate events for all the stakeholders in a comprehensive strategy.

and best industry practices on emissions, and the inclusion (as with water issues) of an obligation for continued research to reduce emissions over the life of the project.<sup>36</sup>

## Summary

Environmental issues can be complex, but baseline expectations for investors can be clear. The goal of preparing for negotiations in this area is to be clear on what these expectations should be.

### 4.4 The Negotiating Team

Establishing a strong negotiating team is critical to the success of any negotiating process. A strong team is built on a strong foundation and has strong communications skills for outreach. It must collate individual positions of different stakeholders into a coherent whole, understand the negotiation process inside and outside government, be aware of and sensitive to local cultural issues in the mining area, and take responsibility for its effort and results.

**The negotiating team should not be making policy for the government, but implementing the policies already made. The preparation process is where policies that need further development must be identified and addressed. The negotiating team translates the policy into action.**

In this section, we review issues related to the interdepartmental team, the core negotiating team, public outreach and the role of the public, the role of outside advice, and the relationship of the negotiating team to the Minister. Every government will have different types of organizational structures. Social and political cultures will also vary and affect how the process works in practice. This purpose of this handbook is not to propose harmonization or one approach over another. Rather, it seeks to suggest some minimum requirements that should fit within all systems.

#### 4.4.1 *The Interdepartmental Team*

The interdepartmental team must be capable of bringing the various types of expertise needed for the negotiating team to be fully informed of, at a minimum:

- The existing law in areas related to mining (tax, environment, labour, etc.)
- Related infrastructure issues (rail, port, etc.)
- The environmental issues the mine may raise (pollution, water use and quality, air quality, etc.)
- The social issues the mine may raise (resettlement, gender, health, social welfare, community health, etc.)
- Mining practice
- Economic development issues (employment, skills development, etc.)
- The community-engagement requirements.

The knowledge and expertise of all the relevant departments is needed to understand existing laws and policies, government objectives in different areas, and so on. Where there are competing interests, as there often are, the interdepartmental process is the place to identify them and find a coherent approach for the negotiators to implement.

<sup>36</sup> See ICMM (2013a) and Nelson and Schuchard (2011).



The interdepartmental process should not be a competitive process with an entry test. There is rarely going to be any harm if a department with a less-direct interest participates. It is best, generally, to err on the side of inclusion rather than exclusion. The object is a set of holistic negotiating goals.

The interdepartmental team is also where the information gathering and assessment of all the issues raised in previous sections must be brought for review and vetting. In the same way, the environmental impact assessment must be vetted by the appropriate environmental agency and that information brought back to the team. Building the full set of information is a critical role, and one that inherently requires significant complementary effort by all the departments.

#### 4.4.2 *The Negotiators*

**The negotiators are the core team that will actually engage in the negotiating process. Not every department will be represented, but the negotiators' responsibility is to represent the government as a whole, not just one ministry, as it is the government that assumes all of the rights and obligations, not an individual minister. The negotiators must, therefore, rely on the interdepartmental team for their inputs and their objectives.**

The negotiators should be experienced in large project negotiations, and those being trained for this work. The team should have people who can contribute from all the key perspectives of the planned negotiating session. Hence the team may change to some extent, depending on the issues for discussion. The tax expert may not need to be present at a negotiation on environmental issues, and the environment expert may not need to be present at a tax negotiation.

The lead negotiator must have the gravitas to command respect, the skill to execute the negotiating plan, and the experience to know how to draw on the skills of the full team. The legal advisor plays a key role in almost every case, both for consistency with local law and for drafting, as well as overall structuring of the negotiations and the deal.

#### 4.4.3 *Public Outreach and the Role of the Public*

The negotiating process requires designated persons for outreach to the public, media and other agencies. It is important for the negotiating process to be giving consistent messages, and that means having designated people doing the communication.

At the same time, it is increasingly common today for community representatives to be part of negotiations, either through a place in the government–company negotiations, or in a separate but related community development agreement (CDA).<sup>37</sup> This issue is critical to sort out early. It is a policy choice as well as an efficiency choice. Again, there is no single answer applicable to all situations. Where there are stronger and clearer local governments, it may be useful to have them on the team, or in the interdepartmental process, even when there is also a separate CDA process.

#### 4.4.4 *Outside Expertise: Capacity provision and capacity building*

For many governments, a key target of aid requests is receiving outside legal assistance during the actual negotiations. However, it is during the process of preparing for negotiations that the need may be even

<sup>37</sup> On CDAs generally, see Sustainable Development Strategies Group, Community Development Agreements Library, available at <http://www.sdsg.org/archives/cda-library>. See also World Bank (2012b); International Council on Mining and Metals (2012); Foti & de Silva (2010); Laplante & Spears (2008).

more acute and diverse, and the inputs most valuable. Consider the range of issues noted above, from economic and fiscal analysis to environmental expertise, structuring to maximize local purchasing and employment benefits, and so on. Many governments lack experienced mining economists that can properly evaluate the value of a resource, the first basic requirement for a successful negotiation. This gap alone often leaves governments dependent on mining companies for the very underpinning of the negotiation process. This is not a negotiating issue, but an issue of preparing for negotiations.

Seeking the right external support is important. Over the past couple of years, most of the focus of discussion on external support has been on the need for legal advice during negotiations. While this is important, it is not any more important than the economic analysis, environmental analysis and so on. The most skilled negotiators can only be as good as their factual grounding.

**The idea of putting the negotiations on a business-like footing, discussed earlier, is important here. For many years, developing country governments have argued that they do not have the capacity to effectively negotiate, yet have not gone out to obtain that capacity. This approach should not be acceptable today. Whether outside expertise is purchased or received on a pro bono basis, developing countries need to put themselves on a proper business footing for undertaking complex negotiations. What a state and community receive in benefits in 10 years is based on what is accomplished in the negotiations. It is a business negotiation, and it should be approached—and invested in—in this manner. Just as companies will get outside expertise when needed, so must governments.**

Today, many organizations provide different types of capacity to developing countries, including legal and accounting and technical capacity to evaluate the value of resources. A government that fails to access the needed capacities in a negotiation, both in preparation for the negotiation and during that process, is failing to meet its obligations to its citizens to maximize the value of the natural resources in question.

Thus, it is critical to identify the types of capacity needed to properly evaluate the information relevant to a negotiation. If this capacity—legal, financial, accounting, environmental, mining technologies or other—is not available in house or within the state, it must be accessed through other available resources.

But the use of outside experts is not without risk. Government must know whom they are hiring. What is their background? Have they worked for governments before? Do they understand sustainable development in the particular county context, and in the mining context? Can they help shape objectives and negotiating strategies with other team members, or do they dominate the process? Will they participate in related capacity-building processes? All experts have their own biases based on their experiences. It is important for governments to know and understand these biases before engaging the experts.

In addition, it is important to ensure that the government team does not become dependent on the experts. The government role is to receive and understand the information. In the end, the government makes the decisions, not the experts. The experts assist in building the skills of other team members, not dampening them down. The experts' role is to assist with information gathering and with the negotiations, but not to take over the process.

Finally, a critical element of any capacity provision agreement, whether paid or pro bono, should be the training of local officials. This can be applied to all the above-noted areas. Whether one negotiation

will suffice to have properly trained local officials is an open question and can only be answered on a case-by-case basis. However, the opportunity provided by accessing critical capacities or skills for a negotiation clearly provides an opportunity for capacity building that should not be missed.

#### 4.4.5 *The Role of Political Leaders*

A critical element in a negotiation is being able to manage the political component. The role of the Minister or President in any negotiation is critical. It can be extremely constructive when Ministers are fully onside with the negotiating strategy, and very destructive to longer-term national goals when short-term personal or political goals are at the forefront of their individual objectives.

The concern is that, in some situations, political officials can have a short-term perspective: the Minister or President may seek credit for the new investment and getting new jobs, etc., while any problems that emerge later may no longer be their problem. The negotiating team, on the other hand, is responsible for taking into account the nature and risks of different possible mid- and long-term problems. Indeed, the whole notion of a sustainable development perspective assumes a longer-term perspective.

**For a negotiation to succeed, the investor must understand that the government is prepared to walk away and seek another investor for the project. Presidents, Ministers and other political officials must be on board with this approach and ensure that potential investors do not get a second back-channel directly to them in order to override the negotiating team.**

Transparency is also a factor here. The more transparent the result of the negotiation, the fewer the opportunities for short-term political or other interests of senior political officials to be called upon to intervene in a negotiation. This is one reason for the strong support for transparency in this handbook.

## 4.5 Entering the Negotiations

The actual negotiation process is often unpredictable. It will yield surprises, diversions, successes, and failures to achieve some specific goals. But there are several techniques and approaches that can help a government succeed. Clear goals, positions, structure and discipline are needed. But these must be in the context of seeking to move from win-lose negotiations to win-win-win negotiations. As discussed above, negotiators must be able to identify interests and opportunities for identifying joint means to achieve them, rather than simply “what is yours or mine.” In the sections below we set out several factors that can assist in this process.

### 4.5.1 *Your Own Goals and Positions*

Before a negotiation begins, the preparation process must be used to identify and consolidate the government’s goals in any negotiation. All of the preceding issues in terms of preparations have to be brought together into the goals and negotiating positions.

### **Negotiating goals are the targets**

**What are we trying to achieve, and why? It is critical to understand the “why,” as this is the basis of the interests that underlie the process. Negotiators must understand both what they are trying to achieve and why they are trying to achieve it. Understanding these can then allow for flexibility in how they are achieved, and for collaborative processes to achieve them that may be different than originally envisaged.**

Negotiating positions should be the starting points in a negotiation. They may or may not actually state the goals *per se*, but are meant to reflect the starting point for how the goals will be achieved. A negotiating position should also reflect the starting point, but leave room to negotiate to get to the endpoint desired.

The positions may also reflect the government's preferred means to achieve its goals. If alternative means to achieve the goals are developed in a negotiation, means that may better achieve both the government and company objectives, it should be easy to adjust the how while still maintaining the goals.

### **What are the red lines?**

In this context, negotiating goals are constant, but the positions and approaches of how to achieve them may vary in response to the negotiating dynamic. But governments must know their red lines in advance: which issues are simply not negotiable, or which limits are not negotiable? Establishing your red lines as part of defining the goals is central to establishing your positions, and what the scope of the final deal might look like.

#### **4.5.2 Understanding the Needs of the Investor**

At the same time as governments must understand their own goals, it is important to understand the needs of the investor to be able to respond properly to the negotiating demands of the investor, and to fashion common objectives. The investor's goals may include, depending on the circumstance:

- The return on investment
- Logistical needs, such as transportation to and from the work site for personnel and all materials and production
- Rail and port facilities to export the commodities mined
- Controlling input costs
- Predictable regulatory environment
- Skilled labour force
- Secure tenure of the project and a secure operating environment

For many investors today, contributing to sustainable development is a part of their goals. This must be clearly acknowledged when it is the case, and used to help build common objectives. When it does not appear to be the case, the negotiators must be able to move the investor to this position. The support of the Minister is clearly required here.

These and other needs are legitimate in the abstract. In practice, a good company will know that achieving them must be balanced with the interests and needs of the state. Just as noted above for government goals, it is important for the company and the government to be able to distinguish between the legitimacy of certain needs, and the means for meeting those needs. For example, as discussed above, wanting a level of regulatory predictability does not mean that a regulatory stabilization clause is required. Other means to understand and have a predictable regulatory environment, as well as a responsible investment where performance improvements are part of the operating ethos, will equally lead to a predictable cost structure for the investment, the real interest behind the notion of regulatory stability.



### 4.5.3 *Moving Toward Common Interests*

It is increasingly important today for negotiators to understand the interests of both sides in order to move to a situation where they can identify common interests, and those areas where the interests may be either on one side or the other, or to some extent in conflict. This should be done in a systematic way, at the beginning of the process.

A first step in the negotiations may, therefore, be a discussion of the interests of each side, prior to a formal negotiation on language or the production of a draft text, unless the government always uses a model contract for its negotiations. Where this is the case, the first discussions on the model should be about the goals and interests behind it, not a deep dive into any specific language.

When there is an understanding of the interests, it is possible to memorialize this—including where there are differences or conflicts—and begin the work of how to achieve the interests.

### 4.5.4 *An Agreement on How to Negotiate*

For a negotiation to be structured, there should be an agreement on how to negotiate. This may involve several elements:

- **Place:** the parties should decide where the negotiations are to take place. It is strongly recommended that they always take place in the host state, and not at the home of the company. Negotiating in the home of the company opens the negotiators to risks that need not, and should not, be taken on. The negotiations should take place where most convenient, but may also benefit at a given time from a site visit to the area of the proposed project.
- **Language:** Government officials will begin at a disadvantage if the negotiations take place in a language in which they do not have the same expertise as the company. Therefore, the language of discussion and of drafting should not be the language of the company, but the language of the host state government.
- **Time:** The negotiations should take the time they need. It is normal for agreements concerning complex projects to take 18–24 months to negotiate. A schedule for the different elements of a negotiation should be set out, while recognizing that this may be adjusted over the negotiating period.

Putting structure to a negotiation will assist the developing country negotiators by ensuring the process is more clear and predictable.

### 4.5.5 *An Agreement on What to Negotiate*

Clarifying the scope of a negotiation is central to the success of a negotiation.

Governments must decide, as discussed previously, what elements of the establishment and operation of the investment will be regulated by the applicable law, and what elements will be in the contract, and be sure these two are well coordinated. Many potential investors will seek divergences from domestic law. Government officials must make clear decisions about whether any such divergences will be permitted or not. By contrast, some domestic law allows for certain areas of discretion in their application. These may more legitimately be subject to some negotiation.

The MMDA can play a constructive role in this regard. The table of contents of the MMDA was carefully constructed to provide a comprehensive list of issues that must be addressed if a holistic vision of mining and sustainable development is to take root. Because it is comprehensive, governments acting in their own preparatory process (or government and the company together) can carefully go through the table of contents and determine what elements are properly covered by the domestic law and what should be in the contract. The relationship between the two sources should then be carefully understood.

Generally speaking, and absent very specific circumstances, it is not a good idea to negotiate departures from generally applicable domestic laws. First, this generally requires formal changes to be made in the law itself by the legislature. Second, this practice allows for—or in some cases even invites—corruption and other forms of mischief to take place. Third, it creates a situation where the law is unevenly applied to different investors, which can trigger issues in relation to most-favoured nation treatment requirements in investment treaties. In short, unless circumstances exist to absolutely require it, negotiators should not allow the scope of the negotiations to include changes in the domestic law.

Their timing in the life cycle of the mine development will also have a significant impact on the content of the negotiations. A contract developed prior to the completion of the exploration phase will look different to one negotiated after that phase is complete. Tenure of the project, certainty of conditions, environmental issues, etc. may all be less certain in earlier phases of a project. The scope of the laws that will be relevant to a given project may also be less certain at an earlier stage of project development. Governments must therefore be more prudent in making certain types of commitments at too early a stage of project development.

This may require two different negotiations, one for exploration and one for development. The MMDA and the model developed here assume the negotiation is at a post-exploration, full development stage. However, government officials must be clear about what stage of development the project is at, and what the implications of this are for the negotiations.

Once the government has set out its own understanding on this issue, it can be taken to the investor for agreement, so that both sides work from the same basis. When an agreement on both how and what to negotiate is achieved, the time is ripe to begin the actual negotiations.

#### **4.5.6 *Staying Within the Negotiating Scope and Capacity***

Already discussed is setting an agenda and list of priorities, avoiding negotiations on matters dealt with in the domestic law, and ensuring that the government has considered and met its capacity needs for the negotiation. Yet even the most effective preparations may not anticipate all events when a negotiation starts, including the risks posed by facing an oversized delegation on the other side.

In particular, it is very easy for many governments to feel overwhelmed in a negotiation, when the investor may arrive with a large team of lawyers, accountants, consultants, valuation experts, etc. How to react to such a circumstance is something that should be considered and planned. The above points are critical to doing so. A negotiating agenda requires an agreed process and decision. Even the largest delegation does not give an investor the right to advance an agenda that the government is not prepared to move on. In short, governments must stay within their own priorities in any session, within their capacities available for that session, and not be led to believe it is in their interest to agree on other matters at any given time, or feel bullied into doing so. Any matter can be delayed for a later session if needed.

#### 4.5.6 Team Leadership and Discipline

Building and maintaining team discipline is an important factor in any negotiation. This starts early in the process and continues until its conclusion, and indeed after that. Discipline is the other side of the coin to leadership. Strong and consistent leadership encourages and supports team discipline.

This discipline includes:

- Being punctual for meetings and for preparing assignments prior to meetings.
- Staying as a team within the negotiating mandate, without reinventing it.
- Staying individually within one's mandate, not seeking to negotiate issues one is not responsible for.
- Not giving information to the other side that one is not expressly authorized to give. There is a great tendency among participants in a delegation to want to show what they know and how much they can do: this can compromise the entire process.
- Not freelancing during the negotiations. No one should believe they can play the "hero" and negotiate an issue on the side with the other party. Only a negotiator specially requested to explore a possible solution to an issue should ever approach or respond to the other party.
- Not speaking without the "direction" of the head of delegation during a negotiation. The negotiating room is not the place to show how smart one is or how good a negotiator one can be. The private delegation room allows for this.

**Maintaining these basic elements of team discipline is of critical importance. Sloppiness and lack of professionalism within the team will translate to sloppiness and lack of professionalism in the negotiations. The investor will quickly spot weak links and seek to exploit them. Understanding this need for team discipline should be addressed clearly in the pre-negotiation process and regularly during the negotiations.**

The lead negotiator is responsible for enforcing team discipline. It can be expected that there will be few, if any, second chances for team members who breach the requirements. A lack of discipline can seriously harm a negotiation.

#### 4.5.7 Keep Your Eye on the Ball and Let Go of the Distractions

Closely related to the preceding point, it is important to stay focused during a negotiation. Like a sporting match, it is critical to "keep your eye on the ball."

A negotiation brings together all types of personalities and circumstances. It is extremely easy for many involved to get caught up in distractions related to personality issues, deliberate attempts to create distractions, the development of personal relationships, outside events that may have some relevance, and each of these both within the delegation and between delegations. When distractions occur, attention and energy are lost to unimportant and often counterproductive matters—individuals focus on the wrong issues and inevitably lose focus on the goals identified in preparatory processes.

In maintaining team discipline it is very important to include a sense of keeping your eye on the ball. Distractions should be identified and sorted out in a manner that does not impact the negotiations. Efforts by the other side in a negotiation to create distractions must be identified and pushed back. While this may all sound trite, even juvenile, it will inevitably be seen in every negotiation. Being aware

of this possibility and able to address it seriously is part of managing the preparations process and the ongoing negotiation process. Wise leadership is needed by the lead negotiator, but the sound judgment of all team members is also needed.

#### 4.5.8 *Managing the Investor's Power Plays*

During the negotiations the president of the company will try to negotiate directly with the Minister or President. The conversation will be brief: "Minister, your negotiators are blocking all progress and making demands we can never accept. You must intervene and stop this or we will have to leave this project completely."

If the Minister's goals are short term, simply signing the contract, this may well work, and the negotiating team will be undercut. Where the Minister is fully engaged, however, with the broader desired outcome and understands that the contract is not an end point but a starting point, this tactic should not work. Communication with the Minister throughout the negotiating process is critical.

### **What are BATNAs and WATNAs?**

Closely related to this is for all the actors to have a common understanding of the BATNA and WATNA: the "best alternative to a negotiated agreement" and the "worst alternative to a negotiated agreement." When the options for development of the resource are known, the impact of not reaching an agreement is seen in its proper context. The BATNAs and WATNAs help guide the types of compromises that a government should and should not make. At the end of the day, if no agreement is reached, the resource remains available for future development; it is not lost. This is extremely important when, as is currently being experienced, opening new mines is very difficult globally, giving mining companies an upper hand in many negotiations (Nikot, 2014).

There is a related phenomenon today: lobbyists for mining companies are very well connected, often to the Minister or President. Former Ministers and family members of senior politicians dominate the lobbyist landscape in country after country. The lobbyists will have a direct and fast line to the Minister or the President, or both.<sup>38</sup> In many instances they may have access faster than the negotiating team itself. This means that the negotiating team must have the full trust of the Minister. And the Minister must be informed of any issues that arise during the preparations for negotiations and during the negotiations themselves as soon as possible.

Ultimately, the political level must accept, as already noted, that saying "no" is sometimes a rational outcome. The goal must never be to complete a negotiation, but to complete a negotiation that meets the government's sustainable development objectives. If it does not, the alternatives, including a delay until market conditions improve, should be relied upon.

<sup>38</sup> For examples, see African Mining Intelligence, at <http://www.africaintelligence.com/AMA>.



## Is every investment a good investment?

Saying “no,” in the end, should not be seen as a failure, but as an affirmation of the role of the government as a proper steward of the nation’s natural resources acting in the best interests of its people. It means this company at this time was not prepared to invest on terms suitable to the government. Saying “no” is a much harder choice to make than agreeing to a bad deal. Ministers and negotiators must always be prepared to say “no” if they hope to get to a deal that does fully reflect their interests. The fact is that not every investment is a good investment for the host country or community. Governments have the responsibility to say no when an investment does not appear to be a good one.

### 4.5.9 Public Information and Community Linkages

The success of a negotiation comes from two levels, the commercial success and the broad acceptance of the agreement by the impacted stakeholders. Indeed, the long-term success of the project is tied very closely to the acceptance of the terms of the deal by the local community, as discussed in section 3.5 (on the social license to operate). Achieving success here is tied closely to the process of negotiation and a sense among the community that their interests are taken seriously, both in preparing for the negotiations and during them.

This issue is far from an academic one. For many years, local communities in developing countries shared a sense of abandonment to the interests of national governments, often hundreds of kilometers away in capitals, and that their interests did not matter. Yet, over the years, it has become clear that the relationship between the mining company and the local community is of paramount importance to the chances of long-term success or failure. Thus, real engagement with the community is important prior to and during the negotiation process. Transparency afterwards is also a related factor.

Negotiating teams should recognize this and have regular meetings with the local community to ensure a coherent result that the community can support. Such meetings will also help with understanding priorities on many of the critical social and economic development issues, and variations that may arise in how these objectives can be met.

Closely associated with this approach is the need for enforceable CDAs, either as part of the principle contract or related to it to ensure enforceability. The CDA needs to be properly coordinated with the government-company agreement. In some cases the CDA will be required by law. In other cases it is a requirement simply of good practice and for ensuring the social license to operate. Toward this end, the information on which it is to be based must be shared with the community, and shared effectively. This means it must be made available in a timely manner, and in a language and location accessible to the community. Equally, the materials should be, to the extent possible, in plain language or with a plain language summary that is clear and accurate.

The negotiation of a CDA is a matter outside the specific scope of this paper, as it concerns primarily the company and the community.<sup>39</sup> For present purposes, it is sufficient to note the need for governments to be supportive of the need for a CDA and to ensure coordination of issues when necessary between the government-company contract and the CDA itself.

<sup>39</sup> For excellent resources on negotiating CDAs see the CDA Library of the Sustainable Development Strategies Group, at <http://www.sdsg.org/archives/cda-library/>.

#### 4.5.10 *Transparency of the Negotiated Contract*

Finally, there is the issue of transparency of the contract. The MMDA, concluded after much consultation within industry, government and civil society, unequivocally calls for the contract to be made public. This is subject to the redaction of truly confidential business information. In addition, the MMDA calls for the publication of monies paid by the company to the government.

It is becoming increasingly standard practice for contracts to be made public.<sup>40</sup> This adds to the accountability of all participants in the process. It reduces opportunities for corruption, and for company “agents” to seek to provide payments. It helps ensure a stronger focus on long-term interests instead of short-term individual goals, and it enhances community support.

As will be seen in Part 6 of Volume 2, it is also important to improve transparency during the implementation period of the contract. Recall again that completing the negotiations is not an end point, but the starting point of several decades of community-company-government relationships. It will be as important to have transparency during these years of implementation as for the duration of the contract itself.

## 4.6 Conclusion

Preparing for negotiations is a time-consuming process. Getting the negotiating process right is also time consuming. Both are essential, however, if the result is to be constructive. We hope that the above provides useful guidance in preparing, in setting a positive and constructive approach, and in supporting an effective negotiating process. In Parts 5 and 6 of Volume 2, we turn to the content of the contract, and the development of implementation mechanisms for the lifespan of the mine and its closure.

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<sup>40</sup> See, for example, the Liberia Extractive Industries Transparency Initiative website: <http://www.leiti.org.lr/contracts-and-concessions.html>.



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