RECENT DEVELOPMENT INTERNATIONAL

PRINCIPLES FOR EXPLORATION AND EXTRACTION RIGHTS

***Guiding Principles for Durable Extractive Contracts*, endorsed by Governing Board of the OECD Development Centre, 10 February 2020. Organisation for Economic Co-operation and Development**

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In February 2020 the OECD endorsed a framework, aimed at governments and investors, for the content and negotiation of extractives exploration and production contracts. The principles are expressed as relevant to all systems of granting petroleum and mineral exploration and production rights – whether by contractual regimes or legal systems of non-negotiable provisions. The purposes of the principles include promoting long-term sustainable development, while attracting and sustaining investment; providing mechanisms for changes in circumstances; and ensuring "a fair share for all parties to the contract and optimise the value from resource development through equitable, sustainable and mutually beneficial contracts and operations". These principles should inform advice and analysis by Australian resources practitioners: of matters in Australia and regarding the involvement of Australian entities in other countries.

1 Background

The Organisation for Economic Co-operation and Development (formally, a group of 37 countries, including Australia) focuses on many areas, one of which is its Policy Dialogue on Natural Resource-based Development (Policy Dialogue). This is described as "an intergovernmental platform for peer learning and knowledge sharing where OECD and non-OECD producing countries, in consultation with extractive industries, civil society organisations, and think tanks, can craft innovative and collaborative solutions for resource-based development".[1]

The Policy Dialogue operates through regular meetings and publications. From 2015, it has been working with governments, industry and civil society on how contracts in the extractives sector can best be designed to endure. A set of draft principles was circulated in 2016 and had extensive consultation and stakeholder review over the next three years.

The final iteration was presented and agreed at the June 2019 meeting of the Policy Dialogue. The document then worked its way up the OECD chain and, on 10 February 2020, the Governing Board of the OECD Development Centre endorsed the *Guiding Principles for Durable Extractive Contracts*[2] (Principles) which are explained below.

2 Guiding Principles (2020)

The document contains a preamble, the Principles, and then explanatory commentary. The implication and applications of the Principles is discussed in the following section, but the Principles are short and can be extracted in full.

I. Durable extractive contracts are aligned with the long-term vision and strategy, defined by the host government on how the extractive sector can fit into and contribute to broader sustainable development objectives.

II. Durable extractive contracts are anchored in a transparent, constructive long-term commercial relationship and operational partnership between host governments, investors and communities, to fulfil agreed and understood objectives based on shared and realistic expectations that are managed throughout the life-cycle of the project.

III. Durable extractive contracts balance the legitimate interests of host governments, investors, and communities, with due account taken, where relevant, of the specific rights of affected indigenous peoples recognised under applicable international and/or national law.

IV. Durable extractive contracts seek to optimise the value from resource development for all stakeholders, including economic, social and environmental outcomes.

To the extent not covered by applicable international and/or national law, durable extractive contracts provide for the identification and management of potential adverse environmental, health, safety and social impacts of the extractive project and establish clear roles and responsibilities for the host government and the investor for the prevention, mitigation and remediation of those impacts, in consultation with affected communities.

V. Durable extractive contracts are negotiated and based on the continued sharing, in good faith, of key financial and technical data to build a common understanding of the performance, main risks and opportunities of the project throughout its life-cycle.

VI. Durable extractive contracts operate in a sound investment and business climate and should be underpinned by a fair, transparent and clear legal and regulatory framework and enforced in a non-discriminatory manner.

VII. Durable extractive contracts are consistent with applicable laws, applicable international and regional treaties, and anticipate that host governments may introduce *bona fide*, non-arbitrary, and non-discriminatory changes in law and applicable regulations, covering non-fiscal regulatory areas to pursue legitimate public interest objectives. The costs attributable to compliance with such changes in law and regulations, and wholly, necessarily and exclusively related to project specific operations, should be treated as any other project costs for purposes of tax deductibility, and cost recovery in production sharing contracts.

If such changes in law and/or applicable regulations result in the investor's inability to perform its material obligations under the contract or if they lead to a material adverse change that undermines the economic viability of the project, durable extractive contracts require the parties to engage in good faith discussions which might eventually lead the parties to agree to renegotiate the terms of the contract.

VIII. Durable extractive contracts are underpinned by a fiscal system that is consistent with the governments' overall economic and fiscal objectives and provides a fair sharing of financial benefits between the investor and the host government, taking into consideration the potential risks, rewards, and country circumstances. As there is no one ideal fiscal regime, each host government needs to identify the optimal mix of fiscal instruments and terms to meet its objectives.

A predictable fiscal regime that includes responsive terms defined in legislation and/or the contract to adjust the allocation of overall financial benefits between host governments and investors to variables that affect project profitability (such as variance in commodity prices, costs, production volume, or resource quality) contributes to the long-term sustainability of extractive contracts and reduces the incentives for either party to seek renegotiation of terms.

Host governments need to generate financial benefits from the extraction of their resources. Durable extractive contracts avoid sustained periods of commercial production with little or no revenue flows to the government.

These *Guiding Principles* are not presented in hierarchical order. They interact with each other and should be considered together. They are high-level in nature and should be read in conjunction with relevant detailed international guidance on specific topics. They can serve as a common reference for extractive contract negotiations, in accordance with applicable international and/or national laws and international commitments, and taking into account national, and broader, sustainable development objectives and priorities.

3 Significance and Application of Principles

The document, like many OECD publications, is a mix of observations and exhortations. In many places, the wording just reports or reflects common dynamics and occurrences in the resources sector, and thus provides limited guidance. However, other parts of the document have more normative import, identifying what governments and companies should do. It is these latter parts which are summarised below.

The scope of the Principles is wide. While the title specifies contracts, the OECD makes it clear that the Principles apply more broadly. The preamble states the Principles "are without prejudice to the choice of the preferred allocation mechanism [of oil, gas, and mineral exploration and production rights] nor do they imply a preference for contractual regimes versus legal systems providing for non-negotiable provisions".[3] Accordingly, the Principles hold relevance even where extractive rights are allocated under legislative systems and criteria (which is the case for most of Australia).

There is an expectation that governments and companies should apply the Principles where possible. The Preamble includes that the OECD "calls upon States, investors, [and] negotiation support providers ... to consider the following principles, and actively promote their application ...".[4] Applying the Principles can be direct or through what the document terms "negotiation support providers": whether that term includes legal advisers is not specified, but, because the Principles may be raised by various parties to the allocation and management of rights for exploration and extraction, it would serve resources lawyers well to be aware of them.

Many parts in the Principles emphasise the legitimacy and importance of companies' commercial interests. Those parts may assist where a company is encountering difficulties with uncommercial or uncooperative government officials and decisions.[5] The Principles may have limited scope where the law already identifies company rights (in contract, legislation, constitution, or international investment treaty) which can be enforced through courts or arbitration. But where the Principles may have greater implication is in their refining and reinforcing the expectations of extractives companies – and their contracts – and *how these expectations may best be navigated*. Recent events, where Rio Tinto mine-works destroyed Indigenous sites *within* the terms of Western Australian legal procedures and contracts,[6] are a case in point. The attention and response to those events illustrate that relying only on contracts and the host country's law can be insufficient to avoid signification problems and harm for an extractives company, and the communities in which it works. The concepts of "stakeholder engagement" and "social licence to operate" are too amorphous to provide guidance.[7] By contrast, these Principles can help identify issues and answers where current extractives rights are inadequate.

The OECD document contains additional "commentary" on each of the above eight Principles. Key aspects are summarised and collated under various topics below.

3.1 Government should, <u>first</u>, determine sustainable development goals to then inform whether and how extractives rights are allocated and managed

The Principles (and the OECD more broadly) recognise that resource extraction can benefit economic and human development: their products are indispensable for human life, and their revenue contribution is vitally important for some countries.[8] However, there are also many instances where host countries and communities have received little benefit, and many impacts, from resources extraction. The Principles do not envisage that government should just enable private sector extractives operations and hope for the best. Instead, the Principles emphasise a priority,[9] evident in Principle I and detailed in further commentary:

- governments need first to determine what strategies and national and local development objectives they want to achieve with their natural resource endowments (the vision) and how they wish to achieve such goals (the strategy);[10] and then
- that vision and strategy should inform the government's objectives in negotiations[11] (or, presumably, the government's discretion and administration where extractive rights arise through "legal systems with non-negotiable provisions" rather than contract), and the government also should ensure a coherent, comprehensive approach across its agencies.[12]

3.2 Community interests are not determined autonomously by Government, and also involve separate engagement by company

The document includes several differing references to community interests, reflecting the complexities here for both government and extractive companies.

> It is the responsibility of the host government to ensure that community interests are protected.[13]

> [C]ommunity engagement is crucial to ensuring the contract's long-term durability.[14]
>
> The contract should provide a mechanism to ensure that the views and concerns of affected communities are taken into account, especially in relation to planning and decision making for projects that may significantly impact them.[15]

These reinforce responsibilities for governments, but also that there must be effective mechanisms directly between the extractives operation and local communities who could be affected by it.

3.3 International standards for Indigenous rights are relevant

Principle III indicates that, where Indigenous peoples would be affected by the extractive operations, "due account [should be] taken" of "the specific rights" recognised under international law. Thus, the fact some country's domestic law may not reflect those international standards does not mean they are irrelevant. This is consistent with other industry and international guidance,[16] and is particularly relevant given the continued divergence between parts of the *Native Title Act 1993* (Cth) and international human rights standards.[17]

Many extractive operations in Australia have sought agreement with Indigenous groups rather than relying solely on rights under the Native Title Act or the laws of the State/Territory. That course can assist in meeting the higher international standards of free, prior and informed consent (FPIC).[18] But there remain questions, in some instances, whether historic contracts and their implementation are consistent with FPIC. A tool was devised in 2018 to assist with auditing and review of these questions.[19]

3.4 Arrange for increased transparency

There should be public disclosure of extractives rights and arrangements, apart from specific aspects which have legitimate proprietary or commercial sensitivity.[20] The Principles suggest that, even during negotiation, the parties "should anticipate … the public disclosure of their future signed contracts".[21]

3.5 Stabilisation arrangements should not restrict legitimate, public-interest objectives

The Principles reinforce that extractives operations should comply with bona fide, non-arbitrary and non-discriminatory changes in law about non-fiscal areas which pursue legitimate objectives in the public interest.[22] The cost of such compliance should be treated "as any other project costs".[23] The commentary details further implications of this, including the corollary: that fiscal stabilisation *is* appropriate where there may be high fiscal or political instability.[24] The document also reinforces the international standards against expropriation.[25] There is, however, contribution to the growing attention and emphasis against tax avoidance and profit shifting.

> The adoption of bona fide anti-avoidance measures or the interpretation of existing laws by host governments to protect the revenue base against tax base erosion and profit-shifting (e.g. on interest deduction limitations and transfer pricing) and consistent with internationally recognised tax practices should not be considered a change in law constrained by stabilisation clauses.[26]

3.6 Environmental and social impact systems should meet international standards

The commentary indicates that each operation's impacts should be specifically considered and addressed, and that sometimes these assessments will mean a project should not proceed.

> [A]ctual and potential direct adverse impacts need to be identified, prevented and, if they cannot be totally prevented, mitigated across the full life-cycle of the project (including decommissioning, abandonment or rehabilitation of the site). It is understood that some negative impacts may make proposed projects non-viable.[27]

Where the laws of a host nation do not meet the relevant international standards in this regard, then companies are expected to comply with the latter.[28] The commentary reinforces the importance of these aspects having meticulous and ongoing attention.

> To the extent not covered by national laws, the extractive contract should delineate responsibility for:
>
> (a) periodically assessing actual and potential adverse impact;

(b) devising and carrying out a prevention and mitigation plan for potential negative impact; and

(c) ensuring appropriate and transparent financial arrangements are in place to ensure that sufficient funds are available for the execution of prevention, mitigation plans and remediation responses (e.g. use of escrow accounts, special funds for decommissioning, bank or company guarantees).[29]

1 OECD web page, Policy Dialogue on Natural Resource-based Development (PD-NR).

2 Governing Board of the OECD Development Centre, *Guiding Principles for Durable Extractive Contracts*, endorsed 10 February 2020. Paris: Organisation for Economic Co-operation and Development.

All following endnotes refer to this document (unless otherwise specified), being the **Preamble** (pp 1, 2), the **Principles I-VIII** (pp 2, 3) or **Commentary** (pars [1]-[59], pp 4-15).

3 Preamble, 1.

4 Preamble, 2.

5 Issues covered include:

investment and business climate needing fairness, transparency and non-discriminatory enforcement: Principle VI, Commentary [6];

discouraging unrealistic expectations at exploration stage: Commentary [7];

accommodation of uncertainties in geology and future markets: Commentary [18], [24], [30];

capital intensity and long payback periods: Commentary [30];

government institutions should have transparency and integrity, and provide fair and clear regulations without unnecessarily high cost of compliance: Commentary [32];

need for assurance on contract enforcement and property rights: Commentary [32].

6 See, e.g., Rio Tinto, Jean-Sebastien Jacques (Chief executive), Submission 25 to the Inquiry into the destruction of 46,000 year-old shelters at the Juukan Gorge in the Pilbara region of Western Australia, 1-4, Hon Warren Entsch MP, Chair, Joint Standing Committee on Northern Australia, 31 July 2020. Canberra: Parliament of Australia.

7 See, e.g., Owen, JR, Kemp, D, "Social licence and mining: A critical perspective" (2013) *Resources Policy* 38(1) 29, 30-31; Robinson, Lucy M., Fardin, J., Boschetti, F., "Clarifying the current role of a social licence in its legal and political context: An examination of mining in Western Australia" (2020) *Resources Policy* 67. Social licence to operate (SLO) is increasingly seen as inadequate, see, e.g., International Resource Panel, *Mineral Resource Governance in the 21st Century: Gearing extractive industries towards sustainable development*, 17 February 2020, 263, UN Environment Programme ("SLO has been a response to manage risk as opposed to a response to deliver sustainable development which for the society is the key expectation. Indeed, depending on the relationship between society and the mining companies, it has been found that where livelihoods are dependent on mining companies, local communities may accept many externalities of mining activities. So, attribution and possession of the SLO does not necessarily mean that communities obtain improved outcomes in return. In essence, SLO defines the minimum of what a mining project can get away with in a particular location. In reality, a mining company can have varying practices in different locations as the local conditions dictate what they can get away with. This narrow and business-driven agenda means that the SLO is an incomplete framework for establishing higher standards of social and environmental performance, and stakeholder engagement for long-term sustainable development [citation omitted].")

8 See, e.g., Preamble, 1; OECD (2017), *OECD Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractive Sector*, OECD Publishing, Paris, 14; OECD (2016) *Collaborative Strategies for In-Country Shared Value Creation: Framework for Extractive Projects*, 9, OECD Development Policy Tools, OECD Publishing, Paris.

9 See above n 8, OECD's 2016 *Collaborative Strategies for In-Country Shared Value Creation,* for further guidance on the actions *and sequencing* which can assist government, industry and civil society progress sustainable development and extractives.

10 Commentary [1]-[2] emphasises the importance of all stakeholders (including industry and community) in the development and implementation of these strategies.

11 Commentary [5].

12 Commentary, [4].

13 Commentary, [6].

14 Commentary, [9].

15 Commentary, [11].

16 See, e.g., United Nations, *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework,* Principle 12 (2011) which has been specifically endorsed and supported by many companies (UN Global Compact, *Statement in Support of UN Guiding Principles and Sustainable Development Goals*, November 2015, including International Petroleum Industry Environmental Conservation Association; International Chamber of Commerce; International Organisation of Employers;

International Council on Mining and Metals; Electronic Industry Citizenship Coalition; and United States Council for International Business). More specific to extractives, examples include International Council on Mining & Metals, *Indigenous Peoples and Mining Position Statement* (16 May 2013, London), and above n 8, OECD's 2017 *Due Diligence Guidance for the Extractive Sector*.

17 Four parts of *Native Title Act 1993* (Cth) amendments in 1998 have been ruled in breach of treaties on racial discrimination and civil and political rights (UN Committee on the Elimination of Racial Discrimination, Decision 2(54) on Australia, UN doc A/54/18, IIA, 6-8, 18 March 1999; Human Rights Committee, Concluding observations: Australia (UN doc A/55/40, [498]-[528], 28 July 2000). The issues are the "validation" provisions, the "confirmation of extinguishment" provisions, the "primary production upgrade" provisions, and restrictions concerning the right of Indigenous title holders to negotiate non-Indigenous land uses. No amendments have been made in these respects, and the inconsistency has been repeatedly identified as an area where Australian law falls below the international standards: see, e.g., Human Rights Committee, Concluding observations: Australia (UN doc CCPR/C/AUS/CO/5, 7 May 2009), [16]; and Committee on the Elimination of Racial Discrimination, Concluding observations: Australia (UN doc CERD/C/AUS/CO/15-17, 13 Sep 2010), [18]. See also Southalan, J, "Human rights and business lawyers: the 2011 watershed" (2016) 90(12) *Australian Law Journal,* 889, 902.

18 Commentary, [10]. The Principles commentary also reinforces the importance of FPIC: "[W]here indigenous peoples or local communities are affected, applicable international and/or national law may require working towards and obtaining free, prior and informed consent (FPIC) as soon as possible during project planning, before activities for which consent should be sought are commenced or are authorised, and the time required for a meaningful informed consultation and participation process needs to be factored into the negotiations and the contract terms".

19 Equitable Origin, Roundtable on Sustainable Biomaterials, La Coordinadora de las Organizaciones Indígenas de la Cuenca Amazónica, "FPIC Monitoring Tool Framework", Annex 3 to Project Report, *Enabling FPIC through Voluntary Standards*, July 2018. An ISEAL Innovations Fund Project.

20 Preamble, 2.

21 Preamble, 2

22 Principle VII, Commentary [35].

23 Principle VII, Commentary [42].

24 Commentary, [54].

25 Commentary, [41]: "Foreign property cannot be expropriated except: (i) for public purposes, (ii) on a non-discriminatory basis, (iii) in accordance with due process of law, and (iv) against adequate compensation".

26 Commentary, [54].

27 Commentary, [22].

28 Commentary, [22]-[23].

29 Commentary, [22].