

Investment contracts

This note provides guidance on the form and content of contracts between investors and governments pertaining to agricultural investments.

The best guarantee of positive benefits from foreign investment is a solid foundation of domestic laws that are properly enforced. In many developing countries, however, the necessary domestic laws may not be in place or may not be sufficiently detailed. Even when they are in place, they may not be implemented or enforced. Contracts can help fill the gaps in domestic laws by providing more detailed guidance on what should be contained in the assessments, and using international standards and best practice as the reference points. However, contracts need to be drafted carefully to maximize benefits and reduce risks.



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RESPONSIBLE AGRICULTURAL INVESTMENT (RAI)

KNOWLEDGE INTO ACTION NOTES

The **UNCTAD–World Bank *Knowledge Into Action Note Series*** is a compendium of practical, thematic guidance documents for use by governments, investors, and other stakeholders in the implementation of responsible agricultural investment principles. Background and a complete list of notes are in *Note 1: Introduction*.



WHAT DOES FIELD RESEARCH SHOW?

This note draws heavily on the International Institute for Sustainable Development's (IISD) *Guide to Negotiating Investment Contracts for Farmland and Water* (IISD, 2014) and the subsequent joint IISD-UNCTAD-World Bank paper entitled *Investment Contracts for Agriculture: Maximizing Gains and Minimizing Risks* (IISD, UNCTAD, and World Bank, 2015).

Adherence to commitments. Some investors overpromise social and economic benefits to the government and local community, in terms of, for example, job creation, value-chain linkages, and outgrower schemes. As such, investor promises should be turned into legally binding commitments and enshrined in the contract.

Gaps in domestic laws. Domestic legal frameworks in many countries have certain weaknesses that fall short of good international practice and standards and/or suffer from gaps, weaknesses, and areas of confusion. Domestic laws for environmental and social impact assessments (ESIAs), for example, exist in most countries, but are either not undertaken or treated as a box-ticking exercise. The government should aim to identify gaps in existing laws and instances where the legal framework falls short of best international practices and standards. The contract can be drafted to clarify the legal framework and fill the gaps.

Inadequate enforcement of laws. Even where domestic laws adhered to international standards, it was noted that more needs to be done to support their application, including through increased capacity and resources, and better monitoring, evaluation, and enforcement. In this regard, an investment contract can play a role in ensuring that investors comply with existing laws and regulations.

Quality of contracts. The quality and depth of contracts made available to researchers was generally poor and insufficient to protect the interests

of host countries or investors. Several countries and regional groups are, however, undertaking concerted efforts to improve the contracts, on the basis of model templates.

Parties to the contract. Depending on the federal structure and land tenure system of the country, the same type of contract may be between an investor and a national government, a regional government and/or a communal leader. The configuration of parties thus needs to be adapted to different contexts (see References and resources).

Community involvement. Local communities are critical at all stages of the investment process: prior to and during the negotiation process, and throughout the life of the project. The long-term success of an investment project depends heavily on the acceptance of the terms of the deal by the local community, who through their support confer on the investor a social licence to operate. Achieving success is closely tied to both the negotiation process and the tone of negotiations as well as a sense that in the community that members' interests are taken seriously throughout the process. Community wishes and interests are not always well aligned with those of the host government or the investor. (See *Note 15: Community engagement strategies*.)

Transparency. Transparency is a key part of the process of implementing and monitoring the obligations of the parties to a contract. It enables local communities and civil society organizations to keep an eye on how the investment is playing out on the ground and whether promises made in the contract are being kept. Although commercially sensitive information may need to be redacted, there is value in making major elements of the contract public and some countries are pursuing this. Liberia, for example, makes the contracts attached to all large-scale agricultural investments publicly available online. (See *Note 10: Public transparency* for more detail.)

Stabilisation provisions. A highly controversial clause found in many investment contracts, particularly in developing countries, is known as a “stabilization” provision. These clauses freeze domestic laws at the time the contract is signed. This means that the investor is either exempt from new laws or that the investor can request compensation for new laws that increase costs or decrease profits. Examples include new environmental measures and increases to the minimum wage. Broad stabilization provisions that address all areas of government regulation are now widely considered to be unacceptable.

Monitoring and enforcement. Designing and negotiating the right contract is only the starting point in the relationship between governments, investors, and communities. Implementing the commitments and obligations contained in the contract is a much tougher and longer-term challenge, particularly where capacity is limited. Governments should not underestimate the time and cost involved in monitoring investments and implementing commitments. Communities and civil society organizations can play an important role as watchdogs and should be assisted by governments and investors through access to information and open channels of communication. (*Note 9: Monitoring investments* provides more detail.)

Reporting requirements. Setting out clear reporting requirements and indicators in a contract ensures that governments and communities can regularly track whether an investor is fulfilling its obligations and commitments.

Dealing with failure. A significant share of investments fail outright or suffer financial or operational difficulties that inhibit the ability to deliver anticipated benefits. Struggling investments often do not use their entire land allocation, resulting in underutilized productive resources. Failed investments often leave a void in their wake, and in some instances governments have had difficulty in reasserting control over land that has been left idle. It is important for contracts to include assignment and termination provisions to deal with failure, either through remedial action or, in the worst case, termination and specifications of what is to happen with the management and control of the land in question thereafter. Provisions for dispute resolution are important, as it is advisable to agree on dispute resolution mechanisms during the negotiation phase.

Changes to business plan. Investors sometimes change business plans or crops when the initial plan proves unviable. The new plan or crop may, however, not be aligned with national development priorities. As such, the contract should require that material changes to the business plan are subject to approval of the government, possibly through a renewed process of project appraisal and screening.

ELEMENTS OF GOOD PRACTICE FOR GOVERNMENTS AND INVESTORS

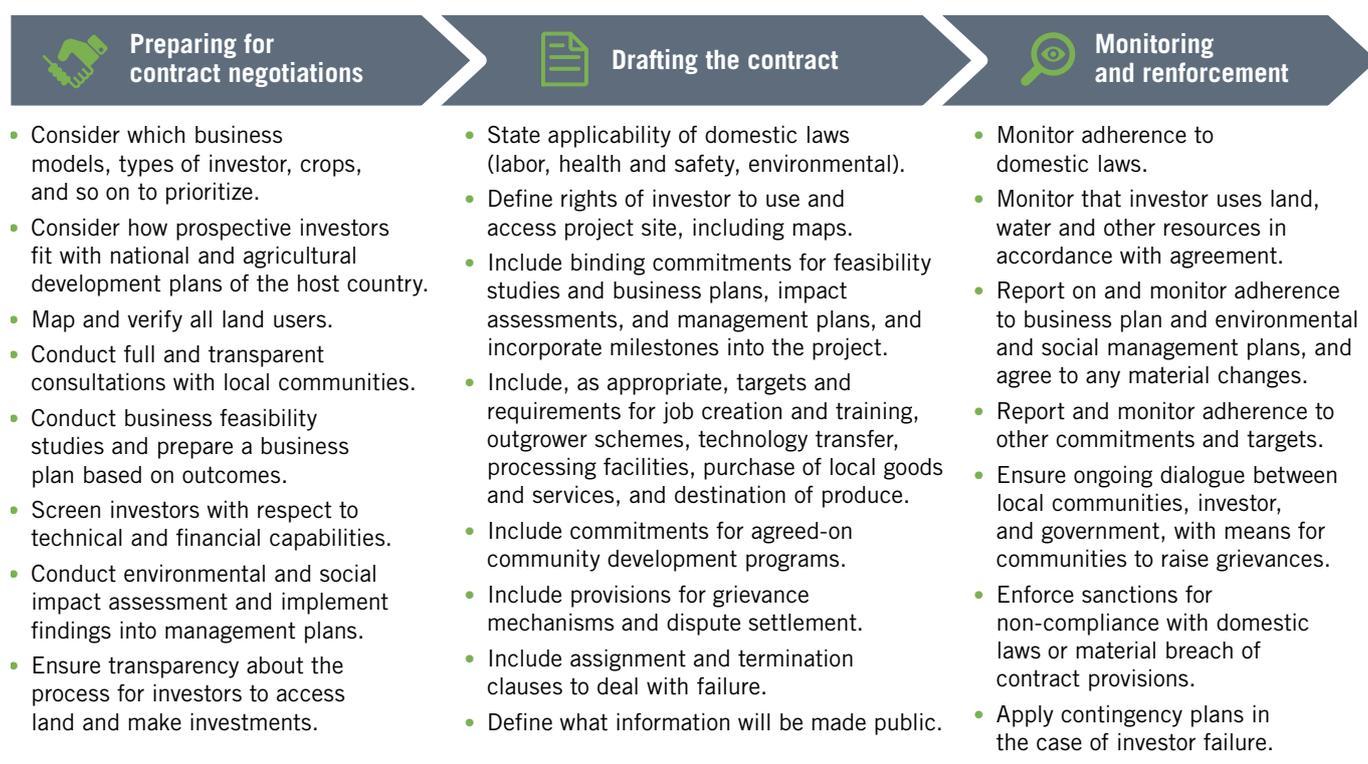
Role of the contract. Three main sources of rights and obligations are relevant to foreign investment in agriculture: domestic laws of the host country; investment contracts; and investment treaties. The best guarantee for achieving positive benefits from an investment is a solid foundation of domestic laws that are properly enforced. For example, where rights to land, water, and other natural resources are clear and recognized in domestic law, rights holders should be entitled to have a say in how to allocate those resources to investors. The establishment of legitimate tenure rights should occur in accordance with the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries, and Forests in the Context of National Food Security and associated guidance documents (see References and resources). Ideally, domestic laws will develop over time to address all issues that may arise in relation to an agricultural investment, and remove the need for investment contracts. For now, though many states still do negotiate investment contracts with investors to lease farmland, so contracts remain a relevant and important legal tool.

Coherence with investment process. Investment contracts between governments and investors are but one of several elements within a broader investment process, including the negotiations and decision-making before, during and after the investment project starts. The different stages require proper sequencing, prioritizing of issues, and an understanding of the socioeconomic context. Getting all of this right can be decisive for the success of the investment and can determine the extent to which the contract can contribute to generating positive sustainable outcomes for governments, communities, and investors.

Coherence with domestic laws. Contracts can help fill the gaps in domestic laws by providing more detailed guidance on what should be contained in environmental and social impact assessments, for example, and using international standards and best practice as the reference point, or how to deal with disputes or grievances from the local community. However, a key challenge when drafting an investment contract is to ensure it works in harmony with existing domestic laws. The contract should not become a vehicle to bypass or undermine domestic laws, or prevent the development of new laws.

Stages in the investment contract process. Figure 1 provides an overview of key issues to be dealt with in each stage in the contracting process. Stage 1 is covered in *Note 6: Screening prospective investors*. Stage 3 is covered in *Note 9: Monitoring investments*. The focus of this note is stage 2.

Figure 1. Key issues at various stages in the investment contract process

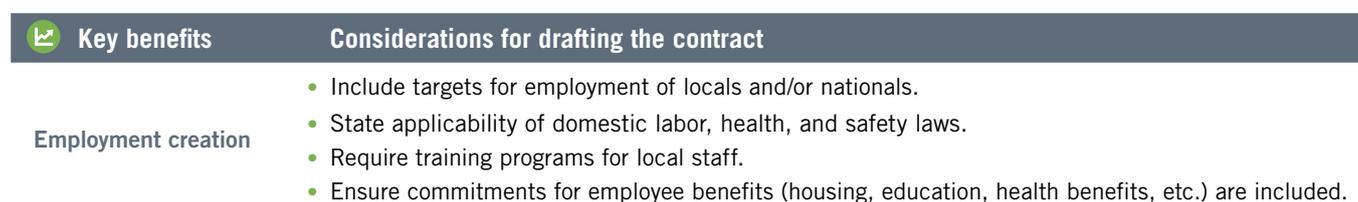


Source: IISD, UNCTAD, and World Bank.

Content of the contract. Negotiating the contract involves defining the rights and obligations of both parties (the investor and the government); stating the applicability of domestic laws, including assignment and termination clauses to deal with potential failures; engaging with local communities in drafting terms and legal provisions; assigning risk allocation in the case of force majeure; establishing grievance redress and dispute settlement mechanisms; and defining what information about the investment will be made public. The IISD *Guide to Negotiating Investment Contracts for Farmland and Water* (IISD, 2014) provides detailed guidance and model provisions to assist governments in developing contracts.

Using the contract to maximize benefits and minimize risk. The joint IISD-UNCTAD-World Bank paper *Investment Contracts for Agriculture: Maximising Gains and Minimising Risks* (IISD, UNCTAD and World Bank, 2015) covers: (1) preparing for contract negotiations, (2) drafting the contract, and (3) monitoring and enforcement. For stage 2, figure 2 shows the considerations in contract formulation regarding the key risks and benefits of agricultural investments.

Figure 2. Key potential benefits and risks: salient considerations in drafting the contract



 Key benefits	Considerations for drafting the contract
Integration of local farmers	<ul style="list-style-type: none"> • Include provision requiring establishment of an outgrower scheme. • Set requirements for technical support or provision of inputs to outgrowers. • Set framework for establishment of a fair, transparent pricing mechanism.
Expansion of market opportunities	<ul style="list-style-type: none"> • Establish commitments for setting up a processing facility. • Require the investor to establish a local business development plan.
Establishment of community development programs	<ul style="list-style-type: none"> • Require investors to establish community development agreements that are annexed to the contract. • Establish terms of and process for community development agreements or financially inclusive business models.
Increased income and improved food security	<ul style="list-style-type: none"> • Include a provision on local community food programs.

 Key risks	Considerations for drafting the contract
Loss of land and poor resettlement plans	<ul style="list-style-type: none"> • Define rights of investor to use and access the project site. • Annex map with geographical boundaries and special features to be left intact. • Prepare resettlement plan, if needed, with consent of resettled persons.
Lack of openness and engagement with local communities	<ul style="list-style-type: none"> • Engage with local communities during the design of the project and drafting terms of the contract. • Include a disclosure provision which outlines what documents will be made public.
Weak assessment of commercial viability	<ul style="list-style-type: none"> • Specify elements to be included in the feasibility study. • Incorporate milestones of the business plan. • Require that material changes to the business plan be reported. • Include assignment and termination clauses to address potential failure.
Poor management of environmental and social impacts	<ul style="list-style-type: none"> • Supplement domestic legislation with specific guidance for elements to be included in assessments and plans. • Incorporate findings of impact assessments and management plans. • Include social and environmental impact assessments as binding obligations. • Require adherence to relevant international environmental and social standards.
Insufficient mechanisms to raise grievances	<ul style="list-style-type: none"> • Include a provision for establishment of grievance and redress mechanism, based on IFC performance standards.

Source: IISD, UNCTAD, and World Bank.

REFERENCES AND RESOURCES

This Note is complementary to the literature and guidance documents to which many organizations have contributed, a selection of which is provided below. Further resources are provided in *Note 2: Additional resources*.

FAO. (2012). [Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security](#). (FAO: Rome).

IIED. (2013). [Reshaping Contracts for Quality Natural Resource Investments](#). (IIED).

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REPUBLIC OF GHANA. (2015). [Model Commercial Agriculture Lease Agreement](#). Ghana Commercial Agriculture Project. (Ministry of Food and Agriculture: Accra).

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UNITED NATIONS HUMAN RIGHTS. (2015). [Principles for Responsible Contracts: Integrating the Management of Human Rights Risks into State-Investor Contract Negotiations](#). (UN: New York & Geneva).



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