

Investment Contracts for Farmland and Water: Ten steps

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Introduction

This document is a tool for parliamentarians, government officials, landholders and local communities who are involved in negotiating investment contracts with foreign investors for agricultural land and water. It presents ten key steps to follow when negotiating the contract from a sustainable development perspective. It is an overview of a more detailed and comprehensive handbook, which proposes model legal provisions for an investment contract.

Such agricultural investment contracts, however, are not required in every circumstance. Where states have the necessary domestic laws and regulations in place, there may be no need for a contract between the state and the foreign investor. Domestic law will govern all issues that may arise in relation to foreign investment, including the issuing of licences and permits for agricultural operations. This is the preferred situation and the dominant practice in most developed countries.

While this document covers a wide range of issues that should be considered when drafting agricultural investment contracts, it should not be construed as an endorsement of the current wave of foreign investment in land, commonly referred to as “land grabs.” There is a growing body of evidence that demonstrates mostly negative impacts from these projects, including that they can reduce food security and undermine local people’s land rights, access to water, food and shelter, particularly for women. Equally worrying, many of the investments have failed to produce the expected benefits, including employment, economic growth, improved skills, transfer of appropriate technology and infrastructure development.

There are alternative farming and investment models that have proven to be economically profitable and more socially and politically acceptable than large foreign-owned plantations. Joint ventures, farmer-owned cooperatives, management contracts, contract farming or outgrower schemes, although not without their own drawbacks, have become preferred farming models for many agribusinesses and supermarket retailers. These models provide farmers with secure income and allow them to maintain ownership over their land, water and other natural resources.

Nevertheless, the reality is that hundreds of contracts are being signed. The Land Matrix Partnership says that more than 1,217 deals were concluded between 2000 and 2009, covering 83.2 million hectares of land, in developing countries (Anseeuw et al., 2012). Sixty contracts were examined for this document, with the goal of providing input to improve the quality of these contracts.

In addition, over the past few years, a number of global and regional initiatives have emerged to help governments respond to the massive wave of investor interest in land and water. They provide important benchmarks and principles to help improve the quality of investment to the agriculture sector (see Annex 1).

A Framework for Investment Contracts: Ten steps

Below are 10 key steps to negotiating and drafting investment contracts that support sustainable development. It is important to note at the outset that negotiating a contract is not an end result to be achieved in itself. Rather, it marks the start of a long-term relationship between the investor, government and local communities. It is the beginning of a process and care must be taken to understand and set a framework from a longer-term point of view.

1. Prepare the Negotiating Environment

The importance of the preparatory phase cannot be overstated. It is a precursor to success in any negotiation. It includes: identifying the country's needs and information requirements; understanding the economics behind the proposed project (and knowing the value of your natural resources); clarifying the role of domestic law in relation to the contract; and preparing the negotiating team, which means ensuring strong negotiating capacity and relevant expertise on the range of issues that will arise in the negotiations.

Before entering into negotiations with an investor, it is important to have a strong understanding of the host country's rural development and agricultural strategies. This will help those responsible for investment negotiations to identify the key areas, communities and crops to prioritize in order to fulfill the country's poverty reduction, food security and rural employment goals. It can also help determine the appropriate type of investment: private or public, domestic or foreign, or a mix.

Country-level data on availability and suitability of land for agricultural production will also help identify the most appropriate areas for investment (here it is equally important to consider predictions for different climate scenarios). Where the national-level data is not available or the quality of data poor, it is still possible to get access to information about land suitability from international organizations, online resources and through discussions with local experts and stakeholders.

Finally, the long-term success of an investment project is closely tied to acceptance by the local community. This is derived through the process of negotiation and by a sense within the community that their interests are taken seriously. Negotiating teams and investors should have appropriate meetings with the local community to ensure a coherent result that the community supports. Finally, it is also important to understand the needs of the investor to be able to respond properly to the negotiating demands.

2. Conduct Feasibility Studies

Business feasibility studies principally address the economic and technical viability of the proposed project. They should also address the key social and environmental factors that may undermine the project viability. Feasibility studies should be conducted and verified by an independent third party before the contract is signed. The results of the feasibility study will assist the investor in developing its business plan. The study should be presented and approved by the government prior to concluding contract negotiations, and its milestones incorporated into the contract itself.

Research now shows that the failure to properly conceive the project and determine its viability is the main cause of the high failure of agricultural investments. In 2012 the World Bank conducted a survey of 179 agricultural investment projects in 32 countries. They found that 50 per cent of the projects were classified as failures or moderate failures in financial terms because the “concept was fatally flawed, for example wrong location, wrong crop, or over-optimistic planning assumptions” (Tyler & Dixie, 2012).

The results of this survey underline the importance of adopting a broad enough framework for business feasibility studies to capture not only narrowly construed economic and technical aspects, but also key external impacts that may pose significant risks to project viability. These types of external impacts may include social and environmental issues and require input from the environmental and social impact assessments (ESIAs).

3. Conduct Impact Assessments

Closely related to the economic feasibility are the potential social and environmental impacts of the project. Domestic legislation for Environmental Impact Assessments (EIAs) exists in most developing countries. About two thirds of the approximately 110 developing countries had enacted some form of EIA legislation by the mid-1990s (Wood, 2003), typically making them a requirement for the investment project to proceed. In principle, before an investment contract is signed and implemented, an ESIA should take place. The contract can then be revised and adapted based on the findings of the ESIA. The possibility of an ESIA leading to abandoning the project should not be ruled out.

In practice, however, ESIAs are often done after the contract is signed but before the investor starts construction and operations. The investor should use the results to develop an Environmental Management Plan and Action Plan. The investor should not be granted the licenses necessary to start production until these steps are complete. Unfortunately, ESIAs are severely deficient in the agriculture sector. The World Bank found that even when ESIAs were required by law they were often not undertaken (Deining et al., 2011).

To make ESIAs more effective, the results and subsequent plans must be incorporated as legally binding obligations in the contract. Failure to comply must amount to a material breach of the contract. The contract should also contain a requirement for annual reporting on the implementation of the two plans, with the reports to be made public and accessible to local communities.

4. Allocate Land and Water Tenure Rights

The issue of land and water tenure is one of the most vexing in relation to agricultural investments. Where land and water tenure systems are well developed and where those rights are clear and vested in local owners or users, they will be entitled to have a say in how the land and water will be allocated to the investor. They will be able to participate in the contracting process, either directly or as a party to an investor-state negotiation. If the government determines that an investment should take place despite the opposition of a local landowner or user, expropriation might be possible, subject to the relevant laws and compensation requirements.

The problem is that, in most states where investment contracts are being signed, land and water rights are often not formally recognized, vague, based on local customs or simply non-existent. Instead, title is often vested in the government, in local chiefs or other community structures. This can lead to a situation in which the investor is allocated secure tenure to land and water, while local communities are left with weak or non-existent tenure rights. Access to land and water for the local community would be undermined as a consequence, a reality that has now been documented by the World Bank, several United Nations agencies and civil society organizations. The issue of land and water tenure for local owners and users must be clearly identified before the contract is negotiated.

5. Determine Financial and Other Incentives

Financial incentives and tax breaks are a common feature of many countries' investment promotion strategies and often enacted in domestic laws and regulations. However, their effectiveness is intensely debated, and no consensus has emerged. Some say incentives contributed to the rapid economic growth of Korea, Mauritius and Singapore. But most say there is little evidence to suggest that incentives contribute to increased investment flows. There is, however, evidence to suggest that the investment climate plays a determining role in attracting investment, and can in some cases make incentives effective. For example, the effect of lowering tax rates for foreign investors is eight times stronger for countries with good investment climates. On the other hand, evidence of the effectiveness of tax holidays is much less robust (James, 2009). Investment incentives can also create an uneven playing field between foreign and domestic investors.

Furthermore, the cost of incentives, in terms of denying developing countries much needed tax revenues, can undermine government efforts to invest in the local economy, in improved access to social services or in environmental conservation. Annual rental payments on land, for example, allow the state to establish a market value on the land that is being leased out and ensure that it becomes productive. It discourages speculative holding of land and water rights. In some cases, the rent or fee is established by legislation or regulation, and it is therefore important to refer to the relevant ministry to identify whether the rates exist.

6. Avoid Stabilization Provisions

A common demand of investors, particularly in Africa, is the inclusion of stabilization provisions. These are clauses in investment contracts that impose obligations on the government to either preclude the application of, or compensate investors for, new or changed laws and regulations that affect the investments. They may apply for a certain period, or

for the full life of the contract and any renewal period. They may extend to a narrow range of fiscal issues or to all new laws and regulations. The Special Representative on Business and Human Rights categorizes stabilization provisions in terms of two broad categories: fiscal issues (taxes, royalties, rents, rates of payment for services provided, etc.) and non-fiscal regulatory areas, such as environment, labour, health and safety (Shemberg, 2008). Broad stabilization provisions that include non-fiscal regulatory functions are now widely considered to be unacceptable. There is, however, some support for limited stabilization provisions for certain fiscal issues, in order to avoid arbitrary or discriminatory acts by the government. This limited fiscal stabilization provision should not override or conflict with domestic law, but may form part of the fiscal bargain in the contract.

7. Specify the Investor's Development Obligations

Specifying the investor's development obligations is an important section of the investment contract from a sustainable development perspective, and the one that is most often neglected. This is the part of the contract where the investor undertakes legally binding commitments to contribute to creating employment, training the local workforce, establishing processing industries, transferring appropriate technology, purchasing local goods and services, and selling part of the production to the local market, among others. The more specific and detailed a contract is on what can be expected from the investor in terms of development contributions, the higher the chance that the project will lead to the expected benefits.

Setting up a Community Development Agreement (CDA) can help create a legal framework for engagement between the investor and local community. The process of negotiating and drafting the CDA is as important as the economic or social benefits that may result. This requires an inclusive and participatory approach. Identifying all affected groups is key. The CDA might allocate a percentage of profits from the project to a Community Development Fund for a range of economic and social activities, which the community defines, and may include health, education, housing, sanitation, infrastructure and skills training. The CDA can create a framework for ongoing dialogue and discussion with the community in the event of conflict or grievances. It can also provide for periodic reviews of the project and its impact on the community and surrounding environment. A number of resources and handbooks exist to help investors and communities negotiate the CDA and can be consulted, including Sustainable Development Strategies Group's CDA Library, World Bank (2012); Center for Social Responsibility in Mining (2011); Otto (2010); Environmental Resources Management (2010); Gross, Leroy & Janis-Aparicio (2005).

8. Identify Environmental Parameters

All developing countries have some form of domestic environmental legislation that will be applicable to the investor. Specifically referring to the relevant legislation in the contract is strongly advised. However, in many developing countries, environmental regulations for large-scale commercial agricultural operations may not yet exist. The investor might introduce new production methods or inputs, such as seeds, fertilizers, chemicals and pesticides. Even if the inputs are not new, the scale of use may trigger unknown environmental impacts. New laws or amendments to existing laws may need to be drafted to account for the new types of production methods and inputs. Where this is so, the investment contract can temporarily help to fill that gap, by imposing a higher environmental standard on the

investor that reflects the potential impacts. This should be an interim step while adequate laws and regulations are being developed, and the contract should never preclude the ability of the government to do so.

While it is hard to clearly identify the measures that the investor should adopt, reference to Good Agricultural Practices (including climate-smart agricultural practices) and using the most up-to-date technologies, particularly those that improve the environmental footprint, can be a useful starting point. The Environmental Management Plan is the principal document where the investor makes commitments to prevent, minimize, mitigate, and improve the potential adverse environmental impacts of the project on soils, water sources and other natural resources.

Sound domestic water management policies are also vital to ensuring responsible and sustainable use of water resources. Water management usually takes place around three broad areas of policy and law, including: (1) quantity of water use (withdrawals from rivers and lakes, interception of rain water and use of ground water); (2) control of water infrastructure (for example, dams, reservoirs and conveyances); and (3) impact on water quality (from pollution, particularly wastewater and chemical runoff).

Importantly, the current global regime of investment treaties and contracts provide foreign investors with legal rights, which can include the right to draw water for agricultural purposes. Unless domestic law and international instruments, including the contract, clearly provide for periodic reviews of water tenure rights, the investor's rights might prevail, even if they conflict with existing or future rights and needs of the local community.

9. Choose an Appropriate Dispute Settlement Mechanism

Dispute settlement is often seen as an important element in a contract. From a host state perspective it is advisable to refer to domestic courts as the forum of choice for disputes arising under the contract. International arbitration should not be encouraged over domestic processes. In instances where international arbitration may be necessary, it should be preceded by an effort to settle the dispute amicably first, and through domestic processes prior to international arbitration. It is advisable for developing countries to require a specific choice of forum that explicitly prevails over any other forms of dispute settlement, including under international treaties. This ensures that a fair, balanced approach to the specific type of legal dispute at issue will take place.

10. Ensure Reporting, Monitoring and Evaluations

Designing the right contract is only the starting point in the ongoing relationship with the investor. Implementing the commitments and obligations contained in the contract is a much tougher and longer-term challenge, particularly with limited capacity, as is often the case in many developing countries. Setting aside a percentage of the income from the project for implementation issues will help ensure that the government has capacity to monitor and evaluate the project effectively. Setting out clear reporting requirements and indicators in the contract will ensure the government can regularly track whether the investor is fulfilling its development and environmental obligations and its commitment to the local community. Transparency is a key part of the process of implementing and monitoring the obligations on both parties to a contract.

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Annex 1: Global and regional initiatives on land and foreign investment

WHAT?	WHOSE INITIATIVE?	DESCRIPTION
Framework and Guidelines on Land Policy In Africa, 2010 (LPI)	African Union, UN Economic Commission for Africa and African Development Bank.	Adopted by African Heads of State at the 2009 African Union Summit, it explains why the land sector has not played its primary role in the development process in Africa and the potential role it can play. It lays out key operational processes and measures to develop comprehensive land policies and to track progress.
Voluntary Guidelines for Responsible Tenure of Land, Fisheries and Forests 2012 (Voluntary Guidelines)	The Food and Agriculture Organization (FAO) initiated the process and it has now come under the Committee on World Food Security, an intergovernmental forum of UN member states trying to address hunger and poverty.	The purpose is to guide governments to improve the governance of tenure of land, fisheries and forests with the overarching goal of achieving food security for all and to support the progressive realization of the right to adequate food. The guidelines seek to: <ol style="list-style-type: none"> 1. Improve tenure governance by providing guidance and information on internationally accepted practices for tenure systems. 2. Contribute to the improvement and development of the policy, and legal and organizational frameworks regulating the range of tenure rights. 3. Enhance the transparency and improve the functioning of tenure systems. 4. Strengthen the capacities and operations of implementing agencies: courts; local governments; organizations of farmers and small-scale producers, fishers, forest users, indigenous peoples; the private sector; civil society; and academia.
Principles for Responsible Agricultural Investments, 2009 (PRAI)	World Bank, UN Conference on Trade and Development (UNCTAD), FAO, International Fund for Agriculture Development (IFAD)	Seven principles for investors to promote responsible investment in the agriculture sector: <ol style="list-style-type: none"> 1. Existing rights to land and associated natural resources are recognized and respected. 2. Investments do not jeopardize food security, but rather strengthen it. 3. Processes for accessing land and other resources and then making associated investments are transparent and monitored, and ensure accountability by all stakeholders, within a proper business, legal and regulatory environment. 4. All those materially affected are consulted, and agreements from consultations are recorded and enforced. 5. Investors ensure that projects respect the rule of law, reflect industry best practice, are economically viable, and result in durable shared value. 6. Investments generate desirable social and distributional impacts and do not increase vulnerability. 7. Environmental impacts due to a project are quantified and measures are taken to encourage sustainable resource use while minimizing the risk/magnitude of negative impacts and mitigating them.
Principles for Responsible Contracts	Professor John Ruggie, UN Special Representative of the Secretary General on Business and Human Rights	Ten principles for governments and investors who are negotiating investment contracts: <ol style="list-style-type: none"> 1. The parties should be adequately prepared and have the capacity to address the human rights implications of projects during negotiations. 2. Responsibilities for the prevention and mitigation of human rights risks associated with the project and its activities should be clarified and agreed before the contract is finalized. 3. The laws, regulations and standards governing the project should facilitate the prevention, mitigation and remediation of any negative human rights impacts. 4. Stabilization clauses, if used, should be carefully drafted so that any protections for investors against future changes in law do not interfere with the state's efforts to meet its human rights obligations. 5. Where the contract envisages that investors will provide additional services beyond the scope of the project, this should be carried out in a manner compatible with the state's human rights obligations and the investor's human rights responsibilities. 6. Physical security for the project's facilities, installations or personnel should be provided in a manner consistent with human rights principles and standards. 7. The project should have an effective community engagement plan through its life cycle, starting at the earliest stages. 8. The state should be able to monitor the project's compliance with relevant standards to protect human rights while providing necessary assurances for business investors against arbitrary interference. 9. Individuals and communities affected by project activities should have access to an effective non-judicial grievance mechanism. 10. The contract's terms should be disclosed, and the scope and duration of exceptions should be based on compelling justifications.
Principles for Responsible Investment in Farmland, 2011 (Farmland Principles)	Private sector initiative—pension and hedge funds	Five principles prepared by eight investment funds for the financial sector: <ol style="list-style-type: none"> 1. Promote environmental sustainability 2. Respect land and human rights 3. Respect existing land and resource rights 4. Uphold high business and ethical standards 5. Report on activities and progress
Large-scale land acquisitions and leases: a set of minimum principles and measures to address the human rights challenge, 2009	Professor Olivier de Schutter, UN Special Rapporteur on the Right to Food	A set of eleven core principles and measures for host states and investors: <ol style="list-style-type: none"> 1. The negotiations should be conducted in a fully transparent manner, and with the participation of local communities. 2. Any shifts in land use can only take place with the free, prior and informed consent of the local communities concerned. 3. States should adopt legislation protecting the rights of local communities, specifying in detail the conditions according to which shifts in land use, or evictions, may take place. 4. The local population should benefit from the revenues generated by the investment agreement. 5. Host states and investors should establish and promote farming systems that are sufficiently labour-intensive to contribute to employment creation. 6. Host states and investors should cooperate in identifying ways to ensure that the modes of agricultural production respect the environment, and do not accelerate climate change, soil depletion, and the exhaustion of freshwater reserves. 7. Obligations of the investor should be defined in clear terms, and be enforceable. 8. Investment agreements with net food-importing countries should include a clause providing that a certain minimum percentage of the crops produced shall be sold on local markets. 9. Impact assessments should be conducted prior to the completion of the negotiations. 10. States shall consult and cooperate in good faith with the indigenous peoples concerned. 11. Waged agricultural workers should be provided with adequate protection, consistent with the applicable ILO instruments.

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