Foreign Investment in Agriculture: Some Critical Contract Issues

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1. – INTRODUCTION

To begin with a note of some controversy: I am less than optimistic about the idea that UNIDROIT can cherry-pick among the issues in this area and focus on just one or two of them in its possible future work. In my opinion, that premise raises a number of concerns, which I shall address in this paper.

I also do not quite share the view that the critical issue in this area is land tenure security for investors. In my opinion, this is not the critical problem for large investors in this area, nor is it a critical factor in seriously reducing opportunity for investments in this area. However, I do agree with the view of Greg Myers 1 and others that land tenure security for small-scale land holders and individual farmers is a critical issue.

This paper will first look at investment in agricultural land in a particular context, and then look at contracts in the framework of the relationship between contracts, domestic law and investment treaties, which are the three primary sources of applicable law in terms of this area. It will then attempt to draw out some of the issues that in my view need to be reflected in what I would call “good” contracts for agricultural investments, followed by some brief recommendations.

Let me begin with something that for present purposes in my view has not drawn nearly the attention it needs today. The land in agricultural investments is really the popular issue, but it is actually a small part of the agricultural investment contract and impact. Foreign investment in agricultural land is in effect an extractive industry, and what is being extracted is the water. And water is simply the most valuable commodity on the planet today, bar none.

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1 See elsewhere in this issue.
Moreover, the importance of water as the most valuable commodity is only going to grow with the impact of climate change over the years to come. There can be no doubt that this is the central issue in large-scale land investments: land without water has zero value for agriculture, zero value. That said, of course land issues also are important. Indeed, both land and water generate critical issues of current and future displacement, community and small land-holder rights issues, and human rights issues, all of which are critical in the equation of investment in agriculture over the longer term.

II. – WHAT INVESTMENT IN AGRICULTURE IS NOT

As an additional introductory matter, I would propose three things that investment in agricultural land is not, or at least not always.

Investment in agricultural land does not equal investment in agricultural production. It depends on how the investor uses the land after it has leased or purchased it. Certainly, the major financial investment houses that are investing in agricultural land as a pure profit play on land have no interest in production. That is not what they are concerned about. The land tenure issue, when phrased as land security for the investor, looms large for such land speculation. But does this make it the proper focus of international work from a broader global policy or legal policy perspective? ²

Investment in agricultural land also does not equal investment in farmers. Certainly, what the World Bank study put out last year showed in terms of large investments in agriculture, the most important way to improve agricultural production is to invest in farmers, not farmland.³ That was clear. A separate United Nations report has made it clear that further to that, by far the best way to do that is to invest in women who are farming, because then the profits actually stay in the community, they go directly to the welfare of the children in the community; the generational impact in terms of development processes is increasingly significant.

The third proposition is that investment in agricultural land does not equal investment in sustainable development. The critical factor from a

² The presentation at this Colloquium by Jonathan M. Lindsay (Senior Counsel, Environmental and International Law (LEGEN), Legal Department, World Bank) on “Investment in land – opportunities and risks: lessons learned from land titling programmes”, is very instructive on this question (see elsewhere in this issue).

sustainable development perspective is not the quantity of investment but the quality of the investments, and whether the investments produce sustainable development benefits in the community and in the country that acts as the host of that investment. This is certainly not automatic. Reversing the negatives to positives, I would submit, requires deliberate decisions and strategies, and that is where the contracts come into play.

III. – INVESTMENT IN AGRICULTURE AS AN EXTRACTIVE INDUSTRY

By contrast, if one approaches the investment in agriculture issues not from a land acquisition or land leasing perspective, but from the perspective of an investment in an extractive industry, one changes what is being looked at in some very significant ways. This perspective requires including multiple dimensions. For example, the economics of the investment, including the development economics, must be considered. This is not a legal issue of the contract content but an analysis of the investment itself from a development perspective. In turn, the contract has to embody what one wants the investment to accomplish, including the local development benefits to be associated with the project. These may include the economic development issues, the social development dimensions, and the environmental dimensions. These, in turn, will encompass a range of human rights issues, including at least the right to water, the right to food, and property rights of local land owners and users. Environmental issues can include the impacts of the project on the environment as well as recognizing the impact that environmental events can have on agriculture in the future, and food security issues. In addition, there are multiple actors, which militates against any standard form contract. There is the investor, national and sub-national governments, the local community or tribal leaders, and individual persons on the land or nearby, all of which have potential interest and all of which may have issues or approaches that ought to be considered.

All of the above is common to the natural resources sector, but to date less so in what are often very skeletal contracts for agricultural investments.

IV. – CONTRACTS, DOMESTIC LAW AND INTERNATIONAL INVESTMENT TREATIES

If one considers this extractive industry context of how large agricultural investments ought to be looked at, or how they might be approached differently than generally conceived today, one may note that there are three relevant sources of applicable law within which the contract sits. One is the
domestic law of a host State, a second is the investment contract, and the third is investment treaties.

I will not expand upon domestic law in much detail. There is a vast array of laws, regulations, and constitutional laws that apply in any given jurisdiction: common law, civil law, tribal and community customary law, and Islamic law may be applicable in any given situation, and all are enforced in domestic courts or other forms of legal proceedings.

One may pause and raise an additional question here in relation to the “push” for western-style land registration systems in many developing countries: is it the responsibility of those whose land title or land use rights are currently identified through tribal or community customary law to fit those rights into a traditional Western approach to formal property law, or is it the responsibility of those who come from a formal property law system and are investing in a different country to fully understand that other system and fit within it?

In relation to investment contracts, the reality today in the areas where the biggest investments are being made is that the State owns most of the farmland. This is certainly the case in most of sub-Saharan Africa, with the exception of countries where tribal land systems predominate. The investment contract therefore is often an international contract between the Government and the foreign investors, not purely a private contract. This has a significant legal impact. The contract can be governed by the law of the host State or another State, or by international law, as the interpretational basis. The contracts often have international arbitration provisions, and there is still a frequent use of stabilization provisions in the contract which in this particular area, because of the huge potential for environmental impacts, can have very significant repercussions down the road. In other words, there is often a very significant mix of private law and public law issues found in agricultural investment contracts. This is very different from a private leasing or land purchase contract.

International investment treaties are the third source of relevant law. There are over 2700 international investment treaties in existence today – the difference between that number and the number referred to earlier in this colloquium (over 3000) is based on the number of treaties that are in force versus the total number known to have been signed. The substance of the matter is not altered in any significant way by this difference in numbers, however. These treaties come through bilateral or regional investment treaties, and they come as a chapter in bilateral or regional free trade agreements or economic partnership agreements. They are formal treaties between
governments that establish rights, but generally no obligations, 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 for investors of the other State party;
- no expropriation without compensation;
- the notion of fair and equitable treatment, which itself has an accordion-like quality that allows it to expand or contract in terms of its interpretation, depending on who the three arbitrators are in a dispute settlement context; and, inevitably today,
- an investor-State arbitration provision for the enforcement of the treaty directly by the investor.

Importantly, contract enforcement can also be brought under the treaty terms in many cases today. Thus, investors frequently end up not just with the dispute settlement forum in the contract, but the contract plus the treaty process.

What is critical, and why this is important in several of the sort of issues that we are talking about in this colloquium, is that international law prevails over the domestic law in the event of inconsistency or conflict. So, if one has a dispute settlement forum under the treaty, the international law will prevail over the domestic law if there is an inconsistency. One frequent result has been that international contracts and treaties have been used to fill in gaps in domestic law. It is here that the importance of the relationship begins to crystallise: these contracts and treaties can fill in the gaps in domestic law either in favour of the investor or in favour of the host State, or in a more 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 is distorted. Also, because the contracts can be transferred to the international treaty dispute settlement process, the problem tends to roll over, not just within the contracts but also in the treaty processes, and the investor is able to choose multiple recourses in the event of a conflict, or whichever one is most favourable to itself.

The relationships can be illustrated with the two pyramids below. In a well-functioning area, one will have a broad base of domestic law (Pyramid 1). That is the base of the pyramid, upon which, or 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, it might be the lease rates or the concession rates, it might be the particular aspects of a Public-Private Partnership. Most critically, the scope of the contract is not such as to alter the domestic law. It is simply to particularise the arrangement between the contracting parties as it relates to matters not covered by the domestic law. And finally, one may find the 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 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, if not all, areas where the large land investments are going now, one finds exactly the opposite structure, an inverted legal pyramid (Pyramid 2). The domestic law is the smallest part of the pyramid. In many cases, it does not exist or is rudimentary in terms of water quality issues, or water quantity allocation issues. For example, there is usually no or limited law in many of these African countries relating to the use of pesticides, simply because there has not been extensive use of pesticides there, so there has been no need for a law to control this. There are similar situations with respect to workers’ health and safety on the farm on large farms, because those economic structures have not existed there to any significant degree. Nor do the formal legal systems have land protection for most rural land users. Hence,
one finds a largely weak or very narrow domestic law base upon which the contracts then come into play. If those contracts deal only with one part of the debate, land tenure for example – which is largely what has happened until now – or the security of the investment in terms of additional stabilisation clauses that preclude the government from applying enhanced law to the investment over the years of that investment – a common second feature – one can easily see a result where a contract has a broader legal reach than the underlying law does, and one which is generally in favour of just one party to the contract. The treaties then come in and because the treaties focus solely on the rights of the investor, there are very few mechanisms within it 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.

Pyramid 2: A poorly-functioning relationship

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 most of the agricultural investments go today. This has significant implications.

V. – WHAT MIGHT A GOOD CONTRACT LOOK LIKE?

This UNIDROIT colloquium is looking at the issue of agricultural investment contracts. Given the above, what might a good contract look like in this field? One might consider the following principles.
First, it must draw from the principles of the extractive industries, not land leasing or land purchase precedents. That is far too narrow a range – it picks one issue as “the” issue when in fact the multiplicity of issues is much greater and there is a need to address all of them. It is here that the concern expressed initially about focusing only on the land tenure issue or even just the relationship between tribal or community customary law and other formal property rights is best seen. The range of issues is enormous, and these issues have to be interrelated in a proper way in the contract. So it becomes very difficult to pick out one issue.

All the actors have to be included in the process in one manner or another. There are different ways to do that. There can be subsidiary agreements, there can be community development agreements that have equal status to the governmental agreement, etc. But at the end of the day, the result has to be comprehensive or the approach, and the investment, are not likely to succeed.

The contract, in my view, has to interact very carefully with the domestic law in the host State, and where that domestic law is weak, it can set basic levels of conduct based on international standards. However, it should not set “ceilings” on domestic laws through the use of stabilization provisions or similar instruments.4

Some specific issues, reflected in the first half of the panel discussions, should include: pre-contractual or pre-operational obligations of the investors, including environmental impact assessment of the proposed use and social and human rights impact assessment as recommended by Professor Ruggie.5 There is also the potential use of international standards where domestic laws are insufficient to meet the needs of the project. The International Finance Corporation Performance Standards are one example that can be used as a floor standard to bolster inadequate domestic law in relation to such assessment processes. Whether these assessments are required before the contract is

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4 This view is being increasingly recognized across the extractive sectors. See, e.g., the Model Mining Development Agreement by the International Bar Association Mining Law Committee, April 2011, at <www.mmdaproject.org>.

done or afterwards, but prior to operationalising the investment, there is no reason why the conditions that come out of the assessments cannot be fully included in the contractual obligations of the investor.

The business feasibility study and the financing plan should accompany the contract and any conditions or undertakings should be incorporated into it as binding obligations. Similarly, the community agreement should accompany the contract in whatever form they might be related.

There is no doubt that land tenure has to be part of the scope of a good contract. Purchase and lease rates, the identification of the land involved, the time period if it is a lease, the required payments to landholders, traditional users or surrounding communities. These latter elements need to be in the contract so that payment goes to the appropriate people rather than to intermediaries, governmental or otherwise.

Also increasingly important is the need to ensure that the agricultural investment rights that are being given by the government do not extend to subsurface rights to minerals, petroleum and gas. That might seem like an obvious point, but the fact is that this has been seen in at least one instance of which the author is aware.

Provisions on non-performance by the investor are also important: what happens if the investor does not comply with its obligations? What happens to the land transfers? What happens to the other elements or the operation of the investment?

It is also important to have provisions that guard against the transfer or sale of the investment without government approval and without the same rules and conditions applying. This has been seen in a number of agricultural investments and there is speculation that this is seen by some less scrupulous investors as a means of evading their contractual obligations. Simply set out, an investor makes the original contract, somehow the investment does not pan out financially, a new owner is found, new rights are assigned but without the same obligations. Such issues need to be addressed through provisions on transfer and resale.

Taxation and other fiscal provisions must be included. I would argue that export limitations based on food security concerns must also be addressed today. Many of the investment contracts today include a provision obligating the government to allow the export of the entire production. These are investments that are geared towards food or energy security in the home State of the investor, but such provisions can lead to food security risks in the host State with consequent risks of social and economic conflict.
A number of common obligations should also be considered, obligations that are equally important for the government and the investor. These might include: anti-corruption issues; protection of human rights, and transparency of contracts and payments as argued in the presentation by the representative of UNCITRAL.6 This is an absolutely fundamental and critical component: without transparency in this process the rest simply disappears into the ether. Transparency here includes both transparency of the contracts and of the payments: both elements are critical.

As already suggested, it is also not sufficient for the social, environmental and human rights dimensions to remain as voluntary principles. One must go back here to the enforcement of the contracts through the treaties. When that is done, it is either hard law or it is not. It is an obligation in the contract or it is not an obligation in the contract. The matter must be understood from the perspective of arbitrators. If the contract says that the investor is not legally required to comply with environmental law, the inclusion of non-binding CSR principles does not alter that. The contract is what counts – the rest of it does not count in the arbitration process – or at least does not count in the same way. So, one cannot usefully say in a contract that the environmental and social elements are voluntary. The existing voluntary processes have to inform what goes in the contract, but the elements do themselves have to be included in the contract.

Water allocation issues are another concern. Water rights are, in my opinion, going to be the central issue in 15 years for almost all these investments. Water quantity is going to diminish almost everywhere, including in the areas where these investments are going to be made. What happens then? How do governments re-allocate water rights? The existing law in most developing countries is generally silent on that issue. Indeed, the water rights in many instances go with the land. As a result, if one has a contract for an agricultural investment that says the investor has the right to farm 200,000 hectares of land, the implication is that the government will ensure that the investor has the water rights allocation to do just that. It is all other users of that water that assume the risks of diminished water availability over the life of the contract. Consequently, equity and the rights of other users require that there be specific provisions addressing changes in water allocation over the life of the contract.

6 Caroline Nicholas, “Devising transparent and efficient concession award procedures” (see elsewhere in this issue).
Some additional provisions should also be considered: local economic linkages to goods and services suppliers by the investor; technology transfer; and again a whole range of issues that come with extractive industry contracts relating to labour, training, minimum employment levels, and so on. I would add that a compliance management and dispute settlement process that is based on reporting to and input from – oversight from – the community where the investment is located should be included. These are the people who have the most immediate interest in enforcement, more so than officials in capitals, often hundreds and hundreds of kilometres away, and with different political issues that they may wish to consider.

VI. – CONCLUSIONS

It is important to note that not every potential investment is a win-win, and some investments should not be going forward. Not all investment is good investment. The important point here is to try and ensure as best as one can that the investments that are made actually do make a positive contribution to development and sustainable development in the communities where they locate.

More specifically in relation to the contracts, this paper has attempted to highlight the need to look at agricultural investment contracts holistically. This militates against specific formulae for just one part of a contract that might distort the relationship to other parts of a contract. This type of single-issue focus can be more limiting of, rather than informing of, a proper perspective on the issues, and can indeed create conflicts with other issues. The need to maintain a holistic approach to agricultural investment contracts is, in my opinion, critical to achieving successful investments in this area.