tion. An international resources bank aimed at promoting mineral development would channel additional foreign exchange to (some) LDCs.[25] But it, too, would aim for a solution where the problem probably is not. IRB financing would be channelled on the basis of geological fortune, not as a function of the reality of the foreign exchange constraint to LDCs' growth and stability.

Could the role of MCNs be greater, if the policy goal were not only to insure against crisis, but also to promote more rapid development? It is evident that in the long term, commitments of long-term investment capital have at least the potential for furthering development and for contributing to the financing of development.[26] Where MNCs go, investment, technology, management—and multinational private bank loans—may follow. But if past is prologue, MNCs will continue to go to the better off among the LDCs; to those countries which already have access to private sources of foreign exchange, and which have thus largely maintained their pre-1973 rates of growth. MNCs will go to those countries already "developed" in the sense of what Professor Kindleberger has called "the capacity to transform". It is arguable that the very definition of underdevelopment is the lack of a capacity to transform, and the least developed have the least of it. These are the countries that are now experiencing zero growth. Neither MNCs nor private banks are flocking to them. For the foreseeable future, their access to foreign exchange will vary with commodity earnings, prices of oil, grain, and manufactured goods, and public assistance.

[25] The International Resource Bank (IRB) was proposed by former Secretary of State Henry Kissinger at UNCTAD IV. It would set up a mechanism for guaranteeing private foreign investment in mineral exploration in LDCs. The fund for financing this arrangement was estimated at $1 billion, $200 m. of which would be the U.S. contribution. The resolution to create an IRB was defeated at UNCTAD, but has been discussed on other forums such as the Council on International Economic Cooperation (CIEC) in Paris and at meetings of the Organization of American States (OAS). There is no indication at present that an IRB will be established in the near future, or that the new administration will continue to pursue this as a separate option.

[26] Whether this potential has been, or will be realized in the interest of LDCs is a matter of debate. But, in spite of the implications of *Global Reach*, *someone* benefits from MNC operations and if there are benefits, they can at least in theory be distributed in favour of LDCs.

Mining Agreements in Developing Countries

ERICH SCHANZE AND OTHERS

ILNR (B.1)

Introduction

THE SUPPLY OF RAW MATERIALS and the transfer of technological and administrative skill are issues of increasing relevance in long-term relations between industrialized and developing countries. These issues converge in mining agreements relating to projects in developing nations. The analysis of the legal constitution of mining projects has traditionally been barred through a lack of information. The agreements were regarded as among the arcana of international business practice. The OPEC initiative has led to an increase in publicity in the oil sector. Here, the policy of exchanging information between producing countries and of exposing the contractual documents to the public has been adopted.[1] In the hard mineral sector, the information problem prevails.

The present paper relies on a collection of legal instruments, affiliated documents and interviews relating to 45 projects in the hard mineral sector (metals) in 27 countries, 25 of which may be classified as developing countries. Although it is difficult to ascertain whether this sample is representative in a strict sense, the large portion of recent agreements (since 1969) represented in the sample supplies an appropriate background for general analysis.

The documents and information were collected for research purposes —in many cases with the explicit promise of confidentiality. We have therefore adopted the general policy of leaving out the name and place of the actual project. The study deals with a limited number of issues of current relevance.

[1] Cf. Zuhayr Mikdashi, "Cooperation among Oil Exporting Countries with Special Reference to Arab Countries", *International Organization*, 28 (1974), pp. 24 *et. seq.*

This study has been prepared in the context of the research project "Transnational Law of Natural Resources" at the Institut für Ausländisches und Internationales Wirtschaftsrecht, University of Frankfurt. *It relates to the authors two volume book* Rohstofferschließungsvorhaben in Entwicklungsländern/ Mining Ventures in Developing Countries *by Kirchner and others (Frankfurt/Deventer: Metzner/ Kluwer, 1977, 1978). In this article the parts were written by Dr. Erich Schanze LL.M. (Introduction and Part I), Fabian G. von Schlabrendorff, M.A. (Part II), Ralph W. Beha, J.D., and Albrecht Stockmayer, LL.M. (Part III), Assessor Michael Fritzsche (Parts IV and VI), and Dr. Christian Kirchner, LL.M. (Part V).*

This study, unlike most analyses in the field, has been written from the perspective of a group of academics: lawyers, economists and political scientists in a European country. The object of the study is a brief analysis and comparison of recent mining agreements, taking specific note of general structures and alternative possibilities in drafting which are available to the developing countries.

I. Present Trends in Mining Agreements

Implications of Framing Complex Issues in Traditional Legal Concepts

The legal area of mining agreements has frequently been prospected with over-generalizing conceptual equipment. The public appearance of a new contract referring to the well-defined circumstances of a specific project has repeatedly given rise to speculation about new concepts of world-wide application. Closer analysis reveals that in a number of instances change did not relate to the substance of the agreement but rather to a change in labels.[2] Given the great diversity of labels, a functional approach seems to be a proper guide to the problems. It should be noted, however, that labels may include notions of substance as they reflect a core of legal policy. "Concession", "Joint Venture", "Service Contract" have been substantive programmes which have defined the general legal approach to highly complex issues. The implications of choosing any one of these specific patterns are manifold.

Basic patterns

The contractual practice of the last decade, on which this study is focused, has produced refined versions of all three patterns. The most sophisticated versions, it may be submitted, have departed from their original ancestry and adopted modifications from all sides. Nevertheless, an understanding of these complex legal vehicles relies on the basic structures involved. The general patterns may be demonstrated in simplified form in the following set of diagrams:[3]

Contractual Co-operation

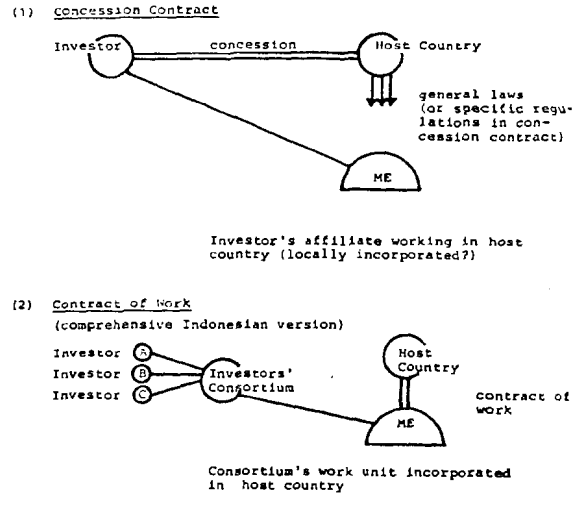
(a) *Concession*

While the great majority of contracts under analysis are based on the pattern of equity participation (corporate co-operation), there is a variety of schemes of contractual co-operation. Among these, the concession contract is playing a declining role. There are, however, noteworthy

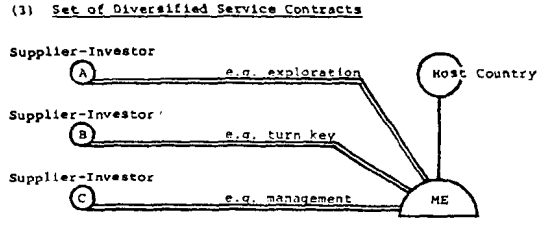
[2] The demonstration of this issue is one of the key topics in: David N. Smith, Louis T. Wells, *Negotiating Third World Mineral Agreements : Promises as Prologue*, Cambridge, Mass.: Ballinger, 1975, esp. pp. 27-53. See also Tom J. Farer, "Economic Development Agreements: A Functional Analysis", *Columbia Journal of Transnational Law*, 10 (1971), p. 200 *et. seq.*

[3] Double lines indicate the fundamental relationship in the scheme. ME means mining enterprise.

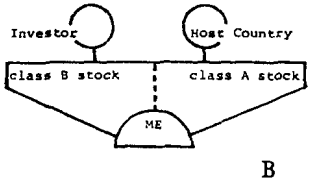
A. *Contractual Co-operation*



A



B *Corporate Co-operation*
(equity joint venture)



B

exceptions. One of the most elaborate recent agreements, concerning a large copper project in a South American state, is in essence a straightforward concession contract. The concession pattern is implemented by various specific obligations of the foreign-owned but locally incorporated company, referring to all sorts of linkages for social and economic promotion. Phase-in of local equity participation is secured through the general mining code.

For smaller projects or for projects where the encouragement of search activities (prospecting, exploration) plays a role, the concession pattern is likely to be an effective basic device for host countries.[4] One example among many of this type of arrangement concerns prospecting, mining and dredging for an uncommon metal in a western North African state.

The mineral concession (mineral lease, etc.) is in most countries extensively regulated by statutory law[5] and remains an essential part of any mining agreement. The departure from the framework of the traditional concession in modern mining agreements stems from the fact that "concession", i.e. the granting of mineral rights, is only one of the many elements to be agreed upon in the current mining projects. The formation of an appropriate working entity, its organization, its control, the distribution of its benefits, the evaluation of its positive and negative impacts on the social and natural environment, and the access of products to foreign markets, have all become paramount issues for legal solution. The framing of these complex issues does not fit into the basic pattern of a general allowance for using state or private property for prospecting and mining purposes. The above-mentioned example of a copper concession, however, shows that the traditional concession concept may be highly mutable.

(b) *Contract of Work*

In the concept of the general contract of work—as used in Indonesia—the foreign-owned but locally incorporated mining company stipulates to the government "to perform work and all other obligations imposed on it by the agreement". There is no corresponding stipulation of the payment for the work, which would be expected from the name of the contract. The *quid pro quo* consists in the corporation's disposition over the extracted product. The government's share is guaranteed through a system of various rents, royalties and taxes. Thus, the general contract of work is in fact a kind of reversed concession. Diagram A (2) above shows that, in theory, there is no direct communication between investor and host

[4] Smith, Wells, *op. cit.*, p. 37, stress the point of simplicity of administration.
[5] Cf. R. S. Collins, "World Survey of mineral rights legislation for land areas", *Institution of Mining and Metallurgy, Transactions*, 80 (1971), pp. A 10 *et. seq.*; Northcutt Ely, *Summary of Mining and Petroleum Laws of the World (in five parts)*. Washington, D.C.: U.S. Department of the Interior, 1971-1974.

state, although the contractor is, as in most modern concessions, the locally incorporated affiliate of the investor or of an investors' consortium. The distinctive feature of these arrangements is certainly not be found in the symbolic reversal of the concession pattern. However, it lies in the detailed clauses of the "work program" of the investor. The various project periods, from surveying through operating and marketing, are defined with care. Other interesting features designed to promote the national interest include clauses concerning the gradual increase of employment of nationals at all levels, the requirement that shares of the company be offered to nationals and the tentative requirement of local processing.

(c) *Service Contracts*

The close regulation in modern agreements of every stage of the mining project intimates that the comprehensive contract with one investor (or a consortium of investors) could be divided into several separate agreements for the preparatory work, the outfitting of the mine and the administration of the venture. The entire control over the project would then remain in the hands of the host country. Technology and administrative skills could thus be "bought" on the international market. In the oil sector, structures of this sort have become common.[6] In the hard mineral sector, various forms of service contracts are included in recent agreements, yet always in connection with some form of equity participation of the foreign partner. There is, however, one recent project in an oil exporting state which is structured exclusively by a service contract.[7]

In the exploration stage, service contracts are available. A number of public institutions offer exploration services, the most important of which are the United Nation's Revolving Fund for Natural Resources Exploration,[8] the French *Bureau de Recherches Géologiques et Minières* (BRGM),[9] and the German *Bundesanstalt für Geowissenschaften und Rohstoffe* (BGR).[10] But the bulk of exploration activities remains in the hands of mining companies, whose activities in these stages are sometimes subsidized by home countries through tax deduction allowances or specific soft loans. While the separation of early project stages from the production phase is likely to strengthen the autonomy and bargaining power of host countries, there are also advantages to an integrated "one hand" approach. Large mining companies possess adequate research facilities and extensive know-how for developing new extraction and processing technologies.

[6] Cf. Robert Fabrikant, *Oil Discovery and Technical Change in Southeast Asia. Legal Aspects of Production Sharing Contracts in the Indonesian Petroleum Industry* (Institute of Southeast Asian Studies, Singapore, 1973).
[7] There are, of course, instances of service contracts after nationalization.
[8] E.g. project in Northern South America, 1976.
[9] E.g. project in the Middle East with option for minority participation in the production phase.
[10] In 1976 the BGR reported that exploration activities (including hydrogeological projects) are being continually carried out by about fifteen working teams in several developing countries, in most cases under the technical assistance programme.

Almost every substantial project requires technology specifically designed for the type of ore and for the size and situation of the mineral deposit. The expectation of profits in the future mine is generally regarded as a strong incentive for the development of unknown procedures and technical approaches.

The major obstacle to be overcome in the implementation of service contracts in the hard mineral sector is the financing of the various stages. Even if the feasibility of a particular project has been demonstrated, large capital outlays and long recoupment periods in the production phase have to be considered.[11]

In the collection of legal instruments under analysis a number of contracts show a tendency toward the service contract pattern. In these arrangements host country majority equity positions are coupled with administrative agreements with a foreign partner. These agreements are designed to secure a constant flow of technology, modern standards of administration and vertical integration into the market. These patterns are generally confined to rich or easily accessible ore bodies and/or to (oil exporting) countries with substantial financial means which seek investment in their own natural resources. All contracts of this sort do not involve elements of high general risk; they concern well-defined projects, the viability of which is generally accepted.

Corporate Co-operation (equity sharing)

(a) *Equity Sharing as an Alternative to Contractual Patterns*

The concept of co-operation between the investor and the developing country in a corporate joint venture has shaped the majority of mining projects over the last two decades. Equity participation by the host countries may at times have amounted to a matter of conviction.

The perceptible trend from concession to joint venture ought not to be ascribed to some inherent virtue of a "joint venture mentality" as much as to the objective financial and political necessity to involve a greater number of parties in a mining project. If one accepts the premise that the focal point of today's projects is not the nature of the mineral rights granted by the state, but the problem how to bring together effectively mineral resources, capital and technology in a functional and economically desirable entity, it follows that a joint commitment in the organizational structure of the entity is a substantial aim of a natural resources policy. However, proper allocation of the key functions of a project need not necessarily rely on a concept of equity participation. Corporate co-operation is to be regarded as an alternative model to advanced forms of contractual co-operation.

[11] Cf. Peter P. Gabriel, *The Transfer of Corporate Skills. Management Contracts in Less Developed Countries* Harvard University, Graduate School of Business Administration, Boston 1967, p. 81.

(b) *Contractual and Corporate Model*

In the contractual model a maximum of autonomy can be achieved. The parties are committed only to the extent of their contractual obligation. For conflict resolution the parties have to resort to third institutions.

Under the corporate model, most functions are carried out through the common corporate administration rather than according to a precise, contractually defined scheme. The administrative entity is likely to develop a degree of independence, and may become an integrative force leading to common perceptions and goals among the parties. This model is well suited to changing and unforeseen circumstances.

Each model holds for either party both inherent advantages and disadvantages; an optimal solution is likely to contain elements of each. This is reflected in the current practice of contract drafting.

(c) *Advanced Concepts of Equity Sharing*

In the initial years of corporate co-operation, well into the nineteen-sixties, the ideal of equal equity participation (50:50 joint venture) played an important role. More recently, it has become obvious that a specific proportion of shares need not ultimately define the full status of the partner. Control may be diversified at various stages and levels to secure an optimal structure for the effective administration of production and development promotion policies. Further, the project corporation's benefits are no longer distributed simply according to the share quotas, but reflect instead the total financial and non-financial flows to all parties. Dividends, taxes and other benefits are to be seen within a comprehensive distributive scheme.

Various specific obligations may be part of the corporate agreement. In practice, the foreign investor will seek to retain a controlling interest in day-to-day operations of the mine, in the policies which lead to the expected return of his investment, and in access to the mineral products. In most instances this interest is secured through a factual majority participation in the venture. There are, however, a number of recent examples where a controlling corporate interest of the host country has been accepted by investing mining corporations. These have been accompanied by contractual arrangements to administer the operation of the project for a fee or a share in the output. There are other recent examples of host country minority (or factual minority) participation which go well beyond a simple corporate arrangement. They include extensive clauses for the integration of the project into the social, economic and ecological framework of the host country. In all these instances, it is clear, that the contracts were not drafted along doctrinal lines, but with the aim of attracting the maximum capital and commitment from the investor's side in order to secure substantive and lasting benefits from the project.

One advantage of any corporate pattern is the possibility of providing for the gradual phasing-in of host country equity. Although this objective may also be reached by legislative provision in the mining code (as in the Peruvian example), contractual phase-in and renegotiation provisions are likely to reflect more closely the economic performance of the enterprise.[12]

Recently clauses have been suggested which provide for renegotiation at given intervals if past and projected net cash flow figures differ from initial expectations.[13]

In summary it seems that traditional legal concepts of concession and simple equity sharing have long been left behind. The latest agreements demonstrate a wide range of complex, hybrid forms of co-operation between mining investors and host countries.

OPEC Experience and Non-Fuel Minerals

It seems to be a truism that OPEC's activities have had a substantial impact on the legal issues involved in the hard mineral sector. The collection of instruments intimates that the decisive turn did not take place as late as 1973, but had already occurred in the late nineteen-sixties. It appears that the metal sector has adopted some of OPEC's pioneering contractual patterns, but after a time lag of several years.

There are, however, a number of economic reasons which affirm the assertion that OPEC's advances cannot be fully matched in all or even most metal commodity markets. Nevertheless, OPEC has taught that the exchange of information and the mutual disclosure of contracts may be an important device for attaining better solutions for producing countries. Even more essential is the increasing awareness, since 1973 and the subsequent general recession, that there is not only a mutual dependency between most industrial and developing countries, but that any substantive shifting of power relations causes feedback on both sides.

Towards a Comprehensive Interest-Analysis

The current experience in the development of the commodity sector should be reflected in the general legal approach to mineral agreements. One conclusion attracting increasing attention is the notion that a mineral agreement is no static "deal" but "merely one step in a process of unfolding relationships".[14] In the light of this, the drafting of contracts is likely to concentrate on practicable sets of procedural rules to allow for constant adaptation to the circumstances.

The departure from the notion of a "commodity deal" has an additional dimension. The awareness of multilateral political and economic dependence in matters of raw material supply and transfer of technolo-

[12] Cf. *infra* Part IV.
[13] Raymond F. Mikesell, *Foreign Investment in Copper Mining. Case Studies of Mines in Peru and Papua, New Guinea.* The Johns Hopkins University Press, Baltimore, 1975, p. 33.
[14] Smith, Wells *op. cit.*, pp. 3 *et. seq.*

gy leads to an analytical approach which may be termed a "comprehensive interest analysis".[15] A systematic analysis of mineral agreements, it is suggested, has not only to take into account the commitments of signatories of the final agreement but has also to consider the full environment of institutions and forces, participating explicitly and implicitly in the arrangement through various channels.

Mineral investments are no longer regarded as mere questions of private concern. It has become a common feature that host countries operate through specialized agencies, which co-ordinate the different problems of fitting the project into the national, social and economic context. Industrial countries are making various efforts on numerous levels to secure a constant flow of raw material supplies. A general dialogue of producers and consumers is emerging. Increasing project size has led to new modes of international financing, as described in Part III. Contracts are reflecting the standards set by international institutions. Regional integration of developing countries is playing an increasing role, as various problems may be solved through mutual assistance on a regional level. Planning procedures are beginning to focus on long-term questions, such as the social and ecological impacts of large industrial projects (cf. Part II). Complex distributive patterns concerning the financial benefits of the project are likely to guarantee stability of the venture (cf. Part IV). General standards of accounting, reporting and auditing have to be developed to secure adequate and comparable information for various institutions monitoring international investments (cf. Part V). Finally, new modes of conflict avoidance and conflict resolution have to be considered, in order to cut down unnecessary economic and social costs affecting the institutions and persons directly and indirectly involved in a mining venture (cf. Part VI).

II. Social and Ecological Impact of Mining Projects

Functions of Protective Provisions

In the past decade, the need for the protection and improvement of the human environment has found world-wide recognition. This new environmental consciousness, originating in highly industrialized countries as a concern about the side-effects of industrial development, has led most developing countries to adopt a broader view of their development goals, including the development of their mineral resources. Both governments of host countries and international institutions financing mineral-related development projects have increasingly insisted on including in mining agreements clauses not only involving the foreign investor in the develop-

[15] Cf. Christian Kirchner, Erich Schanze, Fabian G. von Schlabrendorff, Albrecht Stockmayer, Thomas W. Wälde, Michael Fritzsche, Reinhard Patzina, *Rohstofferschliessungsvorhaben in Entwicklungsländern, Teil 1: Interessenrahmen, Verhandlungsprozeß, rechtliche Konzeptionen* (with an English summary). (Frankfurt am Main: Metzner, 1977.)

V. Accounting, Reporting, and Auditing

Existing Clauses

Clauses dealing with accounting, reporting and auditing are often spread throughout a mining agreement, with separate accounting and reporting requirements included in clauses dealing with marketing, records and audit, and related provisions. In order properly to review the drafting practice of existing mining agreements, one should have a rough idea of what should be regulated by those clauses. Included must be statements as to

— where the books of account have to be kept;
— what rights of inspection the government of the host country shall have;
— what guarantees regarding the confidentiality of information are provided;
— what set of accounting and reporting principles shall be applicable;
— what sort of monthly, quarterly or annual information (balance sheet, statement of income, production statistics, statement of sources and application of funds, data about employment and labour, data about foreign exchange transactions and transfer prices) shall be provided;
— what methods of choosing auditors are applicable; and
— how long a period of time is given for auditing and submitting reports.

Furthermore, it is essential to deal with accounting and auditing in marketing clauses in so far as methods for monitoring transfer pricing must be agreed upon. The same is true for methods for computing net profits. Many existing mining agreements are inadequate in several ways in dealing with these questions. In a typical clause accounting and reporting requirements state only that the company shall have its books audited "as soon as practicable after each accounting year by such independent Chartered Accountant as may be chosen by the Company and approved by the Government". A great number of mining agreements have no accounting, reporting and auditing provisions at all. In a mining agreement of 1966 there is no clause concerning accounting, reporting and auditing requirements, but there is an article dealing with the confidential nature of information. "Neither of the parties hereto shall without the written consent of the other of them disclose to any third party any reports, records, scientific and technical data, sales contracts, commercial transactions or other similar information of a confidential nature of the operations of the Company."

On the other hand, there are several mining agreements which state that books of account have to be maintained in the host country, that these books shall be kept in accordance with generally accepted accounting principles, and that the company has to furnish the government with

annual financial statements, consisting of a balance sheet and statement of income, prepared in accordance with generally accepted accounting principles. Some mining agreements oblige the company to furnish the government with production statistics as well. Many agreements state that company books and accounts are subject to auditing by independent auditors or to review by government representatives. In one mining agreement there is no recourse to "generally accepted accounting principles" but rather to accounting principles normally applied to mining projects. In a recent mining agreement in an African country, it is stated that books and accounts shall be kept in accordance with such accounting system as the government shall approve. This latter clause is more flexible and enables the host government to apply modern accounting standards, which may be more advanced than "generally accepted accounting principles".[72] There are mining agreements which require annual reports; others provide for quarterly reports. A number of mining agreements specify the currency in which accounts have to be reported.

Transfer pricing problems are dealt with in a number of agreements providing for detailed methods of determining those prices applicable for the computation of taxes and royalties. Thus far there is only one draft agreement known which states that the concessionaire shall maintain financial records of its *world-wide* operations—a clause which certainly approaches the transfer pricing problem from a new point of view. This agreement, furthermore, provides for information about all revenues received by the concessionnaire from its world-wide operations and all its expenditures. The company must also present a clear explanation of the financial aspects of such operations. There is no provision for information about labour statistics, or for a statement of sources and application of funds.[73] Methods for computing net profits are outlined in detail, as is normal in such agreements.

In mining agreements concluded in the period after 1970 clauses dealing with accounting, reporting and auditing have become more sophisticated. The reporting and auditing requirements of developed countries have in some cases been taken as examples for the drafting of recent agreements. But even if such reporting and auditing requirements were exactly copied, there would be serious gaps in the information necessary for host countries to monitor the performance of mining projects in their territories. Such deficiencies will be discussed in the

[72] This might be especially true for International Accounting Standards issued by the International Accounting Standards Committee or those proposals to be made by the Commission on Transnational Corporations' Group of Experts on International Standards of Accounting and Reporting; up to now, there is only a set of guidelines of this group's work: See U.N. Doc. E/C. 10/AC. 1/2, E/C. 10/AC.1/3, E/C.10/AC. 1/4 and E/C.10/33.

[73] The International Accounting Standards Committee has issued on 2 June 1976, an exposure draft about "Statement of Sources and Application of Funds" (Exposure Draft 7); this item has been taken up by the CTC for the Group of Experts on International Standards UN. Doc. E/C. 10/AC. 1/2, p. 11, no. 38.

following section and consequences for drafting new mining agreements will be drawn from this analysis thereafter.

Deficiencies of Existing Accounting, Reporting, and Auditing Clauses

In order to assess the performance of a company working on a mining project within the territory of a host country, the government has to be informed as to the calculation methods used by the company to determine the profitability of the project; this means that the government has to legislate for reporting requirements according to the computation needs of the discounted cash flow of the venture.[74]

Up to now, the information to be furnished to the government has been confined mostly to financial data, neglecting non-financial data which are important for evaluating the impact of the venture on the national economy.[75] Reporting requirements which do not include information about the international operations of the investor company can provide only a rough idea of the investor company's performance within the host country.

Auditing by independent auditors may be an efficient way of supervising the investor company's operations, but if international auditing firms are entrusted with this task, the costs for auditing may be substantial. Even if such expenses have to be paid by the investor company, they are tax-deductible items diminishing the host government's income. Even in cases where deduction is not possible, the investor may include such expenses elesewhere in his calculations thus reducing the host country's share in the venture's earnings. As a result of this cost factor, it may be that only annual reports have to be audited, or that reports are kept quite simple, including only a balance sheet and income statement. In such cases, the host country government may be provided with reliable but scant information. If reporting periods are too long, the reports cannot constitute an efficient supervisory tool.

Auditing would not pose these problems if efficient independent auditing firms with international standards were available in the host country. Normally, however, the host country has neither such auditing firms nor enough qualified personnel within the government to review the operations of the company or carefully and thoroughly to evaluate such data as are being provided by the company.[76] The problem of a lack of human resources in the field of accounting, reporting and auditing cannot be solved merely by drafting better mining agreements. This

[74] The discounted cash flow (DCF) approach to the evaluation of profitability of mining projects has been stressed especially by Raymond F. Mikesell, *Foreign Investment in Copper Mining*, p. 5, and by David N. Smith, Louis T. Wells Jr., *op. cit.*, p. 60.
[75] Non-financial reporting is of special interest for developing host countries of multinational corporations; see U.N. Doc. E/C. 10/AC. 1/4, p. 6.
[76] Cf. U.N. Doc. E/C. 10/AC. 1/4. p. 8.

problem is a long-term one which can be managed only by deliberate long-term actions. Some proposals to this end will be made in the following section.

The lack of a concise set of internationally accepted accounting principles makes it very difficult for the host government to supervise operations of investor companies in its territory. Agreements may either simply refer to "generally accepted accounting principles", thereby leaving wide discretion to the investor company, or they may develop their own accounting and reporting principles. The latter method, however, is normally hampered by the lack of qualified personnel to administer such new regulations. This means that such rules can only be developed gradually with the increase in human resources in this sector.

Supervision of the company by the government is further impeded by difficulties concerning the use of different currencies for financial operations, accounting and reporting. Detailed rules, which provide not only for the determination of the currency in which books and accounts have to be stated, but also for specific methods of how to translate from foreign currencies to the reporting currency, have to be developed. This is essential for the computation of taxes and royalties and for the evaluation of transfer pricing as well.

Some Proposals

Training of Local Accounting and Auditing Personnel

Clauses dealing with training for local personnel should explicitly provide for education programmes for accounting and auditing personnel, including education in the home country of the investor company.

Local Auditing Companies

The formation of local auditing companies should be fostered by the host country government, including grants for overseas education. Depending on how rapidly local auditing companies are developed, mining agreements should provide for the government's right to employ such local companies.

Information about International Operations of the Investor Company

Investor companies may be obliged to supply the government with international consolidated statements, including international statements of sources and application of funds.

Extent of Reporting Requirements Referring to the Local Mining Project

Reporting requirements should include balance sheet, income statement of sources and applications of funds, production and employment statistics, and environmental impact reports.

Applicable Accounting and Reporting Principles

Books, accounts and reports should be kept according to national accounting and reporting principles, which from time to time should be brought into compliance with international accounting standards. Thus, the development of national accounting and reporting principles could take into account the administrative capacity of the host country, becoming more and more sophisticated as this capacity increases.

Currency Translation

Principles of currency translation for reporting purposes have to be explicitly laid down in the mining contract. For transfers from local currency into foreign currency or *vice versa*, transaction rates should be specified. For translating the balance sheet, current rates of the closing date should be applied, but varying inflation rates of different currencies have to be taken into account.

VI. Dispute Settlement and Issues of Renegotiation

Mining agreements, more than any other investment contracts, are exposed to disputes between the contracting partners, because of the complexity of fiscal, economic, and other provisions, the usually long-term of the contract (20 to 50 years), and the inevitable shift of bargaining power from the investor's to the host government's side once the investment is executed.[77] As the initial contract only summarizes attitude and expectations at that time, any changing conditions, such as in economic circumstances, in the development of other mines in the host country, or in the legal situation in the home country, can influence the understanding or interpretation of the contract.

Dispute settlement is the final remedy for contracting partners seeking arrangements which minimize the often considerable conflict costs and maintain a mutually beneficial relationship. Disputes arise not only in connection with the interpretation of contract terms; more often, they concern a basic dissatisfaction of one side (usually the host government) with its revenues from the project. Dispute settlement is thus intended to ensure the viability of agreements which, soon after having been signed, run the risk of termination because of changing circumstances and growing expectations.

Arbitration

Arbitration as a form of dispute settlement mechanism can be found in almost every modern mining agreement, with detailed provisions on the

[77] Cf. David N. Smith, Louis T. Wells Jr., "Conflict Avoidance in Concession Agreements" *Harvard International Law Journal*, 17 (1976), pp. 51 *et. seq.*, Theodore H. Moran, *Multinational Corporations and the Politics of Dependence: Copper in Chile*. Princeton N.J.: Univ. Press, 1974, p. 153.

procedure, selection of arbitrators, applicable law, and reference to international institutions (ICSID, ICC, UNCITRAL). Even if arbitration is less often implemented than the number and length of arbitration clauses would suggest, such clauses may none the less have an important effect on the party's behaviour. The likely outcome and the various costs involved in arbitration and in securing compliance with the awards act as an incentive for the parties to plan their actions carefully.

Most present mining agreements include one or several of the following standard provisions on dispute settlement:

— mandatory or voluntary conciliation (as a condition for calling upon arbitration institutions);
— arbitration by *ad hoc* tribunals set up according to contractual dispositions:
— settlement of technical disputes by (international) experts; or
— recourse to institutionalized arbitration tribunals, such as the International Centre for Settlement of Investment Disputes (ICSID) or the International Chamber of Commerce (ICC).

In early mining agreements, *ad hoc* arbitration is stipulated in simple terms, mostly involving one delegate from each side together with a co-opted "umpire". Modern agreements still include such provisions, eventually referring, however, to international institutions. The selection of the members of the arbitration council (arbitrators) is increasingly sophisticated and can rely on preselected persons or members of a restricted panel. The umpire frequently is required to be appointed by an international authority, such as the president or a senior judge of the International Court of Justice, the Chairman of the ICSID or ICC, the Secretary General of the U.N., etc. It does not have to be emphasized how important the predetermination of the umpire is for both sides. The side which does not reply to the request of the other to name an arbitrator may be "punished" by the creation of a "one-man" arbitration tribunal consisting only of the arbitrator appointed by the other side.

A number of disputes in mining agreements are of a technical nature and can only be resolved by the application of professional standards such as "sound engineering and mining", "generally accepted accounting principles", "fair market price", and so forth. The quick settlement of such disputes is especially important when the further implementation of the project depends on time schedules. Therefore, a number of agreements provide for the decision of a single expert, or that of an international consulting firm, to settle questions or issues of this kind.[78] Guidelines for such a decision may also be included in mining agreements. Thus, a

[78] See George R. Delaume, "Excuse for Non-Performance and *Force Majeure* in Economic Development Agreements", *Columbia Journal of Transnational Law*, 10 (1971), pp. 242 *et. seq.*, p. 261.

recent Southeast Asian agreement sets forth objectives to be considered by the expert deciding on the correctness of the feasibility report.[79] Special provisions may be stipulated to ensure an appropriate division of jurisdiction between legal arbitration and expert decision.

Provisions for arbitration by the ICC are rather frequent in mining agreements. The ICC provides for a panel of experienced arbitrators. Motivated to maintain the stability of contracts, ICC arbitrators are likely to incline towards upholding the original contractual terms, giving little recognition to claims for renegotiation. Most agreements today refer arbitrable disputes to the ICSID arbitration centre. The submission to ICSID creates an irrevocable international obligation that cannot be withdrawn unilaterally.[80] Another reason for the superiority of ICSID arbitration is the final nature of the arbitral award which cannot be reviewed by national courts and which is supposed to be sanctioned, without a formal basis, among others, by the World Bank's loan policy. Some developing nations, especially South American countries,[81] try to avoid any international arbitration commitments, viewing them as impositions on their sovereignty and requiring investors to submit exclusively to local courts and to waive any diplomatic protection ("Calvo-Doctrine").

Besides the choice of the arbitration forum, the contracting parties can stipulate various conditions and rules concerning the arbitration procedure and criteria (place, exemptions of jurisdiction, applicable law). As any host country will prefer complete national jurisdiction, it can reduce the impact of international arbitration by dividing the dispute settlement task between the arbitration tribunal and its state courts by exempting certain matters from the jurisdiction of the arbitration tribunal. Some agreements provide for exhaustion of local remedies before proceeding to arbitration. Others exempt matters of municipal law or, for example, tax matters from arbitration. Contracts may also provide for the jurisdiction of state courts in the issuance of execution awards.

[79] "In reaching his decision on any matter referred to him pursuant to Clause X the arbitrator shall judge the reasonableness of any decision of the State having regard to whether the proposals are based on sound mining and engineering practice, take reasonable account of the interests of the people of (the state) and of employees who will be working on the Project, include reasonable steps to protect the environment, are consistent with securing an equitable return on investment to the Company having regard to the risks associated with the Project and the efficient development and maintenance of the Project and are not inconsistent with the balanced development of the area, recognizing the limited present use of the area, the need for its development, the State's desire for the Project to proceed and be economically viable, and the effect the Project must necessarily have on the environment".

[80] Cf. John T. Schmidt, "Arbitration Under the Auspices of the ICSID: Implications of the Decision on Jurisdiction in Alcoa Minerals of Jamaica, Inc., vs. Government of Jamaica", *Harvard International Law Journal*, 17 (1976), pp. 90 *et. seq.*

[81] Cf. Roger C. Wesley, "The Procedural Malaise of Foreign Investment Disputes in Latin America: From Local Tribunals to Factfinding", *Law and Policy in International Business*, 7 (1975), pp. 813 *et. seq.*

Some investors may be ready to accept such a division of matters between the arbitration tribunal and state courts, provided that at least the decision on damages claimed for breach of contract after termination is left with the tribunal.[82]

The rules governing the arbitration proceedings may be drafted into the mining agreement or included by reference to standard arbitration rules, such as the ICSID, ICC and most recently the UNCITRAL rules. More important is the issue of what law should be applied by the arbitrators, and whether their decision-making power should be restrained to specified awards. Some investors may still successfully insist on a general reference to the laws of industrialized countries, e.g. England. The trend, however, is directed towards application of local law, sometimes provided that it is consistent with generally recognized legal principles or with international law. However, the stipulation of local law need not allow host countries to impose legislation having an impact on contractual terms, since some agreements include clauses to the effect that applicable law must be consistent with the agreement and contravening subsequent laws shall not be applicable.

Other current trends in mineral agreements—such as the requirement to give the party in default sufficient time to remedy the breach, or limits for the awarding of damages—place increasing restrictions on a tribunal's decision making power.[83] It may be advisable to refine the legal regime relating to damages, to stipulate possibilities to issue interim awards, or to order specific performances. Such provisions are likely to reduce risks and increase the predictability of decisions for the parties.

Trends in Dispute Settlement

The following points might be considered in future arbitration schemes:

— separation of issues into those which are arbitrable and those subject to renegotiation induced by legitimate interests;
— confining *ad hoc* arbitration to interpretative and technical disputes (international consultants as experts), preferably taking place in the host country;

[82] This position has actually been taken by an important U.S. investor during the negotiation of a Southeast Asian copper project.

[83] E.g. "If this Agreement is terminated pursuant to Section . . . on account of a material breach by Investor, then Investor shall pay to the other side . . . an amount in $-US equal to the aggregate fees that shall have been received by Investor under this Agreement during the 18-month period preceeding the date of termination." (. . . breach by the other side, it "shall pay to Investor all amounts due and unpaid under this Agreement, all Termination Costs, and an amount in $-US equal to the aggregate amount of the fees paid or due to Investor under this Agreement during the 18-month period preceding the date of termination".

"The parties shall be entitled to no remedies of any kind or type whatsoever (except as specified above) and to no damages of any kind or type whatsoever (except for amounts payable under the Section mentioned above) under this Agreement, with respect to the performance of this Agreement, or in any way relating to the Project, the Facilities or action or inaction of any member of the Staff of any employee of Investor or the other side."

— **reserving institutional arbitration** (third-party determination) for basic questions dealing with fundaments of the relationship (the "essence" of the investment relationship); and
— restricting the selection of umpires to a carefully composed panel of persons acceptable to both sides, preferable appointed by authorities of an international organization or host state institutions.

However important arbitration clauses might be, they should not entirely replace clauses dealing with regular renegotiation of general or specific provisions, or at least the commitment of the parties to attempt a conciliatory solution first.

An aspect of arbitration which has tended to promote renegotiation clauses is the experience that arbitration under traditional standards of industrialized countries tends to disfavour host countries.[84] Many agreements have been concluded by investors whose initial superiority in bargaining power has subsequently declined. They have consequently tended to stabilize their early advantages by the use of arbitration, while the arguments of host governments for changes are typically not based in the contract, but on new *de facto* conditions of a political or economic nature. This possible disadvantage of arbitration related to the contract as a whole ("big issues") affects the mode of settlement of interpretative and technical disputes ("small disputes"). One way to resolve this difficulty might be to provide for a distinct forum with agreed-upon procedures and criteria of contractual revision. Third-party determination of "small disputes" might be acceptable to both partners. The resolution of "big disputes", on the other hand, is likely to concern the host country's sovereignty over natural resources, as well as the investor's interest in a sufficient rate of return on his investment. The neutral examination of such vital interests is hardly likely to appeal to either party.

Renegotiation provisions are a recent development in the drafting of mining agreements.[85] Most contracts merely state the commitment of the parties to resolve disputes in "good faith" and in an amicable manner, and to attempt conciliatory arrangements before proceeding to arbitration.[86]

[84] The history of such arbitration shows that in most instances the awards did not favour the host country: Lena Goldfield's case, 1930; *Petroleum Development* v. *Ruler of Quatar*, 1951; *Ruler of Quatar* v. *International Marine Oil*, 1953; *Abu Dhabi* case, 1956; *Saudi Arabia* v. *Aramco*, 1958; *Sapphire International Petroleum* v. *NIOC*, 1963; *Jamaica* v. *Alcoa*, 1974; *Texaco Calasiatic* v. *Libya*, 1977; for other cases see Peter Fischer, *Die internationale Konzession*. Vienna; Springer, 1974, p. 437.

[85] Cf. Farer, (*op. cit.*) did not even mention such clauses, though he tried to establish minimum requirements for economic development agreements.

[86] Excerpt of a Central American agreement:
"The parties express their firm desire to examine, in the most objective and friendly spirit, all disputes which might arise between them in connection with this agreement, in order to settle such disputes. All disputes arising in connection with this agreement and which are not resolved in the above manner shall be finally settled by arbitration . . ."

As yet there are very few contracts with a clause that requires periodic review of the agreement or of specific provisions.[87] Given the tendency toward the regular amendment of agreements, mostly concerning fiscal provisions, it seems likely that in the future, agreements will include clauses requiring the periodic revision of the fiscal regime,[88] thus institutionalizing their instability and hence providing for a more general stability.

[87] Seven years in one draft concession; another draft agreement provides for a maximum revision period of 10 years.

[88] A similar suggestion is made by Raymond F. Mikesell, *Foreign Investment in Copper Mining*. Baltimore, Md.: Johns Hopkins Press, 1975, p. 33.