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Guide to Forestry Contracts

Understanding Key Provisions



DISCLAIMER

This Guide aims to assist the reader in unpacking the technical provisions and language typically found in forestry contracts in order to better understand these contracts and the potential implications of specific provisions across a range of stakeholder interests. The information contained within the Guide should not be construed or relied upon as legal advice. No warranty is made regarding the accuracy or completeness of any information contained within the Guide.

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ISLP: The International Senior Lawyers Project (ISLP) provides the pro bono services of highly skilled and experienced lawyers to promote human rights, equitable and sustainable economic development, and the rule of law worldwide. ISLP assists governments, non-governmental organizations, and other institutions working to build legal capacity and to advance the rights and well-being of their citizens.

CCSI: The Columbia Center on Sustainable Investment (CCSI), a joint center of Columbia Law School and the Earth Institute at Columbia University, is the only university-based applied research center and forum dedicated to the study, practice and discussion of sustainable international investment. CCSI's mission is to develop practical approaches for governments, investors, communities and other stakeholders to maximize the benefits of international investment for sustainable development.

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1. INTRODUCTION

1.1 Overview

Forestry is the management of forested land (either plantation or natural) with the primary goal of harvesting *timber* or other *forest products*¹ to meet human needs. Generally, commercial forestry managers are responsible for managing a forest to maintain a continuous supply of timber, through harvest and forest reestablishment, and to protect wildlife, watersheds, and environmentally sensitive areas from weeds, insects, diseases, erosion, and fire. Forestry management can implicate a wide range of actors, including government departments and agencies, small- to medium-sized private companies, large listed companies and institutional investors, and communities in and near the forests.

The commercial forestry industry can pose significant threats to water quality, land, and biodiversity if not properly managed. The challenge for all parties concerned with commercial forestry is to balance national and global needs for forest products with the need to sustain the forest's ability to produce those products and provide essential ecosystem services, like protecting water quality and supply. In addition, states have duties under international law to respect, protect, and fulfill the human rights of those within their territory and *jurisdiction*. This extends to forestry projects, the human rights impacts of which are increasingly subject to review and assessment.

Many nations have constitutions and laws that strive to balance these needs to achieve sustainable development of forest products. Obligations regarding an investor's use, management, restoration, and preservation of forests are also often further elaborated in forestry contracts, in which a government authorizes a commercial forestry company to harvest timber from forestland in exchange for payments and commitments to manage and restore the land. The purpose of this Guide is to familiarize those concerned with forests and sustainable development with these contracts, which are central to ensuring the sustainable management of forests.

1.2 Types of forestry contracts

Forestry contracts are usually between a government—or occasionally a private landowner—and a commercial forestry company. In some circumstances, government subdivisions, indigenous or other impacted communities, or not-for-profit organizations may also enter into separate agreements with one or both parties to the primary forestry contract, as further discussed in 2.9, *Social Obligations*, below.

There are two major types of forestry contracts, which are often at least partially combined in a single agreement:

¹ Certain key terms used in this Guide are italicized and bolded the first time they are used; these terms are defined in the Glossary at the end of the Guide.

- **Forest management/forest administration contracts:** agreements under which governments *buy* forest management and forest administration goods and services from an investor; and
- **Forest utilization contracts:** typically agreements under which governments *sell* rights to extract and utilize *forest resources* to an investor. These may include exploration contracts, which grant investors the right to explore forest potential, and timber sale or timber harvesting contracts, which grant investors the right to cut and remove timber. Forest utilization contracts can grant an investor varying degrees of land tenure rights, including:
 - “freehold” or “fee simple” ownership interests in the land and resources, meaning complete ownership of the land (the highest ownership interest possible);
 - **concessions**, or leases, over the land and resources, which grant certain temporary rights to possess the land and exploit its resources; or
 - licenses, permits, or *profits a prendre*² allowing access to the resources, meaning the investor has the right to take resources from the forestland, but not to assume possession (temporary or permanent) of that land.

This Guide focuses primarily on forest utilization contracts entered into by a government and a for-profit forestry company. These contracts are usually structured as concessions or leases (the second tenure category above), which typically grant the investor the right to harvest timber on the one hand while requiring it to manage the forest in a manner consistent with the government’s sustainable development goals on the other.

1.3 Fundamental issues in forestry contracts

According to the Food and Agriculture Organization of the United Nations (FAO), forestry contracts should address six key areas to be comprehensive:

- the project’s technical requirements, including the investor’s operational methods and required inputs and outputs;
- the investor’s obligations to respect the rights of, and provide benefits to, communities in or near the **contract area**;
- control mechanisms for the investor’s operations, including procedures permitting the government to monitor compliance with the contract’s terms;
- legal provisions governing the contract, including clauses dealing with boundaries of the contract area, grants of land tenure rights, dispute resolution, changes in laws, and termination of the contract;
- risk and financial requirements, which set out the deposit requirements and financial obligations of the parties; and
- an interpretation clause, which defines terms used and identifies applicable law governing the contract.³

² The right to take from another person’s land something that is part of the soil or is on the soil and is the property of the landowner.

Where these issues are not addressed, or where they are addressed in vague or incomplete terms, problems and disagreements between the parties—or with third party stakeholders, such as affected communities—may arise. Common problems include:

- a government’s failure to collect a “fair share” of the value of forest resources. This can arise due to a number of factors, including inaccurate appraisal of forest resources, poorly designed forest revenue systems, low forest fees, a lack of capacity to adequately collect fiscal revenues or resource fees associated with the project, and bribery and corruption of government officials;
- conflict over local and indigenous communities’ rights to ownership and/or use of forest resources and the land. When these rights are not clearly defined in the contract, there may be confusion and disagreement as to the nature of the rights and entitlements of the various stakeholders. In such cases, communities may be denied their legal right to resources from that land or the right to participate in the issuance, performance and monitoring of forest contracts, which is critical to meaningful engagement with impacted communities; and
- non-compliance with contract terms by the parties, often resulting from inadequate monitoring and government enforcement. Contract violations may lead to degradation of the forest, irreversible environmental damage, loss of biodiversity, loss of forest revenues, and loss of or degradation of the traditional lands of indigenous or other affected communities.

Forestry contracts often include detailed language concerning the respective rights and obligations of all parties. However, for those who are not accustomed to working with forestry contracts, this language may at first glance be difficult to understand. With that in mind, this Guide aims to assist the reader in unpacking the technical provisions and language typically found in forestry contracts in order to better understand these contracts and the potential implications of specific provisions across a range of stakeholder interests.

2. KEY PROVISIONS IN FORESTRY CONTRACTS

This section broadly summarizes and explains the key terms common to commercial forestry contracts. When reviewing any contract, it is essential to consider the language used in these provisions and to assess whether that language provides clarity and context to the contract. It is also important to consider what important terms may have been omitted or only described generally, and the possible consequences of that omission or brevity. For instance, a contract that defines the contract area only in numerical terms (e.g., an approximate amount of hectares within a forest)—and not with precise geographic coordinates—may result in confusion and conflict over the exact boundaries of the land to which rights have been granted.

Another key consideration when reviewing any contract is the contract’s compliance with applicable law. Forestry contracts are generally subject to domestic law, i.e., the constitutional

³ Food and Agriculture Organization of the United Nations et al., *Governance Principles for Concessions and Contracts in Public Forests*, at 56–57 (Dec. 30, 2003), available at <http://www.fao.org/docrep/019/y1398e/y1398e.pdf>.

norms, laws, and regulations of the host State. Ideally, all contract provisions should be reviewed for conformity with such law before the contract is finalized.⁴ This review may also extend to applicable international law—this is particularly important where the forestry contract concerns indigenous lands or protected areas.

2.1 Parties

The *parties* to a contract are the *legal persons* who sign (or *execute*) the contract. By signing the contract, each party agrees to assume certain rights and obligations as described in the contract's terms. In forestry contracts involving public forests (which are the primary focus of this Guide), one party to the contract will be the national government (often represented by a Minister or senior civil/public servant) and the other party typically will be a private sector corporation that wishes to exploit forest resources for value. Throughout this Guide, we will refer to the government party as the 'Government' and the corporate party as the 'Investor.' Of course, in view of the rights granted, it may be that the 'Investor' is referred to as 'Lessee,' 'Tenant,' 'Licensee,' 'Contractor,' 'Concessionaire,' or even 'Grantee.' Though the labels can be diverse, what is important are the rights granted to, and the obligations imposed on, that party.

2.2 Term

Forestry is often a long-term venture, governed by the amount of time it takes to grow an economic product. The term of a forestry contract (that is, the amount of time that the contract will be operative) will depend largely on the particular circumstances applicable to the forestry operation, the outcomes sought, and economic considerations that need to be considered in light of the obligations imposed on the Investor. For instance, in many forestry contracts, the Investor is responsible for ensuring that the forest will grow back after exploitation (reestablishment). Accordingly, the parties may negotiate a contract term that will provide the Investor sufficient time to generate post-harvest revenues and apply a portion of those revenues toward reestablishment.

The initial term of a forestry contract will typically begin on the contract's *effective date*, which may be the date the contract is signed, or, in the alternative, the date that the parties meet certain negotiated conditions to the contract's effectiveness (the *conditions precedent*). The term will then run for the length of time specified in the contract, unless one or both parties to the contract terminate the agreement as permitted by the contract's termination clause (as described in Section 2.18, *Termination*). Often, forestry contracts will also include provisions permitting a renewal or extension of the term if certain conditions or performance benchmarks are achieved by the Investor, such as targets for timber yields, labor productivity, local wages and salaries, and environmental management.

⁴ The State is also bound to its obligations under international law, e.g., under relevant investment and trade treaties and human rights instruments.

For contracts with a term of ten years or more, the FAO recommends including contract provisions that deal with long-term planning and sustainable development and management of forest resources.⁵ These could include:

- a long-term *forest management plan* and a long-term timber supply plan (which will ideally cover operations, forest management, and forest renewal for the contract area);
- clauses allowing for flexibility, such as:
 - o amendment of the contract due to changed circumstances since the time of signing;
 - o modification of the contract to bring it into line with updated resource and environmental standards;
 - o modification of the contract area; and
 - o variation of the methods by which stumpage fees, area fees, and other *levies* are determined; and
- clauses dealing with forest reestablishment, which ideally will be subject to a forest management and environmental management review.⁶

Contracts with shorter terms will often be much simpler, relying on general requirements for development and management of forest resources under existing domestic law.

2.3 Contract area

The contract area is the land delineated for use under the forestry contract. As the scope of the contract area may affect a variety of stakeholders, it is important that the boundaries of the contract area are recorded and made publicly available. Parties may also consider publicizing information about the contract area in terms easily understood by affected communities—for example, by describing the contract area in terms of geographic markers or using the coordinates to prepare a map of the contract area for the benefit of local people. Parties often supplement these descriptions with the precise geographic coordinates in order to avoid any disputes arising due to vague understandings of the contract area boundaries. In some contracts, the boundaries of the contract area are described in an appendix or additional document; noting the existence of these documents in the forestry contract itself can help to minimize disagreements regarding the bounds of the contract area.⁷

2.4 Rights granted and obligations imposed

The “grant of rights” section in forestry contracts sets out the rights of the Investor to access and use the forestland. The Investor’s rights may be divided into “base rights” and “incidental rights.”

“Base rights” are those rights that are central to the operation of the contract, and will typically include rights to enter and use the contract area and to undertake the forestry operation. Details

⁵ *Id.* at 67.

⁶ *Id.*

⁷ Environmental Law Alliance Worldwide, *Natural Resource Contracts: A Practical Guide*, 2013, at 6.

of the resources that may be harvested will also be described here, including their species, size, and location.

“Incidental rights” are those rights that are necessary for, but not central to, the operation of the forestry project. Examples of incidental rights include rights of construction, maintenance, and repair of the infrastructure necessary for the forestry operation, transportation of goods required for the forestry operation in and out of the contract area, and rights to use specified resources (for example, water, clay, and stones) found in the contract area during the forestry operation.

This section of the contract may also impose obligations on the Investor to manage and properly maintain the contract area, including reestablishment obligations. In addition, the Government will usually reserve a right to enter the contract area from time to time to inspect the Investor’s activities (including the activities of any sub-investors). Such a clause will typically allow the Government to ensure the Investor is complying with its obligations under the contract, as well as all applicable laws and regulations, and to review the Investor’s records and documents, including production records and other operational information.

Often, persons other than the parties to the forestry contract (for example, indigenous peoples, local communities, and other users holding licenses for resources located within the contract area) may have preexisting rights over the contract area. Those rights can be acknowledged or reserved in the grant of rights section. For example, the contract may specify that persons inhabiting the contract area have the right to remain there, or it may grant them the right during the term to continue accessing forest resources that are necessary to maintain their culture and livelihood. If this is the case, then the contract should address related issues, such as community engagement, compensation for resettlement or restricted access to designated forest areas, and procedures and mechanisms for resolving local disputes. For a more detailed discussion regarding these issues, see Section 2.9, *Social Obligations*.

A “rights withheld” clause may also be used to specify restrictions on the Investor’s rights. For example, a rights withheld clause can prohibit the harvesting of a particular species or quality of timber, or restrict an Investor’s access to environmentally sensitive or protected areas of forest.

2.5 Security

Typically, a forestry contract will require that the Investor provide a security deposit to the Government to secure the Investor’s performance of its obligations under the contract. If the Investor fails to make a required payment or otherwise meet its obligations under the contract, the Government may have the right to deduct an amount equivalent to the missed payment or the amount the government has to expend to address the Investor’s failure to perform, such as the cost of required environmental cleanup in circumstances where the Investor fails to meet required pollution controls.⁸ Determining the appropriate amount of security that an Investor must provide to the Government and potentially to local communities therefore requires careful consideration. The financial standing of the Investor, and the risk that the Investor may not be

⁸ *Governance Principles for Concessions and Contracts in Public Forests* supra note 3, at 77–87.

around to complete financially burdensome obligations, such as reestablishment, should also be taken into account.

2.6 Forest levies

Determining the appropriate amounts that the Investor must pay in exchange for the rights granted and resources exploited under a forestry contract is a difficult exercise. The FAO suggests that two analyses be undertaken, preferably by an independent Investor:

- an economic analysis, comparing the benefits and disadvantages of the proposed use of the forest (from a social utility perspective) and attempting to place a corresponding monetary value on the contract. This analysis often addresses any issues that may arise for local and indigenous communities; and
- a financial analysis, which is concerned with monetary flows from the proposed use of the forest and is used to estimate the commercial value of the contract (from the perspective of an interested party).⁹

The amounts paid by the Investor can be referred to in the contract as “forest levies,” which may include (or be referred to as) royalties, stumpage, rent, tax, revenues, and other fees.

Levies are normally charged based on the volume of timber harvested, or per area of forest, or a combination of both.

Types of levies based on volume include:

- Stumpage fees – these fees are charged on either a volume or per tree basis. Volume-based stumpage is usually used because prices can be varied based on characteristics that determine the value of the timber (for example, species, quality, and location). Per tree stumpage is rarely used because it does not always reflect the true value of the timber. It is most appropriate where there are difficulties with *log* measurement or where simplicity of administration is required.
- Forest fees – these fees may be levied based on volumes of processed forest products (such as sawn wood or plywood).
- Export taxes – these fees are levied based on the volume of logs or number of processed forest products exported. In some cases, export taxes are used in place of other forest levies (for example, in some countries export taxes are charged in place of stumpage). Export taxes may also be used to encourage domestic processing of forest products.

Types of levies based on forest area include:

- Initial license fees – these fees must be paid by the Investor when the Government agrees to enter into the contract. Occasionally, they may be imposed as a fixed fee; however, more commonly the fee will be area-based, based on the total contract area. In most countries, initial license fees on long-term contracts are minimal in relation to native

⁹ *Governance Principles for Concessions and Contracts in Public Forests* supra note 3, at 77–87.

forests, which require no upfront establishment costs, since the forest has grown naturally without financial investment. It is more common for a payment to be made in relation to plantations where real costs were incurred in establishing the resource.

- Annual area-based fees (or rent) – these fees may be used to encourage more efficient and intensive use of the forest and to improve the ways in which forestry operations are conducted.
- Annual allowable cut fees – these fees are based on the allowable annual cut; they are sometimes used as an alternative to annual area-based fees. For example, a Government may impose a fee on a 200,000-hectare timber concession that is equal to \$1 per hectare per year but at the same time require a minimum rotation period of 20 years and demand a sustainable forest management plan. Thus, in any particular year only 5% of the contract area, i.e., 10,000 hectares, can be harvested, resulting in a maximum fee of \$10,000 for that year. These fees may better reflect the value of the contract and better ensure security of the timber supply because they limit the Investor’s ability to extract only the most valuable woods. However, they can be more complex to implement because the annual allowable cut needs to be calculated beforehand and controls to ensure compliance must be in place.

In addition to the above levies, contracts may stipulate minimum fees (based on area, volume, or both). Additionally, other taxes may apply to the forest contracts (for example, property taxes or sales tax). Annual fees set without regard to actual use or production are often included to discourage “banking” the concession without using the forestland in a manner that would generate income or other fees.

Close consideration of the fees and stumpage rates paid for logging activities is essential to achieving desired sustainability outcomes. For instance, the 2000 IFC report reviewing the implementation of the IFC’s 1991 Forest Strategy noted that over half of IFC’s projects approved between 1991 and 1998 were in State-owned forests, and the stumpage paid in some of the cases studied was lower than the real cost of managing the forests sustainably.¹⁰ Accordingly, the fee and stumpage schemes established financial disincentives for private concessionaires to adopt the more costly option of sustainable forest management.

2.7 Representations, warranties, and covenants

Most contracts involving interests in land will contain a section (or sections) dedicated to representations, warranties, and covenants. *Representations* are statements of fact made by one party on a specific date (often the effective date) to convince the other party to enter into the contract. The party making the representation will then often *warrant*—or *guarantee*—by way of a contractual term that the representation made is true. If it is later realized that the representation made was not true on the date it was made, then the party who made the representation will be in *breach* of the contract—meaning that they have not fulfilled their end of the deal—and the other party will have a right to claim damages, such as money.

¹⁰ *OEG Review – Implementation of the 1991 Forest Strategy in IFC’s Projects, Operational Evaluation Group supra* note 2, at 2.

In contracts relating to land, the party granting the interest in the land may not want to make any representations or warranties, and will prefer to grant the interest in the land on an “as is” basis—that is, without warranty. Conversely, the party obtaining the interest in land will want to have as many reassurances as possible—by way of representations and warranties from the other party—so that they are aware of all relevant risks regarding the land. There are numerous examples of contractual arrangements in which one party pays for land rights only to subsequently learn that the other party did not have the authority to grant such rights (particularly in countries with non-transparent land regimes). To avoid this concern, the Investor may require the Government to be transparent in its representations and warranties about all prior and co-existing claims to the land and resources that are the subject of the forestry contract. Doing so may help the Investor avoid future conflicts with local communities or others who have rights to the land and resources and in turn better safeguard its investment.

In land contracts, representations and warranties are generally designed to cover three separate and distinct areas:

- the status of the parties, and the authority of the party granting land rights;
- the status of the land (and any relevant property); and
- the operation and maintenance of any relevant property.

Some common representations and warranties that may be given in forestry contracts include:

- that the Government owns the contract area free of any *burdens* (meaning that there are no competing claims to all or any part of the contract area that would obstruct or prevent the investor from exercising its rights to the contract area);¹¹
- that the Investor is a duly organized and validly existing corporation under the ***governing laws*** of the relevant jurisdiction;
- that the Investor has the necessary corporate power and authority to conduct its business and fulfill its obligations under the contract;
- that the Investor has no litigation or proceeding pending against it or affecting it or any of its property;
- that the Investor has the necessary technical capabilities and financial resources to perform its obligations under the contract; and
- that the Investor has no obligations under other contracts, laws and regulations, or court rulings that might present a conflict that would prevent it from performing the contract.

In addition to representation and warranties, a contract will typically include *covenants* (or *undertakings*) from each party, which are promises one party makes to another about activities that it will undertake or avoid during the term of the contract. Covenants can be distinguished from representations and warranties in that, while representations and warranties are made as of

¹¹ It is important to note that local communities may disagree with the Government’s characterization of the land as free from any burdens. This may result in conflict between the communities and the Investor and/or Government, which may impede progress on the forestry project. The importance of community consultation and consent are explored further in Section 2.9.1, *Consultation and Free, Prior and Informed Consent (FPIC)*.

a specific date, covenants are forward-looking and relate to future performance. Typical covenants might include:

- that (subject to other clauses of the contract) the Government will not exploit or permit another person to exploit the contract area for commercial purposes;
- that the Government will not grant licenses to any third parties to operate competing businesses within a certain distance of the contract area; and
- that the Investor will conduct all of its operations in compliance with all applicable laws and prudent business practice.

It is important to note that some covenants may be articulated alongside representations and warranties, while other covenants—e.g., the Investor’s environmental obligations vis-à-vis its forestry operations—will be embedded throughout the document.

2.8 Environmental obligations

Pollution prevention, regeneration, watercourse protection, and waste management requirements are often addressed in detail in domestic laws and in a forest management plan. Forest management plans are standard requirements in forestry contracts, usually subject to local government approval and domestic laws and regulations. In some instances, forestry contracts lacking environmental protections are signed well before a required forest management plan is devised; however, Governments interested in proactively addressing environmental obligations may choose to negotiate environmental obligations into the forestry contract or require that a tentative forest management plan be presented before the contract is signed. Where environmental standards and benchmarks are not robustly addressed under domestic law, detailed environmental obligations may be included in the forestry contract, a forestry management plan, or other associated documents to help preserve the contract area’s environmental integrity.

2.8.1 Environmental and social impact assessments

Environmental Impact Assessment (EIA) is a systematic process undertaken to examine and evaluate the potential environmental effects and impacts of a proposed project or activity. In some situations, parties may also be required to undertake Social Impact Assessments (SIAs) to review the potential social impacts (such as relocation, disruption of livelihoods, and impacts on culture) of relevant projects. In combination with EIA, these assessments are commonly known as Environmental and Social Impact Assessments (**ESIAs**).¹²

The object of EIAs is to identify potential environmental impacts and how to mitigate them. In many jurisdictions, EIAs are required by laws, government policies, or treaty law to ensure that decision-makers are informed about—and consider the environmental impacts and predicted outcomes of—a proposed project and what will be done to manage any adverse environmental

¹² Stakeholders may also carry out a Human Rights Impact Assessment (**HRIA**) to examine the project’s potential human rights impacts on community members and individuals. The potential human rights and social impacts of forestry projects are addressed in greater detail in Section 2.9, *Social Obligations*.

effects. EIAs are also recognized as an important sustainability tool in international law. For example, they are referenced in the Rio Declaration, an influential, albeit non-binding international agreement, which was adopted at the 1992 UN Earth Summit to promote global sustainable development. Principle 17 of the Rio Declaration states:

*Environmental Impact Assessment, as a national instrument, shall be undertaken for proposed activities that are likely to have a significant adverse impact on the environment and are subject to a decision of a competent national authority.*¹³

Forestry contracts often include an EIA clause to ensure that project development does not take place without first undertaking an appropriate assessment. EIAs may also be voluntarily commissioned, especially where the Investor has agreed to obtain a forest certification, such as from the Forest Stewardship Council. Local communities should be able to gain access to EIAs, even if public disclosure is not explicitly referenced in the contract, if domestic **legislation** requires such disclosure.

Other contributing stakeholders—including development finance institutions and institutional investors—may also require assessments to be carried out. For example, the International Finance Corporation (**IFC**) imposes quasi-regulation on prospective clients that are seeking IFC funding for their development projects. Prior to project review and approval by the IFC Board of Directors, an IFC investment team communicates with the client and other project stakeholders, travels to the project site, and analyzes potential social and environmental risks associated with the project to assess whether the project complies with IFC ESIA requirements. This is part of an IFC appraisal and due diligence phase for all prospective clients.¹⁴

2.8.2 Watercourse protection and waste management

In general, the term “watercourse” is used broadly, and can mean any level of the system of surface and groundwater channels, tributaries, and the water they contain. Components of freshwater systems that fall under this concept include rivers, lakes, aquifers, glaciers, reservoirs, canals, wetlands, and floodplains. There are forests that occur naturally in a wide range of ecosystems, with a varying amount of water, from estuaries and swamps to wetlands, aquifers, and most commonly, rivers. Forested areas are often in the upper reaches of water catchments and can be an important source of clean water for communities.

Pollution constitutes a major challenge for the world’s watercourses. The United Nations Environment Programme (UNEP) estimates that every day millions of tons of inadequately treated sewage and industrial and agricultural wastes enter the world’s water sources, resulting in

¹³ United Nations Conference on Environment and Development, Rio de Janeiro, Braz. June 3-14, 1992, *Rio Declaration on Environment and Development*, U.N. Doc. A/CONF.151/26/Rev.1 (Vol. I), Annex I (Aug. 12, 1992).

¹⁴ IFC Projects Database, IFC Project Cycle, http://www.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/ifc+projects+databas e/projects/aips+added+value/project+cycle (last visited October 1, 2015).

negative impacts on human health, food production, and the environment.¹⁵ In the forestry context, one of the most significant environmental impacts that can arise is the degradation of land and water resulting from the removal of forest cover, which can cause significant erosion and result in deposit of soils in watercourses. Given the substantial adverse impacts that degraded watercourses may have on the communities and ecosystems that depend on them, parties to forestry contracts need to take appropriate and necessary measures—during both the negotiation and implementation of a contract—to ensure that Investors are mitigating potential harms wherever possible. When negotiating the provisions governing an Investor’s obligations to protect watercourses (which will often be addressed in detail in a forest management plan), the parties may look to international best practice for guidance on how to protect the health of local populations and ensure that forestry activities do not obstruct or impede the proper flow of watercourses.

Waste management is the practice of supervising and monitoring waste disposal, which is inextricably linked with watercourse protection. It is a critical concern in the forestry context, where heavy equipment with fuel and hydraulic oils are present, and other waste issues arise from tires, oil drums, and discarded parts. In many jurisdictions the emission of waste into the environment, and the transport and disposal of waste, is governed by specific legislation; however, parties to a forestry contract may negotiate more detailed waste management requirements that are tailored to the specific project. Detailed waste management provisions may be incorporated in the forest management plan, although parties may also include particularly significant elements in the forestry contract itself. Considerations include avoidance of unnecessary resource consumption, resource recovery (including reuse, reprocessing, recycling, and energy recovery), as well as treatment, containment, and disposal.

Where operations associated with a concession or lease may affect watercourses that are shared with other States, the forestry contract may include an obligation to comply with any watercourse agreements that exist between the neighboring governments. Such agreements may require early notification of any proposed project that may impact those watercourses.

2.8.3 Pollution prevention and restriction on use of certain chemicals

Pollution is the contamination of air, soil, or water by the discharge of harmful substances and includes anything that may cause a detrimental change in the quality of the surrounding environment, affect the safety or health of human beings, or harm wildlife. Pollution prevention is the reduction or elimination of pollution at the source; a fundamental way to accomplish this is by utilizing raw materials and resources more efficiently. In addition to any pollution prevention measures required by law, the parties may negotiate pollution controls tailored to the specific project into the relevant forestry contract and/or forest management plan.

Pollution control in forestry activities is especially important where chemicals are used. While fewer chemicals will be used over the rotation time of a forest than in that of an agricultural area, a single application in forestry activities is likely to be much more significant than a single application in agriculture. Pollution control mechanisms may thus be negotiated with an eye

¹⁵U.N. Env'tl. Programme and Pacific Institute, *Clearly the Waters – A focus on water quality solutions*, at 7 (Mar., 2010), available at http://www.unep.org/PDF/Clearing_the_Waters.pdf.

toward minimizing the risk associated with chemical use. For instance, where particular pesticides are of great concern, it may be prudent to negotiate limits on permitted use levels or, in the alternative, total prohibitions on their use.

Pollution control mechanisms may also seek to minimize the risk of fire and consequent haze, both of which can have devastating health and livelihood impacts on those living in and near the contract area. Furthermore, haze pollution can have significant transboundary impacts, affecting air quality in neighboring States. Accordingly, in addition to any pollution control mechanisms set forth in the contract, the parties may be required to adhere to pollution contract standards mandated by relevant international law, including bilateral and multilateral treaties and regional agreements, such as the ASEAN Agreement on Transboundary Haze Pollution.¹⁶

Adopting pollution prevention practices and techniques at the project level can benefit industry by lowering operational and environmental compliance costs, preventing and reducing waste, and reducing long-term liabilities and cleanup costs. Given the importance of pollution controls, parties may choose to negotiate these at the contract stage rather than agreeing on controls in the forest management plan at a later date.

2.8.4 Regeneration

For communities heavily reliant on land, human well-being and sustainable livelihoods are dependent upon the health and productivity of the land. From a development perspective, productive land and fertile soil are important geo-resources and natural capital assets that need to be protected to ensure long-term (intergenerational) productivity. Permanent deforestation and loss of native vegetation can have substantial direct and indirect effects on the community livelihoods as well as the environment.

For these reasons, forestry contracts may set out each party's obligations regarding the condition in which the land should be returned and the standard of regrowth required. Despite ongoing replanting and other progressive regeneration obligations, there will likely be substantial regeneration necessary towards the end or after a contract's term, at a time when cash flows may be insufficient to fund those obligations. Further, due to the nature of forestry, the effectiveness of any regeneration program will often not be capable of being gauged for several years. Accordingly, some forestry contracts provide for the establishment of a regeneration fund, or require the Investor to provide a bond, an evergreen letter of credit, or a similar security instrument to ensure that sufficient funds will be available to finance the regeneration process.

2.8.5 Required infrastructure

Forestry contracts may include clauses that require the Government to provide the Investor with access to certain infrastructure that is necessary to the Investor's forestry operations, such as roads, rails, or ports (particularly for export of round logs or timber). Alternatively, the Government may require the Investor to build needed infrastructure, such as roads needed to

¹⁶ The ASEAN Agreement on Transboundary Haze Pollution, signed June 10, 2002 (entered into force Nov. 25, 2003).

transport timber from the forestland, or to use existing local infrastructure in its operations, as a means of promoting the local realization of the benefits from investment in forestry and timber extraction projects. For example, a forestry contract may specify that logs may only be transported to port via an existing rail line, or that only local haulage companies may be used. Obligations to provide, build, or use infrastructure ideally will be carefully scrutinized and financially modeled to ensure a net benefit to the parties and local communities.

Infrastructure that is built to accommodate a specific forestry project may need to be removed and rehabilitated after contract completion, or it may be desirable to leave roads, power lines, and other new infrastructure in place for community use after exploitation. A thorough forest management plan will often address this issue, and ideally will be developed in consultation with local communities.

2.9 Social Obligations

At a minimum, States party to a forestry contract are obligated to respect relevant international law norms and domestic legislation relating to the human rights of project-affected communities and individuals, although these obligations will often not be explicitly referenced in a contract. Generally speaking, this includes requirements that the Government guarantee the physical security, liberty, and equal treatment of the population,¹⁷ and that it ensure that the rights of project-affected communities and individuals to health, education, decent work, an adequate standard of living, and to participate in cultural life are all met.¹⁸ Pursuant to the UN Guiding Principles on Business and Human Rights, Investors should also take effective steps to respect the rights of project-affected communities and individuals.¹⁹ An investor may also be bound by certain international standards to which it has agreed, such as the UN Global Compact, which sets forth principles in the areas of human rights, labor, environment, and anti-corruption for participating businesses.²⁰

In some contracts, the parties may elect to elaborate further on the respective social obligations of the Government and the Investor. Contracts may address aspects of the forestry project for which binding legal obligations do exist—such as resettlement—or aspects for which there is often no binding or clearly articulated legal standard, such as community consultation and consent, local employment and procurement, and other Investor activities that typically fall under the banner of corporate social responsibility (CSR). Investors often agree to such obligations in order to minimize the risk of public dissatisfaction and unrest in the communities in which they operate. Some of the most common social obligations addressed in forestry contracts are explored below.

¹⁷ International Covenant on Civil and Political Rights (ICCPR). G.A. Res. 2200A (XXI), 999 U.N.T.S. 171, (Dec. 16, 1966) (entered into force Mar. 23, 1976).

¹⁸ International Covenant on Economic, Social and Cultural Rights (ICESCR), G.A. Res. 2200A (XXI) (Dec. 16, 1966) (entered into force Jan. 3, 1976).

¹⁹ United Nations Office of the High Commissioner for Human Rights, *United Nations Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect, and Remedy” Framework*, HR/PUB/11/04, 2011 at 13-16.

²⁰ United Nations Global Compact, *The Ten Principles*, available at <https://www.unglobalcompact.org/what-is-gc/mission/principles>.

2.9.1 Consultation and “free, prior and informed consent” (FPIC)

All stakeholders stand to benefit from consultation with communities that will potentially be affected by the forestry project. Parties can broaden the information base upon which planning decisions are made, implemented, and evaluated, and consultation may allow local communities to retain their traditional connection to the land and continue to be involved in its management. Specific consultation practices vary from jurisdiction to jurisdiction, with some jurisdictions going so far as to legally require the government and/or investors to consult with local communities when their actions threaten to interfere with local lands, livelihoods, and traditional practices.²¹ For guidance on consultation practices, parties may look to the Rio Declaration Principle 10, which suggests that decisions impacting the environment be made with the participation of all concerned citizens, and that each individual should have appropriate access to information concerning the environment that is held by public authorities.²²

Consultation is even more critical where the forestland is situated on the ancestral lands of indigenous or tribal peoples protected under international law. In these situations, the principle of “free, prior and informed consent” (FPIC) may also apply. FPIC states that a project-affected indigenous or tribal community has the right to be consulted regarding proposed projects that may affect the lands the community customarily owns, occupies, or otherwise uses. It requires that parties undertaking activities affecting such lands ensure that:

- consultation with the community has been carried out in *good faith* and sufficiently *prior* to the commencement of the project;
- the community has been provided all relevant *information* about the proposed project; and
- the community’s *consent* has been obtained in a manner that is *free* from undue pressure or influence.

The obligation to obtain the FPIC of indigenous and tribal communities is included in the International Labour Organization’s *No. 169 Indigenous and Tribal Peoples Convention (1989)* (ILO 169), which is an international instrument that is binding on signatory States. The principle is also articulated in the United Nations Declaration on the Rights of Indigenous Peoples (2007) (UNDRIP). UNDRIP is a resolution of the United Nations General Assembly and is not in itself a binding document; it is, however, regarded as containing many best practice standards with regards to community engagement. The principle is also enshrined in the International Finance Corporation (IFC) Performance Standards on Environmental and Social Sustainability (2012), which sets out requirements for private actors wishing to receive IFC support. While these international instruments are somewhat limited in scope, they nonetheless demonstrate a growing global recognition of the importance of community consultation and consent.²³

²¹See e.g. *Haida Nation v. B.C. (Minister of Forests)*, (2004) SCC 73, 3 S.C.R. 511, at para. 35 (Can.).

²²*Rio Declaration on Environment and Development supra note 13*, at Principle 10.

²³Observers increasingly tend to view the distinction between indigenous and non-indigenous groups as arbitrary—and accordingly, are moving for FPIC to be applied more broadly.

When incorporating these principles into forestry contracts, the relevant provisions may benefit from clear and specific language concerning the scope of consultation. This language ideally would require that communities are engaged early in the project planning process and enjoy ongoing participation, active engagement, and the opportunity to contribute local knowledge and expertise throughout the life of the project. In practice, however, contracts that do make reference to consultation and consent often do so in vague terms, and only occasionally refer the reader to a separately negotiated agreement with the community that may clarify the scope of consultation. These side agreements are identified here as “community agreements” and are addressed in greater detail in Section 2.9.5, *Agreements with local communities*.

2.9.2 Resettlement

Forestry operations that displace communities involuntarily can have significant adverse effects upon affected indigenous and non-indigenous communities alike. Communities may lose access to income-generating land and resources or much-needed water reserves, and even short- to medium-term resettlement may be long enough for traditional and cultural practices to be eroded or lost altogether. To protect against these harms, most jurisdictions have in place domestic legislation that prohibits land confiscation without due process and/or adequate compensation. With respect to indigenous populations, international law provides additional protection through ILO 169, which stipulates that “the peoples concerned shall not be removed from the lands which they occupy” except (1) where “necessary as an exceptional measure” and (2) with FPIC, or if FPIC cannot be obtained, following procedures established by relevant national law.²⁴

Historically, forestry contracts were usually negotiated between Governments and Investors with little regard to potential displacement. This was particularly true in cases where the affected land was communally held (that is, land which is often considered to be “held in trust” for the community by the Government) or utilized only during some parts of the year by nomadic or pastoral communities. In recent years, however, there has been a growing recognition of the need to protect project-affected communities against forced eviction or resettlement. Accordingly, forestry contracts may include a firm commitment to reduce or minimize displacement and resettlement, and alternatives should be considered before decisions to displace or resettle are made.

2.9.3 Local employment and local procurement

Two of the more common social obligations found in forestry contracts are local employment and local procurement provisions. Local employment and procurement offer the potential to act as significant vehicles for sustainable local development. Further economic benefits may also arise when the Investor conducts value-adding processes to timber and forest products (such as processing and cutting) locally rather than exporting them raw. However, the potential opportunities that local employment and procurement offer are often not entirely realized. A limiting factor can be the sophistication of technologies used in large-scale investments, which may require skills that the local workforce does not have. A developer’s ability to procure goods

²⁴C169 Indigenous and Tribal Peoples Convention (June 27, 1989),ILO Convention 169, Art. 16, (entered into force Sept. 5 1991).

and services from local businesses may also be impeded by weak infrastructure and the limited capacity of the local economy.

In light of these factors, there is currently no international obligation for forestry contracts to ensure the employment of the local workforce, nor are developers obligated to source required goods and services locally. Indeed, local employment and procurement requirements may risk running afoul of any international obligations not to give preference to domestic businesses over foreign ones. Nonetheless, some contracts do impose obligations on Investors to provide specialized training for local employees, or to source goods and services locally where possible, in order to address the issue and provide for the technical development of local communities. To that end, forestry contracts often include quota requirements—stating, for instance, that a percentage of positions at a given skill level must be filled by locals, or that a percentage of goods and services required by the developer must be supplied by local businesses. The definition of “local,” however, can be a matter of debate; unless the contract contains a clear definition of which persons are to be considered “local”, it may be unclear whether members of project-affected communities should receive the benefits of local employment and procurement provisions, or whether individuals who are merely citizens of the host country would also be included.

2.9.4 Other social obligations

Some forestry contracts include further obligations to the community on the part of the developer in addition to local employment and procurement. These may include requirements that the Investor provide certain goods or services to the community (such as health care, education, infrastructure, skills training, and access to food and improved water sources); that the Investor consult with and obtain the consent of the affected community (as discussed in 2.9.1, *Consultation and “free, prior and informed consent” (FPIC)*); and that the Investor design and implement a grievance mechanism to address community complaints related to the project.

In addition to being included as Investor obligations in the forestry contract, these obligations may arise from the Investor’s own internal corporate social responsibility (CSR) policy or from negotiations with the affected community. Regardless of the source, by undertaking these additional social obligations to affected communities, Investors and Governments can realize certain advantages. For example, providing these additional benefits and mechanisms for engagement can help the Investor engender trust and goodwill in the community, thus facilitating smooth operations at the project level and preventing unrest that may disrupt development. These benefits can also help to support poorer host States that struggle to provide important services, provided that they are limited to services that the Investor is well placed to provide, and that they do not result in the Investor replacing the State as the primary provider of social services. Best practice favors designing benefit plans that are sustainable—for instance, by ensuring that schools or health clinics will continue to be staffed and supplied in the Investor’s absence, or by ensuring that clean water access points are self-sustaining.

2.9.5 Agreements with local communities

When a forestry contract requires an Investor to undertake social obligations and/or commitments to potentially impacted communities, these are often further elaborated in enforceable side agreements between the affected communities and the Investor. Such agreements go by various names, including memoranda of understanding (MOUs), community development agreements (CDAs), community benefits agreements (CBAs), and community development plans.

Typically, these agreements will cover a range of matters, including compensation for lost land, loss of income, and property damage; commitments to train and hire locally; CSR commitments; joint oversight committees; and consultation and grievance mechanisms. In some cases, community agreements may also provide for royalties or other profits to accrue to the community (often in the form of a community development fund). These revenue-sharing schemes may be tied to the project's profits; however, it is preferable for them to be tied to total revenue, thus ensuring a steady stream of benefits for the community.

2.10 Monitoring and audits

A process of monitoring an Investor's performance to ensure that it is complying with its contractual obligations and other applicable law is necessary for the success of any large-scale project, including forestry projects. There are various levels of monitoring, from internal reviews and self-reporting to legislated regimes. Obligations of parties to conduct monitoring are generally audited by an independent body to ensure objective assessment of the Investor's compliance with the contract's terms and to ensure that the interests of all stakeholders are taken into account.

Persons charged with monitoring an Investor's performance may be required to assess compliance with obligations that are principle-based—that is, based on general, loosely defined principles (e.g., that “appropriate” steps be taken to minimize environmental damage)—or prescriptive—that is, obligations that set forth detailed standards and compliance benchmarks. In some jurisdictions, these obligations may already be prescribed by law. Where no clear compliance benchmarks exist under local law, an Investor's obligations will ideally be drafted to include suitable standards to ensure that compliance can be effectively monitored.

Local community involvement in the monitoring process can greatly increase effectiveness by adding resources to stretched government capacity and by building community trust in the forestry operation.

2.11 Tax

Forestry taxes serve a purpose that is distinct from the rationale behind traditional taxation schemes. Taxation of forestry contracts represents the price for the right to extract a scarce resource, whereas traditional taxes are concerned with revenue maximization. The relevant nation's government is responsible for ensuring that development of the forestry sector contributes to public revenues in return for the benefits forestry sector investors gain from

exploitation of the natural resources. Typically, taxation schemes are articulated in domestic legislation; forestry contracts may offer additional detail and clarifications, and sometimes set out exemptions from certain taxes that the Government has agreed to provide to the Investor.

Over the years, the number of taxes on forestry activity has increased. Charges are levied on the volume of trees at various stages, for example at the *felling* stage and at the stage of processing. Some types of taxes are even differentiated by species of tree. As a result, a tree could be subject to as many as 20 taxes, fees and charges, based on volume, species, degree of processing, and administration actions required (see Section 2.6, *Forest levies*, for a further description of some common taxes, fees, and charges).

2.11.1 Tax Payment and Enforcement

Tax payment and collection varies significantly by jurisdiction. In the forestry context, the contract will usually specify which taxes are to be paid by whom and how. The Government is responsible for enforcing the Investor's obligations to pay its taxes. The non-payment of tax may be considered criminal and therefore any enforcement action is likely to be taken in domestic courts. In such situations, any arbitration tribunal that may have been created pursuant to the terms of an investment contract may not have the power to hear the taxation dispute.

2.12 Anti-bribery and corruption

Parties must guard against bribery and corruption in their forestry project dealings, as required by national and international legislation—including legislation in the home country (where the Investor is legally organized) and in the host country (where the forestry operation is situated). In the U.S., legislation requires that domestic companies adhere to strict anti-bribery and anti-corruption standards when conducting business abroad. For instance, the U.S. Department of Justice has taken an expansive view of what cases fall under the *Foreign Corrupt Practices Act 1977* (FCPA). The FCPA prohibits U.S. companies from paying (or offering to pay) foreign officials to obtain business, and it further applies these restrictions to foreign entities and citizens who commit such acts while in U.S. territory. Engaging in any such activities is a criminal offense, and penalties for such offenses include severe fines and imprisonment.

The UK *Bribery Act 2010* is also extensive in its application. Of most concern for many businesses is Section 7, which states that an entity associated with a person who has offered a bribe may be liable for an unlimited fine if it has not implemented adequate procedures to prevent corruption. The UK Ministry of Justice has stated that it considers contractual anti-corruption standards to be “adequate procedures” within the meaning of Section 7.²⁵

As the international regulatory environment for cross-border businesses becomes more complex and expansive, anti-bribery and corruption clauses in contracts have become extremely important. Parties looking to include these provisions in forestry contracts may look to model clauses such

²⁵ United Kingdom Ministry of Justice, *The Bribery Act 2010 Guidance about procedures which relevant commercial organisations can put into place to prevent persons associated with them from bribing (section 9 of the Bribery Act 2010)*, March 2011, at 23.

as the ICC Anti-corruption Clause, which was published by the International Chamber of Commerce in 2012 to assist companies that seek to embed anti-corruption principles into their contractual agreements.²⁶ The ICC Anti-corruption Clause includes, among other things, representations from the parties that they have not engaged in any corrupt activities in connection with the relevant contract, covenants from those parties that they will not engage in any such corrupt activities throughout the life of the contract, and provisions establishing measures to be taken if one party discovers that the other has engaged in such prohibited activities.

2.13 Assignment and novation

Assignment and *novation* clauses deal with the transfer of benefits and obligations of a contract to a person or entity not party to the original contract.

Assignment is the transfer of the benefit of a contract to a new party, but not the obligations. Novation, on the other hand, essentially puts the new party into the shoes of the party novating (that is, transferring the contract), such that the new party is treated as if they had signed the original contract, and thus assuming all of the obligations the novating party had undertaken. A lease is often referred to as being assigned, and a contract is usually novated.

The assignment and novation clause in a contract will set out the conditions under which the rights and obligations may be transferred (if at all). These clauses are typically restricted in situations where:

- high value confidential information is disclosed throughout the course of the contract. This is problematic in that the party who the rights are assigned to will have the same access rights to the other party's confidential information as the assigning party did; and
- where the identity of a contracting party may be important due to their expertise or because of their *covenant strength*. The covenant strength of a party refers to a party's financial ability to fulfill its obligations under the contract or to deal with claims that may arise as a result of contract breaches.

Assignment and novation issues that may arise in relation to forestry contracts include:

- whether or not the Investor will be able to sub-contract. In some forestry contracts, the Government grants the Investor the right to divide up the contract area and create sub-agreements with sub-Investors. If the Investor is allowed to sub-contract, the parties will need to carefully consider what conditions will apply to the sub-contract; and
- whether or not the Investor will be able to assign its rights under the forestry contract—including its rights to access and/or possess the forestland and exploit the forest resources—to a lender as security (or *collateral*) for a loan. In some situations, the Government may allow the Investor to pledge its interests in some or all of the contract area so that the Investor may obtain financing to carry out the operations contemplated by

²⁶ICC Commission on Corporate Responsibility and Anti-corruption, and the Commission on Commercial Law and Practice, *ICC Anti-corruption Clause* (2012), available at <http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2012/ICC-Anti-corruption-Clause/> (last visited October 1, 2015).

the forestry contract. Again, parties must be very careful to ensure that the conditions under which such an assignment or pledge of interests will be allowed are satisfactory, and will ideally set out in the forestry contract what will happen if a creditor forecloses on the collateral or otherwise exercises remedies in relation to it.

2.14 Confidentiality and publicity

Confidentiality clauses are designed to ensure that certain types of information shared between the parties to a contract remain confidential and not publicly available. These clauses usually require each party to protect the other party's trade secrets or other information conveyed in confidence and not readily available to the public.

Governments, Investors and local communities may have different views on what constitutes confidential information and how far confidentiality should reach. For example, they may have different views regarding whether the forestry contract itself should be made publicly available. Confidentiality clauses that are narrowly tailored to cover only information that genuinely needs protection help the Government avoid any conflicting duties it may have with respect to confidentiality (with regards to the Investor) and transparency (with regards to affected communities and the general public). Furthermore, they help the Investor avoid accusations of engaging in secret, closed-door deals with national governments, and disclosure of deal terms that affect local communities may engender more trust within such communities.

Generally, information covered by a confidentiality clause remains confidential for the life of the contract. In addition, some confidentiality clauses may also survive the termination of the relevant contract, which means that the parties must treat information covered by the clause as confidential despite the expiration of the contract's term. In the context of a forestry contract, this is usually not considered good practice from a human rights, sustainability, and good governance perspective. This also may not meet the commercial needs of a Government, where it has a legitimate interest in disclosing information regarding investments in its forestry sector.

Certain types of information are usually exempt from a confidentiality clause. This tends to be information that is already in the public domain or information that must be disclosed by law. Further exemptions can be mutually agreed by the parties during contract negotiations.

2.15 Stabilization

Stabilization clauses are sometimes included in contracts between an Investor and a Government. These clauses aim to protect an Investor's rights when changes in law arise after the contract comes into force. In the context of forestry contracts, a Government may make changes to its forestry or environmental protection legislation or policies, which may adversely affect an Investor's rights or obligations under a forestry contract. Investors may seek the inclusion of a stabilization clause to mitigate the risks arising from subsequent changes to laws.

A stabilization clause may require the Government to refrain from doing certain things. For example, such a clause may prohibit the Government from materially increasing taxes or royalties payable by the Investor under the contract. Alternatively or additionally, a stabilization

clause may exempt the Investor and its operations under the contract from compliance with laws or regulations adopted by the Government after the contract was executed, or may require that the Investor be compensated for changes in law affecting its investment.

Stabilization clauses can be grouped into five categories:

1. Intangibility clauses – these clauses prohibit the Government from nationalizing the operations covered by the project or amending the contract without the Investor’s consent.
2. Consistency clauses – these clauses may be combined with another type of stabilization clause, and provide that legislation enacted by the Government will only apply to the Investor’s operations under the contract if it is consistent with the contract.
3. Freezing clauses – these clauses “freeze” the legislation and regulations affecting the Investor and its operations under the contract to those that existed at the date of the contract. Freezing clauses generally state that legislation and regulations enacted after the commencement of the contract will not apply unless the Investor agrees to be bound by them. Freezing clauses can be either “full freezing clauses,” covering all laws concerning the operations under the contract, or “limited freezing clauses,” which only freeze some laws (for example, relevant tax laws).
4. Economic equilibrium clauses – these clauses seek to ensure that the Investor is compensated for the costs of complying with any laws or regulations adopted after the contract begins. In contrast to freezing clauses, economic equilibrium clauses do not excuse Investors from complying with the new laws or regulations. As with freezing clauses, economic equilibrium clauses may be either “full” or “limited.” A full economic equilibrium clause protects the Investor against the economic consequences of all changes in legislation and regulations, whereas a limited economic equilibrium clause may only apply to certain laws and regulations, or may only be triggered if compliance costs exceed a certain amount.
5. Hybrid clauses – these clauses contain some elements of freezing clauses and some elements of economic equilibrium clauses and generally require the Government to restore the Investor to the material position it was in before the law changed. This could be by way of compensation or by providing a special exemption from the law.

Stabilization clauses can be controversial given their potential impact on sustainable development and human rights, particularly when the clause does not create exceptions for changes in law related to labor, human rights, health and safety, the environment, or other social issues. Some stabilization clauses will explicitly carve out such areas, while others are written to only cover limited fiscal issues.

2.16 Dispute resolution

Dispute resolution clauses are designed to select the mechanisms that the parties can use to resolve disputes that may arise under a forestry contract. Parties may choose among a range of mechanisms, including negotiation, mediation, court proceedings, and arbitration.

Arbitrations are often perceived as offering efficient dispute resolution processes and adjudicators with high levels of expertise regarding international investment law and transactions. However, arbitration proceedings, particularly when held in another jurisdiction, may also involve higher costs than domestic proceedings, which can be particularly challenging for host governments with limited resources. In addition, arbitration panels often do not address considerations relating to other interested or affected stakeholders (such as impacted local communities), and confidentiality rules governing arbitration can severely limit the amount of information those stakeholders receive regarding resolution of the dispute. In order to mitigate these concerns, contracts may stipulate that arbitration can only be used by the parties after they have attempted to resolve the dispute using all available domestic remedies. Resolution through domestic systems allows for strengthening of domestic precedent and jurisprudence governing forestry and contract law, as well as more transparent communication of information to all affected parties.

2.17 Force majeure

Force majeure clauses are designed to operate on the occurrence of an event outside the parties' control that prevents one or both parties from performing their obligations under the contract.

There are two aspects to the operation of force majeure clauses:

- the definition of force majeure events; and
- the operative clause that sets out the effect on the parties' rights and obligations if a force majeure event occurs.

The term "force majeure" does not have a universal definition, and is therefore open to interpretation by the courts of the relevant jurisdiction. For the avoidance of doubt, parties often clearly define what can constitute a force majeure event in the contract. Examples of force majeure events include strikes, war, civil unrest, and extreme weather events. Often force majeure clauses will take into account any potentially harmful situations that are more likely to arise in the particular country or region concerned.

If a party's obligations under a forestry contract are prohibited or otherwise affected by a force majeure event, then a party may rely on a force majeure clause as a defense to a claim that it has failed to fulfill its obligations under the contract.

2.18 Termination

Termination clauses allow one or both parties to end the contract prior to expiration of the term if certain events occur. These can include:

- Breach of contract – typically, if a party fails to comply with the terms of an agreement (a *breach of contract*), and the breach is immaterial (*i.e.*, it does not prevent the continuation of the entire contract), the other party will not have a right to terminate the contract. Rather, termination would usually result from a *material breach* (a breach that goes to the heart of the contract and negatively affects the outcome of the entire agreement). Even in light of a material breach, the party in default must typically still be notified of the breach and be given a chance to correct its actions within a set period of time. However, there may be “bad acts” (or repudiations) that cannot be remedied and will give rise to an immediate termination right (for example, breach of confidentiality, breach of anti-corruption legislation, invasion of protected areas, materially exceeding allowed and sustainable levels of consumption). Such breaches can give rise to different types of damages; for instance, the party in breach may have to pay money damages or rectify the breach.
- Frustration of the contract – when an event outside the control of either party makes it impossible for the parties to fulfill some or all of the obligations created by the contract (for example, on the occurrence of a sustained force majeure event).
- Failure to meet performance criteria – contracts may also include performance criteria. A performance criterion applicable to many forestry contracts is a requirement to meet minimum levels of production. If such levels are not met, the Government may have the right to terminate the contract unless the breaching party makes a compensation payment.

Termination clauses will also typically provide for termination by agreement between the parties or by the payment of a compensation/termination fee by one party to the other. Often this fee will be on a sliding scale, so terminating early in the term triggers a higher fee than where the contract is terminated closer to expiration of the term.

Some termination clauses will set out how parties must give notice of their intention to terminate (including the form of the notice, the required content, and the time within which notice must be given). The consequences of termination, such as the availability of restitution or liquidated damages, may also be dealt with in the termination clause. These clauses usually take into account any special laws or regulations around termination that exist in the relevant jurisdiction.

2.19 Notice

A notice clause states how the parties to a contract will communicate with each other (usually in written form). The notice clause works in conjunction with other provisions of the agreement that specify the circumstances when notice is required (e.g., notice of certain material events, such as investigations or lawsuits affecting a particular party and/or its operations). Notice clauses may also address what happens when a party changes address or when delivery is refused or rejected. Notice clauses can be very important if relations between parties deteriorate and litigation is contemplated, or when one party needs to serve an important notice (for example, a termination notice) on the other.

2.20 Governing law

Governing law clauses enable the parties to specify the system of law that will apply to determine the rights and obligations of the parties and the interpretation of the contract and its effect if a dispute arises. However, governing law clauses do not indicate how disputes are to be resolved, which is why parties often include a separate dispute resolution clause in the contract.

Most multinational corporations engaged in forestry projects generally act through local traders or agents who will enter into forestry contracts with landholders. This is why many forestry contracts are domestic contracts, and are accordingly governed by domestic law.

When the contract involves international parties, it may be possible for the parties to select a particular law to apply to the contract, although a court may in some cases choose to disregard this choice. If a dispute arises, and the contract does not specify the applicable law, parties will need to seek advice on whether the law and the courts in that jurisdiction are likely to apply. As mentioned above, parties may also seek to avoid having disputes heard in local courts by including an arbitration clause and nominating a different location, such as London or Singapore.

2.21 Indemnification

An indemnity is a contractual promise by one party to a contract (“X”) to compensate for losses incurred by another party to the contract (“Y”) resulting from claims brought against Y by a third party. Indemnities commonly cover the following types of losses:

- breach of representation or warranty by X;
- breach of other contractual obligations by X;
- violations of law by X;
- losses incurred by Y under specified conditions; and
- third party claims against Y under specified conditions (for example, intellectual property infringement claims, product liability claims, or personal injury claims).

Forestry contracts will commonly feature reciprocal indemnities in relation to losses arising out of:

- negligence, carelessness, or willful misconduct by one party (often with the limitation that that negligence, carelessness, or willful misconduct, or the loss itself, must be connected in some way with the contract area);
- accidents, damage to property, injury, or death suffered by any person occurring in or near the contract area and caused by the party giving the indemnity (or its employees, associated persons, etc.); and
- contractual breaches.

Indemnities may also be used to reallocate economic value in a transaction, even if neither party is to blame for the events that trigger the indemnity. In the case of an acquisition, for example, an indemnity may be used to adjust the purchase price by reallocating value or risk based on issues

that arise after the transaction is completed. And indemnities may be used to reapportion risk where there is uncertainty as to the rights afforded under the contract or the potential for third party claims against a party.

It is regarded as best practice for Governments to avoid indemnifying forestry companies against environmental damage claims, and to avoid contractual provisions that require the host country to establish a particularly high level of Investor culpability in order to hold it accountable for environmental damage (requiring, for instance, proof that environmental damage was caused through gross negligence). Companies can ensure they are prepared to cover any environmental damage caused, either by securing insurance, posting a bond or the guarantee of a parent company, or by creation of a fund tied to a steady source, such as gross revenue.

2.22 Definitions

The definitions section of a contract sets out the key terms that will be used throughout the contract and explains what those terms mean. Difficulties with interpretation arise where contracts are drafted inconsistently. Defined terms help the parties achieve uniformity and clarity of meaning throughout the contract, and a well-considered definitions section can be instrumental in avoiding disputes over the meaning of terms that might otherwise be ambiguous.

In forestry contracts, the definition of the resources in question will be extremely important. To avoid creating any uncertainty, parties often specify the biological classification of any living resources or products in the definitions section.

3. GLOSSARY

This Glossary provides basic summaries of certain terms that frequently appear in forestry contracts. However, each forestry contract may have its own set of defined terms, which may be tailored to the relevant forestry project and may differ from the definitions here. For this reason, it is important when reviewing any forestry contract to refer to that contract's definitions section (as further described in Section 2.22, *Definitions*).

Assignment: The transfer of a right or obligation under a contract from one party to another. When assignment occurs, the original parties to the contract do not change, meaning that the transferor remains liable for any breach. (This is in contrast to *novation*, defined below.)

Chain of Custody: In the context of a forestry contract, *chain of custody* refers to the path of custodianship of logs, timber, and wood products through the different stages of production from source of origin to end use, including harvesting, transportation, interim storage, processing, distribution, and export. The chain of custody continues despite changes in the state of the product—for example, changes resulting from the timber being cut, processed, split, or sorted.

Concession: The grant of exclusive privileges by the Government or controlling authority. In the context of forestry contracts, it specifically refers to grant of the rights to enter upon the land and to harvest the trees upon the land in order to make profit.

Condition Precedent: An event that must take place before a party to a contract is required to perform its own obligations under the contract.

Contract Area: The area of land to which the forestry contract applies.

Effective Date: The time at which the contract takes effect. The effective date is frequently specified in the Definitions section of the contract and often refers to the point when all parties have signed the contract or when certain conditions are met.

Felling: The process of cutting down an individual tree as an element of the task of logging.

Forest Management Plan: A document describing the manner in which commercial forestry will be carried out, and which may specify optimum harvest rates, means of minimizing environmental impacts, measures to ensure the health and safety of workers, and processes to accommodate interests of local communities.

Forest Product: Any material derived from forest resources, including but not limited to flora, fauna, and microorganisms that may be exploited for social, economic, or other benefits.

Forest Resources: Any resources of practical, commercial, social, religious, spiritual, recreational, educational, scientific, subsistence, or other potential use to its human that

exists in the forest environment. Forest resources are not limited to flora, fauna, or microorganisms.

Force Majeure: An event that produces a fundamentally different situation to that contemplated by the parties when entering the contract, rendering the contractual obligations incapable of being performed. A force majeure clause suspends or removes liability when a force majeure event occurs without the default of either party. For example, war, natural disasters, blockades, and riots are often considered force majeure events, and each party's obligations under the contract may be suspended for the duration of that event.

Governing Law: The system of law designated by the parties to apply to the operation of the contract and any disputes arising from it.

Jurisdiction: The authority to interpret and apply the law, or to govern and legislate, which is granted to a formally constituted legal body, such as a court or political leader. The term jurisdiction is also commonly used to refer to the geographical area over which such authority applies. (See also *Governing Law*.)

Legal Person: A human or non-human entity—such as an individual, corporation, or recognized organization—that is treated as a person for limited legal purposes. Such entities have legal rights and are subject to legal obligations, meaning that they can sue and be sued, own property, and enter into contracts.

Legislation: A body of laws that has been promulgated by a governing body.

Levies: A duty or tax collected by authorities.

Liability: Legal responsibility for the consequences of a parties' act or omission, enforceable by civil remedy or criminal punishment.

Log: The portion of a tree, with or without side limbs and with bark removed, that is otherwise substantially intact and intended for further processing.

Novation: The transfer of all rights and obligations under a contract to a new party. In such cases, the new party is said to “step into the shoes” of the old, or “novating,” party.

Stabilization: A stabilization clause removes or limits the ability of the Government to alter an Investor's obligations or entitlements with regards to a particular project by revising legislation relevant to a particular project after the forestry contract is signed. A stabilization clause will maintain the legal status quo of the original contract by either exempting the parties from the changes in law, or providing for compensation of the Investor for any losses resulting from the changes.

Timber: Sawn or cut wood or logs.

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