FLASHPOINT BRIEFING: 2018

Conflict sensitivity and the pre-investment stage

Human rights due diligence in conflict-affected settings: Guidance for extractives industries

SUMMARY

For extractives companies operating in a conflict-affected setting, incorporating conflict sensitivity and human rights considerations during the pre-investment phase is an opportunity to create a more comprehensive picture of risk. By anticipating issues at an earlier stage, companies can factor in costs and begin to identify ways to address some of these issues early on, saving themselves from potential problems during a later phase of the project. This flashpoint briefing aims to raise questions for consideration, and highlight where more information, research or discussion is useful. It will also identify some potential points where influence can be exercised from company, financing institution and civil society perspectives, as well as indicate the 'red lines' where influence is limited. This flashpoint briefing accompanies International Alert's *Human rights due diligence in conflict-affected settings: Guidance for extractives industries.*[1]

Issue

For extractives companies, pre-investment activities can be characterised by commercial negotiations to attain contracts and licences, agree terms and conditions, and discuss expectations and responsibilities in business relationships. Factoring in conflict issues at this stage can help create a more comprehensive picture of risk, anticipate issues that the company is likely to encounter or inherit, and ensure projects, budgets and timelines account for this.[2] This makes business sense: as risks have a bearing on other contractual considerations, it is best if they are considered alongside commercial aspects, and accounted for in commercial agreements.[3]

For civil society, it is not very clear what actually happens during the pre-investment stage, what conversations this encompasses, how negotiations take place, who is heading them, etc. Therefore, there is a need to further unpack this issue to enable practitioners and advocacy organisations to better target their efforts when advocating for responsible investment, particularly in conflict-affected settings.

Yet practical challenges mean conflict risks likely may not receive adequate consideration in pre-investment activities. Firstly, there are commercial sensitivities. Within companies, information is handled on a confidential basis and, from an external perspective, it is hard to fully understand the process, access information, and identify who participates in negotiations on behalf of the company – or indeed, the government.[4]

Secondly, conflict risks may not be immediately apparent: as indicated in this guidance, CAS can include a much wider range of contexts than originally assumed – such as those with high levels of criminal violence, or those with localised pockets of violence. This points to the reality that, depending on how the conflict context, and political, economic and social events change the scenario after an initial investment, local levels of violence can escalate once the investment is made.

For the purposes of the paper, the term 'company' refers to the organisation undertaking extractives development, and 'financing institution' refers to the organisation (public or private) providing the finance for the extractives development. It is not within the scope of this paper to explore whether there are different implications depending on the type of investment (equity vs. debt) and lenders (public vs. private).

Increasing attention to responsible investment

There is increasing sensitivity of lenders and investors to social and conflict risks in relation to the decision-making processes.[5] To this end, there are several notable initiatives and efforts to promote responsible investment practices, detailed below in chronological order of development.

- Founded in 2005, the Principles for Responsible Investment (PRI) is a UN initiative that brings together an international network of investors to understand the implications of sustainability for investments, and supports signatories to incorporate these issues into their investment decision-making and ownership practices.
- Former Special Representative on Business and Human Rights, John Ruggie, developed the *Principles for responsible contracts: Integrating the management of human rights risks into state-investor contract negotiations* as an addendum to the UNGPs. It is a product of four years of consultations and research during his mandate, whereby he identified international investments as a key instrument affecting business' human rights impacts, and provides recommendations on how to integrate human rights into the process.
- Launched in 2016, The Dutch Banking Sector Agreement is a multi-stakeholder initiative that commits Dutch banks to actively combatting and preventing potential human rights abuses carried out by clients. By taking a collaborative approach on complex issues, the agreement makes it possible for banks to do more to ensure respect for human rights in investment and financing matters, for example, with regard to working conditions, freedom of association in trade unions, child labour and land-use rights.

Business case

Given that in CAS risks can include project delays and disruptions, higher financing and insurance costs, and allegations of complicity in human rights abuses, it is in the company's interest to more fully consider and integrate conflict risks into investment decisions. This gives a more in-depth and holistic picture of 'risk versus reward' when it comes to investment decisions. Ultimately, due diligence allows companies to avoid unnecessary costs, work towards co-responsibility of all actors and ensure long-term success.[6]

Stating to the business partner the company's commitment to human rights (or in certain contexts where this is too sensitive, commitment to health and safety, workers' rights, etc.), as well as raising issues and concerns, is a way to engage in a dialogue on what actions need to take place to proceed and, where possible, incorporate these into contract agreements. It also provides an opportunity to factor in the costs of conflict as well as include more realistic timelines for community consultations, including free, prior and informed consent where applicable. There are interesting developments in this regard coming from financial institutions and insurers, who have translated social risk and company–community conflict costs into financial risk.[7] For example, the Superintendency of Banks, Insurance and Private Pensions Funds in Peru has regulated due diligence in the financial sector as a response to the costs of social conflict. The due diligence requires clients of financing institutions to consider conducting a conflict analysis and social baselines, and mechanisms for community engagement and conflict resolution, amongst other measures.[8]

Introducing these considerations at pre-investment can also create more leverage and control over how issues are addressed, as once the decision is made, from the company's perspective, its influence will decrease.

Standard assumptions and responses

'As a company, we have limited leverage with the government.'

While engaging with governments from CAS can be a challenging task, they also have particular interests in attracting foreign direct investment and demonstrating market credibility, therefore there is opportunity in this moment to discuss, agree and document the parameters and expectations. Indeed, the reality is that the need for foreign direct investment in CAS creates a risk that governments prioritise short-term economic needs over long-term sustainable development – without the capacity to sufficiently legislate, regulate and monitor industry operations. This creates an even greater need for responsible companies to fully consider risks and engage in conversations with government about expectations related to the conditions for investment. Using materials such as the Principles for Responsible Contracts provides clarity and practical guidelines for both government and companies in the process of investing.

'Raising conflict issues will slow or derail our commercial negotiations.'

In consultations with business representatives, Alert found no evidence that raising conflict issues would derail a bidding process. Some did indicate that it would slow the process, but with good reason: taking the time to ensure processes are robust and transparent also establishes the company as a credible player. Should there be a change in government or regime, the company is then not seen as 'too close' to the previous administration or willing to take shortcuts to achieve agreement.

When conversations are sensitive in nature, business leaders interviewed for this report also emphasised it should not be *whether* concerns are raised, but *how*. It is about establishing from the start of the engagement the expectation that the company will act in line with its own standards and values, including on human rights. Approached from this perspective, companies can focus on their own practices versus being critical of the government.

The costs of getting it wrong: Inadequate due diligence in the Sudan

An oil consortium was investigated by the International Prosecution Chamber in Stockholm for the role it played in the Sudanese conflict 1997–2003 and possible complicity in war crimes. A report by the European Coalition on Oil in Sudan claimed that the consortium "should have been aware of the abuses committed by the armed groups that partly provided for their security needs. However, they continued to work with the [Sudanese] government, its agencies and its army."[9]

Another oil company has faced a class action lawsuit in the US courts under alien tort law on the allegation of complicity with the Sudanese government on human rights abuses in its area of operation. The lawsuit and subsequent appeals were ultimately rejected, but the company divested its assets under mounting public pressure, stating the political risk was too great.[10]

'It is not possible to access adequate information about conflict risks at this stage.'

It may not be possible to undertake full on-the-ground assessments, but desktop studies and political risk indexes can help to establish where more thorough research and consideration is required; at this stage, it is possible to identify national and international experts in academia, NGOs, and consultants to engage and draw upon in order to gain this additional information. At this stage, it is also possible to map state functions, actors and instruments to facilitate effective planning and management of human rights risks and support engagement of those that may be impacted[11] as well as identify clashes between national and international legislation on conflict and human rights issues.

This also speaks to the relevance of leveraging other due diligence processes and collaborating where possible. For example, one financial institution worked with clients with business relationships in Bangladesh in identifying human rights gaps in initiatives developed in the wake of Rana Plaza and developing additional measures to address them. Another example comes again from the Dutch Banking Sector Agreement, in which members collectively undertake value chain analysis in high risk sectors (starting with gold, cocoa and palm oil) as a way of addressing the challenge of insufficient information. Sector Wide Impact Assessments (SWIAs), which serve as a public resource, can also play a role in providing companies with relevant information for their own due diligence.[12]

'Investment decisions are very confidential – even within the company.'

Even when internal company actors are not party to investment decisions, it may be possible for them to review existing internal due diligence processes. This can help identify where processes are adequate and where they can be strengthened, so that they are fit for purpose at the time of the negotiation.

Work can also be done internally to raise the profile of the importance of considering conflict and human rights at pre-investment. Exposure to this discussion, for example, through training and capacity building or consultations with high profile experts to engage with senior management, can ensure that those involved in decision-making and negotiations are able to identify and address issues. Even when there isn't a specialist in the investment team, equipping the broader team with skills can be effective.[13] This also speaks to the need to raise accountability to the highest levels within the organisation so that those involved in negotiations have the mandate and authority to raise the issues.

'It is the responsibility of the state, not a company, to disclose information about licensing and contracts.'

Governments have the public responsibility to disclose contracts when there is a high human rights risk related to an investment, as is likely in CAS. However, this is not readily the case so it is in the company remit – and interest – to agree upfront how the terms will be released during the investment process.[15] Companies may have concerns that disclosing contractual terms puts them at a competitive disadvantage. As the costs of not disclosing usually end up being greater (loss of trust, time and resources spent dealing with complaints and concerns),[16] governments can even the playing field by requiring all companies to operate to the same principles. The Extractives Industry Transparency Initiative and, to a certain extent, the Dodd-Frank Act and the EU Non-Financial Reporting Directive,[17] also work to establish a more level playing field by requiring all companies to adhere to the same disclosure requirements.

Key conflict issues

How pre-investment processes are managed has a bearing on whether the process exacerbates or ameliorates conflict. This is especially the case in the following circumstances:

- *When investment agreements do not adequately consider long-term sustainable development needs***.** If the state's short-term economic needs are prioritised at the expense of longer-term sustainability considerations in investment agreements, there is more risk of negative environmental, social and human rights impacts over the long term, which in turn will undermine stability and likely drive conflict. For example, in many countries with extractive industries, there is a call for economic development models that allow different sectors to co-exist and grow.

- *When legal due diligence is too narrow.* A sole focus on legal compliance with national regulatory frameworks can leave gaps. For example, a company may undertake due diligence on land titling and find the agreement in compliance with the national law, but miss the degree of community opposition deriving from historic misappropriation of land. In CAS, widening the lens beyond legal compliance increases the chances issues will be identified pre-investment so that sufficient measures can be put in place.

- *When civil society expectations on disclosure are not met, driving tensions and distrust.* Extractives industry investors are beginning to favour contract publication in recognition that it increases trust with stakeholders, gains buy-in, and helps with expectation management.[18] While some information is proprietary, in practice much can be done to circumvent the problem. For example, the Principles for Responsible Investment indicate that for confidential clauses in contracts, the general subject matter can be identified along with the expected release date of information that is confidential for a time-bound period.[19]

- *When the state lacks the capacity to fulfil their obligations under international frameworks, for example, free, prior and informed consent.* Non-conformance, disagreement on what conformance looks like, or inability to fulfil can all drive or exacerbate conflict and lead to project delays or even the inability to proceed. In addition to identifying the obligations during pre-investment, it is important to anticipate likely issues arising from achieving consent and – in consultation with relevant parties – identify mutually acceptable approaches.

The costs of getting it wrong: Inadequate community engagement

Issues over land rights and inadequate consultation during initial stages of the investment led to indigenous communities blocking the Mareña Renovables wind farm development in Mexico. Ultimately, this meant starting over and undertaking a feasibility study for an alternative site. The consultation process for this was monitored closely by one of the main financing institutions before they committed to investing in the new site, following grievances raised because of a consultancy firm undertaking such tasks without sufficient supervision of the financing institutions initially.

Options and alternatives

Conflict sensitivity in pre-investment is an area of emerging practice: certainly, more research needs to be done. Alert offers some preliminary ideas and suggestions to companies, financing institutions and civil society as a basis for further consideration and discussion. Much of this is based on existing good practice for human rights and conflict sensitivity.

Companies

- Develop tools (such as checklists) and procedures to ensure a consistent approach to identification of risks and opportunities. For example, see Alert's self-assessment tool[20] to guide human rights due diligence decisions and the screening tool to guide conflict-sensitive business practice.[21]

- Be adequately prepared and have the capacity to address conflict risks and implications during negotiations, with a clear idea of how the project's objectives, opportunities and risks relate to company responsibilities.[22]

- Ensure that those in the negotiating team have the skills and remit to raise considerations. This directly relates to the level at which there is accountability for issues relating to conflict within the company – if it is not at board or senior management level, then the negotiating team will not be prepared to raise considerations at this stage. It also requires the authority and skill required to raise sensitive issues; for example, executive leaders talking to their counterparts within the government as light-touch diplomacy.

- Explore whether it is possible to consult with peacebuilding and human rights organisations before making a final investment decision, to understand risks, develop best practices, and establish dialogue. In certain circumstances, this would also include talking to human rights defenders.

- At a minimum, human rights clauses should be included in investment agreements and contracts. For example, a non-operator in a joint venture partnership should include human rights considerations in the joint operating agreement. While what is agreed on paper doesn't always reflect practice, it creates a platform for engagement at later stages, and the opportunity to take actions such as using third-party monitors or home-state diplomacy if issues arise.

- Consider what conditions can be made as a requirement for investment. For example, where workers are not allowed to organise themselves into trade unions, companies can consider whether this should be made a requirement[23] (while also ensuring appropriate safeguards so that this does not put them at further harm).

- Along with the state, companies have a responsibility to manage expectations of communities in relation to investments, and consult with affected communities before the contract is finalised. This requires agreeing with the state on the scope and the respective responsibilities, including methods of communications and engagement.[24]

In circumstances in which international humanitarian law applies, any risk of criminal or civil liabilities should be fully analysed before the final investment decision. This could create a no-go scenario from a civil society perspective. This means going beyond political risk indexes and employing sufficient legal expertise in investment decisions. It also means being prepared to act upon these findings should serious risks be uncovered, as companies have the responsibility to immediately disengage from business relationships in situations involving a broad range of gross human rights violations.[25]

Civil society

There are certain aspects of the pre-investment process that fall under company–state jurisdiction, which means civil society has very little influence over the design of the company's investment strategy, or how they interact with the state. However civil society can 'influence the influencers', particularly through government and financial institution engagement.

- There is a role for civil society in helping to strengthen government's legislative and regulatory capacities. For example, recognising that a strong and functioning legislative framework and sound policy leadership was required for managing different aspects of oil in Uganda, Alert initiated a Parliamentary Forum on Oil and Gas (PFOG), a group of MPs across parties who have been engaged in a series of training, workshops and field exchanges to learn from experiences of countries that have been successful in using oil resources for development. In response to participants' requests, Alert also developed a handbook on oil and gas regulation as a reference tool for legislators to use to guide reforms.

- Civil society can contribute to investor due diligence and knowledge sharing. For example, leading Dutch NGOs participate in the Dutch Banking Sector Agreement, or academic institutions like the London School of Economics' Centre for the Study of Human Rights link international investment law and business and human rights. The next step is for these initiatives to also consider the role that conflict plays in investment and the relation with human rights.

Civil society can seek to understand and influence the investor portfolio, with targeting the financing institution an effective advocacy strategy. For example, as a response to the Dakota Access Pipeline in the US, and concerns about its lack of consultation with nearby indigenous communities and proximity to indigenous lands and sensitive riverine environments, campaigners have run a high-profile campaign targeting the banks and pension funds providing finance and advocating for the institutions to divest.

Financial institutions

- International financing institutions are expected to undertake their own due diligence on investments to identify, prevent and mitigate human rights impacts (as outlined in the Organisation for Economic Co-operation and Development's Guidelines for Multinational Enterprises[26] or the International Finance Corporation's Performance Standards[27]), as well as have remedy mechanisms (the OECD's National Contact Points and the IFC's Compliance Advisor Ombudsman) for remediation of impacts.

- International financial institutions are expected to outline the roles and responsibilities of both the investor and the state in relation to the project – including the rules for resolving any disputes that arise in relation to roles and responsibilities.[28]

- There is debate on whether financing institutions should be considered as causing, contributing to or linked to negative human rights impacts by their clients. A similar discussion has taken place with cases of complicity in war crimes or crimes against humanity. What is clear is that there is much investors can do to improve the human rights situation and mitigate negative impacts related to client activity. For example, one private financing institution commissioned an independent report of an oil company's activity in Virunga National Park, the Democratic Republic of Congo, as a response to growing concerns about the impact of the company on the protected World Heritage site. The report served as a tool for engagement with the company on the issue.[29]

Endnotes

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International Alert

346 Clapham Road, London, SW9 9AP, United Kingdom

Tel +44 (0)20 7627 6800 **Fax** +44 (0)20 7627 6900

Email info@international-alert.org

www.international-alert.org

/InternationalAlert @intalert

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