UPHEAVAL AND UNCERTAINTY IN MINERAL REGULATION IN PARTS OF AFRICA: RESURGENCE OF RESOURCE NATIONALISM HIGHLIGHTS THE IMPORTANCE OF INVESTMENT TREATY PROTECTIONS

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Legal Briefings

The last few months have seen significant changes to mining regulations in various African states, giving rise to a concern that a regional trend of resource nationalism may be (re-) emerging. In this context it is important for companies associated with the mining sector to be aware of the protection international investment treaties may provide against the impact of resource nationalism on their assets, and how to maximise that protection before risks materialise. Peter Leon, Partner and Africa Co-Chair in Johannesburg, Andrew Cannon, Partner and Iain Maxwell, Of Counsel, both in London, consider some of the developments, before discussing how companies can use investment treaties to protect themselves against the risks they pose.

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RECENT DEVELOPMENTS IN TANZANIA, THE DEMOCRATIC REPUBLIC OF CONGO (“DRC”), ZAMBIA AND SOUTH AFRICA

TANZANIA

Recent changes to Tanzania’s mineral law regime are at one extreme of the developing trend. In July 2017, Tanzania enacted drastic amendments to the 2010 Mining Act, as well as two new laws asserting the Government’s “permanent sovereignty” over its natural resources (not only minerals but oil and gas as well) (see here for more details). Among other changes, the Government:

- empowered itself to renegotiate terms in mining contracts which Parliament considers “unconscionable”. “Unconscionable” terms are defined to include those providing for foreign laws or dispute resolution mechanisms;
- immediately banned the exportation of unprocessed minerals;
- raised royalty rates; and
- increased Government shareholding rights, including a minimum sixteen per cent non-dilutable free-carried interest in any mining company operating under a mining licence or a special mining licence. The Government is entitled to increase this interest to an extent equivalent to the total tax expenditure incurred by the Government in favour of the mining company (up to a maximum of fifty per cent); and
- prohibited investors from resorting to international dispute resolution mechanisms, prescribing that natural resource related disputes “shall not be a subject of proceedings before any foreign court or tribunal” and shall only be adjudicated by Tanzanian judicial and statutory bodies.

In January 2018, Tanzania published a set of new regulations under the amended Mining Act. The most onerous of these are the “Local Content” regulations, which came into force on 10 April 2018, requiring mining companies:

- to have at least five per cent ownership by an “indigenous Tanzanian company” to be eligible for the grant of new mining licences;
- to meet substantially increased quotas for local recruitment, training and procurement of

local goods and services; and

- to conduct business through Tanzanian banks and only use the services of Tanzanian financial institutions, insurance brokers and legal practitioners.

Rather than clarifying the new regime introduced in 2017, the 2018 regulations exacerbate the uncertainty and concerns around impossibility of compliance. In a more recent development, in June 2018 the Tanzanian Government announced further tightening of controls on the industry, including a requirement that large-scale mining licences will only be issued after Cabinet approval. Moreover, the Government has also stated that it will no longer sign new mineral development agreements, which guarantee a stable tax and regulatory regime for existing mining companies. A number of foreign-owned mining companies currently benefit from such clauses.

Articles discussing the legislative and regulatory reforms in Tanzania in more detail can be found here and here.

THE DRC

In the DRC, the 2002 Mining Code has been significantly revised, with effect from 28 March 2018. Among other things, the revised Code:

- increases the royalty rates on most minerals;
- introduces a ten per cent royalty on minerals which are designated “strategic substances”;
- removes the stabilisation guarantees previously stipulated, which exempted licence holders from complying with changes to the fiscal and customs regime for 10 years; and
- increases the State free carry non-dilutable equity stake from 5% to 10%.

The DRC Government and international mining companies have been engaged in negotiations to manage these changes. However, it was reported in June 2018 that despite ongoing discussions between mining companies and the DRC Government with a view to amending the Code, regulations have been signed to implement the Code into law without any concessions to industry.

The DRC Government has also indicated its intention to renegotiate existing mining contracts in the coming year, and the state-owned mining company Gécamines has even threatened to institute arbitration proceedings against companies that refuse to participate in the process. For more detail see our recent brief here.

ZAMBIA

In March 2018, Zambia reportedly imposed a US$8 billion tax demand on Canadian mining company First Quantum relating to duties on mining equipment imported between 2012 and 2017, US$7.8 billion of which is made up of penalties and interest. The Zambian Revenue Authority has also indicated it has initiated detailed compliance audits of all mining companies.

SOUTH AFRICA

Finally, the situation in South Africa remains in a state of flux, where the High Court recently ruled that the Mining Charter (a Government document setting black economic empowerment ("BEE") targets) does not create binding obligations. The Government has lodged an appeal against the decision, which will likely only be heard towards the end of this year (and a further appeal could take another year to finalise). As a result, mining companies still do not know which targets they are required to meet in respect of ownership, management and the procurement of local goods and services, or what the legal consequences of non-compliance might be.

Whilst the new draft Mining Charter published for public consultation on 15 June 2018 has been received by many as an improvement on the previous draft, there is nonetheless some cause for concern for both existing miners and those considering new mining operations in the country. For example, recognition of historical achievement of BEE targets has now been included but there are still uncertainties as to requirements when Black investors sell their BEE interest. Moreover, those who obtain new mining rights will have to meet an increased 30% BEE requirement (from 26%) within five years but also absorb the burden of a 10% free-carried interest to be given to qualifying employees and local communities. In addition, holders of existing rights will have to top up their BEE shareholding within five years. At the same time, the draft Mining Charter substantially increases quotas for the procurement of goods and services from BEE entities as well as BEE representation at all company levels. (Further analysis of Mining Charter III is available here and here and Peter Leon's interview on Classic FM discussing the Mining Charter III is available here).

Far-reaching amendments to South Africa’s 2002 Mineral and Petroleum Resources Development Act remain unresolved after more than five years. Drafted in 2012, introduced into Parliament in 2013, and hastily passed in 2014, the amendments would have the effect of (among other things):

- elevating the contested Mining Charter to the status of binding law, and giving the Minister of Mineral Resources the power to amend or repeal it “as and when the need arises” (thus obviating the current litigation);
- requiring Ministerial consent for the transfer of any interest in an unlisted company, as well as a controlling interest in a listed company; and

- giving the Minister of Mineral Resources effectively unlimited powers to “designate” any mineral or mineral product to be offered to local beneficiators at discounted prices (in quantities, qualities and timelines prescribed by the Minister), failing which they may not be exported without the Minister’s prior written approval.

Although the President referred these amendments back to Parliament in 2015, citing concerns over its constitutionality, the Government has not withdrawn them, and they thus continue to weigh on investor confidence as Parliament persists with a slow, stunted and heavily-criticised process of reconsideration.

THE IMPORTANCE OF RIGHTS ENSHRINED IN INTERNATIONAL TREATIES

The recent developments in these states, and elsewhere, highlight the importance of rights enshrined in international treaties, which are protected from the vagaries of local politics. Investment treaties provide a stable framework of protections upon which investors can rely even when there is upheaval in local laws and regulations.

Through such treaties and by planning ahead, investors can enhance the security of their investments and their negotiating leverage with the host state. Such leverage can help to protect and preserve the smooth operation of an asset – and help to provide an avenue for recourse against the host state in the event arbitrary and/or discriminatory state acts do nevertheless occur.

HOW DO TREATY PROTECTIONS ARISE?

Investment protection treaties – whether bilateral ("**BITs**"), regional or multilateral – typically provide a range of substantive protections to companies or nationals from one State party to the treaty (the Home State) who have an investment in another State party to the treaty (the Host State).

Equally important, such treaties typically also include the right for a protected investor to bring international arbitration proceedings against the Host State to enforce those rights.

WHAT TYPES OF PROTECTIONS CAN BE AVAILABLE?

Whilst each treaty is different, there are a number of fundamental substantive protections or guarantees which are typically included in such treaties. Most treaties include a prohibition on expropriation without compensation, whether directly or indirectly through a series of governmental acts which encroach on an investment and result in it being deprived of value. An example is the successful unlawful expropriation claim brought by Rusoro Mining v Venezuela with respect to the nationalisation of its investment constituting mining concessions and contracts to explore and produce gold. Many treaties also include prohibitions on discrimination, guarantees of national and most-favoured-nation treatment (where the investor is guaranteed treatment in the Host State as favourable as that provided to nationals of the Host State and nationals of any third state) and the guarantee of fair and equitable treatment (or "**FET**").

FET clauses provide particularly versatile protection and have been interpreted as precluding a denial of justice by the courts of the host state; protecting an investor’s legitimate expectations; and requiring fairness in administrative decision-making. While not all regulatory changes will amount to an expropriation or a breach of the FET guarantee, where the state’s exercise of its regulatory power involves procedural unfairness or lack of due process, bad faith, discrimination or a failure to protect an investor’s legitimate expectations as to how it will be treated, an FET claim under an available treaty (if there is one) may be possible. For example, Crystallex International Corporation recently brought a claim against Venezuela for breach of the FET guarantee based on its failure to secure a required environmental permit several years into a gold mining project.

An investment treaty may also contain a guarantee of full protection and security for the investment. Such a standard has been interpreted by some tribunals as offering a guarantee that extends beyond physical protection of an investment to the security of the regulatory environment in which the investment is made. By way of example, in a claim by Copper Mesa Mining against Ecuador, the tribunal found that the guarantee of full protection and security had been breached by Ecuador through its flawed reaction to an anti-mining blockade of one of Copper Mesa’s mines.

HOW CAN INVESTORS ENSURE THE AVAILABILITY OF SUCH PROTECTIONS?

As already alluded to, investment treaties only protect investments made by nationals or companies of the Home State in the Host State. Therefore, in order for an investor to benefit from investment treaty protection, there must be such a treaty in place between the Home State and the Host State.

Where there is not a treaty in place between the Home State and the Host State that incorporates broad substantive protections and the right to enforce those protections through international arbitration, it may be possible, at the outset of a transaction (or at latest before a dispute arises), to structure the investment via a subsidiary or other entity in a country which does benefit from such a treaty. Treaty protection should therefore be a significant consideration at the early stages of a project. It is sensible to consider structuring for investment protection at the same time as reflecting on the most tax efficient investment structure, and also to keep the options under review throughout the life of an investment, as the treaty protections available may change over time.

WHAT IS THE PROCESS FOR EFFECTIVELY ENFORCING TREATY RIGHTS?

Many investment treaties allow the investor to elect to arbitrate disputes between it and the host state before an independent ad hoc international arbitration tribunal. Mining companies have taken advantage of this right in order to avoid having to bring a claim against the host state before that host state's domestic courts. Access to international arbitration also reduces the need for the investor to leverage any political influence it has with its own government to try to resolve the dispute through diplomatic channels.

Mining companies may also benefit from domestic law protections or guarantees governing the legal treatment of investments made in the territory and, of course, should include robust contractual protections where possible. However, neither the existence of possible avenues of redress under domestic law nor contractual risk management can completely insulate a foreign investment from the exercise of state powers. Investment treaties can therefore provide a valuable risk-mitigation tool for those establishing mining operations abroad.

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