HERBERT SMITH FREEHILLS

UPHEAVAL AND UNCERTAINTY IN MINERAL REGULATION IN KEY AFRICAN MINING JURISDICTIONS

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Legal Briefings

Resurgence of resource nationalism highlights the importance of investment treaty protections

The last year has seen significant changes to mineral regulation in key African mining jurisdictions, 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. This bulletin briefly considers some of the last few months' developments, before discussing how companies can use investment treaties to protect themselves against the risks they pose.

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

Recent changes to **Tanzania's** mineral law regime are at one extreme of the developing trend. In July 2017, Tanzania enacted drastic amendments to its 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.

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;
- meet high quotas for local recruitment, training and procurement of local goods and services;
- 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. For more detail on the legislative and regulatory reforms in Tanzania, see our recent briefs (here and here).

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 ten years.

The DRC Government and international mining companies are currently engaged in negotiations to manage these changes. For more detail see our recent brief (here).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.In Kenya, the 2017 Mining (State Participation) Regulations afford the State a free-carried ten per cent equity interest in any mining right granted after the 2016 Mining Act came into force on 27 May 2016.

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.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 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.

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. These include prohibitions against expropriation without compensation, 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.

An example of a successful unlawful expropriation claim is that brought by Rusoro Mining against Venezuela concerning mining concessions and contracts to explore and produce gold.

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.

Further detail on the investment treaty protections available and how to take advantage of them can be found in a recent Herbert Smith Freehills article on investment treaty protection in the mining industry available here.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

PETER LEON
PARTNER, JOHANNESBURG
+27 10 500 2620
Peter.Leon@hsf.com

ANDREW CANNON
PARTNER, CO-HEAD, PUBLIC INTERNATIONAL LAW PRACTICE, DEPUTY HEAD, GLOBAL ARBITRATION PRACTICE , LONDON
+44 20 7466 2852
Andrew.Cannon@hsf.com

HANNAH AMBROSE
SENIOR ASSOCIATE, LONDON
+44 20 7466 7585
Hannah.Ambrose@hsf.com

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