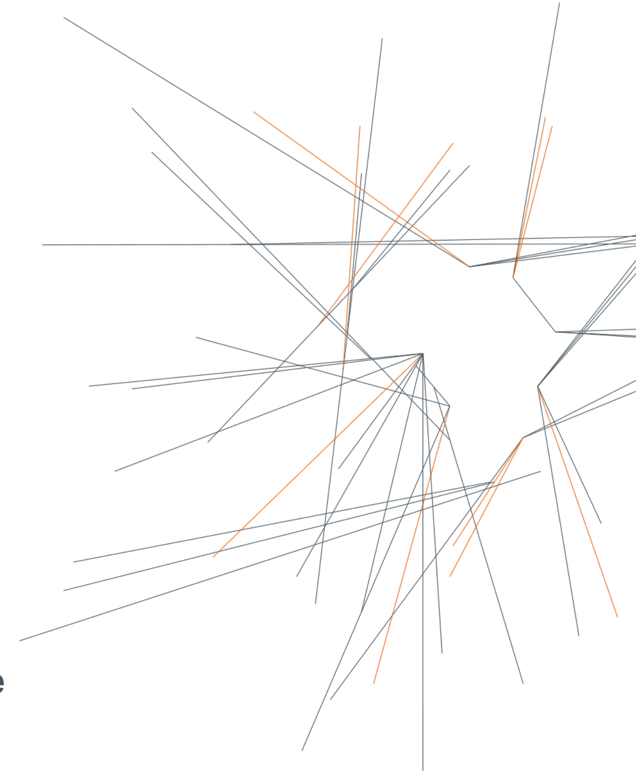
WEBBER WENTZEL

in alliance with > Linklaters



THE GROWTH OF RESOURCE NATIONALISM IN AFRICA

PETER LEON

Head: Africa Mining and Energy Projects

Webber Wentzel, Johannesburg, South Africa

PDAC International Convention, Trade Show & Investors Exchange

MineAfrica's 11th Annual Investing in African Mining Seminar

Toronto, Ontario, Canada

Tuesday, 5 March 2013

© Webber Wentzel 2013

WHAT IS RESOURCE NATIONALISM?

Ernst & Young

Authors of Business risks facing mining and metals 2012-2013

"*Resource nationalism is not a new phenomenon but has risen to prominence during the latest so called commodity 'super cycle'. We have witnessed a domino effect as country after country has sought to extract a fairer share of the rewards from depletion of its mineral endowment. Resource nationalism is regarded as the top risk of doing business in metals and mining whether that is in developed or developing economies.*"

WHAT IS RESOURCE NATIONALISM?

- Resource nationalism is the umbrella term for several different measures through which states seek to exercise greater control over their natural resources with the object of deriving a greater share of the economic benefits that accrue from the extraction of these resources.
- In 2012, Ernst & Young, in their *Business risks facing mining and metals* report, identified resource nationalism as the "*biggest risk*" facing the mining industry globally for the second year running.
- Resource nationalism is:

  contagious

  - As more (particularly major) mining jurisdictions adopt resource nationalist measures, this creates policy space as much as domestic pressure for other resource-rich countries to do the same.

  cyclical

  - Resource nationalism tends to arise when commodity prices are high. Mining's relatively quick recovery from the 2008-2009 economic crisis made it a prime target for states seeking to boost weak balance sheets.
  - Resource nationalism today is, however, not dictated solely by increasing commodity prices, and has in fact been resistant to recent price downturns. It thus also needs to be understood in the context of wider social and political drivers.

AFRICAN RESOURCE NATIONALIST TRENDS

- The forms in which resource nationalism manifests vary widely, including, among other measures:
  - outright nationalisation of mining companies, whether compensated or uncompensated;
  - increased state participation through, among other measures, a state owned mining company;
  - fiscal measures;
  - mandated beneficiation (often through the imposition of export levies);
  - mandatory local inputs; and
  - local equity and participation requirements.
- Recently, the following resource nationalist trends have emerged in African mining jurisdictions:
  1. The imposition or increase of royalties or mining taxes.
  2. A mandatory requirement for state equity carry in mining projects.
  3. Indigenisation and local equity requirements.
  4. The review of mining contracts, with a view to possible renegotiation or cancellation.

ROYALTIES AND MINING TAXES

- Mining royalties and taxes may take a number of different forms, including:
  - Increasing general taxes (*ie* corporate income tax, dividends, withholding tax and capital gains tax), limiting deductions, and ring-fencing a company's projects.
  - Increasing royalties, which are usually payable as a percentage of production or revenue.
  - Introducing super profit, windfall profit or resource rent taxes.
  - Imposing import taxes (on goods and services) or export taxes (on minerals) with the purpose of promoting local procurement and beneficiation, and stimulating local business and industrialisation.
- Although different taxes have their own particular risks, generally they decrease the potential reward for mining projects in implementing countries, and thus potentially discourage investment.
- Sudden changes in regime can also defer or delay mining projects, and can result in the withdrawal of investment.
- Increasing mineral royalties can also increase operating costs and mineral cut-off grades, potentially sterilising marginal mineral deposits.

ROYALTIES AND MINING TAXES

Prominent examples of this trend

- Ghana, in its national budget for 2012, introduced the following fiscal reforms which are applicable to all mining companies:
  - increasing the corporate tax rate from 25 to 35 per cent;
  - reducing capital allowances from 80 to 20 per cent for five years; and
  - ring-fencing mining projects for fiscal purposes.

  The budget also proposed a windfall profit tax for mining companies, which has been deferred.
- The Democratic Republic of Congo's new draft mining code under discussion proposes a new tax on "*super profits*". According to recommendations, when mineral prices rise above 25 per cent of a reference price projected in a project's feasibility study, the state will retain 50 per cent of this "*super profit*".
- Tanzania is also considering the imposition of a windfall profit tax.
- Ivory Coast has, however, recently reconsidered the imposition of a windfall tax on its gold mines, but has said it will focus instead on adjusting royalties to increase state revenue.

STATE EQUITY CARRY

- This occurs where the state, through regulation, solicits a share of a mining company. This exhibits an attempt by governments to retain ownership of their mineral resources.
- The acquired interest may either be:
  - *free carried:* where the state acquires the share without any contribution; or
  - *contributed:* where the state is required to pay for the share.
- Shares acquired by states in this fashion are sometimes held by a designated state-owned mining company.
- Provision for state equity carry, especially where the state is awarded a sizable *free carry* share, can have a significant impact on the reward mining companies can expect to receive from mining projects. This may, in turn, reduce investment in implementing countries.

STATE EQUITY CARRY

Prominent examples of this trend

- Guinea published a new Mining Code published in September 2011 which:
  - grants to the state an automatic 15 per cent free carried non-dilutable interest in all new mining projects for bauxite, iron ore, uranium, gold and diamonds; and
  - a right to acquire additional interest, on a fully paid up basis, up to 35 per cent of the equity in the rights holder (for all minerals).

  The 2011 Code is currently under review, but state participation rates are apparently unlikely to change.
- The Democratic Republic of Congo's new draft Mining Code, which is currently under discussion, proposes to give the state a minimum free carried, non-dilutable 35 per cent share in all new mining projects (currently there is provision for a 5 per cent free carried, non-dilutable share).
- A host of other countries also have legislation which entitles the state to a share in mining projects. These countries include Botswana, Burkina Faso, Ivory Coast, Ethiopia, Senegal and Tanzania.

INDIGENISATION AND LOCAL EQUITY REQUIREMENTS

- A state may introduce legislation which requires a minimum local shareholding in all mining companies.
- In theory, such measures ensure that local populations benefit directly from mining revenue.
- However, indigenisation and other local equity requirements can be costly, complicated, conducive to the enrichment of elites, and possibly a breach of the non-discrimination norm under international investment treaties.
- It should be noted that indigenisation policies are not always purely resource nationalist focused. They often reflect a social transformation agenda and aim to ensure long-term structural and societal change, especially in countries with historical racial inequalities (for example, South Africa, Namibia and Zimbabwe).

INDIGENISATION AND LOCAL EQUITY REQUIREMENTS

Prominent examples of this trend

- South Africa requires mining companies to be 26 per cent owned by historically disadvantaged South Africans by the end of 2014 as part of the government's black economic empowerment programme.
  - The shareholding is, in principle, to be paid for at market value. Lack of necessary capital has, however, led to many transactions being vendor financed.
  - Black economic empowerment has largely enriched a well connected elite.
- Zimbabwe passed its indigenisation law in 2010 requiring foreign companies to transfer 51 per cent ownership to a local partner selected by the state.
  - In early January 2013 Impala Platinum and the Zimbabwean empowerment Minister signed an agreement which will see the company vendor-finance the acquisition of a 51 per cent shareholding in the company by black Zimbabwean groups.
- Kenya gazetted the Mining (Local Equity Participation) Regulations on 12 October 2012. The Regulations provide that mining companies must cede a minimum of 35 per cent of their equity to local investors, without an indication of whether the cession will be compensated. The Kenyan Attorney General has, however, subsequently advised mining companies that the regulations will only be applied to mining licenses issued after the regulations came into force.

MINING CONTRACT REVIEWS

- Some African countries have launched mining contract reviews with the intention to either renegotiate or cancel existing mining concession contracts. These processes are often focused on ensuring that the country obtains a greater share of the benefits of mining activities.
- Many of the countries which are seeking to renegotiate their mining contracts are those that signed deals during a time of low market prices when there was less competition and governments were in a weaker position to negotiate.
- The uncertainty caused by contract reviews – which might lead to the cancellation or renegotiation of mining contracts – is a danger for existing investors, and a possible deterrent to further investment in the country.
- Where the contract is subject to a bilateral investment treaty, its variation may violate the fair and equitable treatment principle on the basis that it upsets the company's legitimate expectations it had when entering into the contract. The affected investor may thus bring international arbitration proceedings against the offending state.
- Stabilisation clauses – which seek to preserve the sanctity of contract against the sovereign right to change the law – may also protect companies. Recent contract reviews have, however, specifically targeted these clauses.

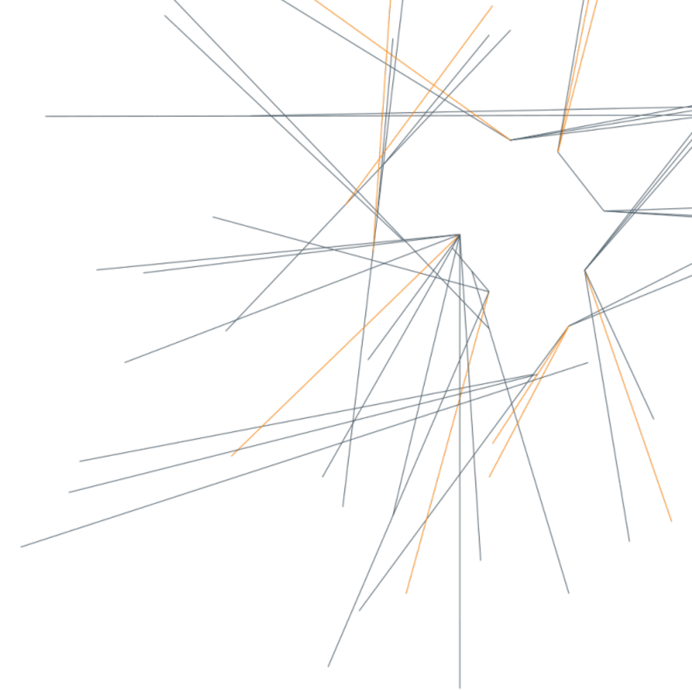
MINING CONTRACT REVIEWS

Prominent examples of this trend

- Sierra Leone has announced that a newly constituted National Minerals Agency will launch a sector-wide review of contracts in March 2013 to bring contracts in line with "*the best interests of the country*".
- Ghana set up a committee to review its mine development agreements with mining companies in February 2012. The committee's mandate is to review and renegotiate agreements that are not in the best interests of the country. The review coincided with increased mining taxes, which many mining companies would have been protected against by stabilisation clauses which are included in a number of mine development agreements.
- Guinea launched a mining contract review process in September 2011 to "*root out unconscionable provisions*" granted by previous administrations.
- Contract reviews are, however, also frequently linked to drives for increased transparency and fairness in the mining sectors. For example, Guinea's contract review is targeting contracts signed in the 2008-2010 period when the country was ruled by a military junta. On 15 February 2013, the Guinean government also published existing mining contracts on a state-run website in a bid to improve transparency in the sector.

WHAT MAY MITIGATE THESE RISKS?

- Companies should maintain a transparent relationship with governments and help them appreciate the value their projects can bring to the country.
- While not a fail-safe mechanism, foreign investors can remain welcome if they engage in infrastructure development, making themselves integral to the development process.
  - Vale has adopted this approach in Mozambique.
- Companies should also increase their "*social licence to operate*" by adopting a sound corporate social responsibility strategy (for example, developing healthcare initiatives, building schools and investing in other community projects).
- Investors can also seek opportunities to partner with the host government and increase the state's stake in the private sector's success ('win-win').
  - De Beers' 50/50 joint venture with Botswana is a singular success.
- The over-arching challenge is to strike an equitable balance of interests, ensuring that mining is productive, profitable, as well as fair to foreign investors, host states and affected local communities alike.
  - The Model Mine Development Agreement developed by the mining law committee of the International Bar Association is designed to assist parties to strike this equitable balance and could serve as a helpful template for negotiations.



Peter Leon

Head: Africa Mining and Energy Projects

Webber Wentzel, Johannesburg

South Africa

peter.leon@webberwentzel.com

www.webberwentzel.com

JOHANNESBURG

10, 16 & 18 Fricker Road,

Illovo Boulevard,

Johannesburg, 2196, South Africa

T +27 11 530 5000

CAPE TOWN

15th Floor, Convention Tower

Heerengracht, Foreshore

Cape Town, 8001, South Africa

T +27 21 431 7000

Legal Notice: these materials are for training purposes only and do not constitute legal or other professional advice