Mining

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RISKY BUSINESS - INTERNATIONAL MINING INVESTMENT AND THE RISKS OF POLITICAL INTERVENTION

"Only those who will risk going too far can possibly find out how far one can go".

The words of T.S. Eliot could be a rallying cry to those intrepid souls in the mining industry who, in the hope of reaping vast rewards, continue to invest in economically and politically unstable but mineral-rich emerging markets of the world.

At the same time, rising global demand for mineral resources (principally coal, copper, iron ore and gold) and attendant increases in commodity prices are focusing the interest of governments seeking to increase their gains from local mining industries. As a result we are witnessing significant political intervention in mining by governments in regions such as Latin America, Russia, Southern Asia and Africa.

Intervention by governments can take a variety of forms, from increased regulation and stringent licensing requirements, prohibitive taxes on production and trade embargoes, through to refusal by governments to honour contracts, cancellation of operating licences and permits and, ultimately, nationalisation and expropriation of mining assets without compensation. Introduction of currency controls is another way in which governments may make it impracticable for foreign entities to continue operating in that jurisdiction.

Recent intervention

Recent examples of such activity have been seen in Venezuela with widespread nationalisation of the mining industry by the government of Hugo Chavez. Governments have also intervened in other Latin American countries including Bolivia, Ecuador and Nicaragua.

In Africa, the Zambian government recently announced the suspension of issuing new mining licenses whilst simultaneously launching an audit into mineral rights granted to companies in recent years. The reforms aim to tackle corruption in the sector with the issuing of new mining licenses being resumed once the audit has been completed and problem areas have been identified.

Elsewhere, in the East African region, Eritrea faces tougher United Nation sanctions. At the time of writing, a UN draft resolution that would ban mining companies from investing in the country's mineral resources was under discussion in retaliation to its alleged support of Islamists rebels in Somalia.

Also, the Indonesian government has recently intervened in the coal market by setting a benchmark price for exports of Indonesian coal.

Even in developed countries such as Australia governmental intervention is evident. The recent announcement of the controversial carbon tax that will come into force on 1 July 2012 will have a significant impact on mining companies in the region.

Political risks insurance

Investors can shield themselves against some of the impact of government intervention by obtaining Political Risks Insurance (PRI). PRI plays an important role in assisting trade finance and commodity trading throughout the world, particularly in emerging markets. PRI policies will often include coverage not only for political intervention by the government but also terrorism, riot and civil commotion, insurrection and rebellion, war and civil war. This wide scope is particularly relevant in view of the recent unrest in Côte d'Ivoire and indeed throughout the Middle East and North Africa.

PRI coverage can be obtained from commercial insurers, from export credit agencies and international organisations such as the World Bank's Multilateral Investment Guarantee Agency (MIGA) and the African Export-Import Bank.

Practical steps

In view of the constantly changing geo-political landscape, it would be prudent for all mining companies and participants in the international trade of mining commodities to bear the following points in mind before investing in a new project or transaction:

1. Due diligence - Appropriate due diligence is vital. Research the local political risks and seek advice from local counsel as to whether any licences or permits are required for the proposed activity/trade (and, if so, ensure such licences are in place).

2. Insurance - Where appropriate, obtain PRI cover (though in some instances the cost may be prohibitive and cover unobtainable). Go through the terms of the policy carefully with your broker to ensure that it is tailored to your requirements and risks.

3. Contract negotiation - The terms of all contracts with government agencies, suppliers, contractors and customers should be reviewed carefully. Even if the local political landscape is relatively stable, the situation can change quickly and unexpectedly. Ensure that appropriately drafted clauses are inserted to deal with possible political intervention. For example, include a widely drawn force majeure clause.

4. Operational management - Efficient operational management which is sensitive to concerns of the local community is vital, not least from a public relations perspective. If governments perceive that foreign mining companies are not returning sufficient benefits to local populations or investing in local infrastructure, they may well be more inclined to intervene. Often there are mandatory local content requirements.

5. Vigilance - Monitor developments closely and, if PRI cover is in place, keep insurers informed by disclosing developments and giving prompt notice of any claims. Always check the terms of the policy to avoid missing any deadlines.

6. Lobbying - If political intervention seems likely, investors may consider approaching officials at the relevant authorities to voice their opinions on the subject. Naturally, much depends on the openness and transparency of the government in question. It is also important to be mindful of provisions of anti-bribery and corruption laws, such as those in the UK and the USA, which purport to have extra-territorial effect.

7. Disputes - Where a dispute arises which cannot be resolved through discussion, this may give rise to arbitration and/or court proceedings between any of the affected parties to the relevant contract.

   If the contract contains an arbitration clause providing for arbitration administered by the International Centre for the Settlement of Investment Disputes ("ICSID"), a dispute resolution facility provided by

the World Bank, the investor may consider bringing arbitration proceedings against the host government. Of course much will depend on the facts of the matter and the contracts in place. There may be a bilateral treaty in place which permits proceedings to be brought by a foreign corporation against the host government. There could be practical difficulties in establishing jurisdiction and enforcing any resulting award or judgment. Of course, commercial reality may preclude any such action being brought.

8. Disclosure obligations - Should political intervention lead to litigation or arbitration, there is likely to be close scrutiny of correspondence and dealings with the relevant government agencies, counterparties and indeed any relevant internal correspondence. Full records should be kept of all correspondence and/or meetings or other communications regarding the matter.

In summary, it is clear that the biggest winners in mining deals will be those companies that are most adequately armed to deal with the various risks involved either from extensive forward planning or understanding their options when things go wrong. Whilst the risks are significant, the potential rewards on offer are huge.

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At HFW, we have extensive experience advising clients in all aspects of mining and commodities, from M&A, insurance, due diligence, contract review and arbitration/ litigation, including bringing proceedings against host governments.

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