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Mining

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Global Overview

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Global mining overview

Exploration continues to be active, perhaps even skyrocketing – literally. In April 2012, a group of billionaire visionaries announced plans to mine asteroids in space. But for now, at least, mining companies have plenty of issues to focus on here on earth. With the global financial crisis still lingering, some countries are being tempted to seize more control of their mineral resources while others are tightening business regulations. Within the industry itself, several years of high commodities prices have helped pay for a buying spree of junior mining companies and now mergers of some of the industry giants are in the works.

In this article, we explore some of the most notable themes in the mining and minerals industry this year.

Resource nationalism

The global financial crisis continues to plague capital markets and to create tension for governments worldwide. In Africa, mining is booming but the economic benefit has been limited for most local populations (with notable exceptions in countries such as Botswana). Within this environment – as in many emerging economies – African governments face increasing pressure to redistribute the wealth derived from their natural resources.

Resource nationalism is a serious risk affecting the global mining industry – particularly in emerging markets. It is now increasingly being used to exert a measure of control and as a means of knowledge transfer. In 2011, the governments of Guinea, Zambia and Zimbabwe all introduced (or at least went on record as considering) greater equity participations in mining projects. Mozambique has structured a state vehicle to hold participation interests in mining projects.

Guinea's new government recently passed legislation allowing the state a free carry interest of 15 per cent in all new mining projects with the right to purchase a further 20 per cent interest on specified terms. The government has expressed interest in obtaining 'blocking minority' rights in mining projects. Perhaps more worrying is the review of mining rights granted by the previous government, which echoes a similar process undertaken by the Democratic Republic of Congo a few years ago.

Zambia's new government also moved quickly to demonstrate its commitment to negotiate additional benefits from the mining sector. Although the country has clearly expressed its interest in continuing to work with industry, the government has been reviewing several methods of ensuring increased benefits to the country as a whole from the industry. These measures include a review of the tax framework, a regulatory environment (including export permitting) and considerations pertaining to increased equity participations in projects.

In Zimbabwe, the government introduced measures in 2011 to require the transfer of 51 per cent of foreign owned mining companies to indigenous Zimbabweans pursuant to the country's indigenisation and empowerment legislation. The resulting uncertainty in the investment community as the government attempts to implement such measures has had a significant impact on the willingness of investors – both existing and new – to continue the development of Zimbabwe's mining industry.

In the Democratic Republic of the Congo (DRC), our firm recently acted for First Quantum Minerals and for the International Finance Corporation and the Industrial Development Corporation of South Africa after the company was excluded from its three mining properties. The process began with two international arbitrations in an attempt to have the properties reinstated to First Quantum. Then in one of the largest recoveries in a sovereign related dispute, the company agreed to settle all outstanding disputes by selling its three DRC mining properties to Eurasian Natural Resources Corp. for US$1.25 billion.

In South Africa, a lobby within the ruling African National Congress (ANC) party has also recently called for the nationalisation of mines. The government has, however, rushed to assure investors that mine nationalisation is not the formal position of the ANC.

African countries are not the only ones susceptible to resource nationalism. In October 2011, Indonesia's President talked about 'unfair contracts with foreigners' when he introduced the country's new Energy Security Policy. Then four months later, the government introduced Government Regulation No. 24, which restricts foreign investment in the country's lucrative mining industry.

Of particular concern is the sudden increase in the foreign divestiture requirement from 20 per cent to 51 per cent. There is some debate as to whether this change will apply to existing mine operations or only to new contracts. But there appears to be no debate as to who will have priority right for the divested shares – that will continue to be the purview of the central, provincial and regional governments. In a country where business and politics so often overlap, some observers have noted that the increase in foreign divesture requirements will coincide with Indonesia's 2014 Presidential election.

In March 2012, Australia's Labour government pushed through Parliament its own mineral resource rent tax on coal and iron ore profits – the country's two biggest exports. Australia's previous government had failed in its more ambitious plan to impose a 'super profits' tax on most minerals.

The Indonesian example, and to a lesser extent Australia's, points to some of the other measures governments employ – in addition to or instead of increasing their equity stake in projects. Wealth redistribution can come through increasing taxes and royalties, undertaking policy reviews, and introducing greater oversight and attention to linkages programmes.

It is unlikely we will see a return to the rampant nationalisation of mines that occurred previously in Africa and Latin America. There is now a general recognition that for many countries, outright nationalisation of their mineral resources did not yield the desired results. So while governments are actively looking at means of ensuring a wider distribution of the benefits derived from their countries' natural resources, they are doing so with the knowledge that it is essential to attract and retain international investment.

Regional developments: MENA and BRIC

MENA

Known for their rich oil reserves, the countries of the Middle East and North Africa are putting a new focus on the mining industry. The MENA Mining Congress in Dubai in October 2011 attracted international crowds of mining companies, industry participants and governments despite anxieties about political instability in the region.

It is expected that the MENA countries will continue to actively court mining projects in the region. It is likely that this will come through a liberalisation of rules governing mining activity, significant investments from state-owned enterprises, and a shift toward modern contracts used elsewhere for major project developments.

Brazil

Mineral production is up significantly in Brazil and the country is on track to set a new five-year record for investment in mining. Brazil's Mining Institute predicts investment will continue to grow and may reach $75 billion annually by 2016. This growth builds on the meteoric increase in the value of mineral production over the past decade from US$7.7 billion to US$50 billion – a 550 per cent increase.

Still, Brazil is not immune to the issues that temper mining investment periodically in other jurisdictions. The country is enjoying a historically low unemployment rate (6.2 per cent in March 2012), which is already putting pressure on wages and other labour issues at large infrastructure projects across Brazil. In spring 2012, the country's complex web of taxes was in the news again because of proposed new production taxes in at least three states. The federal government is also planning to double its royalty taxes on key minerals – most notably iron ore and gold.

Russia

While Russia is home to the world's largest iron ore reserves, it ranks fifth in global production. Yet taking a bigger share of the iron ore business may not be a current priority. The country remains focused on tapping its energy resources and has – like other gold producers – benefited of late from high gold prices. Now rising domestic labour costs and energy costs are starting to cut into profits in all parts of the Russian mining industry. The current political climate is also worrying for investors.

India

Coal represents roughly 80 per cent of mining activity in India yet the country still struggles to feed the growing domestic appetite for power. The Indian economy, which has experienced tremendous growth since economic liberalisation in 1991, is also hungry for precious and base metals. The government's National Mineral Policy, 1993 opened the door for foreign direct investment. However almost 20 years later, India's red tape, coupled with ongoing and prolonged drafting and consideration of a new mining law, continues to stall overseas and domestic mining activity.

Still, India's mining industry cannot be ignored. An interesting domestic merger created the world's seventh largest diversified mining company in February 2012. Sesa Goa and Sterlite Industries, both subsidiaries of Vedanta Resources, merged to create the US$20 billion Sesa Sterlite. Sesa Goa is India's largest iron ore producer and Sterlite is a significant producer of zinc, aluminium and copper.

China

The world's leading steel producer remains focused on securing its own sources for iron ore worldwide. Chinese investment – by both state-owned enterprises and private companies – in mining assets continues to grab headlines worldwide. But evidence of a perhaps inevitable slowdown in the Chinese construction industry and infrastructure development is triggering concern in the global markets. Copper prices are vulnerable given that China consumed approximately 40 per cent of refined copper in 2011. Aluminium and other industrial metal prices are also at risk due to market swings.

The opposite storyline emerges when looking at rare earth minerals – global demand for products such as electronics and green energy continue to drive demand upward. And it is China that mines and refines more than 90 per cent of the world's rare earth minerals. In March 2012, the United States, the European Union and Japan filed a complaint against China with the World Trade Organization. They allege that China's severe export restrictions on rare earth minerals violate world trade rules. Perhaps the rare earth mines coming online soon in Australia and California will inject enough new supply to ease tensions.

Regulatory developments

Despite the growing economic clout of the MENA and BRIC countries, the UK and the US continue to set the standard for global business. The implementation of new bribery legislation in the UK has direct implications for companies operating around the world. Similarly, regulatory reform of financial institutions in the US is being watched closely in the wake of the global economic meltdown of the late 2000s. Meanwhile, global institutions continue to grapple with complex issues related to corporate social responsibility.

UK Bribery Act

The extraterritorial reach of the UK Bribery Act 2010 (enacted on 1 July 2011) is likely to be the most significant regulatory change affecting the global mining industry. It significantly toughened UK law relating to foreign corrupt practices by making any company with a UK connection subject to UK rules governing its business practices abroad.

The UK Bribery Act applies to both the act of bribery or of receiving a bribe and it applies to bribery of private employees and public officials – domestic or foreign. In all scenarios, an intention to corrupt need not be shown and the penalties – both civil and criminal – can be stiff. Many of its provisions go further than the US Foreign Corrupt Practices Act, which was long heralded as the most stringent anti-corruptions legislation in the world. For example, the United States acknowledges the reality of so-called 'facilitation payments' when conducting business in some jurisdictions, but the UK's Bribery Act bans them completely.

Any company governed by the UK Bribery Act is required to disregard local customs unless a payment is permitted or required by the written law of the country in question, namely being in legislation or a written and published judicial decision. Otherwise, the test of what is proper or improper for overseas or UK is the same – what a reasonable person would expect in the UK.

There is still some disagreement as to which foreign companies are affected by the Bribery Act. According to the UK Ministry of Justice, merely listing stock on a UK stock exchange is not sufficient to create a place of business. But the Serious Fraud Office (the prosecuting authority) appears to be taking a more aggressive line, following more closely the US model that makes the FCPA applicable to any company listed on a US exchange. So for now at least, all companies should conduct a risk assessment and put in place a top-down culture and compliance programme against bribery and corruption to avoid potential liability of criminal prosecution.

Dodd-Frank Wall Street Reform and Consumer Protection Act update

On 15 December 2010, the US Securities and Exchange Commission (SEC) proposed rules to implement the provisions of section 1502 (conflict minerals disclosure) and section 1504 (payments by resource extraction issuers to governmental authorities) of the US Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The original deadline set by the SEC for receipt of comments on the proposed rules was 31 January 2011, and the Dodd-Frank Act required the SEC to adopt final rules by mid-April of that same year.

Yet more than one year after the deadline, the SEC has not yet adopted final rules and continues to receive comments on the rule proposals from companies that expect to be required to comply with the final rules: industry groups, foreign regulators, government officials and ministries that have an interest in the form of the final rules, non-governmental organisations, religious organisations, members of the US Congress and the public. These comments have touched on most significant aspects of the SEC's proposed rules, including concerns regarding the anticipated cost to companies of implementing the proposed rules versus the rules' effectiveness and benefits, the extent to which the rules would give effect to the intent of the US Congress in enacting sections 1502 and 1504 of the Dodd-Frank Act, which companies will be subject to the rules, and the ability of companies to comply with the rules if adopted in the form originally proposed.

Given the diversity of the often detailed and practical comments on the proposed rules, it is difficult to predict what changes the SEC may make to its original rule proposals. The uncertainty created by the delay in the implementing those rules should end soon. The SEC has advised that it anticipates adopting final rules for the conflict minerals and payment by resource extraction issuers disclosure requirements by the end of June 2012.

IFC's Performance Standards

The IFC is an affiliate of the World Bank Group that provides advice and financing for private sector projects and ventures in developing countries. It is the largest global development institution focused on the private sector in developing countries. It has adopted Performance Standards to 'define clients' roles and responsibilities for managing their projects and the requirements for receiving and maintaining IFC support'.

As of 1 January 2012, the IFC's Revised Performance Standards came into effect. In May 2011 the Board of Directors of the IFC adopted amendments to its Performance Standards and released the language in August 2011. Perhaps the most notable revision was to Performance Standard 7 (PS7), which addresses interactions with groups of indigenous peoples. There is some controversy about the inclusion of the concept of 'free prior informed consent' where in the past PS7 has only required 'free, prior, informed consultation'. Although a careful reading of PS7 reveals that consent is only required in a few circumstances (relocation, impacts on cultural property) and consultation towards consent is required for most other project development, this subtlety has been lost in the discussion and many now refer to PS7 as requiring consent of indigenous peoples.

United Nations & OECD Initiatives

On 16 June 2011, the UN Human Rights Council endorsed the 'Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework' (Framework) proposed by John Ruggie, the Harvard University professor who was appointed special representative of the UN secretary-general for business and human rights. Professor Ruggie spent six years researching business and human rights practices involving governments, companies, business associations and civil society worldwide. Ruggie first proposed the Framework in June 2008, resting on three pillars:

- the state duty to protect against human rights abuses by third parties, including business;
- the corporate responsibility to respect human rights; and
- greater access by victims to effective remedy, both judicial and non-judicial.

The Human Rights Council unanimously approved the Framework in 2008. The Framework was the first step in the process. The guiding principles for implementing the Framework are meant to be a more detailed guide for governments. The guiding principles recommend how governments should set clear rules for business regarding human rights and how business in turn should demonstrate its commitment to respecting human rights.

Building on Professor Ruggie's report, the Organisation for Economic Co-operation and Development (OECD) updated its Guidelines for Multinational Enterprises in December 2011. The OECD guidelines map out 'voluntary principles and standards for responsible business conduct in areas such as employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition and taxation'.

The OECD guidelines recommend that 'business enterprises should have in place policies and processes appropriate to their size and circumstances'. These include having a policy commitment, conducting a human rights due diligence process to address potential problems, and having a process to remediate problems.

To ensure corporate commitment to human rights, the OECD guidelines call for companies to adopt a policy statement that:

- is approved at the most senior level of the business enterprise;
- is informed by relevant internal or external expertise, or both;
- stipulates the enterprise's human rights expectations of personnel, business partners and other parties directly linked to its operations, products or services;
- is publicly available and communicated internally and externally to all personnel, business partners and other relevant parties; and
- is reflected in operational policies and procedures necessary to embed it throughout the business enterprise.

The guidelines are still relatively new and it will be interesting to see how widely the idea of such a policy commitment to human rights is adopted.

Look ahead

A great deal of industry and mainstream business media coverage in the year ahead is likely to revolve around merger and acquisition activity between the mining giants. The long-anticipated merger of Switzerland's two majors – Glencore and Xstrata – that would create the world's fourth largest diversified mining company has been drawing headlines since the discussions were made public.

The mining industry itself will monitor resource nationalism, continued maturation of mining activity in the MENA and BRIC countries, and the growing pains of regulations and evolving global standards surrounding business practices and corporate social responsibility.

Obviously the mining industry will continue to closely monitor the pulse of global demand for commodities. Any signs of malaise will call into question the wisdom of continuing to spend heavily on new mining developments in any jurisdiction. A slowdown will not be good news for anyone involved in the mining industry.

**With contributions by Tanneke Heersche, John Turner, Dimitri Cavvadas, Azlinda Ariffin-Boromand, Richard Cliff, Jonathan Martin, Sunny Sodhi, Edmond Luke, Steven Beharrell, Martin Fisher-Haydis and Kevin O'Callaghan.*

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