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ARBITRATION IN AFRICA

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Is your glass half full or half empty?

Attendees at this year's Mining Indaba[1] will be split between the doom-mongers and the eternal optimists. In between these two binary poles, there will be a range of views as to whether 2016 will mark the bottom of the market with an upside to follow or whether there are further tough times ahead for the next few years. Will 2016 bring boom or bust to the mining sector?

In either case, you'd have to have been living on Mars for the last 12 months not to have noted that the commodities sector is going through a particularly tough time; the current trough is the longest experienced in living memory and there are few signs of a recovery in the short term. So what's this got to with arbitration and why should you read on?

Why disputes are inevitable

Well, the old truism holds firm that hard times mean more disputes. Another proposition with which even the most sceptical miner could not quarrel is that prevention is better than cure. Thus, if it is accepted that more disputes are likely to be the order of the day in the mining sector over the next few years (whether you like it or not), then it should also be accepted that you need a Plan B; a process to determine those disputes effectively and efficiently when they arise. Mining projects involve significant capital expenditure and take time before the investment starts to generate a revenue stream and a return on capital invested. There's a lot that can go wrong before the mine produces a profit. Even in the best of times, there will be the perennial 'stuff' that happens which leads to disputes that need to get resolved. Things like environmental damage arising from the spillage or leakage of toxic substances; equipment not operating as it ought to or not being delivered to the mine site on time) and so forth.

Added to this we have the headwinds of a falling growth rate in the industrial development of China, which for many years had powered the commodities supercycle; demand for metals such as aluminium, copper, iron ore and nickel grew sharply as the country urbanized and built infrastructure. This reduction in demand (and a range of other factors including projects coming in stream from the boom years) has led to a glut in supply and a corresponding fall in commodity values. This has had a knock-on effect with a scaling back of capital-intensive investment by mining companies. That too has an effect, with an excess of capacity amongst specialist mining contractors and suppliers of mining equipment. Many of those on the supply side for mining also work in the other mineral extractive sector, oil & gas. Here too, the commodity price has fallen, leading to cancelled projects.

1 Indaba is the Zulu word for "meeting" and refers to the gathering of those involved in African mining that has taken place for over the last 20 years in Cape Town.

According to the FT, Energy groups have shelved nearly $400bn of spending on new oil and gas projects since the crude price collapse, pushing back millions of barrels a day in future output from areas including Africa.[2]

Hard deals increase tensions

The cancellation or postponement of all these projects means that contractors who geared up during the boom times are now faced with a very thin market. Whilst this has caused some contractors and suppliers to fail and others to merge and consolidate their business with others, overall there is still more contracting capacity than demand. This can lead to the contracting side accepting lower pricing offers from mining developers and agreeing more onerous terms under the development contracts. However, the award of contracts on unrealistic terms is rarely a sustainable strategy for either side of the equation. Cost and schedule overruns, where the contractor engaged to develop the mine has provided an overly optimistic price and schedule for completing the works (possibly in order to secure the contract) but then encounters problems that cause him to spend more and take longer, are not in the best interest of the mine owner. However, in this scenario, the contractor has no where else to turn but towards the mine owner who it is hoped will have the sympathy and cash to bail the contractor out of his problem. The reality is that mine owners do not have unlimited stocks of altruism or cash, particularly in the current commodities market. The end result is a rise in disputes in the mining sector.

Resource nationalism disputes

The other rising trend in the mining sector is that of resource nationalism. This affects Africa along with a number of other emerging economies which are heavily dependent upon the natural resources sector. As values in the sector have reduced, states which borrowed heavily against expected resource revenues now face budgetary shortfalls.

Populist governments are often tempted in these circumstances to require a re-calibration of their relationship with foreign investment capital with a view to providing the host government with a greater share of the revenues whether through tax receipts, increased mining licence fees and royalties or some form of action that is designed to encourage the mining company to sell out its investment at an undervalue.

Even though a mining company may have negotiated and agreed a stability agreement whereby the host government agrees to extend the term of a mining lease, maintain royalties and taxes at a certain level for a certain period and similarly not interfere with the mining companies investment, that will not stop the host government coming back some years later to 'review' the stability agreement and seek to adjust this. The host government's justification is invariably on the grounds that the particular commodity is of strategic importance to the country. Such a scenario is being played out currently in Ghana where the government is seeking to re-negotiate stability agreements entered into with international mining companies (who are continuing to resist any such re-negotiation).

Whilst there is no single answer to the problems faced by those wishing to develop mining projects in Africa in the current economic and geo-political climate, arbitration has emerged as the mechanism of choice for the resolution of international mining disputes. Much of this is due to the preference of the international investment community for an external tribunal independent of the local court system in the host country. External investors often perceive themselves to be at a disadvantage compared to the host country entity with

2 Financial Times, 14 January 2016: "Delayed oil projects total nears $400bn".

whom they have to do business and feel exposed if the ultimate dispute resolution process is limited to the local courts. The mining licence will invariably be granted by the relevant Ministry For Mines and Minerals (or its equivalent) and the fear is that the local court will side with the host country entity if there is a dispute about the terms of that licence. The same considerations arise where the dispute is with a local contractor.

The fact is that when foreign investors are pledging to invest tens or hundreds of millions of dollars into a mining project, they do so by taking a calculated risk that the project will perform at least as well as the minimum metrics on the financial model underpinning the business case. However, well advised parties will also ensure they have a 'Plan B' – a means to refer to dispute off to arbitration in case the proverbial hits the fan. It's a bit like having Plan A, which assumes the weather will be dry but Plan B in case it rains. Plan B is like an umbrella as it is designed to keep you dry and restore you to Plan A (which was the position you should have been in had the problem not arisen and the dispute not occurred). Climate experts agree that it tends to rain in sub-Saharan Africa. This is also where a lot of the mineral wealth of Africa is to be found.

Arbitration under the contract

There are two types of 'umbrella' for this purpose; the contractual version that is suited to the common types of commercial dispute that arise and a larger, more far-reaching version which is designed to protect you from the host government changing the ground rules. It's worth looking at each type in turn. Both are really important but it is only in recent years that the latter type has become more prominent as a means of protection.

For the run-of-the-mill mining disputes (namely, not those where the host government starts to throw around its weight), Africa is well served by a number of international arbitration centres, particularly the International Chamber of Commerce (ICC) in Paris and the London Court of International Arbitration (LCIA) in London. Both institutions provide an administered arbitration service and many of the mining disputes in Africa end up being resolved via ICC or LCIA rules, with the venue for the arbitration hearing being somewhere outside of Africa, be it London, Paris, Geneva, Stockholm or some other well-equipped city location. In addition, there are a number of regional arbitration centres in Africa covering north, south, east and west regions. Taking each in order, these comprise the Cairo Arbitration Centre ("CRCICA"), the Arbitration Foundation of Southern Africa ("AFSA"), the London Court of International Arbitration in Mauritius ("LCIA-MIAC") and the Common Court of Justice and Arbitration ("CCJA"). The latter was established by the Organisation for the Harmonisation of Business Law in Africa ("OHADA") and which acts as both in an arbitration administrative body and a Court and largely covers Franco-phone West Africa.[3]

In 2015, the CCJA (acting in its judicial capacity) upheld an arbitration award which had been granted in favour of a Cameroonian entity (International Business Corporation SA) against the Cameroonian National Oil Company. The significance of that decision was that the CCJA had to determine a number of issues raised by the Respondent National Oil Company all of which were designed to de-rail the arbitration award. On each of the issues raised, the CCJA came down firmly in favour of the Claimant. That determination by the CCJA has been seen as providing positive support within an African institution for arbitration under the OHADA regime and for the arbitration process generally.

3 The OHADA Treaty comprises 17 African states, namely Benin, Burkina Faso, Cameroon, Central African Republic, Chad, the Comoros, Congo, Côte d'Ivoire, Equatorial Guinea, Gabon, Guinea Bissau, Guinea, Mali, Niger, Senegal and Togo.

The LCIA-MIAC Arbitration Centre is also worth of mention given that this is a relatively recent (2011) creation, established with the support of the LCIA to administer African arbitrations within Africa (Mauritius). This centre has its own set of arbitration rules which can be used by parties of any nationality, notwithstanding the absence of any connection with Mauritius. Its big selling point is that it aims to have African disputes resolved by arbitrators who have deep experience of practising in Africa, with the venue for the arbitration being a neutral African country; Mauritius.

Arbitration under BITs - arbitration but not as we know it

It is in the area of resource nationalism where parties need a different type of umbrella. With apologies to Mr Spock and Star Trek fans, this is arbitration but not as we know it.

Mining projects involve the investment of large sums of money, involving capital values upwards from US$50 million into the US$ billions. With such large sums at stake, the risks of successfully developing and operating a mining project need to be addressed when assembling the investment. This is part of the due diligence process that should include consideration of Bi-lateral Investment Treaties ("BITs") These treaties are necessary to support trade agreements entered into between states around the world. BITs help encourage and support the flow of investment and business between bi-lateral member states.

African states have signed more than 830 BITs but the terms of each differ with each having been negotiated individually. However, the majority of BITs will have a series of common features. These include protection against unlawful expropriation by the host government or state entity where the investor is deprived substantially of all the value of its investment. Another typical feature of a BIT is the requirement of fair and equitable treatment which includes protection of an investor's legitimate expectations, e.g. as to the stability of the regulatory framework. A further and important feature of most BITs is that the investment-related dispute can be brought before an international arbitration tribunal and are assessed under public international law, thus removing the state's power to interfere.

Unlike arbitrations referred to the LCIA, ICC or one of the regional African bodies, there is no need for the project documents to identify expressly the applicable BIT or provide for all disputes to be referred to arbitration. In fact, there is no need for an arbitration clause at all. If the actions of the state entity are sufficient to trigger the BIT, the umbrella can be erected without permission of the host government (subject perhaps to exhausting other remedies through the dispute resolution machinery of the contract, depending on the terms of the relevant contract).

Another really important point about investor-state arbitration is that the proceedings are a matter of public record. Thus, the fact that an investor has referred a state entity to arbitration under a BIT provides an adverse advertisement to the international investment community that this particular state may not be one with which those investors wish to do business. As foreign direct investment is necessary for the development of African resources, BITs remain an integral part of maintaining the correct balance between investor and host state.[4]

4 Capital investment levels in sub-Saharan Africa in 2014 rose from $42bn to $61bn (Financial Times, 19 May 2015: "Foreign direct investment in Africa surges".

Take away points

For mining companies expanding existing facilities or building new ones in Africa, you need to do proper due diligence and you need a Plan A to make sure the project proceeds in accordance with your economic assumptions. You also need a Plan B in case matters take a turn for the worst. These factors are important for those investing equity, providing debt or other forms of credit support for the mining company.

For those looking to invest in mining projects in Africa, it is always worth looking at the terms of the BIT between the host government and the state in which the investor is domiciled. Some BITs are better than others and forum shopping is sometimes encountered where the investor establishes an entity in a state which has a particularly favourable BIT with the host government state, for the simple reason of providing the best protection for its investment.

Disputes are a fact of commercial life and over the long term life of a mine (be it 5, 15 or 50 years), 'stuff' will happen. When it does, it's best to make sure you have a clear process set out in the development contracts that enables the dispute to be resolved effectively and efficiently by an impartial tribunal of qualified experts, operating outside of the jurisdiction of the host state. Moreover, where the dispute arises because of what is (or is perceived to be) some form of resource nationalism by the host country, an investor-state arbitration under a BIT may be the ultimate form of protection for the mining investor.

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