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CD corporate disputes

MINING SECTOR DISPUTES

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MINING SECTOR DISPUTES

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CD: Could you provide an overview of the volume, size and scope of disputes currently taking place within the mining sector?

Ford: Disputes tend to be either relatively small or rather large. It seems that the mid-range disputes, if they are occurring, are not reaching the public arena. The scope is typical of this type of dispute, ranging from disputes between producers and purchasers where price fluctuates outside expected ranges or where the product does not meet specifications, possibly due to attempted cost savings.

van Zyl: While it is difficult to quantify the volume and scope of disputes in Africa, it is safe to say that there are strong incentives for mining companies worldwide to avoid disputes, and to resolve them amicably where they do arise. These disputes are complex and difficult to resolve in any forum, partly as a result of the difficulties associated with determining the value at stake and appropriate compensation.

Rigby: Claims for damages around the world are substantial and in North America typically range from tens of millions to billions of dollars. The scope of these claims is varied and includes revocation or non-granting of licences and permits, disputes over taxation and royalties and non-disclosure of material information during asset sales. Given the extremely lengthy nature of legal due process, compound interest on damages claims can be quite substantial. Then there is the issue of the award of costs for attorney and expert fees, which can also be substantial. The majority of disputes appear to be between a sovereign government and a mining company, but disputes between mining companies are also common.

> **"The trends that fuel disputes tend to be regional in nature, with one factor being the differing philosophies around the ownership of natural resources."**
>
> *Andrew van Zyl, SRK Consulting (South Africa) (Pty) Ltd*

McKibben: While we cannot comment specifically on the volume or size of mining-related disputes, in Australia the scope of these disputes currently centres on contractual terms, personal injury,

labour and employment, and regulatory and tax and stamp duty issues. This is due to the nature of the Australian mining industry, which is dominated by a few large companies supported by numerous junior explorers and developers, often with limited levels of in-house expertise. This means widespread sharing of risks and rewards through joint venturing, earn-in, royalties or other contingent payment arrangements, especially given the way that mining ties up capital for significant periods before returns are made.

Nelson: Activities in the mining sector can potentially give rise to a variety of disputes, including contractual disputes between joint venture partners over expenditures or division of profits, contractual disputes between the mining operator and sub-contractors, environmental disputes between local constituents and the mining operator and other disputes between the mining investor and the government. Mining is a particularly dispute-prone field given that any mining project will usually involve multiple parties working collaboratively over extended periods of time. Furthermore, the large amounts of capital needed to conduct major mining operations and the potentially lucrative returns from mining, combined with the fact that many metal and mineral deposits, are in jurisdictions foreign to the mining investor's own home state. Since commercial arbitration is generally private, there is no body of data that would definitively show the size and scope of all disputes being arbitrated in the mining sector.

CD: What particular trends and developments – such as commodity prices, supply chains, sanctions, among others – are fuelling disputes in this space?

van Zyl: The trends that fuel disputes tend to be regional in nature, with one factor being the differing philosophies around the ownership of natural resources. A number of agreements in developing countries focus on ownership and the valuation of government stakes and future payments, such as royalties, dividends and taxes. Due to cyclical impacts on these valuations, stakeholders may feel they are receiving inadequate compensation, or the project financing may even collapse as the stake granted becomes unaffordable in the face of lower commodity prices. If the local value system characterises mining as an activity that extracts from the population's inheritance, then it is difficult to fully resolve a dispute by means rooted purely in the legal system. Another driver is increased transparency and third-party assurance requirements. Legislation such as the Foreign Corrupt Practices Act and the Equator Principles has led to allegations and disputes over payments and processes.

McKibben: In Australia, there has been an escalation in conflicts between contractual counterparties, primarily around interpretations

relating to obligations to deliver against a construction contract, a mine plan, a take-or-pay contract or a technical study, such as a bankable feasibility study. Another common area of dispute is the definition or quantification of a mineral resource and ore reserve – often with reference to the JORC Code 2012. Regulatory issues have largely arisen from a perceived change in the regulator's guidance regarding forward-looking statements and the information needing to be disclosed to potential investors when considering investing in mining equities. Declining revenues from mineral royalties have led to a greater inclination by state revenue agencies to dispute and litigate tax and stamp duty assessments.

Rigby: Current trends include the increasing impacts on mining with changes in government and their policies, such as changes to fiscal terms like tax, royalties and commodity export tariffs, as well as outright bans on certain mining-related activity. They also include inadequate disclosure and due diligence, and the influence of vocal social opposition upon government politics.

Nelson: Some years ago, high commodities prices accelerated investment in the sector, but a mid-decade drop in metals and minerals prices has seen investment slow down. This fluctuation has altered the economics of many mining contracts, which has inevitably fuelled disputes. For example, in 2007, India's state-owned Steel Authority of India (SAIL) entered into a contract to purchase coal from two Australian companies at a fixed price. After the contract was signed, there was a sharp rise in coal prices and the Australian entities failed to deliver the coal at the contracted price. SAIL commenced a New Delhi-seated ICC arbitration where it was awarded over $150m in damages in 2011. By definition, fluctuating commodity prices are related to changing supply and demand for commodities.

Ford: The volatility in commodity prices and demand makes it difficult for all the parties in the supply chain to estimate price and volume. Demand appears to be fluctuating unexpectedly of late, coming out of the depressed commodity market of a couple of years ago. It does not appear to have reached a stable level or even a stable rate of growth. As a result, the various players in the market can be caught. There are typically about three to five different parties from the miner to the consumer of the product, with separate contracts between each one. When one of the purchasers – usually the last one – cannot take the product or insists on a price reduction, this can have a domino effect back to the miner, or one of the players in the middle carries the can.

CD: Broadly speaking, what particular dispute management and resolution techniques would you suggest are most

suitable for this sector? How would you evaluate the benefits of mediation, arbitration and litigation?

McKibben: The proliferation of sophisticated contracts in the Australian mining industry means that disputes are anticipated and well-planned dispute mechanisms are generally in place. Given the inherently high level of uncertainty and risk associated with mineral projects, the ability to foresee the potential for disputes and implement appropriate procedures and processes for their resolution is highly important. While not the only mechanisms for the resolution of commercial differences and disputes, arbitration and binding determinations by experts or dispute boards represent appropriate means of managing and resolving conflicts, prior to the onset of litigation.

Rigby: Mediation rarely seems to work because many mediators are not experienced in this sector and do not fully appreciate the many economic, technical, environmental, social and political issues. Without this expertise, litigation and arbitration may be preferable routes. Ultimately, it comes down to the quality and judgement of the arbitration tribunal or judge and jury, and how well and truthfully the respective legal cases are prepared. The devil really is in the detail, and this can give rise to some surprising judgements with equally unexpected awards.

> **"I am a strong proponent of mediation, particularly in this sector where companies often have long term contracts."**
>
> *Cameron Ford, Rio Tinto*

Ford: I am a strong proponent of mediation, particularly in this sector where companies often have long term contracts. Mediation is a very useful tool where it is important to preserve and develop lengthy relationships. Often neither party can afford to terminate the relationship and needs to find a way to resolve the dispute and carry on with the contract. Often the dispute is not of the value or nature to justify ending the relationship. Mediation has commercial benefits as well as those usually touted of being confidential, non-confrontational, self-determinative, flexible as to processes and outcomes, quick and cheap.

Nelson: Arbitration has long been a preferred mechanism for resolving mining disputes. It has the advantages of confidentiality and – relative to certain countries' courts systems – some degree of speed. Indeed, many parties will typically want to avoid having to resort to local courts for disputes relating to mining licences, particularly given the inefficiencies inherent in various host countries' court systems and the need for a prompt resolution in order to maintain the value of the mining concession. Prospective mining investors investing in a foreign country should evaluate the options available to structure the investment through a country that has an investment treaty with the host state in order to ensure access to investor-state arbitration.

van Zyl: No 'one size' will fit all circumstances. The optimal technique will differ between countries, and will depend on where the parties are located and which of the stakeholders is initiating the dispute. Different agreements, laws or regulations will cover each of these parties. What is important for the client to understand is the 'inherent uncertainty' of certain mining issues in light of the burden of proof in the litigation environment. When arguing the technical basis of a dispute like valuing a prospect, it may be difficult to conclusively prove what is reasonable or unreasonable. Reasonable compensation is difficult to determine even when given a specific set of circumstances at a given time. Anecdotally, there does seem to be a move toward arbitration and in some jurisdictions this can be a good solution. However, there is some resistance from governments to be subject to an 'outside' authority.

CD: Have there been any recent cases of note? What lessons can the

mining industry learn from the resolution of these disputes?

Nelson: Aside from the *Crystallex* case, several other cases have arisen from president Hugo Chavez's measures related to the Venezuelan gold mining sector, resulting in large damages awards against the country, including *Gold Reserve v. Venezuela and Rusoro Mining v. Venezuela*. Investor-state cases also give a window into the challenges facing certain regions and projects. The ongoing controversy related to Canadian mining investor Centerra's investment in Kyrgyzstan's largest goldmine, Kumtor, is a good example. Centerra has commenced two PCA-administered UNCITRAL arbitrations against the state. The first, initiated in 2006, reportedly related to certain state measures including a $1.2m unauthorised tax, was settled in 2009. Notwithstanding this settlement, the Kumtor mine has been the source of continued political tension, prompting a number of environmental actions and criminal investigations against Centerra by Kyrgyz local authorities, which are currently being challenged in a second arbitration commenced by the investor in 2016.

van Zyl: It is important to arrive at a result that can be considered reasonable by both sides, which will lay the basis for an amicable conciliation of the dispute before it damages the relationship. One example involved disputes over geology, accuracy of studies and other modifying factors crucial to the determination of value. This case required a relationship of trust to be built, as well as a detailed analysis of the uncertainty – identifying the party at risk should the uncertainty not be resolved. Both parties needed to be able to satisfy themselves that their specific concerns were addressed in the final agreement.

Ford: An important milestone was passed in 2016 with the first decision of the Singapore International Commercial Court in *BCBC Singapore Pte Ltd and Anor v PT Bayan Resources TBK and Anor*. The case involved a dispute between Australian, Singapore and Indonesian companies over the use of technology in the production of sub-bituminous coal from mines in East Kalimantan. It was noteworthy for mining and other companies in international transactions because it was the first step in validating the SICC as a viable alternative to litigation and international arbitration. With the concern over time and cost in arbitration, and the fear of domestic preference in litigation, parties have been watching the SICC to see if it can overcome these perceptions. BCBC Singapore was transferred to the SICC on 4 March 2015, hearings were held over two weeks in November 2015 and on another day in January 2016 and a 110 page judgment was delivered in May 2016.

Rigby: A process of mediation prior to arbitration and litigation can be adopted, provided there are experienced and entirely independent technical, financial and legal minds at work. However, difficulties arise in terms of funding this approach. In many cases, internal legal counsel may be all too eager to go the legal route, as this is generally their raison d'être. There are many variables in mining that can marginalise a project, so ideally the parties would begin with the end in mind when negotiating agreements – by accommodating all of the aspects that could go wrong. Even then, there should be clauses and dispute resolution language for unforeseen circumstances.

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>
> *Neal Rigby, SRK Consulting (U.S.), Inc.*

McKibben: Native title remains a significant and contentious issue for mining companies in Australia. As a consequence of the decision in *McGlade v Registrar National Native Title Tribunal*, between 120 and 150 registered Indigenous Land Use Agreements (ILUAs) that were not signed by all members of the Register of Native Title Claims may have been rendered invalid. The decision increased the uncertainty regarding ILUAs and required mining companies to engage in costly procedures to ensure that all named applicants are parties to, and execute,

the ILUA. In June 2017, Australia's federal parliament passed the Native Title Amendment (Indigenous Land Use Agreements) Bill 2017, restoring legal certainty for ILUAs, which have been central to productive and cooperative partnerships between the minerals industry and indigenous communities over the last two decades.

CD: What issues would you suggest companies consider when dealing with a dispute as it arises? What early steps can assist the process?

van Zyl: Regular and deliberate contact and communication with all stakeholders can help companies retain the initiative, as it gives early warning of potential disputes. This applies particularly where a mining company's social licence to operate can be affected; taking a dispute into court may lead to long-term disruption, even if the company is successful in winning the case. Agreements that address risks and uncertainty up front and allow governments to manage their exposure can limit the number of disputes that arise. For instance, some clauses might include provisions that assume approval in the event of no response within a given timeframe. While the need for such clauses is understandable, it is preferable to have governments respond on time.

Ford: One of the most useful things disputants can do is get people talking to each other in person, rather than by correspondence or even by phone, instead of through lawyers. The interpersonal dynamics of face-to-face discussions are significantly different from those in written correspondence. Of course, lawyers have their place and may need to write formal letters for legal purposes, but to actually resolve the dispute there is little better than having the protagonists in the same room as early as possible. Sometimes it is enough for the parties to negotiate without a facilitator, but often an independent mediator will provide the necessary breakthrough using her mediation skills. This is one reason dispute resolution boards have been successful in the construction industry, because the disputants are brought together early to thrash things out.

McKibben: Conflict avoidance and mitigation measures widely adopted in the Australian mineral industry include proactive management so that issues are raised early and difficulties are addressed in a positive and objective manner. It is also important to have clear contract documentation and a strategy for dealing with key risk areas, as well as a sound understanding of partner objectives, effective communication channels, timely provision of information and good payment practices. A key mechanism in joint ventures is a stringent management profile encompassing an operating

committee, timely communication between parties and coordination between the joint venture committee and parent companies. A vital aspect of construction contracts is the diligent recording and tabling of issues. Often, there are very well-resourced contractor teams managing contracts for owner teams that are not as well resourced. Owner clients should recognise the risk and ensure that they have adequate skills and capacity to manage contractors.

Nelson: As with any dispute, the first steps to take when tensions arise are, to first gather all relevant information and to maintain open lines of communications with the opposing side. As a part of this exercise, given that mines are 'on-shore' and heavily dependent on local resources, it is critical to keep dialogue open with local government, community and unions. If investor-state arbitration is an available option, parties must be aware of relevant 'cooling-off' periods and be sure to document the events that triggered the dispute. This also applies in cases where contracts provide for multi-tiered dispute resolution clauses. Parties must also be aware of other applicable procedural requirements, such as treaty requirements to exhaust local remedies prior to commencing investor-state arbitration. During this pre-dispute phase, and even during the course of formal dispute resolution, whether by arbitration or litigation, parties should explore settlement options and solutions that are agreeable to all parties.

> **"It is important to build in contractual risk allocation in mining contracts, which are often long term, to prevent disputes from arising during the life of the project."**
>
> *Timothy G. Nelson, Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates*

Rigby: It is vital to ensure transparency and dialogue from the outset, and not to 'go legal' too soon. Companies should exhaust all other options first. For mining companies, it may even be worth financially incentivising their external counsel to reach resolution out of court.

CD: What steps can mining companies take to help prevent disputes from surfacing, particularly when drafting commercial agreements? In your experience, do they have a tendency to pay too little attention to dispute

resolution clauses during contract negotiations?

Nelson: It is important to build in contractual risk allocation in mining contracts, which are often long term, to prevent disputes from arising during the life of the project. For example, parties may wish to consider force majeure clauses excusing performance upon the occurrence of certain events. It is also important to consider the inclusion of clear exit provisions, and, if appropriate, liability caps, in mining contracts – whether it be with the state or other private entities. On occasion, exiting the investment, and the country of investment, may be preferable to long drawn-out disputes. For example, with the discovery of shale in the US, a US company with a long-term investment contract for mining coal in a foreign jurisdiction may consider it economically more viable to exit that contract and divert resources to the extraction of shale domestically.

Rigby: It is difficult to anticipate every eventuality when drafting commercial agreements, but large mining agreements typically include the use of some form of tribunal counsel for dispute resolution. Often, though, particularly with smaller agreements, governing law and jurisdiction are not given enough consideration. It is important to agree to an unbiased and mutually acceptable location for all parties. There also needs to be tougher language regarding corruption and force majeure clauses for unreasonable actions by either party, followed by a clearly defined, step-by-step resolution process.

> **"In our experience, many Australian mining companies pay minimal attention to dispute resolution clauses during deal negotiations."**
>
> *Jeames McKibben, SRK Consulting (Australasia) Pty Ltd*

McKibben: In our experience, many Australian mining companies pay minimal attention to dispute resolution clauses during deal negotiations. Furthermore, many key technical terms are either inadequately or inappropriately defined, reviewed and interpreted within contracts. Key dispute areas often centre on the definition of levels of technical study and categorisation of resources, despite the longstanding industry guidance. A key aspect in construction contracts is to select the most appropriate contract style, determined by where

execution risk lies and who should best carry this. By way of example, underground development projects do not lend themselves to lump sum type contracts, due to the inherent variation in ground conditions that can easily impact ground support costs and schedules.

Ford: Like many companies, there is no doubt that mining companies could pay more attention to dispute resolution clauses. Frequently, those clauses are part of a template negotiators are wary of changing – negotiating counsel may not be aware of the latest developments in dispute resolution or the most appropriate method for the particular contract, counsel could feel that the substantive provisions are strong enough to deal with most eventualities or simply the clause is being considered at the end of long negotiations when no-one has much energy to argue over apparently non-essential terms. Companies should seriously consider multi-tier dispute resolution clauses to nip disputes in the bud before they can only be resolved by formal proceedings. Tiered clauses requiring negotiation and mediation bring the parties together. Many external dispute resolution lawyers do not like tiered clauses because they inhibit their freedom to commence formal proceedings immediately.

van Zyl: Stakeholder engagement is essential for avoiding disputes. Companies need to purposefully engage with their stakeholders in order to understand their concerns while maintaining the initiative. Private sector disputes tend to be easier to resolve as the authority selected to resolve the dispute is accepted by both parties. However, disputes with governments and communities can be more complex; in particular, a court or arbitrator's judgement and authority may not be acknowledged as legitimate. Understanding the sources of uncertainty, particularly those that drive value, is key to constructing agreements that minimise disputes. Companies that focus on a positive message, particularly when this messaging is primarily driven by a desire to boost their share price, can limit their ability to negotiate agreements with governments and communities that provide space to negotiate cyclical downturns. It is ultimately in the interest of the company to have engaged and informed stakeholders.

CD: How do you envisage the outlook for the mining sector over the next 12 to 18 months in terms of the nature and prevalence of disputes? Do you believe companies are well-prepared to deal with disputes arising from international mining agreements?

Rigby: Disputes are not likely to reduce in the foreseeable future. There are a number of new arbitrations and litigations in the pipeline, in countries such as the US, Tanzania, Indonesia

and the Democratic Republic of Congo. The major mining companies have the financial muscle and resources to manage such disputes, but not so the juniors. Juniors are often shocked at the inordinate time and excessive costs involved in prosecuting a case. Recent developments in which major law firms fund or part-fund litigation and arbitration cases – and the availability of speculative funds – hardly help to resolve a dispute. Neither, of course, does unreasonable positioning at the outset of a dispute.

McKibben: Despite many years of operating in foreign jurisdictions, and the increasing complexity of mining agreements, Australian mining companies continue to find themselves in dispute. While they may have initially negotiated a robust but fair agreement, they also need to review it periodically to allow for mutually agreed amendments. It should go without saying that in all jurisdictions a robust dispute resolution clause is a necessity, setting out a clear pathway to a resolution. This should always begin with facilitative processes such as mediation and then, if necessary, escalate to arbitration to ensure finality.

Ford: The volatility of the market will produce disputes where a party cannot absorb the impact of the other party's actions. Most companies use formal disputes as a last resort but some will be forced to it because of their financial circumstances. I do not think they are any better or worse prepared than usual, but I have no doubt they could be better prepared by using the methods described here. Even where they do not have existing mediation agreements, they should seriously consider seeking the other party's agreement to a mediator for the instant dispute. They could propose a mediator for joint ad hoc appointments or consult institutes such as the Singapore International Mediation Centre which can assist in discussing mediation with a reluctant counterparty.

van Zyl: Disputes with communities and governments appear to be increasingly frequent. These are generally difficult to deal with since they involve participants that do not have purely commercial motives. Formal channels to resolve a dispute may also be ineffective if the authority imposed by contract is not recognised by a community, for example, that was not party to the contract. As the commodity market improves and valuations rise, mining companies would be wise to be circumspect about their story to shareholders. 'Over-selling' their project's potential returns is likely to increase demands from communities and government, and will undermine the durability of their mining agreements. Irrespective of their approach, however, certain actions by the government, such as changes to mining codes and carbon taxes, have created substantial uncertainty regarding tenure, returns and general ability to plan

and finance projects. These will inevitably lead to disputes and are not limited to developing countries.

Nelson: The potential growth of renewable energy sources, the drop in commodity prices, increased scrutiny over the environmental and social impact of mining, China's reportedly decreased appetite for metals and all of the other trends mentioned here suggest that there are no constants in the mining industry. Given the current dynamics of the mining industry, this sector is prone to see further disputes over the next 12 to 18 months. If mining contracts include well-drafted dispute resolution clauses and the investments are structured through countries that give the investor access to investor-state arbitration, then, aided by experienced counsel, parties should be equipped to deal with challenges. CD