Investing in Africa

Looking through the legal prism

Presentation for Australia Africa Mining Industry Group

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3 July 2013, Perth

AAMIG Australia-Africa Mining Industry Group

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Introduction – Key topics and themes

- What can be achieved in this session – the danger of over-generalisation
- The general commercial outlook – where are the opportunities?
- The legal framework and particular legal challenges
- Building blocks in developing your project
- Managing project risk – an investor's key objective
- A key African player - getting to know Development Finance Institutions
- Infrastructure and resources – a symbiotic relationship
- Legal due diligence (Guillaume Blanc)
- Financing African projects (EFIC)

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- Projects team of **20 senior lawyers in Perth, London and Johannesburg** with a focus on Africa – project development, project finance, corporate & commercial
- H&H Trinity formed in 2011 to service Australian clients investing in Africa and Asia. Combines a premium Australian projects firm in association with one of Africa's most experienced law firms
- Each of H&H and Trinity highly rated by leading legal guides (resources and Africa): **H&H Top 20** in Australia for mining and energy – **Trinity top 10** for Projects in Africa
- Combined African experience list of over **500 projects/transactions**
- **Competitive fees and risk-sharing structures (particularly relevant in high risk projects in Africa)**
- African experience **on-the-ground in Perth**
- Strong network of clients including commercial banks, DFIs and investors, infrastructure providers, suppliers
- Network of correspondent firms across Africa
- Language capabilities

The commercial framework (1)

- So, what's the investment outlook in Africa?
- For resources, increased focus by governments on value extraction in the form of:
  - increased share of profits;
  - increased obligations on resource companies to invest in-country;
  - increased State participation.

The commercial framework (2)

- Increased sovereign share of mining sector profits while attempting to balance private investment incentives
- Recent and proposed amendments to legislation:
  - increased royalties (e.g. in Tanzania, Mauritania, Burkina Faso but contrast others – Guinea and Botswana?)
  - increased corporate tax rates (e.g. Ghana)
  - a new tax on “super profits” (e.g. in Côte d’Ivoire and DRC, Tanzania)
- Some “maturing” of tax incentive schemes to encourage investors

The commercial framework (3)

- Mining companies are being required to do more to increase local employment and business opportunities
- Illustration: Burkina Faso's draft new Mining Code:
  - preferences given to local Burkinabé companies for supply of goods and services;
  - provisions increasing local employment through priority recruitment;
- Illustration: Mali's new Mining Regulation
  - New rules to promote the development of local communities through Community Development Plans.

The commercial framework (4)

- State Participation in mining operations is viewed by many Governments as a means to:
  - extract economic benefits;
  - provide a measure of control; and
  - provide a means of knowledge transfer.
- State Participation has been identified by investors as one of the biggest risks affecting the sector.
- See:
  - Zimbabwe (51% to indigenous investors)
  - Burkina Faso (additional participation by “negotiation”)
  - Mauritania (optional maximum 10%)

The commercial framework (5)

- General financing environment difficult
- But mining is only half the story.
- Infrastructure (H&H Trinity: 45 active infrastructure projects in Africa)
- Agriculture (H&H Trinity: 5 active large-scale agricultural projects)
- Private equity - significant increase interest from private equity investors (Helios, 8 Miles, Carlyle fund)
- This should be of interest to all West Australian, including mining developers

Legal Framework

- 54 countries. 54 legal systems.
- Specific issues to consider when structuring your project:
  - Types of corporate vehicles
  - Indigenous shareholdings
  - Financing matters (capital restrictions, interest payments …)
  - Registering and enforcing of security
  - Insurance
  - Employment
  - Land
  - Dispute resolution
  - Compliance
  - Bribery

Successful structuring: Building blocks

- Understand the risks (and managing them)
- Where’s the money coming from?
- Logistics – are you on the ground?
- Feasibility – do you have a project?
- Local support
- Advisers – international and local
- Government support
- DFI support
- The importance of tax
- Compliance

Risk management (1): Risk? What risk?

- How is risk approached in your company?
- Typically, informally; some visits, meetings, ask the lawyers … decision
- Very little disciplined risk analysis at an early stage of investment – project gathers a momentum of its own
- Often too late to unwind – tax and corporate structures are a particular problem

Risk management (2): And it's a real risk

- The spectrum of risk is wide; depends from who's perspective
- And it's a real risk in development, financing and operations particularly on the regulatory side:
  - Corruption – the Opacity Index
  - Administrative barriers to investment
  - General approvals
  - Sectoral licensing
  - Site development
  - Operational requirements
- And of course, "ultimate" political/regulatory risk
  - First Quantum (DRC)
  - Rio Tinto: Guinea
  - ACR: Marange
  - Creeping Expropriation

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Risk: The discipline of project finance

- Benefits of looking at risk through the eyes of project finance lenders
- Project finance teaches us that:

  "… *risk should be allocated to the party best able to manage that risk*…"
- Risk allocation is important but in Africa it is essential (delays and shareholder dissent magnified)
- Inadequate passing of risk means the project is unbankable or will require sponsor support … or worse.
- Importance of early analysis and understanding of risk.
- It's also a good discipline in risk mitigation

The discipline of project finance

- Project-specific risk
  - Completion risk: EPC
  - Operating risk
  - Market
  - Participant risk
  - Supply or resource risk
  - Infrastructure risk
  - Environmental risk
  - Currency risk
  - Engineering risk
  - Syndication risk
  - Interest risk
  - Legal risk
  - Force Majeure
- Political/sovereign/regulatory risk

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Project specific risk (1)

- Completion risk: EPC/construction
  - EPCM vs EPC
  - Design risk
  - Interface
  - Mechanics for passing risk (time specific; LDs; termination for delay)
- Operating/maintenance risk
  - Cost, management and technical components
  - Obligation to provide specific level of service
  - Payment mechanics – risks/reward
  - Termination

Project specific risk (2)

- Market risk: who's going to buy the product? What's the commodity price going to do?
- Supply risks
- Participant risk: who is the sponsor?
- Environment
- Foreign exchange
- Engineering/design risk
- Infrastructure risk
- Syndication: will the banks be there?
- Interest risk: possibility of interest rate escalation
- Legal risk
- Force majeure

Political/regulatory risk: General

- What is political risk? Widely mis-understood term
- List items of political risk that can affect your project

Political and regulatory risk

- Historically:
  - Expropriation (communists)
  - Political violence (revolutionaries)
  - Currency transfer/inconvertability (WWII)
- But more extensive now:
  - “creeping expropriation”
  - disruption of access to infrastructure
  - failure to provide security
  - targeted fiscal measures
  - spurious allegations of fraud/breach of agreement
  - unusual compliance activity
  - revocation/denial of operational/environmental permits
  - changes in law affecting rights or imposing burdens

Mitigating political/regulatory risk

- Traditional sovereign risk mitigation
  - Political risk insurance – a tool of last resort?
  - Host government contracts
  - Bilateral investment treaties
- Integrated approach to risk mitigation
  - Invest in transparent relationships with host government
  - Align interests with host government
  - Align with multi-lateral agencies – victim status
  - Encourage direct government participation
  - Open, competitive bidding, avoiding ‘fast track’ arrangements
  - Examine the political connections of your local partners carefully
  - Compliance
  - Don’t limit channels to national or local government

Political risk: PRI

- PRI coverage
  - Expropriation
  - Breach of contract
  - Political violence
  - Currency risks (transfer and convertability)
- Partial risk guarantees
- Credit guarantees
- Export credit agencies

Political risk: PRI

- Key players
  - MIGA (multi-lateral) – political risk insurer within the World Bank
  - EFIC, CDA, OPIC (bilateral)
  - Private insurers

Political risk: PRI

- Advantages
  - Claims made against insurer not government
  - Good coverage for political violence
  - Arbitration may not be required
  - Certainty
- Disadvantages
  - Expensive
  - Are you fully covered in quantum?
  - Are all political risks covered? What about discrimination, protectionism, breach of contract?

PR: Host Government Contracts

- What are they? Concessions, licences, implementation agreements, PSCs, development agreements, land use agreements.
- Can include stabilisation clauses and freeze regulatory or tax regimes.
- Where is the arbitration?
- Is the government party to a relevant convention?
- Advantages
  - Contractual claims can be made in arbitration
  - Can specify exactly what political events apply
- Disadvantages
  - Long process for negotiation
  - Can ministries bind all levels of government – change of Government
  - Are all political risks covered?

Political/regulatory risk: BITs

- What are bilateral investment treaties?
- Wide protection for foreign investors and granted direct rights of international arbitration
    - “Fair and equitable treatment”
    - National treatment standard
    - Most favoured nation standard
    - Free transfer of funds
    - Protection against expropriation

Political risk/regulatory: BITs

- Advantages
  - Immediate
  - All existing and future investments covered
  - Binding on all levels of government
  - Governed by international law
  - No privity of contract required
- Disadvantages
  - Do you satisfy nationality requirements
  - Differences in scope of coverage, reservations, coverage
  - Australia has how many BITs with African countries?
- The importance of investment planning. Where should you incorporate your group companies?
- But be careful when you're BIT shopping – are you adequately covered?

Mitigating with DFIs

- Who are these development finance institutions?
- Benefits of DFI support and involvement
    - Long term debt
    - No need for political risk insurance?
    - Higher level of risk
        - Resources (i.e. projects outside of gold, nickel and copper)
        - Countries with higher risk profile
        - infrastructure
    - Sovereign risk
    - Regulation/legislation reform
    - Contact in government
    - Infrastructure development

Mitigating with DFIs

- Who are these development finance institutions?
- Historic divide between resources and infrastructure financing in Africa:
  - Infrastructure – DFI stomping ground
  - Resources – private investment
- DFI involvement in resources has historically been low (particularly when compared to infrastructure).
- Very few opportunities for DFI debt financings to meet criteria for investment (most projects that have found capital are able to finance from the commercial debt and equity market).
- But, the thirst for infrastructure has changed the dynamic. The penny that links mining and infrastructure has finally dropped.

> "*African governments must strategically target tying mining investment to PPI in energy. After all, it is the sector that is most likely able to draw private participation and power purchase agreements underwritten by large mining operations can further help in unlocking finance*" UN Economic Commission for Africa: December 2011

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Mitigating with DFIs

- DFIs have increasingly turned their attention to resources because:
  - larger projects – not only gold anymore (increased infrastructure needs for bulk commodities and therefore DFI involvement)
  - commodity prices (DFI financing more likely when conditions are challenging and equity and commercial debt not readily available)
  - foray of Australian mining companies (bring better ESI profiles)
  - creativity: Increased number of available facilities, funds, products
  - increased co-operation between commercial banks (e.g. Standard Bank, Nedbank, RMB, ABSA, Stan Chart) and DFIs

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DFI Investment in mining

- DFI investment in mining – select transactions (H&H Trinity members):
    - Equinox Lumwana copper (Zambia): (EIB)
    - Red Back mining (Ghana): (Proparco/EIB)
    - Bauxite mine debt financing (Guinea): CDC
    - Iron Ore Project (Sierra Leone)
- Other
    - Kenmare Moma (Mozambique): Titanium (EAIF)
    - Bisha Eritrea (Eritrea): Ore concentrate (EAIF)
    - MOZAL (Mozambique): Aluminium smelter (with IDC) (EIB)
    - Red Back (Ghana): Gold (Proparco)
    - Gallery Gold (Botswana): Gold (Proparco)
    - Kenmare Moma (Mozambique): Titanium (FMO)
    - Kasbah Resources (Morocco): Tin (Africa Lion)

DFI Investment in infrastructure

- Examples of DFI investment in infrastructure (H&H Trinity members):
  - Rabai power project (Kenya) – Power deal of the year (PF Magazine) – FMO, Proparco, Emerging Africa
  - Lekki toll road (Nigeria) – African PPP of the Year (Euromoney) – Macquarie Bank.
  - 300MW wind project (Kenya) – Consortium of DFIs and commercial banks
  - Hydropower project (Zambia): Copperbelt Energy Corporation (DBSA/FMO investors)
  - US$450m Gas IPP (Ghana): Africa Finance Corporation
  - Coal IPP and Port (Kenya): Aldwych International (FMO and PAIDF investment)
  - $105m Olkaria III Geothermal (Kenya) - FMO, DEG, KfW, EAIF
  - $1.2b Sasol pipeline project (Mozambique/SA) – DBSA/FMO/DEG, ADB/Proparco/EIB

DFI investment in infrastructure

- Port development (Djibouti) – AfDB, Islamic Development Bank
- $150m waste-to-energy power plant (Mauritius) – Standard Bank, DFI consortium
- Wind project (Cape Verde) - Renewable deal of the year (PFI) – AFC
- Geothermal project (Kenya) – Sustainable Energy deal of the year (PFI) – FMO, Propoarco, EAIF
- US$400m ethanol, power, sugar project (Tanzania) – DBSA, AfDB
- Accra to Kumasi Toll Road (Ghana) - FMO
- Airports disposal (Tanzania) – Macquarie Bank (funds AIIF, AIIM)
- Fundraising Power Developer (Pan-African): PAIDF, FMO, DBSA
- Kelvin power station acquisition (South Africa): FMO, DBSA (and Macquarie Bank)
- Wind Project acquisition (Cape Verde): Africa Finance Corporation
- Power project acquisition (Ghana): Africa Finance Corporation
- Partial listing (Zambia): FMO/DBSA

DFI requirements

- Minimum investment conditions
    - size of project/investment
    - the “black art” of bankability (see later): who is the sponsor; sovereign risk; infrastructure; technology; market
    - reserve threshold: some banks require 50% reserve tail
    - security over assets
- Economic contribution
    - must make contribution to poverty reduction
    - employment and fiscal revenues
    - see Mineral Deposits Ltd (Senegal) (45% of employees were Senagalese)
    - tax revenue (DFI’s will consider “tax optimisation” but will be viewed cautiously)
    - overall risk mitigation: low revenues may lead to renegotiation by governments

DFI requirements

- Financial subsidiarity
  - Must be a lack of investors or private lenders
  - High commodity prices over last few years
- Social and environmental benefits/obligations
  - Compliance with environmental and social legislation
  - IFC Performance Standards
  - Employment and fiscal revenue

Political risk conclusions

- Consider whether you can structure to ensure BIT protection … **do it early**
- Negotiate, where possible, arbitration and stabilisation in HGCs … **devil in the detail**
- PRI … **tool of last resort?**
- Integrated risk mitigation measures – have you met your friendly DFI neighbours?

Notice

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