Managing Tension Between Investors and Governments of Extractives Rich Countries: The First of a Three-Part Series. 'A Commentary on the Nature and Source of the Tension.' **Sheila Khama October 2020**

Context

In most industries, disagreements and legal disputes between regulators and investors are commonplace, but they are particularly common in mining, oil and gas development industries. Three examples come to mind, namely the 2011 dispute between Anglo American Corporation and the of Chilean Government's Codelco, the 2013 disagreement between Rio Tinto and the Government of Mongolia and finally the 2018 dispute between the Government of Tanzania and Barrick Gold. In citing these three cases, I do not express a view on the legal merits or lack thereof of each case. I merely cite these cases to illustrate a pattern. The focus of my comments is thus a personal perspective on what I think lies at the heart of this pattern. Experience shows that there are certain internal and external forces that give rise to tension, which periodically result in disagreement and/or litigation. I comment on what I see as the generic source of this tension. I examine the environment in which the relationships between host governments and investors are managed and the underlying conditions that frame the relationships. I offer a view on how the dynamic often leads to periodic disputes.

A Few Examples: First, here is a quick outline of the three cases.

Anglo American Corporation and Chile's Codelco

In 2011 Anglo-American Corporation and the state-owned copper producer Codelco in Chile were locked in a conflict over the state-owned entity's desire to acquire additional shares in Anglo American Corporation's copper producing subsidiary in that country. The disagreement, which ended up in litigation, arose over Codelco' s position that it had a right to acquire up to a 49% stake in Anglo's subsidiary. For its part, Anglo argued that Codelco could only acquire a minority stake of about 24.5%. After a legal standoff, the two settled the matter, with Anglo acceding to the state's position just before a Chilean court deadline demanding the company's compliance.

Rio Tinto and the Mongolian Government

In mid-2013 Rio Tinto, the world's second-largest producer of iron ore, reached an agreement with the Mongolian government for the company to proceed with investments towards the development of an underground copper and gold mine. The company was expected to invest somewhere between US$250 and US$300 million. The project had been delayed because of a protracted tax dispute between the investor and the Mongolian authorities, which was finally resolved.

Barrick Gold and the Tanzanian Government

In January 2020, a subsidiary of Barrick Gold, one of the world's leading gold producers signed an agreement with the Government of Tanzania to end a long-running tax dispute between two. In so doing, the parties essentially also developed a framework for negotiations with other miners that might also run afoul of the Tanzanian government's expectations. The settlement provided for
Barrick's subsidiary to pay US$300 million in outstanding taxes and to put that matter and other disputes to rest. For its part, the Government of Tanzania lifted an export ban that had been imposed on the company's gold concentrates after the authorities impounded the production from the company's mines in that country for more than a year.

Key Questions and Observations

Using these three examples as context, I answer the following fundamental question:

What are the underlying conditions and relationship dynamic that breed the tension?

Divergent Interests

Governments need investors' financial and technical resources to turn natural wealth into tangible economic benefits. Investors need access to the resources and an environment that permits uninterrupted project delivery. This mutual need for each other gives a false appearance of converging interests. The reality is more like an alliance born of

necessity. This is probably the first hairline crack in a fractured environment surrounding relationships between host governments and investors in the mineral, oil and gas industries. Additional cracks appear as governments that depend on the electorate for the popular vote turn their attention to the public, seducing them by publicly questioning the fairness of licensing terms. Investors, on the other hand, are driven by commitments to financiers and shareholders to secure meaningful returns. Though not mutually exclusive, executionally the goals can be difficult to reconcile. In cases where the law grants the state equity in the project (essentially legislating a partnership), the situation worsens, making the management of the company potentially challenging. A major failure on the part of both is the initial reluctance to consciously acknowledge this divergence. This reluctance accompanies the absence of a willingness to proactively manage the risk that the divergence poses to the ongoing relationship. The outcome is a growing lack of synergy, a deepening mistrust and an increased misalignment of goals. In any relationship, this situation invites disaster because sooner or later tension ensues and relations become polarised. A US-based firm called WaterStreet Partners has conducted extensive studies of this problem, and the pattern is consistent.
www.waterstreetpartners.net/blog/managing-strategic-partner-relationships-five-steps-to-success

Knowledge Asymmetry

As with other sectors of the economy, mining, oil and gas industries operations occur within an environment of accepted systems, processes and standards specific to the business. Inside these industries, this environment is well understood, taken at face value and its integrity deemed self -evident. However, the same cannot be said for some representatives of host governments. Not only do some lack understanding of the interplay of the environment, but they are also suspicious of the nature of and motives behind some of the processes and systems deployed by the industries. Some see them as a deliberate effort by companies to evade regulatory scrutiny. One good example is understanding systems for valuing commodity exports for taxation purposes. Another is the ability to distinguish legitimate repatriation of revenue to recoup investment (sometimes confused with transfer pricing) from illicit repatriations meant to evade taxation. In both cases the lines between lawful and unlawful practices can be blurred. In some cases, failure by investors to share information either for legitimate reasons or due to sheer opacity exacerbates the problem. In other cases, the heavy hand of the law becomes a logical line of defence for states frustrated by what they see as companies depriving the country of valuable revenue.

Historical Legacy of Multinational Companies

A large part of the relationship management challenge facing investors and host governments is what I simplistically term the historic legacy. Circumstances in which investors from the global north exploit resources in the global south present an additional complexity and source of potential tension because in many global south countries, multinational companies in mining, oil and gas industries have historically been partners of governments in the global north seeking to expand their political sphere of influence. Therefore governments in the global south are reluctant to accept that motives of modern-day investors are more forthright or benevolent.

In Southern Africa, the relationship between the British imperial government and Cecil Rhodes's companies offers a good example. Many governments cite Rhodes as proof of the intertwined nature of the interests of governments in the north with those of investors from that same region. Worse still, they argue that these motives are contrary to the interests of host nations. Although perhaps historically accurate, the assumption that investors speak for interests of the governments of their countries of residence is incorrect in today's investment environment. Multinationals may reside in the world's financial capitals in the north, but that does not necessarily mean the investors are themselves citizens of those countries. Therefore one cannot assume that the shareholders have active relations with the politicians of developed nations and are therefore potential agents of foreign policy. Because most large companies are listed in different stock markets throughout the world, many of the shareholders are indeed global citizens from different parts of the world, including the global south itself. Additionally, stock changes hands daily. For instance BHP Billiton, Rio Tinto and Glencore Xstrata, the top three mining companies, are quoted in several stock markets. In oil, the same is true for BP, ExxonMobil and Enron. Admittedly, the dynamics change where the multinational is largely state controlled, owned or influenced, as is the case with Equinor (formerly Statoil). Nevertheless, this historical

perception holds sway over the views of many governments and their representatives. To a large extent, the tension that exists between host governments and multinationals in this sector stems from this perception and from the resulting reception host governments and their citizens give the investors.
In contemporary times, China's mix of diplomacy and trade through state-owned Chinese entities has added a new dimension to the debate. In my view China has taken the phenomenon to a different level, but governments in the global south view China less sceptically. Some global south leaders appear willing to indulge China and give the leaders of that country the benefit of the doubt. But China's state-owned entities are profiting from diplomatic relations in a very material way, one that mimics the legacy of previous colonial interests. Others argue the materiality skews in China's favour. What historic legacies will emerge a century from now is anyone's guess.

External Pressure

Citizens of host countries have a strong sense of ownership of natural resources. However, to profit from the economic value of mineral, oil and gas resources, countries must first attract investment, technological know-how and marketing expertise. Historically (and currently) these resources reside outside many developing countries. Therefore, instead of being seen as partners in development, the investors are often seen as external parties who do not share the interest of these countries and who are driven primarily by self-interest. Sadly, this perception has created an 'us and them' mentality that undermines the principles of partnership and of shared value.
Because of this and also because of a growing level of mistrust in both governments and large companies, the host governments are under pressure from citizens to demonstrate that they are not weak when dealing with multinationals and that they extract fair value for the nation's mineral wealth. This pressure often manifests itself in revisions of agreements, tax regimes and mineral concessions. This is a major source of concern for investors who have to grapple with changing project economics and investment environments. Lack of security of tenure and an unstable environment is a major source of discomfort for investors struggling to reassure shareholders and lenders that their investments are secure. However, given public pressure, these changes are practically inevitable given the political reality for most host governments looking to curry favour with the electorate.
By contrast, while all parties acknowledge the need for natural resources to deliver benefits to citizens of resource-rich countries, few address the question of how and by whom. This lack of clarity between governments and industry with respect to accountability to the public is a major problem. At one extreme, some argue that paying rent and taxation is sufficient contribution by investors and that downstream of that governments are responsible for fair and equitable distribution to their citizens. At the opposite end, others argue that the parties are jointly responsible. Lack of consensus leads to counter-allegations and damage to relations.

Public Expectations

Finally, my sense is that, although perhaps legitimate, some public expectations are disproportionate to reality and lead to false outcomes. In this regard, the highly visible nature and financial scale of many resource development projects do not help. First, they tend to attract media and therefore public attention. Eager politicians wanting to appease the public and bullish markets driving investor enthusiasm all raise the expectations of citizens who mistakenly assume that the physical scale and financial investments correlate to future personal benefits. Second, because of the time delay between when such announcements are made and the availability of public revenue and the direct impact on the lives of citizens, public expectations for a better life inevitably are not met. The outcome is potential fallout and counter-accusations between governments and investors, as each looks for a fall guy.

Conclusion

Clearly, these are major challenges for both host governments and investors that are not likely to dissipate. All the more reason I think it is better for the parties to jointly proactively and systematically addressed them. If they are not, the impact will continue to be counterproductive, as the challenges are likely to continuously manifest in undesirable ways.
