

# MINING AND MINERALS AND INTERNATIONAL ARBITRATION ALERT



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### LOCAL CONTENT REQUIREMENTS IN THE EXTRACTIVE INDUSTRY: A DOUBLE-EDGED SWORD

Balancing the need for regulation promoting sustainable economic development through foreign direct investment in certain sectors of an economy becomes difficult where a country's international investment and trade law obligations prohibit or restrict the domestic imposition of quantitative and qualitative restrictions on the import of goods or services in such sector.

# LOCAL CONTENT REQUIREMENTS IN THE EXTRACTIVE INDUSTRY: A DOUBLE-EDGED SWORD

*South Africa has recognised that, except for encouraging downstream value-addition (beneficiation) in the minerals sector, policy tools and regulatory frameworks must be implemented to ensure that the extractive industry provides broader benefits to society.*

Balancing the need for regulation promoting sustainable economic development through foreign direct investment in certain sectors of an economy becomes difficult where a country's international investment and trade law obligations prohibit or restrict the domestic imposition of quantitative and qualitative restrictions on the import of goods or services in such sector.

South Africa (similar to other countries endowed with mineral resources) has recognised that, except for encouraging downstream value-addition (beneficiation) in the minerals sector, policy tools and regulatory frameworks must be implemented to ensure that the extractive industry provides broader benefits to society.

The draft Reviewed Mining Charter (Reviewed Mining Charter) released for public comment on 15 April 2016 by the Minister of Mineral Resources (Minister) reaffirms the South African government's commitment to ensure that, from a "local content" perspective, any holder of a mining right will be obliged to source a certain percentage of its capital and consumable goods from South African businesses (as is already the case in terms of the current Mining Charter, despite a lower threshold).

The Reviewed Mining Charter records the following:

"Enterprise development and local procurement are one of the key instruments to achieve both competitiveness and transformation of the mining industry. It also presents opportunities to expand economic growth that allows for the creation

of decent jobs and widens scope for market access of South African capital goods, consumer goods and services.

To achieve this, a mining right holder must ensure that procurement policies and actual procurement is aligned to the following:

#### Capital goods

- (a) A mining right holder must procure a minimum of 60% locally manufactured capital goods from BEE compliant manufacturing companies.
- (b) 30% of the above 60% must preferably be given to small business development which are BEE compliant, a minimum of 10% of the 30% must be reserved for BEE compliant enterprise development.

#### Consumables

- (a) A mining right holder must procure a minimum of 70% of locally manufactured consumables from BEE compliant manufacturing companies.
- (b) A minimum of 30% of the 70% must be given to small business development which are BEE compliant, a minimum of 10% of the 30% must be reserved for BEE compliant enterprise development."



# LOCAL CONTENT REQUIREMENTS IN THE EXTRACTIVE INDUSTRY: A DOUBLE-EDGED SWORD

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*Policy documents such as the draft Reviewed Mining Charter (and the current Mining Charter) sets out local content requirements to achieve economic objectives may well be subject to challenge (through domestic court processes or international dispute resolution systems) for failing to comply with international investment and trade law obligations.*

The rationale behind the use of local content requirements by South Africa in the mining sector (similar to other resource rich countries) is motivated by the need to address the following developmental imperatives:

- to gradually reduce the over-reliance on natural resources with respect to their contributions to national income, foreign exchange, and exports;
- the paradox of plenty, that is, the unacceptably high prevalence of poverty and inequality amid an abundance of resource riches (Karl 1997);
- to mitigate and manage social and political risks due to rising expectations domestically for a better and more equitable distribution of wealth; and
- the need to create more job opportunities, given the capital-intensiveness of the extractive sector.

As a sovereign state South Africa has the right to adopt any policy or regulatory framework which has the objective of achieving the developmental imperatives aforesaid. However, policy documents such as the draft Reviewed Mining Charter (and the current Mining Charter) sets out local content requirements to achieve economic objectives may well be subject to challenge (through domestic court processes or international dispute resolution systems) for failing to comply with international investment and trade law obligations.

The existing international World Trade Organization trade rules on certain forms of local content requirements are very clear in either prohibiting, allowing or restricting the grounds for any form of quantitative restrictions. The draft Reviewed Mining Charter contemplates that 60% of all capital goods and 70% of all consumable goods required by holders of mining rights must be procured from BEE compliant local manufacturers of such goods. These restrictions may be inconsistent with South Africa's obligations in terms of the General Agreement on Tariffs and Trade of 1994 read with the Agreement on Trade-Related Measures which prohibit any trade-related measures inconsistent with Articles III (national treatment) or XI (quantitative restrictions) of GATT. In respect of quantitative restrictions Article III (4) of GATT specifically prohibits measures requiring the "purchase or use by an enterprise of domestic products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production".

In addition, it should be remembered that despite the termination of certain Bilateral Investment Agreements (BITs) most of those BITs contain sunset provisions for 15 or 20 years from date of termination. That implies that any adverse policy changes by government which affects the 'investment' of a company holding a mining interest or right in South Africa, which investment pre-dates the

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termination of any BIT, could potentially still be deemed as a breach of the relevant BIT. The Southern African Development Community Protocol on Finance and Investment also provides further recourse to international arbitration to existing investors who have a qualifying investment for any breach by South Africa of its obligations contemplated therein. There is accordingly a fine-line between a state's regulating what is deemed to be in the 'public interest' and the rights foreign investor could enforce on the basis that the state breached, amongst others, the 'fair and equitable' principle contemplated in BITs or multilateral investment agreements.

From a broad-based economic developmental perspective it is understandable that the South African government must ensure the meaningful economic participation for historically marginalised people in the mining industry. In that regard the South African government must be unapologetic in putting policies and legal frameworks

in place to ensure that this objective is achieved. However in doing so it must ensure that the policies and legal framework adopted do not expose it to legal challenge (domestic court challenges or international arbitration) due to inconsistency with international trade or investment law obligations. There are a number of other local content requirements imposed by government through national treasury and other government departments (Department of Trade and Industry and Department of Energy) which are open to challenge on the aforesaid basis or for the failure to follow a proper process in deriving at specific local content targets for local manufacturing (designated sectors for local content). The rationale for certain of these decisions or directives by national treasury or other government agencies may be questionable.

A further Alert highlighting these issues will follow in a later edition.

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Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 3 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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