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Vedanta Resources v Zambian State Mining Company ZCCM-IH: Does Anyone Win?

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With over $3 billion invested by Vedanta Resources in Zambia since it became a shareholder in Konkola Copper Mines (KCM) in 2004, it is a less optimistic turn of events with Vedanta Resources and fellow shareholder, the government-owned Zambian State Mining Company ZCCM-IH (ZCCM), being at loggerheads in arbitration.

In this post, we examine what led to this downward spiral in relations and what this means for investors in the mining industry in Zambia.

Why Arbitrate Against Zambia?

On 21 May 2019, the Zambian government sought an *ex parte* order from the Lusaka High Court in Zambia to appoint, Mr Milingo Lungu, as provisional liquidator of Konkola Copper Mines (KCM), one of the country's biggest employers in the mining industry. KCM is majority-owned by Vedanta Resources (part-owner of the Mumbai listed Vedanta group of companies) and the Zambian State Mining Company ZCCM-IH (ZCCM) holds a roughly 20 percent stake.

Why did Zambia take such a serious step against one of its most prominent investors? The Zambian government appears to have several grievances with Vedanta's operations in Zambia. The application to liquidate was not based on liquidity issues but rather on grounds that the winding-up would be "just and equitable". The ZCCM alleges mismanagement and a failure to pay dividends amongst other concerns. Separate to this, the Zambian government alleges that the KCM breached its license agreement and misrepresented its expansion plans in Zambia and owes tax to the government. It is Vedanta's position that to the contrary – the Zambian government owes the KCM some USD 180 million in VAT tax refunds.

Vedanta's history in Zambia has not been the "cleanest". In September 2015, a group of around 2,000 Zambian villagers filed a lawsuit against Vedanta Resources in UK court over water pollution caused by its subsidiary's KCM operations. They claim that the water pollution from the Nchanga Copper Mine damaged their lands and livelihoods. Vedanta Resources challenged the English Courts jurisdiction to hear the dispute. This year the Supreme Court ruled that the Zambian villagers' case against Vedanta Resources can be heard in English courts.

Moreover, in 2018, the English High Court ordered the KCM to pay $139 million plus costs to the ZCCM for sums owed as part of a copper and cobalt price participation agreement dating back to 2004, when Vedanta took over the Zambian copper mine.

Arbitration or Liquidation?

Vedanta did not agree with the liquidation of the KCM and argued that it is procedurally incorrect for the ZCCM to have filed for liquidation before the Zambian Courts as the parties agreed to refer disputes to arbitration.

The KCM Shareholder Agreement contains an arbitration agreement that provides for disputes to be referred to arbitration under the UNCITRAL Rules with Johannesburg as the seat of arbitration.

Vedanta, therefore, filed for arbitration against the ZCCM. Vedanta also successfully obtained an *ex parte*order in the High Court of South Africa granting it leave to institute an urgent interim application (the Urgent Application) out of the South African High Court in Johannesburg against the ZCCM, and Mr Milingo Lungu in his capacity as provisional liquidator of the KCM.

Vedanta applied for an interim court order declaring that the ZCCM has breached the KCM Shareholders' Agreement by pursuing winding-up proceedings against the KCM in Zambia, and to direct the ZCCM to withdraw those proceedings. The application was brought under the recently adopted South African International Arbitration Act 15 of 2017, which is based on the UNCITRAL Model Law.

On 24 July 2019, the South African High Court in the case of *Vedanta Resources Holding Limited v ZCCM Investment Holdings Plc and Lungu, Milingo N O*granted granted an anti-suit injunction in support of the arbitration agreement in the KCM Shareholder Agreement and blocked the winding up of the KCM. The judge found that the grounds on which the ZCCM had applied for the provisional liquidation such as alleged mismanagement, failure to pay dividends and others, all had a sufficient nexus to the KCM Shareholders Agreement and fell under the arbitration agreement.

The international arbitration community will no doubt applaud the South African High Court's approach. However, it is a bold order from the Court in finding jurisdiction to issue the interim order as the parties to the proceedings and the KCM are all registered outside South Africa. In fact, the only nexus with South Africa is the seat of arbitration being Johannesburg. The judge appears to have adopted the approach from English case law of affirming the power of the national courts at the seat of arbitration to issue anti-suit injunctions restraining proceedings in a foreign court.

Vedanta has since proceeded with the arbitration; the outcome remains to be seen.

What Will This Case Mean for the Zambian Government and Investor-State Disputes in Zambia?

Whether the Vedanta case represents a fundamental policy shift in Zambia's approach to protecting foreign investments which would likely lead to more investor-state disputes or whether it is a one-off case is difficult to say with any confidence at this stage. The government has given mixed

signals as to its approach to the protection of foreign investments.

On 9 July 2019, the Financial Times reported President Mr Lungu calling for divorce from private international mining companies after they complained that steep taxes imposed by his government had stifled production. He is quoted as saying that "*They are liars, they are cheats and they take us for fools?.?.?.?those who are uncomfortable to stay in our house can go out*". The FT then stated that the President had accused mining companies of breaking promises to invest.

However, Zambia's Mines Minister Mr Richard Musukwa was quoted as describing the Vedanta case as "*an isolated case*" that should not be used to damage Zambia's image and that the "*case should instead be used as a signal to other mining companies not complying with the law to put their house in order*".

Like most low and middle-income countries, Zambia views attracting Foreign Direct Investment (FDI) as an assured route to economic growth through the injection of capital into sectors such as mining.

Since independence in 1964, the mining industry has provided the traditional base for Zambia's foreign exchange earnings and continues to be the major contributor to export receipts, accounting for more than 70 per cent of Zambia's export earnings as at 2017. The mining sector and its support industries provide major employment and the infrastructure backbone to areas that would otherwise lack the impetus for sustained development.

As far back as 1991, the Zambian government has pursued, in fits and starts, a policy of privatisation and liberalisation of its laws and regulatory practices in an effort to attract FDI. Bilateral Investment Treaties (BITs) were a central plank in this effort.[1)]

The structural issues with BITs and the protections which they give to foreign investors are well known. It is said that BITs tend to overemphasize the protection of foreign investors while doing little to promote or protect home-country interests. Broad compensation requirements for regulatory takings, for example, can have a chilling effect on host-government policy making. In particular, BITs are perceived as giving foreign investors the power to challenge democratic choices by host states and they elevate property rights over any other consideration (include human rights) and allow for fully confidential procedures which undermine efforts at transparency and anti-corruption efforts.

These issues have led to a rethink globally about the use of BITs. For example, South Africa took the dramatic step of cancelling its BITs and replacing it with a domestic statute for protecting foreign investments.

The Zambian government is at a crossroads. Zambia was regarded as a stable home for mining investment compared with neighbours Zimbabwe and the Democratic Republic of Congo and it enjoyed significant inflows of FDI on the back of the favourable comparison with its neighbours.

The government has to find a balance between attracting investment into Zambia by liberalising, promoting and protecting foreign investment; creating a transparent and predictable investment environment which includes an effective dispute resolution mechanism which enjoys investor confidence. Simultaneously, the government should be sensitive to removing what can be seen as favourable or preferential treatment for foreign investors over domestic investors and their

investments.

There is no doubt that the actions taken in the Vedanta case have shaken investor confidence; however, the approach taken to the reference of the dispute to arbitration and in particular whether the government participates in the arbitration and abides by the award of the tribunal will determine whether foreign investors retain confidence in the regulatory environment in Zambia.

References

?1 It is difficult to be definitive as to the number of BITs which Zambia has signed and which are in effect. One source puts the number of BITs at 15 signed of which 6 are in force, another gives the figure of 13 BITs, while a third identifies 31 BITs of which two are ratified, eleven signed and eighteen existing in draft form.

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