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MINING AND COMMODITIES ARBITRATION TRENDS 2023

– THOUGHT LEADERSHIP

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This year promises to be a very busy one for dispute resolution practitioners in the mining sector. Disruptions caused by the Russia-Ukraine war, the ensuing economic sanctions on Russia and its retaliation measures severely affected the global mining and commodities markets in 2022. The situation is likely to continue in 2023 due to ongoing sanctions taken by the US, the EU and other countries, and the resulting economic consequences. We also expect to see additional restrictions imposed in 2023, notably by the US, on metals extracted in Russia.

Compliance with sanctions will remain a priority for mining companies in 2023 but they will have to navigate a variety of new rules and regulations adopted as part of these changes, which may be a challenge. The restrictions and barriers implemented by the Russian Federation are also likely to trigger new disputes, including those related to investor protection or to the terms of companies' withdrawals of their businesses from Russia.

More generally, the pressure on mining companies is expected to continue, triggered by supply and demand disruptions worldwide, price volatility, and increasing environmental and emissions regulations for the mining and metals industry. In 2022, macroeconomic instability and inflation led investors to turn to traditional safe-haven metals, such as gold, causing record prices. In parallel, decarbonisation and costs-saving policies led many mining companies as well as downstream processors of metals to favour 'greener' mining technologies, which, in turn, had an impact on operations and profitability. Those trends are expected to continue in 2023, with mining companies having to make sure that they are supported by outside dispute resolution counsel early on to help them navigate the new political and economic climate.

Restrictions on minerals from Russia

Russia is a key supplier of metals such as palladium, nickel, aluminium and steel, all of which are indispensable to the supply chains of manufacturing production. Russia is also a major supplier of coal. At the start of the Russia-Ukraine war, the European Commission adopted a series of sanctions against Russia, but it has, until recently, avoided targeting Russia's metals sector, partly due to fears over the impact on global supply chains.

The situation is changing. In October 2022, the European Commission extended the import ban starting in 2023-2024 on both (i) semi-finished steel products that originate in the Russian Federation and (ii) steel products manufactured in third countries (other than Russia), using Russian-origin steel. In December 2022, the European Commission also banned new investments in Russia's mining sector with the exception of certain raw materials such as aluminium. Meanwhile, the US government announced in October 2022 that it was considering a ban on aluminium imports from Russia.

Compliance with these measures and sanctions will remain a priority for companies operating in the mining and metals sector but navigating a raft of new legislation at a global level will bring challenges.

The Russia-Ukraine war has also caused many foreign investors to withdraw their businesses from the Russian Federation. Considering the barriers implemented by the Russian government, we expect to see a rise in investor-State disputes as well as commercial disputes related to the terms of the withdrawals. International arbitration is the most appropriate forum for many of the new legal battles that will inevitably flow from these disruptions.

Continuing supply tension for battery metals

Battery metals such as cobalt and nickel are facing supply chain constraints driven mainly by the electrification of transport and infrastructure. It is expected that, by 2025, electronic vehicles (EV) will be responsible for 39.3% of cobalt demand and 12.8% of primary nickel demand. The global energy crisis and the Russia-Ukraine war have also played a role in supply difficulties. The prices of nickel and lithium have surged in recent months, with Russia being a key nickel producer.

As demand for EVs has accelerated, so too has aggregate demand for lithium. Lithium miners have been unable to keep up. Bloomberg reports that the volume-weighted average prices for lithium-ion battery packs increased to US$151/kWh in 2022, a 7% rise from 2021. However, some experts expect to see a price inflection in 2023, as decelerating demand growth will ease market tightness.

It is expected that price volatility, often combined with unstable political and economic environments in relevant countries (such as in Africa), will continue, increasing the risks of supply and demand disruptions as well as major pricing disputes in the mining and metal sectors.

Although market sentiment is clearly supportive of the expansion of battery metal supply, the ability of mining companies to execute and take new resources into exploitation is being affected by a range of non-commercial factors. These include sovereign risk, which in recent years has increased significantly in battery metals (and across the broader family of 'technology metals', which includes rare earths) as some governments have acted to subject such minerals to special regulation as 'strategic minerals'. Overt restrictions on foreign investment, coupled with more subtle measures against foreign-owned technology metals projects, have impeded the development of high-grade resources in certain countries.

The challenge of expanding supplies is further complicated by the need to limit environmental damage and ensure sustainable extraction and production methods. As a result, mining companies and metals producers will have to employ new recycling technologies to prevent shortages. The operating environment will become increasingly difficult for mining companies trying to balance their costs while also meeting requirements from an increasing number of governments around sustainability issues. Environmental pressures also mean higher demand for cleaner ores, such as high-grade iron ores which can be transformed into steel more cleanly than less-pure forms.

The role of gold as a hedge against macroeconomic instability and inflation

The price of gold, traditionally a safe haven, surged in 2022, a trend which may continue in 2023.

In the third quarter of 2022, according to the World Gold Council, central banks bought nearly 400 tons of gold. This was 300% more than in the third quarter of 2021 and amounted to the largest quarterly increase in central bank gold reserves since the World Gold Council started keeping records in 2000. In December 2022, the People's Bank of China reported that it had purchased over 30 tons of gold in the previous month.

It is expected that investors will continue to buy gold as a hedge against inflation and economic disruptions, which, in turn, is likely to spur demand considerably. Experts believe that prices could easily move above US$2,100 an ounce by the end of 2023. At the national level, this may see gold producers come under pressure to pay higher royalties or special taxes on their profits, as occurred at the peak of the last commodity price cycle. Experience shows that the ability of individual gold producers to navigate such changes depends heavily on the strength of the legal protections available to them (particularly whether they have access to international arbitration against the host government, through either contract or treaty).

At a global level, with a quick resolution of the Russia-Ukraine war looking unlikely, and with additional tensions elsewhere, governments may also increasingly favour gold for their reserves in the months to come.

Impact of operational improvements on mining operations

The mining and metals industry is undergoing major changes as mining companies continue to adopt automation and other technologies to increase efficiency, decrease costs and improve safety. These new technologies include data analytics, autonomous vehicles, wireless communications, digital sensors and human-machine interfaces.

Mining companies are also increasing investments in operational intelligence to optimise their production at the lowest cost possible, while decreasing their environmental impact. Since operational intelligence automates a mining operator's data and integrates information across its value chain and between mine sites, it results in data-driven decisions which ultimately assist in improving operational efficiencies and maximising performance.

These operational changes are causing parties outside the mining industry to wake up to the fact that the mining industry is a major source of innovation. According to consulting firm, McKinsey & Company, digital innovations in the mining industry will have a potential economic impact of approximately US$370 billion per year worldwide in 2025.

The mining sector is increasingly focusing on cleaner technologies, sustainability and ESG. For example, in the transition to a low-carbon economy is mining companies are being required to invest in green energy so as to lower their carbon footprint. More and more mining companies are expected to implement green mining technologies such as electromobility. This includes, among other things, replacing diesel engines in heavy vehicles with electric motors that run on hydrogen-powered fuel cells and seeking suppliers that prioritise renewable energies.

Pressure on mining companies to 'go green' will continue in 2023 and beyond. The challenges for industry participants will include ensuring that their operational and other improvements do not undermine their off-take obligations, volume commitments, relationships with suppliers and customers, compliance with the ever-growing spread of environmental regulations and, more generally, their reputations in respect of carbon footprints. As the wave of innovation continues, mining companies will need to take steps to ensure that their intellectual property is properly protected (learning from the experiences of major international oil companies in the 20th century).

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