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TO: Department of Mineral Resources
ATTENTION: Ms. Sibongile Malie
DELIVERED: By email
Sibongile.Malie@dmr.gov.za
DATE: 31 August 2018

COMMENTS ON THE DRAFT BROAD-BASED SOCIO-ECONOMIC EMPOWERMENT CHARTER FOR THE MINING AND MINERALS INDUSTRY, 2018

Introduction

The following concise submission is prepared following a request for public comment by the minister of mineral resources Samson Gwede Mantashe on the draft Broad-based Socio-Economic Empowerment Charter for the Mining and Minerals industry, 2018 (Mining Charter, 2018, hereafter).

About Sakeliga

Sakeliga is a non-profit organization registered in the Republic of South Africa and represents more than 12 500 members in businesses across different sectors of the South African economy. Sakeliga supports constitutional order, free markets and a favourable business climate in the interests of its members as well as in the common interest wherever its members do business.

Summary of concerns

Mining is a historic and important industry in South Africa. It supports domestic production through resource inputs, and contributes to mineral exports, foreign currency receipts and employment. A weakened and hampered mining sector is not beneficial to the South African economy.

In our estimation Mining Charter, 2018, will continue counterproductive mining policies and is unlikely to support much-needed new mining investment. Mining projects, in general, are highly dependent on up-front capital investment. Weaker mining investment is likely to decrease mining productivity and, consequently, mining output. Poorer mining output, we

t. 012 880 1951 | diens@sakeliga.co.za
58 Union Ave / Unielaan 58, Kloofsig, Centurion, SA | Posbus 17216, Lyttleton, 0140

Direkteure: A. Brink, D.J. de Villiers, B. du Plessis, P.J. le Roux, Dr. C.P. Lerm, D.J. Pretorius, M.B. Pretorius, N.H. Vlok, P.A. Naude

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maintain, is harmful to the economic prospects of all people in South Africa and not only those involved in mining.

Since South Africa's mining jurisdiction competes with other mining jurisdictions across the globe it is necessary to carefully consider the compliance burden government places on the industry. If the regulatory requirements for legal mining are set too onerous by government, as we think it presently is, it would logically make other competing mining jurisdictions relatively more attractive.

Should other jurisdictions outcompete South Africa's mining jurisdiction on grounds of policy and regulation, the results, clearly, would be fewer local mining ventures and less of the possible ensuing economic benefit, than would be possible in a friendlier and less hampered and restrictive regulatory environment.

Mining Charter, 2018, in our estimation is overly prescriptive and likely to be detrimental to progress in the local mining industry. Mining Charter, 2018 appears to presume that government must be increasingly involved in nearly all aspects of the business of mining through wide-ranging interventions. Our concern is that such excessive legal prescriptions will further bind the hands of mining entrepreneurs with mounting regulation.

Most, if not all, of the provisions of Mining Charter, 2018, are likely to increase the risk and cost of mining in South Africa, yet specifically, Mining Charter, 2018, in our estimation, will weaken the mining industry in three ways:

- Firstly, by imposing excessive additional risk to ownership which will impede capital investment;
- secondly, by imposing additional and excessive costly government interference with procurement processes, which will reduce economic efficiency in mining and;
- thirdly, the Charter mandates "trickle dividends" as a percentage of EBITDA, seemingly in spite of any reasonable commercial considerations or concerns of relevant companies. This, we expect, will place adverse pressure on the cash flow of mining projects.

Lastly, we are also concerned about the legal precedent continued by Mining Charter, 2018. In our estimation the Mining Charter moves beyond proper law making and exemplifies policy that takes on a the status of legislation whilst bypassing regular parliamentary lawmaking



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processes. We deem this form of regulation likely to be *ultra vires*, problematic, and harmful to the rule of law in general.

It should be noted that many of the requirements for legal mining indeed are in government's control. It is within government's purview even to consider decreasing regulation and freer markets in mining, which is the route we would rather recommend government take for lasting economic growth and true broad-based empowerment.

OWNERSHIP STRUCTURES

Existing mining rights and pending applications

In essence, Section 2.1.1 of Mining Charter, 2018, requires holders of existing mining rights, those deemed in compliance with the provision for achieving 26% BEE shareholding, to "supplement" BEE shareholding to a minimum of 30% within five years. The stipulation in Section 2.1.2 to supplement BEE shareholding to at least 30% in five years will also apply to companies with pending applications under the 26% BEE shareholding requirement lodged under the 2010 Mining Charter, when these applications are approved

Sakeliga does not agree with these mandates for additional transfers of shareholding. Although it is not entirely clear which steps mining companies may take to comply with the 30% stipulation of Mining Charter, 2018, it is reasonable to infer that this mandate aims for a further dilution of current shareholders' interests and ownership control through regulatory coercion.

A **coerced** dilution of ownership interest and control will benefit the new beneficiaries of BEE shares at the expense of existing shareholders, who are both black and white. This we find inherently unfair.

If mining companies do not issue and give away new shares to supplement their BEE shareholding, they would have to buy back current shares from non-BEE (white) shareholders either by raising debt, or by using cash intended for other commercial purposes including investment or expansion. This, in our view, is likely to carry detrimental consequences in the form of increased debt or decreased re-investment, which harms efficiency.

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New mining rights

In our estimation the great potential for harm in Mining Charter, 2018, is its likely disincentives for new mining projects. Section 2.1.3 sets stipulations for 30% BEE ownership at applications for new mining rights.

In this Section, the mandatory stipulations for shareholding are even more and, we argue, way too prescriptive. Mining Charter, 2018, specifies a 10% non-transferable “free-carried interest” shareholding, of which 5% should go to qualifying employees and 5% to host mining communities. This mandated transfer of shareholding is certain to raise the risk profile of new mining investments in South Africa.

The 10% free carried interest shareholding amounts to a direct transfer of ownership to individuals who in all likelihood will contribute virtually zero capital to the new mining project. This would mean investors in a new mining venture would stand lose a sizable portion, or 10%, of company capital for the mere act of undertaking a new mining project. We deem such a risk as excessive and likely a large disincentive to new mining investment.

For example, let’s assume an existing mining company is applying for a new mining right. The company has 100 shares and has a R1 000 million (R1 billion) in financial capital for investment in a new mining project in South Africa. Mining Charter, 2018, would require this company to set aside 30 of these shares for BEE shareholding leaving 70 non-BEE shares. Twenty of the 30 BEE shares could seemingly be ‘funded’ in some form or another. However, given the risk profile of new mining ventures in South Africa, it is unlikely that such shares could be fully funded at their current market value. The original investors, however, would lose a sizable say over their initial capital investment within five years. This, we hold, is already very likely to deter marginal capital investors from new mining projects.

Within 5 years, the original investors would have had to have transferred the 10 shares with a vested free carried interest. These shares represents 10% of the company in the example’s financial capital, or R100 million of the original investment. In essence, the investors in new mining ventures seemingly stand to lose 10%, or R100 million, of their investment, even if the venture proves unsuccessful.



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Bear in mind that mining investments usually have lengthy lead times. The “free carried” share transfers demanded by Mining Charter, 2018, will likely vest even before many new mining projects have entered into commercial production and generates income: a state of affairs that will likely add even more risk for investors in new mining projects.

In our estimation, Mining Charter, 2018, excessively and unnecessarily increases the risk to new mining projects in South Africa by coercively diluting important ownership control from capital investors. Reasonable investors certainly cannot be expected to take lightly to this additional risk. Consequently we foresee a high likelihood of less new mining investment than would have been possible without Mining Charter, 2018.

Interference with procurement

Sakeliga does not support coercive requirements for procurements spending. Mining Charter, 2018, continues harmful interference through excessive stipulations for procurement to mining companies. Generally speaking, economic efficiency requires businesses to produce as much output of products and services as possible with as little input of economic factors as possible. Mining Charter, 2018, will place onerous and economically harmful regulatory prescriptions for important commercial decisions on mining companies.

Sakeliga regards government legally dictating to mining companies, or any businesses for that matter, from whom they should be buying goods and services as highly problematic. One concern is that such mandates are likely to introduce economic inefficiencies and, even worse, perverse incentives for rent seeking into mining supply chains, which, in our estimation, will result in less efficient employment of scarce economic resources.

Trickle dividends

Mining Charter, 2018, requires mining companies to pay a “trickle dividend” of a minimum of 1% of EBITDA from the sixth year of a mining right to host communities and qualifying employees. In our estimation, such requirements will place the cash flow of mining ventures under pressure, which will also increase the risk to mining operations in South Africa.

t. 012 880 1951 | diens@sakeliga.co.za
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Concluding remarks

Sakeliga does not foresee Mining Charter, 2018, in contributing to a stronger and more vibrant South African economy. The Charter, in our estimation, will hamper new mining investment and solidify costly economic inefficiencies in the mining sector.

A less efficient and productive mining sector will hamper the entire South African economy, which, given present economic difficulties, is not something we believe the country can afford.

Yours faithfully,

Gerhard van Onselen
Senior Analyst
Sakeliga

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