Can Simandou infrastructure deal

Rail and port agreement progress could carry the economic development hopes of many nations with it

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The recent signing in Conakry of an investment framework for the Simandou iron-ore project marks the beginning of a new chapter in a long-running story.

The scope of the accord between the government of Guinea and the Rio Tinto-led consortium is, for the most part, typical for a large mining project in a frontier country.

However, the proposals for developing a 650km railway and deep-sea port are quite novel, and will be followed carefully by an array of interested parties. Finding a durable, balanced and bankable approach to the development of large-scale mining infrastructure is now arguably the greatest challenge facing the world's leading mining companies and resource-rich countries in Sub-Saharan Africa.

The infrastructure for Simandou, which could cost in the order of US$15 billion, is to be owned and financed by an independent infrastructure company (InfraCo) and made available to third parties on an "open access" basis. This approach is a marked departure from the traditional integrated model, where both the mine and its associated infrastructure are under the ownership and control of a mining company. If the InfraCo model successfully facilitates the shared-use of Simandou infrastructure, this will enable broad-based economic development within Guinea, including, critically, wider and more rapid development of its abundant mineral resources.

The potential for leveraging mining infrastructure to achieve broad-based growth in frontier countries has been highlighted by Sir Paul Collier of the University of Oxford, Jeffrey Sachs of Columbia University and other leading experts. McKinsey Global Institute (MGI) estimates that the world's resource-driven countries will require more than US$1.3 trillion of infrastructure investment each year until 2030 (four times the average achieved from 1995 to 2012) to sustain their projected GDP growth.

MGI argues that they should boost their "infrastructure productivity" by ensuring that resource-related infrastructure is efficiently shared. Of the US$111 billion of infrastructure constructed annually by extractive companies, MGI believes a "substantial portion" could be shared among resource companies, or between resource companies and other sectors.

The effective sharing of Simandou infrastructure has the potential to transform the economy of Guinea, which is one of the world's poorest nations. In the case of the railway planned for Simandou, it could, for example, be extended to serve other mining projects, including world-class deposits at North Simandou and Mount Nimba that might otherwise become stranded, while at the same time reducing cost of accessing the infrastructure for all parties.

Direct access to Simandou's rail, road and port infrastructure could also underpin labour-intensive activity in agriculture, forestry and other sectors targeted for development in the government's "Southern Growth Corridor" plans.

Enabling growth by opening access to privately-owned, critical infrastructure has long been a goal of the world's policymakers. Early 20th century courts in the United States, armed with the Sherman Act, forced owners of "essential facilities" to grant access to competitors on fair and non-discriminatory terms. The same principles are now being used to require technology companies to license essential IP to third parties. There are many examples of legislation imposing sweeping, sector-focused reforms based on open-access principles.

An example is the US Telecommunication Act of 1996, which, in the words of the Federal Communications Commission, was designed to "let anyone enter any communications business – to let any communications business compete in any market against any other".

Opening access to infrastructure within the mining industry has proven to be particularly challenging. The difficulties are perhaps best illustrated in the iron-ore-rich Pilbara region of Western Australia. Despite sustained efforts over more than two decades by legislators and successive governments to enable junior mining companies to use the rail and port facilities controlled by two large mining groups, few access deals have ever been struck.

After years of trying, Fortescue Metals Group chose to construct its own infrastructure for the Cloudbreak project, and agreed to operate it on an open access basis. Last year, when Fortescue proposed access terms to a competitor that some observers regarded as unattractive, Western Australia's Premier Colin Barnett lost patience.

Commenting on the chronic delays and cost overruns experienced in major projects across his state, he claimed: "The biggest obstacle to timeliness and keeping costs down is disputes and lack of agreement and a lack of sharing infrastructure in the mining and the petroleum sectors… the companies need to look at themselves".

That Pilbara mining infrastructure remains "open access" largely in theory only highlights the formidable challenge facing governments in sub-Saharan Africa seeking to maximise economic development from their natural resources. Lacking well-developed competition laws or similar regulatory tools, they have to date relied on securing access commitments from miners within mining concession agreements.

Unfortunately, the promises are often vague, poorly drafted and subject to numerous exceptions that can be used by miners to reject or delay access requests. The reasons given for resisting access applications often include: insufficient capacity, adverse effect on operating costs, or conflict with potential expansion plans.

The InfraCo model proposed for Simandou is promising and, if appropriately implemented, has many advantages for the project's stakeholders. For Rio Tinto and its partners, their capital outlay could be limited to the cost of the mine (perhaps US$5 billion).

This should improve equity returns, and will be cheered by shareholders demanding greater capital discipline within the mining industry. For the Guinean government, which has the right to purchase further equity in the mine over time, the cost of exercising its

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option is less onerous than if mine and infrastructure were combined.

If the commercial arrangements for InfraCo are structured carefully, long-term funding from infrastructure investors, sovereign wealth funds and institutional investors could be facilitated. Many of these pools of capital have an unsatisfied appetite to deploy funds in well-structured African projects that can deliver long-term, stable cash flows. But perhaps most significantly, an independent InfraCo will have the ability, and the incentive, to grow its customer base and to build its network "footprint". This, in turn, should satisfy policymakers and other interested parties that access applications will be handled fairly and free from conflicts of interest.

The detailed arrangements for InfraCo will be critical to its success and legacy, and will need to resolve a number of important questions, including:

- Will the Rio Tinto-led consortium, as the important "first mover", secure special rights over the infrastructure such as priority access, preferential tariffs and/or expansion options and, if so, will these create operational or financial challenges for future access-seekers?
- How will access eligibility and tariffs for future access-seekers be determined, and will InfraCo have discretion to offer concessional rates to local small- and medium-sized enterprises (SMEs) and passenger rail services?
- How will disputes concerning access and tariffs be settled, and will the risk of costly legal proceedings and associated delays discourage access-seekers?
- What contractual and financial commitments will be required from access-seekers, and will local SMEs be in a position to provide these?
- Will InfraCo have discretion to implement future infrastructure expansions to meet growing demand, and how will these be funded and the risks associated with expansions be managed?

It will be critical to strike an appropriate balance between the interests of the Rio Tinto-led consortium (as the first mover) and future access-seekers (who are key to achieving broad-based growth). If a workable and bankable InfraCo model emerges, it will be good news for the Republic of Guinea, and will establish an important precedent for the rest of Sub-Saharan Africa.

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