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Arise South Crofty

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It would be fanciful to suggest that the proposed reopening of the South Crofty tin mine in Redruth signals a renaissance in the UK mining sector. But the proposed resumption of mining at this world-class Cornish deposit is more than eye-catching. It represents a significant development in the industry.

Shut since 1998 having produced an estimated 400,000 tonnes of tin in its mine life, South Crofty is a substantial mine boasting estimated reserves of 2.5m tonnes of ore containing 44,000 tonnes of metal. Above and beyond the sentimentality held for the Cornish tin industry, now permanently preserved by its Unesco "world heritage" status, a reopened mine of this magnitude means real job, infrastructure and investment opportunities for the region.

South Crofty adds to a list of other impressive UK mining projects currently in different stages of development and operation across the country.

Just down the road from South Crofty on the edge of Dartmoor, Wolf Minerals has commenced operations at its Drakelands tungsten and tin mine. One of the largest tungsten deposits in the world this is one of only two mines outside of China with a production capacity greater than 3,000 tonnes a year.

Further afield, Sirius Minerals is advancing the development of its vast $2.9bn potash mine in the North Yorkshire moors. Having concluded key planning and permitting stages, Sirius has recently engaged a bank group for the project financing of its stage 2 capital costs for the mine and associated infrastructure.

And on a smaller scale, but equally significant, Dalradian Resources and Scotgold Resources are developing gold mine projects in Northern Ireland and Scotland respectively. Earlier this year, Dalradian announced increased grade and reserve figures for its high grade Curraghinalt gold deposit. At the same time, Scotgold announced the launch of its bulk processing trial and first gold pour at its Cononish gold and silver project.

These five UK projects are very different in scale, size, timing, development, markets and mineral production. But, both individually and collectively, they are of great importance when looking at the UK mining sector today.

Based on the most recent British Geological Survey[1] figures, there are over 2,300 active mines and quarries in the UK. A large majority of these current workings, in fact more than 75 percent of them, are mining construction aggregates, industrial minerals and building stone – sand/gravel, limestone,

1 Directory of Mines and Quarries 2014, British Geological Survey 2014.

igneous and metamorphic rock (basalt, gritstone) clay and shale, crushed rock and sand. More than 35 per cent of all current workings in the UK are sand/gravel and limestone operations alone. Many of these mines are owned and operated by the commercial end-users of the minerals with the domestic building and construction market being the key source of revenue for these operations. It is not surprising that the latest BGS data records only one mining operation in the UK for each of tungsten, potash, tin and gold/silver.

As new UK mine developments have been few and far between in the last half century, the regulatory framework and processes that underpin their development and operation remain relatively old fashioned, but not overly restrictive or unduly onerous. There is no single legislative regime for mining. Precious metals and coal still vest with the state, with mining requiring Crown Estate and Coal Authority licences respectively. For all other minerals, the owner and operator must take title from the actual surface land owners through a lease arrangement. These are privately concluded contracts, but capable of being registered against the land title at the Land Registry.

All mining operations require local authority planning permission, not unlike any other industrial undertaking. Conditions of such permissions will, amongst other things, include compliance with environmental and reclamation requirements, in particular as regards waste and water usage. (Planning permission was, and remains, a major aspect for Sirius Minerals and one that has impacted the development schedule. But location and the sheer size and complexity of the project means that, even by normal mining standards, planning and the environment are key risk factors). There are certain mine-specific health and safety requirements for mine operators to comply with set out in particular mining legislation. Mining operations will also be required to comply with all other laws and regulations that apply to UK businesses generally, including tax, employment/labour, accounting and, where relevant, exports.

In summary, the UK legislative and regulatory framework can be considered as broadly supportive of mine development and mining operations. Labour and infrastructure is available and accessible. Data is relatively up-to-date and reliable. Geology is really just what it is. There has been recent recognition that the UK contains some important, strategic minerals that could be monetarised in the face of changing global consumption trends for different types of industrial metals.

All this said, South Crofty, and the other current development projects cannot realistically be seen as heralding a renaissance in the industry. However, symbolically and practically, they do represent advancement in the form of new projects. Drakelands is the first new metals mine to come into production in the UK for more than four decades. Production at Cononish would see the first commercial production of gold in Scotland. They show that mining projects can be developed in the UK within a largely sensible and reliable regulatory and legal environment, a fair fiscal system and available resource and infrastructure. They further represent diversity in an industry currently focused on construction aggregates and industrial minerals and one that was traditionally dominated by coal.

Indeed, it would be remiss not to mention coal in any discussion on UK mining. In doing so we halt the positive mood from the preceding paragraphs. Some surface mining continues. Just recently (and not without controversy) permission has been granted for the new Highthorn open cast coal mine in Druridge Bay, Northumberland. In the short term there remains a domestic market for these sort of operations as the UK's existing fleet of coal-fired power plants are wound down and replaced with new gas, nuclear and renewable power generation capacity.

Yet the closure in December last year of the UK's last deep coal mine at Kellingley concluded the sad demise of the UK deep coal mining industry. The "why"s and the "what if"s are well documented and not for this commentary.

However, the context is important. It shows how the success and failure of any mining project and, in the case of coal, a mining industry, is determined so heavily by the markets into which the commodities are sold and their economics, rather than, in may cases, geology, geography and location.

The UK coal mining industry is not where it is today because the coal has run out. It is where it is now because fewer people want to buy coal, and, specifically to coal, those who do and can buy it can do so more cheaply elsewhere. Similarly, and as South Crofty proves, the Cornish tin industry did not collapse because the tin ran out. It collapsed because the world's tin markets changed radically.

In both cases, it is less to do with the UK as a location for a mine and more to do with the markets into which production is sold and the effect these markets have on revenues and the ultimate viability of mining operations.

Of course location is an important factor in the success or failure of a mine. As the world's iron ore markets collapsed due to reduced steel consumption, the West African miners were seen to be even worse affected by the truly dreadful ebola tragedy happening at the same time. As global thermal coal prices plummeted, it was arguably the US miners who have seen the worst of it in the face of the US administration's war on domestic coal and home-grown shale gas development.

The simple fact is that it is hard work building a mine wherever you choose to do it. Arguably, it is no less challenging to do so in the UK as it is in, say, Senegal, Kazakhstan or Bolivia. The development hurdles to cross are largely the same. Political issues aside, these can be managed and mitigated. Ask the excellent management teams of Strongbow, Wolf, Dalradian, Scotgold and Sirius what have been the most challenging development issues for their respective UK mines, and it is likely that you will get very similar answers from teams developing mines in West Africa, Central Asia, South America and beyond. And then once built and operational, all mines, wherever there are, must navigate the markets into which their production is sold. For our five UK projects, the tin, tungsten, potash and gold/silver global markets will be key factors determining their success.

The industry will watch South Crofty and the other UK projects with interest. For so long now the UK has been a place where capital is raised and advisory expertise has been hired, and then both exported for mine projects far afield. For now, there can and should deservedly be a collective feeling of pride that these five UK projects are where they are today.

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Article

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Mining in Southern Africa – Some Comparisons

By Ian Coles, Partner and Head of Global Mining Practice

Introduction

The development of the mining industry in Southern Africa (excluding the Republic of South Africa) has been patchy and uneven. In this article we seek to discover any underlying themes which might suggest the factors behind successful development. These are beyond the global themes affecting the development of the mining industry today, most notably the downward curve for commodity prices (although possibly that is about to change) and, particularly in the emerging markets, resource nationalism. For purposes of the analysis we will look at Angola, Botswana, Mozambique, Namibia and Zimbabwe. Zambia is excluded on the basis that mining already makes a very significant contribution to the overall economy and has been written about extensively.

Angola

The country has a relatively under-developed mining industry, having historically concentrated on oil & gas as the major commodity under exploitation. The steep decline in energy prices has placed the domestic economy under stress, with support from the IMF and the international financial community being sought. As a result the government has been encouraged to initiate policies designed to diversify the economy. While the mining industry only currently accounts for a small percentage of GDP it is potentially a key driver. For example, Angola is already the world's fourth largest diamond producer by value and sixth largest by volume.

A recent report in Hellenic Shipping News Worldwide speculated that the mining industry in Angola might generate revenue in the region of US$ 7.5 billion by as soon as 2018. Less than half of the country has been explored to date, albeit the legacy of mining of a different type might still present barriers to exploration activity in certain regions.

The mining industry in Angola is currently growing at an average rate of 5.3% per annum. Potential minerals for exploration include phosphate, copper and iron ore although diamonds are expected to be the major contributor to the industry in the foreseeable future (in 2014 diamond exploitation generated around US$1.6 billion in revenue). The potential for expanded activity is illustrated by the fact that one joint venture, including partners such as Odebrecht and Alraosa, is responsible for around 75% of all diamond production.

A new Mining Code was enacted in 2011 with a view to encouraging international investment in the industry. In particular the new law sought to establish security of tenure - where successful exploration results in the ability of the exploration licence holder to exploit the relevant deposit. The free carried interest maintained by the government in mining projects was also reduced to 10% - more in line with industry norms; particularly in Africa (although there is also an option for the government to participate in actual production). Royalties and taxes were also reduced. The code emphasises the importance of local communities. Engaging

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with those communities in connection with the development of any mining project is made a mandatory obligation. In addition 5% of revenues accruing to the government are required to be invested in the area where any project is located. Where price competitive, local content is to be preferred.

Botswana

Botswana already has a successful mining industry - particularly in connection with diamonds (where it is the world's largest producer) and coal. Botswana is also home to the world's biggest rough diamond sorting and valuing company - Diamond Trading Company Botswana. Much of the recent news in connection with the local coal industry though has been dominated by news of Anglo American's disposal of non-core assets - in this case the transfer of its interest in the Morupule mine and closure of the Mmamabula coalfield. The need for power across Southern Africa though has increased the focus on Botswana's coal and coal bed methane resources and the potential for the development of associated power stations. Beyond diamonds and coal mining activity also takes place in connection with gold, copper, nickel, cobalt and other minerals. Taken as a whole the mining sector accounts for approximately 20% of Botswana's GDP.

In addition to its prospectivity Botswana is a highly attractive location for international investment. Politically it is a stable democracy with an open economy. There are virtually no restrictions on foreign ownership of local enterprise and no exchange controls. Dividends, etc can be remitted offshore with no restriction (subject, of course, to payment of any local tax - withholding tax in the region of 7.5% is currently assessed). There is a stable and reliable legal system, including court processes. In the most recent Fraser Institute Annual Survey of Mining Companies Botswana was ranked fifth of all African countries in the index for investment attractiveness (Morocco ranked first, followed by Burkina Faso, Ghana and Namibia). Contributors to the survey noted that, in contra-distinction to several other African countries, Botswana has moved to improve the local fiscal regime for investors during the current depressed environment for commodity prices.

All minerals in the ground belong to the State with the right to explore and exploit those minerals being granted under a well understood and defined licensing system. Licences (other than with respect to diamonds) are granted for a period of up to twenty five years. The government also has the right to acquire a carried ownership interest in mining projects in an amount of up to 15%. Royalties are levied at the rate of 5% (for precious metals), 3% (for base metals) and 10% (for precious stones).

Mozambique

Mozambique is richly endowed with commodities. In addition to substantial energy fields it possesses diverse mineral deposits such as coal, heavy sands, graphite, gold, phosphates, rare earths and precious stones. Until recently it had been one of the success stories on the African continent, enjoying economic growth above 7% per annum for almost ten years. Required investment in infrastructure has also been forthcoming (for example the construction of railways and port facilities to access the stranded coal deposits in Tete province). The major story in Mozambique in recent times though has been in the political and financial arenas.

As in Angola, steeply declining energy prices have put pressure on the Mozambique economy. Following an IMF financing it transpired that almost US$1 billion of previously undisclosed debt had been raised by the government. Ostensibly raised by the state-owned tuna fishing company to finance a new fleet it appears that the loan proceeds were used for other purposes. Following the discovery government access to international financial markets has been constrained and Moody's downgraded the country to B3. International perception remains poor. The country is ranked 180 (out of 188) on the UN's human development index. Mozambique ranks in the bottom quartile of African countries for investment attractiveness in the Fraser survey.

On the other hand the abundance of natural resources in Mozambique remains a given. The legal and regulatory regime applicable to mining is also perceived to be quite helpful (it ranks relatively well for this factor in the Fraser survey). There has also been some good news recently with the announcement of the raising of funds to complete the Balama graphite project and the signing of offtake contracts in connection with the same. However, going forward much will depend on the view taken by the international financial community in relation to the country and its government.

Namibia

Of all the countries in the Southern African region Namibia arguably has the most attractive story to tell when seeking to attract investment in the mining industry. The country is highly prospective for minerals with uranium, copper, gold, phosphate and diamonds all being present. The country offers a stable political system, a reliable and functioning legal system and a positive approach to the regulation of the mining industry. In the Fraser survey Namibia ranks fourth among African countries in the investment attractiveness index. In particular the country ranks very highly for certainty in connection with the implementation and administration of mining and environmental regulations.

The mining law in Namibia though is quite old - having been originally enacted in 1992. However it does provide the critical security of tenure required to encourage exploration activity. Recent BEE legislation will mean that ownership structures may need to be adjusted although the final form of the legislation and associated regulations may yet be further amended. Subject to these considerations foreign ownership of mining companies is generally unrestricted.

Zimbabwe

If Namibia is the most advantaged jurisdiction in this brief survey then Zimbabwe is surely the least. In the 2013 World Bank Doing Business Survey Zimbabwe ranked 172 out of 185 countries. While richly prospective - with substantial gold, platinum, chrome, diamond, coal and nickel deposits - the current political and economic background acts as a substantial barrier to any foreign investment. Large mining companies have been invested in Zimbabwe for many decades but several - seeing no prospect for improvement in an economic environment where performing assets are key - have started to depart. Rio Tinto left in 2015. Many who remain are doing do purely defensively to protect existing investments. Government demands for increased participating ownership interests to be granted to the State and for the funding of beneficiation and other infrastructure are obviously not assisting. By way of example, the government recently ordered licence holders in the Chiadzwa diamond field to leave the region with production being taken under the control of the government.

The significance of the industry for Zimbabwe remains obvious though. Just last month it was reported that the export of platinum by Zimplats accounted for 9.7% of the country's total export earnings. A further 3.8% was accounted for by exports from Mimosa. Exporters are supposed to have been incentivised by virtue of a 5% bonus payment on funds generated but this is payable in local bond notes and the absolute value of the notes is far from clear - particularly in the longer term. Sceptics fear that this is simply the re-introduction of the failed Zimbabwe dollar by another name.

Conclusion

Many of the countries in the Southern Africa region have taken great strides to adjust the environment for mining activity in a manner which brings the same closer to global industry standards. However, putting aside those issues impacting the mining industry on a global basis it is clear that by far the greatest single factor in determining the success of the industry across Southern Africa is political. While capital for investment in new projects is certainly available from a variety of sources it is also easily mobile. Competition for that capital across the globe is intense and, in making the long-term decisions required for investment in new projects, investors are bound to prefer countries where stability and transparency are the norm.

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Legal Update
July 13, 2016

US SEC Adopts Final Rules for Payments by Resource Extraction Issuers

On June 27, 2016, the Securities and Exchange Commission (SEC) adopted final resource extraction issuer payment disclosure rules.[1] The SEC adopted these regulations in response to a mandate of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which added Section 13(q) to the Securities Exchange Act of 1934 (Exchange Act). Section 13(q) directed the SEC to issue rules requiring resource extraction issuers to include in an annual report information on any payment made by the issuer, a subsidiary of the issuer or an entity under the control of the issuer to a foreign government or the US federal government for the purpose of the commercial development of oil, natural gas or minerals. This is the second time that the SEC has adopted rules to implement Section 13(q) of the Exchange Act.

In August 2012, the SEC adopted resource extraction issuer payment disclosure rules, but those rules were vacated in July 2013 by the US District Court for the District of Columbia. In September 2015, the US District Court for the District of Massachusetts ordered the SEC to file an expedited schedule for promulgating final rules. The SEC proposed new resource extraction issuer payment disclosure rules in December 2015, and, adhering to the expedited schedule it filed with the court, the SEC adopted the final rules in June 2016.

The final rules require resource extraction issuers to disclose payments made to US federal or foreign governments for the commercial development of oil, natural gas or minerals. New Rule 13q-1 requires resource extraction issuers to file their payment information reports on Form SD. (Form SD is the same form currently used for conflict minerals reporting.) The specific disclosure requirements for resource extraction issuer payment disclosure, as well as key definitions, are set forth in new Item 2.01 of Form SD, titled "Resource Extraction Issuer Disclosure and Report."

Compliance Date

A resource extraction issuer will have to file a Form SD containing payment disclosure annually, not later than 150 days after the end of the issuer's fiscal year, but the SEC has provided a transition period for compliance. Resource extraction issuers will first need to comply with the final rules for fiscal years ending on or after September 30, 2018. This means that calendar-year companies impacted by the new rules will first need to comply by late May 2019.

Required Disclosure

Under Item 2.01 of Form SD, a resource extraction issuer must annually disclose the following information regarding its most recently completed fiscal year:

- Type and total amount of payments, by payment type, made for each project;

- Type and total amount of payments, by payment type, for all projects made to each government;
- Total amounts of the payments made, by payment type;
- Currency used to make the payments;
- Fiscal year in which the payments were made;
- Business segment of the issuer that made the payments;
- Governments that received the payments and the country in which each such government is located;
- Project of the issuer to which the payments relate;
- Particular resource that is the subject of commercial development; and
- Subnational geographic location of the project.

Pursuant to Item 2.01 of Form SD, resource extraction issuers will have to provide a brief statement in the body of the form directing investors to the payment information contained in an exhibit to the form. The exhibit must provide the payment information using the XBRL interactive data standard. Resource extraction issuer payment disclosure must be made at the "project" level. An activity or payment that does not fall within the categories specified in the final rules will nevertheless need to be disclosed if it is part of a plan or scheme to evade the required disclosure.

The payment information must be provided on a cash basis. The required resource extraction issuer payment disclosure does not have to be audited. Information that is disclosed pursuant to the rules will be "filed" rather than "furnished," making the disclosures subject to liability under Section 18 of the Exchange Act. Although filed, the information and documents filed in or with the Form SD will not be deemed to be incorporated by reference into any filing made under the Securities Act of 1933 or the Exchange Act unless the issuer specifically incorporates it by reference into such filing.

Alternative Reporting Regimes

A resource extraction issuer may satisfy its disclosure obligations under Item 2.01 of Form SD by including, as an exhibit, a report complying with the requirements of any alternative reporting regime to which it is subject that the SEC deems to be substantially similar to the requirements of Rule 13q-1. The alternative report must be the same as the one prepared and made publicly available pursuant to the requirements of the approved alternative regime, subject to any necessary changes set forth by the SEC.

When relying on alternative reporting pursuant to a regime deemed substantially similar, the issuer must state, in the body of Form SD, that it is relying on the alternative reporting provision of Form SD, identifying the alternative reporting regime for which the report was prepared and describing how to publicly access the report in the alternative jurisdiction. The issuer must specify that the payment disclosure is included in an exhibit and state where the report was originally filed. The alternative report must be provided in XBRL format. An English translation of the entire report must be filed if the alternative report is in a foreign language. Project names may be presented in their original language in addition to the English translation.

Unless the SEC provides otherwise in an exemptive order, a resource extraction issuer may follow the submission deadline of the approved alternative jurisdiction if it files a notice on Form SD-N on or before the due date of its intent to file on such basis. If the issuer fails to file such notice or if it files the notice but does not file the alternative report within two business days of the alternative jurisdiction's deadline, it will not be allowed to rely on the alternative reporting rules in the following fiscal year.

On the same date that the SEC adopted the final resource extraction issuer payment disclosure rules, it adopted an order[2] recognizing the following alternative reporting regimes as meeting the substantially similar requirement:

- The European Union's accounting directive (Directive 2013/34/EU) as implemented in a European Union or European Economic Area member country;
- The European Union's transparency directive (Directive 2013/50/EU) as implemented in a European Union or European Economic Area member country;
- Canada's Extractive Sector Transparency Measures Act; and
- The US Extractive Industries Transparency Initiative (but only with respect to payments made to the US federal government and only to the extent that the issuer complies with the 150-day deadline of the resource extraction issuer payment disclosure rules).

Reporting Persons

All resource extraction issuers will have to make the payment disclosures, without regard to whether they are domestic or foreign issuers. The new rules define "resource extraction issuer" as an issuer that is required to file an annual report with the SEC pursuant to Section 13 or 15(d) of the Exchange Act and that engages in the commercial development of oil, natural gas or minerals. "Commercial development of oil, natural gas, or minerals" is defined as exploration, extraction, processing and export of oil, natural gas or minerals or the acquisition of a license for any such activity.

Resource extraction issuers must disclose payments made by a subsidiary or controlled entity as well as direct payments made by the issuer. An entity is "controlled" if the issuer consolidates the entity or proportionately consolidates an interest in an entity or operation under the accounting principles applicable to the financial statements included in the resource extraction issuer's periodic reports filed pursuant to the Exchange Act.

According to the adopting release, the SEC does not consider an issuer to be a resource extraction issuer if it merely provides products or services that support the exploration, extraction, processing or export of such resources, such as an oil field services issuer that manufactures drill bits or provides hardware to help companies explore and extract resources or that is engaged by an operator to provide hydraulic fracturing or drilling services. However, if the oil field services issuer makes a payment to a government on behalf of a resource extraction issuer, the resource extraction issuer will have to disclose such payments.

Targeted Exemptions for Delayed Reporting

The final rules contain two targeted exemptions providing for delayed reporting in specified circumstances.

Exploratory Activity. The final rules permit resource extraction issuers to delay disclosing payment information related to exploratory activities until the Form SD that is filed for the fiscal year immediately following the fiscal year in which such payment is made. Exploratory activities for the purpose of this delayed reporting include all payments made as part of:

- Identifying areas that may warrant examination;
- Examining specific areas that are considered to have prospects of containing oil and gas reserves; or
- A mineral exploration program.

However, delayed payment reporting is permissible only for exploratory activities that were commenced prior to any development or extraction activities on the property, any adjacent property or any property that is part of the same project.

Acquired Entity. If a resource extraction issuer acquires or obtains control of an entity that has not been subject to new Rule 13q-1 or an alternative reporting regime's requirements in such entity's last full fiscal year, such resource extraction issuer will not be required to report payment information for that acquired entity until the Form SD filed for the fiscal year immediately following the effective date of the acquisition. Reliance on this accommodation must be disclosed in the body of the Form SD filing. If the acquired entity was required to comply with such resource extraction issuer payment disclosure prior to the acquisition, this delayed reporting exemption will not apply.

No Exemptions for Violations of Foreign Law or Categories of Issuers

All resource extraction issuers must publicly disclose the information required by Item 2.01 of Form SD. Except for the above-described targeted exemptions allowing for delayed disclosure, the rules do not contain any express exemptions, even in situations where public disclosure of the payment by the resource extraction issuer would violate the laws of a foreign jurisdiction. Instead, resource extraction issuers can apply to the SEC for exemptive relief on a case-by-case basis in accordance with the procedures set forth in existing Exchange Act Rule 0-12.

Similarly, there are no exemptions for categories of issuers that fall within the definition of resource extraction issuer. For example, there are no exemptions based on size, ownership, foreign private-issuer status or extent of business operations constituting commercial development of oil, natural gas or minerals.

Other Key Terms

Payment. This term is defined for the purposes of the resource extraction issuer payment disclosure rules as a payment that is:

- Made to further the commercial development of oil, natural gas or minerals;
- Not *de minimis*; and
- One or more of the following: taxes, royalties, fees, production entitlements, bonuses, dividends, payments for infrastructure improvements and community and social responsibility payments that are required by law or contract.

De minimis. As set forth in Form SD, "not *de minimis*" means any payment, whether made as a single payment or a series of related payments, which equals or exceeds $100,000 or its equivalent in the resource extraction issuer's reporting currency during the fiscal year covered by the Form SD. In the case of any arrangement providing for periodic payments or installments, a resource extraction issuer must use the aggregate amount of the related periodic payments or installments of the related payments in determining whether the payment threshold has been met for that series of payments and, accordingly, whether disclosure is required.

Project. Under the resource extraction issuer payment disclosure rules, a "project" means operational activities that are governed by a single contract, license, lease, concession or similar legal agreement, which form the basis for payment liabilities with a government. The definition expressly allows agreements that are both operationally and geographically interconnected to be treated by the resource extraction issuer as a single project. An instruction to Item 2.01 of Form SD provides the following non-exclusive list of factors to consider when determining whether agreements are operationally and geographically interconnected to constitute a project:

- Whether the agreements relate to the same resource and the same or a contiguous part of a field, mineral district or other geographic area;

- Whether they are performed by shared key personnel or with shared equipment; and
- Whether they are part of the same operating budget.

Commercial development of oil, natural gas or minerals. As noted above, the rules define this term as the exploration, extraction, processing and export of oil, natural gas or minerals or the acquisition of a license for any such activity.[3] This term plays a significant role in the rules, both in identifying a resource extraction issuer and for determining the payments that must be disclosed. In turn, the terms exploration, export, extraction and processing are critical to an understanding of what constitutes commercial development of oil, natural gas or minerals. However, of these terms, the SEC has only defined export and extraction in the final rules.

Export. This term is defined for the purposes of the rules as the movement of a resource across an international border from the host country to another country by a company with an ownership interest in the resource. The definition of export expressly excludes the movement of a resource across an international border by a company that:

- Is not engaged in the exploration, extraction or processing of oil, natural gas or minerals; and
- Acquired its ownership interest in the resource directly or indirectly from a foreign government or the US federal government.

The rules also specify that export does *not* include cross-border transportation activities by an entity that is functioning solely as a service provider with no ownership interest in the resource being transported.

Extraction. This term is defined as the production of oil and natural gas, as well as the extraction of minerals.

Processing. While processing is not defined in the rules, an instruction to Item 2.01 of Form SD provides the following non-exclusive list of midstream activities that are included in the term:

- Midstream activities such as the processing of gas to remove liquid hydrocarbons;
- Removal of impurities from natural gas prior to its transport through a pipeline; and
- Upgrading bitumen and heavy oil through the earlier of the point at which oil, gas, or gas liquids (natural or synthetic) are either sold to an unrelated third party or delivered to a main pipeline, a common carrier or a marine terminal.

According to this instruction, processing also includes the crushing and processing of raw ore prior to the smelting phase but does not include the downstream activities of refining or smelting.

Foreign government. The rules define this term as a foreign government; a department, agency or instrumentality of a foreign government; or a company at least majority owned by a foreign government. This term includes a foreign national government as well as a foreign subnational government, such as the government of a state, province, county, district, municipality or territory under a foreign national government. However, "Federal Government" means only the US federal government and does *not* include subnational governments within the United States.

Additional Instructions

The instructions to Item 2.01 of Form SD permit the issuer to report the payments either in US dollars or in the issuer's reporting currency. If payments are made in currencies other than US dollars or the issuer's reporting currency, the issuer can choose one of three available methods to calculate currency conversion. When calculating whether the *de minimis* threshold has been exceeded, a resource extraction issuer may be required to convert the payment to US dollars even though it is not required to disclose those payments in US dollars (for example, when a resource extraction issuer is using a non-US dollar reporting currency). In these instances, the resource extraction issuer may use any of the three permitted methods for calculating the currency conversion as long as it uses a consistent conversion method for all currency conversions within a particular Form SD filing and discloses the conversion method that it uses.

The instructions provide examples of types of "bonuses" (signing, discovery and production bonuses) and "fees" (license fees, rental fees, entry fees and other considerations for licenses or concessions) covered by the rules and specify that royalties include unit-based, value-based and profit-based royalties. Another instruction clarifies that payments for taxes levied on corporate profits, corporate income and production are intended to be disclosed but not payments for taxes levied on consumption, such as value-added taxes, personal income taxes or sales taxes.

According to the instructions, if dividends are paid to a host government in lieu of production entitlements or royalties (such as where a national oil company owns shares of a holding company formed to develop the resources), the dividends must be disclosed. However, dividends paid to governments holding common or ordinary shares of the issuer need not be disclosed so long as the government is treated the same as all other shareholders.

Additionally, an instruction clarifies that resource extraction issuers must disclose in-kind payments—such as a payment to the host government expressed in quantities of crude oil. The issuer must determine the monetary value of the in-kind payment and tag the information required for currency disclosure as "in-kind." The instruction permits the issuer to value the in-kind payment at cost or, if cost is not determinable, at its fair market value and requires a brief description of how the issuer calculated the monetary value.

If a resource extraction issuer makes an in-kind production payment but then repurchases the associated resources within the same fiscal year, the issuer must report the payment using the purchase price (rather than at cost or, if cost is not determinable, fair market value). However, if such in-kind payment and subsequent repurchase are made in different fiscal years and the purchase price is greater than the previously reported value of the in-kind payment, the resource extraction issuer must report the difference in values in the later fiscal year (if the difference exceeds the *de minimis* threshold). In other situations, such as when the purchase price in a subsequent fiscal year is less than the in-kind value already reported, no disclosure relating to the purchase price is required.

Public Compilation

In accordance with the mandate of the Dodd-Frank Act, Rule 13q-1 provides that, to the extent practicable, the staff of the SEC will periodically make a compilation of the information required to be filed pursuant to the resource extraction rules publicly available online. The adopting release made it clear that the SEC rejected the suggestion that issuers submit their annual reports to the SEC confidentially, with the SEC using those confidential submissions to produce an aggregated, anonymized compilation that would be made available to the public. While Rule 13q-1 permits the staff to determine the form, manner and timing of the compilation, it specifies that the staff may not make the information contained in such compilation anonymous, whether by redacting the names of the resource extraction issuers or otherwise.

Practical Considerations

SEC reporting companies involved in the oil, natural gas or mining industries, even if such activities are not the primary focus of their business, will need to carefully assess whether they may be subject to the new reporting obligations, particularly when they have foreign or offshore operations. While reporting companies that are engaged in exploration or extraction of oil, natural gas or minerals pursuant to a lease, license or concession granted by a foreign government or the US federal government are the most likely to be subject to the resource extraction payment disclosure rules, companies engaged in related activities, such as processing (including midstream operations and the ownership of processing facilities) and exporting oil, gas and minerals, should carefully review the nature of such activities and the nature of any payments made to government entities.

Although there is a transition period before reporting is required, companies affected by the rules should realize that there may be considerable start-up time and expense required in order to be ready to comply by the required deadline. These could include IT consulting, establishing new reporting systems, training local personnel on tracking and reporting and developing guidance to ensure consistency across reporting units. Some companies may need their accounting groups to develop new information systems, processes and controls.

Because the definition of "project" is determined based upon agreements that form the basis for payment liabilities with a government and are operationally or geographically interconnected, companies that fall within the definition of resource extraction issuer should begin considering which agreements will constitute a project at the drafting and negotiation stage. These determinations of which agreements will constitute a project will in turn determine the reporting units for which payments must be tracked and disclosed.

Resource extraction issuers should review existing agreements governing their projects to determine if any include confidentiality provisions that would be breached by the new rules. If there are any such provisions, it may be prudent for the issuer to use the time permitted by the extended compliance date to negotiate amendments to permit the disclosure required by the SEC's new rules or to seek waivers of such contractual provisions.

Companies that fall within the definition of resource extraction issuer should also begin a review of their systems and controls for financial accounting and financial reporting to determine what additional procedures and processes they may need in order to report the payments required to be disclosed. Additional disclosure controls and procedures may need to be implemented in order to track payments by subsidiaries and controlled joint ventures to governments and government-controlled entities, as well as to comply with the new XBRL reporting requirements.

For companies with existing procedures for tracking and recording subsidiaries' payments to foreign governments for Foreign Corrupt Practices Act purposes, it is possible that only minor tweaks to existing controls and processes may be necessary. On the other hand, if it appears that significant modifications to a company's systems and controls are needed in order to capture and report the requisite payment data, then the lead time to be prepared to comply with the new disclosure requirements will be significantly longer.

To prepare for compliance, companies that will need to report resource extraction payments under the SEC's rules may want to review the experience of companies that are reporting under similar payment regimes, such as the alternative reporting regimes that the SEC has determined to be substantially similar, as discussed above under "Alternative Reporting Regimes."

Because Form SD is not part of an issuer's annual report on Form 10-K, quarterly report on Form 10-Q or periodic report on Form 8-K,[4] the resource extraction issuer payment disclosures will not be subject to certification by the chief executive officer and chief financial officer of the issuer.

Since the time the SEC originally adopted the resource extraction issuer payment disclosure rules that were subsequently vacated, other jurisdictions have adopted comparable payment disclosures rules. Nevertheless, it remains to be seen whether the recently adopted final rules will competitively damage public companies that are resource extraction issuers or result in greatly increased expenditures for them as a result of compliance costs and lost opportunities with host governments having non-disclosure laws.

Foreign issuers that are exempt from, or not subject to, the requirements of reporting under an alternative reporting regime will need to determine whether they are also exempt from reporting under the new resource extraction issuer payment disclosure rules. If they are not exempt from the final rules, they will need to determine whether to comply with the final rules or to seek an exemption from compliance with such rules as described above under "No Exemptions for Violations of Foreign Law or Categories of Issuers."

Resource extraction issuers should determine sooner rather than later whether compliance with the final rules will violate the laws of a foreign jurisdiction as the final rules do not provide an exemption in such a situation. If such an issuer finds that it has conflicting disclosure obligations, it should start seeking an exemption from the final rules as soon as possible so that it will still have plenty of time to plan for compliance if the request for an exemption is denied.

The resource extraction issuer payment disclosure rules have been subject to litigation from both ends of the political spectrum, with litigation challenging the SEC's initial rules followed by litigation demanding that the SEC adopt rules in accordance with the Dodd-Frank mandate. It is possible that there could be additional litigation. However, as discussed above, there are steps companies should be taking to prepare for disclosure. Therefore, resource extraction issuers should *not* count on litigation delaying or overturning this Dodd-Frank mandate; they should use the time available now to prepare for compliance.

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Endnotes

1 Available at https://www.sec.gov/rules/final/2016/34-78167.pdf.

2 Available at https://www.sec.gov/rules/other/2016/34-78169.pdf.

3 Section 13(q) of the Exchange Act defines "commercial development of oil, natural gas or minerals" as including exploration, extraction, processing, export and other significant actions relating to oil, natural gas or minerals or the acquisition of a license for any such activity.

4 Form 20-F, Form 40-F and Form 6-K, as applicable, in the case of foreign private issuers.

EU agreement on regulation against conflict minerals

On 16 June 2016, the European Union (EU) agreed on a framework for an EU regulation to stop the financing of armed conflict and human rights abuses through trade in minerals and metals from conflict zones. Following years of negotiations between the Council of the European Union, the European Parliament and the European Commission (and input from industry stakeholders and human rights campaigners) as to the scope and stringency of the proposed legislation and, in particular, whether it should impose mandatory or voluntary trade rules, a compromise position has been reached. Companies operating in the EU which are mining, refining or importing tungsten, tantalum, tin and/or gold (3TG) will be under a mandatory obligation to perform due diligence checks on their suppliers and certify that their supply chains are free from minerals which have caused or financed violence within conflict-affected and high-risk areas anywhere in the world. However, after much debate, it has been agreed that the mandatory scheme will not extend to imports of finished products containing 3TG.

The text of the legislation is yet to be finalised but is expected to incorporate OECD diligence and self-certification guidelines, requiring EU smelters, refiners and importers of 3TG to (1) establish strong company management systems; (2) identify and assess risk in the supply chain; (3) design and implement a strategy to respond to identified risks; (4) carry out independent third party audits of the supply chain due diligence at identified points in the supply chain; and (5) report on supply chain due diligence. EU member states' competent authorities will be responsible for ensuring compliance and for determining penalties for non-compliance, to be monitored by the European Commission. Furthermore, the European Commission proposes to publish a list of 'responsible importers' to be available to the public – a first of its kind.

Small volume importers of 3TG (e.g. for dentistry) will, at least initially, be exempt from the mandatory scheme so as to avoid encumbering their businesses with unreasonable administrative obligations, and there will be no requirements for end-users or investors in impacted sectors. Recycled metals, existing EU stocks of 3TG and by-products will also be excluded from the legislation. Perhaps fortunately for many EU-incorporated companies, who will have been keen to avoid the administrative burden and cost of the mandatory diligence and reporting requirements, the legislation will not extend to imports of finished products containing 3TG, notwithstanding that the majority of 3TG is imported into the EU within finished products, such as inside mobile phones, lightbulbs and laptop computers. Human rights organisation Amnesty International has expressed a concern that this legislative gap allowing companies that import 3TG in their products to escape the requirements significantly diminishes the usefulness of the regulation and defeats its intended purpose. However, it is expected that larger EU manufacturers and sellers of such products will be "encouraged" to comply voluntarily with the due diligence requirements of the regulation and to report on their sourcing practices based on a new set of performance indicators to be developed by the EU Commission, and the EU Commission has asserted that it remains committed to evaluating periodically whether this voluntary system is adequate and if not, potentially extending the scope of the legislation.

The new regulation will push the EU to the forefront of the fight against conflict minerals. As compared with the United States' 2011 offering - Section 1502 of the Dodd-Frank Act, which applies similar mandatory rules to importers of 3TG sourced from the Democratic Republic of the Congo (DRC) and nine neighbouring countries - the proposed EU regulation will apply in respect of 3TG imported from conflict-affected and high-risk areas worldwide. Where the US rules have been criticised for diverting trade away from the DRC region, with companies avoiding that region entirely in favour of other areas where they are not subject to the supplementary obligations - resulting in more problems in an already poverty-stricken region -the proposed EU regulation could be commended for applying the rules so widely that companies cannot easily divert their operations to alternative regions solely to avoid complying with these obligations. Such is the global reach of the legislation that, while the European Commission will publish within a "Handbook for Operators" an indicative list of such areas designated as such by a panel of experts, companies sourcing from areas not on the list which might objectively fall within the principles-based definition of "conflict-affected and high-risk areas" will nonetheless be required to comply with the legislation.

Informal legislative negotiations are expected to be concluded in the coming months, with finalisation of the legislative text to follow. Once adopted by the EU Council and the European Parliament and published in the EU's Official Journal, the EU regulation will be directly applicable in all EU member states. While the EU has proposed a two-year transition period from enactment of the legislation to allow companies to introduce audit systems and has indicated that it would be open to recognising existing industry due diligence schemes subject to certain conditions, it would be prudent for companies falling within the scope of the regulation to be cognisant of the compliance framework required, given the lengthy process of gathering data to conduct due diligence.

With the recent Brexit decision, the legislation will apply to UK companies within scope for at least as long as the UK remains a member of the EU; it remains to be seen what (if any) impact an exit from the EU would have on the application of the legislation to such companies.

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Alternative Funding Sources For Mining Projects

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Tom Eldridge

There has been recent, cautious suggestion from within the mining project finance sector that sentiment is changing for the better. Certainly not boundless optimism, and not even a belief that the market has seen off the worst of it and is rebounding. But there are some signs that conditions are softening with an indication that the equity and debt markets, effectively shut for so long now to the junior and midcap miners, might just be opening again, albeit slowly and quietly.

When the last great commodity supercycle crashed to a spectacular halt, as dramatically reduced demand for metals, raw materials and other resource consumption meant metal prices fell as quickly as they had risen previously, many mining projects became unviable as investment concerns.

Precious and base metals, bulks and other industrials, strategic and specialty projects all suffered. No one across the mining and minerals sector avoided the downturn and the effect this had on investment so vital for mine development.

Without doubt, mining projects owned by the major mining houses were adversely affected too; however, it was those miners owning single or small assets, often at, or near to, development stages, and with balance sheets really no stronger than their reserves in the ground, who suffered so drastically. The consequential withdrawal, and almost complete disappearance, of the equity and debt markets from the sector as the natural funding source for mine development and capital programs was almost unprecedented.

To compound the misery caused by the stressed commodity markets, the banks and other financial institutions were working through their own internal problems. The lasting effects of the liquidity crisis, followed by a new world of regulation around capital requirements and banking operations, meant lending any new money became more difficult.

This was made even harder in the context of commodity and resource markets where traditionally risk-weighting considerations for project finance loan assets had been an internal challenge for banks. (Arguably, had the mining and metals' sector continued to enjoy the same bull market for the last few years that it did in previous ones, bank debt may not have been available still in the same volumes and on the same terms as it had been prior to the liquidity crisis because of these issues).

The miners, therefore, were presented with a double-pronged onslaught: equity investors of yesterday redeploying cash into other asset classes and debt providers locked-up by both the absence of that equity and unsympathetic credit and risk committees.The traditional gearing models for junior mining greenfield projects relied heavily on substantial amounts of equity being committed and spent first, with project finance debt often only accounting for 50-60 percent of the total capital cost (particularly in respect of more exotic mineral production and challenging locations).

As always with commodity-based projects, timing is everything. And those junior miners with assets in most need of capital, to either bring them into production or to expand existing production, were hit hardest.

While the development or expansion of many mining assets was shelved, with capital programs suspended and operations put on care and maintenance, some miners faced down the toughest of conditions and brought their assets into production.

The Junior Miners Response and Alternative Funding Sources for Mining Project Finance

As predicted by many within the industry, private equity funds did not rush in to fill the gap left by equity and conventional project finance debt. While a number of specific resource-focused funds did feature as capital providers, mining and minerals was, and remains, an asset class generally too challenging for PE liquidity and hurdle rate requirements. So how did certain miners secure the necessary capital to finance projects into production when others failed?

There were some who sought more traditional options for funding where the prime equity and debt markets would not oblige — this, of course, not being the first (or, dare we say it, last) time those markets retracted from the sector.

Cash

There were, of course, those who had cash available going into the funding crisis. There were also those few with assets capable of being sold in the market, with the sale proceeds made available for development.

With supportive shareholders content to see cash committed to, and actually spent on, development, those miners came through relatively intact. But they were the few. The funding crisis period did not bear witness to the cash-rich majors taking advantage of the troubled times and acquiring exploration, development or producing assets at a discount; they too were having their own funding issues.

Private Placements

Existing shareholders were tapped for new investment. This was in the form of rights issues, preferential equity, high yield notes, convertible instruments and other structured forms of equity and quasi-equity investment with an overriding requirement to avoid dilution. All of these were documented and issued in very different ways, but with the one common aspect of eye-wateringly high returns or coupons reflecting the troubled times.

Contractors

Miners also looked to their contractors and suppliers. As with any industry in stressed times, the stakeholder community in a development project tends to expand (at the request of management and insistence of equity) to a larger pool of participants who are expected to "have skin in the game" and to "share the pain." Thus, more traditional forms of contractor finance were deployed.

Contractors and suppliers facing employers with no access to funding and, as result, on the verge of bankruptcy, had no real option but to amend their contracts. Key construction and supply contracts were varied to defer fees, rental payments and staged payments on terms that mitigated employer liquidity problems and provided the contractors with financial upside on a delayed basis (either in the form of interest payments in cash on deferred payments, other bonus structures and, in some cases, equity allotments in the mining operator/employer in lieu of payments due and owing).

Government

There were even mining operators who were able to renegotiate royalty commitments and other fiscal arrangements with host governments. While each of these arrangements were bespoke, the principle underpinning them was that the money saved from royalty payments was being redeployed into capital programs that would enhance the value of the asset and, in the longer term, increase the return to those governments.

Royalties

There were miners who were able to sell royalties on their projects. In return for an initial capital payment, buyers receive a share in the project's future revenues for the mine life. The buyer's entitlement is commonly to a "net smelter return," being a fixed percentage share in the gross revenues of a project less certain, defined costs for transportation and processing. Traditionally, royalty transactions funded relatively small costs for exploration and early stage development projects. But more royalties were sold during this period to bring assets into actual production, and sometimes for greater capital amounts than had been previously seen.

In certain jurisdictions, royalties can attach to the actual mining property title through a legal registration process. This means they are capable of binding any purchaser of those mining properties, and are not limited to just a contractual right to enforce payment against the mining operator who sold the royalty in the first place.

During this period, and particularly in jurisdictions where royalties could not attach to the title, royalty documentation, in some instances, allowed a purchaser to demand repayment of its capital payment in certain default scenarios, and to have that repayment obligation secured on the assets of the mining operator. Traditionally, upfront payments were generally not capable of being repaid early, or indeed secured. Further, the economics of a royalty transaction tended to provide that the buyer received a return on its capital spread proportionately over the entire life of mine. In recent times, there has been suggestion that some of the royalty structures put in place gave buyers the same downside protections as a secured lender would traditionally insist on, but, at the same time, the financial terms of the royalty were such that the buyer received full value and more for its capital investment at a much earlier stage in the mine life.

Offtakers

Perhaps the most notable funding source during this period, and the one most distinct to the mining and metals sector, came from the actual buyers of the mine production.

In the first instance, it was industrial consumers of metals who sought to secure supply direct from the mines. They had the balance sheets to provide upfront, advance payments. They did not require financial hedging instruments to support these payments. These payments could be used for capital programs, mine development and even working capital. In return, the buyers received fixed-term discounted metal delivery commitments in volumes sufficient to both “repay” the advance payments and to supply their industrial and manufacturing divisions.

Traditionally, metal traders have played roles in providing forms of offtaker finance at the mine site level. However, a trader’s interest in the metal being committed under an offtake contract is very different to that of an industrial buyer. The former being solely financial, the latter being solely about supply security. Without a market into which the trader could sell the necessary volumes committed under its mine offtake contract, there was little incentive for that trader to put any of its capital at risk.

So enter the metal streaming companies.

These were large, highly specialized buyers of precious metal mine production. They had big balance sheets and a risk appetite to match. Streaming contracts combine elements of industrial offtaker transactions and royalty structures; like industrial offtake agreements, the metal streamer makes an upfront capital payment in return for a priority allocation of metal at a discounted price; and, like royalty transactions, the metal streamer enjoys preferential benefits in the mine operations for the life of the asset (in the form of discounted production, rather than the net revenues available to the royalty purchaser).

Advance payments under streaming contracts could be considerable capital investments. As such, the contracts provided for similar default and repayment protections for the buyers and a condition that the mine assets were secured in favor of the buyers. Like the secured royalties, streaming exposures, up to the point sufficient metal had been delivered to the buyer to “repay” the advance capital payment, gave the buyers the same protection as project finance lenders in the mining sector would commonly enjoy. After that point, the buyers secured life of mine priority to a percentage of production at an agreed discount. And if the contract was terminated early due to seller/operator default, a payment became due to the buyer. This payment would be based on a net present value calculation of the return the buyer should have obtained from receiving discounted metal had the contract survived for the mine life.

The Future — Some Questions and Considerations

Returning to our opening statement, that there are signs that traditional equity and debt markets might be opening again, what does the future hold for junior miners with development assets in search of capital investments?

Given the range of alternative funding sources discussed above, there are a number of miners with complicated capital structures. Capital structures that have been put in place during highly stressed times in order to get to production levels required to support returns to shareholders.

There can be no doubt that the alternative funding sources have allowed production to come on stream with a view to maximizing shareholder value as best as possible during the period. As such, mining companies and mining projects have survived the toughest of times. In doing so, investment and continued production has been secured, and with it, jobs and livelihoods of those closest to, and dependent upon, mining operations. In a sector defined by resourcefulness and resilience, this cannot but be applauded.

But the question has been: at what cost in the long run? Can miners raise new equity quickly when existing shareholders have been afforded preferential rights in return for their rescue financing? With the life of mine deals structured as royalties and metal streams, will new equity come into a project if it is perceived that value could be diverted from shareholder returns for the mine life to the buyers' in the form of priority allocation of net revenues (in the case of royalties) and discounted metal (in the case of the streamers)?

Important questions arise as to whether streaming and other offtake structures can coexist with traditional project finance lending. There have been examples of this, and indeed streaming contracts generally provide for a set of intercreditor principles that would support a debt financing of the same asset at a later date.

The considerations in such capital structures include the ability to share security over mine assets, and whether all assets are shared equally or are distinct and ring-fenced in respect of specific exposures: for example, the stream having priority security interest over production and the debt having priority over all other mine assets. Other considerations revolve around enforcement of security: how and when can security be enforced, and by whom? Traditionally, voting constructs in intercreditor agreements are based around the size of the respective exposures and the expected returns to each of the creditors (reflecting their position in any capital structure and their risk placing and giving them priority over other creditors). These are made difficult when the returns on a loan investment and a return on a prepaid stream investment are so different.

Fundamentally, a stream sees its full value returned over the life of the mine, whereas, the return profile on a project finance loan will never extend so far, and rarely extends beyond a sensible 30 percent reserve tail. In an enforcement scenario, a lender may be able to obtain sufficient value through either a court or bank/receiver-led asset sale where, for example, the trucks, equipment and other capital assets are sold separately and relatively quickly. This may well be at odds with a stream provider who, based on the above, would have a preference for the project to be sold as a going concern with any buyer assuming all of the obligations under the streaming agreement. The enforcement scenarios are very different and are unlikely to realize value for both sets of creditors.

Further questions arise as to the extent to which commodity hedging (nearly always a condition to project finance lending and providing for downside price protection to the producer and upside value to the commodity provider) can ever coexist with a life of mine stream. There have been suggestions that the two are, in fact, mutually exclusive.

The above is not intended to be an assessment of the merits of the alternative sources of funding; rather, it is a consolidation of some of the questions and considerations currently surrounding the sector. In previous times of financial stress, miners have been able to access the equity capital and debt markets, albeit on a limited basis and at a price. They have taken the pain of high coupons and margins and restrictive terms and covenants. But as the markets have turned in their favor they have been able to refinance and unwind some of these positions with cheaper debt and less restrictive covenant packages. If the equity and debt markets are indeed showing signs of improvement, the considerations above will be some of the central issues in determining how certain junior miners can access these markets, and at what price given existing capital structures based on alternative sources of finance.

—By Tom Eldridge, Mayer Brown LLP

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Article

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Challenges to preserving value in a debt restructuring

By Rachel Speight, partner in the Global Mining Group and Alex Wood, counsel in the Restructuring, Bankruptcy and Insolvency Group.

When any industry faces challenging times, thoughts turn to what might happen to those companies which are unable to maintain their solvency and service their existing debt.

The mining industry is no different. If steps such as cutting costs, improving productivity, selling or mothballing unprofitable operations, raising new equity and refinancing existing debt do not yield the hoped-for results, companies may have little choice other than to restructure their existing debt or, in extremis, enter into one or more formal insolvency procedures as a protective step if they are to avoid creditor action.

Debt restructuring and formal insolvency are complicated processes in the best of circumstances, placing significant demands on even the most experienced management teams. However, factors specific to the mining industry may make achieving a debt restructuring particularly challenging.

Formal insolvency procedures in certain jurisdictions, unless part of a carefully planned strategy, may ultimately destroy the value of the underlying business (which may explain why the industry has seen relatively few formal insolvencies to date). This puts pressure on stakeholders (management, banks and other lenders, suppliers and other counterparties, employee unions and, where relevant, governments), where possible, to achieve quickly a consensual debt restructuring which provides the company with a realistic platform for future long-term trading in a world of lower commodity prices.

Whilst traditionally bank debt was prevalent, alternative capital providers are now entering into the market. Many companies have complicated capital structures, including senior bank debt, bond debt and streaming, vendor and royalty finance, as well as hedging arrangements. As between them, the rights of the various lenders will be the subject of inter-creditor arrangements. As any decision on a debt restructuring is likely to require the consent of a high proportion of lenders, with their differing rights and commercial interests, achieving a consensual solution is inevitably challenging.

This problem is not unique to the mining industry and, in other sectors, companies have sought approval from the UK courts for "schemes of arrangement" in order to complete a debt restructuring which had the benefit of significant lender support but which support fell short of the consent thresholds imposed. UK schemes are available to non-UK companies which can establish a "sufficient connection" to the jurisdiction and may therefore be of assistance to mining companies outside the UK, including those with no apparent current link to the UK. In a recent case, a Dutch company successfully established a sufficient connection to the UK by changing the law governing its bond debt from New York law to English law.

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Challenges to preserving value in a debt restructuring

Whilst restructuring negotiations continue, management will need to monitor cash flow and maintain a dialogue with other stakeholders, particularly suppliers, in order to ensure that they do not take action against the company (including arbitration to recover unpaid debts and/or insolvency proceedings) which might jeopardise continued trading pending the completion of negotiations with lenders.

If pressure from unpaid stakeholders is building, management will need to consider whether a protective insolvency filing is appropriate – in many jurisdictions, once a company enters into an insolvency process, it will have the benefit of a moratorium on creditor action. Typically the group structure comprises a series of separate operating companies incorporated in the various countries where the mines are located, together with intermediate holding companies and a parent company incorporated elsewhere, hence multiple filings may be required. If one company has assets in a number of different jurisdictions then ensuring that the moratorium is recognised and enforced by the courts in each such jurisdiction will be key.

The decision to make a protective insolvency filing will be a difficult one for management, given that this may trigger rights to terminate licences and key contracts. Throughout the restructuring process, the directors will need to have regard to their legal duties when making key decisions. These will vary between jurisdictions but they may owe their duties predominantly to the company's creditors, and not its shareholders, if the company is insolvent. They will also need to be aware of any strict obligations upon them, for instance, a requirement to make an insolvency filing if the company is cash flow or balance sheet insolvent. Regular reviews of trading, cash flow, performance against targets, progress of any ongoing asset disposal programmes (together with the progress of the restructuring negotiations themselves) and advice on the options for (and implications of) insolvency filings in relevant jurisdictions will be critical information for management.

Across the industry there is already a broad awareness of other issues which mining companies will face in the context of any restructuring, including untested insolvency procedures in less sophisticated legal jurisdictions, the impact of development finance, the differing outlooks of lenders (for instance par vs. distressed investors), the role of governments and the potential power of employee unions.

One particular issue, the implications of which are worth noting, is that in some jurisdictions, once the company enters into an insolvency process, the business is managed by an insolvency officeholder. It may be very difficult for the officeholder to gain a sufficient understanding of a complex business (including obligations under environmental legislation which, if breached, may lead to personal liability) in order to be able to trade the business for any length of time. Whilst comfort from the courts and discussions with regulators may help, the consequent destruction of value if production ceases will be detrimental to all stakeholders.

Ultimately, if value is to be preserved, a consensual debt restructuring which avoids the need for a formal insolvency filing may be the only option for many mining companies who are unable to maintain solvency and service their existing debt.

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What companies need to know in relation to DPAs

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At the end of November 2015 the Court approved the first ever Deferred Prosecution Agreement ("**DPA**") in the UK, between the Serious Fraud Office ("**SFO**") and Standard Bank plc (now ICBC Standard Bank plc) ("**the Bank**") for the corporate offence of failing to prevent bribery (in breach of section 7 of the Bribery Act 2010 ("**section 7**")).

What is a DPA?

DPAs have only been part of UK law since 2014. A DPA is an agreement between the SFO and a company (and only a company – individuals cannot enter into a DPA) by which the SFO agrees not to prosecute in exchange for which the company admits an alleged offence, cooperates with the SFO and pays any fines or other penalties, as well as, in some instances, being subject to the appointment of a monitor. Only the SFO can offer a DPA (the company cannot ask for one), and the DPA must be approved by the Court as being "fair, reasonable and proportionate". The first DPA was such an important development that it was approved by the President of the Queen's Bench Division of the High Court, Sir Brian Leveson. He handed down his judgment approving the DPA on 30 November 2015.

The facts behind the first DPA

The Bank entered into a joint mandate with what was at the time a sister company in Tanzania, Stanbic Bank Tanzania Limited ("**Stanbic**"), to raise funds of US$600 million for the Government of Tanzania by way of a sovereign loan note. The fee was to be 2.4% of the funds raised, i.e. approximately US$14.4 million. Of this 1%, or c. US$6 million, was to be paid to a third party Tanzanian "facilitation agent". It subsequently emerged the facilitation agent was a 'shell' company to enable the US$6 million to be paid to Tanzanian government officials, allegedly to ensure that the mandate for the loan note was given to Stanbic and the Bank.

The Bank left it to Stanbic to perform all the "know your client" checks for the facilitation agent. However Stanbic only performed the checks required for it to open a bank account. The SFO contended, and the Bank did not dispute, that because of this delegation of responsibility the Bank's procedures had not been adequate, such that it had no defence to the charge of failing to prevent bribery. When the US$6 million fee was removed in three large tranches by the officers of the facilitation agent, Stanbic employees escalated their concerns that the payment may have been a bribe, which were also communicated to the Bank.

The Bank then notified the SFO of the allegations before it began any internal investigation. In his judgment approving the DPA, Leveson highlighted this early self-reporting as an important mitigating factor, as well as the Bank cooperating with the SFO by:

- agreeing with the SFO how the internal investigation (performed by an independent law firm) would be conducted;

- providing all the documentation captured by that investigation to the SFO;
- facilitating the SFO's interviewing of witnesses; and
- strengthening its anti-bribery policies and procedures.

Following this investigation, the Bank faced an offence of failure to prevent bribery by persons associated with the Bank (being Stanbic and the relevant corporate officers at Stanbic) in breach of section 7.

Under the terms of the DPA Standard Bank had to agree to: disgorgement of the Bank's profit arising as a result of the mandate which had been won by the bribe; compensation; payment of a financial penalty; paying the SFO's costs; commissioning and submitting to an independent review of its anti-bribery and corruption policies and procedures; and cooperating with all relevant authorities in relation to the offence. Even excluding the last two requirements – where the cost is unknown – Standard Bank had to pay more than US$30 million. However, as a DPA is not a criminal conviction for the purposes of the EU Public Procurement Directive, the Bank is not automatically debarred from bidding for public contracts. Just as importantly, the Bank had certainty that there would not be a contested trial and that the SFO was satisfied no further action was needed in relation to the facts in question. This meant the Bank could draw a line under the offence and get back to its business.

Section 7 – failing to prevent bribery

Section 7 introduced a new corporate offence where a company fails to prevent bribery by an "associated person", defined as a person who performs services for or on behalf of the company. This is a very wide category of person and crucially is not limited to employees of a company but includes (for example) agents or employees of subsidiary companies. The company has a defence to the charge if it can prove that it had in place "adequate procedures" designed to prevent associated persons from paying a bribe. However there is not yet any case law on what procedures are "adequate".

What lessons can a board take from these developments?

Most companies are unlikely to face such clear examples of potential corruption as the Bank did. Given the emphasis in Leveson's judgment on how early the Bank had raised the issue with the SFO, no doubt companies will want to report allegations as early as possible. However if the company is listed this would require a public announcement, with implications for the share price.

Any board considering whether or not it should cooperate with the SFO with a view to the SFO offering a DPA should bear in mind that not only did the SFO see the report produced for the Bank following the independent investigation, but the SFO sanctioned that investigation. Leveson's judgment made clear that this meant that the SFO was provided not only with the documents it requested, and access to the investigating law firm's document review platform, but also with a "summary of first accounts of interviewees" before the Bank "facilitated the interviews of current employees". This clearly gives the SFO access to all information under investigation by a law firm nominally instructed by the board.

However a board must make the best decision for the company in all the circumstances and will have to judge when it is the right time to report its suspicions to the SFO, with all the consequences that follow.

Conclusion

The facts giving rise to the Bank's DPA fell neatly into the type of case for which a DPA was intended. These have shown the high hurdles – especially the high level of cooperation with the SFO – that a company must clear before a DPA will be offered by the SFO, let alone one being successfully negotiated before being approved by the Court.

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Article

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Why asteroid mining is the future - and a legal minefield

By Ian Coles, Partner and Rachael O'Grady, Associate

Luxembourg recently announced its ambitious intention to enter the field of asteroid mining. According to many, this is where the future lies – the harbouring of extra-terrestrial minerals will mean Earth's dwindling natural resources are no longer a concern and the procurement of water in outer space, and its ability to be converted to rocket fuel, will revolutionise space travel. There are currently a number of companies already dedicating significant resources to space mining and it is thought a single asteroid could be worth up to a trillion US dollars.

Luxembourg plans to offer funding and investment to private enterprises for research and development in this area. It also envisages creating a legal framework by the end of this year to allegedly ensure the spoils of these galactic mining endeavours would remain the property of whichever companies had managed to recover them.

However, herein lies the black hole with Luxembourg's grand plan: there is currently no international legal framework that governs the mining of asteroids. While Luxembourg may very well proceed to pass whatever domestic legislation it may wish, as indeed the United States did with its Space Act of November 2015, it should do so only with due and proper regard to international law, which supersedes national law, if its acts are to have any meaningful effect.

The current international framework governing activities of nations in outer space is the extremely successful but now somewhat outdated 1967 Outer Space Treaty ('Treaty'), which was promulgated in the midst of the Cold War. The purpose of the Treaty was to ensure that the exploration of space by all nations would only be undertaken peacefully and in a spirit of international cooperation. Significantly, it specified that outer space was to be regarded as the common heritage of mankind and prohibited the sovereign appropriation by any State of the moon or any other celestial body. Arguably therefore, under international law, asteroids, and whatever minerals they may contain, cannot be claimed by States or their nationals.

However, those determined to pursue asteroid mining exploits have, naturally, chosen to interpret the Treaty in ways to better suit and justify their cause. Arguments have been raised, for example, that the prohibition by the Treaty against the appropriation of celestial bodies does not extend to the minerals contained within those bodies. Others have argued that the prohibition relates not to private enterprises but only to States. Whichever side of the argument is correct, three things are certain. First, international law on this subject is, at the very best, unclear. Second, no international legal framework exists which actively grants States, or their nationals, substantive rights to mine asteroids. Third, the international law governing outer space desperately needs updating if it is to keep pace with modern advances and rectify the lacunae that new technologies have revealed within it. In the meantime, investors and companies in this sector will be exposing themselves to a significant legal risk.

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Article

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Time for change in Nigeria

By Doye Balogun

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Which is Africa's largest oil-based economy? Few would miss out on the points if that came up as a pub quiz question, but a lesser known fact is that Nigeria is blessed with commercial deposits of about 37 different minerals scattered across the country and was a major exporter of coal, tin, columbite and other minerals until the early 1970s.

That was until the end of the civil war, (which had led to several mines being abandoned), with further growth also hampered by the oil boom of that decade.

Fast forward to 2016, with crude oil prices having dropped to as low as US$27 a barrel from near US$120/bbl in June 2014 and the domestic currency, the Naira, hitting an all-time low of ₦400:US$1 on the parallel market last month. The result is a stage on which to reignite the age-old debate on the need to diversify Nigeria's economy.

On examination of the legal framework surrounding Nigeria's mining industry, there appears at least one industry capable of providing this much needed economic diversification. Converting this potential, however, faces serious challenges.

The legal framework of Nigeria's mining industry is relatively well-established. At its heart is the Nigerian Minerals and Mining Act 2007. As with many mining jurisdictions, property rights in land are vested in the Nigerian government, which grants concessions to investors to carry out mining activity. The licensing regime under the act is varied and includes:

- A reconnaissance permit carrying non-transferable rights of access to mining land for the purpose of searching for mineral resources and removing surface samples in small quantities (one year; renewable annually)
- An exploration licence carrying exclusive rights of exploration (three years; renewable for up to two terms of two years each)
- A small scale mining lease carrying exclusive rights to carry out mining operations on an area not exceeding 3km² (five years; renewable for further terms of five years each)
- A mining lease carrying exclusive rights to carry out mining operations within a mining lease area not exceeding 50km² (up to 25 years; renewable for further terms of up to 24 years)
- A quarrying lease (five years; renewable for further periods of five years)
- A water use permit, which remains valid to the extent the underlying mining lease, small scale mining lease or quarrying lease to which it relates, remains valid.

The application fees for the above concessions are very modest and licence holders enjoy generous tax incentives. The government has no free-carry rights and royalties range from 3-5% depending on the type of mineral (and may be reduced or waived where minerals are exported solely for experiment or analysis in reasonable quantity).

One might expect these features to provide an attractive landscape for mining investors. However, the reality is somewhat different.

Time for change in Nigeria

According to Central Bank of Nigeria reports, the mining sector accounts for only 0.14% of GDP, and 3.8% of non-oil export revenue – a surprising statistic given the volume of known mineral deposits in the country.

By contrast, crude petroleum and natural gas account for up to 15% of the country's GDP, though they generate over 90% of Nigeria's foreign exchange revenues and typically 75-85% of its government revenues. While the slump in oil price has forced attention to shift to other industries, there are a number of practical challenges to overcome in order to achieve any meaningful development of the mining industry.

First, significant investment in transport infrastructure will be required in order to move products from mines to market. There is already some limited rail infrastructure (for example into the port of Warri) and the location of some projects may mean that waterways can be used (as with the Agbaja iron ore project), but a lot more investment, particularly into rail and road facilities, is required. As has been widely reported, Nigeria's power deficit would also need to be addressed to provide continuity to projects.

Accredited laboratory testing would also require investment so mining companies can make decisions about exploration using reliable data. Nigeria reportedly has 84 accredited laboratories to test locally manufactured products for international standards, compared with 340 in South Africa, over 300,000 in China, and about 13,000 in the USA, making it necessary to carry out accreditation outside of Nigeria at both a financial and time cost.

Finally, it is no secret that the volatile security situation in the north of the country (home to many of Nigeria's minerals) is another reason for the cautious approach to foreign investment. President Buhari has made crushing Boko Haram one of the central tenets of his new term and announced towards the end of last year that the group had been "technically defeated" (bonus points in that pub quiz for those able to elucidate that phrase).

Speaking to a French trade mission in 2015, President Buhari said: "Our government came into office at a time when many people had abandoned the country's manufacturing, agricultural and mining sectors.

"We are doing our utmost best to encourage diversification into these sectors, which can employ a lot of people and we will welcome your support in this regard."

But while Nigeria's mining industry has the potential to become the mainstay of the economy, in order for it to achieve that status the government will need to pay more than lip service to the development of the industry this time around.

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Article

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Changes to Mining Codes in Africa

By Ian R. Coles, Partner and Head of Global Mining Group; Mayer Brown LLP

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Mining codes change frequently. A recent World Bank publication estimated that over a period of 20 years governments in 110 different countries had amended the local mining code – approximately 25 of these were in Africa. Historically this has been in the context of encouraging foreign direct investment, frequently through pressure for change from donor agencies. More recently though, economic interests have come to the fore, particularly in connection with the level of royalties and taxes demanded by governments. Requiring local content during the development of a mining project is also a frequent theme. In addition requirements for transparency, highlighted by legislation such as the Dodd-Frank Act in the US and the Bribery Act 2010 in the UK have motivated changes in mining legislation.

One of the most recent examples of change – and one where competing interests played out in the public domain – is in Zambia. The budget statement for 2015 (an election year – which was probably relevant) announced an increase in mineral royalties from 6% to 8% (in the case of underground mining) and to 20% (in the case of open cast projects). Other tax increases were also proposed. In aggregate the new proposals were estimated to produce a 30-40% increase in the amount of revenue generated for the state by the mining industry.

Immediately sponsors took to the airwaves to press that the proposals would render many projects unviable. Following the elections the government announced in April 2015 that the royalty rate for all mines would be set at 9%. This remained a significant (50%) increase on the rate which had previously existed but nothing like as large an increase as had previously been proposed for open cast projects. The new tax regime was scheduled to come into effect on 1 July. However during the course of June the government rolled back the proposed changes even further – with royalties on open cast and underground mines set at 9% and 6%, respectively. In addition other sponsor friendly changes to the way income tax was calculated were announced.

In the realm of free carried interests, and in March 2015, the Minister of Mines of DRC submitted a draft of a new mining code to Parliament. The draft is awaiting approval but contemplates an increase in the state's free carried ownership interest in mining projects from 5% to 10%. This is one of a steady stream of amendments to the mining code which have been made in DRC over the past several years.

Kenya is another country which has made various efforts to increase the host state's revenue from mining projects. The difference here is that a mature mining industry has yet to develop – there are relatively few producing mining projects of any size and the mining industry has historically produced less than 1% of GDP. The latest attempt in this direction is incorporated in the new Mining Bill which is expected to be passed into law. The legislation contemplates a 10% free carried interest in new projects (mining companies would also be obliged to float 20% of their shares on the

Nairobi Stock Exchange). Some non-material changes to the income tax regime are contemplated but of greater concern to the mining fraternity is the proposed increase in royalty rates (for example from 3% to 10% for titanium ores and increasing to 12% for diamonds). Mines processing minerals locally would be entitled to a lower royalty rate.

Other examples in Africa include a new mining code in Senegal which was proposed to be implemented by the end of 2015. Unlike many revisions to mining codes this does not contemplate a total revamp of the law (as, for example, occurred in an earlier change to the mining code in Guinea Conakry in 2011). While it does contemplate higher royalties and taxes, concessions are granted to investors in the form of higher permitted ownership interests. On the other hand a requirement to contribute to local development funds is provided for along with provisions for stricter compliance with the terms of mining licences. However, a stability regime is provided for such that an existing licence will continue to be governed by the code as in effect when that licence was originally granted.

One of the most recent changes to a mining code in Africa occurred in June 2015 in Burkina Faso. With the new code, Burkina Faso joins the wave of mining law reforms throughout Africa that emphasise transparency and accountability by both mining companies and host governments. Along with the newly enacted anti-corruption laws, the new code aims to bring greater clarity and transparency to the mining industry while increasing state revenues from mining. It also specifically enumerates the fundamental obligation and responsibility of mining companies to respect and protect human rights. In doing so, it introduces several reforms that will impact current and future mining operations in Burkina Faso.

The code provides for the creation of four new funds, including a local development fund and a rehabilitation and mine closure fund. Exploitation license holders will pay 1% of their monthly gross turnover (or the value of the extracted products) to the local development fund. The rehabilitation and closure fund will be financed through a mandatory annual contribution from mining companies that will be determined based on an environmental impact assessment. The code introduces several obligations in support of local business and employees. The revised code also reduces uncertainty and increases transparency within the mining sector, in line with international standards (for example Kimberley Process and the Extractive Industries Transparency Initiative).

The change in mining codes in Africa is therefore a dynamic process, reflecting both the economic environment and increased needs for both local participation and transparency. The continued pressure on commodity prices and the globalisation of the mining industry will ensure that these changes will continue to occur.

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Article

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China's Current Involvement in Mining in Africa

By Zhen Han, Beijing Corporate & Securities partner at Mayer Brown

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There is no doubt that mining in Africa has been attractive to Chinese investors. According to statistics from the Ministry of Commerce of the PRC (the "MOFCOM"), the National Bureau of Statistics of the PRC (the "NBS") and the State Administration of Foreign Exchange of the PRC (the "SAFE"), in 2013, exploration and/or mining of oil and gas and non-oil and gas minerals attracted approximately 24.7% of China's total direct investment in Africa in that year, and as of the end of 2013, the accumulated direct investment from China in mining in Africa reached US$6.92 billion, amounting to 26.4% of China's accumulated direct investment in Africa.

2014 and 2015 saw a few further Chinese investments in mining in Africa, although China's outbound mining investments has slowed down in general:

- In December 2015, Zijin Mining Group Co., Ltd. ("Zijin") completed its acquisition from Ivanhoe Mines Ltd. of a 49.5% interest in Kamoa Holding Limited, which owns the Kamoa copper project in the Democratic Republic of the Congo (the "DRC").
- In October 2015, Zijin, through its wholly owned subsidiary Jinjiang Mining Limited, completed further acquisition and now owns 60.47% of the shares of NKWE Platinum Limited, which holds world class assets in the Bushveld Complex in South Africa.
- In April 2015 Shandong Iron and Steel Group acquired 75% stake in the Tonkolili iron ore mine in Sierra Leone from African Minerals, following which Shandong Iron and Steel Group now owns 100% of the mine and associated infrastructure.
- In November 2014, Zijin acquired a 51% stake in La Compagnie Minière de Musonoie Global SAS, which owns the Kolwezi copper mine project in the DRC.

So far Chinese companies have invested in or been involved in exploration and mining projects in many African countries, including Algeria, Angola, Cameroon, the Central African Republic, the DRC, Gabon, Ghana, Guinea, Liberia, Mozambique, Namibia, Nigeria, the Republic of Sierra Leone, South Africa, Sudan, Tanzania, Uganda, and Zambia.

Non-oil and gas minerals involved mainly include:

- Bauxite – e.g., the bauxite mining project in Guinea invested by China Henan International Cooperation Group Co., Ltd.;
- Chromium ore – e.g., the chromium ore mine in South Africa invested by Sinosteel Corporation;

China's Current Involvement in Mining in Africa

- Copper – e.g., the Chambishi copper mine in Zambia invested by China Nonferrous Metal Mining (Group) Co., Ltd.; the copper exploration project in Tanzania invested by China Henan International Cooperation Group Co., Ltd.; the MKM copper and cobalt mine and the Luishia copper and cobalt mine in the DRC invested by China Railway Resources Group Co., Ltd.; and the Kolwezi copper mine and the Kamoa copper project in the DRC invested by Zijin;
- Iron ore – e.g., the Sicomines iron mine in the DRC invested by China Railway Group Limited and Sinohydro Corporation Limited; the Simandou mine in Guinea invested by Aluminum Corporation of China Limited; the iron ore exploration project invested by China Henan International Cooperation Group Co., Ltd.; and the Tonkolili iron ore mine in Sierra Leone invested by Shandong Iron and Steel Group;
- Manganese – e.g., the manganese mine in Zambia's old industrial town Kabwe invested by Chiman Manufacturing Ltd., a private company from China; the Bembélé manganese mine in Gabon invested by CITIC Dameng Mining Industries Limited;
- Nickel – e.g., the Munali nickel mine in South Africa invested by Jinchuan Group Co., Ltd. ("Jinchuan") and China-Africa Development Fund;
- Platinum-group metals – e.g., the Garatau and Tubatse projects in the Bushveld Complex in South Africa invested by Zijin; and the Frischgewaagd-Ledig mine in South Africa invested by Jinchuan and China-Africa Development Fund; and
- Uranium – e.g., the Langer Heinrich uranium mine in Namibia invested by China National Nuclear Corporation.

Having said that, China's investment in mining in Africa has not constituted a substantial portion of China's total outbound investment worldwide. Based on statistics from the MOFCOM, the NBS and the SAFE, as of the end of 2013, the accumulated direct investment from China in mining in Africa only accounted for approximately 1% of China's total outbound investment worldwide.

Even considering China's total investment in Africa alone, more than two thirds were invested in industries other than mining. Statistics from the MOFCOM, the NBS and the SAFE show that, by the end of 2013, construction (26.1%), finance (14%), manufacturing (13.4%), and scientific research and technical services (5.1%) had also attracted substantial portions of China's investment into Africa.

It is worth noting that China is a very latecomer to mining in Africa. Major investments from China into mining in Africa did not happen until about only 20 years ago. China is also still a small player in mining in Africa compared to Western investors, in terms of both the investment amount and the number of projects.

Against this background, many challenges faced by Chinese investors, both from within and outside, are not at all surprising. Good projects are less available, hence the intense competition between Chinese investors and investors from other countries, and even among Chinese investors themselves.

Chinese investors in mining in Africa have been increasingly diversified. Large state-owned mining companies have been the major players, but privately owned companies, large and small, have become more and more active. However, there is still a general lack of strategic planning, outbound investment experience, necessary professional and language capabilities, understanding of local laws and regulations and grasp of cultural differences and social norms. This has often led to inconsistent decision-making, insufficient due diligence and underestimation of risks during transaction stages, and difficulties in compliance with local rules, challenges in cross-cultural communications with local workers and communities in day-to-day management of local companies. But failures have been reflected on by Chinese investors and lessons are being learned. It is reasonable to expect that Chinese investments into mining in Africa in the future will become more strategic, and the investment process more efficiently and professionally managed.

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Turkey - Mining Sector

Overview

KEY FACTS

- 77 out of the 90 minerals that are traded worldwide can be found in Turkey
- It has very rich deposits for approximately 50 of those minerals, including lignite, coal, gold, iron and copper
- Turkey has 72% of global boron reserves and 33% of global marble reserves
- It has 2.5% of the world's industrial raw material reserves and 1% of the world's coal reserves
- Its wealth in minerals is mainly a result of Turkey being part of the Tethyan-Eurasian Metallogenic Belt within the Alpine-Himalayan orogenic system

Over the last decade, with a move towards liberalisation and the privatisation of some major state owned mining enterprises, Turkey's mining industry has seen a fast growth in its profits and revenues. The industry is attracting an increasing amount of local and foreign investment and production due to, amongst many other reasons, the country's established infrastructure and favourable tax regimes. However, Turkey's mining potential still remains largely untapped.

Ownership

Under Turkish law, all natural resources are exclusively owned by the State. The State has the exclusive right to explore and operate facilities related to minerals, however it can transfer this right to individuals and legal entities for a specific period of time through the granting of a licence. Once a licence is granted, there is no requirement for a Government entity to hold an interest/share in the mining investment.

Legislation

The main legislation applicable to exploration and extraction of mineral resources is Mining Law No.3213 (1989); this has been amended from time to time, most recently on 18 February 2015 by Law No. 6592 (Amendment Law). There is also related secondary legislation in the form of Regulation on the Implementation of Mining Activities and Regulation on Mining Activity Permits.

Turkish mining law divides minerals into five groups with some of them split into detailed sub-groups. The main groups are:

- Group I: Sand, gravel, brick clay, cement clay, marl
- Group II: Marble, decorative stones, limestone, basalt
- Group III: Salts, CO_2, gas
- Group IV: Lignite, coal, gold, silver, copper, zinc, chromium, iron, cobalt, nickel, aluminium, trona, sulphur
- Group V: Diamond, sapphire, opal, amazonite

Regulatory Bodies

There are two main government authorities:

- **Ministry of Energy and Natural Resources (MENR)** - sets out general rules and policies for mining, as well as performing regulatory and supervisory overseeing of mining operations; and
- **General Directorate of Mining Affairs (GDMA)** - is responsible for day-to-day activities such as granting licences for mining rights and supervising mining activities.

Additionally, the General Directorate of Mineral Research and Exploration is a separate body attached to the MENR. It conducts scientific technological research on mineral exploration and geology, which is made available to those in the mining industry. It also publishes very useful information such as reports on quantities and breakdowns of mineral reserves, information on licence holders, and the export trends of minerals in Turkey.

Licences

There are two types of licences that can be issued by the GDMA, summarised as follows:

- **Exploration licence** - grants the holder the right to carry out mineral exploration activities. It is usually granted for 3 years however it can sometimes be extended. For some of the mineral groups, an exploration licence is not required. An applicant must first submit standard forms to the GDMA, which should include information about the applicant and the relevant site. After receiving this the GDMA will inform the applicant of the site's availability and reserve it for a period of two months. Within that period, the applicant must submit various documents to the GDMA in order to obtain the licence including a preliminary survey report, an exploration plan report and evidence of the financial capability of the applicant.
- **Operation licence** - grants the holder the right to operate a mine. The term of a licence is dependent on the mineral the applicant intends to excavate. Although it can be extended, the term will not, ordinarily, exceed 60 years. For the majority of the mineral groups, having an exploration licence is a prerequisite for applying for an operation licence. An applicant must submit a detailed operation plan to the GDMA before their exploration licence expires. They must also submit evidence that the operation licence fee has been paid and that they have the financial capability to realise the project. However, it is important to note that an operation licence does not grant the licence holder the right to commence operation activities. To do so they must obtain an operating permit. An operating permit can only be issued after other necessary permits have been obtained such as applicable environmental permits.

Licence holders are subject to various obligations under both licences, failure to comply with these may lead to the termination of the licence.

Payments

- **Licence fees**- consist of an application fee, payable on the grant of the lease, and an annual licence fee thereafter. There is a new system in operation under the recently enacted legislation, however current licence holders will not need to comply with this until 1 January 2016. Under the new system, there is no longer a requirement for an applicant to provide a security deposit and all fees are included under a single licence fee system. Whilst previously the Ministry of Finance determined fees annually, the minimum fees charged for each type of licence is now determined by two fee charts annexed to the new Mining Legislation. These are multiplied according to the parameters associated with the different mineral groups. They will increase annually in line with the annual revaluation rate determined by the Tax Procedural Code No. 213.
- **Royalties**-are annually paid to the government for the extracted minerals. These will differ depending on the type of mineral, although for most minerals it is 4%. If they are not paid on time they are subject to default interest.
- **Finder's fee**- is payable if the extracting company did not discover the presence of that mineral on that particular site. It is set at 1% of the extracted ore's value.
- **Tax**- Earnings obtained through mining operations are subject to income and corporate tax. However there are certain tax incentives available for those involved in mining activities including land allocation priority, VAT exemption for imported machinery and equipment used in mining operations, and corporate income tax allowance.

Important things to note

- **Restriction on recipients of rights**-Mining rights can only be granted to Turkish citizens or legal entities established under Turkish Law. However, companies established in Turkey, with foreign capital in accordance with Turkish Commercial Code No.6102, will be deemed to be Turkish companies.
- **Consent of MENR**- is required for mining activities in areas reserved for public service, public interest or within 60 metres distance of those areas.
- **Health and Safety Regulation**: In Turkey's legislative framework, workplaces are classified according to their hazard levels; all mining activities are classified as very hazardous. Therefore they are subject to obligations contained in the Law on Occupational Health and Safety, in addition to those contained in the Mining Safety Regulations.

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Article

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Arbitration in Africa

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Is your glass half full or half empty?

Attendees at this year's Mining Indaba[1] will be split between the doom-mongers and the eternal optimists. In between these two binary poles, there will be a range of views as to whether 2016 will mark the bottom of the market with an upside to follow or whether there are further tough times ahead for the next few years. Will 2016 bring boom or bust to the mining sector?

In either case, you'd have to have been living on Mars for the last 12 months not to have noted that the commodities sector is going through a particularly tough time; the current trough is the longest experienced in living memory and there are few signs of a recovery in the short term. So what's this got to with arbitration and why should you read on?

Why disputes are inevitable

Well, the old truism holds firm that hard times mean more disputes. Another proposition with which even the most sceptical miner could not quarrel is that prevention is better than cure. Thus, if it is accepted that more disputes are likely to be the order of the day in the mining sector over the next few years (whether you like it or not), then it should also be accepted that you need a Plan B; a process to determine those disputes effectively and efficiently when they arise. Mining projects involve significant capital expenditure and take time before the investment starts to generate a revenue stream and a return on capital invested. There's a lot that can go wrong before the mine produces a profit. Even in the best of times, there will be the perennial 'stuff' that happens which leads to disputes that need to get resolved. Things like environmental damage arising from the spillage or leakage of toxic substances; equipment not operating as it ought to or not being delivered to the mine site on time) and so forth.

Added to this we have the headwinds of a falling growth rate in the industrial development of China, which for many years had powered the commodities supercycle; demand for metals such as aluminium, copper, iron ore and nickel grew sharply as the country urbanized and built infrastructure. This reduction in demand (and a range of other factors including projects coming in stream from the boom years) has led to a glut in supply and a corresponding fall in commodity values. This has had a knock-on effect with a scaling back of capital-intensive investment by mining companies. That too has an effect, with an excess of capacity amongst specialist mining contractors and suppliers of mining equipment. Many of those on the supply side for mining also work in the other mineral extractive sector, oil & gas. Here too, the commodity price has fallen, leading to cancelled projects.

1 Indaba is the Zulu word for "meeting" and refers to the gathering of those involved in African mining that has taken place for over the last 20 years in Cape Town.

According to the FT, Energy groups have shelved nearly $400bn of spending on new oil and gas projects since the crude price collapse, pushing back millions of barrels a day in future output from areas including Africa.[2]

Hard deals increase tensions

The cancellation or postponement of all these projects means that contractors who geared up during the boom times are now faced with a very thin market. Whilst this has caused some contractors and suppliers to fail and others to merge and consolidate their business with others, overall there is still more contracting capacity than demand. This can lead to the contracting side accepting lower pricing offers from mining developers and agreeing more onerous terms under the development contracts. However, the award of contracts on unrealistic terms is rarely a sustainable strategy for either side of the equation. Cost and schedule overruns, where the contractor engaged to develop the mine has provided an overly optimistic price and schedule for completing the works (possibly in order to secure the contract) but then encounters problems that cause him to spend more and take longer, are not in the best interest of the mine owner. However, in this scenario, the contractor has no where else to turn but towards the mine owner who it is hoped will have the sympathy and cash to bail the contractor out of his problem. The reality is that mine owners do not have unlimited stocks of altruism or cash, particularly in the current commodities market. The end result is a rise in disputes in the mining sector.

Resource nationalism disputes

The other rising trend in the mining sector is that of resource nationalism. This affects Africa along with a number of other emerging economies which are heavily dependent upon the natural resources sector. As values in the sector have reduced, states which borrowed heavily against expected resource revenues now face budgetary shortfalls.

Populist governments are often tempted in these circumstances to require a re-calibration of their relationship with foreign investment capital with a view to providing the host government with a greater share of the revenues whether through tax receipts, increased mining licence fees and royalties or some form of action that is designed to encourage the mining company to sell out its investment at an undervalue.

Even though a mining company may have negotiated and agreed a stability agreement whereby the host government agrees to extend the term of a mining lease, maintain royalties and taxes at a certain level for a certain period and similarly not interfere with the mining companies investment, that will not stop the host government coming back some years later to 'review' the stability agreement and seek to adjust this. The host government's justification is invariably on the grounds that the particular commodity is of strategic importance to the country. Such a scenario is being played out currently in Ghana where the government is seeking to re-negotiate stability agreements entered into with international mining companies (who are continuing to resist any such re-negotiation).

Whilst there is no single answer to the problems faced by those wishing to develop mining projects in Africa in the current economic and geo-political climate, arbitration has emerged as the mechanism of choice for the resolution of international mining disputes. Much of this is due to the preference of the international investment community for an external tribunal independent of the local court system in the host country. External investors often perceive themselves to be at a disadvantage compared to the host country entity with

2 Financial Times, 14 January 2016: "Delayed oil projects total nears $400bn".

whom they have to do business and feel exposed if the ultimate dispute resolution process is limited to the local courts. The mining licence will invariably be granted by the relevant Ministry For Mines and Minerals (or its equivalent) and the fear is that the local court will side with the host country entity if there is a dispute about the terms of that licence. The same considerations arise where the dispute is with a local contractor.

The fact is that when foreign investors are pledging to invest tens or hundreds of millions of dollars into a mining project, they do so by taking a calculated risk that the project will perform at least as well as the minimum metrics on the financial model underpinning the business case. However, well advised parties will also ensure they have a 'Plan B' – a means to refer to dispute off to arbitration in case the proverbial hits the fan. It's a bit like having Plan A, which assumes the weather will be dry but Plan B in case it rains. Plan B is like an umbrella as it is designed to keep you dry and restore you to Plan A (which was the position you should have been in had the problem not arisen and the dispute not occurred). Climate experts agree that it tends to rain in sub-Saharan Africa. This is also where a lot of the mineral wealth of Africa is to be found.

Arbitration under the contract

There are two types of 'umbrella' for this purpose; the contractual version that is suited to the common types of commercial dispute that arise and a larger, more far-reaching version which is designed to protect you from the host government changing the ground rules. It's worth looking at each type in turn. Both are really important but it is only in recent years that the latter type has become more prominent as a means of protection.

For the run-of-the-mill mining disputes (namely, not those where the host government starts to throw around its weight), Africa is well served by a number of international arbitration centres, particularly the International Chamber of Commerce (ICC) in Paris and the London Court of International Arbitration (LCIA) in London. Both institutions provide an administered arbitration service and many of the mining disputes in Africa end up being resolved via ICC or LCIA rules, with the venue for the arbitration hearing being somewhere outside of Africa, be it London, Paris, Geneva, Stockholm or some other well-equipped city location. In addition, there are a number of regional arbitration centres in Africa covering north, south, east and west regions. Taking each in order, these comprise the Cairo Arbitration Centre ("CRCICA"), the Arbitration Foundation of Southern Africa ("AFSA"), the London Court of International Arbitration in Mauritius ("LCIA-MIAC") and the Common Court of Justice and Arbitration ("CCJA"). The latter was established by the Organisation for the Harmonisation of Business Law in Africa ("OHADA") and which acts as both in an arbitration administrative body and a Court and largely covers Franco-phone West Africa.[3]

In 2015, the CCJA (acting in its judicial capacity) upheld an arbitration award which had been granted in favour of a Cameroonian entity (International Business Corporation SA) against the Cameroonian National Oil Company. The significance of that decision was that the CCJA had to determine a number of issues raised by the Respondent National Oil Company all of which were designed to de-rail the arbitration award. On each of the issues raised, the CCJA came down firmly in favour of the Claimant. That determination by the CCJA has been seen as providing positive support within an African institution for arbitration under the OHADA regime and for the arbitration process generally.

3 The OHADA Treaty comprises 17 African states, namely Benin, Burkina Faso, Cameroon, Central African Republic, Chad, the Comoros, Congo, Côte d'Ivoire, Equatorial Guinea, Gabon, Guinea Bissau, Guinea, Mali, Niger, Senegal and Togo.

The LCIA-MIAC Arbitration Centre is also worth of mention given that this is a relatively recent (2011) creation, established with the support of the LCIA to administer African arbitrations within Africa (Mauritius). This centre has its own set of arbitration rules which can be used by parties of any nationality, notwithstanding the absence of any connection with Mauritius. Its big selling point is that it aims to have African disputes resolved by arbitrators who have deep experience of practising in Africa, with the venue for the arbitration being a neutral African country; Mauritius.

Arbitration under BITs - arbitration but not as we know it

It is in the area of resource nationalism where parties need a different type of umbrella. With apologies to Mr Spock and Star Trek fans, this is arbitration but not as we know it.

Mining projects involve the investment of large sums of money, involving capital values upwards from US$50 million into the US$ billions. With such large sums at stake, the risks of successfully developing and operating a mining project need to be addressed when assembling the investment. This is part of the due diligence process that should include consideration of Bi-lateral Investment Treaties ("BITs") These treaties are necessary to support trade agreements entered into between states around the world. BITs help encourage and support the flow of investment and business between bi-lateral member states.

African states have signed more than 830 BITs but the terms of each differ with each having been negotiated individually. However, the majority of BITs will have a series of common features. These include protection against unlawful expropriation by the host government or state entity where the investor is deprived substantially of all the value of its investment. Another typical feature of a BIT is the requirement of fair and equitable treatment which includes protection of an investor's legitimate expectations, e.g. as to the stability of the regulatory framework. A further and important feature of most BITs is that the investment-related dispute can be brought before an international arbitration tribunal and are assessed under public international law, thus removing the state's power to interfere.

Unlike arbitrations referred to the LCIA, ICC or one of the regional African bodies, there is no need for the project documents to identify expressly the applicable BIT or provide for all disputes to be referred to arbitration. In fact, there is no need for an arbitration clause at all. If the actions of the state entity are sufficient to trigger the BIT, the umbrella can be erected without permission of the host government (subject perhaps to exhausting other remedies through the dispute resolution machinery of the contract, depending on the terms of the relevant contract).

Another really important point about investor-state arbitration is that the proceedings are a matter of public record. Thus, the fact that an investor has referred a state entity to arbitration under a BIT provides an adverse advertisement to the international investment community that this particular state may not be one with which those investors wish to do business. As foreign direct investment is necessary for the development of African resources, BITs remain an integral part of maintaining the correct balance between investor and host state.[4]

4 Capital investment levels in sub-Saharan Africa in 2014 rose from $42bn to $61bn (Financial Times, 19 May 2015: "Foreign direct investment in Africa surges".

Take away points

For mining companies expanding existing facilities or building new ones in Africa, you need to do proper due diligence and you need a Plan A to make sure the project proceeds in accordance with your economic assumptions. You also need a Plan B in case matters take a turn for the worst. These factors are important for those investing equity, providing debt or other forms of credit support for the mining company.

For those looking to invest in mining projects in Africa, it is always worth looking at the terms of the BIT between the host government and the state in which the investor is domiciled. Some BITs are better than others and forum shopping is sometimes encountered where the investor establishes an entity in a state which has a particularly favourable BIT with the host government state, for the simple reason of providing the best protection for its investment.

Disputes are a fact of commercial life and over the long term life of a mine (be it 5, 15 or 50 years), 'stuff' will happen. When it does, it's best to make sure you have a clear process set out in the development contracts that enables the dispute to be resolved effectively and efficiently by an impartial tribunal of qualified experts, operating outside of the jurisdiction of the host state. Moreover, where the dispute arises because of what is (or is perceived to be) some form of resource nationalism by the host country, an investor-state arbitration under a BIT may be the ultimate form of protection for the mining investor.

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Article

The Mining Legal Regime In Mozambique

By Paulo Rage

Mozambique recently enacted Law No 20/2014 (Mining Law), followed by Law No 28/2014 (Specific Regime of Taxation and Benefits of Mining Activities), which puts in place its new mining legal regime. These new laws aim to align the legal framework of its mining industry to the country's current political and economic aims. Their enactment was in response to the new developments in the mining sector, to ensure more competitiveness and transparency and guarantee the protection of rights and their correlated obligations. Additionally, the new legislation seeks to protect the national interests, improve State's revenues and share its benefits with the communities.

Overview

The Mining Law focuses on improving regulation of the use of mineral resources. Its intention is to achieve a more conducive and stable environment in the mining sector than that created under former Law No 14/2002, by providing a clearer and more detailed legal framework. The Law expressly excludes activities involving oil & gas, which are regulated by a separate set of laws.

The Mining Law reinforces state ownership of the mineral resources located underground, onshore and offshore. It also creates the High Authority of the Mining Industry, a public entity with administrative and financial autonomy that will define the structure and competencies for the entire sector. Furthermore, it creates the National Institute of Mines , a regulatory entity that will create guidelines for the participation of the public and private sector in exploration, exploitation, processing, exporting and importing mining products and their derivatives.

Mining Rights and Contracts

The mining rights are awarded by a public tendering process in which applicants are required to provide specific details concerning the proposed mineral activities. In the decision for granting such rights, the State will consider the date of filings and the best conditions proposed to the State. Mining rights for the available areas will be assigned to applicants who meet the legislative requirements. Applicant legal entities must present their corporate documentation, including detailed identification of its shareholders. Under the Mining Law, rights to undertake mining activities can only be granted to Mozambican natural or legal persons. This differs from provisions under Law No 14/2002 that allowed foreign incorporated entities to hold exploration licences. The transfer of rights and obligations conferred under mining concessions to a related or to a third party is subject to government approval, including the transfer of shares, quotas or other forms of interests. There are very limited situations in which mining rights can be revoked or expropriated. The Mining Law provides 7 types of mining rights/titles: (1) Exploration and Research License; (2) Mining Concession; (3) Mining Certificate; (4) Small-scale Mining Certificate; (5) Mineral Treatment License; (6) Mineral Processing License; and, (7) Mineral Products Commercialization License. The extraction of mineral resources for construction does not require a mining title or authorization provided that it fulfills legislation requirements.

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When negotiating with the State, investors must ensure that their mining concession contracts contain: a) the State's share in the mining business; b) local employment and professional career plan; c)incentives for adding value to the minerals; d)actions to be taken concerning social responsibility; e)a memorandum of understandings between the government, the company and the communities; f)mechanisms for dispute resolution, including arbitration; and g)how the surrounding communities will benefit from the mining business. They should also ensure they comply with the local content requirements for the procurement of goods and services for mining activities introduced by the Mining Law. The concession contracts will be available to the public by their publication in the Official Gazette. To ensure compliance with the terms and conditions of the contracts, the right holders are subject to the provision of a financial guarantee. In addition, any data obtained during the performance of the mining conssesion contracts shall be property of the State. The state also has the right to inspect the performance of the contracts, in order to ensure the rational and sustainable use of mineral resources.

Taxation and Foreign Exchange Issues

Legal entities conducting mining operations in Mozambique are subject to the payment of general taxes, in addition to the industry specific taxes. Thus, the investors will be subject to the following taxes:

a) Income Tax – IRPC (32% on net profits and capital gains);

b) Value Added Tax – IVA (17% on sales, as debt rate being a creditable tax and exempt on exports);

c) Tax over the Mining Production - IPM (vary from 1,5% to 8%, depending on the mineral);

d) Tax over the Surface – ISS (fixed value per hectare and per year of the project); and,

e) other local and minor taxes, when applicable.

In accordance with the Mining Law, the State will guarantee the expatriation of funds, upon presentation by the holder of tax discharge certificates. This guarantee includes: a) expatriation of profits and dividends resulting from eligible investments; b) royalties or other indirect compensations for the investment associated with the assignment or transfer of technology or other rights; c) depreciation and interests on loans contracted in the international financial market and applied in investment projects in the country; d) repatriation of foreign capital invested; e) amounts corresponding to the payment of obligations to other non-resident entities, as the import of products and services.

Land and Environmental Issues

The right to conduct mining activities is separate from 'use of land' rights and others pre-existing rights. However, they will dove-tail in terms of extension rights and duration. The State has precedence over other pre-existing 'use of land' rights. The preceding land rights shall be extinguished only after the payment of a fair indemnification to the holder. Once the project is closed, the State can reassign to interested parties the 'use of land' rights, giving preference to the holders of the pre-existing rights in the reacquisition of such rights.

Investors engaging in mining activities must also ensure the protection of the local environment and refrain from causing any damage to cultures, soils, constructions, equipment or improvements. If any damage occurs, the concessionaires have the obligation to indemnify the affected stakeholders, in compliance with the applicable laws. Explosives and radioactive materials shall be handled in accordance with a separate licensing procedure to ensure the adoption of safety measures. In the decommissioning process of a mine, the concessionaires should not close or abandon the project without implementing the mine closure program approved by the competent authority. In some situations, the legislation requires the provision of a financial guarantee to cover the costs of rehabilitation and closure of the mine. An environmental audit must be conducted to ensure that concessionaires have fulfilled their obligations of rehabilitation and closure of the mine, in order for the financial guarantee to be refunded.

Local Content and Labor Issues

A percentage of the revenues of the State related to mineral extraction will be designated for the development of the communities where mining projects are located. The State can order the purchase of mining products at market value, to use it in local industry or in local energy sector, whenever the State's commercial interests require it. As a local content requirement, foreign entities that provide services to mining operations are required to be in "association" with Mozambican individuals or entities. However, the nature of such an association is not defined.

Also, the acquisition of goods or services above a certain value to be defined by law must be made by a public tender, which must be published through the media. Preference should be given to local products and services. The recruitment of personnel for mining companies shall also be published in major newspapers in the country, or through or available mediums (radio, television and internet). Concessionaires are required: to create structures to ensure the organization and participation of the communities that are located within the concession areas; to guarantee the employment and technical-professional training for Mozambicans; and, to ensure their participation in management positions. General labor legislation in Mozambique and specific labor laws for extractive sectors (mining and oil & gas) establish a more flexible regime, but limit the number of expatriates (up to 10%), as a general rule.

The Mozambican State demonstrated its desire to improve the business environment in its mining sector by issuing this new mining legal regime. The legislation and the willingness of the public and private sectors to develop a safe, efficient and sustainable partnership model, could provide a platform to dramatically boost the Mozambican economy and to consolidate expectations around the discoveries of natural resources in Mozambique. The implementation of this legal framework could potentially foster more competitiveness, transparency, protection and guarantees for both the State and the investors, having as a natural consequence the improvement of Mozambican economy, employment and social development.

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Article

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Beneficiation Legislation – does it achieve the desired effect?

By Rachel Speight

In recent years many emerging economies have looked to increase their domestic revenues from the mining industry. This has been attempted via taxes, royalties, state-ownership, local content quotas and increasingly local beneficiation programmes, as illustrated by comments from Jacob Zuma at the recent "Forum for China-Africa Cooperation Summit", where he emphasised that African economies are looking to "prioritise beneficiation and value-addition". It has also been endorsed by the African Union and regional bodies such as the Southern African Development Community (SADC).

The objective of local beneficiation is for raw materials to be processed in the country in which they are mined rather than exported for beneficiation overseas. Processing raw materials locally can bring economic benefits, such as increased income from taxation and increased profits once the processed materials are exported. It can also improve the quality of life of those living locally – creating jobs, providing opportunities to develop a skilled workforce and generating more money to reinvest in local communities. One method of introducing a local beneficiation regime has been through regulation and new or amended legislation (such as export bans, tax breaks or licensing controls) but it seems that this government-led approach has not achieved the desired results.

Botswana is widely considered to have the most successful example of a programme to increase local beneficiation. De Beers began cutting diamonds in Botswana over 20 years ago, and through partnership with the government of Botswana, the Diamond Trading Company Botswana was created, which is a 50/50 joint venture between the government and De Beers. By 2013, De Beers had moved all its international trading activity from London to Botswana. Although not perfect, this beneficiation programme has achieved positive outcomes such as improved infrastructure, a skilled workforce (today nearly 3,000 workers in Botswana are cutting and polishing diamonds to export). In addition there is the knock-on effect of boosting local businesses, such as hotels, leisure centres and restaurants, and, arguably most importantly, the project has helped to signal that Botswana is a safe and welcoming place for foreign investors, creating a stable climate for future growth.

Some legislation has been amended in Botswana during the life of this programme, such as the Mines and Minerals Act (1999) which gives more control over exploration licences to the government of Botswana. But more significant legislative changes, such as export bans, have not been introduced in the way that they have in certain other jurisdictions. The reasons for the success of

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the Botswana beneficiation project are not therefore thought to be due to legislative innovations, but more down to good communication between the government of Botswana and the board of De Beers, and a desire from both parties to work together for a mutually beneficial outcome. Such co-operation, seen in initiatives such as a government-industry steering committee, has helped to generate the other elements required for successful local beneficiation.

Where the imposition of legislation is the starting point for a local beneficiation programme, the same success does not yet seem to have followed. In Zimbabwe in 2011, legislation was brought in banning the export of chrome ore. The intention being that chrome be processed locally, bringing all the associated economic benefits that go with this. Unfortunately smelting capacity, power shortages and infrastructure capabilities in Zimbabwe were not able to cope with the volume of chrome ore, which began to stockpile in the country. And so, in June 2015, the ban was lifted and the 20 percent export tax on the raw metal was also scrapped.

In Zambia, a 10 percent export tax on unprocessed copper was introduced (intended as an incentive to promote local beneficiation). However, this law introduced in 2011, was suspended in October 2013, reinstated in a modified form a month later and recently the government has suggested introducing a total ban on the export of unfinished mineral products. This uncertainty has unsettled investors and resulted in corporations stockpiling their copper with concerns over whether the smelting capacity of Zambia was able to cope with such a beneficiation project.

It can be argued that De Beers and Botswana had a somewhat unique relationship. The government and the corporation had been in partnership for decades and the trust and understanding created by this partnership left the two very able and willing to work together to create a mutually beneficial system. But what this example and the less successful examples above do show is that beneficiation legislation without support from the industry can be damaging, creating uncertainty and deferring vital international investment.

It can be difficult for governments and corporations to work together as their aims and objectives may be quite different. A government may be looking, first and foremost, to improve the country's economy and increase the quality of life of local people, while a corporation needs to look to its shareholders and might therefore be more concerned with producing a good and marketable product and keeping costs low in a struggling commodities market.

In the absence of easy cooperation, legislation has surfaced as the best solution, with proposals for further new laws in 2015 in Ghana (requiring the local beneficiation of bauxite), Indonesia (increasing tin royalties on exports) and Zimbabwe (introducing a 15 percent export duty on unrefined platinum (which was later suspended)). The question is whether the necessary improvements in (for example) local smelting capacity, skill levels and power supplies can be expected to be generated following legislative incentives, and whether the required expertise and technology for successful beneficiation will be shared among all parties if industry is uncomfortable with such legislation.

It is important that a robust legislative framework exists so that beneficiation is regulated and local benefits are assured. But if the groundwork is not laid before legislation is implemented, and a productive relationship between government and industry is not maintained, then a successful beneficiation programme does not seem to be easily achievable: the problem seems too complex for legislation alone to solve.

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Article

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London: The Principal Global Mining Finance Centre?

By Ian R. Coles, Partner and Head of Global Mining Group; Mayer Brown LLP

The mining industry is facing challenging times. A combination of a freefall in commodity prices, a sharp turn in Chinese economic strategy and a consequential dearth of capital for the industry means that it is not possible to call time on this difficult period. This absence of capital has led to some naval gazing among pundits as to which location offers the best prospects to the industry for sourcing money. The subject was recently debated by a panel at the Mines & Money conference in London (a panel which the author moderated).

It has been suggested that the attractiveness of a hub can be simply assessed through whether professionals wish to live there. London would seem to tick many boxes here. London's location in a central time zone also assists with communications. Aside from these considerations though a hub for mining finance needs to offer substantial capacity for equity, debt and trading. London is able to offer all three. The London Stock Exchange is one of the principal exchanges for the listing of large mining companies. AIM, while bereft of activity for the last several years, has been a historical source of capital for the junior/ mid-cap sector. For debt most of the financial institutions active in the mining industry have teams resident in London. In trading the LME and several precious metal trading associations offer important capacity.

Several centres can lay a claim to surpass the level of activity in London in connection with any one of these constituent parts but few can claim dominance, or even a prominent position, in all three. For many years Toronto has probably been the leading source of equity capital through the TSX and related exchanges (although on one analysis more has been raised on the ASX). None of Toronto, Perth or Sydney though offer the depth in debt finance, at least for projects globally, as can be found in London. While trading is a global business the presence of the LME, LBMA, etc in London means the presence of a large number of trading professionals. When the number of other professionals active in the mining industry - such as lawyers, accountants, etc - is factored into the equation then the critical mass story in London becomes compelling.

There is a long history of raising equity capital for the mining industry in London – Antofagasta for example is one of the oldest companies listed on the LSE. While the valuation of global mining companies listed on the LSE has been in decline for the past couple of years there has been an uptick in the actual number of listings. On the other hand LSE is perceived to be expensive when compared with the costs of listing elsewhere. A further factor favouring London has been the growth of the number of private equity funds specialising in the mining sector. While there has been much discussion about the actual investments made by such funds there is no doubt that a significant number of those funds are based in London, and that the funds have money to invest. The AIM market seems

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destined to continue in the doldrums for the moment - although the number of de-listings in the mining sector which have occurred during 2015 are apparently no worse than historical averages.

London's undisputed status as a major commercial banking hub ensures that the mining community is well-served for corporate debt and project finance. Chinese banks are also beginning to realise the need for a presence in London to do business with the mining industry. The bond market thrives although arguably the greatest source for bond funding remains the US. The availability of debt finance seems to remain liquid. It is the equity piece of the capital puzzle which provides the greater challenge. The large investment banking community ensures a critical mass for M&A and other advisory activity. What is less clear is the amount of activity in the growing alternative sources of debt funding such as streaming and royalty finance. While there are several groups based in London which provide this option many seem to be based in traditional mining centres such as Perth, Toronto and Denver.

In connection with trading the level of activity in London continues to be impressive. More than 80% of global non-ferrous metal trading is conducted on the LME markets. There are challenges though. Low commodity prices mean that the exchanges have to market significantly to keep up volume (although having said that there seems to be some evidence that the macro funds are taking significant positions). More sophisticated technology and platforms offer significant challenges. On the other hand scandals such as those related to the Chinese warehouses serve as a reminder that London based systems do afford greater certainty and transparency. The various exchanges have also anticipated global competition by forging alliances with exchanges elsewhere to ensure enhanced global coverage and competitiveness. The increasing degree of regulatory control and requirements, including MiFID II, have been cited by some as a challenge to the competitiveness of the trading community in London. Paradoxically, however, the same may have the reverse effect as it supports confidence in systems and in any event the steep regulatory curve of the last 3-5 years seems to be flattening out.

In summary, while the competition is stiff London would appear to be more than holding its own as a principal global centre for mining finance. Location and quality of life issues have provided a helpful background landscape - a landscape which has helped foster significant critical mass. The dynamic looks well set for the future - although complacency will have to be avoided.

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Editor
Erik Richer La Flèche

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EDITOR'S PREFACE

I am pleased to have participated in the preparation of the fourth edition of *The Mining Law Review*. The *Review* is designed to be a practical, business-focused 'year in review' analysis of recent changes and developments, and their effects, and a look forward at expected trends.

This book gathers the views of leading mining practitioners from around the world and I warmly thank all the authors for their work and insights.

The first part of the book is divided into 22 country chapters, each dealing with mining in a particular jurisdiction. Countries were selected because of the importance of mining to their economies and to ensure broad geographical representation. Mining is global but the business of financing mining exploration, development and – to a lesser extent – production is concentrated in a few countries, Canada and the United Kingdom being dominant. As a result, the second part of this book includes eight country chapters focused on financing.

The advantage of a comparative work is that knowledge of the law and developments and trends in one jurisdiction may assist those in other jurisdictions. Although the chapters are laid out uniformly for ease of comparison, each author had complete discretion as to content and emphasis.

The mining sector is facing uncertain times. Commodity prices are lower and continue to be soft. Demand growth from China, the world's largest consumer of commodities, has slowed considerably. New markets such as India are not picking up the slack. Operating costs in certain markets exploded during the good years and must now be reined in. Traditional lenders to the industry are more highly regulated and have less flexibility to assist companies during this difficult time. Equity markets know that big declines in the price of commodities have preceded recessions and bear markets and as a result are doubly cautious.

While times are tough, we know that mining is cyclical and that continued world population and economic growth as well as the depletion of current resources mean that growth in the mining sector will resume. The only question is when.

In the meantime, we are seeing a return to basics coupled with innovation. Companies are reducing their operating costs and curtailing exploration efforts. Executives are looking at new ways of doing things, from cost sharing to automation to alternative financing. When financing projects, companies now attempt to secure most if not all of the financing upfront. To do this they have to cobble together financings from various sources, including stream and royalty arrangements that in the past were only available once a project had been considerably de-risked. Adapting the financings to the particulars of each projects and making sure that the various bits work together and form a coherent whole is a source of interesting and sophisticated work for mining lawyers these days.

But companies are not the only ones implementing change. In some jurisdictions, Quebec for example, governments and other stakeholders (e.g., indigenous peoples) are taking advantage of the lull to put into place comprehensive strategies for welcoming new mining projects. Such strategies include clear timelines for the approval of projects, objective project approval standards, investments in infrastructure (e.g., ports, roads, railroads, airports and power lines), andtransparent rules regarding the sharing of project benefits among local communities, indigenous peoples and government, all so as to be able to ramp up quickly when opportunity strikes.

As you consult this book you will find more on topics apposite to jurisdictions of specific interest to you, and I hope that you will find this book useful and responsive.

Erik Richer La Flèche
Stikeman Elliott LLP
Montreal
October 2015

Chapter 30

UNITED KINGDOM

Kate Ball-Dodd and Connor Cahalane[1]

I INTRODUCTION

London is a leading financial market for international mining companies seeking to access the equity capital markets. The London Stock Exchange's Main Market is the listing venue for many of the world's largest mining groups by market capitalisation, including Anglo American, BHP Billiton, Glencore and Rio Tinto. The London Stock Exchange's growth market, AIM, also remains a popular listing venue for junior mining companies seeking to raise capital for exploration and development projects.

As at 30 June 2015, there were 34 (2014: 34) mining companies admitted to trading on the Main Market, with a combined market capitalisation of approximately £143 billion (2014: £200 billion). On the AIM market there were 126 (2014: 136) mining companies admitted to trading as at 30 June 2015, with a combined market capitalisation of approximately £3.7 billion (2014: £4.1 billion).[2]

In the 12-month period from 30 June 2014 to 30 June 2015, mining shares performed poorly as commodity prices continued to fall with many reaching their lowest levels in a number of years. These difficult conditions for mining companies have meant that the UK's equity capital markets have seen low levels of activity in this sector. With the public markets all but closed to mining companies, private equity has become an important provider of capital to the sector, in particular to junior miners, and it has been reported that over the past two years approximately US$12 billion has been raised by private equity funds for investment in mining and metals companies.

1 Kate Ball-Dodd is a partner and Connor Cahalane is a senior associate at Mayer Brown International LLP.

2 Source for Main Market and AIM statistics is the London Stock Exchange website, www.londonstockexchange.com.

i New issues

In the 12-month period from 30 June 2014 to 30 June 2015, two new mining companies were admitted to the Main Market. In December 2014, Goldbridges Global Resources plc, a gold miner with assets in Kazakhstan, moved up to the Main Market from AIM. In May 2015, South 32 Limited, a diversified metals and mining company with mining assets producing bauxite, alumina, aluminium, silver, lead and zinc, manganese, thermal and metallurgical coal, and nickel, was admitted to trading on the Main Market following its demerger from BHP Billiton.

Three mining companies were admitted to trading on AIM in the 12 months from 30 June 2014 to 30 June 2015. The largest mining entrant to AIM by market capitalisation was Bacanora Minerals Limited, an exploration and development company with operations in Mexico focusing on borates and lithium, which raised £4.75 million resulting in a market capitalisation of £66.5 million on its admission in July 2014. In December 2014, Dalradian Resources Inc, a development and exploration company whose main asset is the Curraghinalt gold deposit in Northern Ireland, was admitted to trading on AIM. Dalradian's market capitalisation on admission was £53 million. The only other mining company to join AIM during the period was Tengri Resources, a development company with a gold-copper project in the Kyrgyz Republic. On its admission to trading in July 2014, Tengri had a market capitalisation of £18 million.

ii Secondary offerings

The largest Main Market secondary offering in the period from 30 June 2014 to 30 June 2015 was by Petropavlovsk Plc, a gold miner with significant assets in Russia, which in February 2015 raised £155.2 million through a rights issue as part of a refinancing of its debt. In February 2015, Anglo Pacific Gold plc, a global natural resources royalty company, raised £39.5 million through a placing and open offer of ordinary shares in connection with its acquisition of royalty interests in the Narrabri coal project in New South Wales. In October 2014, New World Resources plc, a Central European hard coal producer, completed a placing of shares to its existing shareholders, raising proceeds of approximately £27.3 million as part of a balance sheet restructuring.

During the same period, the largest secondary offering on AIM was by EMED Mining Public Ltd, an exploration and development company with assets in Europe, which in June 2015 raised £64.9 million through a placing and open offer. The next largest secondary offering on AIM was by Kirkland Lake Gold Inc, a Canadian gold producer and explorer with assets in Ontario, which raised £17.9 million through a placing in February 2015. Sirius Minerals plc, a potash development company, raised £15.8 million in March 2015 through a placing of ordinary shares.

II CAPITAL RAISING

i General overview of the legal framework

Under the UK listing regime, different admission criteria and listing rules will apply depending on whether a company is seeking to have its shares (or other securities) admitted to a regulated market governed by the EU Prospectus Directive,[3] such as the Main Market, or to AIM, which has a more flexible regulatory structure.

Official List

In order to be admitted to the Main Market, a company must first apply to the UK Listing Authority (UKLA), a division of the UK's Financial Conduct Authority, to join the Official List.

Mineral companies

For the purposes of the Listing Rules (LR), which set out the admission requirements for the Official List, a mineral company is a company with material mineral projects (not just those whose principal activity is the extraction of mineral resources). The materiality of projects is assessed having regard to all the company's mineral projects relative to the company and its group as a whole. Mineral projects include exploration, development, planning or production activities (including royalty interests) in respect of minerals, including:

a metallic ore, including processed ores such as concentrates and tailings;

b industrial minerals (otherwise known as non-metallic minerals), including stone such as construction aggregates, fertilisers, abrasives and insulants;

c gemstones;

d hydrocarbons, including crude oil, natural gas (whether the hydrocarbon is extracted from conventional or unconventional reservoirs, the latter to include oil shales, oil sands, gas shales and coal bed methane) and oil shales; and

e solid fuels, including coal and peat.

Admission requirements

The Official List is divided into two segments: standard listings and premium listings. A standard listing is one that satisfies the minimum requirements laid down by the EU Prospectus Directive. A premium listing denotes a listing that meets more stringent criteria that are not required by the EU Prospectus Directive but that are seen as providing additional investor protections. A mineral company may apply for either a premium or standard listing provided it complies with the relevant admission requirements.

Standard listing

A mineral company seeking a standard listing must comply with the general admission requirements set out in the LR.[4] These include a requirement that the company is duly incorporated (either within the UK or, if a non-UK company, in the company's place of incorporation), and that the securities to be listed must be free from any transfer restrictions (subject to certain exceptions).[5] If the company is making an offer of new

3 EU Prospectus Directive (2003/71/EC).

4 LR 2.

5 LR 2.2.4R. For example, this does not prevent the company's shareholders from entering into agreements among themselves restricting their ability to transfer shares.

securities, any necessary constitutional, statutory or other consents required must be obtained prior to listing.[6] The expected market capitalisation of the securities to be listed must be at least £700,000 in the case of shares and £200,000 in the case of debt securities. While the UKLA has a discretion to admit a company with a lower market capitalisation if it is satisfied there will be an adequate market, from a practical perspective it is likely that the market capitalisation would need to be significantly higher for a listing to be economical.[7] While there is no requirement for a company seeking a standard listing to confirm to the UKLA that it has sufficient working capital to meet the requirements of the business for the next 12 months, if the company is also producing a prospectus (which is likely to be the case – see below), it will be required to include a working capital statement in the prospectus confirming whether the business has sufficient working capital for that period.

Premium listing

If a mineral company is seeking an admission of its shares to the premium segment of the Official List, in addition to the minimum requirements applicable to all listings set out above, the company must confirm to the UKLA that it has sufficient working capital available to meet the requirements of the business for the next 12 months.[8] At least 25 per cent of the class of the company's shares to be listed in the premium segment must be in the hands of the public in one or more EEA countries at the time of admission.[9] Where the company is already listed in a non-EEA country, shareholders in that country may be taken into account. For this purpose, 'public' means shareholders other than those holding 5 per cent or more of the class of shares being admitted, and also excludes shares held by the directors of the company or any persons connected to the directors.

Mineral companies are exempt from the premium listing requirement (which would otherwise apply) to have at least 75 per cent of their business supported by a historic revenue earning record.[10] If a mineral company seeking a premium listing cannot comply with the requirement to have published accounts covering at least three full years because it has been operating for a shorter period, then it must have published or filed historical financial information since the inception of its business.[11]

Controlling shareholders and relationship agreements

Following amendments to the LR that came into effect in May 2014, where an applicant for a premium listing will have a controlling shareholder on admission, the issuer must have in place a written and legally binding relationship agreement with the controlling

6 LR 2.2.2R.

7 LR 2.2.7R and LR 2.2.8G.

8 LR 6.1.16R.

9 LR 6.1.19R.

10 LR 6.1.9.

11 LR 6.1.8.

shareholder and have a constitution that allows the election and re-election of independent directors to be conducted in accordance with a dual voting structure set out in the LR.[12]

A controlling shareholder is defined as any person who exercises or controls (on their own or together with any person with whom they are acting in concert) 30 per cent or more of the voting rights.[13]

The relationship agreement must include provisions to ensure that the controlling shareholder complies with the following undertakings:

a transactions and arrangements with the controlling shareholder (or any of its associates, or both) will be conducted at arm's length and on normal commercial terms;

b neither the controlling shareholder nor any of its associates will take any action that would have the effect of preventing the new applicant or listed company from complying with its obligations under the LR; and

c neither the controlling shareholder nor any of its associates will propose or procure the proposal of a shareholder resolution that is intended or appears to be intended to circumvent the proper application of the LR.

Independent business

All applicants for a premium listing must now be able to demonstrate that they will be carrying on an independent business as its main activity.[14] The LR set out the following guidance on factors that will indicate when a company will not be considered to have a independent business:

a a majority of the revenue generated by the new applicant's business is attributable to business conducted directly or indirectly with a controlling shareholder (or any associate thereof) of the new applicant;

b a new applicant does not have:
- strategic control over the commercialisation of its products;
- strategic control over its ability to earn revenue; or
- freedom to implement its business strategy;

c a new applicant cannot demonstrate that it has access to financing other than from a controlling shareholder (or any associate thereof);

d a new applicant has granted or may be required to grant security over its business in connection with the funding of a controlling shareholder's or a member of a controlling shareholder group;

e except in relation to a mineral company (which has specific eligibility requirements in relation to its interests in mineral resources – see below), a new applicant's business consists principally of holdings of shares in entities that it does not control, including entities where:
- the new applicant is only able to exercise negative control;

12 LR 6.1.4B.

13 LR 6.1.2A.

14 LR 6.1.4.

- the new applicant's control is subject to contractual arrangements that could be altered without its agreement or could result in a temporary or permanent loss of control; or

f a controlling shareholder (or any associate thereof) appears to be able to influence the operations of the new applicant outside its normal governance structures or via material shareholdings in one or more significant subsidiary undertakings.[15]

Prospectus

As well as complying with the above admission requirements, a company seeking admission to the Official List (to the standard or premium segment) or making a public offer of securities in the UK must publish a prospectus setting out sufficient information to enable investors to make an informed assessment of the assets and liabilities, financial position, profits and losses, and prospects of the company.[16] The company must also confirm in the prospectus whether is has sufficient working capital to meet the requirements of the business for the next 12 months. The prospectus must be submitted for review by the UKLA, which will assess whether the document complies with the disclosure requirements set out in the Prospectus Rules (PR). A prospectus must not be published unless it is approved by the UKLA.[17] In the case of an offer of shares, the company and its directors must take responsibility for the contents of the prospectus, and may be liable for any inaccurate or misleading information in the document or for failure to comply with the relevant disclosure standards.[18]

Specific eligibility requirements for mineral companies

In addition to the independent business requirements set out above, if a mineral company seeking admission to the Official List (to the standard or premium segment) does not hold a controlling interest in a majority by value of the properties, fields, mines or other assets in which it has invested, the company must be able to demonstrate to the UKLA that it has a reasonable spread of direct interests in mineral resources and has rights to participate actively in their extraction, whether by voting or through other rights that give it influence in decisions over the timing and method of extraction of those resources.[19]

Specific content prospectus requirements for mineral companies

In March 2013, the European Securities and Markets Authority (ESMA) published an updated edition of its recommendations for the consistent implementation of the EU

15 LR 6.1.4A.

16 Section 87A(2), Financial Services and Markets Act 2000.

17 A company that has its home Member State in another Member State may also have a prospectus approved by the competent authority in that jurisdiction and seek to have the prospectus 'passported' into the UK pursuant to Articles 17 and 18 of the EU Prospectus Directive.

18 PR 5.5.

19 LR 6.1.10.

Prospectus Directive, with revised recommendations as to the content requirements for prospectuses published by mineral companies.[20] When reviewing a prospectus, the UKLA will take into account these recommendations, which in effect supplement the requirements of the LR and PR.

The recommendations recognise that mineral companies are distinct from other companies in that a key factor in the assessment of their value relates to their reserves and resources. The recommendations seek to ensure that appropriate levels of transparency and assurance over the reserves and resources figures are made available to investors by setting out a framework for the additional disclosure of reserves and resources information, including the following information segmented using a unit of account appropriate to the scale of the company's operations (rather than on a per-asset basis):

a details of mineral resources and, where applicable, reserves and exploration results and prospects;

b anticipated mine life and exploration potential or similar duration of commercial activity in extracting reserves;

c an indication of the duration and main terms of any licences or concessions, and legal, economic and environmental conditions for exploring and developing those licences or concessions;

d indications of the current and anticipated progress of mineral exploration or extraction, or both, and processing, including a discussion of the accessibility of the deposit; and

e an explanation of any exceptional factors that have influenced the foregoing items.

Competent persons report

A competent persons report (CPR) is also required for all initial public offering prospectuses regardless of how long the company has been a mineral company. A CPR may also be required for secondary issues, but not where the company has previously published a CPR and has continued to update the market regarding its resources, reserves, results and prospects in accordance with one of the recognised reporting standards.

The CPR must be prepared by a person satisfying the competency requirements of the applicable codes or of the organisation set out in the recommendations, or who is a professionally qualified member of an appropriate recognised association or institution with at least five years of relevant experience.

The content requirements for the CPR are set out in the ESMA 2013 recommendations. These requirements vary depending on whether the CPR relates to a company with oil and gas projects, or a company with mining projects. The CPR must be dated not more than six months prior to the date of the prospectus, and the company must confirm that no material changes have occurred since the date of the CPR that would make it misleading. A list of acceptable internationally recognised reporting

20 ESMA update of the Committee of European Securities Regulators' recommendations for the consistent implementation of Commission Regulation (EC) No. 809/2004 implementing the Prospectus Directive (20 March 2013).

and valuation standards is also set out in the recommendations. The mining reporting codes are aligned with the Committee for Mineral Reserves International Reporting Standards (and do not include US SEC Industry Guide 7 on mining, or the Russian or Chinese standards).

Depository receipts

Companies incorporated outside the EU seeking admission to the Main Market often choose to do so through an issue of depository receipts. This is particularly the case for companies located in jurisdictions with restrictive foreign exchange controls where requirements to pay dividends in the local currency could make an investment in the company's shares less attractive to international investors. Depository receipts are negotiable instruments that represent an ownership interest in a specified number of the company's shares. The underlying shares are issued to a depository, which in turn issues depository receipts that can be denominated in a currency other than the issuer's local currency. Dividends received by the depositary can then be converted from the local currency into the currency of the depository receipts. Depository receipts may only be admitted to the Official List through a standard listing.

High Growth Segment

In March 2013, the London Stock Exchange launched the High Growth Segment, a new Main Market segment that sits alongside the premium and standard segments and provides an alternative route to market for European companies. As the High Growth Segment is an EU-regulated market, companies listed on this segment must comply with certain EU standards, including the Financial Conduct Authority's Disclosure Rules and Transparency Rules and the Prospectus Rules. However, as companies on the High Growth Segment are not admitted to the Official List, the LR do not apply and instead companies must adhere to the London Stock Exchange's High Growth Segment Rulebook.

The High Growth Segment is intended to attract medium and large high-growth companies that do not meet the eligibility criteria of the premium segment, in particular in relation to the free float requirement. However, the eligibility criteria for the High Growth Segment requires all companies seeking admission to be revenue-generating trading businesses, and mineral resource companies at the exploration stage are expressly listed as being ineligible for admission to the High Growth Segment.[21]

AIM

AIM is the London Stock Exchange's market for smaller and growing companies. Due to its status as an 'exchange regulated market' for the purposes of the EU Prospectus Directive, AIM is governed by a more flexible regulatory regime than the Main Market.

21 Guidance Note 2 to Rule 2.1 of the High Growth Segment Rulebook.

Role of the nomad

While admission to the Official List is regulated by the UKLA, the London Stock Exchange oversees the regulation of AIM and compliance with the AIM Rules. Each company seeking admission to AIM must appoint a corporate finance adviser that has been approved by the London Stock Exchange to act as a nominated adviser or 'nomad'. The company's nomad is responsible for assessing whether the company is an appropriate applicant for AIM, and for advising and guiding the company on its responsibilities under the AIM Rules.

Admission requirements

Unlike the Official List, there are generally no minimum market capitalisation requirements for a company seeking admission to AIM. However, investment companies must raise a minimum of £3 million in cash through an equity fundraising to be eligible for admission to AIM.[22]

There are also no express minimum requirements as to the applicant company's trading history or the number of shares in public hands although the nomad will consider this when assessing the company's suitability for listing. The shares must, however, be freely transferable and eligible for electronic settlement.

Fast-track admission to AIM

Companies that are already listed on certain other exchanges may qualify for AIM's fast-track admission process, in which case the company will not be required to produce an admission document.[23] To be eligible for fast-track admission, a company must have its securities traded on an AIM designated market[24] for at least the past 18 months, and should also have substantially traded in the same form during this period. Examples of mining companies who have used the fast-track process include Wolf Minerals Limited, which is also listed on the ASX and was admitted to AIM in November 2011, and Central Rand Gold Limited, which transferred its listing from the Main Market to AIM using the fast-track process in August 2013.

Admission document

A company seeking admission to AIM (other than a fast-track applicant) is required to publish an admission document. The company's nomad will be responsible for assessing whether the admission document complies with the content requirements

22 Rule 8, AIM Rules for Companies. For this purpose an 'investing company' is any company that has as its primary business or objective the investing of its funds in securities businesses or assets of any description.

23 However, as with any company seeking admission to AIM, a fast-track applicant may be required to produce a prospectus under the EU Prospectus Directive where, for example, an offer of securities is made to the public and no relevant exemption is applicable.

24 These include the Australian Securities Exchange, Deutsche Börse Group, NYSE Euronext, Johannesburg Stock Exchange, NASDAQ, NYSE, NASDAQ OMX Stockholm, Swiss Exchange, TMX Group and the UKLA Official List.

set out in the AIM Rules. While these requirements are less onerous than those that apply to a prospectus, a company preparing an admission document is subject to a general requirement to disclose any information that the company reasonably considers necessary to enable investors to form a full understanding of the assets and liabilities, financial position, profits and losses, and prospects of the applicant and its securities for which admission is being sought, the rights attaching to those securities and any other matter contained in the admission document.[25]

Due to the less onerous disclosure requirements, and as the admission document is reviewed and approved by the company's nomad rather than the UKLA, the process and timetable for admission to AIM can often be shorter and more flexible than the process for admission to the Official List.

Prospectus requirement for AIM companies

Although AIM is not a regulated market for the purposes of the EU Prospectus Directive, where a company seeking admission to AIM is also making an offer of its securities to the public in the UK, the admission document may also need to be approved as a prospectus by the UKLA unless it can avail of an applicable exemption. Where a company is offering its shares through a private placement, it will usually seek to rely on an exemption available for offers addressed solely to qualified investors, or fewer than 150 natural or legal persons per EU Member State (i.e., other than qualified investors).

Specific content requirements for mineral companies

In addition to the general requirements set out in the AIM Rules, a mining company seeking admission to AIM is required to comply with the AIM Guidance Note for Mining, Oil and Gas Companies (the Guidance Note).[26]

The Guidance Note states that nomads are expected to conduct full due diligence on mining companies seeking admission to AIM, including by carrying out site visits and personal inspections of the physical assets where it is practical to do so. A formal legal opinion from an appropriate legal adviser is also required on the incorporation status of the company and any relevant subsidiaries, as well as the company's title to its assets and the validity of any licences.

Competent persons report

A mining company seeking admission to AIM is required to include in its admission document a CPR on all its material assets and liabilities. The CPR must comply with the disclosure requirements set out in the Guidance Note and the company's nomad is responsible for ensuring that the scope of the CPR is appropriate having regard to the applicant's assets and liabilities.

The CPR must be prepared no more than six months prior to the date of the admission document by a person who meets the minimum requirements for competent persons set out in the Guidance Note. These require the competent person to be a

25 Schedule 2(k), AIM Rules for Companies.

26 AIM Guidance Note for Mining, Oil and Gas Companies (June 2009).

professionally qualified member of an appropriate association, independent of the applicant and to have at least five years of relevant experience.

Where information is extracted from the CPR for inclusion elsewhere in the admission document, that information must be presented in a manner that is not misleading and provides a balanced view. The Guidance Note also requires that the competent person must review the information contained elsewhere in the admission document that relates to the information in the CPR, and confirm in writing to the applicant and the nomad that the information is accurate, balanced, complete and not inconsistent with the CPR.

Lock-ins for new mining companies

The Guidance Note and the AIM Rules require that, where a mining company seeking admission to AIM has not been independent and earning revenue for at least two years, all related parties (which include the directors and any shareholders holding 10 per cent or more of the voting rights) and applicable employees must agree not to dispose of any interest in the company's securities for at least one year from the date of admission to AIM.

ii Tax considerations

In general terms, the UK tax regime does not distinguish between domestic mining companies and overseas mining companies that are subject to UK tax (for example, as a result of being tax resident in the UK or carrying on a trade through a permanent establishment in the UK).

The basic UK tax regime for mining companies is similar to that for other companies – the main rate of corporation tax is 20 per cent (set to reduce to 19 per cent from 1 April 2017, and 18 per cent from 1 April 2020), there is no limit on the period for which tax losses can be carried forward and set off against future profits (provided that they are incurred in the same trade that suffered the losses and relief is not withdrawn in certain circumstances following a change in the ownership of the company incurring the losses), and the usual withholding taxes regime applies. In broad terms, withholding tax applies at a rate of 20 per cent (subject to any applicable double tax treaty and certain other exemptions) to interest and royalty payments. There is no withholding tax on dividends.

The usual capital allowances regime for long-life assets and integral features (8 per cent writing down allowance per annum) and other plant and machinery (18 per cent writing down allowance per annum) applies to mining companies. In addition, persons engaged in mining activities can benefit from the mineral extraction allowance, which is a form of capital allowance available to those who carry on a mineral extraction trade (a trade consisting of, or including, the working of a source of mineral deposits) and incur qualifying expenditure. Qualifying expenditure for these purposes can include expenditure on mineral exploration and access, and expenditure on acquiring mineral assets (defined as mineral deposits, land comprising mineral deposits, or interests in or rights over such deposits or land).

A major advantage offered to mining companies by the UK is that there are no specific mining or mineral taxes (although excise duty is payable on mineral oils, at varying rates, unless an exemption applies). There is also, generally, no UK VAT on exports. However, mining companies' activities may render them subject to the following indirect taxes:

a climate change levy: a tax on energy, with a variable rate depending on the nature of the fuel used. Reduced rates are available for energy intensive businesses that have entered into a climate change agreement with the Environment Agency;

b aggregates levy: a tax on the commercial exploitation (which includes both extraction and importation) of gravel, sand and rock, currently charged at £2 per tonne – this is subject to various exemptions, including exemptions for spoil from any process by which coal or another specified substance has been separated from other rock after being extracted from that rock, for material which is more than half coal, and for spoil from the smelting or refining of metal; and

c landfill tax: a tax on the disposal of waste to landfill, currently charged at the standard rate of £82.60 per tonne or the lower rate of £2.60 per tonne (set to increase to £84.40 and £2.65 per tonne respectively from 1 April 2016), depending on the material being disposed of; there is an exemption for the disposal of naturally occurring materials extracted from the earth during commercial mining or quarrying operations, provided that such material has not been subjected to and does not result from a non-qualifying process carried out between extraction and disposal. From 1 April 2015, disposals in Scotland are subject to the Scottish landfill tax, which applies to the same activities and at the same rates as mentioned above.

Apart from the mineral extraction allowance, there are no special allowances or incentives for persons engaged in mining activities, or their investors or lenders.

III DEVELOPMENTS

On 1 October 2012, ESMA published a consultation paper seeking views on proposed further amendments to its recommendations regarding mineral companies. These include proposed amendments to the definition of 'material mining projects' to clarify that materiality should be assessed from the point of view of the investor; and projects will be material where evaluation of the resources (and, where applicable, the reserves or exploration results, or both) that the projects seek to exploit is necessary to enable investors to make an informed assessment of the prospects of the issuer. In addition, ESMA proposes to establish a rebuttable presumption within the definition of materiality that mineral projects can be material both where the projects seek to extract minerals for their resale value as commodities; or the minerals are extracted to supply (without resale to third parties) an input into an industrial production process (which includes but is not limited to the example of stone extracted in the cement and aggregates industry) and there is uncertainty as to either the existence of the resources in the quantities required or the technical feasibility of their recovery.

The consultation paper also sets out a proposal to amend certain of the existing exemptions from the requirement to publish a CPR, including a new exemption for non-equity securities (other than depositary receipts over shares).

ESMA expects to publish revised recommendations in due course.

Appendix 1

ABOUT THE AUTHORS

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Kate Ball-Dodd is a partner in the corporate department of Mayer Brown International LLP. She has a wide-ranging corporate practice that encompasses corporate finance, mergers and acquisitions (including public takeovers), equity fund raisings, joint ventures, and corporate governance. She advises a number of quoted companies and financial intermediaries on the UKLA Listing Rules and Disclosure and Transparency Rules, the Prospectus Rules, the AIM Rules, the Takeover Code and general company law. Ms Ball-Dodd speaks regularly at external conferences on corporate governance and takeovers.

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Article

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African Mining Law Updates

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There has been a wave of reform in mining legislation all over sub-Saharan Africa, with movement toward codes that seek to improve the regulation and transparency in this growing industry. Reform objectives have commonly included increased state participation and introduced new tax regimes and local content obligations, measures aimed to boost revenue from the industry. This article provides an insight into the most recent reforms taking place in a number of these countries.

Burkina Faso

Burkina Faso's transitional parliament adopted a new Mining Code in June 2015 which addresses various areas including:

- **Mining Conventions and Mining Titles:** A technical commission will be created to oversee the granting of exploration licenses and mining conventions. Mining conventions, no longer required during the research phase, have been reduced to a validation period of 20 years and may be renewed for successive periods of 5 years. By contrast, exploration permits remain valid for 20 years. Permit holders are required to notify the Ministry of Mining of any significant changes in the feasibility study, or risk incurring a penalty of 1% to 4% of the production value;
- **Tax Regime:** There are several tax regime changes at the exploration and exploitation phases. Significantly, a 20% capital gains tax has been imposed on the transfer of mining titles, except where the transfer is to a company created for the sole purpose of holding an exploitation license. Corporate income tax and capital gains tax are fixed at 17.5% and 6.25% respectively. Additionally, tax stabilisation provisions are extended to any new mining taxes, royalties and duties;
- **State Participation:** The State's free equity participation is maintained at 10%, however the state can now acquire additional equity: and
- **Local Preference:** A local development fund and a rehabilitation and mine closure fund have also been created under the new law. These are financed through a mix of a 1% monthly tax on exploitation production, State contribution and a mandatory annual contribution from mining companies based on environmental impact assessments.

Democratic Republic of Congo

In March 2015, the Democratic Republic of Congo's Minister of Mines submitted a draft of a new mining code to the Congolese Parliament to replace the 2002 Mining Code. This draft is awaiting approval but addresses:

- **State participation:** The State's free equity participation will reportedly be raised from 5% to 10%.

- **Corporate Tax:** to be reduced by 5% to 30%; and
- **Royalty Payments:** Gold royalties of 3.5%.

Gabon

The Gabonese Government enacted a new mining law earlier this year with the aim of increasing its mining industry's contribution to GDP from 6% to 25% in the next 15-20 years. The key areas addressed are:

- **State Participation:** The State is entitled, through the national mining company *Société Equatoriale des Mines* (SEM), to a 10% free-carried participation in the capital share of any exploitation company, with an option to acquire an additional 25% at market value;
- **Local Preference:** Title holders are required to prioritize the employment of Gabonese nationals and set up annual training programs for Gabonese employees; and
- **Tax Regime:** Corporate tax remains unchanged at 35% while royalties are subject to negotiation, with lower rates applied to more difficult, cost-intensive projects. The Code continues to provide tax exemption for mining operations during the exploration phase, including duty-free imports of working equipment.

Kenya

The Kenyan Government passed a new Mining Bill in July 2015, the key changes made concern:

- **State and Local Participation:** The Government is entitled to a 10% free carried interest share in new projects. Mining companies, under the bill, are required to sell 20% of their shares on the Nairobi Securities Exchange (NSE);
- **Tax Regime:** The Income Tax Act has been amended to harmonise tax rates in the extractive industry by setting the withholding tax rate at 5.625% for contractual services and 12.5% for training; and
- **Royalty Payments:** Royalty rates have been increased, with those imposed on minerals like titanium ores rising from 3% to 10% and those on diamonds increasing to 12%. Mines that process their minerals locally will be entitled to a lower rate. Revenue from Royalties will be split between local communities, county governments and national government (which it will invests its share in an infrastructure development fund and a sovereign wealth fund.

Mozambique

On 1 January 2015 a new mining tax law came into force, creating a single piece of legislation for tax matters regarding the industry. It addresses:

- **Rent tax:** A new 20% tax rate applied to the net cash flow of a mining project, from the moment at which it exceeds a rate of return of 18% before tax; and
- **Mining production tax:** This tax rate has been reduced to: 8% for diamonds, 6% for precious stones or metals, 3% for base metals and 1.5% for sand and rock. These rates are levied on the value of the extracted mineral product after treatment, the determination of which is governed by specific rules. Under the new law there is a tax stabilisation period of 10 years, however this is subject to an additional payment of 2% of the tax due from the eleventh year of production.

Senegal

Senegal is on the verge of introducing a new mining code, in particular this will deal with:

- **Mining Titles:** The law limits the types of mining titles available to only "small mine permits" or "mining permits". Mining permits will be issued for an initial term of between 5-20 years, a change from the current Mining Code (introduced in 2003) under which mining concessions are granted for up to 25 years; and
- **State Participation:** Free equity State participation will be maintained at 10%, with an option to acquire an additional 25% equity at market value.
- **Tax Regime:** Tax provisions will be enumerated in the General Tax Code while royalty rates will vary depending on the mineral being mined. The new code will also require title holders to contribute 0.5% of their annual turnover to a local community fund.

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Article

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Ethiopia still drawing a crowd

By Ian Coles

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The recent Ethiopia International Mining Conference, which took place in Addis Ababa on 24-24 September, is a timely reminder of the interest in mining in Ethiopia and the likely prospects for further development of that industry over the short to mid-term future.

The conference attracted hundreds of delegates from around the globe. Attendees reflected the full spectrum of those involved in the industry - from academics to geologists, professional advisers, developers, NGOs and finance providers. The various presenters and panellists reflected that broad interest and seemed to confirm the results of a poll taken by Mining Journal at the Indaba conference held in Cape Town earlier this year. That poll placed Ethiopia third (behind Ivory Coast and Burkina Faso) as the most favourable emerging markets in Africa for the development of mining activity.

Ethiopia, one of the most populous countries in Africa and with a booming local economy, is host to a wide variety of metals and other commodities. Potentially significant deposits of both base and precious metals exist as well as deposits of softer commodities such as potash and phosphate are known to exist. However, while there is much talk about the development of larger projects artisanal mining still accounts for around 90% of extracted mineral value in Ethiopia. This was reflected in the significant amount of discussion afforded to the artisanal sector at the recent conference.

Turning now to some of the current projects being pursued. The Tulu Kapi gold project, which was presented at the conference in Addis Ababa, is being developed by Kefi Minerals. The project involves a probable ore reserve in the region of one million ounces The development agreement between Kefi and the government was formalised in April 2015 and provides for a 20 year exploitation licence and, as provided for in the Minerals Law, a government free carried interest at the level of 5 per cent. The developer is working towards gold production commencing in 2017. In September of this year Kefi provided an update indicating that the peak funding requirement for the project had been reduced by $10 million and that equity funding would be raised at the level of the project company in order to minimise shareholder dilution. Already operating - and the largest gold producer in Ethiopia - is the Midroc project in Lega Dembi, previously a state-owned mine but privatised and transferred to Midroc Ethiopia in 1997.

A further project under development is the Danakil potash project in the Afar region located in the North East of Ethiopia. The deposit is part of the extensive Danakil Depression. Other sponsors seeking to develop projects in this Depression include Circum Minerals with a property covering some 365 square kilometres. Circum is now reportedly looking for a partner to assist in the development of the project given the substantial capital expenditure potentially involved (some reports place this at an amount of more than $2 billion). In addition Israel Chemicals Ltd. (having taken over Allana Potash Corp.) is developing a similar sized area next to the Circum deposit. The Depression in fact extends over the border into Eritrea where the national mining company has a 50 per cent interest in a project being explored.

Ethiopia still drawing a crowd

Elsewhere East Africa Metals is in the course of developing the multi-metal Harvest project located 600 kilometres north of Addis Ababa. The same company is also developing the Adyabo project 264 kilometres to the west of the Harvest project. In a different part of the mining industry Gemfields is working on an exploration project for emeralds. Finally a potentially significant tantalum deposit exists at the Kenticha project located in the Oromia region of Southern Ethiopia. This deposit is in the process of being worked on by a group of partners.

Detractors from the potential for the development of the mining industry in Ethiopia point to the difficult political environment and the advantages enjoyed by those who keep close connections to the ruling political elite. On the other hand the political environment in Ethiopia has remained by and large stable, a position which is not enjoyed by several other African countries competing for investment. Corruption is widely regarded to be less of an issue than elsewhere in Africa. However, local bureaucracy and administration is generally under-resourced and under-developed with the consequence that permitting and other necessary day-to-day activity can be slow. Security of tenure and land rights can also raise difficulties - as can an occasionally fast and loose approach to the recognition of contracts. In addition there is a dearth of government funded centrally available geological data. On a positive note though Ethiopia has joined EITI as a candidate country.

In addition to these local challenges basic infrastructure - power, roads, etc - needs significant improvement. As a land-locked country security of access to ports remains a concern. Djibouti continues to be the main ocean access route although alternatives involving both Kenya and Somaliland are being evaluated and invested in. In relation to power Ethiopia possesses huge potential for hydropower generation and the proposed Renaissance Dam project would - at 6,000 MW - be one of the largest power plants in Africa.

The overall view at the conference was one of cautious confidence in the future. Ethiopia undoubtedly plays host to some very interesting deposits. The local economy is booming - the country has managed double-digit economic growth over the past decade thereby comfortably out-stripping most other African jurisdictions. While not all NGOs are confident that the mining industry will move to occupy a significant part of the local economy the World Bank has recently predicted that mining could contribute $2 billion to the local economy by 2025. That would represent a significant advance over the current position and most of those present at the conference seem to believe that this level of progress was certainly achievable.

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2015 Burkina Faso Mining Code

By Alban Dorin

Introduction

Burkina Faso's National Transitional Council (*Conseil National de Transition*, CNT), acting as Parliament, has approved a new legislation to amend the Mining Code (Law no. 031-2003/ AN dated 8 May 2003). The CNT, which has been in power since the popular uprising last October and is charged with guiding the nation to elections later this year, passed the new law on 26 June 2015.

A bill amending the 2003 Mining Code was first proposed in 2013. It was later withdrawn due to low commodities prices and strong opposition from mining operators.

With the new Mining Code, Burkina Faso joins the wave of mining law reforms throughout Africa that emphasize transparency and accountability by both mining companies and host governments. Along with the newly enacted anti-corruption law, the new code aims to bring greater clarity and transparency to the mining industry while increasing state revenues from mining. It also specifically enumerates the fundamental obligation and responsibility of mining companies to respect and protect human rights. In doing so, it introduces several reforms that will impact current and future mining operations in Burkina Faso.

State Participation

The new Mining Code maintains the 10% free equity State participation of the previous code but expressly allows the State to acquire additional equity if it reaches an agreement with the mining company in accordance with the provisions of the Uniform Act on Companies. The new language suggests an intention to increase State participation by acquiring a greater share capital in mining operations.

Moreover, it creates a "preferential" dividend status whereby the State has priority in the distribution of dividends and is paid before any other allocation of distributable profits.

In furtherance of its goal to encourage transparency, the new law prevents certain government officials, such as the head of state and ministers, from holding title to mining concessions.

Mining Conventions and Mining Titles

With the new Mining Code, the Burkinabe government seeks to improve regulation and supervision of the mining industry. A technical commission will be established to oversee the granting of exploration licenses and mining

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conventions. Mining conventions are no longer required during the exploration phase and exploration licenses remain valid for a period of 20 years. By contrast, the duration of mining conventions is reduced from 25 years to 20 years, but may be renewed for consecutive periods of 5 years (previously 10 years).

License holders are required to notify the Ministry of Mining of any significant changes in the feasibility study as regards production estimates. Failure to adequately amend the feasibility study could give rise to penalties ranging from 1% to 4% of the production value, depending on the magnitude of change.

The new Mining Code provides for additional grounds for revoking mining titles, which include on-site employment of children, undue delay (more than one year) or suspension of exploitation and non-renewal of licenses upon expiration.

Surprisingly, the mining code suggests that the exploitation license is a right in rem on immovable property which may only be subject to a pledge (and no longer a mortgage), which seems inconsistent with OHADA law.

Tax/ Customs Regime and Community Development

The new law introduces several tax regime changes at the exploration and exploitation phases, as well as a 20% capital gains tax on the transfer of mining titles. However, transfers of licenses to Burkinabe companies created for the sole purpose of holding an exploitation license are exempt from the foregoing transfer tax.

In addition, the revised code eliminates the statutory language that provided for a 10 point tax reduction on mining profits during the exploitation phase. Instead, license holders will now incur a fixed corporate income tax of 17.5% and a tax of 6.25% on income derived from investments. While these figures resemble those in the previous code, they differ in that the rates are now fixed. All other mining taxes and royalties will be determined by implementing regulations.

The code further provides for the creation of four new funds, including a local development fund and a rehabilitation and mine closure fund. Exploitation license holders will pay 1% of their monthly gross turnover (or the value of the extracted products) to the local development fund. The rehabilitation and closure fund will be financed through a mandatory annual contribution from mining companies that will be determined based on an environmental impact assessment.

The mining code specifies that 1% duty payable to the local development fund also applies to holders of an exploitation license granted pursuant to the former mining code.

The code also contains specific custom duties exemptions for mining materials and equipment, with the exception of passenger vehicles, at each stage of a mining operation.

Stabilization Provisions

Tax stabilization provisions are guaranteed through the validity of the license or up to 20 years, whichever occurs first. Unlike the previous mining code, the new Mining Code extends tax stabilization provisions to any new mining taxes, royalties or duties.

Local Preference

The code introduces several obligations in support of local business and employees. It requires, for example, that mining companies give preference to qualified local employees, businesses and contractors. Similarly, mining companies are required to provide professional training to local managers. Quotas for these obligations will be established in a forthcoming implementing decree.

Conclusion

While individual countries have adopted varied approaches, recent mining code reforms in Africa have generally focused on increasing state participation, royalties and local content obligation.

With the new Mining Code, Burkina Faso has introduced changes to the mining industry that are not only intended to benefit the local community, but increase state revenues from mining through increased state participation and new mining taxes.

The revised code also reduces regulatory uncertainty and increases transparency within the mining sector, in line with international standards (Kimberley Process and the Extractive Industries Transparency Initiative).

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The murky business of investigating corruption

By Alistair Graham and Chris Roberts

Allegations of fraud, bribery or corruption can damage or destroy a company's reputation even when there is no basis to the allegations. Once the allegations are made the Director of the Serious Fraud Office (**"SFO"**) need only believe that there are "reasonable grounds" to suspect that an offence which involves serious or complex fraud has been committed in order to open an investigation (section 1(3) of the Criminal Justice Act 1987), with the added adverse attention and publicity that brings.

The SFO has identified the mining industry as the corporate sector with the highest rate of foreign bribery[1] with 41% of these bribery cases concluded since 1999 involving knowledge by corporate management, including the CEO. As the SFO's Joint Head of Bribery and Corruption put it in a recent speech: "we're talking about companies like yours, and people like you."[2]

It is important to remember that the SFO is both investigator and prosecutor – ultimately it is judged by how many successful prosecutions it can secure. In this context, when faced with an SFO investigation, what stance does the SFO adopt and how should the company react? The situation is changing.

The SFO's point of view – "leave it to us"

When allegations are first raised, the first response of many directors will be that they want to understand all the allegations and the events giving rise to them. This has traditionally been achieved by way of an investigation performed for the company by an external law firm.

Recently however senior members of the SFO, including the Director David Green QC, have publicly and repeatedly warned against a company instructing external lawyers to investigate allegations made against the company or its employees. The SFO does not view these investigations and reports the law firms produce detailing their findings as being sufficiently "independent". It argues that there is an "inherent conflict"[3] in a law firm being instructed by the board of directors to investigate the alleged actions of the company's employees. The SFO also has concerns that the company and the law firm will make inappropriate claims of legal privilege which may have the effect of hindering the SFO in its investigation or subsequent prosecution. Finally, the SFO believes that "the crime scene can be churned up"[4] by a law firm's investigation.

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1 OECD Foreign Bribery Report 2014 – the extractive industries represent 19% of cases involving bribery of a foreign official.
2 Speech at the Global Anti-Corruption and Compliance in Mining Conference 2015.
3 David Green interviewed in *The Times* on 27 August 2014.
4 David Green interviewed in *The Times* on 27 August 2014.

The SFO's recent stance is to try to persuade companies that there is no advantage in hiring an independent law firm to investigate the allegations of fraud, bribery or corruption. On the contrary the SFO would prefer and advocate that the company should trust the SFO to investigate, without recourse to the company's own lawyers and in some cases suspend any ongoing investigation. The most high-profile example where this has occurred is the SFO's investigation into Tesco's accounting practices, where Tesco is reported to have halted its inquiry to allow the SFO to complete its own.

The stick – the SFO's approach to prosecutions

Recent cases have shown that where the SFO has started a prosecution it will pursue it determinedly, even at considerable cost to all concerned. A recent example demonstrating the SFO's approach in relation to the natural resources sector is the prosecution of the directors of Celtic Energy Ltd.

The SFO charged the directors of Celtic Energy and its lawyers with allegedly conspiring to defraud local authorities in South Wales by prejudicing their ability effectively to enforce obligations to restore open case mining sites to open countryside and/or agricultural use. After a 2 year investigation and a year-long prosecution the charges against all the defendants were dismissed in February 2014. The SFO had substantially changed its case several times during the course of the prosecution.

However, rather than accept the Court's decision, the SFO applied for a rarely-sought order, "a voluntary bill of indictment", which in effect allowed it to bring the prosecution a second time. This second attempt was rejected in November 2014 and the judge described the SFO's changing its case several times as causing the defendants "real prejudice"[5]. At a subsequent hearing in February 2015 the judge ordered the SFO to pay the defendants' costs and described the SFO's legal analysis in the case as being subject to "regular, cataclysmic change, each successive change being fundamental" and that these changes "lacked legal merit and.... [e]ach was, from the outset, doomed to fail."[6]

However the SFO has also had a number of recent successes; so how should a company respond?

The carrot – Deferred Prosecution Agreements ("DPAs")

In February 2014 the SFO was granted the authority to agree DPAs with companies. Under the terms of a DPA the SFO must charge the company with a criminal offence but proceedings are automatically suspended because the company has agreed to certain conditions with the SFO. These could include payment of a financial penalty or compensation to third parties. The DPA must be approved by a judge and, if approved, a costly and disruptive criminal trial will have been avoided and an agreed sanction imposed. Note that DPAs cannot be offered to individuals. DPAs avoid the need for a prosecution and provide certainty to the company that the investigation is over, drawing a line under the allegations.

However the SFO will only agree to offer a DPA where the company is regarded by the SFO as cooperating. This enables the SFO to exert significant pressure over the company until it is satisfied that the company is cooperating.

Further, entering into a DPA requires that the company admits an element of wrongdoing. A major risk companies need to consider if offered a DPA in such circumstances is that where the company has not instructed an external law firm to perform a complete independent

5 *Serious Fraud Office v Evans & ors* [2014] EWHC 3803 (QB), paragraph 95.

6 *Serious Fraud Office v Evans & ors* [2015] EWHC 263 (QB), paragraphs 157 to 158.

investigation it will be entirely reliant upon the information identified by the SFO, as will any law firm advising on the terms of the DPA.

Therefore whilst a DPA may bring certainty and draw a line under allegations, it is still in effect an admission that an offence took place. Once a DPA has been agreed the SFO will consider if it should try to prosecute individual directors who were involved in the relevant events – who, it must be remembered, cannot agree a DPA with the SFO.

The tightrope

The SFO has become an increasingly aggressive organisation in both its guises as investigator and as prosecutor. Companies under investigation are presented with a range of ways to respond, including from cooperating fully (by allowing the SFO to investigate without any independent legal investigation) to refusing to cooperate at all (by instructing an external law firm to perform a full independent investigation and defending allegations all the way to trial) save for complying with the SFO's requests as far as it is legally required to do so.

The position a company should adopt will vary depending upon the circumstances. Whilst a board will want to know if the allegations have any foundation and, if so, how wide they spread, it may wish to commission an independent investigation. However if in the course of that investigation it becomes clear that an offence has been committed, then it may be appropriate to consider ceasing the internal investigation and allowing the SFO full access to the relevant documentation.

The key is to ensure that the Board takes the decision that is in the best interests of the company in all the circumstances. This may involve cooperating with the SFO at an early stage or asserting its right to defend and defeat allegations which lack legal merit and are doomed to fail. Unfortunately both options can be long, complex and costly whatever stance the Board decides to adopt.

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Proposed European law against conflict minerals

On May 20th the European Parliament voted in favour of a strong and binding law that requires companies operating in the EU who are importing tungsten, tantalum, tin and gold (3TG), as well as importing products containing those minerals, to certify that their supply chains are free from minerals that have caused violence within conflict areas. The European Parliament voted in favour of this much more restrictive law over the less restrictive one previously proposed by the European Commission last year.

The European Commission had proposed legislation that was viewed by many to be more 'business friendly'. But the proposals were criticised by certain elements of the European Parliament and by some lobbyists for two main reasons. Firstly it was felt that the voluntary, self certification element of the legislation would not be adhered to by a majority of companies operating in conflict areas, due to the extra costs certification would incur. Secondly it was felt that the proposals to just target those companies importing the raw products into the EU did not go far enough, considering the majority of 3TG is imported into the EU within finished products, such as inside mobile phones and laptop computers.

As a result of these criticisms the new proposals are considerably more stringent. It is now proposed that the legislation be mandatory and not voluntary and that rather than applying to just importers of the raw product from conflict areas into the EU, importers of manufactured products containing 3TG from conflict areas will also be required to certify the absence of minerals blamed for violence. Such rules could now effect 800,000 companies within the EU. The certification procedure will follow the previous proposal in using OECD certification guidelines. These guidelines require companies to first establish strong company management systems. Second, to identify and assess risk in the supply chain. Third, to design and implement a strategy to respond to identified risks. Fourth, to carry out independent third party audits of the supply chain due diligence at identified points in the supply chain. Fifth, to report on supply chain due diligence.

With such stringent regulations being put forward, in many respects the EU is now looking to lead the fight against conflict minerals. In 2011 the US implemented Section 1502 of the Dodd-Frank Act that also aimed the break the link between armed groups and the trade of 3TG minerals. However, this US legislation is much weaker legislation, compared to that proposed by the European Parliament. The Dodd-Frank Act only focuses on the Democratic Republic of the Congo and nine neighbouring countries, compared to the European Parliament proposal which covers all of the conflict areas of the world. Furthermore, Parliament's proposal, unlike the Dodd-Frank act, proposes that the European Commission publishes a list of 'responsible importers' to be available to the public. If this is implemented it would be the first of its kind.

However, the new proposals have also been met with criticism, particularly from conservatives within the European Parliament and from a number of business lobbyists. From Africa's perspective, where many of the minerals from conflict areas are mined, it is thought that the bill will have a significant negative effect on African 3TG production. This is especially true for small and medium sized enterprises (SMEs) operating within legitimate trade channels in conflict areas, who may not be able to afford the requirements. As a result such enterprises may be forced to locate elsewhere. The French business group, Medef has lobbied MEPs warning them of what it sees as the costly consequences of regulating the whole supply chain. There will also likely be issues over deciding which areas should be classified as conflict areas.

Nonetheless, the proposals have a long way to go before they have the possibility of becoming law. They are still in draft form and will firstly require member-state review, before then being subject to negotiations between the Parliament, the Council and the Commission. The negotiation process will also be further complicated by the fact that the bill only passed through the Parliament with a relatively slim majority.

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Creating a Business Hub in West Afria

By Ian Coles

There is no doubt that business is increasing in West Africa. While the usual obstacles and barriers remain, from infrastructure development to political stability and terrorist threats, the majority of the countries in the region have experienced growth over the last 5-10 years and optimism for further growth remains in most quarters. One question that has occupied commentators though is whether any one (or more) countries in the region might emerge as a hub for business in the region, whether in one or more industry sectors. Certainly the region is large enough to suggest the possibility for hubs emerging. The region has a population of 245 million - albeit 65% of the same live in rural areas. Obviously the area is highly prospective for mining activity - but there is no suggestion of a regional hub in that industry emerging to date.

On the other hand a recent study published under the auspices of the African Development Bank, the OECD and the United Nations (African Economic Outlook 2014) reported that "Africa is the world's fastest growing but least globally integrated continent". The study went on to posit that the reasons for this were principally (a) lack of legal architecture for regional integration, (b) poor physical infrastructure, and (c) trading relationships built on links with the rest of the world rather than regional neighbours. The study went on to note that several of the African regional groups (including that in West Africa) trailed the five-nation East Africa Community in promoting and establishing integration.

The answer to the question might turn to some extent on what we mean by **"West Africa"**? Perhaps the most obvious answer here is to look at the membership of the Economic Community of West African States (**"ECOWAS"**). This body includes 15 core countries. Other references to the region occasionally include Chad and Cameroon, countries further to the East but perhaps with significant economic ties to Nigeria and elsewhere. Some other definitions include Mauritania but that country is possibly more usually grouped with the Maghreb jurisdictions of North Africa. As will appear later in this article Morocco is also attempting to position itself as a potential hub for the region but, again, it is more usually grouped with other Maghreb countries and of course is located on the northern edge of the West Africa block. Also of relevance is the fact that eight countries in the region (Benin, Burkina Faso, Cote d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo) are members of the West Africa Economy and Monetary Union (**"WAEMU"**) and thereby share a common currency, a common central bank, a development bank, a regional stock exchange and a common banking regulator. ECOWAS also has plans for a single currency.

There are possibly more obstacles to the development of a business hub in West Africa than other regions. First there are significant cultural differences - arising from varied ethnic, religious and historical backgrounds. Second, local infrastructure - while improving - restricts the ease of movement around the

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region. In addition, the economies of various countries in the region are hugely different - from the mixed free-market economies of countries such as Ghana and Nigeria to countries almost entirely dependent on limited numbers of commodities. Political issues may also present an obstacle - particularly in the case of those jurisdictions with unitary party/dictatorship governing bodies who may have limited interest in seeing influence being exerted by other countries in the region.

There is modest literature or study on the topic of the establishment and growth of regional hubs in West Africa. The growth of hubs elsewhere, such as London, Singapore and Hong Kong would suggest that ease of communication and life style quality are important factors. A benevolent regulatory environment for business growth is also obviously important (currently of critical importance to London in the context of the financial industry). Experience would also suggest that once hubs are established there is a virtuous circle surrounding them and it becomes increasingly difficult for other cities in the relevant region to mount competition for hub status (upmost here are the repeated attempts of cities such as Frankfurt and Paris to mount a challenge to London for the status of principal finance hub in Europe).

Possibly the most interesting recent study on the topic was that conducted by the IMF earlier this year and entitled “Making Senegal a Hub for West Africa”. The study was published in the context of a government sponsored development plan to promote Senegal as such a hub. Furthering some of the points referred to above the study noted several categories where improvement would need to be seen before becoming a hub would be a feasible objective. These included strengthening the fiscal framework, external stability (principally the current account deficit and exchange rate), export diversification, the establishment of social safety nets to assist those living below the poverty line and improved infrastructure (in particular with respect to power supply). Of interest, the study was principally focused on the prospects for economic growth - the premise being that such growth would enable Senegal to act as engine for growth in the wider West Africa region and thereby become a hub for broader activity in that region. The time horizon for the targeted economic growth and emergence as a regional hub was 20 years. The IMF study estimated that this would require an annual growth rate in the region of 7-8% in the short term (almost double that achieved in the recent past - in fact West Africa as a whole has only seen 2.5% growth over the last three years while the population has been growing by 2.2% per annum). In Africa as a whole only two countries (Ethiopia and Angola) have experienced double digit growth over the period 2005-2013. Growth based on FDI aimed at export industries rather than growth based on an increased debt burden was highlighted by the report.

Size might be expected to define a likely hub. The bigger (and more successful) the economy the more people who are attracted to the country in question. Nigeria has a massive advantage here. GDP in 2013 was almost $500 billion. GDP for Morocco in the same year was almost $200 billion. Contrast these numbers with Senegal (approximately $25 billion), Mauritania (approximately $9 billion) and Cote d’Ivoire (approximately $43 billion) and the imbalances are clear. On the other hand this did not prevent Singapore rising as a business hub for South East Asia but that needed a highly focused and long-term initiative from central government to create the right environment to encourage offshore investment (including regulatory regimes and a crack down on corruption).

In December 2014 CNN ran a story relating to the experts view on the “Nine finance hubs of the future”. The sole city selected in Africa was Casablanca. Given its geographical location Casablanca is aiming to act as a financial hub for North, West and Central Africa through the establishment of the Casablanca Finance City Authority (“CFCA”). CFCA is working to build a technology infrastructure and legal environment which will encourage the presence of foreign lenders wishing to do business with Africa. The CFCA, originally established in 2010, has attracted companies such as BNP Paribas and AIG. A similar article in the Financial Times in July of last year noted that in March 2014 the CFCA was included in the Global Financial Centres Index for the first time, ranking 62nd overall and second in Africa. Half of the applicants for entry to the CFCA have been from Europe, 14% from the US, 7% from the Gulf and the remainder from Africa. Advantages of CFCA membership include tax incentives, streamlined visa and work permit process and free management of assets in foreign currencies. There are perceived to be two existing financial hubs in Africa, Johannesburg and Mauritius. Neither of those has an obvious nexus with West Africa, particularly Francophone West Africa. In the finance sector Senegal has also recently been making efforts to be seen as a hub for Islamic finance

Mention should also be made of hubs outside the financial sector. Notwithstanding power generation issues as a result of failing rains and gas supply issues Ghana has been spoken about as a potential hub for purposes of power transmission. Of possibly greater significance however is the reported establishment of Nigeria as a regional hub for petrochemicals and fertiliser. The Nigerian National Petroleum Corporation expects this to occur by 2017. In addition it appears that Nigeria will attempt to establish itself as an aviation hub (although the jury seems to be out as to whether this will be in Abuja or Lagos).

It is clear that the creation of business hubs for the West Africa region is at an early stage. As the CNN article referred to above noted "You have to be a successful city in order to be a successful financial center". The same observation might apply to business hubs generally - to act as a hub people need to see the city in question as a good place to live as well as to conduct business. The sheer size of Nigeria would suggest it as an obvious hub for industry - albeit it seems unlikely to make a stamp in the mining sector. Cultural differences with other countries in the region may also act as a brake on its potential as a hub. It seems more likely that a variety of hubs by industry sector will be created - maybe Nigeria for energy and possibly Morocco for finance. Even this will take time given the overall level of economic growth and development. A single hub across multiple industries seems much further away.

Special report

MARINE MINING

Seeking returns in uncharted waters

Despite obstacles, both countries and industry are keen to see deep-sea mining become a reality

Ruth Green

This time last year one of the most talked-about deep-sea mining projects seemed to be on the rocks as Nautilus Minerals was at loggerheads with the government of Papua New Guinea and its Solwara 1 gold, copper and silver project seemed but a lofty pipe dream.

By May the pair had resolved their differences and Nautilus confirmed that the Papua New Guinea (PNG) government had placed US$113 million into escrow, satisfying the conditions needed for the state to take a 15% stake in the polymetallic project off the coast of PNG.

Since then nothing, cyber attacks included, have really threatened to derail the project, which the company is hoping to bring on stream by early 2018. However, in February it was the turn of Chatham Rock Phosphate, which is looking to mine phosphate nodules on the Chatham Rise, some 400km east of Christchurch in New Zealand, to face disappointment when the country's Environmental Protection Authority (EPA) rejected its marine-consent application on environmental grounds.

This was the second seabed-mining application to be rejected since New Zealand introduced a law restricting economic activity in New Zealand's offshore Exclusive Economic Zone in July 2013. In June last year Trans-Tasman Resources' proposal for its South Taranaki Bight iron-sands project was also rejected amid concerns over the project's potential environmental impact.

Wylie Spicer, counsel at McInnes Cooper, recently spoke at the Deep-Sea Mining Summit in Aberdeen, and said the decision on Chatham Rock Phosphate really floored delegates there.

"The decision on Chatham Rock came on our last day in Aberdeen and I think the people that have been involved, whether as geologists or advisers, were shocked by the decision," he told *Mining Journal* from his office in Calgary.

"The two decisions – Chatham and the one that came before, TTR… the industry in New Zealand is not happy with these results," he said.

Chatham did not hold back in expressing its own disappointment, saying it was "aghast" at the EPA's decision. However, Ian Coles, a partner at Mayer Brown, said New Zealand was not alone in flagging up environmental matters.

"New Zealand has a very strict approach to environmental issues, although other countries have expressed concern over disturbances to marine ecosystems caused by deep-sea mining," he said.

"The two commercial rebuffs in New Zealand have certainly heightened the enthusiasm from environmental groups," agreed Spicer.

And as environmental concerns continue to be highlighted, considerable questions are also being raised about the economic viability of some of the proposed deep-sea mining projects.

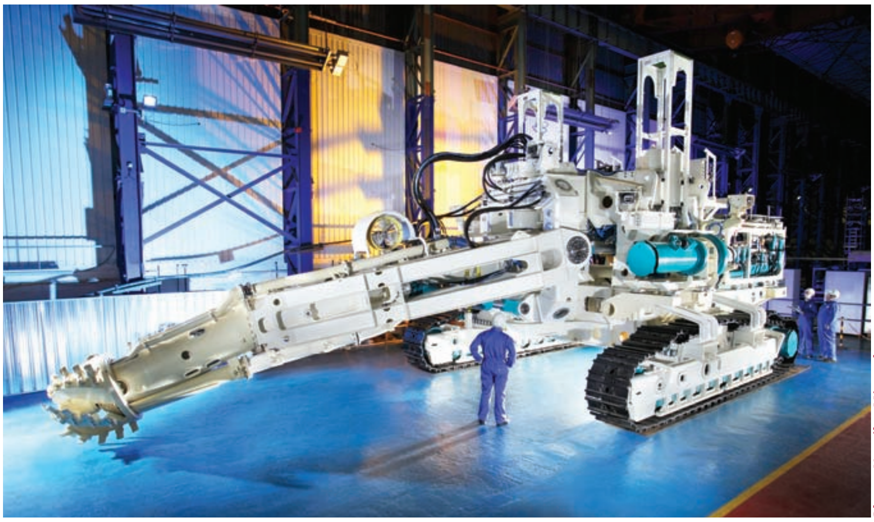

Photo: Nautilus Minerals

Nautilus Minerals' Solwara 1 project is set to come on stream by early 2018

"New Zealand has a very strict approach to environmental issues, although other countries have expressed concern over disturbances to marine ecosystems caused by deep-sea mining"

Although some estimates suggest marine mining could provide some 5% of total rare-earth elements supply by 2020, Coles admitted the sheer expense is making some projects that were once alluring now seem less appealing.

"The equipment needed to access rare earths – or any other mineral on the sea bed – is expensive," he said. "This is compounded by the fact that many of the reported rare-earth deposits on the sea bed are in very deep water, particularly those potentially rich deposits that lie off the continental shelf next to Japan. Given that several potentially large on-shore deposits are in the course of being developed – particularly in Africa – the comparative economics of developing a seabed project may not be so compelling."

Jeff Ardron, a senior fellow at the Institute for Advanced Sustainability Studies (IASS), who also spoke at the Deep-Sea Mining Summit Aberdeen, agreed the economics behind the argument of exploring for REEs under the sea did not stand up.

"The idea that we need to go into the sea for REEs isn't true, at least not now. It's just not economically attractive," he said.

"People thought back in 2011 that metal prices were only getting stronger, there would be no end to China's development and it would hoard its rare-earth elements. Therefore, deep-sea mining looked like a good idea. Four or five years later I don't think we can make that same argument."

Ardron said that although mining companies such as Nautilus and DeepGreen argued that deep-sea mining projects would benefit the economies of Small Island Developing States (SIDS), he said the longer-term economic impact of these types of projects had still been largely overlooked to date.

"If we're going to do deep-sea mining and it's a big if, because economically it's not as attractive as it was initially thought to be, but if it's going to be done it will have to be done carefully or it could cause more harm than good to the small island states," he said.

Special report

"I think the discussion that we've seen so far focuses on environmental concerns, which are legitimate and a lot of researchers are looking at them. But almost no one is talking about the socio-economic impact and it's almost like a blind spot. I'm really concerned that we're going to repeat history and we're sleepwalking into a socio-economic catastrophe. The only way that it can be averted is if we start talking about it and planning for it."

He cited the example of the phosphate-rich state Nauru, which once boasted the highest per capita income enjoyed by any sovereign state in the world during the late 1960s and early 1970s, but now bore the environmental and economic scars of mining. After more than 80% of the island's surface was strip mined and the phosphate reserves were exhausted, the island's wealth plummeted.

"My fear is what we've seen happen already in Nauru is going to repeat itself unless we're extremely careful," he said, adding that the SIDS could learn from the example set by Norway, where prudent financial spending and employment policies in place have guaranteed the country's ability to avoid the so-called dreaded 'resource curse'.

"These governments are now saying that they're going to do deep-sea mining and I wonder if they're going to show the fortitude and the restraint that Norway has shown or if they will slip under the curse in the way that so many other countries have done."

Photo: Anderson Smith

Underwater in the territorial waters around Papua New Guinea

Approvals and licences

Under the UN's Convention on the Law of the Sea, mining rights on the seafloor are controlled by the International Seabed Authority (ISA), which since 2001 has approved and signed 20 contracts to explore for polymetallic nodules, polymetallic sulphides and cobalt-rich ferromanganese crusts in the deep seabed.

The ISA has set aside concession areas as part of its 'reserved area' earmarked for developing nations, meaning that only developing nations are eligible to apply for licences there to conduct undersea exploration. Consequently, nations including the Cook Islands and Tonga have put themselves forward for the concession areas.

In January, the Republic of Kiribati, through state-owned Marawa Research Exploration, signed a 15-year contract with the ISA to explore for seafloor manganese nodules and conduct scientific studies in a section of the Clarion-Clipperton Zone (CCZ). The CCZ spans about 7,240km^2 and lies in the Pacific Ocean halfway between Hawaii and Mexico.

Spicer said this move by the ISA had benefited some unlikely contractors. "Singapore now has an application in and because Singapore – this is one of the oddities to me of the way the ISA defines things – is considered to be a developing nation and what that means is that it can apply to have a lease in one of these reserved areas," he said.

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In February, the ISA signed a 15-year contract with Singapore-listed Ocean Mineral Singapore (OMS) to explore for polymetallic nodules in the CCZ. OMS is owned by Singapore's Keppel Corporation.

Perhaps more interesting still, UK Seabed Resources, a wholly owned subsidiary of Lockheed Martin, is a minority shareholder in the company. UK Seabed Resources has already signed its own exploration contract with the ISA that expires in 2028. Last July the ISA approved a second plan of work submitted by the company for exploring polymetallic nodules in a separate area.

And some of the world's other major economic powers are also getting in on the game.

In January 2014, JOGMEC signed a 15-year contract to prospect and explore for cobalt-rich ferromanganese crusts in Tokyo, while Russia has signed contracts to explore for cobalt-rich ferromanganese in the Magellan Mountains in the Pacific Ocean and polymetallic sulphides in the Mid-Atlantic Ridge.

Last August the ISA received an application from China Minmetals to explore for polymetallic nodules in the CCZ. Curiously, the IMF still considers China a developing country, which means it is also eligible to apply for licences to explore the area reserved for developing nations.

"Last year it was Singapore saying it was a developing country now China is doing the same, looking for its fourth lease in the high seas"

However, Ardron said China's increasing dominance in the deep-sea mining sector could pose some problems ahead.

"Last year it was Singapore saying it was a developing country now China is doing the same, looking for its fourth lease in the high seas," he said.

"This raises the question of whether one country can just continue to gobble up massive areas of the global seabed? How do we make the decision to set some areas aside for other countries? Or for future generations? Where and how do you draw the line? The ISA, up until now, has more or less swept these kinds of difficult questions under the carpet, but I hope they don't sweep this one away as it's a legitimate question."

Another issue mentioned by Spicer was the lack of transparency surrounding the approval process, presided over by the ISA's Legal and Technical Commission.

"One of the problems, and it was raised quite directly in Aberdeen, is essentially the work of the Legal and Technical Commission, which is really the heart of the whole seabed-mining piece, is secret,"

▶ *Continues on page 18*

Marine mining projects

Atlantic 1

Commodity: Diamonds
Ownership: Debmarine Namibia, a wholly owned subsidiary of Namdeb Holdings, which is a 50:50 joint venture between the Namibian government and De Beers.
Project team: Chief executive Otto Shikongo
Location: Off the southwest coast of Namibia
Geology: Mining takes place on the ocean floor at water depths ranging from 70m-140m. Diamonds are recovered in a completely sealed environment with no human interaction. The company operates five diamond mining vessels – MV Debmar Atlantic, MV Debmar Pacific, MV !Gariep, MV Grand Banks and MV Mafuta.
Status: Preliminary results suggest Debmarine Namibia produced 1.3Mct in 2014, which was largely in line with 2013 levels. Despite a 19-day strike in the September quarter, production was boosted by strong operational performance by the new MV Mafuta vessel.
Latest: Namdeb Holdings owns 100% of Debmarine Namibia's sea licences, which originally expired in 2020. However, Anglo American revealed recently that the company has received a 15-year licence extension for both land and sea operations to 2035. Debmarine Namibia is due to acquire a new exploration vessel from Norway in June 2016.

Chatham Rock Phosphate

Commodity: Phosphate
Ownership: Chatham Rock Phosphate
Project team: Managing director Chris Castle
Location: The permit area spans 820km^2, 450km east of Christchurch and at 400m water depths on the Chatham Rise
Geology: The deposit was originally discovered by New Zealand scientists in 1952. The best sampled area of 380km2 has an identified resource of 25Mt. The total area to be mined each year is about 30km^2 and over 15 years will amount to 450km^2, or approximately 0.5% of Chatham Rise. A recent study by RSC Consulting revealed an inferred resource of 80 million m^3 of phosphorite at an average grade of 290kg/m^3, an estimated 23.4Mt of phosphorite.
Status: At the end of March 2014 the company submitted a draft marine consent application to the Environmental Protection Authority (EPA) to mine phosphorite nodules on the Chatham Rise. On February 11, 2015, the EPA said it had refused the application, finding: "The destructive effects of the extraction process, coupled with the potentially significant impact of the deposition of sediment on areas adjacent to the mining blocks and on the wider marine ecosystem, could not be mitigated by any set of conditions or adaptive management regime that might be reasonably imposed."
Latest: Chatham Rock has said it is continuing to develop strategies to progress the project and is considering re-submitting its marine consent application.

Solwara 1

Commodity: Copper, gold and silver
Ownership: Nautilus Minerals (75%) and Papua New Guinea government (15%). The following are major shareholders in Nautilus: MB Holdings (28.14%); Metalloinvest (20.89%) and Anglo American (5.99%)
Project team: Chief executive Mike Johnston, vice-president for projects Kevin Cain, vice-president for PNG operations Adam Wright, and PNG country manager Mel Togolo
Location: Territorial waters of Papua New Guinea
Geology: The Solwara 1 deposit is located on the seafloor at a water depth of 1,600m. The project has an indicated mineral resource of 1.04Mt, grading 7.2% of copper, 5.0g/t of gold, 23g/t of silver and 0.4 % of zinc and an inferred mineral resource of 1.54Mt, grading 8.1% of copper, 6.4g/t of gold, 34g/t of silver and 0.9% of zinc.
Status: Nautilus was granted the first mining lease for the project in January 2011 and in April 2014 it signed an agreement with the PNG government, which paved the way for the project to move into production. As per the agreement, in exchange for the government's 15% stake in the project, in December Nautilus received the previously escrowed US$113 million from the PNG government.
Latest: The company has announced the commissioning and factory acceptance testing of its third and final seafloor production tool (SPT), the auxiliary cutter, which deals with rough terrain and creates benches for the other SPTs to work.

UK Seabed Resources

Commodity: Polymetallic nodules
Ownership: UK Seabed Resources, a wholly owned subsidiary of Lockheed Martin UK Holdings (LMUK)
Project team: Stephen Ball, chief executive of Lockheed Martin UK and UK Seabed Resources
Location: Pacific Ocean
Geology: The application area covers a total surface area of approximately 58,000km^2 in the eastern part of geological submarine fracture zone known as the Clarion-Clipperton Zone.
Status: The exploration licence for the project was approved by the ISA in March 2013.
Latest: In July 2014 the ISA approved a second plan of work submitted by UK Seabed Resources for exploring polymetallic nodules in a separate area.

Nautilus Minerals: Solwara 1 Project Vessel Update

PRODUCTION SUPPORT VESSEL

Vessel Charter signed with MAC*

- Low Nautilus capital contribution
- 5 year charter @US$200K/day
- Option to extend or acquire the PSV
- PSV being built by experienced Chinese yard
- Delivery of PSV by end 2017

*Marine Assets Corporation (MAC), a marine solutions company based in Dubai which specialises in the delivery of new build support vessels for the offshore industry

Special report

Continues from page 16

he said. "All you know about it is that such and such a country has made an application for such and such a space, and at the end of it you get a result of a recommendation but you've no idea what's going on in the meetings.

"The people that know are the people that make the application as they go and make a presentation, but then the Legal and Technical Committee just goes away and makes up its mind and at least publicly you don't see anything other than a report of what they're recommending. And you would think that once the industry starts to take of that that just isn't going to hold water."

Ardron agreed more needed to be done to make relevant scientific information more available and the overall bidding process much more transparent.

"Right now the ISA's Legal and Technical Commission is a closed door process. They do not attribute decisions at the end, they do not say if they voted on things or who voted on what. Although they have conflict of interest guidelines, they have no reporting on them, so we don't know how well these rules are being followed."

In mid-March the ISA issued a report containing a draft framework for regulating exploitation activities in the reserved area. The report is available to download from the ISA's website and the authority's members and stakeholders are invited to submit comments on the draft framework by May 15.

Deep-sea technology

Developing suitable technology, let alone at a cost comparable to that used in land-based mines, continues to be an ongoing challenge for the marine mining sector. However, Spicer pointed to two companies – Krypton Ocean Group and Marshall Hydrothermal – which could offer two interesting alternatives.

"Krypton Ocean Group's proposed method of mining doesn't rely at all on what I would call the traditional oil and gas model – which really is what Nautilus is doing – but has a remotely operated vehicle that does everything at the bottom of the ocean and then brings it up to the surface.

"Also, what Marshall Hydrothermal is proposing to do is not to take the minerals from the vents, but to take the steam and turn it into electricity, which is quite interesting. Certainly in the case of Marshall

Geologists examining drill core

Photo: Nautilus Minerals

"Developing suitable technology continues to be an ongoing challenge for the marine mining sector"

you wouldn't think it would run into the same environmental problems if all they're doing is sucking steam up from the top of the vent."

There has been progress elsewhere. The European Union recently launched a 42-month research and development programme to design and build a robotic, underwater mining prototype with associated launch and recovery equipment to perform field tests at four mine sites across the EU.

The Viable Alternative Mine Operating System project will cost approximately €12.6 million (US$13.38 million) and involves a consortium of 17 project partners led by engineering group BMT Group and Soil Machine Dynamics.

Although there have been some developments even in REEs, Mayer Brown's Coles said commodity-price volatility would continue to weigh heavily on investor sentiment.

"There are a couple of projects utilising seabed mining, so over time there will be less concern over the reliability of the technology and less time needed for testing etc. Much also depends on the price of rare earths – still a difficult factor to predict given continued Chinese domination of global production."

Although the jury may still be out on marine mining, Spicer said for now at least, companies and countries still had a vested interest in seeing deep-sea mining projects come to fruition. "Often when I start to talk to people about seabed mining they start to glaze over, but 20 years ago they were glazing over when we were talking about drilling for oil in deep water 300 miles off the coast," he said.

"We're there because we have to be and to some extent I think that's what's obviously driving this industry, particularly because of the minerals available, which are all very important for the 21st century."

Preview: Mines and Money Hong Kong

SINO-AFRICAN TRADE

China reignites its love affair with Africa

Long-term value in Africa's mining sector still evident to investors with deep pockets

Ian Coles*

China's hunger for foreign assets is a well documented phenomenon, given the country's need to support its rapid growth trajectory and a population of 1.3 billion. China's appetite for foreign assets is especially prevalent in Africa.

China and Africa have been trading partners for centuries, but political and diplomatic relations grew particularly close in the second half of the 20th century when China threw its support behind African liberation movements.

Today the relationship has more of an economic flavour. Africa is looking for reliable partners as it navigates through the early years of an economic resurgence while Chinese companies are seeking to put capital to work and, in the case of the mining industry, to source commodities to fuel the Chinese economy.

As with any relationship, challenges remain. China is facing a host of perception-related issues in Africa as many locals grow suspicious of its true intentions, and chafe under the different expectations of Chinese employers. At the same time, Africa is trying to address a range of legal and infrastructure hurdles so as to improve transparency and win the confidence of new investors

Photo: Gilles Sabrie

Rio Tinto's Jan Du Plessis shakes hands with Chalco chairman Xiong Weiping in 2010 as Chalco agreed to pay US$1.35 billion for a stake in the Simandou iron-ore project in Guinea

While Chinese official data for foreign direct investment in Sub-Saharan Africa is unreliable – in part because much investment is routed through offshore jurisdictions – comprehensive third-party datasets that take into account funds committed, M&A and infrastructure contracts show Africa is China's largest investment destination.

Mineral resources and energy have historically attracted by far the most Chinese foreign direct investment.

It is estimated that investment in the mining and metals sector accounts for around 40% of all Chinese foreign direct investment in Africa.

A large part of China sourced financing has been to secure Africa's natural resources, frequently – at least in the past – deploying the so-called "Angola Model" whereby recipients obtain low-interest loans from China secured by commodities such as minerals.

China Eximbank completed its first oil-backed loan with Angola in March 2004 and this model assisted Chinese companies to obtain exploration concessions in that country.

In 2008 China Railway Group used the same model to gain the mining rights to copper and cobalt mines in the Democratic Republic of the Congo (DRC). China has made a significant number of similar investments since then.

It is argued though that these loans are not made by China to gain access to resources, rather the resources are used by African countries to secure loans, often at higher interest rates than those charged by commercial banks. A consequence is that Chinese companies are able to gain lucrative construction contracts.

Significant investments made by Chinese entities in the mining industry in Africa span the continent from the DRC (Zijin Mining) to Guinea (Chinalco)

Preview: Mines and Money Hong Kong

and Mozambique (Wuhan Iron & Steel). More recent investments have been made in Zimbabwe (Sinomach), Zambia (Zhonghui) and Gabon (Sinomach again).

Other investments include Fenxi Mining Group in a coal project in Kenya and Yinfu Gold's acquisition of a copper mine in Zambia.

However, while mining investments ramped up during the first 10-12 years of the current century, particularly between 2005 – when Beijing cancelled the quotas on the purchase of foreign exchange for overseas investment – and 2011, investment levels in African mining have fallen over the past couple of years.

For example, industry estimates put the decline in investment during 2014 at around 10%. This might be no surprise given the perception that many previous investments, some at the very large end of the investment scale, have failed. Wang Jiahua, vice-chair of the China Mining Association, has reportedly speculated that up to 80% of China's investments in overseas mining assets have not been successful.

A change in strategy

At the Mining Indaba conference held in Cape Town in February 2015 the view given by most commentators was that China was making a return to Africa after a gap of a couple of years, with particular interest being shown in deposits relating to copper, iron ore and uranium.

Reporting on the mood at the conference the *Financial Times* was of the view that China was no longer looking at the industry in Africa purely as a pool of commodities to fuel its domestic economy. Rather, Chinese entities were more likely to be interested in the absolute level of return on investment.

Having said that, China still plans to move away from relying on the major iron-ore producers, such as Rio Tinto and BHP Billiton, and towards more China-originated production, with one aim being to increase the latter from 40% to 50% during the five-year period from 2015-2020.

China continues to absorb around 50% of global iron-ore production. In the precious metals sector the need for China to move away from the US dollar as a reserve currency might encourage further investment in the gold sector.

It should also be kept in mind that competing jurisdictions for Chinese investment do not always present easy targets.

Recent issues with taxation in Australia and strategic domestic considerations in Canada, by way of example, create issues for China outbound investment.

In summary, the size of the Chinese economy means that China will always need to source minerals from offshore assets. That need, and the corollary African need for inbound investment, will ensure continued Chinese participation in the mining industry in Africa for the foreseeable future. ▼

"It is estimated that investment in the mining and metals sector currently accounts for around 40% of all Chinese foreign direct investment in Africa"

**Ian Coles is head of the global mining practice at Mayer Brown International LLP*

Photo: Jinchuan

In 2011, Hong Kong-based Jinchuan Group acquired Metorex, which has mines in Zambia and the DRC, in order to expand its African metals portfolio

MAYER • BROWN

Article

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Beyondbrics – Rare Earths In Africa

By Ian Coles

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This month (February), mining professionals will descend on Cape Town for Indaba, one of the largest mining investment conferences in the world. At the top of the agenda for many of these attendees will be Africa's capabilities as the next global provider for rare earths.

Global demand for rare earth production continues to increase. Ernst & Young has estimated the value of the market by 2015 as between $4 billion and $6 billion. The greatest demand comes from Japan – annual imports are estimated as being in the region of $500 million.

China currently meets this demand, supplying over 90 per cent of the world's rare earth. We may see even more rare earths coming out of China now too, as earlier this year it was reported that the country's strict export quota has been dropped to comply with the World Trade Organisation's ruling last year. The country had initially introduced the quotas to combat what it called an unfair return on rare earths due to the very high environmental costs.

From as early as 2010, Africa has been hailed as the potential answer to the problem around China's dominance of the rare earths market. Australia and Canada possess some rare earth deposits but it is thought Africa has the most potential, with more than half of the world's carbonatite deposits on the continent (the rock formation which yields rare earths.) Looking back even further, South Africa was probably the largest supplier of rare earths in the world. Today, as least two projects in South Africa, Steenkampskraal and Zandkopsdrift have been re-opened and should re-commence production soon.

Other countries in Africa have the potential to produce even more rare earths - the Nuguala project, located in Tanzania has been called the largest, highest grade rare earth undeveloped project outside China. Wigu Hill is another rare earth project in Tanzania owned by Montero Mining & Exploration. Bordering Malawi also has significant potential as does Mozambique, Kenya, Tanzania, Somalia and Namibia.

That said, although there are a few projects up and running in Africa, capital for exploration remains scarce. One reason for this is offtakers are reluctant to enter into long-term supply contracts to support exploration and other early stage activity. Price instability for most rare earth elements means that incentives for producers to sell into the spot market can be substantial. This reduces the length of supply contracts, which were previously one - five years long to three months or less.

A further problem, not just for African countries, but for any country with rare earth deposits is that there is no standard process for the extraction and beneficiation of rare earths. This inevitably makes it a lengthy process and is in stark contrast to the lead time for the developments of other metals – the pre-production of a gold mine can be as little as two years compared to seven for a rare earth project. In order to optimise profits a unique processing system is needed so that the relative proportions of the various rare earths found in each ore body are extracted.

Environmental concerns are also a factor when considering extracting rare earths. It's been reported that in Baotou, China, where a large proportion of the country's rare earth extraction is carried out, a mine's tailing pond has been leaking into groundwater and is threating a major water supply for Northern China. Processing one ton of rare earths produces 2,000 tons of toxic waste.

So, when the opportunities afforded by the supply and demand imbalance are set against the challenges faced in connection with the development of a rare earth deposit, can Africa be part of the solution here?

In short, yes. It is clear that there are opportunities for the development of rare earth projects in Africa. Just last Autumn, mining company Cortec announced it had found deposits worth $62.4 billion in Kenya. However, it is a telling statistic that at present there appear to be only three projects at feasibility study or pre-feasibility study stage. The dearth of capital, when coupled with the difficult market supply and demand model, is bound to make the development of projects difficult for those in the junior mining sector. However, there is no doubt at all as to the quality of the prospective resources.

One potential answer lies with technology assistance from foreign end-users. In May 2013 the Malawi government launched a project to explore for both rare earths and natural gas, a project supported by rare earth technology from Japan Oil, Gas and Metals National Corporation. This type of technological assistance is likely to be of great importance if Africa is to be able to develop opportunities in the rare earths sector. It is also likely to be key for those countries which, unlike China, have yet to develop significant ties with host governments in Africa.

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Project Finance Group Of The Year: Mayer Brown

By **Zachary Zagger**

Law360, New York (January 23, 2015, 6:01 PM ET) -- Mayer Brown LLP's global project finance group leveraged its attorneys and resources around the world in several game-changing projects including successfully facilitating negotiations to restructure the $5.4 billion Panama Canal expansion, keeping the project moving amid conflict between the parties, earning it a spot as one of Law360's Project Finance Groups of the Year.

The firm represented companies and government bodies in major infrastructure financing deals around the world from several North American and South American infrastructure projects to mining projects in Africa, designing innovative and unique financing deals to meet the specific needs of each project.

"It seems to me that the hallmark of a deal of the year in a major international law firm is that it should be a notable deal in its own right, that is unique or innovative in terms of the structure, but also that the firm has successfully harnessed the resources it has around the world and brought them together to solve the client's problem," said Barry N. Machlin, co-Chair of Mayer Brown's Global Projects group.

Highlighting Mayer Brown's project finance group work was the representation of the Panama Canal Authority, known as the ACP, in the ongoing Panama Canal expansion, arguably the most significant infrastructure project in the world.

However, despite the global importance of the project, cost overruns estimated to be about $1.6 billion brought it to a screeching halt, causing particular problems for Mayer Brown's client, the ACP, which suffers $300 million in lost shipping toll revenues for every year of delay. The firm steered negotiations on the ACP's behalf to find a way to resolve the liability issues between it and the contractor while keeping the construction moving forward.

"The parties to this transaction found themselves in a bit of a quandary, which was how to achieve a restructuring of the financial arrangements funding the construction activities in a way that did not prejudice or interrupt either party's right to ultimately pursue the parties' claims so that ultimately the cost overruns could be settled between the parties in accordance with the contractual procedures," Machlin said.

Machlin likened the deal to trying to sit down at a folding card table in the middle of an active battlefield to try to resolve a conflict while the shooting continues around you. Ultimately, the parties agreed to set aside liability issues to arbitration, and the project is expected to be completed and operational in the first quarter of 2016.

In South America, Mayer Brown advised on the Rutas de Lima toll road project in Peru, which required $1 billion in investment across several tranches of bonds to cover multiple risk factors.

The structure included an “extraordinarily uncommon” move to have a tranche of bonds denominated in local currency and sold to international investors, said partner Christopher Erckert, whose work on the deal landed him on Law360's list of Project Finance MVPs.

“It proves that there was a market for Peruvian currency denominated investment among international investors,” Erckert said. “The country hopes that this is sort of a watershed deal.”

The firm also continued its strong reputation in the mining sector advising Nedbank Ltd. and Rand Merchant Bank in an $88 million senior debt facility for an African unit of Canadian miner Aureus Mining Inc. developing the New Liberty Gold mine in the Republic of Liberia.

The project showed not only Mayer Brown’s already strong presence in mining and in Africa but is also a signal of the firm’s renewed emphasis on the continent as the firm has expanded globally through several firm acquisitions over the past decade, making it one of Law360’s Global 20 firms last year.

“We are placing a huge amount of emphasis in our Africa program,” said London-based partner Ian Coles, who heads the firm's Africa and Mining practices and co-heads the Project Finance practice. “We have been doing deals in Africa since 1992 and in upwards of 20 different African jurisdictions, including many firsts. … We absolutely see this as a continuation where we are in the market with respect to mining project finance generally and in Africa specifically.”

In addition, Mayer Brown’s project finance group worked on several significant U.S. projects like the public-private partnership for Texas SH 183, a toll road in the Dallas/Fort Worth Area. The the Texas Department of Transportation, or TxDOT, had tried to solicit bids through a traditional approach but failed to garner any competition receiving only a single bid.

The firm then helped design a model that allowed the state to keep toll revenues, financing the projects with $600 million in progress payments from TxDOT and $250 million in financing provided by the developer, and also included an agreement that the private partner operate and maintain the project for 25 years. The new approach attracted three bidders.

“I think that this transaction has a potential to have a major impact in the market in several ways,” said partner Joseph Seliga, who worked on the deal, noting that TxDOT is already pursuing a similar structure in other projects as well as several other jurisdictions. “On top of that, it provides greater impetus for the further development of the design-build finance approach, whether or not you include the longer operation and maintenance agreement.”

--Editing by Philip Shea.

MAYER • BROWN

2015

EPC Contracts

Controlling cost blowouts on mining developments

By Jonathan Hosie

EPC Contracts

Controlling cost blow-outs on mining developments

The world of mining in 2015 is a challenging one for those looking to bring projects into development. Deflated commodity prices and fragile investor confidence mean that only the most robust projects are likely to make the investment case.

There is no shortage of money, with investment funds seeking good rates of return and many mining projects offering the prospect of delivering such returns, sometimes at eye-watering levels. Most commentators would also agree that projects with good quality assets, managed by an experienced team are two prerequisites for convincing investors to make the all-important decision. However, when assembling a development proposition and advancing along the road towards project development, investors and lenders alike need to have confidence that management has an achievable plan and can deliver against that plan. That includes demonstrating a coherent approach to project management of the development phase, once the economic case has been verified through pre-feasibility and bankable feasibility studies.

A key component of any such development is controlling the costs of bringing the mine into production. Whilst the market dictates the commodity price for the eventual production output, what developers ought to be able to control is the development cost.

Traditionally, the international market for mine developments has promoted the use of the EPCM[1] model to organise the diverse resources that are often entailed in a mine development. However, the problem with the EPCM model is that it is a consultancy agreement, not a hard-edged delivery mechanism. The EPCM contractor will not, in the event of a cost blow-out, underwrite that risk. While the completion risks are carried by the individual suppliers of specialised plant and sometimes by the construction contractors undertaking the infrastructure work elements, there is no one party with overall responsibility for ensuring that the project is delivered within budget and on time. That is, no one party other than the project sponsor itself. That is a big risk to carry for any party but more so where the sponsor may be a single project company with limited assets beyond the project itself.

In the brave new mining world of 2015 and beyond, perhaps the market needs to reassess the EPCM approach and look instead to hard-edged EPC contracts to successfully deliver projects. This is arguably a better way to manage and avoid the well publicised cost blow-outs that have beset some major mining developments in recent times.

The two articles that follow examine the use and some of the features of EPC contracts and in particular those produced by FIDIC[2]. Under the EPC model, the risk of completing the project within budget and on time are allocated to the contractor, who retains single-point responsibility if those metrics are not met. This model makes it easier for the developer to assure equity investors and debt providers that the capital budget and the expected date for production will be met.

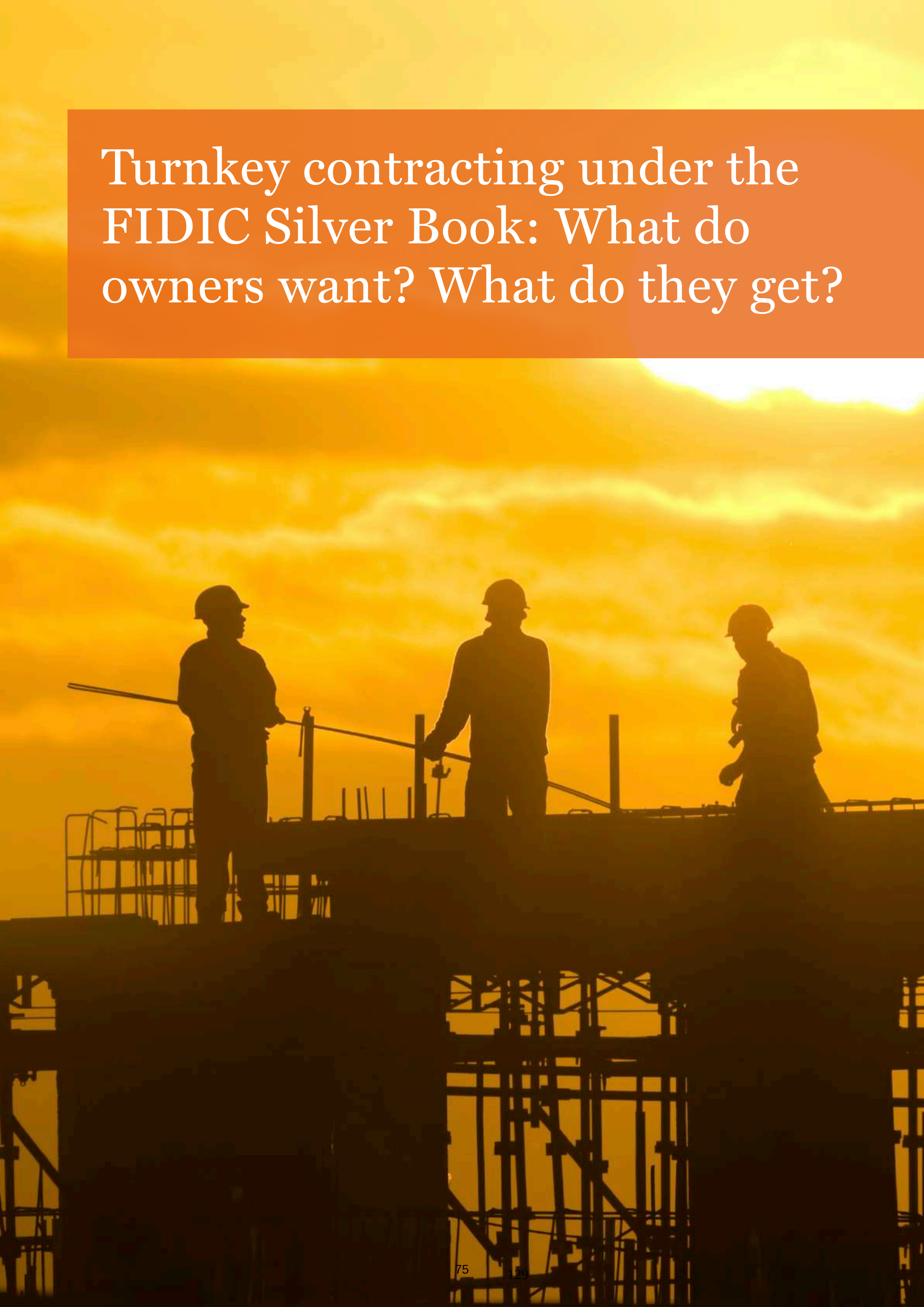
Mayer Brown has a wealth of experience in this area.[3]

1 Engineer Procure Construction Management.

2 Fédération Internationale Des Ingénieurs-Conseils.

3 in January 2015, the firm was awarded Project Finance Group Of The Year by Law360. This prestigious award recognized the work of the firm in representing companies and government bodies in major infrastructure financing deals around the world from several North American and South American infrastructure projects to mining projects in Africa, designing innovative and unique financing deals to meet the specific needs of each project.

Turnkey contracting under the FIDIC Silver Book: What do owners want? What do they get?



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Turnkey contracting under the FIDIC Silver Book: What do owners want? What do they get?

Jonathan Hosie[1]

Introduction

This paper concerns turnkey contracting and asks the questions 'What do owners want? What do they get?' The analysis is given a contractual setting by reference to the *Conditions of Contract for EPC Turnkey Projects* published by FIDIC, otherwise known as the Silver Book.[2] Reference was also made to the ICC Model Contract when this paper was first planned, though the ICC's new Model Contract for Major Projects has not yet (August 2007) been published.[3]

The FIDIC Silver Book was produced in 1999, in response to a perceived need for a form of contract 'where certainty of final price, and often of completion date, are of extreme importance'.[4] Its publishers also recognised that turnkey projects are popular in project financed deals, where lenders require greater certainty about a project's final costs than is allowed for under contracts that reflect the traditional allocation of risks, such as FIDIC's Red and Yellow Books.[5]

The introductory notes to the Silver Book further recognised the practice that prevailed prior to its publication, namely for parties to take the pre-1999 versions of the FIDIC Red or Yellow Books and alter these in order to transfer significant additional risks to the contractor, in an attempt to obtain a higher level of assurance as to outturn cost, quality and time.

This paper looks at some aspects of turnkey contracting at the macro level and, in terms of specific features of the FIDIC Silver Book, at certain issues at the micro level. The thesis developed is that owners do not get the turnkey solution they want. This is primarily because a turnkey solution is not as simple as it sounds, due to the inevitable complexities of large projects and the decreased risk appetite of contractors in the global projects arena. There is a shortfall between expectation and actuality in many of the FIDIC provisions, which means that the appearance of risk transfer to the contractor is not as complete as might be suggested by FIDIC's use of the term 'Turnkey' to describe the Silver Book.

Turnkey contracting

The idea behind the turnkey approach is, putting it crudely, for the contractor to be given the job to engineer, procure and construct the required works and then, once ready for operations, to hand over the keys to the owner so that it may operate the facility. Turnkey, in principle, means a contract whereby the contractor provides whatever is necessary for a certain purpose.

1 The views expressed in this paper are personal to the author and are not intended to be imputed to Mayer Brown International LLP or to any client of that firm.

2 FIDIC (International Federation of Consulting Engineers), 1999 suite of standard forms (eg Conditions of Contract for Construction (new Red Book), Conditions of Contract for Plant and Design-Build (Yellow Book), Conditions of Contract for EPC Turnkey Projects (Silver Book)), obtainable via www.fidic.org. Direct quotations from the FIDIC Silver Book in this paper retain the formatting of the original.

3 The ICC Model Contract for the Turnkey Supply of an Industrial Plant was first published in 2003 (ICC Publication 653, obtainable from www.iccbooks.com). The ICC's Task Force on turnkey transactions, under the Commission on Commercial Law and Practice (CLP), has drafted the ICC Model Turnkey Contract for Major Projects (due for publication later in 2007), designed to be more suitable for large civil works or for contracts for the supply of plant, where the contractor undertakes to supply a complete facility.

4 Introductory note to First Edition of FIDIC Silver Book (see note 2).

5 See note 2.

Turnkey contracting is sometimes also referred to as 'Lump Sum Turnkey' or 'LSTK', emphasising the intended bargain of the parties, with responsibilities allocated to the contractor to deliver the project on time and to a required performance level, in return for payment of a fixed price. A lump sum turnkey price will include contingency allowances to hedge against the risk of things costing more or taking longer to deliver. Owners expect to pay a premium for a turnkey contract.[6]

Another acronym seen frequently in this context is EPC: 'Engineer, Procure and Construct'. Thus, an EPC contractor is responsible for the engineering design of the works, its procurement and subsequent construction.[7] Indeed, the Silver Book's full title is 'Conditions of Contract for EPC Turnkey Projects'. Thus it uses the terms EPC and turnkey interchangeably, meaning the same thing.

A feature of the turnkey approach to contracting, including revenue-generating facilities, is the requirement for the contractor to prove the reliability and performance of the plant and equipment. Thus particular prominence is given in the drafting of turnkey contracts to the testing, commissioning and handover of the works and how this is to be undertaken. Such appproaches are common in process engineering projects, where the output may be energy generation, water treatment, petrochemicals or natural resource processing (mining). It is of critical importance in such projects not only for the project to be delivered within time and cost constraints but also to be delivered so that it is capable of meeting its designed production and output levels.

Performance of the asset is particularly key in those turnkey projects funded through project financing. Lenders' security is dependent largely on the ability of the completed facility to operate and generate revenue, whether power, chemicals, processed metals or road toll revenue. This prominence is reflected in the General Conditions of the FIDIC Silver Book: the 'Time for Completion' of the works includes not simply completing the works so that the owner can take them over, but also 'achieving the passing of the Tests on Completion'.[8]

Against this background, we can start to ask (and suggest some answers to the question): 'What do owners want?'

Projects have a large number of moving parts

A point worth stressing at the outset is perhaps obvious, but nonetheless important. This is the fact that a turnkey contract will be but one part of the contractual framework and one component of the risk management arrangements and contractual framework used on large projects. Thus, the extent to which risk is allocated to the contractor under turnkey arrangements will depend upon a range of other factors, including the availability and strengths of guarantees from the project's sponsors. Where a sponsor will not provide any, or only a limited form of, completion guarantee to lenders, this obviously increases the need to allocate completion risk away from the sponsor. In these circumstances, the obvious candidate for the risk, given that it will be in the best position to manage it, will be the turnkey contractor. The turnkey contract is the means by which the risk is allocated.

A linked point is that projects commonly require a range of skills and products which are not always available from a single turnkey contractor. By way of example, large petrochemical projects may have a series of turnkey contracts for various technologies represented by different process units, plus an infrastructure or utilities turnkey contract. Each process unit will be engineered, procured and constructed by a different turnkey contractor, working alongside each other albeit within the site locations or 'battery limits' of their respective process plants.[9]

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6 However, it is increasingly common for turnkey contracting to be based on, or involve, an initial cost reimbursable or target cost element. See also notes 7 and 12.

7 The acronym 'EPCM' is also encountered frequently on international projects, but this is very different from EPC. EPCM is a services-only contract, under which the contractor performs engineering, procurement and construction management services.

8 Clause 8.2 of the FIDIC Silver Book (see note 2).

9 For the US$5bn SABIC petrochemical project in Saudi Arabia, turnkey contracts were entered into for various plants forming the project, including Technip for the olefins plant; Toyo for the glycol ethylene plant; Aker Kvaerner and Sinopec for the polyethylene and polypropylene plants; and Foster Wheeler who are undertaking the project management plus utilities and offsites.

The key risk in any construction project is *completion risk* – that the works may not be completed:

1 Within the agreed lump sum price; or

2 Within the agreed time scale programme; or

3 To the required performance quality.

In a turnkey arrangement, it is the contractor who has responsibility for and control over (at least in theory) each of these elements of completion risk. However, even at this fairly fundamental level, difficulties can be encountered depending upon the sources of information that make up the design for certain plants which may threaten the intended turnkey product the owner is procuring.

The idea that turnkey contracting provides the owner (and its lenders) with single-point responsibility is attractive, because it suggests that costly disputes and recourse difficulties when something goes wrong will not be increased by arguments within the supply chain as to who may be at fault. However, and as noted above, large projects will frequently involve a number of turnkey contractors undertaking different parts of the overall project, each according to its own specialist skills.

Further potential for interface clashes (and additional erosion of the single-point responsibility quality that owners expect from a turnkey solution) arises where a plant contains one party's proprietary technology but is otherwise delivered by another contractor. In these circumstances the so-called 'turnkey' contractor will not necessarily be willing to provide the full wrap in terms of assuring the outturn performance of the plant. This can be seen particularly in the petrochemical sector, where process units often involve the use of technology owned and licensed by third parties. If the third party company which owns the technology licence is not the same company that undertakes the works under turnkey terms, there is an obvious difficulty in obtaining a single-point responsibility wrap under one contract from one EPC contractor.[10]

Impact of an over-heated market

Another factor that militates against some of the perceived advantages of turnkey contracting is that of market pressure. At the time of delivering this paper, it is probably no exaggeration to state that the global construction economy is overheating. Demand for construction goods and services is high, driven particularly by the industrialised growth of large economies in both the People's Republic of China and in India.

This demand (and the high price of crude oil) is also driving the further exploitation of raw materials and processed goods. Thus, the mining sector has, over the last 18 months, enjoyed a significant resurgence, which has led to a large number of new and old reserves being developed. Equally, petrochemical companies have seen a series of mega-projects in areas close to feed stock supplies in the Middle East, as global construction activity drives the demand for products such as polyethylene, polypropylene and other processed carbon derivatives.[11]

These market pressures are having a big impact on the risk appetite of the turnkey contracting market (as well as on prices and programmes, as the entire supply chain feels the strain of excess demand). In particular, the decreased appetite for risk amongst contractors means that it is no longer a feasible procurement strategy to transfer all completion and other risks to the turnkey contractor. Different sorts of deals are being engineered, notably ones where contractors are engaged effectively on a two-stage basis, the first stage being a reimbursable Front End Engineering Design ('FEED') contract. During this stage, the contractor undertakes its design, obtains firm vendor quotations, may be even places orders for certain long lead equipment and generally firms up on the scope of supply. When the contractor can be sufficiently certain as to the scope of design and expected outturn cost and date fot completion, such matters may then be fixed as the contract is 'converted' into an LSTK or turnkey arrangement.[12]

10 The turnkey contractor will likely seek to carve out from its liability problems arising due to technology performance, or to cap its liability by reference to the recourse available from the technology provider.

11 Plastics & Rubber Weekly (3rd February 2007 and 22nd May 2007 – see www.prw.com) reported that Nova Innovene will de-bottleneck all its expandable polystyrene (EPS) production units in Europe to boost output, and will increase its production capacity. Demand for this product is expanding, driven by the buoyant construction market.

12 For a more in-depth look at such procurement strategies, see Nick Henchie and Phil Loots, 'Worlds Apart: EPC and EPCM contracts: Risk Issues and Allocation', ICLR July 2007.

Such arrangements may be engineered through a single contract, which contains a mechanism to convert the contract from a reimbursable to a fixed LSTK basis. Alternatively, owners and their preferred contractors may enter into a separate FEED or Preliminary Engineering contract which, once completed, can form the basis of the parties entering full EPC terms. However, in the latter case owners will seek to find some enforceable mechanism to help ensure that the contractor will enter into the LSTK arrangement (with all its attendant risks). The risk for the owner otherwise is that its preferred contractor seeks to re-negotiate underlying terms and conditions under the full EPC contract to reduce its overall risk.

A scoresheet for the FIDIC Silver Book

Against the background of all these issues, it may be instructive to see how the FIDIC Silver Book Conditions deal with such matters. As a general rule, FIDIC discourages amendments to its forms. However, market practice (for better or for worse) is to amend these documents to cater for issues which commonly arise in practice and, of course, to take account of the particular features of each project.

Rather than a review of the entire provisions of the FIDIC Silver Book, this paper proposes to concentrate on a number of key areas. First to be considered will be how unforeseen ground conditions are dealt with. The second is how design liability risks are addressed. Also reviewed are the arrangements for testing, completion and taking over of the plant. The analysis will conclude with a review of force majeure, limitation on liability and extensions of time provisions.

This analysis establishes that there is probably a shortfall between expectation and actuality when the FIDIC Silver Book is used. Risk is not fully transferred to the contractor (absent further amendment to the contract conditions). Overall, this analysis bears out the proposition that owners who opt for the turnkey approach using the FIDIC Silver Book do not get what they want.

Unforeseen ground conditions[13]

The approach taken by standard forms of engineering contract to unforeseen ground conditions has, traditionally, been to adopt a test of foreseeability. Thus, clause 12 of the ICE Conditions provides:

> 'If during the carrying out of the Works the Contractor encounters physical conditions (other than weather conditions or conditions due to weather conditions) or artificial obstructions which conditions or obstructions could not, in his opinion, reasonably have been foreseen by an experienced contract, the Contractor shall as early as practicable give written notice thereof to the Employer's Representative.'[14]

The FIDIC forms were originally based on the ICE Conditions of Contract.[15] Thus, it is not surprising that under the FIDIC Red and Yellow Books this traditional foreseeability test is applied. Clause 4.10 of those FIDIC forms requires the employer to have made available all relevant data in his possession on sub-surface conditions, not later than 28 days prior to the submission of the tender. Clause 4.11(b) then dictates that the contractor is deemed to have based the contract amount on such data. The owner warrants the accuracy of the information he has provided and the contractor is only responsible for interpreting the data. Further, under the FIDIC Red and Yellow Books the contractor is deemed to have obtained all necessary information as to risks which may influence or effect his tender for the works. He is also deemed to have inspected and examined the site and other available information. However, these deeming provisions are limited to the extent that the investigation by the contractor is practicable, taking into account cost and time.

On the allocation of risk for unforeseen ground conditions, the FIDIC Red and Yellow Books thus adopt the ICE clause 12 approach: the owner carries the risk of physical conditions which could not have reasonably been foreseen by an experienced contractor at the date of tender.

13 See also Julian Bailey, 'What Lies beneath: Site Conditions and Contract Risk' (SCL paper 137, May 2007).

14 Institution of Civil Engineers, ICE Conditions of Contract 7th ed (ICE7), Design and Construct version, London, ICE/Thomas Telford (2001).

15 Indeed, further editions of the FIDIC forms have followed later editions of the ICE forms and vice versa. As Edward Corbett notes in the introduction to his book, FIDIC 4th: A Practical Legal Guide, London, Sweet & Maxwell (1991), the drafting of FIDIC's 4th edition of the Red Book was heavily influenced by the ICE's 5th edition, after which the ICE's own 6th edition adopted some of the innovations introduced by FIDIC's 4th.

The FIDIC Silver Book, in keeping with its turnkey approach to risk allocation, takes this one important step further. Whilst the owner provides information to tendering contractors, it is the contractor who is responsible for verifying as well as interpreting that data. There is no warranty by the owner as to the sufficiency or completeness of the information provided. Under the FIDIC Silver Book, the risk of adverse ground conditions is intended to be allocated to the contractor. Clause 4.12(c) provides a catch-all statement to the effect that the contractor accepts responsibility for having foreseen all difficulties and costs, even those which are not foreseeable:

> 'The Contract Price shall not be adjusted to take account of any unforeseen difficulties or costs.'

It will not be surprising to learn that, in practice, the provisions of the Silver Book are commonly subject to heavy negotiation between the parties. This is particularly so in the current global construction market, where contractors' appetite for risk is much reduced by the sheer volume of work opportunities available to them. It is at this point that the expectation of owners that they will receive turnkey assurance starts to dissipate. This may occur in a variety of ways in relation to unforeseen ground conditions.

One device is simply to revert to the more traditional test of foreseeability so that the risk of the unforeseeable remains with the owner. Another is for the risk to be taken by the contractor but only after it has had ample opportunity to satisfy itself as to risks, contingencies and other circumstances concerning the site conditions. This would be commonly undertaken during the FEED stage, where testing is undertaken on a reimbursable basis (ie paid for by the owner), so that the contractor can take an informed view as to the likelihood of there being adverse ground conditions.

A further variant on this is to take the existence of ground condition reports and all the surveys and to use these to extrapolate assumed conditions. If variances are found in practice from the assumed conditions which affect time or cost, their impact is allocated back to the owner rather than transferred to the contractor.

Thus and in a number of ways, the global projects market finds ways around the standard form risk allocation represented by the FIDIC Silver Book conditions. Such approaches tend to ameliorate the rigidity of the turnkey solution: a number of risks remain with the owner.

Design liability

In the same way that unforeseen ground conditions may impact the certainty as to outturn of the contract price and time for completion, the issue of design liability can play a major role in determining the extent to which the turnkey solution is deliverable.

Again, and as noted in the introduction to this paper, turnkey arrangements necessarily suggest that the contractor is required to take full responsibility for the entirety of the design of the works. This will often be a point of contention, particularly where initial design work has been undertaken on behalf of the owner, with such designs being provided to the contractor during the tender stage with the requirement that it is to take on full responsibility for such design.

Numerous disputes arise in practice where there are changes in the design of the works following award of the contract. Such variations in design will be argued to give rise to relief for the contractor in terms of time and money entitlement. The counter-argument to this (in the case of changes in design) is to characterise the change as simply design development, which does not serve to increase the contractor's entitlement to time or money. It may be instructive to consider the treatment under clause 5.1 of the FIDIC Silver Book, which addresses general design obligations:

> 'The Contractor shall be deemed to have scrutinised, prior to the Base Date, the Employer's Requirements (including design criteria and calculations, if any). The Contractor shall be responsible for the design of the Works and for the accuracy for such Employer's Requirements (including design criteria and calculations), except as stated below.'

Having established this deemed universe where the contractor has scrutinised the owner's designs (presumably to verify and satisfy itself, although this is not stated explicitly),[16] the FIDIC Silver Book pushes home the point further, clause 5.1 going on:

> 'The Employer shall not be responsible for any error, inaccuracy or omission of any kind in the Employer's Requirements as originally included in the Contract and shall not be deemed to have given any representation of accuracy or completeness of any data or information, except as stated below. Any data or information received by the Contractor, from the Employer or otherwise, shall not relieve the Contractor from his responsibility for the design and execution of the Works.'

The rest of the same clause then goes on to carve out from the matters for which the contractor is responsible a number of matters for which the owner retains responsibility; but the list is very limited in scope. Hence the approach of the FIDIC Silver Book is for the EPC/turnkey contractor to create a single design liability wrap around the project, with the contractor being responsible both for the integration of the design and the construction of the works.

However, in practice this risk allocation is frequently changed. Depending on the market, the change may be to increase the risk to the contractor; or to increase the extent of the carve-out in respect of liability for which the contractor is not liable, thereby decreasing the contractor's risk. Conversely, there may be other provisions in the contract, such as notes on drawings or process diagrams forming part of the employer's requirements, that indicate that the design has not yet been fixed and remains to be confirmed, say by the equipment vendors.

Owners may seek to tighten up and improve on such provisions by using devices seen elsewhere in the FIDIC Silver Book (as well as in the ICE forms), namely further deeming provisions. Thus, clauses that deal with the sufficiency of the contract price and all of the risks, contingencies and other factors that the contract is deemed to make allowance for, help ensure that the owner has an LSTK assurance from the contractor. The FIDIC Silver Book scores well in this aim.

Of course, it is a matter for negotiation on each project exactly how complete a full design liability wrap can be achieved. It may be, in a particularly soft market where contractors and equipment vendors are in short supply and high demand, that owners will face substantial resistance to their attempts to achieve the full wrap. Equally, such risk transfer may be agreed, provided the financial risk contingency for the obligation is sufficiently generous to persuade the contractor to take that risk.

At the macro level on large projects, one also sees that the contract structure adopted for delivery of the project also militates against the turnkey assurance. This is because, as previously noted, large projects will frequently be delivered by a number of different EPC/turnkey contractors. That creates interface issues, which means it is just not possible to have one EPC/turnkey contractor giving a single-point responsibility risk assurance wrap for the entire project.

16 In Co-operative Insurance Society v Henry Boot (Scotland) Ltd [2002] EWHC 1270 (TCC), 84 Con LR 164, 19 Const LJ 109, Judge Richard Seymour QC held that an obligation for a contractor to 'complete' the design provided by an owner necessarily imported a duty for the contractor (under the JCT80 contractor design supplement form) to use reasonable care to verify the adequacy of that design.

Handover, testing and commissioning

If one starts from the proposition that owners want an LSTK product, then that assumes that the owner allocates to the contractor control of the works up to the point at which the contractor hands over the keys. Is this realistic on projects for which the standard form FIDIC Silver Book is adopted?

In many cases, the owner does not want to wait to take over the plant (in the sense of having control) only after the plant is tested, commissioned, performance-tested and ready for start-up. Often the owner will in fact be an experienced operator of the plant. It will therefore want its own people operating the plant as soon as it is able. In the energy sector, it will want to start selling electricity as soon as it is being generated following commissioning, but often prior to performance testing. In the petrochemical sector, owners will want this level of control at the point at which hydrocarbons are introduced into the various systems making up a plant. For mining projects, the same applies in relation to the start-up and commissioning activities where ore enters the processing plant to be treated. Whether it is the generation of electric current or the introduction of the hydrocarbons or ore into the processing system, at this point the plant will simply be at the stage of testing and commissioning. The project will not yet have reached final completion and passed its performance tests.

How does the FIDIC Silver Book address the issue? The short answer is that it does not. The Silver Book simply moves through the stages whereby the plant is first engineered or designed (clause 5, *Design*), to how it is to be constructed (clause 7, *Plant, Materials and Workmanship,* and clause 8*, Commencement, Delays and Suspension*), then on to what would normally be mechanical completion (clause 9, *Tests on Completion*). It then deals with the process of handover to the owner (clause 10, *Employer's Taking Over*). Following this, the FIDIC Silver Book provides an option for further testing (clause 12*, Tests after Completion*).

The FIDIC Silver Book does not deal explicitly with the issue commonly encountered on many large projects: the need for provisions to reflect the pre-completion control required by the owner. The testing and commissioning of plant is always a risky enterprise: vessels and pipework are pressurised and 'hot' testing may be implemented. This is an important issue, because control brings with it responsibility and risk. This has contractual implications (eg possible triggering of warranty or defects liability provisions), as well as impacting on insurance coverage (signalling, potentially, the end of the contractor's All Risk cover and the commencement of the Operational or Business Interruption cover). This is another area where it is suggested that owners do not get what they want (absent amended provisions to deal with the issue).

Clause 17 (*Risk and Responsibility*) and clause 18 (*Insurance*) will also need careful review and likely revision in this regard. It is worth mentioning that clause 30 of MF/1 (*Use before taking-over*)[17] recognises the possibility of early owner use of the works for commercial operation. This applies where, due to default of the contractor, issue of a taking-over certificate has been delayed by over one month but is subject to the works being 'reasonably capable of being used.'

In practice, the FIDIC Silver Book terms will often be subject to amendment to allow the owner's team to have control and commercial operation (but not responsibility), by providing expressly for such an apparent dichotomy. There will also be a need to provide some protection for the contractor. Balancing of interests can be achieved by allowing for the contractor to disclaim liability where the owner's team fail to act in accordance with the contractor's reasonable instructions.

17 Institution of Mechanical Engineers/Institution of Engineering and Technology, Model form of General Conditions of Contract (MF/1), 2000 Edition (Revision 4); obtainable via www.theiet.org/publishing/.

Force majeure

If turnkey means the allocation of risk to the contractor, then clause 19 of the FIDIC Silver Book (*Force majeure*) leaves the door open for that risk to migrate back to the owner. Indeed, in a sense, much of this risk never leaves the owner.

The impact of the risk of a *force majeure* occurrence receives a similar treatment across all FIDIC forms: both the time and cost impacts of such an event are allocated to the owner.[18] I am not aware of any other standard form of construction contract that adopts this approach, other than the UK's Engineering and Construction Contract (otherwise known as the NEC).[19] Most other standard form contracts allocate the time risk of the *force majeure* event to the owner, but leave the cost impact as neutral. Not so with FIDIC, even under the Silver Book.

The other point is that the FIDIC Silver Book's definition of what constitutes *force majeure* is wider than one might have expected, given the supposed turnkey qualities of this form. Whilst under clause 19.1 *force majeure* has to be 'an exceptional event or circumstance', all that is also required is that it is beyond the reasonable control of the party and could not have been reasonably provided for before entering the contract, or having arisen, have been reasonably avoided or overcome; and is not substantially attributable to the other party.

It is, of course, possible to draft *force majeure* clauses more tightly than this. As frequently seen on non-recourse financed projects, tighter definition of the risk can be achieved by providing a list of what is not *force majeure*. From an owner's perspective, it may not get its supposed turnkey solution unless the Silver Book's standard provisions are amended.

Limitations of liability

The turnkey credentials of the FIDIC Silver Book are further undermined by the provisions of clause 17.6 (*Limitation of liability*). This clause is in two parts. The first part consists of a mutual waiver and release by each party in favour of the other in respect of liability for any indirect or consequential loss, subject to exceptions. Those exceptions relate to the owner's obligation to pay the contractor any loss of profit or other loss sustained, where the contractor is entitled to terminate the contract due to the owner's default. A further exception relates to the indemnities provided by the contractor in favour of the owner in respect of loss or damage to people or property not attributable to any act or omission on the part of the owner. These two categories of exception are therefore limited in scope.

Of course, on large projects with revenue generating facilities, the indirect losses have the potential to be very great indeed. However, the wholesale exclusion of such losses from those recoverable against the contractor underline the lack of realistic assurance obtained by owners when engaging contractors to undertake works under the FIDIC Silver Book turnkey conditions.

The second part of clause 17.6 comprises a financial cap on liability. Again, there are a number of stated exclusions to this (certain types of loss, which are, in effect, carved out of the cap) but the default position under the FIDIC Silver Book is that the total liability of the contractor shall not exceed the contract price.

Of course, having excluded liability for indirect or consequential losses, it might indeed be difficult for any contractor to perform so badly such that the recoverable loss would exceed the contract price. Such direct loss would presumably involve the cost of repairs or replacement of works. Such loss may also be incurred through the imposition of delay damages.

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18 The treatment of force majeure is slightly different under FIDIC short form and dredging contracts, in that these erroneously fail to provide that a force majeure event releases the affected party from its obligations under the contract. For further details, see the author's paper presented to the FIDIC International Users Conference (London, 11th-12th December 2006) A later version of this paper is available at http://www.mayerbrown.com/london/practice/article.asp?pnid=1544&id=3288&nid=1562.

19 Institution of Civil Engineers, Engineering and Construction Contract/The New Engineering Contract (NEC3), London, ICE/Thomas Telford (2005); obtainable via www.neccontract.com.

Furthermore, in the current market, it is rare for contractors to agree anything approaching 100% of the contract price when negotiating caps on liability particularly on the mega-projects where the contract price is in multiple hundreds of millions of dollars or in the multi-billion range. Contractors will simply not risk their balance sheet. Each case, of course, turns on its own facts and much will depend upon the contract price and the overall risk profile. That said, owners may start off suggesting a cap at less than 50% of the contract price, only to find themselves engaged in a downward trajectory as the contractor uses its market power to reduce its potential exposure.

Extensions of time

The FIDIC Silver Book adopts the term *'Time for Completion'*, allowing the flexibility to apply this to a series of milestones. These can include passing of the tests on completion or other significant milestones during the course of the project.

In common with other standard form construction contracts, FIDIC Silver Book contains a mechanism for the extension of this Time for Completion in clause 8.4. The events giving rise to an entitlement to an extension of time include the issue of formal variations and any other delay or act of prevention attributable to the owner. The latter is a useful catch-all and helps counter arguments that any such act of prevention by the owner might otherwise put time at large.[20] Nevertheless, the operation of this provision creates a potential gateway for increased time (and subsequent cost) claims.

In addition, and rather unhelpfully, the other event giving rise to potential extension entitlement is defined in clause 8.4(b) as:

> 'a cause of delay giving an entitlement to extension of time under a Sub-Clause of these Conditions ... '

One therefore has to search the rest of the FIDIC Silver Book to find those sub-clauses which confer on the contractor an entitlement to an extension of time. One example is sub-clause 4.24 (*Fossils*). If any fossils, coins or articles of value or antiquity, structures or other remains or items of geological or archaeological interest are found on the site and if the contractor suffers delay, it is to give notice to the owner and is entitled to an extension of time for any delay 'if completion is or will be delayed ... '. This is the same formula as in clause 8.4 and involves, potentially, a prospective assessment as to the impact of the event upon the Time for Completion.

It is perhaps surprising that, under the FIDIC Silver Book, the extension of time provisions do not expressly require the contractor to take steps to avoid or mitigate the cause of delay, nor do they seek to make entitlement to any such extension conditional upon taking such steps.[21] For owners seeking a turnkey solution, it is likely that they will want the extension of time provisions under the FIDIC Silver Book to be strengthened considerably and clarified to gather in all those conditions which might give rise to an entitlement. Such clarity allows the events to be more closely managed and delays to be avoided, or at least mitigated.

As to how progress and, indeed, extensions of time may be measured, the FIDIC Silver Book contains provisions requiring the contractor to submit a programme and to revise this:

> 'whenever the previous programme is inconsistent with actual progress or with the Contractor's obligations'.[22]

This, of course, gives rise to the potential for confusion, as the programme may be updated for actual progress which represents a position of default (due to culpable delay on the part of the contractor). This makes it difficult to assess the impact on the Time for Completion, which may not have changed if there had been no events giving rise to an entitlement to extend. This is another area where care needs to be taken in the operation of the contract. Amendments to the Silver Book may be appropriate.

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20 Assuming, for this purpose, that the governing law of the contract is one that recognises such a concept; not all legal systems do.

21 The exception is in the case of force majeure. The definition in clause 19.1 of the FIDIC Silver Book (see note 2) requires that the event, as well as being 'exceptional', must be something which the party affected could not reasonably have provided against, or once having arisen, is not something which could reasonably have been avoided or overcome.

22 Clause 8.3 (see note 2).

Of course, such extension of time provisions are necessary in order to provide the contractor with relief against its potential liability for liquidated damages, if it fails to complete the works by the Time for Completion. However, and equally, the reality is that if there are changes in design which, arguably, go beyond design development and constitute a formal variation, or if there are acts or omissions on the part of the owner which delay, impede or prevent the contractor from maintaining progress and achieving the Time for Completion (or to the extent that the contractor can demonstrate that such completion 'will be delayed', as above) then the supposed certainty of the turnkey solution is again rendered more illusory than real.

Such practical difficulties are frequently compounded on large projects where there may be a number of separate EPC/turnkey contractors engaged by the owner, undertaking different parts of the project. The possibility that one EPC contractor may cause (allegedly or otherwise) delay to another is a potent risk. In practice, owners will engage one contractor to oversee and project manage all project activities, from engineering and procurement through to construction management. Whilst that contractor will not underwrite the performance of the various EPC/turnkey contractors engaged on the project, it will commonly be incentivised to ensure tight control and monitoring of their activities. This provides a system whereby the project can be managed effectively so that the owner has some assurance that the project will complete within its time, cost and performance targets. Frequently the project management role is also given to the same contractor who undertakes the infrastructure EPC contract for the works. This is because that same contractor has most direct physical and technical interface with each of the separate EPC/turnkey contractors. As noted earlier, large projects have a number of moving parts, when viewed as a series of contracts.

Conclusions

This paper did not set out to be critical of the FIDIC Silver Book, in the sense of producing gratuitous complaints. It is easy for lawyers to criticise any standard form, equally any form of bespoke construction contract. It is right too to recognise that, in many respects, the FIDIC Silver Book does what it says on the tin: the provisions dealing with unforeseen ground conditions, responsibility for the owner's design and the provisions as to the sufficiency of the contract price are all good devices that help assure the Silver Book as a true turnkey contract. However, there are undoubtedly a number of areas where the turnkey qualities of the form can be improved by tighter drafting. This may be something FIDIC wish to take on board in its next edition of the Silver Book.

The other major factor militating against the FIDIC Silver Book achieving turnkey credentials for owners' projects is the size, shape and structure of the projects on which it is used. These factors cannot be attributed to FIDIC, though a clearer recognition of their impact by both owners and contractors (and their respective advisers) can only help improve the eventual quality of the contractual and management arrangements established for such projects.

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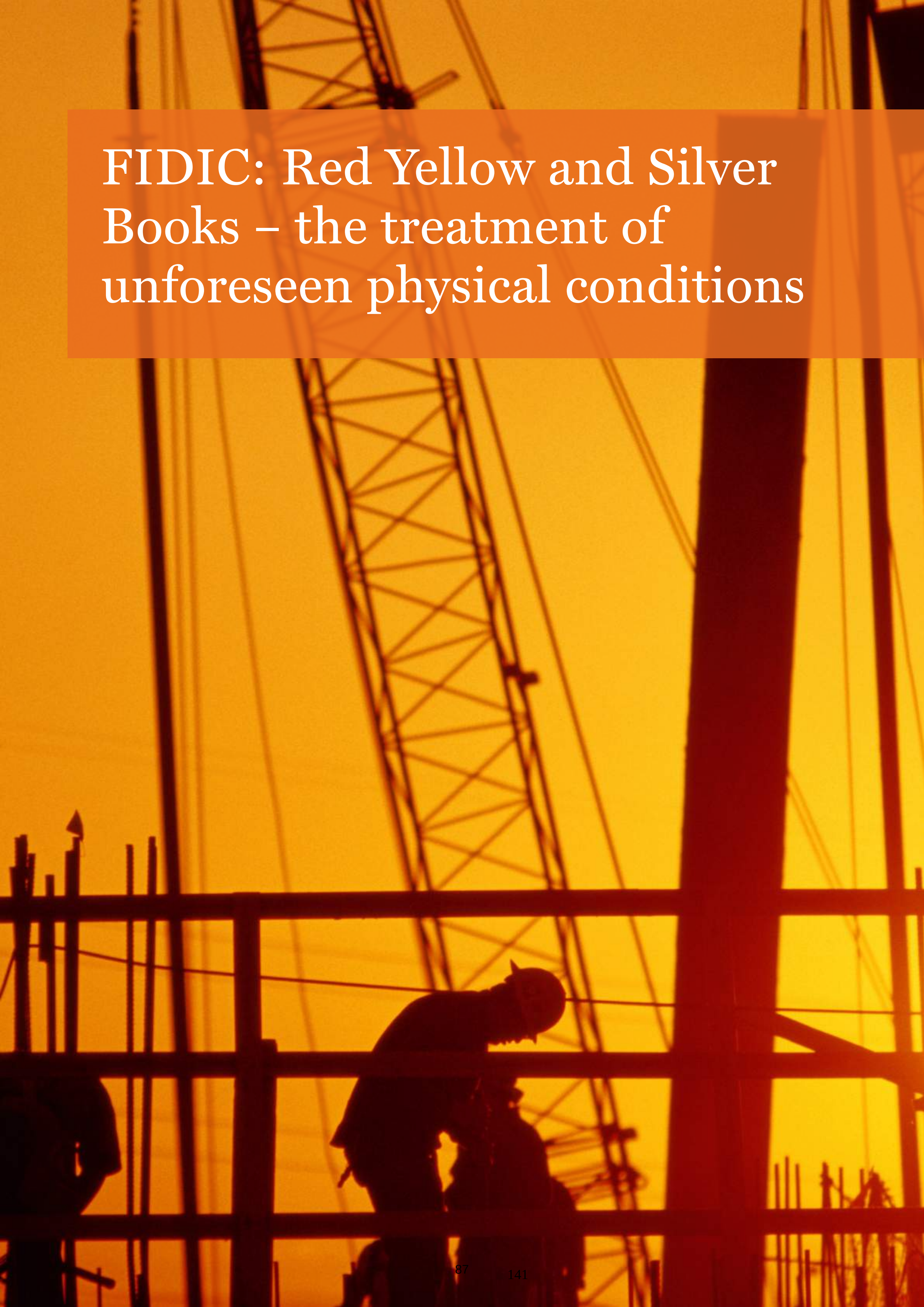
FIDIC: Red Yellow and Silver Books – the treatment of unforeseen physical conditions



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FIDIC: Red Yellow and Silver Books – the treatment of unforeseen physical conditions

An abridged version was published in the *Construction Law Review* published by the Chartered Institution of Civil Engineering Surveyors in July 2014.

Introduction

Whilst the FIDIC standard forms have their origins in the fourth edition of the ICE Conditions of Contract,[1] they have been exported to both common law and civil law jurisdictions and are nowadays widely encountered in projects in west, east and northern Europe, the Middle East, Africa, the Far East, China and South America.[2] FIDIC forms of contract are also sometimes encountered on UK projects, notably where international clients, contractors and their advisers look to use an 'international' standard form as a basis of their contract.

In this article, I want to examine how some of the FIDIC forms of contract treat the issue of unforeseen physical conditions. I shall also look briefly at the prerequisites for advancing a claim for extra time or money under the FIDIC forms and comment on a recent case decided in the Technology & Construction Court in London concerning the FIDIC Yellow Book.

Contract administration under FIDIC

This article starts by focusing on these issues in context of the Red, Yellow and Silver Books (there are others). The Conditions of Contract for Construction (the Red Book) is designed for traditional procurement, where the Contractor constructs according to the Employer's design. Valuation under the Red Book is based on a bill of quantities with unit rates; it is not a lump sum contract. Further, under the Red Book a third party independent Engineer administers the contract on behalf of the Employer. The Engineer is also present under the Conditions of Contract for Plant and Design - Build (the Yellow Book) where the Contractor is responsible for errors in the Contractor's Documents but generally speaking not for errors in the Employer's Requirements.[3] In contrast, under the Conditions of Contract for EPC Turnkey Projects (the Silver Book), there is no independent Engineer and the Contractor is responsible for all of the design and construction activities. Such hard delineations are often adjusted in practice; the FIDIC forms represent a starting position for negotiation and are very often changed.

However, the key point is that the Engineer occupies an important role under FIDIC Red and Yellow Books as he acts both as Employer's representative for the purpose of administering the contract in issuing instructions for Variations and the like, as well as acting in a neutral capacity in evaluating entitlements that arise such as adjusting the Time for Completion for Variations. Under the FIDIC Silver Book, conceptually design responsibility is allocated to the Contractor who is paid to provide a turnkey solution so the need for an Engineer to administer the contract is removed. However, this is another hard delineation that is seldom maintained in practice on turnkey projects using FIDIC Silver; the Employer will often want its Engineer to act as the Employer's Representative, to perform certain administrative and other tasks otherwise allocated to the Employer. For instance, this could be for the purpose of issuing Determinations under Sub-Clause 3.5 or assessing entitlements to additional time or money under Clauses 8 and 14.

1 Published in January 1955, with the first edition of the FIDIC Red Book being published in 1956.

2 FIDIC is less prevalent in the North American market because that market already has a corpus of its own standard forms of engineering contract.

3 Under Clause 1.9 of the Yellow Book, it is provided: *"If the Contractor suffers delay and/or incurs Cost as a result of an error in the Employer's Requirements and an experienced contractor exercising due care would not have discovered the error when scrutinising the Employer's Requirements ... the Contractor shall give notice to the Engineer and shall be entitled subject to sub-clause 20.1 to ...* (a) *an extension of time ... and* (b) *payment of any such Cost plus reasonable profit..."*

Allocation of risk for ground conditions

An important feature of the Red, Yellow and Silver Books is the degree to which risks are allocated to the Contractor in relation to unforeseen physical conditions. The approach taken by standard forms of engineering contract to this risk has, traditionally, been to adopt a test of foreseeability. Thus, clause 12 of the ICE Conditions of Contract for Design and Construct[4] provides:

"If during the carrying out of the Works the Contractor encounters physical conditions (other than weather conditions or conditions due to weather conditions) or artificial obstructions which conditions or obstructions could not, in his opinion, reasonably have been foreseen by an experienced contractor, the Contractor shall as early as practicable give written notice to the Employer's Representative."

Given the origin of the FIDIC forms, it is not surprising that under FIDIC Red and Yellow Books, this traditional foreseeability test is also applied. Clause 4.10 of those FIDIC forms requires the Employer to have made available all relevant data in his possession on sub-surface conditions, not later than 28 days prior to the submission of the tender. Clause 4.11(b) then dictates that the Contractor is deemed to have based its Contract Price on such data. The Employer warrants the accuracy of the information he has provided and the Contractor is only responsible for interpreting the data. Further, under the FIDIC Red and Yellow Books the Contractor is deemed to have obtained all necessary information as to risks which may influence or affect his tender for the works. He is also deemed to have inspected and examined the site and other available information. However, these deeming provisions are limited in their application *"to the extent"* that the investigation by the Contractor is *"practicable, taking into account cost and time."* This provides the Contractor with some basis for relief in the event its investigations (due to the constraints of available time and cost) do not reveal matters which subsequently manifest themselves in the form of sub-surface conditions different to those assumed when tendering and later entering into the contract.

On the allocation of risk for unforeseen ground conditions, the FIDIC Red and Yellow Books nevertheless broadly adopt the ICE clause 12 approach: the Employer carries the risk of physical conditions which could not have reasonably been foreseen by an experienced contractor at the date of tender.

The FIDIC Silver Book, in keeping with its turnkey approach to risk allocation, takes this one important step further. Whilst the Employer provides information to tendering contractors, it is the Contractor who is responsible for verifying as well as interpreting that data. There is no warranty by the Employer as to the sufficiency or completeness of the information provided. Under the FIDIC Silver Book, the risk of adverse physical conditions is intended to be allocated to the Contractor, who *"accepts responsibility for having foreseen all difficulties and costs of successfully completing the Works."* Clause 4.12(c) provides a catch-all statement to ram home the point: *"The Contract Price shall not be adjusted to take account of any unforeseen difficulties or costs."*

Contractors' reactions to Silver Book risk transfer

It will not be surprising to learn that, in practice, these particular provisions of the Silver Book are commonly subject to heavy negotiation between the parties.

One device is simply to revert to the more traditional test of foreseeability so that the risk of the unforeseeable remains with the Employer. Another device is for the risk to be taken by the Contractor but only after it has had a reasonable opportunity to satisfy itself as to risks, contingencies and other circumstances concerning the site conditions. This is commonly undertaken during the FEED stage, where investigations and design development is undertaken on a reimbursable basis (i.e. paid for by the Employer), so that the Contractor can take an informed view as to the physical site conditions and arrive at a design, methodology, programme and a Contract Price for the works that is robust and reliable.

A further variant on this is to take the existence of ground condition reports and all the surveys and to use these to extrapolate assumed conditions which are then included as a benchmark under the contract. If variances are found in practice from the assumed conditions which affect time or cost, their impact may be allocated back to the Employer rather than retained by the Contractor.

Of course, the Contractor may also price the risk by including a sufficiently large contingency in the Contract Price. However, in a market where there is an excess of contracting capacity, with contractors chasing turnover and bidding prices at zero or negative margins, the likelihood of a winning bid containing an adequate risk allowance may be considered small.

Much depends on the relative bargaining power of the parties and, of course, the skill and experience of their advisers.

4 Second edition (September 2001) and officially withdrawn in August 2011, to be replaced by the new Infrastructure Conditions of Contract.

A recent decision on the FIDIC Yellow Book: *Obrascon*

A recent case involving a contract based upon FIDIC Yellow Book is illustrative of the issue as to foreseeability: *Obrascon Huarte Lain SA v Attorney General for Gibraltar* (2014).[5] The judgment in the *Obrascon* case was delivered by Mr Justice Akenhead in the London TCC on 16 April 2014.

This dispute arose out of a contract entered into in December 2008 with a 24 month completion period and a Contract Price of some £30.2 million. However, some two years in to a two year contract, the Contractor found itself two years late, with delay damages clocking up at a rate of £5,000 per day and having been paid only a third of the Contract Sum but with substantial running costs continuing. OHL forecasted that it needed nearly £80 million further to complete the job with further substantial costs for dewatering and decontamination of ground water and dealing with contaminated materials which it claimed were *"unexpected" and "not accounted for in the offer"*.[6]

The only road between Spain and Gibraltar crosses the airport runway. The road has to be closed when a plane lands. The works were intended to avoid this transport clash and ease congestion. The Employer required a new dual carriageway to be constructed, running along the eastern edge of the airport runway and a twin bore tunnel under one end of the runway in order to provide a route for traffic, thereby removing the transport clash with incoming and outgoing flights.

The illustrative design provided to tenderers delineated the route of the intended tunnels and included an environmental statement which contained advice as to the presence of contaminated material in the made ground. This made ground would have to be excavated as part of the works. The Contractor ultimately launched its claims (originally under the Contract and thereafter before the Court)[7] for an extension of time and additional payment on the basis that it had encountered large quantities of contaminated ground and different types of rock which it had not reasonably foreseen at tender stage. These were said to amount to *"Unforeseeable"* physical conditions under Clause 4.12 of the FIDIC Yellow Book terms which had affected progress, caused delay and justified an increase in the cost of the works payable to the Contractor. The progress of the works had also been adversely impacted by heavy rainfall and the Contractor sought relief for this event too.

As noted above, FIDIC Red and Yellow (and even more so in the case of Silver) require the transfer of certain risks to the Contractor in respect of site conditions. In *Obrascon v Attorney General for Gibraltar,* it was necessary for the Court to apply the FIDIC definition of *"Unforeseeable"* in the Yellow Book. This is defined to mean *"not reasonably foreseeable by an experienced contractor by the date for submission of the Tender."* The approach of the Judge is text-book stuff but a salutary reminder because, as *Obrascon* illustrates, contractors may sometimes be suspected of having underestimated the extent of site risks and thereby bid a Contract Price that is inadequate for the extent of the works required to complete the project.

Application of the foreseeability test

In relation to the application of the foreseeability test, the Judge said some interesting things which contractors (whether under FIDIC or other forms of construction contract with similar tests) would be well advised to consider.

Thus and in relation to contamination reports and related data provided to the tendering contractors: *"I am wholly satisfied that an experienced contractor at tender stage would not simply limit itself to an analysis of the geotechnical information contained in the pre-contract site investigation report and sampling exercise".* The Judge went on to *"adopt what seems to me to be simple common sense by any contractor in this field"* when contemplating the presence of contaminants (as a result of use over many years) in made ground which had to be removed (and disposed of) as part of the works.[8]

Further, in reviewing the particular site characteristics in Gibraltar, the Judge said this: "*Tendering contractors must and should have known and appreciated that historically, the site had been influenced environmentally by its military use (over hundreds of*

5 Obrascon Huarte Lain SA v Attorney General for Gibraltar [2014] EWHC 1028 (TCC).

6 Paragraph 109 of the Judgment.

7 The proceedings were commenced in the High Court in Gibraltar but the parties subsequently agreed to transfer these to the specialist Technology and Construction Court within the High Court in London.

8 Paragraph 215 of the Judgment.

years) which could be a source of contamination from heavy metals and trace elements and by its use as an airport area, where it would be expected that evidence of the presence of hydrocarbons and related derivatives would be found … the ES[9] *contained reference to the history and various historical maps and … actually showed the precise position of earthwork rifle butts in 1869 pretty well along the line of the tunnel and adjacent ramps … it must have been obvious to anyone who applied any real thought to this that the residues of what soldiers had been firing with on these rifle ranges would include the lead in the bullets or musket balls likely to have been used. Those butts had obviously been levelled years before 2007; thus foreseeably there would have been lead spread around the area within the made ground."*[10]

In other words, contractors are not limited to reviewing only the data that the Employer makes available. Rather, when assessing what is *"reasonably foreseeable by an experienced contractor"* the law expects the contractor to read around the subject and use its own experience and common sense. However, the Judge found on the evidence that *"OHL did not in fact anticipate, expect or in practice plan for encountering any significant quantities of contaminated materials at all"*.[11]

Further and where empirical data is supplied, contractors are expected to review this intelligently. In *Obrascon*, the ITT included a requirement that tenderers should allow for 10,000m^3 of contaminated material. This led to the Judge to conclude *"in my judgment any experienced contractor tendering for the road and tunnel works would foresee that there would or at least could realistically be substantial quantities of contaminated material."* He went on to find that the 10,000m^3 figure *"was hardly anything more than a 'say' figure and is in effect a warning to tendering contractors that a sizable amount of contaminated ground should be anticipated."*[12]

The judgment is also interesting in what it says about the reliability of expert evidence where the data issued at tender stage is itself only a sample. That information included a contamination report which was based on a series of boreholes which revealed a wide variety of depths at which contamination was present in the made ground. However, the Judge found that the expert evidence which sought to extrapolate from or interpolate between the samples to produce an assessment as the amount of such contamination was *"no more than guesswork and essentially unreliable"*.[13]

As the learned Judge noted, it might be different if excessive quantities of hydrocarbons were found at the same depth over say ten samples within a 400m^2 area; that might allow for a reliable extrapolation/interpolation exercise to be carried out. Similarly, it might be easier to draw conclusions from a series of Standard Penetration Tests as to the likely strength of rock. However, the results of the contamination sampling within the made ground showed a much more random distribution, which meant that a definitive conclusion as to the likely amount of contamination was not available. In such circumstances, prudent contractors should allow for more, not less, quantities of potentially contaminated material.

What should the contractors do to address the risks they ought reasonably to foresee?

The Judge also provided some guidance as to how a contractor in OHL's position should have addressed the foreseeable risk of contamination. Whilst each case turns on its own facts, it is suggested that the steps recommended by the Judge are more likely than not to be applicable in the majority of similar cases. Based on the evidence provided to tendering contractors in *Obrascon*, the Judge suggested that OHL could reasonably have done all or some of the following:

Make a substantial financial allowance within the tendered price for dealing with what was likely to be a large quantity of contaminated material;

Plan and price for a post-contract site investigation including further trial pits and testing in order to build up a picture of where there was contamination, then establish a working method on how to remove it and what to do with it;

Plan to remove all the made ground as having a good chance of containing contaminants; and

Plan the design and method of construction to allow for randomly distributed quantities of significant contaminants in the made ground.

9 Environmental Survey report issued to all tendering contractors.
10 Paragraph 215 of the Judgment.
11 Paragraph 224 of the Judgment.
12 Paragraph 219 of the Judgment.
13 See paragraph 220 of the Judgment.

Ultimately, in *Obrascon* the Judge found that the Contractor did not in fact encounter physical conditions in relation to contaminated material over and above that which an experienced contractor could reasonably have foreseen by the date of submission of its tender. It followed that the contractor's claim for *"Unforeseeable"* physical conditions failed in relation to the contamination. The Judge made a similar finding in relation to the extent of contaminated ground water.

OHL also encountered rock (when excavating for the diaphragm wall panels) at higher levels than it said an experienced contractor at tender stage could reasonably have foreseen. As a result it had to adopt a different and more time consuming costly working method to excavate through the rock. Here, the Contractor was partially successful, with the Judge assessing that *"experienced contractors could not reasonably have foreseen 500m³ of the hard material or rock that would need chiselling"*[14] and allowed this quantity as being unforeseeable. It might be noted that this was against the Employer's expert evidence to the effect that over 4000m³ was foreseeable.

FIDIC, Contractors' claims and conditions precedent

There is one particular clause in FIDIC forms which strikes fear into the heart of even the most well organised contractor, namely the condition precedent that must be satisfied in order to recover against what otherwise may be an entirely meritorious claim.

Clause 20.1 of FIDIC Red, Yellow and Silver Books is in the same terms and provides that if the Contractor considers it is entitled to an extension of time and/or any additional payment, it is required to give notice *"describing the event or circumstance giving rise to the claim as soon as practicable, and not later than 28 days after the Contractor became aware, or should have become aware, of the event or circumstances"*. Clause 20.1 goes on to provide that if the Contractor fails to give such notice then time is not extended, neither is he entitled to additional payment and the Employer is discharged from liability. In the *Obrascon* case, it was accepted by Counsel for the Contractor that Clause 20.1 imposes a condition precedent to entitlement which must be satisfied if the claim is to be successfully advanced.

This is an important judgment from a well-respected senior TCC Judge on a FIDIC provision which Contractors and Employers frequently fight over.[15]

The Judge found that there was no prescribed form for giving notice under Clause 20.1. Thus, email correspondence, minutes of meetings and other written records could, in principle, suffice as notice provided it was clear what was being notified. However, the Judge made clear (and *Obrascon* is now authority for the proposition) that in order to constitute a valid notice under Clause 20.1 of the FIDIC Yellow Book form, the notice must be in writing, must be clear that the contractor intends to notify a claim and must describe the event or circumstance relied upon.

Clause 20.1 is in materially similar terms under FIDIC Silver, Yellow and Red Books[16]. This case is therefore of wider application when it comes to considering whether notice of a contractor's claim has been validly communicated. However, FIDIC's Gold Book, published in 2008, requires notices to comply with certain express requirements including being *"identified as a Notice and include reference to the Clause under which it is issued"*[17]. The *Obrascon* case may encourage parties to tighten up the drafting of their FIDIC-based contracts when using Silver, Yellow or Red Books, adopting some of the drafting clarifications found with the Gold Book.

Pulling the trigger under Clause 20.1 notifications

Interestingly, in relation to the operation of Clause 20.1 for claims for extensions of time, in *Obrascon* the Judge went back to the source of such entitlement which is to be found in the wording of Clause 8.4 of the FIDIC form. This provides that *"the Contractor shall be entitled ... to an extension of the Time for Completion if and to the extent that the Completion ... is or will be delayed by any of the following causes ..."*. The Judge seized on the words *"is or will be delayed"* and noted that the *"event or circumstances giving rise to the claim"* could arise either when it was clear there will be a delay (a prospective delay) or when the delay had been at least started to be incurred (a retrospective delay). This led to a more generous time scale for the Contractor to notify the delay.

14 Paragraph 270 of the Judgment.

15 Similar condition precedent language is also found in NEC 3 contracts.

16 Save that under Silver, notice is given to the Employer as there is no Engineer (unlike under Red and Yellow Books).

17 Gold Book, Clause 1.3

However and importantly, this runs counter to the requirement in Clause 20.1 for the Contractor to give notice within 28 days after it *"became aware, or should have become aware, of the event or circumstance"*. If the Contractor ought to know that completion *"will be delayed"* by some event, then Clause 20.1 says it should notify within 28 days and if it fails to do so, it forfeits its right to an extension of time. However, according to the logic applied by Mr Justice Akenhead in *Obrascon*, the Contractor has the option of postponing notification until such time as the effect of the delay *"is"* occurring. Whilst it should be recognised that Clause 8.4 deals with matters of entitlement whereas Clause 20.1 is concerned with the requirement to give a notice of any claim, Clause 8.4 nevertheless refers to such entitlement being *"subject to Sub-Clause 20.1"* which indicates that the claim notification requirements under Clause 20.1 are intended to prevail. Thus, the Judge's finding as to the operation of Clause 8.4 of the FIDIC Yellow Book (which is identical in the Red and Siler Books) may be regarded as controversial. All that said, the Judge's reasoning is hard to fault. As he pointed out:

"The wording in Clause 8.4 is not: 'is or will be delayed <u>whichever is the earliest</u>'" (my emphasis).

Of course, *Obrascon* is a decision of the English High Court, decided under English law and therefore applies English common law principles. It may not necessarily be followed in other jurisdictions.

In any event, applying these requirements in relation to the weather delay claim, even though as a matter of fact the Judge found that six days delay was caused by the impact of rainfall, the Judge also found that the notice relied upon by the Contractor did not in fact describe *"the event or circumstance giving rise to the claim"* but referred to a future effect of rainfall on the contaminated material on site, rather than the effect of the rain as it fell. Harsh as it may seem, this notice was found not to comply with the requirements of Clause 20.1 and the weather delay claim therefore failed.

Termination

The *Obrascon* contract (following the standard FIDIC text) said it could be terminated for failure by the contractor to comply with a notice requiring it to remedy a failure to carry out *"any obligation"* under the contract. But what if an unremedied breach is trivial? Does the termination option still apply?

The court noted that *"Hudson's Building and Engineering Contracts"* (12th Edition) had correctly stated that determination clauses such as the one in question will generally be construed as permitting termination for significant or substantial breaches, as opposed to trivial, insignificant or insubstantial ones. That accorded with commercial common sense. The parties could not sensibly have thought (objectively) that a trivial contractual failure could lead to contractual termination. One day's culpable delay on a 730 day contract or $1m^2$ of defective paintwork out of $10{,}000m^2$ good paintwork would not, for reasonable and sensible commercial people, justify termination, even if the contractor did not comply with a notice to remedy. On the other hand, the breach did not have to be repudiatory. What is trivial and what is significant or serious will depend on the facts.

This issue is likely to be relevant for Contractors engaged under FIDIC forms of contract. It is also likely to be relevant where Contractors are engaged on terms where the contract provides for specific remedies, for breach say of an obligation to comply with the specification and with a termination right applicable after a long-stop date, as may be encountered under many bespoke EPC contracts. This case is consistent with other judicial guidance to the effect that the remedy has to be proportionate to the damage.

Some concluding remarks on the impact of *Obrascon*

The default position for dispute resolution under FIDIC contract forms calls for arbitration as the ultimate forum for dispute resolution. As FIDIC is often used on overseas projects between parties of different nationalities, international arbitration is also seen as preferable to litigating disputes in the local courts, avoiding issues as to quality of the local tribunal as well as issue of enforceability.[18] It is therefore unsurprising that there are not many publicly decided cases on FIDIC forms of contract. The *Obrascon* case merits a read if only for this reason alone.

However, *Obrascon* is also of interest because it illustrates the practical application of the foreseeability test. This is likely to impact in cases where it is considered the contractor has not taken proper care during tender stage to evaluate site risks and build these into his design, working methodologies, programme and pricing. Where the terms of the Contract allocate such risks to the Contractor, up to the extent of reasonable foreseeability, it is perhaps an obvious point (albeit one seemingly ignored by the contractor in this case) that some careful thought needs to be given to identifying and pricing site risk. In the words of the Judge in the *Obrascon* case: *"It is difficult to avoid the conclusion that OHL knew that there was going to be some contamination but hoped to avoid having to do anything about it"*.[19] If ever there was a salutary warning for contractors, this is it.

The judgment in *Obrascon* also emphasises that under English law, non-compliance with Clause 20.1 notice requirements in the FIDIC suite of contracts precludes a Contractor from pursuing what might otherwise be a valid claim.[20] This may encourage closer adherence to such provisions in jurisdictions where Clause 20.1 may be regarded as having a similar effect.

Finally, *Obrascon* provides a new (and potentially controversial) approach as regards the notification of Contractors' claims for an extension of the Time for Completion under the FIDIC suite of contracts. Whilst Clause 20.1 states that notice of any such claim should be given within 28 days of the date when the Contractor becomes aware, or should have become aware of the event giving rise to the right to claim, Clause 8.4 only requires notice from the date when the effect of the delay is actually experienced, which could be later than the time limit contemplated by Clause 20.1. As the extension of time claims of Contractors often entail substantial sums of money, this point is of more than mere academic interest.

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18 If the host states of the contracting parties have ratified the 1958 New York Convention on the Recognition and Enforcement of Arbitral Awards, the award should be enforced through the local court.

19 Paragraph 55 of the Judgment

20 FIDIC Gold Book moderates this draconian impact by conferring upon the DAB jurisdiction to overrule the 28 day limit where it finds that the reason for late notification was "fair and reasonable".

Main legal issues regarding financing of mining projects in Eritrea

The mining potential of the small eastern African country, Eritrea, is unexploited. In 2009, the Eritrean government granted eight new exploration licences to foreign mining companies. Mining in Eritrea has attracted the interest of more than 14 mining and exploration firms from Australia, Bermuda, Canada, China, Libya, the United Arab Emirates and the UK. The Bisha Mine (a unique gold, copper and zinc mine) in Eritrea is Eritrea's flagship project and is being run by Canada's Nevsun Resources Ltd with a forty percent stake held by the Government of Eritrea.

Obtaining a licence to mine in Eritrea is a valuable asset and a way to benefit from the untapped mineral resources of Eritrea. However, to ensure that the project is bankable and to organise project financing for a mining deal in Eritrea there are a number of issues that need to be kept in mind. We discuss below some of the main issues that arise in relation to project financed mining deals in Eritrea.

1. Legal system

The State of Eritrea currently has transitional laws that were established when Eritrea obtained independence from Ethiopia in 1993. The laws in Eritrea are based on civil law systems. The Constitution of Eritrea will take effect once the parliamentary and presidential elections are held in Eritrea despite being ratified in 1997. The legal system is slowly developing in Eritrea, but only incrementally, and the lack of clarity on the nature of the laws and their interpretation, and the fact that there are no precedents to rely on means there is uncertainty as to the legal system. Moreover, unfortunately, the political situation in Eritrea adds to this uncertainty.

As is prevalent in other emerging markets, the only way to deal with this legal system risk is by taking the benefit of political risk insurance to guard against the precipitous act of a local government or related body.

2. Mining Rights

The legal framework which governs mining and related activities in Eritrea is set out in the Minerals Proclamation 68/1995 as amended by Mineral Proclamation 165/2011, Mining Income Tax Proclamation 69/1995 and Regulations on Mining Operations Legal Notice 19/1995. Once granted, the mining licence will entitle the person to whom the grant is made to mine Eritrea. The types of licence available are a prospecting licence (valid for 1 year and non-renewable), an exploration licence (valid for an initial 3 years, but may be renewed twice for terms of 1 year and with further renewals possible in certain circumstances) and a mining licence (valid for a period of 20 years with optional 10 year renewals). The mining licence is usually a small document containing the details of the area where mining is to be carried out and all the terms and conditions of the licence are provided in a separate mining agreement. The mining licence grants a usufruct right to use the mining land area to the mining company.

The Government of Eritrea has the right to acquire a participating interest of up to 10% in any mining investment. Proclamation 165/2011, which authorises the Eritrean Government to "acquire, without cost to itself, a participation interest of up to 10 percent of any mining investment". The amendment further permits the Government, "equity participation not exceeding a total of 40 percent, [including the aforementioned 10%] the percentage, timing, financing, resulting rights and obligations and other details of which shall be specified by agreement." As previously stated, Proclamation 165/2011 amends Proclamation 68/1995, which only allowed the Government 30% equity participation, including a 10% or less participation interest. It is understood that in previous agreements, the Government of Eritrea, after acquiring the 40% under Proclamation 165/2011, has contributed to one third of the development and capital costs of mining operations.

Moreover, under the Regulation of Mining Operations (Legal Notice 19/1995), the holder of a mining licence shall pay the Eritrean government a royalty pursuant to Article 34(1) of Proclamation 19/1995. The royalties amount to 5% in relation to precious minerals, 3.5% for metallic and non-metallic materials including construction materials and 2% in respect of geothermal deposits and mineral water.

Usually, no separate grant of land use rights apart from the mining licence is provided to the mining company. However, such a document becomes important for the purposes of creating security by way of mortgage in favour of the lenders - one of the important parts of the security package of the lenders is usually a mortgage over the immovable property of the mine in favour of the lenders. Moreover, there is no registry or other forum currently existing in Eritrea for the purpose of the registration of the mortgage.

3. Security Creation

According to Eritrean law, security by way of pledge of movable property and a mortgage over immovable property can be created. A key characteristic of a pledge is that it requires dispossession of the asset by the pledgor over which the pledge is being created. Such dispossession may be deemed in the case where instead of the asset being delivered, the document of title, without which the asset pledged cannot be disposed of has been delivered to the beneficiary of the pledge. In view of the security package of the lenders which would usually include all equipment, the project contracts, bank accounts, insurance policies etc, mining licence and the mining agreement – it would be next to practically impossible to deliver the originals documents for all these items to the lenders for the creation of pledge.

It is not clear (again due to lack of legal precedent) if security over future assets can be created in Eritrea. It is typical in a project finance transaction that the lenders take security over the assets acquired by a mining company during the course of the development of the project. In addition to the procedural issues of executing a new security agreement to cover future assets, this issue becomes more important as *ad valorem* stamp duty is paid each time a security agreement is executed in Eritrea (refer to point 9 below).

Another important point to note is that there is no law relating to trusts in Eritrea. This becomes particularly important for project finance transactions which generally involve a consortium of lenders. One usual way to deal with this issue in civil law jurisdictions is to have a parallel debt structure in the documentation. Unfortunately as this has not been done in Eritrea before, no one understands if such a structure would work in Eritrea and this would mean that security will have to be created in favour of all the lenders.

4. Enforcement of Security

Similar to most civil law jurisdictions, enforcement of security is not possible without going to a court of law which means that the enforcement process would be lengthy. In this regard, a view exists that once a default has occurred the parties could agree to enforce the security by direct transfer to a third party without going to a court of law. However, this is merely one interpretation of Civil Code in Eritrea as the same has not been put to test in Eritrea. Also, to add to the uncertainty, upon enforcement by a direct transfer the secured assets can be transferred to one of the lenders only and not to an agent of the lenders or a third party.

5. Enforcement of foreign judgements and foreign arbitral awards

The Civil Procedure Code provides that foreign judgements (subject to any international conventions) and foreign arbitral awards may not be enforced in Eritrea unless reciprocity is ensured (meaning that the execution of arbitral awards made in Eritrea is allowed in the country where the arbitral award is made).

Eritrea is not a party to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards. No such reciprocity exists and no foreign arbitral awards or foreign judgements may be enforced in Eritrea. This is one of the biggest concerns for international financiers lending to a mining project in a Eritrea.

6. Foreign currency

There is no express restriction under Eritrean law on an Eritrean entity opening an offshore account. The mining proclamation entitles a project company to open a bank account offshore and keep its foreign currency earnings overseas. In this regard, the mining proclamation provides that the holder of a mining licence producing exportable minerals may "retain abroad in an external account a portion of its foreign currency earnings as may be determined by directives to be issued by the Bank of Eritrea and pay from the retained earnings where foreign currency may not be readily available by the Bank of Eritrea for the following purposes (1) to import equipment necessary for mining operations, (2) for services, leases and licences to be paid for in foreign currency in accordance with agreements entered into, (3) for reimbursement for loans and debt services due legally to financial institutions outside Eritrea, (4) for compensation payable to foreign employees not permanently resident in Eritrea and (5) for such other activities with contribute to the process and enhancement of mining operations".

It appears that the law as regards determining the "portion" of foreign currency that may be retained abroad has not been finalised as yet as no directives of the Bank of Eritrea have been issued which determine this amount.

The mining agreement usually prescribes the amount that the mining company can retain offshore which consequently means that any amounts in addition to such limits would need to repatriated back to Eritrea. Such a provision generally provides the maximum amount that can be kept offshore is the next 3 months foreign currency payments of the project company.

Notwithstanding the condition in the mining proclamation providing that payment from retained earnings may be made only when foreign currency "may not be readily available by the Bank of Eritrea", it appears that money offshore can be used for payments for the permitted purposes as per the mining agreement at any time.

7. Export of Metals

A mining company can sell the mineral products offshore in long term sales contracts provided the Minister of Energy and Mines has approved such long term sales contracts. The Minister of Energy and Mines has the right to require the project company to sell all or a percentage of its production, other than mineral product already subject to long term or other contracts, to the State or an Eritrean person for the fair market value of the mineral product. Due to such a requirement, it is useful for the project company to ensure that it sells all its mineral products through long term sales contracts.

8. Insurance

While there is no specific law in Eritrea that requires an Eritrean company to insure with an Eritrean insurer, the mining agreement usually has a restriction that the local mining companies should be given an equal opportunity to provide insurance services before a company decides to place the insurance overseas. In any event, currently there is only one insurance company in Eritrea which is the National Insurance Corporation of Eritrea (NICE).

9. Tax issues

Income Tax –at a rate of 38% on taxable income in accordance with Proclamation 69/1995.

Stamp taxes – ad velorem stamp duty of 1% of the value is payable on security agreements in Eritrea, however, there is no clarity as to what constitutes "value" – i.e. whether it refers to the value of the property being secured or the amount of the debt secured under the document. This is an additional, uncertain cost issue for a project.

For a transfer of property or shares, stamp duty is payable at a rate of 4% on the estimated value of the property and the new members of a company pay stamp duty on the value of their invested share. Furthermore, the Inland Revenue Department has the right to determine the value (if the value agreed between the transferor of the property and the transferee is found to be unacceptable). This stamp duty would, therefore, be payable on a transfer of assets (including the mining licence) or of shares in the project company on an enforcement of security.

Withholding tax – there is a 10% withholding tax on payments of interest made by a resident Eritrean offshore. This has a significant affect on the overall economics of the project.

10. Direct Agreement of the lenders with the Government

As is usual in emerging markets the lenders want a direct relationship with the Government which has granted the mining concession to the mining company borrowing money from the lenders. Such a concept of direct arrangement with the lenders is alien to the Eritrean Government and to date it has been hesitant to enter into binding arrangements with lenders. The only way around this seems to be to keep the Government informed of the involvement of (and the benefit to the project and the Government of working with) the lenders to the project from the very beginning and hopefully with the conclusion of the project financing of the Bisha Mine the Government will become open and amenable to a working alliance with project lenders.

11. Signing process

Another important hurdle for doing a project finance transaction in Eritrea is the process of signing the financing documents. In today's virtual world, the majority of the closings happen on the internet with each party executing documents in counterparts. However, this process cannot be adopted for Eritrean deals. If the documents are completely executed outside of Eritrea, then for such documents to have effect in Eritrea they should be executed in the presence of the consular office of the Eritrean embassy in the country where the documents are executed. On the other hand, if documents are wholly or partially executed in Eritrea the requirement is that documents get executed before the High Court of Asmara for the documents to have effect in Eritrea.

Project financing has been extensively used in emerging markets to facilitate the development of mines and other natural resources and it seems that it could also be used for the development of mines in Eritrea. Though Eritrea is a difficult jurisdiction for project finance transactions, the example of Bisha mine and the keenness of the Eritrean Government to develop its country, seem to provide the promise of a positive future for project finance transactions in Eritrea. Needless to mention that these project finance transactions are challenging to work on from a legal perspective.

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