Guiding Principles for Durable Mining Agreements in Large Mining Projects

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In recent years ‘resource nationalism’ has topped or been prominent in the concerns of the international mining industry. The opposite side of the same coin has been host nations seeking larger and wider benefits from their mineral endowment. The consequence of host nation aspirations has been reviews of and revisions to statutory and contractual terms. Mining companies have responded by seeking to expand and make more visible their contributions to host nations while also stressing (and not infrequently protesting) that states reviewing existing laws, regulations or contractual terms creates unpalatable investment risk in an already inherently risky business. Can there be an approach and a legal framework that create durability of agreement by satisfying the needs and wants of investors and of host nations?

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1 For example, see Ernst & Young annual report, Business risks facing mining and metals 2013–2014, in which resource nationalism ranks third in the top ten greatest risks, having been number one in the prior two years and number eight even as far back as 2008.
The authors – who are both highly experienced in negotiating and implementing complex mining agreements (often in under-developed nations) – propose guiding principles for creating modern and durable mining agreements. The principles are particularly relevant for large composite projects2 to meet the new and evolving socio-economic and geopolitical realities of the 21st century, alongside meeting the abiding needs of very large, risky and long-term investments that are inherent to large mining projects.

The 2000s have seen dramatic changes in the global mining sector. Following decades of a long-term downward trend in the prices of metals and minerals, starting in 2004 prices rose very substantially in real terms and, despite some subsequent volatility and cyclicality, they have stayed high enough3 to create significant returns for the owners of existing mines. The principal driver of this has been Chinese and wider Asian demand for metals and minerals and the challenge, practically and economically, to develop new mine capacity to meet this new demand.

As well as its effects on markets, the Chinese and Asian development story has been an example to mineral-owning less-developed nations that transformative social and economic development can be achieved. Aspiration to that, coupled with a feeling that the owners of the financial and technical capital required for mining have been getting too great a share of the benefit of high commodity prices, has led host nations to review the terms and conditions under which existing mines operate, under which existing exploration and development projects are advancing and under which future activities will take place.4

Since the dawn of industrial mining the defining purpose, in general, of mineral legislation has been to provide a framework meeting the needs of investors and mineral consuming markets. That has meant providing security and stability for the miner. Benefits to host communities and populations have been incidental outcomes rather than core objectives. In essence, the benefits to those constituencies were based on localised jobs and additional tax income for the country – in the latter case with the assumption that this tax would implicitly benefit the population. In some cases, the benefits from

2 ‘Large composite projects’ refers to projects that involve mining facilities together with extensive infrastructure such as railways, roads and ports.
4 These occurrences are well explained and examples are given in Chapter 3 of David Humphreys’ 2012 paper Transatlantic Mining Corporations in the Age of Resource Nationalism, www.transatlanticacademy.org/publications/transatlantic-mining-corporations-age-resource-nationalism.
mining have been significant and durable – one can think of the shining examples of the contribution of mining to the nations of Australia, Botswana, Canada and Chile, but these are the positive examples.

Investors in mining enterprises are exposed to substantial technical, logistical, economic and political risks founded in vast immovable investments that typically take a long period to repay and to earn a required return. This is particularly the case for composite projects that require major investments in transport and port facilities – facilities that are often of interest and value beyond the mining enterprise and therefore attract requests for capacity that others may use. For investors to fund, or one way or another to underwrite such facilities, clarity and stability of investment terms as well as security is essential. That is entirely reasonable. It is also predictable that investment will be inhibited where such conditions do not exist.

In the modern context, the demand for metals and minerals was fairly predictable until the early 2000s. It was either stable or gently rising. Expansions or improvements in existing operations, and/or in the development of a few new operations with distinctive economic advantage, were sufficient to meet demand. The economics of the mining industry were, in general, challenging on investors, and the economic realities of the industry often gave little realistic hope or strength to mineral-owning nations to achieve much from their minerals. Thus, in the post-Cold-War years between 1990 and 2004, the developed-country mineral-consuming nations called the shots. For new opportunities to be explored and developed there had to be potentially significant competitive advantage over existing operations and they had to be in a jurisdiction offering stable terms competitive with those of other nations. It was in many respects ‘a buyers’ market’, that is an investors’ market, and thus the traditionally recommended form of mining agreement predominantly focused on the needs of investors.

However, since 2004, and progressively more so until recently, the balance has moved towards the host nation.5 As observed above, host nations have developed new aspirations based on what they have seen China and other successful emerging economies achieve. Many less-developed nations cannot aspire to a manufacturing-led transformation such as China’s, or a service-led transformation such as India’s, but they do have the natural resources the rest of the world requires. Governments and peoples of these countries believe their nations should see significant and sustained developmental benefits from the value of their vital natural resource inputs to the rest of the world’s economy and prosperity; and they have increased bargaining power to demand it.

5 Ibid Chapters 4 and 5.
Governments and peoples believe that the development and exploitation of their nation’s minerals should be undertaken in such a way as to result in broader development in their nation and that the mining enterprise should be shaped and subject to terms reflecting that. They seek resources-led transformation. There is a perception that the exploitation of natural resources is a one-time economic opportunity to catalyse wider development. This induces expectations for the contribution of mining projects to economic development and the satisfaction of current national constituencies and of future generations.

The aspirations of mineral-owning nations, and especially the legislative, fiscal and agreement reviews and changes that have in varying ways flowed from these aspirations, have been broadly described by the mining industry and many associated with it as ‘resource nationalism’. Resource nationalism manifesting itself this way is discouraging to investment and is therefore negative both for investors and for mineral-owning nations. Using the principles the authors propose, this can change.

At the same time as the context within which the industry works has changed as described, the situation of the industry itself has changed in challenging ways. Particularly since the global financial crisis of 2008, the investing market has become dissatisfied with the large scale of many new capital investments in the mining industry and with the tenure risks it perceives accompanying many of those, the latter often stemming from resource nationalism. The consequence is that mining companies are looking for greater security even in a time when the socio-political context is challenging the traditional approaches to achieving that.

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6 Higher commodity prices have driven higher material and equipment costs for the mining industry constructing new projects; also, the level of demand for engineering and construction services has stretched capacity and inflated costs for these services. These inflation factors sit alongside the often massive scale of operations required to have competitive unit production costs against the large scale of established mines, for example, in iron ore, that were created in earlier eras on a smaller scale and have greatly expanded during their years of operation, thus driving down unit cost and increasing the minimum scale required to be competitive.

7 Prominent examples include: (i) in Mongolia changes to mining legislation in 2006 included the introduction of ‘deposits of strategic importance’, meaning that Mongolians (state or private companies or citizens) would own more than 51 per cent of the equity in projects identified as strategic deposits. Large confiscatory taxes (windfall profits tax) on gold and copper concentrate were also introduced. These imposed a 68 per cent tax on sales of copper and gold when priced above certain levels; (ii) in 2011, following a government review of contract terms in the Democratic Republic of Congo (DRC), Freeport McMoRan Copper & Gold Inc and Lundin Mining Corp agreed new, more costly, contract terms for the Tenke Fungurume mine, which had begun operation in 2009, and at the same time in DRC First Quantum had its licence for a large project revoked when it failed to reach agreement; (iii) in 2008 the government of Guinea revoked the northern half of Rio Tinto’s rights to the Simandou project; and (iv) plans by the government of Indonesia that foreign miners must sell 51 per cent of their assets to Indonesians after ten years of production.
Principles for a durable agreement form

Today, because of host country expectations and strength, it is not enough for a mining agreement to be designed only to attract and facilitate investment by providing clear and secure terms to satisfy investors. Host countries and other stakeholders expect more. To address the modern realities, the authors propose three core principles for a durable mining agreement. Such an agreement should:

• be founded in discussed and mutually agreed objectives of each party;
• define an economic balance within which the enterprise will operate and outside of which terms will be adjusted to return the enterprise to the agreed balance; and
• in the form of agreement, draw on the scheme of modern public-private-partnership (PPP) agreements.

The concept is not to suggest that the miner is a country developer or that its investment should be less certain – absolutely not. The aspiration of host countries to country development and an equitable economic balance is, however, the context of the miner’s enterprise, and it is increasingly the lens through which many and various interested parties will judge the miner’s performance and, indeed, its legitimacy. The authors’ goal is increased performance and reduced risk for all.

In 2011, the IBA produced a Model Mine Development Agreement (MMDA 1.0)\(^8\) with the goal of creating more durable agreements that would avoid the mining agreement renegotiations that have occurred in some jurisdictions in recent years. These reviews and renegotiations have been driven by host country dissatisfaction with the economic balance set by terms agreed under very different socio-economic and geopolitical circumstances of past years, often quite distant past years – the 1960s through to the 1990s. MMDA 1.0 drew on many existing successful mining agreement examples – it is in fact really a compendium of possible terms rather than a model agreement. Many of those terms are useful examples providing security and predictability to the miner in some specific areas and a commitment on the part of the miner to the state in respect of certain protective social and environmental aspects. MMDA 1.0 very much represents a traditional mining agreement approach as favoured by the industry’s traditional investors.

This traditional approach, however, while having some merits, does not reflect the modern socio-political and geopolitical context. That context is continually evolving amidst the changing global economic balance.

\(^8\) See www.ibanet.org/Article/Detail.aspx?ArticleUid=41f1038e-dcbf-44fd-ad17-898b7aa04a1a.
The traditional approach enshrines the essence of the agreement and its purpose in detailed clauses, which seek to cast in stone terms relating to future decades of operation, while those clauses are founded in the context of the time they are agreed; or indeed, if we look to past precedents, to the profoundly different socio-economic and geopolitical context of past decades. Consequently, this traditional approach seeks to create an agreement that will not, in reality, provide stability and resilience in the long term. In other words, it will not yield a durable agreement.

What is needed is an approach that balances investor concerns with modern and evolving socio-economic and socio-political dynamics while avoiding the hazards of too loose or too constraining an agreement. A key goal is to create an agreement that minimises the possibility of disruptive future renegotiations that are costly for all concerned. The goal is an agreement that will be stable and predictable in the long term.

The principles the authors propose draw on proven and robust concepts from other sectors (especially public-private infrastructure) and which, in some substance, actually reflect what has been occurring in the international mining sector in recent times in respect of large composite projects.

To create modern and durable mining agreements, a sound principle is first to put aside consideration of pure legal mechanics. Instead, the parties should start with a detailed setting down of the mutually agreed objectives of each for the enterprise and for the agreement, based on a joint evaluation and understanding of those. The subsequent detailed mechanics of the agreement will be based on those. The objectives will head the agreement and be an enduring reference in the future conduct and equilibrium of it.

The agreement should also draw on existing and/or emerging local law as well as relevant international mining sector precedents (and useful precedents from other sectors such as infrastructure and energy). A key proviso is that local law is particularly important in civil law jurisdictions, in which it is not possible for the parties contractually to agree terms if those terms are either inconsistent with or not permissible under public order provision or deriving from authoritative laws or case laws.

More generally, it is in the interests of all parties for terms and conditions to be as much as possible the commonly prevailing terms and conditions as opposed to party- or sector-specific terms. The latter too often prove to be controversial with a range of stakeholders and therefore ultimately precarious and/or reputationally awkward.

For a mining agreement to be durable it must be seen to be fulfilling the objectives of both parties (and, as noted, must correspond with the legal system of the country rather than simply past well-tested norms of the industry – the latter of which tend to have a strong foundation in English
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speaking, common law jurisdictions\(^9\)). One of those parties is a nation state with many-layered objectives that cannot be described only in terms of jobs created, tax revenues and GDP contribution. Host nations are seeking more complex outcomes and engagement with various layers of the state.

In essence, to be durable the mining agreement should be conceived to be at its heart a ‘goals-based’ agreement with terms that support those goals rather than purely a ‘terms-based’ agreement.

To achieve this more durable character of mining agreement, a valuable model is the construct of modern PPP agreements used to grant long concessions for public infrastructure. Those agreements, for long-term investments in public infrastructure, provide for the investors to make a required return over decades under clear and equitable principles. These render the venture to be sustainably acceptable to a wide public in the long term. They are in essence an agreed consensus at the outset on the enduring economic and financial parameters for the project, based on an agreed and transparent business case. This ensures that the core objectives and fundamental terms remain satisfied during the life of the enterprise.

Typically, a successful PPP agreement of this nature will set out at the beginning the objectives and the fundamental rights and the obligations of both parties, including key economic standards and ratios. This is more than a ‘whereas’ clause, although the precision of such a clause can be a valuable construct alongside the PPP concept. The goal is to provide an objective statement of the purpose of the agreement – indeed, of the whole enterprise the agreement facilitates – such that the legal mechanics of the agreement terms can be created and implemented from the substance of the objectives. Occasionally in future years, in the face of fundamentally changed external circumstances and based on quite simple and well-tested mechanics embedded in the agreement, detailed terms can be adjusted to reflect the founding objectives of the parties and thus re-establish overall contractual equilibrium in line with the objectives. In this way the agreement is durable and subject to lower risks than in a more traditional agreement constrained by its detailed clauses defined at one point in time.

While the PPP concept may sound like a radical step for a mine development agreement, it is in fact what is implicitly being created in the substance of contemporary (re)negotiations of mining agreements and certainly what hosts nations are seeking. Yet at present, by being an implicit rather than an explicit creation, it is being badly understood and shaped, and thereby causes conflict, stress and delay rather than creating positive and timely progress. The latter would be good for all. Those (re)negotiations could be more efficient and effective if the partnership essence were made

\(^9\) See n 5 above, Chapter 1.
explicit, at least in the form if not the name of the agreement. The authors are not yet suggesting mining agreements be replaced by PPP agreements, but rather that a modern mining agreement could valuably draw on certain best practice PPP concepts and models.

Conceptually, the relationship can be reconceptualised from a mining agreement granting rights to the miner, to a collaboration agreement, akin to a collaborative joint venture, in which each party is bringing different things to fulfil mutually agreed and understood objectives: the objectives of both parties. In return, this triggers concepts that are easy to translate into enforceable clauses or regulations – such as hardship, right to economic equity, special rights of the state when public interest is at stake, special rights of the private investor when sovereign rights are triggered, guarantee of fair and efficient compensation, limitation of speculative profits balanced by various guarantees to make reasonable profit over the life of the venture, simplification of the permitting process, clarification of the tax and customs situation, clear procedures for land use, transparency of the accounts, etc.

Mining inherently involves very large, risky and long-term investments. Consequently, simplicity, clarity and certainty of the key investment terms are essential for dealing smoothly with significantly changed external conditions, and without complex renegotiations. Those who invest money and skills in mine development very reasonably expect and require that clarity and certainty. On the other side of this, the host nation is in a strong position to require that its people will receive equitable benefits from the exploitation of its resources throughout the life of the venture. Those equitable benefits include a perception of developmental transformation in the country. Both of these perspectives are especially important when today’s new mine developments can be huge\(^{10}\) – the product of the scale economies and achievements of the sector in the past few decades. In reality, especially for large composite mining projects involving new infrastructure in poorly developed regions, the enterprise is best conceived as one of partnership and shared benefit.

For the mining agreement to be an enduring agreement that will not be subject to fundamental review and renegotiation over years and potentially decades of existence, it needs to create a framework of understanding and process that can accommodate and respond in a secure manner to potentially significant changes in circumstances, while at the same time enforcing rights and obligations. The beauty of this approach is that it has been tested and implemented in practice via PPP agreements with reasonable success in the last two decades.

Conclusions

The approach proposed for durable mining agreements for large mining projects is to create agreements whose terms are founded in and shaped by mutually agreed objectives that head and form part of the agreement. With these, in a world of significantly evolving economic, socio-economic and geopolitical balance, specific agreement terms may occasionally be adjusted to reflect changed conditions, yet always within the framework of the founding objectives and parameters – which include key economic standards and ratios – providing easy reference for dealing with changes. In this way the agreements can be more durable than the traditional form of mining agreement, whose balance was set by detailed specific clauses and where those clauses reflected conditions of the day or of earlier periods.

An unerring fact is that the miner needs security and predictability including reasonable expectations of profits in relation to the risk taken. Today alongside that, and increasingly so, society is seeking to have its needs met when the miner is granted rights. Civil and political society has many sources of empowerment to achieve their wants, be that, for example, the sovereign power of governments to impose their will, coupled with the bargaining power they have in a competitive world for mineral resources, or the support of external agencies and pressure groups prepared to emphasise inequities they perceive in the balance of power and benefit that existed up until recent years.

The increased wants and empowerment of society reflect exactly the changing environment in which it is wise to think of a different concept of a mining agreement; not to seek a ‘best-worded’ and ‘comprehensive’ grant of rights, with accompanying corporate social responsibility (CSR) obligations, but instead to create collaboration for mutually agreed purposes, of shared value: on one side a purpose and right to make money, on the other side a purpose and right to an equitable economic balance and to achieve developmental outcomes (the authors prefer ‘developmental outcomes’ to ‘economic development’ as the latter can be too narrowly defined in GDP terms). Both parties will have rights in the compromise that allow them to achieve their respective goals and will have obligations to the other to flex the compromise to circumstances such that the goals of each can be equitably sustained.

In effect the mining agreement becomes at its heart a ‘goals-based’ agreement with terms that support those goals rather than purely a ‘terms-based’ agreement. Under a goals-based agreement, the terms may be adjusted from time to time to maintain a mutually acceptable equilibrium. This is very much like a modern best-practice PPP agreement. It is therefore a tested and safe concept.

11 See n 5 above, Chapter 5.
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