

RAISING MINING DEBT CAPITAL

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This is a general overview of the subject matter and should not be relied on as legal advice. For specific legal advice on the topic and related matters, please contact the author or any member of Fasken Martineau DuMoulin LLP’s Global Mining Group or Banking & Finance Group.

***With assistance from Daye Kaba, Jon Holmstrom and Thomas Wexler of Fasken Martineau DuMoulin LLP.**

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Debt financing is prevalent in the mining industry. Some of the reasons for using debt include its cost as opposed to cost of equity, potential tax advantages (including the deductibility of interest) and avoiding share dilution. Debt is also used to increase the return from mining projects and to facilitate risk diversity, which may allow a mining company to undertake multiple projects while minimizing harm to the company as a whole in the event of the failure of one project.

This paper will briefly consider the following topics relating to raising debt capital in the mining industry:

- (a) types of debt capital;
- (b) mining project finance risks from a lender's perspective;
- (c) mining project finance issues from a borrower's perspective;
- (d) some key items in mining project finance loan documentation; and
- (e) mining project finance security considerations.

Given the breadth of these topics, this paper can only highlight certain key aspects of them and is not intended to be an exhaustive review of the issues. This is a general overview of the subject matter and should not be relied on as legal advice.

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1. TYPES OF DEBT CAPITAL

1.1 Corporate v. Project Financing

Corporate debt financing in the mining industry consists of typical debt financing arrangements where a lender lends the money to a borrower on the basis of the borrower's overall balance sheet and creditworthiness.

Project financing refers to debt financing that is non recourse or limited recourse to sponsors where lenders extend the loan on the basis of the projected revenues from the operation of a project and rely on the assets of the project as collateral for the financing. Completely non-recourse financings are extremely rare and it is much more common to see limited recourse financings where there is recourse to the sponsors until at least completion of the project. Because of the capital intensive and risky nature of the mining industry, project finance is commonly used as a method of financing mining projects. Project financing is a form of debt financing available to junior mining companies that do not have strong balance sheets, as well as intermediate and senior mining companies that want to carry out projects with limited or defined corporate risk.

The balance of this paper will focus on various issues related to mining project financing.

1.2 Project Finance in the Mining Industry

Project finance in the mining industry may involve the following debt financing arrangements, or various combinations:

- (a) **Senior debt:** a class of debt that has priority with respect to the payment of interest and principal over subordinated debt and over all classes of equity. Senior debt can be secured or unsecured.
- (b) **Mezzanine debt:** secured or unsecured high yield subordinated debt that represents a claim over a company's assets that is subordinate to senior debt and may rank prior or subordinate to other classes of subordinated debt, but has priority with respect to the payment of interest and principal over all classes of

equity. Because the mezzanine debt is subordinated to the senior debt and possibly unsecured, it commands a higher interest rate than senior debt.

- (c) **Second lien debt:** debt that is subordinate to the rights of other, more senior debt issued against the same collateral, or a portion of the same collateral. If a borrower defaults, second lien debt stands behind higher lien debt in terms of rights to collect proceeds from the collateral.
- (d) **Convertible debt:** debt that is exchangeable for a specified number of common shares at a predetermined price, usually at the option of the holder. The investor in convertible debt usually wants to achieve a minimum assured rate of return with an “equity kicker”. From the issuer's perspective the attractiveness of issuing convertible debt is that it results in greater marketability and a lower interest rate. In addition, if the convertible debt is ultimately converted because the stock has fared well, the issuer will have received an interest deduction for equity. Convertible debt issued to the public is usually unsecured and senior lenders regard it as near-equity.
- (e) **Non Convertible debt:** the issuance of units comprising non-convertible unsecured notes by mining companies is increasing but not yet common. These debt securities are issued by way of private placement or public offerings. Although there is no requirement to include common shares or warrants as part of issuing the notes, investors often request such “sweeteners”.
- (f) **Bridge financing:** temporary method of financing used by a borrower before longer term arrangements are able to be established. Bridge financing may require various levels of security and may also require a commitment from a long term senior lender to repay the bridge financing or a “firm” underwriting commitment for an equity issue.
- (g) **Line of credit/standby credit facilities:** may be obtained and repaid on a regular basis during the life of the project.

1.3 Project Financing Sources

Project financing sources include banks and non-bank financial institutions such as pension funds or insurance companies, hedge funds and private equity fund. On larger projects often a syndicate of banks is required and one or more banks are mandated as lead arrangers for the financing. A syndicate is usually required for larger projects because banks have country, industry and customer concentration limits they can not exceed individually. The use of a syndicate spreads the lending risks among a number of lenders and makes financing available that otherwise could not be provided by only one lender. In addition, there are good business reasons for the lead lenders and sponsors to involve a syndicate of lenders.

If the project is in a developing country multilateral development banks or international financial institutions (IFIs) and export credit agencies may be involved. IFIs include the World Bank, African Development Bank, European Bank for Reconstruction and Development, Asian Development Bank, Inter-American Development Bank and Caribbean Development Bank. IFIs provide financial support in the form of loans and guarantees to governments and the private sector in developing countries for projects that promote the economic, social and political development of these countries. Export credit agencies such as the Canadian Export Development Corporation provide trade finance and risk management services to exporters and investors.

Depending on the location of the project, it may be essential to involve IFIs and export credit agencies in the project financing in order to attract commercial lenders because of the “political risk insurance” they provide. The involvement of IFIs and export credit agencies can potentially increase the complexity of the negotiations and documentation for the project financing due to the nature of IFIs and export credit agencies and the multiple objectives that may be pursued.

2. MINING PROJECT FINANCE RISKS – THE LENDER’S PERSPECTIVE

2.1 What are Lenders Looking For?

Lenders are the last to commit their funds to a project but often provide more than half of the overall project costs (the balance of the funds are typically sourced by the sponsor through equity capital). While lenders take a near-equity approach to their project finance loans, their primary

objective is to ensure that the loan principal is repaid with interest. Lenders will not provide project financing unless the Lenders are reasonably confident on that the project will generate sufficient income to repay principal and interest on their loans with an appropriate cushion for contingencies. It is the assurance of this income together with control over the project and security over all of the project assets that allow lenders to make their project finance loans.

Some critical matters that lenders look for in project financings include, but are not limited to: (a) a bankable project and bankable feasibility study, (b) a special purpose vehicle structure, (c) the life of mine plan, financial model and development plan, (d) hedging arrangements, (e) due diligence, including title to the project, sponsor reputation and management team, (f) equity contribution and contingent support, (g) insurance coverage, (h) completion test, and (i) comprehensive security. This is not an exhaustive list of critical matters but is intended to highlight some of the matters that are considered by lenders. The matters listed in items (a) through (e) are discussed below in this section 2 and the matters listed in items (f) to (i) are discussed in other sections of this paper.

2.2 Bankable Projects and Bankable Feasibility Studies

Is the project “bankable”? The word “bankable” is often used in the context of mining project financings but it is not defined or may not be used in a consistent manner. For example, definitive feasibility studies and material project contracts are sometimes referred to as bankable. Structures that allow projects to be funded by bank debt are also called bankable. A general description of the term might be a project that is in a form and has the content that lenders view as suitable for financing and conforms to mining market practice. Whether or not a project is bankable is a fluid and subjective concept but one that is generally understood by mining project financing participants.

The completion of a bankable feasibility study is crucial for any mining project financing. Canadian securities laws define a feasibility study as a comprehensive study of a mineral deposit in which all geological, engineering, legal, operating, economic, social, environmental and other relevant factors are considered in sufficient detail that it could reasonably serve as the basis for a final decision by a financial institution to finance the development of the deposit for mineral

production. The lenders will require that they have their own technical engineer or consultant appointed who will, among other things, review and report on the feasibility study.

2.3 Special Purpose Vehicle Structure

Another key component of a bankable project is that the project should be owned by a special purpose vehicle (SPV) that does not own any other assets other than the project and project related assets. SPVs vary in form and what form should be used will ultimately depend on the type of project. SPVs can include, among others, unincorporated joint ventures, general partnerships, limited partnerships and incorporated companies. Each form of SPV has benefits and drawbacks. Incorporated companies are often used in mining project finance structures because (a) they have separate and distinct legal personalities which enables the SPV to borrow in its own name, own its assets and grant security interests over its assets, (b) shareholders have limited liability which generally means that sponsors who participate in the equity of the SPV have their liability limited, and (c) they exist in perpetuity which is important for long term projects.

A SPV structure is beneficial from both the lenders' and sponsor's/borrower's perspective. Lenders require this in the event that the project encounters difficulty which leads to financial problems. The lenders want to be in a position to exercise their remedies, including possibly restructuring the original financing without interference from other creditors who may rank equally with the lenders. If other assets are owned by the borrower, the lenders will usually insist that security be granted over those assets as well, or that the lenders' consent to release non-project related assets from the security structure. Lenders are often reluctant to release such assets from their security package prior to completion of the project or in situations where the project is not meeting expectations. In addition, if any other financing has been provided to the borrower, appropriate intercreditor or subordination agreements will have to be negotiated and settled.

Another potential advantage of the corporate SPV structure is that post-closing the SPV borrower may be a bankruptcy remote entity that will not be adversely affected if the parent sponsor company becomes insolvent. In addition to separate legal personality, other steps may

be taken in an effort to ward off substantive consolidations in an insolvency filing of an insolvent parent group.

From the sponsor's perspective, the sponsor typically wants to insulate itself from liability for the loan repayment and also wants to be released from its guarantee and covenants after completion of the project in order to pursue other business opportunities. By establishing a SPV which only holds the project, the lenders are able to loan the funds directly to the SPV borrower which will be liable for the repayment of the loan. Since the lenders will not have recourse or only limited recourse to the sponsor for the loan repayment, the project finance is referred to as being or "non-recourse" or, if there is some form of recourse such as a sponsor guarantee, "limited recourse".

2.4 Life of Mine Plan, Financial Model and Development Plan

The lenders will require the borrower to prepare a life of mine plan, financial model and development plan. The life of mine plan and financial model are discussed below in section 3.

2.5 Hedging Arrangements

The lenders will require the borrower to establish a hedging program and enter into hedging arrangements with the lenders. This is done to provide protection from changes in currency, interest rates and metal prices. Lenders expect to obtain this ancillary business as part of the project financing mandate. It would not be unusual for lenders to require the borrower to hedge at least 50% of the projected production.

2.6 Due Diligence, Sponsor Reputation and Management Team

In project financings, after completion occurs lenders generally have recourse only to the project's assets in the event of a default. Accordingly, lenders must perform thorough due diligence of the project before committing funds. In this regard, the assistance of experienced lead legal counsel is essential. In addition, lenders must be comfortable with the reputation of the project sponsor and have a high level of confidence in the sponsor's and borrower's management teams.

3. MINING PROJECT FINANCE ISSUES – THE BORROWER’S PERSPECTIVE

3.1 Understanding the Mining Project Finance Process

Mining companies that have evolved to the stage where they require project financing are desirous of obtaining project financing on as favourable terms as possible in a cost and time efficient manner. However, many mining companies, especially junior mining companies, that are seeking project financing may be doing so for the first time and may not have experience with the rigours and intensiveness of the project financing process.

Frequently junior mining companies that are pursuing project financing for the first time have raised capital through private placements or public equity markets which for quite some time were relatively easy to tap into. Since they are familiar with equity financings and the relative speed with which they can be closed and the funds obtained, first time project finance borrowers may tend to base their expectations on equity financings experiences and not project financings. However, such a comparison may not be particularly helpful because of the fundamental differences between equity financings and project financings. In equity financings, generally speaking, investors are looking at the long term prospects of the company that holds the project (either directly or indirectly through a SPV subsidiary) and the investors will share in any upside that occurs due to the success of the project. Project finance lenders do not share in the project upside (unless they hold some form of equity securities or other ancillary business) and are loaning money they want to be repaid in full with interest.

3.2 Managing the Process

For project sponsors that are contemplating project finance for the first time, a lot of time, expense and frustration can be avoided by understanding the extent of and reasons for the lenders’ requirements, anticipating those requirements as far in advance as practical and structuring the project to meet those needs. Some of these requirements were discussed above in section 2 and some others are discussed below. Experienced financial and legal advisers can be retained to assist with some of these matters.

While the lenders will work with the project sponsor/borrower and convey their expectations, if the sponsor’s/borrower’s management does not have project finance experience or if they have

the experience but have determined it would be more effective to not manage the process in-house it may be beneficial for sponsors to retain financial advisers who have such expertise to provide financial advisory services for the project financing. Sponsors may engage financial advisers for either part or all of the project finance process. There are a variety of project finance consultants in the mining industry these days and these include individual consultants, financial advisory boutiques and banks that are active in the mining industry. Which type of financial consultant that is most appropriate for a project financing will depend, among other things, on the level of project finance experience that the sponsor's management team possesses and the time that they will be able or intend to devote to the project finance process. The scope of the responsibilities undertaken by financial advisers can vary considerably from discrete advice on the financial model to primary responsibility for all aspects of the project financing.

It is also essential that sponsors/borrowers retain experienced legal counsel who understand the project finance process. Experienced legal counsel can save time and money in project financings because they are able to assist the sponsor's with the preparations for the project financing, they understand the lenders requirements and can be proactive in identifying potential issues. In addition, they are familiar with the form and substance of the finance documents that will be prepared by the lenders' counsel which enables those documents to be settled efficiently and effectively.

3.3 Allocation and Mitigation of Risk in Project Financing

Central to any project financing is a myriad of agreements including, but not limited to, loan and security documents, off-take agreements, construction agreements, equipment agreements, operating agreements, maintenance agreements, and power purchase agreements. In a project financing all parties are expected to assume risks that are customarily allocated to appropriate project participants. For example, risk allocations may involve (a) reserve risk being borne by the lenders, (b) completion risk being borne by the sponsor through a completion guarantee, (c) construction risk being borne by the construction contractor, (d) insufficient mineral demand risk being borne by the off-taker, (e) permit and concession risk being borne by the mine operator, and (f) political risk, if applicable, being mitigated by sovereign guarantees, participation by IFIs and export credit agencies, or by private market political risk insurance.

3.4 Equity Contribution and Contingent Support

Lenders do not provide mining companies with 100% of the project's financing requirements and an equity contribution will be required by the project sponsor. The lenders will usually require the equity contribution to be invested in the project prior to the first drawdown under the loan agreement. A requirement that one-third of the total project cost be paid up by the sponsor before any bank financing is available would not be unusual. The borrower or sponsor will also be required to provide additional liquidity to fund possible construction cost overruns and commissioning delays. This contingent support may be provided by cash in a secured account, letter of credit or performance bonds. Furthermore, the lenders will usually require the sponsor to provide a guarantee of the borrower's obligations to the lenders. This guarantee may be released upon satisfaction of the completion test.

3.5 Life of Mine Plan

The borrower will be required to prepare a life of mine plan setting out the timing of construction, technical data related to the project, capital expenditures, expected ore and metal production levels, estimated cash and full costs of production and other expenses, including, but not limited to, discretionary expenditures approved by the lenders, management fees, royalties and taxes. The life of mine plan will reflect the project's ore reserve model and must be materially consistent with the feasibility study presented to the lenders during due diligence. The borrower will be required to notify the lenders of any material revisions to the life of mine plan and must obtain the lenders' consent prior to implementing such revisions.

3.6 Financial Model

The borrower will be required to develop a financial model to analyze the economics of the project and to calculate pro forma financial covenants. The financial model will be updated in accordance with the terms of the finance documents to reflect changes to the project's assumptions and recommendations arising from the due diligence review completed by the independent engineer appointed by the lenders. The initial financial model will be used to assess the project's performance relative to the financial covenants.

3.7 Governing Law of Primary Financing Documents

Sponsors should give consideration to what laws will govern the primary financing documents such as the loan agreement. The security documents will be governed by the laws where the relevant assets are located. Foreign banks will frequently have a preference and often this will be for English or New York law to be used in the loan agreement, particularly when the project is located outside of Canada. However, there is no significant legal reason why Ontario or British Columbia law could not be used in a loan agreement in situations where there is a Canadian sponsor and the project is located outside of Canada. The financial benefit to the sponsor is that costs will be reduced as there will be the elimination of one set of legal counsel for both the sponsor and the lenders.

4. SOME KEY ITEMS IN MINING PROJECT FINANCE LOAN DOCUMENTATION

The documentation process for a mining project financing will usually involve the negotiation, preparation of settling of the commitment documents (which typically consist of a commitment letter, term sheet and fee letter) and definitive finance documentation (consisting of the loan, security and closing documents) and then satisfaction of conditions precedent to financial closing and the initial advance.

The structure of the loan agreement for a mining project financing is generally similar to non mining project financing loan agreements and will include provisions relating to: (a) definitions and interpretation, (b) drawdowns of loans, (c) yield protection, (d) project accounts, (e) insurance, (f) conditions precedent, (g) representations and warranties, (h) covenants (affirmative, reporting, negative and financial), (i) events of default, (j) agents, and (k) miscellaneous matters. There will also be detailed schedules to the loan agreement.

Loan agreements that are used for mining project financings will incorporate additional provisions relating specifically to the mining project finance and some of these key items include, but are not limited to, the following:

- (a) ***Independent Engineer:*** An independent engineer will be appointed by the agent in consultation with the borrower for the purpose of conducting a technical due

diligence review of the borrower's feasibility study and financial model. Terms of reference for the independent engineer may include initial project due diligence, a review of project documents, monitoring of construction, ramp up of operations and confirming satisfaction of drawdown conditions and the completion test.

- (b) ***Project Accounts:*** The lenders will require that a number of bank accounts be established in connection with the project financing. Some of the common project accounts consist of an equity contribution account, proceeds account, operating account, debt service reserve account, casualty loss account, contingent support account and distributions account. The borrower will be required to grant security over all the accounts in favour of the lenders.

The sponsor's equity contributions will be deposited into an equity contribution account. All cash receipts of the borrower (including all amounts received from sale of output) will be deposited into a proceeds account. The borrower will also be required to maintain a debt service reserve account that will be funded from project cash flow and that always has a minimum cash balance representing the borrower's debt service obligations under the loan agreement estimated for a stipulated period of time (which may be a period of six months or longer). The debt service reserve account may not be required to be funded until the earlier of completion or the first scheduled principal repayment.

Transfers out of the accounts will only be permitted for certain purposes, such as for use for operations, repayment of principal and payment of interest, and in a stipulated order but only if certain conditions are satisfied. For example, the proceeds account provisions may state that disbursements from the proceeds account will only be permitted if there is no event of default or no potential event of default and they are made in the following order of priority:

- (i) project capital costs in accordance with the feasibility study, financial model and construction budget approved by the lenders;

- (ii) approved operating costs, other budgeted capital expenditures, hedging costs and government royalties and taxes;
 - (iii) interest and fees payable to the lenders under the finance documents;
 - (iv) principal repayments to the lenders under the finance documents;
 - (v) transfers to the debt service reserve account; and
 - (vi) voluntary prepayments or restricted payments/distributions.
- (c) **Insurance Requirements:** These will be very extensive and can take considerable time to settle and put in place depending on the location of the project. For projects that are located in certain jurisdictions the lenders may require the borrower to obtain political risk insurance which, if available, can be expensive to obtain. The lenders will require assignment of all insurance policies and the security agent being named as additional insured and loss payee.
- (d) **Conditions Precedent:** The obligations of the lenders to make the loans under the loan agreement will be subject to the satisfaction by the borrower of stipulated conditions to closing and receipt of specified documents, each which must be satisfactory to the facility agent and lenders. Conditions precedent in mining project finance loan agreements are extensive and may include, but are not limited to, the following: (i) authorizations and approvals, (ii) loan documents, (iii) security documents, (iv) independent technical consultant report, (v) financial model report, (vi) insurance consultant report, (vii) title to the project assets, (viii) project documents, (ix) no material litigation, (x) no material adverse change, (xi) no default, (xii) models and budgets, (xiii) fees and taxes, (xiv) environmental reports, (xv) accounts, (xvi) legal opinions, (xvii) insurance, (xviii) due diligence, (xix) hedging documents and program, and (xx) bring down certificate.
- (e) **Representations and Warranties:** These may include representations and warranties covering (i) authorizations for the project, (ii) mining claims,

(iii) feasibility study, (iv) life of mine plan, financial model and development plan, (v) project information, (vi) title to the project and project assets, and (vii) compliance with environmental laws.

(f) ***Affirmative Covenants:*** These may include covenants relating to (i) construction progress reports, (ii) environmental compliance, (iii) construction and acceptance of the project, and (iv) material project documents.

(g) ***Reporting Covenants:*** These may deal with budgets, the life of mine plan, the financial model and the development plan, including updates and changes to them.

(h) ***Negative Covenants:*** These will limit financial indebtedness, liens and payments. The restrictions on payments may prohibit any payments (other than permitted payments) being made prior to the later of completion and the first principal repayment. The payment restrictions may be relaxed after that time provided there is no event of default or prospective event of default, the debt service reserve account is fully funded, a stipulated debt service coverage ratio is met and there is a stipulated minimum balance in the proceeds account.

(i) ***Financial Covenants:*** These may include the following financial covenants relating to the project: (i) debt service coverage ratio, (ii) loan life coverage ratio, (iii) project life coverage ratio and (iv) reserve tail ratio. For illustrative purposes, simplified sample descriptions of these financial covenants are set out below:

(i) **Debt service coverage ratio:** means for any period, the ratio of cash flow available for debt service during such period to the interest and principal payments under the facility during such period.

(ii) **Loan life coverage ratio:** the ratio of the aggregate discounted cash flow available for debt service over the remaining life of the loans to the amounts outstanding under the facility.

- (iii) **Project life coverage ratio:** the ratio of project life discounted cash flow available for debt service to the amounts outstanding under the facility.
- (iv) **Reserve tail ratio:** means the ratio of the metal contained in ore reserves remaining to be mined at the scheduled maturity of the facility to the total metal contained in the life of mine ore reserves.

In addition, the project sponsor may be required to comply with a tangible net worth covenant prior to completion of the project.

- (j) **Events of Default:** These will include events of default relating to (i) failure to satisfy financial tests, (ii) breach of representations and warranties, (iii) breach of finance documents, (iv) failure to achieve completion by the stipulated completion date, (v) breach of material project documents, (vi) cancellation or repudiation of mining claims or authorizations, (vii) the occurrence of an expropriatory event by a governmental authority, and (viii) any abandonment of or unscheduled stoppage or disruption to mining/production for greater than a stipulated period of time.
- (k) **Completion Test:** This test typically cover technical aspects of the project such as the physical facilities, production tests (such as mining, milling, recovery, unit cost and concentrate quality tests), financial matters and legal compliance. The satisfaction of the completion test is signed off by the borrower, the independent engineer and the facility or administrative agent. While the test contains many technical and production elements it is crucial that they be drafted in clear language to avoid misunderstandings as to when the completion tests are satisfied. The satisfaction of the completion test may trigger a step down in interest rates, release of the project sponsor from its guarantee and other obligations and entitle the borrower to make certain permitted payments.
- (l) **Sponsor Requirements:** The sponsor will be subject to many of the same representations and warranties, and affirmative, reporting and negative covenants that apply to the borrower as well as certain financial covenants. As noted above,

the sponsor may be released from these obligations as well as its guarantee once the project is complete.

5. MINING PROJECT FINANCE SECURITY CONSIDERATIONS

Lenders require effective security over all of the assets that the borrower owns or may own in the future. This includes, but is not limited to, security over (a) real property, (b) deposits, (c) mine output, (d) mine licences, permits and concessions, (e) project contracts, (f) bank accounts (onshore and off-shore), (g) securities of subsidiaries, (h) shareholder and intercompany loans and (i) insurance proceeds. With such extensive security requirements, it is easy to see why it is preferable to use a SPV as the borrower which only owns the project and project related assets.

There are several areas where the lenders' need for a comprehensive security package may not be able to be realized. First, the civil codes in certain jurisdictions, many of which were enacted before the creation of mining project finance, do not necessarily provide for an effective security interest over every type of asset such as the common law concept of a floating charge or debenture (which extends a security interest over all of a borrower's assets regardless of type, location or time of creation or acquisition). Fortunately, many jurisdictions are revising their legal systems to facilitate the security taking process.

Second, certain countries' foreign investment legislation may prevent strategic assets – mineral deposits or land overlying those deposits – from being mortgaged in favour of foreign lenders, or owned by them following foreclosure. Lenders attempt to allay this problem by having an onshore entity hold the “restricted” assets in trust for offshore lenders.

Third, and sometimes the most consuming, is the issue of contractual rights and permits. In most circumstances, a borrower is required to assign to its lenders, by way of security, its rights in contracts, permits and other third-party claims. This affects only the assignment of the borrower's contractual rights and does not ensure performance by a counterparty to that contract. Without a direct contractual link with the counterparty, lenders can face difficult situations. For example, a borrower might default prior to completion of the project while the construction contractor is still on site and refuses to continue work without all payments being made current. Or, a borrower could default for operational reasons and the lenders may wish to sell the mine or

the mining company, yet find that the authority responsible for the mining concession refuses to allow a new owner to operate the asset.

To avoid these issues, lenders insist on direct contractual relationships with counterparties to key contracts and permits. Generally known as direct agreements, tri-partite agreements, consents or collateral warranties, these documents should, at minimum, provide for (a) consent to the security, (b) consent to the assignment to a purchaser, (c) appropriate grace periods, the counterparty to recognize the lenders' right to cure the borrower's default and substitution rights in the event of non-curable defaults such as borrower insolvency, and (d) for the counterparty to continue performing its obligations with a successor to the borrower. While direct agreements are negotiated between the counterparty and the lenders, the completion of these documents to the lenders' satisfaction is a condition precedent for drawdown and it is the borrower's responsibility to ensure that the agreements are obtained in a form that is satisfactory to the lenders.

Sponsors should anticipate the requirement to obtain a direct agreement and endeavour to obtain at the time of negotiation of the material contract an agreement to negotiate in good faith a mutually acceptable direct agreement with the lenders. If the direct agreement requirement is only raised during the negotiation of the financing documents, the form of the material contract may have already been settled and some cost may have to be incurred or concession made by the sponsor or borrower in order to obtain the third party's consent. Contractors operating on international mining projects are accustomed to negotiating direct agreements with lenders but less sophisticated counterparties often initially resist this requirement.

Lenders tend to take a realistic view as to what can be obtained and over what time frame. For example, many lenders will not insist on direct agreements with all contractual counterparties, especially for non-material contracts or where the counterparty's services are offered to any paying customer. In certain countries, concessions or licences granted to a mining company are considered a unique privilege for the original borrower and are not transferable even to a credit-worthy successor nominated by the lenders in a restructuring. At best, lenders may have to settle for comfort from the relevant authority agreeing to consider granting the mining rights to an acceptable successor.

6. SUMMARY CONCLUSION

This paper has highlighted certain key aspects regarding types of mining debt capital that are available, mining project finance risks from a lender's perspective, mining project finance issues from a borrower's perspective, some major items in mining project finance loan documentation and mining project finance security considerations. Each of these topics is extremely broad and there are many other issues that need to be considered but this paper is not intended to be an exhaustive review of all of the issues.

Due to the nature of the risks that lenders face in mining project financings the requirements to obtain project financing are considerable and the process is intensive. The mining finance process can proceed much more efficiently and effectively if borrowers understand the lenders' requirements and anticipate those requirements as far in advance as possible.