

Mothballing mines: pre-empting the issues

The significant drop in commodity prices throughout 2012, coupled with the substantial increase in mining costs in Australia, has rendered the operation of numerous mines economically unviable and caused many miners to seriously consider closing or "mothballing" operational mines.

While it may be hard to think about downturn in boom times, miners can significantly reduce their risk and exposure by establishing an appropriate regime to deal with downturn issues at the very start of their project.

The options available to miners to "mothball" a mine can range from winding down some or all of the operational functions at the mine and maintaining the mine on a care and maintenance basis with a view to ramping up production again in more favourable economic conditions, through to walking away from the mine and all of the related contracts.

Any decision to mothball an operational mine cannot be made solely on cash flow (or lack thereof) and future prospects, but includes numerous legal and political issues.

In addition to obvious costs such as redundancies and remediation costs, significant costs arise from terminating contracts, ranging from day-to-day mine operation contracts and take or pay contracts, through to sales contracts that require the delivery of minimum quantities of the resource to the purchaser.

The financing arrangements that underpin a miner's investment in a mine will also influence the manner in which a mine may be mothballed. And in certain circumstances, the financing arrangements may also

influence the continuing viability of a miner.

Even though the mine will be closed and environmental rehabilitation undertaken, unless the ground is to be surrendered, there will be ongoing obligations to monitor the closed mine's impact on the environment and otherwise comply with tenement conditions and environmental licences.

And lastly, where the mine is of significance to the State economy, the reaction of the relevant State government to the mothballing may cause additional issues.

Contract design: Ensuring appropriate "get out" mechanisms

Terminating contracts that underpin the operation of a mine can be an extremely costly exercise in circumstances where contractors or counterparties are not in default.

This is particularly so where the miner has not properly considered early termination options when they entered into the contract, and is exacerbated where the parties have

agreed that express good faith obligations will affect their contractual relationship.

Miners must turn their minds to the possibility of mine closure before entering into mine related contracts and insist on, amongst other things, the inclusion of early termination rights such as rights to terminate:

- where the mine is no longer economically viable; and
- for convenience.

Well-drafted termination rights will give assurance to the miner that, even in a worst case scenario, the costs of closing the mine have been considered and are appropriately accounted for, and will ensure that terminating the contracts and sub-contracts that regulate the operation of the mine will be a simple and cost-effective process, rather than one riddled with high legal costs and the potential for litigation.

In a worst case scenario, miners could be forced to mine at a loss for significant periods of time (and possibly for the whole life of mine) if that proves a cheaper option than closing the mine.

Preparing for worst case scenarios

Where financing arrangements underpin a miner's investment in a mine or a portfolio of mines, the mothball options for a secured mine will be influenced by the miner's view on the residual value of the economically unviable mine and its ability to manage its existing financing arrangements.

Miners that have the financial capacity to manage existing financial arrangements without contributions from the unviable mine have greater options available to them – including maintaining the mine on a care and maintenance basis.

However, miners that don't have the financial capacity to absorb the mothballing of the mine on a care and maintenance basis will need to consider their ability to restructure their financing arrangements or otherwise be forced to choose between selling the mine (with the consent of the lenders) or having the mine sold for them when the lenders put in a receiver.

The decision will often be determined by the miner's view on the residual value of the mine. In certain circumstances, it may make economic sense for a miner to simply walk away from the mine and hand the keys to the lenders (by way of initiating a liquidation or voluntary administration). In other circumstances, it may make economic sense to sell the mine and restructure any residual debt against the remaining assets of the company.

Where the miner is in financial distress, the directors need to be mindful of their duties under general law and as set out in the Corporations Act. If the miner is insolvent, or there is real risk of insolvency, the directors' duties expand to include creditors

(including employees with outstanding entitlements). The most relevant for the directors during this period is the duty to prevent insolvent trading. Accordingly, the directors need to be constantly aware of the miner's financial position and if concerned, should seek independent advice on their duties and options available to them.

Maintaining an open dialogue with government and stakeholders

Operating a mine involves obligations to comply with expenditure, environmental and other conditions attaching to the relevant tenements, as well as obtaining and maintaining a range of environmental permits, approvals and water licences.

For as long as the company wishes to keep the mine, albeit mothballed, and thus keep the relevant mining lease(s) on foot, there will be ongoing compliance obligations as well as obligations to ensure that any environmental impacts arising from the mothballed mine are managed appropriately and in accordance with the relevant environmental standards. Some regulators may also require preparation and approval of a formal care and maintenance plan that addresses such issues.

Depending on the nature of the mothballing and the mine itself, some environmental and water licences may be able to be relinquished.

Managing ongoing environmental obligations and the potential impacts will require communication with the relevant mines and environmental government departments, as well as discussions with the local communities affected by the closure of the mine.

Where a mine is of State significance, is a significant local employer, or where there are material obligations owed to local native title claimant groups, it will be beneficial to plan the communications strategy carefully and tailor it to the different audiences.

Native title claimants will want to understand the impact of the mine's closure on the flow of benefits to the local Aboriginal community, particularly where the relevant agreements do not expressly address a mothballing scenario.

Government and community stakeholders will be focused on alternative employment opportunities and the prospects for reopening the mine if economic conditions change.

Contacts

Sydney

Mark Pistilli

Partner

T: +61 2 8922 8001

E: mark.pistilli@cliffordchance.com

Jane Ann Gray

Special Counsel

T: +61 2 8922 8013

E: janeann.gray@cliffordchance.com

Amelia Horvath

Senior Associate

T: +61 2 8922 8023

E: amelia.horvath@cliffordchance.com

Daniel Collins

Senior Associate

T: + 61 2 8922 8043

E: daniel.collins@cliffordchance.com

Deniz Tas

Associate

T: +61 2 8922 8066

E: deniz.tas@cliffordchance.com

Perth

Michael Lishman

Partner

T: +61 8 9262 5502

E: michael.lishman@cliffordchance.com

Jon Carson

Partner

T: +61 8 9262 5510

E: jon.carson@cliffordchance.com

Justin Harris

Partner

T: +61 8 9262 5503

E: justin.harris@cliffordchance.com

Tracey Renshaw

Partner

T: +61 8 9262 5505

E: tracey.renshaw@cliffordchance.com

Paul Vinci

Partner

T: +61 8 9262 5504

E: paul.vinci@cliffordchance.com

Robyn Glindermann

Counsel

T: + 61 8 9262 5558

E: robyn.glindermann@cliffordchance.com

Sean Houthuysen

Senior Associate

T: +61 8 9262 5519

E: sean.houthuysen@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

HKG-1-992544-v1

www.cliffordchance.com

Clifford Chance, Level 16, No. 1 O'Connell Street, Sydney, NSW 2000, Australia

Clifford Chance, Level 7, 190 St Georges Terrace, Perth, WA 6000, Australia
© Clifford Chance 2013

Clifford Chance is a law firm with liability limited by a scheme approved under Professional Standards legislation

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh* ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Clifford Chance has a co-operation agreement with Al-Jadaan & Partners Law Firm in Riyadh.