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Mining terms: "Use-it-or-lose-it" provisions

by
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Many mining laws and agreements incorporate "use-it-or-lose-it" (or "working") provisions that require investors to begin production in a timely way —rather than sitting on deposits —and that they maintain a given level of production in the future. Useful in the past, these provisions take on even more importance with the rush for "critical minerals".

Governments have encountered investors who negotiated rights, for example, to gold deposits, only to do nothing, hoping that gold prices would someday increase. Other firms intended to sell their deals to larger mining firms—but failed to do so quickly. Vertically integrated companies have sought rights to deposits as an option, in case they someday need the minerals for their downstream facilities.

Recently, risks for host states have grown as firms and their home governments rush to control so-called "critical minerals".

Rivalry is particularly strong among the major automobile producing countries—mainly China, Germany, the United States, Japan—that are going electric. But battery technology is constantly changing. Lithium has been "hot" recently, but future technologies may rely on other minerals. The same uncertainty arises for wind power and consumer and defense electronics. Thus, projecting demand for a particular mineral is very uncertain. As a result, investors may try to tie up deposits that they may never develop, or which they eventually shut down with falling demand. There is some evidence that suppliers of uranium to nuclear power plants have recently sought deposits mainly as security in case the ones they already control are cut off. In these cases, a state may commit its resources for years to a firm that never commences production or ends production prematurely. Expected government revenue and jobs fail to materialize.

If the host government prefers income sooner rather than later, it needs to ensure that its minerals are not simply viewed as an option by investors. “Use-it-or-lose-it” provisions address this risk by enabling host countries to seek other investors should development not proceed or if production is severely cut back. States without such provisions become easy targets for the first cutbacks if agreements in other states include provisions under which investors lose their mining rights if production is scaled back.

There are five key components of working provisions:

- Insistence that commercial production begins in a timely way.
- Requirements that production be maintained at agreed levels.
- Procedures for notices and time to remedy failures.
- Penalties for not conforming to these requirements.
- Procedures for granting waivers for specified reasons.

These components are usually covered in different parts of a mining agreement or mining legislation, but some are frequently missing.

Early mining agreements called for land rent, but rents were rarely sufficiently high to deter investors from delay. A number of more recent agreements call for specified expenditures to be made by certain dates. However, defining relevant expenditures has proved difficult (e.g., should home-office overhead be included?) and monitoring expenditures is even more difficult.

In theory, a better approach might be to specify in mining agreements the date by which commercial production must begin and what volume must be maintained. However, since possible production levels are likely to be uncertain at the time of agreement, a more practical and more common approach has been to require that a detailed feasibility study and work plan be submitted by a certain date for approval and that the production plan in the study be adhered to.

The consequences of failure to satisfy use-it-or-lose-it provisions should be clear: right of the government to terminate the agreement.

To be sure, investors must be able to seek waivers. But negotiators have sometimes found it difficult to decide which government entity should grant waivers and the criteria that justify these. The mining ministry may seem obvious, but it is typically staffed by engineers and geologists. It may be better to grant authority to the finance ministry, as it is more likely to have the economic and financial skills to evaluate waiver requests. Governments might also require the approval of both ministries. However, in no case should investors be able to turn to government-appointed directors on their boards to seek approval, as they face conflicting interests.

Events covered in force-majeure clauses obviously provide justification for investors' failure to meet obligations. This means that the drafting of "force majeure" definitions needs careful attention. Waivers might reasonably be granted for temporary closures related to maintenance and acts of government or when investors can demonstrate that operating costs are higher than market prices. However, waivers should not be granted for vague "market conditions". And any waivers that are granted must be for short, specified periods. Waivers could also be conditional on payments during slowdowns, viewing them as costs of option to investors. Determining appropriate payments would require negotiation and, perhaps, expert assistance.

In any event, a government that meets resistance to including "use-it-or-lose-it" clauses in an agreement or is faced with demands for exemption from such provisions in mining legislation should explore questions about the investor's intent rather than backing off from insisting on such provisions.

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