Fiscal stability agreements offer protection against increases in mining royalties

By Betsie Strydom

Among all the comments surrounding the commencement of mining royalties, few have considered that there is no guarantee that mining royalties will remain capped at 5% and 7% in South Africa.

The Mineral and Petroleum Resources Development (MPRD) Act 28 of 2002 allows the State, as custodian of South Africa's mineral and petroleum resources, to impose royalties on the transfer of mineral resources.

The Mineral and Petroleum Resources Royalty Act 28 of 2008, ("the Royalty Act") which came into effect on 1 March 2010, specifies that the royalty rate for refined mineral resources and for unrefined mineral resources is calculated by applying complex formulae, written to take into account the profitability of a mine. Royalties are currently capped at 5% for refined mineral resources and 7% for unrefined mineral resources.

Significantly, several countries have recently increased mining royalties. Thus:

- Chile's mining royalties, currently between 4% and 9%, will be raised to 5% to 9%, - due to legislative difficulties with implementing these increases immediately, several large mining companies operating in Chile have agreed to voluntary increases in mining royalties in the meantime;
- Brazil is contemplating increases in mining royalties;
- Russia has introduced a tariff on nickel exports;
- Ghana has raised mining royalties from 3% to 5%; and
- Australia recently raised mining royalties.

Mining companies typically make long term financial investment commitments. To generate certainty about the costs associated with their South African mining projects, they can consider entering into "fiscal stability agreements".

The Royalty Act authorises the Minister of Finance to conclude binding fiscal stability agreements with extractors; agreements that can apply to the extractors' existing mineral resource rights or to mineral resource rights which the extractors anticipate acquiring.

Fiscal stability agreements guarantee the terms and conditions that will apply to the mineral resource rights (for as long as the extractor holds the rights) and to all participating interests subsequently held by the extractor in respect of the right. In particular, such agreements protect the extractor from increases in the mining royalty rate.

Legislative amendments to mining royalties will have no force and effect if they exceed the royalty that was agreed in the fiscal stability agreement. If the mining royalties are reduced, the extractor will be able to benefit from the reduction.

Fiscal stability agreements can only be concluded in respect of prospecting rights, exploration rights, mining rights and production rights granted in terms of the MPRD Act, including leases or subleases mentioned by the Act's section 11. Mining or reconnaissance permits are not eligible for fiscal stability protection.

A binding fiscal stability agreement relating to the anticipated acquisition of a mineral resource right is only valid if that mineral resource right is granted within one year after date of conclusion of the fiscal stability agreement.

Binding fiscal stability agreements may be assigned by the extractor to another person who is acquiring the prospecting right or exploration right from the extractor. The right to assign the rights acquired from fiscal stability agreements in respect of *prospecting* or *exploration* rights can be freely assigned.

However, an extractor may only assign the rights arising from fiscal stability agreements in respect of *mining rights* or *production rights* to another person if both the extractor and the other person form part of the same group of companies, as defined in section 1 of the Income Tax Act, on the date of disposal.

An extractor can unilaterally terminate a fiscal stability agreement at any time, and the termination will take effect from the day after the last day of the year of assessment in which the agreement is terminated.

> Prospecting rights, renewals thereof and an initial mining right converted from the prospecting right and a renewal thereof; and exploration rights, renewals thereof and initial production rights converted from an exploration right or renewal thereof, are treated as one and the same mineral resource in the hands of the extractor, if they relate to the same geographical area.

If the State breaches a fiscal stability agreement, and the failure has an adverse economic effect on the determination of the royalty payable by the extractor who is a party to the fiscal stability agreement, the extractor is entitled to compensation (which includes interest) in respect of the increase in the royalty or to an alternative remedy that eliminates the impact of the State's failure.

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