

Main legal issues regarding financing of mining projects in Eritrea

The mining potential of the small eastern African country, Eritrea, is unexploited. In 2009, the Eritrean government granted eight new exploration licences to foreign mining companies. Mining in Eritrea has attracted the interest of more than 14 mining and exploration firms from Australia, Bermuda, Canada, China, Libya, the United Arab Emirates and the UK. The Bisha Mine (a unique gold, copper and zinc mine) in Eritrea is Eritrea's flagship project and is being run by Canada's Nevsun Resources Ltd with a forty percent stake held by the Government of Eritrea.

Obtaining a licence to mine in Eritrea is a valuable asset and a way to benefit from the untapped mineral resources of Eritrea. However, to ensure that the project is bankable and to organise project financing for a mining deal in Eritrea there are a number of issues that need to be kept in mind. We discuss below some of the main issues that arise in relation to project financed mining deals in Eritrea.

1. Legal system

The State of Eritrea currently has transitional laws that were established when Eritrea obtained independence from Ethiopia in 1993. The laws in Eritrea are based on civil law systems. The Constitution of Eritrea will take effect once the parliamentary and presidential elections are held in Eritrea despite being ratified in 1997. The legal system is slowly developing in Eritrea, but only incrementally, and the lack of clarity on the nature of the laws and their interpretation, and the fact that there are no precedents to rely on means there is uncertainty as to the legal system. Moreover, unfortunately, the political situation in Eritrea adds to this uncertainty.

As is prevalent in other emerging markets, the only way to deal with this legal system risk is by taking the benefit of political risk insurance to guard against the precipitous act of a local government or related body.

2. Mining Rights

The legal framework which governs mining and related activities in Eritrea is set out in the Minerals Proclamation 68/1995 as amended by Mineral Proclamation 165/2011, Mining Income Tax Proclamation 69/1995 and Regulations on Mining Operations Legal Notice 19/1995. Once granted, the mining licence will entitle the person to whom the grant is made to mine Eritrea. The types of licence available are a prospecting licence (valid for 1 year and non-renewable), an exploration licence (valid for an initial 3 years, but may be renewed twice for terms of 1 year and with further renewals possible in certain circumstances) and a mining licence (valid for a period of 20 years with optional 10 year renewals). The mining licence is usually a small document containing the details of the area where mining is to be carried out and all the terms and conditions of the licence are provided in a separate mining agreement. The mining licence grants a usufruct right to use the mining land area to the mining company.

The Government of Eritrea has the right to acquire a participating interest of up to 10% in any mining investment. Proclamation 165/2011, which authorises the Eritrean Government to "acquire, without cost to itself, a participation interest of up to 10 percent of any mining investment". The amendment further permits the Government, "equity participation not exceeding a total of 40 percent, [including the aforementioned 10%] the percentage, timing, financing, resulting rights and obligations and other details of which shall be specified by agreement." As previously stated, Proclamation 165/2011 amends Proclamation 68/1995, which only allowed the Government 30% equity participation, including a 10% or less participation interest. It is understood that in previous agreements, the Government of Eritrea, after acquiring the 40% under Proclamation 165/2011, has contributed to one third of the development and capital costs of mining operations.

Moreover, under the Regulation of Mining Operations (Legal Notice 19/1995), the holder of a mining licence shall pay the Eritrean government a royalty pursuant to Article 34(1) of Proclamation 19/1995. The royalties amount to 5% in relation to precious minerals, 3.5% for metallic and non-metallic materials including construction materials and 2% in respect of geothermal deposits and mineral water.

Usually, no separate grant of land use rights apart from the mining licence is provided to the mining company. However, such a document becomes important for the purposes of creating security by way of mortgage in favour of the lenders - one of the important parts of the security package of the lenders is usually a mortgage over the immovable property of the mine in favour of the lenders. Moreover, there is no registry or other forum currently existing in Eritrea for the purpose of the registration of the mortgage.

3. Security Creation

According to Eritrean law, security by way of pledge of movable property and a mortgage over immovable property can be created. A key characteristic of a pledge is that it requires dispossession of the asset by the pledgor over which the pledge is being created. Such dispossession may be deemed in the case where instead of the asset being delivered, the document of title, without which the asset pledged cannot be disposed of

has been delivered to the beneficiary of the pledge. In view of the security package of the lenders which would usually include all equipment, the project contracts, bank accounts, insurance policies etc, mining licence and the mining agreement – it would be next to practically impossible to deliver the originals documents for all these items to the lenders for the creation of pledge.

It is not clear (again due to lack of legal precedent) if security over future assets can be created in Eritrea. It is typical in a project finance transaction that the lenders take security over the assets acquired by a mining company during the course of the development of the project. In addition to the procedural issues of executing a new security agreement to cover future assets, this issue becomes more important as *ad valorem* stamp duty is paid each time a security agreement is executed in Eritrea (refer to point 9 below).

Another important point to note is that there is no law relating to trusts in Eritrea. This becomes particularly important for project finance transactions which generally involve a consortium of lenders. One usual way to deal with this issue in civil law jurisdictions is to have a parallel debt structure in the documentation. Unfortunately as this has not been done in Eritrea before, no one understands if such a structure would work in Eritrea and this would mean that security will have to be created in favour of all the lenders.

4. Enforcement of Security

Similar to most civil law jurisdictions, enforcement of security is not possible without going to a court of law which means that the enforcement process would be lengthy. In this regard, a view exists that once a default has occurred the parties could agree to enforce the security by direct transfer to a third party without going to a court of law. However, this is merely one interpretation of Civil Code in Eritrea as the same has not been put to test in Eritrea. Also, to add to the uncertainty, upon enforcement by a direct transfer the secured assets can be transferred to one of the lenders only and not to an agent of the lenders or a third party.

5. Enforcement of foreign judgements and foreign arbitral awards

The Civil Procedure Code provides that foreign judgements (subject to any international conventions) and foreign arbitral awards may not be enforced in Eritrea unless reciprocity is ensured (meaning that the execution of arbitral awards made in Eritrea is allowed in the country where the arbitral award is made).

Eritrea is not a party to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards. No such reciprocity exists and no foreign arbitral awards or foreign judgements may be enforced in Eritrea. This is one of the biggest concerns for international financiers lending to a mining project in a Eritrea.

6. Foreign currency

There is no express restriction under Eritrean law on an Eritrean entity opening an offshore account. The mining proclamation entitles a project company to open a bank account offshore and keep its foreign currency earnings overseas. In this regard, the mining proclamation provides that the holder of a mining licence producing exportable minerals may “retain abroad in an external account a portion of its foreign currency earnings as may be determined by directives to be issued by the Bank of Eritrea and pay from the retained earnings where foreign currency may not be readily available by the Bank of Eritrea for the following purposes (1) to import equipment necessary for mining operations, (2) for services, leases and licences to be paid for in foreign currency in accordance with agreements entered into, (3) for reimbursement for loans and debt services due legally to financial institutions outside Eritrea, (4) for compensation payable to foreign employees not permanently resident in Eritrea and (5) for such other activities with contribute to the process and enhancement of mining operations”.

It appears that the law as regards determining the “portion” of foreign currency that may be retained abroad has not been finalised as yet as no directives of the Bank of Eritrea have been issued which determine this amount.

The mining agreement usually prescribes the amount that the mining company can retain offshore which consequently means that any amounts in addition to such limits would need to be repatriated back to Eritrea. Such a provision generally provides the maximum amount that can be kept offshore is the next 3 months foreign currency payments of the project company.

Notwithstanding the condition in the mining proclamation providing that payment from retained earnings may be made only when foreign currency “may not be readily available by the Bank of Eritrea”, it appears that money offshore can be used for payments for the permitted purposes as per the mining agreement at any time.

7. Export of Metals

A mining company can sell the mineral products offshore in long term sales contracts provided the Minister of Energy and Mines has approved such long term sales contracts. The Minister of Energy and Mines has the right to require the project company to sell all or a percentage of its production, other than mineral product already subject to long term or other contracts, to the State or an Eritrean person for the fair market value of the mineral product. Due to such a requirement, it is useful for the project company to ensure that it sells all its mineral products through long term sales contracts.

8. Insurance

While there is no specific law in Eritrea that requires an Eritrean company to insure with an Eritrean insurer, the mining agreement usually has a restriction that the local mining companies should be given an equal opportunity to provide insurance services before a company decides to place the insurance overseas. In any event, currently there is only one insurance company in Eritrea which is the National Insurance Corporation of Eritrea (NICE).

9. Tax issues

Income Tax – at a rate of 38% on taxable income in accordance with Proclamation 69/1995.

Stamp taxes – ad valorem stamp duty of 1% of the value is payable on security agreements in Eritrea, however, there is no clarity as to what constitutes “value” – i.e. whether it refers to the value of the property being secured or the amount of the debt secured under the document. This is an additional, uncertain cost issue for a project.

For a transfer of property or shares, stamp duty is payable at a rate of 4% on the estimated value of the property and the new members of a company pay stamp duty on the value of their invested share. Furthermore, the Inland Revenue Department has the right to determine the value (if the value agreed between the transferor of the property and the transferee is found to be unacceptable). This stamp duty would, therefore, be payable on a transfer of assets (including the mining licence) or of shares in the project company on an enforcement of security.

Withholding tax – there is a 10% withholding tax on payments of interest made by a resident Eritrean offshore. This has a significant affect on the overall economics of the project.

10. Direct Agreement of the lenders with the Government

As is usual in emerging markets the lenders want a direct relationship with the Government which has granted the mining concession to the mining company borrowing money from the lenders. Such a concept of direct arrangement with the lenders is alien to the Eritrean Government and to date it has been hesitant to enter into binding arrangements with lenders. The only way around this seems to be to keep the Government informed of the involvement of (and the benefit to the project and the Government of working with) the lenders to the project from the very beginning and hopefully with the conclusion of the project financing of the Bisha Mine the Government will become open and amenable to a working alliance with project lenders.

11. Signing process

Another important hurdle for doing a project finance transaction in Eritrea is the process of signing the financing documents. In today's virtual world, the majority of the closings happen on the internet with each party executing documents in counterparts.

However, this process cannot be adopted for Eritrean deals. If the documents are completely executed outside of Eritrea, then for such documents to have effect in Eritrea they should be executed in the presence of the consular office of the Eritrean embassy in the country where the documents are executed. On the other hand, if documents are wholly or partially executed in Eritrea the requirement is that documents get executed before the High Court of Asmara for the documents to have effect in Eritrea.

Project financing has been extensively used in emerging markets to facilitate the development of mines and other natural resources and it seems that it could also be used for the development of mines in Eritrea. Though Eritrea is a difficult jurisdiction for project finance transactions, the example of Bisha mine and the keenness of the Eritrean Government to develop its country, seem to provide the promise of a positive future for project finance transactions in Eritrea. Needless to mention that these project finance transactions are challenging to work on from a legal perspective.

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