

Mining 2012 – Peru

Sandra Orihuela

Orihuela Abogados

1 Provide an overview of the mining industry in your country. What significance does the mining industry have as a component of the national economy?

Peru is a multi-metallic country that has one of the world's largest mining reserves. It is a worldwide producer of copper, gold, zinc, silver, lead, iron, tin, molybdenum and tungsten. In the last two decades Peru has experienced solid political stability, which has enabled it to maintain strong economic growth. Peru's growth rate in terms of GDP was 7 per cent in 2011. Mining has grown and continues to grow at a sustainable percentage every year, a consequence of continuous private investment during the last 10 years. Mining exports reached \$27 billion in 2011.

While copper production decreased by 0.94 per cent in February 2012 with respect to the same month of the prior year, gold production has increased by 4.75 per cent as of May 2012 with respect to the same months in 2011. Zinc production increased by 0.71 per cent, silver by 0.07 per cent, and lead production increased by 21.94 per cent with respect to the prior year.

Since mid-2011, the relationship between the mining industry and the government focused around the 2011 presidential elections that brought the nationalist candidate Ollanta Humala to power. Mining companies appeared concerned about the impact of the new government on the overall economy and its policies towards the mining industry. However, Peru's newly elected president reaffirmed early on that his government would respect all existing contracts with mining companies. He also reached an agreement with the country's leading mining companies to impose a new tax on net profits. Miners without signed stability agreements will now pay royalties ranging between 1 and 12 per cent of their operating profits, and will be subject to a windfall profits tax of 2 to 8.4 per cent over their net profits. With respect to social issues, the current government faced serious issues with respect to opposition towards the development of the large Conga project managed by Minera Yanacocha, which resulted in the imposition of a state of emergency in the Cajamarca province where the project is located. The first quarter of 2012 focused on the new government resolving the water issues impacting Conga, with the government hiring a team of three international environmental consultants to review the already approved environmental impact study (EIA) presented by Yanacocha. The evaluation report indicated that the IEA met the required standards but suggested certain substantive improvements. The company's decision on whether to proceed with the EIA and the substantive improvements suggested by the consultants is not final as of the date of this writing.

In spite of social related conflicts, mining today remains a key component of Peru's economy, as it is an industry that will maintain its predominance for many years to come.

2 Describe the legal and regulatory framework. What laws establish and grant authority to the mining authorities?

Mining in Peru is primarily regulated by national laws and regulations enacted by the Peruvian Congress and the executive branch of government. The prin-

cipal legal framework on mining is set forth in the 1992 General Mining Law and its amendments. The mining sector is regulated by its Law and Regulations on Organization and Functions, pursuant to which the Ministry of Energy of Mines (the MEM) was created. It is the principal government entity that, together with its various offices, departments and agencies, is responsible for the mining sector in Peru. The MEM is a member of the Executive Branch of government, and it is responsible for putting in place specific policies and rules governing the matters in its jurisdiction, namely energy, hydrocarbon and mining activities.

The MEM is not the only authority enacting mining-related regulation; there are several government bodies with authority over specific matters that are relevant to the mining industry, as follows:

- Environmental: MEM, Ministry of the Environment (MINAM), Agency for the Supervision of Investments in Energy and Mining (OSINERGMIN), Ministry of Agriculture (MINAG), National Service of Protected Areas (SERNANP), General Directorate of Coastguards (DICAPI), National Institute for the Development of Andean, Amazonian and Afro-Peruvian (INDEPA), National Authority of Water (ANA), and the local governments.
- Tax: MEM, National Tax Authority (SUNAT), Ministry of Finance (MEF).
- Administrative: MEM, Mining and Metallurgical Geological Institute (INGEMMET), Ministry of Transport and Communications (MTC), Ministry of Culture (MC), National Port Authority (APN), DICAPI, General Directorate of Arms, Ammunition and Explosives (DICSCAMEC), Public Registry (SUNARP).
- Labour: Ministry of Labour (MINTRA).
- Safety and Security: OSINERGMIN, APN, MINTRA, National Institute of Civil Defence (INDECI), General Directorate of Environmental Health (DIGESA).

The MEM is also responsible for decentralising and transferring some of its responsibilities to the local governments. Local governments may put in place rules regarding mining to be applicable in their respective jurisdiction, so long as such rules and local laws do not conflict with MEM rules or other laws and regulations.

3 Describe the investment regime applicable to foreign company involvement in mining projects.

Foreign investors in Peru have the same rights and obligations as Peruvian investors. There are generally no restrictions on the involvement of foreign investors in any business activities, including mining. However, the Peruvian Constitution provides that no foreign person may directly or indirectly acquire or otherwise possess, among other things, land or mining properties within 50 kilometres of Peru's national borders without obtaining express, prior governmental authorisation in the form of a Supreme Decree.

In addition, Peru offers legal stability agreements that can be entered into by private investors with the Peruvian government for 10 or 15-year terms to

protect their investments and enjoy a number of benefits. Mining investors with stability agreements will benefit from tax stability (including income, export, labour, and certain tax exemptions), free disposition of currency generated by exports, non-discrimination with respect to the exchange rate, accelerated depreciation for certain assets and the option of maintaining accounting in a foreign currency. Also, mining concession title-holders that have projects in the exploration stage may apply to have the right of early recovery of sales tax paid during the exploration phase.

4. Is your country a party to international investment treaties applicable to mining projects undertaken or sponsored by foreign companies?

Peru has entered into treaties and agreements with various countries, some of which relate directly to mining, and others which relate to foreign investment, dispute resolution, double taxation and inter-country relations, all of which are relevant in the ambit of mining in Peru. Generally, these do not change the role of the local government authorities in mining transactions, nor do they require any direct relationship between the investor and the government.

Specifically, Peru has entered into FTAs with China, the US, Canada, Chile and Singapore. It has entered into BITs for the reciprocal protection and promotion of foreign investment with Australia, the UK, Ecuador, Argentina, Bolivia and Colombia, among others, thereby establishing a solid legal framework that provides for the protection of investment and guarantees national treatment for foreign investors from those countries. It has also signed bilateral conventions with Canada, Chile and Brazil, as well as a convention with Andean Community member states to prevent double taxation. It is also a signatory to certain environmental treaties relevant to mining. Peru has also entered into conventions and agreements with Ecuador to facilitate cross-border mining projects in their border areas.

Lastly, Peru is also a member of the World Trade Organization, the Multilateral Investment Guarantee Agency, the Andean Community and the UN Convention on the Recognition and Enforcement of Foreign Judgments, all of which have relevance with respect to foreign investment in mining in Peru, and Peru is committed to the arbitration of investment disputes under the World Bank's International Center for the Settlement of Investment Disputes.

5. What in general terms is the mining exploration and exploitation permit or concession regime? What is the licensing regime?

The Mining and Metallurgy Geological Institute (INGEMMET) grants title to mining concessions. There are four types of concession titles:

- mining concessions, which are granted in order to allow mining activities;
- production concessions, which allow the title-holder to process the minerals;
- general labour concessions, which allow the title-holder to provide ancillary services to mining concession title-holders; and
- mining transport concessions.

In applying for concessions, the applicant is required to provide public notice, by publishing information in local newspapers, indicating the concession being requested and the area in which it is located. In order to maintain title to mining concessions, title-holders have to pay certain annual fees and extract minerals or reach certain investment requirements within a certain period of time. Those requirements are further explained in question 6.

Mineral deposits are the property of the government, who has the right to carry out all mining industry activities via state-run mining companies. If a public entity acquires a concession that previously belonged to an individual, it must be granted at a public auction. Most concession titles, however, have already been granted to private parties, and are freely transferable.

With respect to permits, prior to carrying out prospecting, an environmental impact statement must be submitted to the MEM. Before commencing exploration activities, an environmental impact study, including a social relations plan and a certification that there are no archaeological remains in the area, must be submitted to and approved by the MEM. Before commencing exploitation activities, an additional and more encompassing environmental impact study must be submitted for approval by the MEM, which must include a draft mine closure plan. In addition to the aforementioned requirements, other permits and

licences must be obtained from the relevant governmental agencies in order to carry out mining activities, including permits for water use, deforestation and industrial and domestic waste. Failure to do so can result in fines or suspension of mining activities.

6. What types of duties, royalties and taxes must be paid by the mining project company as a condition to obtaining or continuing a mining concession? What remedial actions are available to the granting authority when such levies are unpaid?

Mining concession title-holders are required to pay certain annual fees in order to maintain their concessions. The first payment is made at the time the concession is formally requested, and subsequent payments are due annually thereafter. The fees are calculated based on the size of the concession as recorded in the public Mining Registry. Payment of fees can be made one year in arrears, but if the title-holder fails to make the payment for two consecutive years, the respective concession will expire.

There is also an obligation on title-holders to reach an Annual Minimum Production (AMP) per hectare prior to the end of the tenth year of ownership, calculated from one year after the date on which the concession was granted. If the title-holder fails to comply with the AMP requirement, an annual penalty must be paid per hectare, starting at the 11th year until the year in which AMP is reached. If AMP is not reached by the 15th year, the respective concessions will expire.

While there are certain exemptions to delay expiration or cancellation of a mining concession resulting from the lack of compliance with the annual payment, investment or production requirements, the main objective behind these obligations is to require the mining concession holder to develop and extract minerals from the mining concession. The government allocates revenue derived from mining amongst local governments and other institutions.

In addition to any specific fees or investment requirements, mining title-holders must comply with their corporate tax obligations, just like any other entity doing business in the country. Peru taxes mining companies with the same taxes applicable to other economic activities. However, mining companies have the added burden of paying mining royalties and special mining taxes, which are applicable upon certain requirements being met.

7. What in general terms is the water rights regime? What is the availability of water for mining facilities? What techniques or activity have you seen in your jurisdiction to address limited or shared water resources?

The Law on Water Resources governs the management of water in Peru. The law defines water as a delicate renewable natural resource that is vital to human life and of strategic importance for sustainable development, the maintenance of natural systems and cycles, and the safety of the country. There is no private ownership of water bodies in Peru as these belong solely to the federal government.

Local offices of the National Water Authority grant water rights, and the rights are independent from land or mining concession rights. They are granted for a predetermined period of time based on the volume of water required to be used, and can be renewed for a maximum period equal to the period granted for mining activities as set forth in the approved environmental impact assessment. The party granted water rights must consume no more than the amount of water permitted, during the time it is authorised to do so, and is subject to fines or loss of the water rights. Given that water rights are separate from the land and concession rights, they cannot be mortgaged together with those rights.

Mining companies usually utilise water from rivers, underground wells or rainwater. Companies are becoming more creative with respect to alternative techniques and activities to address water use, recycling and conservation, including building shared water dams and reservoirs for the storage of water during the rainy season.

8 What in general terms is the surface rights regime (use and occupation of surface; access routes; pipeline and electric line routes; roadways or railways for product transport)?

Obtaining title to mining concessions does not ensure permission to use surface lands. Permits for surface land use must be obtained from the individual land-owners via agreements entered into between the concession title-holder and the landowner. In the event the owner is a peasant community, such communities are recognised by the Peruvian government as legal entities, so the agreement must be approved by a minimum vote of the assembly of the members of the community, as further provided in specific legislation on the matter. A concession title-holder can also petition the MEM via an administrative process for an easement to be imposed on the landowner. The application requires a valuation of the land and a payment of compensation to the landowner. Also relevant with respect to the use of surface land is the existence since May 2010 of legislation that follows the provisions of Convention 169 from the International Labour Organization, giving prior consultation rights to the indigenous and original communities over developments in their lands.

Further, easements over surface land are usually used for access routes or to benefit the mining concessions located under the surface. When a surface land easement is granted to benefit a specific mining concession, such an easement is usually perpetual and runs with the land, meaning that the right is inseparable from the rights of the mining concession and continues to exist for the benefit of subsequent owners of the mining concessions.

9 What is the availability of power for remote mining facilities? May mining facilities generate their own power?

The Interconnected National Electric System (SEIN) is the national network through which electricity is provided to the majority of Peru via generators, transmitters, and distributors of electricity, which are all connected to the network. Mining companies can have electric power supplied from the SEIN, if available, depending on the location of the mining projects and the power required. To do so, they can contract directly with electricity generating companies or electricity transmitting companies that are part of the SEIN to obtain power for their facilities, in each case negotiating the price for the services.

Mining companies can also elect to generate their own electric power. This is usually more costly than utilising SEIN power, but this may be the only option for companies with projects where SEIN electricity is not an option. In such cases, the company must apply with the appropriate administrative authorities to obtain a concession or the appropriate approvals for electricity generation, and must be in compliance with all of the legal and administrative requirements before approval will be granted.

10 What are the grounds for lawful termination of rights under a mining concession, water rights or surface rights or power (generation or transmission) rights? What remedies are available to the concessionaire if rights are wrongfully terminated?

Mining Rights

Mining concessions can terminate by automatic expiration; abandonment; cancellation; annulment; or renunciation. Concessions expire automatically after certain set periods of time when the title-holder fails to pay annual fees, reach minimum production, pay penalties or make certain financial investments, as explained in question 6.

Concessions are abandoned when, in the process of applying for the concession, the party does not fulfil all of the application requirements. Concessions are cancelled when the right sought cannot actually be located or when there are priority rights of third parties already in existence. Concessions may be voided when requested by persons disqualified by law. Further, a title-holder can renounce his rights in the concession or any part thereof via a specific request to the granting authority. Any challenge to the granting of mining concessions must first be made via an administrative process and once such means have been exhausted, a claim can be brought before the judiciary.

Surface Rights

Given that surface rights are independent and separate from mining concession

rights, these must be acquired separately from the land surface owner, and termination thereof will depend on the private agreement providing for such rights.

Water Rights

The following processes can terminate water use rights:

- the title-holder renouncing his rights;
- the voiding of the administrative approval in which such use was granted;
- cancellation due to the death of the title-holder;
- the expiry of the term for which the use of water was granted;
- the termination of the purpose for which the right was granted; or
- the failure to use the right during a two-year period.

Water rights may be revoked under the following circumstances:

- failure to make two consecutive required payments for the use, the fee or any other financial obligation;
- when the title-holder to the right has been sanctioned due to serious violations; or
- due to water scarcity or quality problems, as declared by the governing authority, which prevent its use.

Water rights can also be terminated pursuant to a final judicial decree calling for the termination of such right.

Power Rights

An electricity concession can be terminated by a voluntary declaration of the title-holder. The power concession can also be cancelled if the title-holder:

- fails to register the concession agreement in the corresponding registry within a specified deadline;
- does not comply with the infrastructure as required in its approved application, unless due to force majeure determined by the MEM;
- shuts down its facilities during a 876 cumulative hour period during a calendar year, without justifiable cause;
- lowers the quality of the generator or transmission, and after being sanctioned, does not operate its facilities pursuant to applicable norms;
- lowers the quality of distribution, and after being sanctioned, does not have valid contracts with generator companies or does not render services according to standards agreed upon contractually;
- lowers the quality of the distributor, does not accredit its provision guarantee during 24 months, unless it has called for a public bid and has not received any bids to cover all of its requirements; or
- repeated failure to pay generators for the provision of energy provided such payment is not the subject of controversy.

Dispute Resolution

When administrative proceedings for recourse are exhausted, a party may file an appeal before the courts within 30 days after the parties in the dispute have been notified of the decision from the administrative proceedings.

11 Describe the extent to which the legal and regulatory regime is conducive to the installation or provision of essential infrastructure

Peru's private investment policies encourage the construction and development of infrastructure projects by private parties with incentives for private investment. In the mining industry, there are benefits for mining companies that invest in infrastructure projects for public use, including for example, income tax deductions and exemptions from revocation or expiration of their mining concessions when they have invested in such infrastructure projects. There are similar incentives for investors in other industries, including the electric and hydrocarbon industries.

12 Please provide a description of the collateral security arrangements permitted in your jurisdiction, relating particularly to the mining project's ability to grant to creditors a perfected security interest (whether by mortgage, pledge, trust, etc) in concession rights, water rights, surface rights, related easements, permits, licences (including environmental), land and bank accounts. Are there any limitations to the ability to transfer such rights to a successor owner/operator of the mine?

The most common collateral security arrangements relating to mining projects in Peru are the mining mortgage, the mining option, and the pledge.

A mining concession can be used as the underlying security to guarantee an obligation by way of a Mining Mortgage Agreement, representing a lien over the concessions during the term of the agreement to secure financing for the concession title-holder or as security for a creditor to whom the title-holder owes a debt. The title remains in the name of the title-holder during the term of the agreement, and the title-holder also remains in actual possession of the mortgaged concessions and can carry out work therein during the term of the mortgage. The mortgage must be registered at the public registry.

A mining option contract gives a third party the right to acquire the mining concessions from the title-holder after compliance with certain conditions, generally including payments of certain agreed upon amounts or investments in exploration or other work at the concessions. The mining option is exclusive, for a maximum period of five years, and can be publicly registered, meaning there is an encumbrance on the mining concession title, thereby serving as collateral security for the party to whom the option is granted.

Finally, a pledge agreement is a security arrangement via which a lien is granted over the assets specified therein. This can include shares in an entity, tangible assets used in mining exploration and exploitation activities, as well as future receivables, bank accounts, dividends and profits, among others.

Generally speaking, these types of agreements can be freely assigned without prior governmental approval, unless otherwise specified by the parties therein. The liens should be registered with the corresponding public registry in order to put third parties on notice that the concessions or assets are encumbered by such agreements.

13 Is it accepted practice for creditors financing a mining project to enter into an agreement with the mining authority in connection with the creation, perfection or acknowledgement of the collateral security interests granted to the creditors in mining projects, including to facilitate the transfer of such rights to a successor owner/operator? Is there any requirement, benefit or limitation to such agreements?

It is not common practice for creditors to enter into an agreement with the mining authority in connection with the creation, perfection or acknowledgement of the collateral security interests granted to them.

However, as previously explained, agreements providing for such security interests can be registered in the mining registry, in which case any such registered encumbrances will be senior to any others that are not registered and of which the general public therefore has not been put on notice. Unregistered agreements can be nonetheless enforceable, but registration does ensure that the lien is made public. The seniority of registered security rights is based on which rights were registered first, notwithstanding the date on which such agreements were entered into.

14 What means of enforcement are available to creditors in connection with collateral security interests in mining rights?

The execution of a mining mortgage is carried out pursuant to the General Mining Law. The law provides that the concessions must be sold at a public auction in the event the creditor wishes to execute the mortgage, and the proceeds from the sale will be first used to pay the creditor the amount of the debt that was secured by the concessions.

The Law on Guarantees on Tangible Assets governs the execution of a pledge. The procedure set forth thereunder that is most commonly used is a privately run auction to sell the assets covered under such a pledge, although in the event there is any problem with such an auction, the creditor can seek a

court ordered auction. The parties can also agree that the creditor can take over the subject assets in satisfaction of the debt. Certain judicially ordered proceedings may also be available depending on the type of assets secured by the pledge.

15 What insurance must be placed with domestic insurance companies? Can insurance be placed abroad? Can claims be paid directly offshore? Are there restrictions with respect to obtaining reinsurance outside the country, and obtaining assignments or cut-through endorsements to permit claims (and payment) to be made directly to owners or creditors outside the jurisdiction?

Peruvian legislation provides for the freedom to obtain insurance and reinsurance from outside Peru. There are, however, specific provisions for registration and compliance by insurance providers. Insurance claim payments are to be paid based on the provisions of the subject policies or contracts, and should be paid to local accounts designated for such a purpose.

16 Describe any requirements related to the use of domestic and foreign labour, suppliers and contractors.

The Law on the Employment of Foreigners and its regulations governs the hiring of foreign labour. The law includes restrictions on the hiring of foreign labour and it limits Peruvian entities when hiring foreign labour to a total of 20 per cent of the total number of company employees, the combined compensation of which persons is not allowed to exceed 30 per cent of the total wages paid by the company. There are exceptions for certain skilled workers and for managerial positions. Further, any foreign employee must obtain an appropriate visa permitting the person to work in Peru, the type of which depends on the length of time of the employment agreement, which has an initial period of one year. The employment agreements must be registered with the Ministry of Labour. All workers, whether domestic or foreign, or whether hired as employees, consultants or independent contractors, are also subject to Peru's tax regime, applicable based on the tax residency of the worker and the type of services being provided.

Workers in Peru may be hired via 'outsourcing' companies, but those companies must be registered with the government for the purpose of deciding which personnel will be used. They may only be used for temporary, complementary or specialised work. Under certain circumstances and with respect to certain services to the mining industry, the service provider must be registered with the MEM.

ORIHUELA ABOGADOS

Sandra Orihuela

sog@orihuelalegal.com

Av. Republica de Panama 3570

Office 1102

San Isidro

Lima

Peru

Tel: +(305) 381 0900

Fax: +(511) 421 5424

www.orihuelalegal.com

17 Can any liabilities extend beyond the mining project company to its owners, mortgagees, or creditors?

Under Peruvian tax laws, legal representatives and other parties that are granted powers by a legal entity in Peru will be personally liable for taxes and other formal obligations of such entity only when they have wilfully, negligently or in abuse of their powers, caused the company to fail to comply with its tax obligations. In such a case, liability will be joint and several among the company and those parties, and the tax authorities can demand that such debts are paid in full at any of the time and by any or all of such parties. The Tax Code provides definitions for what constitutes wilful misconduct, gross negligence and abuse of powers, and the Peruvian tax administration has the burden of proving such conduct.

Criminal proceedings can be brought against company management for environmental liabilities. Failure to control possible environmental harm or to comply with environmental regulations will result in the imposition of fines and could result in potential criminal charges against the management of a company for crimes related to harming the environment and human health. This means that directors, managers and other legal representatives can be held criminally liable, with possible penalties ranging from very significant fines to imprisonment.

The concept of ‘piercing the corporate veil’ does exist in the Peruvian legal system, but it is not codified and is currently based only on legal doctrine. Therefore, its application is still limited, and usually in order for shareholders to be liable for the liabilities of the company, strong evidence to show that the entity was formed solely for the purpose of committing a fraud would be required.

18 Describe any other relevant legal considerations related to financing of mining projects in your jurisdiction.

The BVL Junior of the Lima Stock Exchange (the BVL) is a segment of the BVL that is designed to offer junior mining companies the opportunity for financing for exploration via the Peruvian capital market. National and foreign companies can list, but they must comply with certain requirements, including completing certain minimum exploration work and incurring certain costs and expenses within a mining concessions area (either as direct or indirect titleholder of the concessions, a party to an option or an assignment related to the concessions, or a party to a joint venture related to the concessions) in a period of three years.

19 In recent times, several governments have mandated concession renegotiation, or revisited royalty and taxation regimes, in light of increased commodity values. Has there been any such activity in your jurisdiction?

In 2011 Peru created two additional levy over mining, the Special Tax on Mining (IEM) and the Levy on Mining (GEM), in addition to amending the manner in which mining royalties are applied. In spite of these changes not being applicable to those miners holding stability agreements with the government, many have decided to voluntarily pay the new taxes. The general perception following the new taxes is that Peru remains competitive as a mining investment destination.

20 Please provide electronic links to any of the principal statutory and regulatory compilations referred to in your answers to the foregoing questions, including items such as Mining Law, foreign investment regime applicable to mining and environmental law and regulation.

- The Constitution of Peru: <http://www.tc.gob.pe/legconperu/constitucion.html>.
- List and complete text of regulations to the mining law and mining activities, including the General Mining Law: www.latinlaws.com/country/peru/mining%20and%20energy.
- Mining Canon Law: www.minem.gob.pe/minem/archivos/file/dgaam/guias/actiemployaci.pdf.
- The decree under which the Ministry of Energy and Mines is created: www.minem.gob.pe/minem/archivos/file/electricidad/legislacion/001energiayminas/dley25962.pdf.
- Trade Facilitation Law: www.congreso.gob.pe/ntley/imagenes/leyes/28977.pdf.
- Listing and text of principal labour legislation in Peru: www.latinlaws.com/_link.php?link=http://www.mintra.gob.pe/mostrarResultado.php?id=54&tip=54.
- Law governing stability agreements: www.latinlaws.com/_link.php?link=http://www.proinversion.gob.pe/RepositorioAPS/0/0/JER/MARCOLEGALTRIBUTARIO/09-D_L_662.pdf.
- Law governing the legal stability contracts with the government: www.snmpe.org.pe/repositorioaps/0/0/jer/hid_legisla/LegislacionHidrocarburos/LeyOrganicaReglamentos/Ley_27343.pdf.