Cassels

The Equator Principles: Impacts and Mitigation Strategies for Mining Companies

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The most recent iteration of the Equator Principles, released in October 2020, has been adopted by 137 Equator Principles Financial Institutions (EPFIs) across 38 countries at the time of writing. In the months following the release of the updated Equator Principles, the pandemic was a primary focus and, as a result, we've only recently started to see a refocussing of lenders on the Equator Principles.

Application of the Equator Principles to Mining Projects

The Equator Principles are promoted as a way to ensure that projects financed by EPFIs are developed in a socially responsible and environmentally sound manner.

Companies obtaining mining project-related financing from an EPFI should expect that the Equator Principles will apply, at least to some extent. Generally mining projects will be classified as either Category A (which are projects with potential significant environmental and social (E&S) risks and/or impacts that are diverse, irreversible, or unprecedented) or Category B (being projects with more limited potential E&S risks and/or impacts that are few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures).

In the case of Category A projects, the Equator Principles will apply comprehensively. In the case of Category B projects, the Equator Principles will still apply although certain elements may not be required depending on risk level.

Practical Implications for Mining Companies and Mitigation Strategies

Increased Reporting and Other Covenants, Requiring More Resources and Resulting in Increased Costs

Where the Equator Principles apply, companies will be subject to additional reporting and other covenants, which ultimately will result in increased costs. The extent of these covenants will vary, but we've seen a recent trend of EPFIs seeking to include comprehensive covenant panels. More onerous and far-reaching covenant panels will result in a burden on the company, from both a resource and cost perspective, that can be quite significant.

A Balancing Act

Bearing in mind the potential for significant impacts on the company, companies should work with EPFIs to apply the Equator Principles in a measured and balanced manner. While it will, of course, be important for EPFIs to comply with the Equator Principles, companies will likely wish to strike a balance between what is reasonable from the company's perspective (in terms of reporting and other covenants, resources and cost) and what is reasonable and necessary from an EPFI's perspective to ensure compliance with the Equator Principles.

By way of background, the Equator Principles Association has published a number of guidance notes on the application of the Equator Principles, including providing template provisions for EPFIs to refer to in financing arrangements. Some EPFIs have relied on this guidance to support the inclusion of comprehensive Equator Principles covenant panels. However, the Equator Principles Association has indicated that (1) the guidance notes are not required legal framework, (2) the structure of the loan will depend on the nature of the loan and project, and the complexity of the E&S risks and (3) the template clauses will be subject to commercial agreement and negotiations.

As each project is different, companies will want to emphasize that the Equator Principles should be applied on a project-by-project basis, with appropriate adjustments for relevant mitigating factors. While the inclusion of any one covenant in and of itself may not impose a significant burden on companies, the overall impact of comprehensive covenant panels can be quite significant. Covenant panels that include compliance requirements that go beyond what is required by the Equator Principles and applicable law will require companies to devote more time and resources to these matters. And the impact of these additional requirements can be even more significant for projects in less developed countries, where E&S laws may fall below IFC Performance Standards, and the compliance jump is that much more significant. When companies have modeled their E&S expenses on the basis of compliance with applicable laws, for example, these requirements will likely result in significant expenses that have not been included in the company's budget. As such, it will be important for companies to ensure that any additional covenants are proportionate to, and reflective of, the specific project and associated E&S risks, while still ensuring compliance with the Equator Principles.

Cost Consideration

Depending on the extent of the proposed covenant panel, there may be a significant cost that should be taken into consideration when companies are considering the overall cost of capital. The impact of these additional costs may be something that companies wish to discuss with EPFIs, particularly where a covenant panel goes beyond what is required by the Equator Principles.

Additional Oversight = Increased Costs/Time

The Equator Principles provide for oversight of E&S matters by an Independent Environmental and Social Consultant (IESC). From a practical standpoint, appointing an IESC will add another layer of requests and another diligence process that companies will need to satisfy, both before financial close and throughout the term of the loan. The oversight and requests from the IESC will require more resources, will result in increased costs for the company and may extend the initial diligence process. As a result, identifying an IESC as early as possible in the financing process will be an important factor in minimizing delays and streamlining E&S efforts.

Application of Equator Principles by Non-EPFIs

Even where financing is not provided by an EPFI, the Equator Principles may still be applied (or they may be introduced in at a later date).

There have been instances where a facility is provided by a non-EPFI lender, but because that lender anticipates assigning at least a portion of the facility to other lenders, Equator Principles concepts have been included in the loan documentation to allow for assignment to EPFIs. However, each EPFI has its own unique internal guidance documents and protocols relating to the Equator Principles and, as a result, pre-emptively negotiating provisions to address the Equator Principles in anticipation of future EPFI lenders may not save time/expense.

Reporting by EPFIs

The Equator Principles require EPFIs to publicly report information on transactions that have reached financial close. There are certain minimum reporting requirements and, while many EPFIs report in accordance with the minimum standards, the reporting of some EPFIs goes beyond what is required by the Equator Principles and, in some cases, includes analysis and commentary on key risks and sufficiency of mitigation measures. As a result, the reporting practices of EPFIs may be a factor that companies wish to consider when choosing financing partners.

We are no longer in an era where a single covenant to comply with the Equator Principles will be sufficient. If EPFIs are involved in a financing, it will be important for companies to begin discussions around scope as early as possible. Starting these discussions early will allow companies time to consider the requests that are being made, the added resources the company will require, the related costs and how to best mitigate the impact of the Equator Principles on the company's business.
