

## **OUTLOOK FOR 2011 IN CHILE'S MINING SECTOR**

The efficient and superbly managed feat of rescue of the 33 Chilean miners trapped 2,000 feet underground for 70 days was an affecting spectacle for the world and will be ranked one of the most inspiring events in modern memory. For investors, it also served to demonstrate that Chile is a well-run country that should be promoted sharply up investment league tables, and that in an era when commodities are of paramount importance to the global economy, they are becoming an essential part of investors' portfolios.

Let us elaborate:

First, following a year of recovery in 2010, Chile is enjoying good economic results. From a GDP contraction of 1.5% in 2009 and its first recession in a decade, growth in 2010 is likely to be in the 5 - 5.5% range. In December 2010, the Standard & Poors credit ratings agency raised its outlook for Chile from "stable" to "positive". In its review, the agency also confirmed Chile's foreign currency ratings (A+/A-1) and its local currency ratings (A+/A-1+) and held its assessment of transfer and convertibility risk at AA. This put Chile at an advantage as compared to two regional powers - Brazil and Mexico - for which S&P retained its "stable" outlook.

Second, Chile's ability to assemble a state-of-the-art rescue operation using people and resources from all over the world - a drill rig from Schramm of Pennsylvania, New Zealand sensors, Australian 3D mapping technology and video equipment from Japan - demonstrated the country's ability to flourish in a competitive globalized market. Chile is at the forefront of developing mining and mineral processing technology, openly and actively seeking input from all sources with a reasonable interest in improving mining practices.

Third, while there are other countries with Chile's economic stability and developmental capability, they do not have Chile's wealth of natural mineral resources and they generally have substantially higher labor costs. Chile has been well managed under governments of both its political parties, but its current pro-business regime seems likely to be more active in removing obstacles to growth and encouraging the investment needed for it. An example of such pro-activity was the "Chile, Land of Opportunities" investment seminar organized by the Foreign Investment Committee together with the ProChile export promotion agency and Chile's Economic Development Agency (CORFO), which took place in Beijing in November 2010 during President Sebastián Piñera's first official visit to China.

Opening the seminar, Mining Minister Laurence Golborne referred to the opportunities for investment in mining that Chile offers Chinese investors, drawing attention to copper, but also other minerals such as molybdenum, gold, lithium and silver. "Chile has the human capital, infrastructure, network of suppliers and access to capital markets that initiatives of this type require," he told the seminar. "That is reflected in the fact that the most important international mining companies have operations in Chile," he added.

Chinese investors have already stepped up efforts to increase outbound acquisitions, mainly focused on buying undervalued mining and metal assets and companies. This trend has been illustrated by China State Grid International Development Limited's joint venture with Quadra mining for the development and operation of the Sierra Gorda project and Franke mine in Chile.

## **Regulatory Framework and Key Recent Developments**

### **Regulatory Framework**

The Chilean mining industry is regulated by a set of clear and sophisticated mining and environmental regulations.

In addition, the clear policy of the government to attract foreign investment is reflected in the legal and tax systems, as well as the specific foreign investment regulations. It is often stated that Chile has a stable and transparent legal framework for foreign investment, characterized by clear, non-discriminatory and non-discretionary rules. The flexibility of Chilean foreign investment and tax laws contribute to foreign investment confidence.

Under Chilean law, foreign investments must be brought into Chile using any of several legal statutes. The most frequently used are:

- i) The Foreign Investment Statute, known as Decree Law N° 600 ("DL 600"), a special voluntary investment regime; and,
- ii) Chapter XIV of the Central Bank's Compendium of Foreign Exchange Regulations.

These regulations establish a framework for the administration of the government's foreign investment policy.

## **Key Recent Developments**

- Recently, large private sector mining interests have voluntarily adopted a new royalty scheme that raises their taxes as the government seeks funds to pay for reconstruction after the devastating earthquake of February 2010 and Chile's long term development. The companies that have adhered to this new system are Antofagasta Minerals, BHP Billiton, Anglo American, Xstrata and Freeport-McMoRan Copper & Gold, which represent approximately 80% of the national volume production.

The aforementioned mines currently pay a royalty of between 4% and 5%, whereas the new scheme initially sets this royalty at 4% to 9% on a sliding scale and raises this to 5% to 14% as from 2018. The percentage ultimately paid by mines will depend upon their operational margins. Acceptance is not obligatory, but the government has offered to extend the period of tax invariability for those companies that voluntarily adhere to the new taxation scheme - giving them immunity to any changes to the taxation scheme by future governments.

Some mining executives have commented that the new scheme undermines Chile's business confidence and could scare away investment. Still, the majority opinion is that the overall amount of the royalty tax paid by any company will not increase exponentially and record copper prices will spur on further investment in Chile.

- Following the San Jose mine accident of 2010 that trapped 33 Chilean miners underground for 70 days, the government announced the creation of a commission to review Chilean legislation on workplace safety, mechanisms for enforcement and the level of fines for infringements. Looking forward, more regulation is expected, which could pose some challenges to deal activity, but will force companies not only to comply with legal regulations

## **Likely developments in 2011**

### **Increased Chinese Investment and Project Financing**

Chile is one of two Latin American countries expected to have higher GDP growth in 2011 than 2010, thanks to strong domestic demand and a favorable external backdrop (high copper prices). Given Chile's responsive political system, the transparency of its public institutions, its strong fiscal performance and solid macroeconomic policy coordination, the Chilean economy has become more resilient to external shocks and natural disasters.

Many years of careful economic management have boosted its capacity to take countercyclical measures and mitigate the impact of such events. It is expected that domestic demand will continue to enjoy strong momentum and copper prices are likely to remain elevated, supporting an increased output of copper, Chile's largest export by value. The main risks to this favorable scenario are strong appreciation pressures and global uncertainty; however, these will likely be countered provided China continues its strong growth and urbanization.

This positive economic outlook, together with Chile's stable and regulated mining industry, means that Chile will likely continue to attract Chinese participation in developing mines, through an inflow of foreign capital and funds, human forces, equipment and technologies.

Finally, the evident lack of barriers to global capital flows creates other opportunities for Chinese to cooperate with Chilean enterprises in possession of mineral resources, but in want of related debt and project financing. Chinese investors will distinguish themselves from others by showing a long-term interest in investing in Chile due to China's stable demand for raw materials in the future.

### **Potential Reform to DL 600**

As a result of an agreement between government and opposition legislators during passage of the afore-discussed law that created the new mining royalty tax, a commission has been set up to study possible changes to the DL600. Although this law reform process is in an early stage, any changes will surely only benefit Chinese outbound investors as the Chilean government works to actively promote the consolidation and growth of China-Chile trade and investment relations.

### **Additional Guidance**

Foreign investors should ensure that they understand the foreign investment framework and legal and tax aspects. Therefore, the importance of having excellent advisors to provide counsel is critical.

In our firm's opinion, the best way for Chinese companies to enter Chile is to become partners with Chilean companies and develop joint activities, which will allow China to enter easily in a market that it is relatively unknown to them. In particular, you need advisors who have excellent relationships with both public and private sectors to help lobby and successfully execute the deal.

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This article was written by Grasty Quintana. For further information, please visit [www.gqmc.cl](http://www.gqmc.cl).

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