

Asset Conservation Strategies for Mining Companies and the Use of Special Committees

Introduction

Mineral exploration and development companies are currently experiencing difficult market conditions within which to raise required funding. The project debt and public markets are currently closed to financing and the costs of development have been increasing. In addition, the prices for most metals have fallen off dramatically from the price levels in existence at the time many of the current projects were started. In these circumstances, companies are being forced to evaluate the sustainability of projects currently under development. In addition to evaluating potential strategic options (including a sale of the company or a strategic partnership with a bigger industry player), companies may also have to evaluate an asset conservation strategy. An asset conservation strategy may be preferred to a sale or strategic partnership which in the current market may result in a “firesale” and/or significant dilution to existing shareholders.

Asset Conservation Program

The purpose of an asset conservation strategy is to preserve value for shareholders by minimizing project development in the short term in order to preserve cash and bridge the company until such time as a permanent financing or other strategic option can be implemented (or implemented on more favourable terms than are currently available).

Elements of an asset conservation program may include the development and implementation of:

- a shutdown or hibernation plan at the project site and related offices and facilities;
- a review of existing contractual obligations and an assessment of potential liabilities resulting from an implementation of an asset conservation program;
- a communications plan for public disclosure of the decision to implement an asset conservation program and communication with significant stakeholder groups;
- a plan with respect to dealing with suppliers and cancelling commitments to conserve cash;

- an employee/human relations plan (including downsizing and/or employee retention plans);
- a “value in the ground” maximization plan (including an exploration plan to increase reserves during the asset conservation period);
- an equipment salvage analysis;
- a financial reporting plan and periodic cash flow updates; and
- a strategy for evaluating potential financing and/or strategic alternatives following the announcement and implementation of the asset conservation program.

Use of a Special Committee and Recommended Practices

In the circumstances of evaluating whether to implement an asset conservation program, it may be prudent to establish a special committee of the board of directors to review matters and report to the board of directors. While there is no legal obligation to establish a special committee in these circumstances, the use of a special committee may offer a number of advantages, including enhanced efficiency in the decision making process and mitigating the potential influence or bias of senior management (eg, management may have a bias toward continuing the project development).

Below is a list of recommended practices (derived from Canadian and US experience) with respect to the use of special committees.

Timing

A special committee should be established as soon as possible in the process.

Composition

The members of a special committee should have no interest in the matters under consideration other than that of a shareholder and should be free of any disabling conflicts. The independence of the members of a special committee is a context-driven determination (ie, independence for general securities law purposes may not be sufficient). The use of questionnaires (distributed to and completed by

members of the committee and reviewed by counsel) is one way to focus attention on the determination of independence.

A multi-member committee is preferable to a single member committee.

Compensation

Since considerable time will normally be required to carry out their work, the members of a special committee are entitled to special compensation.

Mandate

A special committee must be given a clear mandate that has been approved by the board of directors, reflected in the written record and understood by the members of the special committee. In addition to being given the authority to act with respect to the relevant matter, a special committee must also be given the authority to retain and compensate its own professional advisors.

Counsel

A special committee should have its own legal advisors. The special committee should also have access to the corporation’s internal and external counsel so that it has the benefit of their knowledge as part of its process.

Financial Advisor

Directors of a corporation are protected from liability if they rely in good faith on financial information with respect to the corporation or the relevant matter under consideration provided by an appropriate officer or the auditor of the corporation or on a report of a professional advisor. For example, in transactions with financial implications, retaining and obtaining the advice of a financial advisor is an effective way for directors to demonstrate that they have acted on an informed basis and to protect themselves. In the context of deliberations relating to an asset conservation program, the use of an independent accounting firm is recommended (an accounting firm can assist in the generation of cash flows and related financial modeling).

The special committee should take care not to lose control of its processes or to let its professional advisors make decisions for them. Only the business decisions of directors have the benefit of the business judgement rule. Professional advisors should advise, not decide.

Deliberations

A special committee must act in an informed, deliberate and careful manner. Given the spectre of self-interest and the usually small size of special committees, the courts may look carefully at the number, length and frequency of meetings and the attendance of each member. In person meetings are more desirable than telephone meetings, particularly for important deliberations.

Privilege

Counsel to a special committee must be sensitive to issues of attorney-client privilege. The client is the special committee, so disclosure to management or other directors will waive privilege.

Liability, Indemnification and Insurance

Counsel to a special committee should consider and advise the members of the special committee of litigation and personal liability risks to which they may be exposed. This will necessarily involve a careful review of the indemnities and insurance coverage provided by the corporation to directors.

Minutes

Reasonably detailed minutes should be kept of all meetings of a special committee. The minutes should describe the time spent, the deliberations undertaken, the issues discussed, the advice received and considered and the decisions taken by the special committee. The minutes should be prepared by counsel to the special committee.

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

ABOUT McMILLAN LLP

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Our Mining Group has extensive hands-on experience in mineral industry issues, in Canada and internationally. Members of the Mining Group have been actively involved in issues and transactions through all stages of exploration, development and production (including the purchase and sale of mines and mineral product) and related environmental issues (including mine closure). We advise on project financing, securities issues, bank financing, take-over bids, foreign investment, government relations, negotiations with First Nations and corporate social and responsibility issues. In addition, the Mining Group provides mineral policy and strategy advice to governments and industry participants globally.

For further information, please contact Jeff Snow or Sean Farrell or one of the other members of our Mining Group:

Frank Archibald	416.865.7187	frank.archibald@mcmillan.ca
Michael A. Burns	416.865.7261	michael.burns@mcmillan.ca
Jason Chertin	416.865.7854	jason.chertin@mcmillan.ca
Charles Chevrette	514.987.5003	charles.chevrette@mcmillan.ca
Carmen L. Diges	416.865.7925	carmen.diges@mcmillan.ca
David R. Dunlop	416.865.7175	david.dunlop@mcmillan.ca
Sean M. Farrell	416.865.7910	sean.farrell@mcmillan.ca
Michael Friedman	416.865.7914	michael.friedman@mcmillan.ca
Barbara Hendrickson	416.865.7903	barbara.hendrickson@mcmillan.ca
Neal Hewitt	416.865.7287	neal.hewitt@mcmillan.ca
Larry Markowitz	514.987.5052	larry.markowitz@mcmillan.ca
Anastasia Mamay	416.865.7897	anastasia.mamay@mcmillan.ca
Robert K. McDermott	416.865.7085	robert.mcdermott@mcmillan.ca
Todd A. Miller	416.865.7058	todd.miller@mcmillan.ca
Jean-François Pelland	514.987.5081	jean-francois.pelland@mcmillan.ca
Michael Peterson	416.865.7839	michael.peterson@mcmillan.ca
Jeffrey Rogers	416.865.7818	jeff.rogers@mcmillan.ca
Robert Scavone	416.865.7901	rob.scavone@mcmillan.ca
Karim Sharobim	514.987.5010	karim.sharobim@mcmillan.ca
Jeffery Snow	416.865.7931	jeff.snow@mcmillan.ca
Robert Wisner	416.865.7127	robert.wisner@mcmillan.ca

www.mcmillan.ca



McMillan LLP

Toronto | t 416.865.7000 | f 416.865.7048
 Montreal | t 514.987.5000 | f 514.987.1213

Barristers & Solicitors