Understanding Streaming Agreements and Royalty Agreements: Alternatives to Traditional Financing

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I. Introduction[*]

The earliest royalties involved payments to a sovereign in exchange for the right to extract minerals owned by the state. This concept was later adopted by prospectors and the owners of mineral rights, who often retained a royalty upon selling, leasing or optioning the mineral rights to another party who may develop and mine them. In addition, royalties are often used in the context of joint venture arrangements when a participant is diluted below a threshold percentage and its participating interest is converted into a royalty. Such royalties commonly include unit royalties, gross overriding royalties, net smelter return royalties and net profits interest royalties.[1] Usually, royalties are payable in cash. However, some royalties (typically, precious metals royalties) provide the holder of the royalty (Royalty Holder) with the option to receive the royalty payment in minerals (that is, "in kind").

In the context of options and joint ventures, the royalty is usually a small part of a larger commercial arrangement. The granting of the royalties under such agreements is contingent on some future event, which may or may not occur. Unfortunately, there is a tendency to pay less attention to drafting the royalty than the main agreement in such circumstances. Often, the royalty provisions are sparse and are attached as a schedule, sometimes without a lot of care taken to integrate the schedule with the body of the agreement or to deal with various contingencies that could occur if the royalty is ultimately granted.

More recently, royalties have been sold to royalty investment companies or other investors in order to provide financing for exploration,

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[*] For additional coverage of streaming agreements, see Mark T. Bennett & Kari MacKay, "Under the Rocks Are the Words: How a Metal Purchase Agreement Revolutionized Alternative Financing and Launched the New Majors—A Look Back at the First Decade of Streaming Transactions," 60 *Rocky Mt. Min. L. Inst.* 16-1 (forthcoming 2014).

[1] There are other less common royalties, including net mill returns, gross smelter return royalties, net proceeds of production, and others, that will not be considered in this paper.

development and mining operations, as traditional sources of equity and debt financing have become more difficult to obtain. Like streaming agreements, these royalty agreements are likely to be self-contained, internally consistent agreements with more expansive provisions, because the royalty is the focus of the agreement, not an ancillary part of it that may or may not ever come into effect.

Streaming arrangements are a much more recent development, first emerging in their current form around 2004. A streaming arrangement typically involves the payment of a large up-front deposit (or a series of payments upon achieving certain milestones) by a party (Purchaser) to an operator in exchange for the right to purchase all, or a specified percentage, of the production of a specific refined metal at a predetermined price (Fixed Price) below the market price. The Fixed Price is usually set at the estimated cost to produce such metal.

The metal to be purchased is usually a by-product of the mine (e.g., silver or gold from a copper mining operation), but it may also be the primary metal mined (e.g., gold from a gold mine). The deposit can provide valuable financing to the operator in developing, constructing, or expanding its mining operation, or to refinance existing debt. Unlike most royalty agreements, streaming agreements contemplate the delivery of metals (most commonly, gold or silver) or, more typically, associated credits which can be sold on metals markets. Streaming agreements are long and complex commercial agreements, which are negotiated between sophisticated parties and therefore lack the uncertainty that can arise with many royalty agreements that do not deal with many of the contingencies that could occur in the future.

In this paper, royalties will be referred to as “Royalties” (and their associated agreements as “Royalty Agreements”) and streaming arrangements will be referred to as “Streaming Transactions” (and their associated agreements as “Streaming Agreements”).

II. Royalty Agreements

A Royalty in the mineral exploration and mining industries typically involves a right of the Royalty Holder to receive a cash payment from an operator of some portion of the proceeds from the sale of minerals sold from production of the property to which the Royalty relates. In some cases, the Royalty Agreement can provide the Royalty Holder with the right to obtain payment in the form of a portion of the minerals extracted from the property, which is known as “taking in kind.” Royalties may be payable on only one mineral, such as gold, several minerals, such as gold, silver and copper, or on all minerals extracted from the property to which the Royalty relates.

Royalties may be used in structuring purchase, option and joint venture transactions involving mineral properties, or may be granted on mineral properties and sold to generate revenue for the operator. In the case of an outright sale of a mineral property, the prospector or owner may negotiate the retention of a Royalty on the property, usually in addition to receiving other consideration such as cash or shares of the acquiring corporation (particularly if the acquiring corporation is a publicly traded company). In an option agreement, the optionor may negotiate the retention of a Royalty on a mineral property upon exercise of the option.

In the context of a joint venture, one party usually contributes a property and the other party contributes cash, and the parties are required to contribute pro-rata in financing the joint venture. In the event a party does not contribute its pro rata share of funding, a joint venture agreement will usually provide that the non-contributing party's participating interest is "diluted," and if it is diluted below a certain threshold (usually, 5 to 15%), the non-contributing party's participating interest is converted into a Royalty.

Royalties are non-participating interests in the mining project, which means that the Royalty Holder makes no further investment and has no right to participate in or have any say in the development or mining operations. Furthermore, the Royalty Holder generally does not have the right to review technical information or data, such as exploration results on the property to which the Royalty relates, and may not have the right to review or audit the books and records of the operator to verify the veracity of the operator's calculations of the Royalty, absent express rights granted by Royalty Agreement.

The most common Royalties are unit royalties, gross overriding royalties, net smelter return royalties and net profits interest royalties. There are no "standard form" agreements for any of the foregoing types of Royalties, but there are similarities in respect of how each type of Royalty is calculated that differentiates it from the others.

[1] Unit Royalty

A unit Royalty (Unit Royalty, also known as a "fixed rate" or "production" royalty) is a Royalty based on the price per unit of measure (e.g., $1.00 per tonne) without any deductions for costs. The Unit Royalty is typically used for low-unit-value material which can be marketed after minimal processing and which is relatively homogeneous, such as solid bulk minerals like coal,[2] iron ore, phosphate, potash, salt or sulfur, and gravel, cobbles, limestone, or other industrial minerals.[3]

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[2] In recent years, the trend for coal royalties has been to state the production royalty as a percentage of the amount received by the operator from the sale of coal, which unlike a fixed price per tonne accounts for price fluctuations in the price of coal. A variation on this theme is to provide for the greater of a fixed price per unit and the percentage of sales price,

One benefit of the Unit Royalty is that it is easy to calculate and, therefore, easy to verify. The Unit Royalty works well if inflation is low and commodities prices are relatively stable. However, if there is a significant increase in operations costs or decrease in commodity costs, the Unit Royalty can become a burden on the economics of the project. On the other hand, if operations costs significantly decrease due to technological advances or if the price for which the commodity may be sold increases significantly, the Royalty Holder will not participate in the financial windfall.[4]

To ameliorate these downsides to some extent, some Unit Royalties include an annual increase (or decrease) in the price per unit to be paid to the Royalty Holder based on an index of inflation (or deflation),[5] or may include more than one price per unit to be paid to the Royalty Holder, which is determined by the market price of the commodity (e.g., $1.50 per tonne of coal if the market price for coal is below $60, and $2.00 per tonne if the market price for coal is $60 or greater).

[2] Gross Overriding Royalty

A gross overriding Royalty (Gross Overriding Royalty) is usually calculated based on the percentage of the value of mineral products produced, without deduction for costs or with deduction for the costs to make the mineral products marketable and to deliver them to market. The Gross Overriding Royalty is best applied to commodities that can be sold with minimal processing, such as diamonds. Gross Overriding Royalties for diamonds are calculated by multiplying the negotiated Royalty percentage by the appraised value of the diamonds at the mine site.[6] Like Unit Royalties, Gross Overriding Royalties are payable regardless of whether the mine is profitable.

[3] Net Smelter Returns Royalty

A net smelter return Royalty (NSR Royalty) is based on a percentage of the revenue generated from the sale of ore, concentrates or other mineral products produced from mining property, less certain allowable deductions. Usually, the deductions are limited to (1) transportation costs from the mine to the buyer (usually a smelter, refinery or mint); (2) insurance and

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which protects the royalty holder from downside price changes but enables participation in increases in sales prices. *See* Burns H. Errebo, "Coal Royalties," 26 *Rocky Mt. Min. L. Inst.* 3-1, 3-4 (1980).

[3] Bruce C. Kirchhoff & Karol L. Kahalley, "International Mining Royalty Issues," 57 *Rocky Mt. Min. L. Inst.* 15-1, 15-3 (2011).

[4] *Id*.

[5] Ralph W. Godell & Paul J. Schlauch, "Precious Metals Royalties," 35 *Rocky Mt. Min. L. Inst.* 10-1, 10-17 (1989).

[6] Peter L. Webster & Chris G. Baldwin, "Selling the Crown Jewels: Diamond Royalties and Marketing Agreements in Canada," 50 *Rocky Mt. Min. L. Inst.* 13-1, 13-10 (2004).

security costs for transporting the mineral product from the mine to the buyer; (3) all costs, expenses and charges paid or incurred in connection with the refinement or beneficiation of the mineral product, including all smelter and refinery charges and all weighing, sampling, assaying, representation and storage costs, metal losses and umpire charges, and penalties for impurities charged by the processor, refinery or smelter; and (4) *ad valorem* taxes relating to severance or sale of mineral product (excluding the seller's income taxes). There is typically no deduction for the cost of mining or milling ore at the mine site, for capital costs, or for any other costs associated with the production, marketing or sale of mineral products. Typically, NSR Royalties are set at between 0.5% and 3% of net smelter returns.

The NSR Royalty is based on the recovery of metal and not the metal content mined, so the NSR Royalty may be affected by the type of processing chosen (e.g., heap leach typically results in lower recovery of gold than conventional milling). Recovery of the metal may also be negatively affected if more than one mineral is being extracted from ore in the milling process.

A NSR Royalty usually becomes payable as soon as production begins, and therefore is considered as a cost of production in determining the economics of a mine. A NSR Royalty that is too high, or a series of such Royalties burdening a property, may make it uneconomical to mine a property, or result in premature closing of an existing mine when, for example, higher grade ore is mined out and lower grade ore that would otherwise be mined is not because a profit cannot be made on it. A NSR Royalty may be structured so that it ends after a specified number of ounces of precious metal is produced, for example, or continue for the life of the mine. A benefit of the NSR Royalty is that it is easy to calculate and verify. For example, "gross receipts" will be the amounts paid to the operator by the smelter or refinery, as evidenced by "settlement sheets" provided by the smelter or refinery.

[4] Net Profits Interest Royalty

The net profits interest Royalty (NPI Royalty) is a percentage of the profits realized from operations carried out with respect to the property less operations costs and after all exploration and development costs have been recovered by the operator. Often, interest on money borrowed by the operator for the project is also deductible in calculating profit. In some cases, the agreement provides for accounting reserves to be established for reclamation and working capital, which amounts are also deductible.

Unlike the NSR Royalty, the holder of the NPI Royalty will not accrue payments on the Royalty upon commencement of commercial production, since the operator will be entitled to deduct all exploration and capital costs (which may be large) prior to earning a "profit." NPI Royalties are typically difficult to calculate and therefore can be subject to disputes between the operator and the Royalty Holder. NPI Royalties can be subject to "creative accounting," which is why some commentators have referred to this Royalty as the "no profits intended" royalty. From the operator's perspective, NPI Royalties may be preferable to NSR Royalties because payments need not be made until a "profit" is obtained, which means that, unlike the NSR Royalty, the NPI Royalty does not act as a cost of the project which must be considered in determining whether the property can be mined economically.

Typically, NPI Royalties are set at 10% to 20% of profits or more, but due to the extensive deductions and the delay in receiving payments until exploration and capital costs are paid, it is possible that the Royalty Holder may receive less in Royalty payments than if such holder had a 0.5% to 3% NSR Royalty instead.

[5] Some Common Royalty Provisions

The provisions of the Royalty Agreement may permit the Royalty Holder to specify that it wishes to receive the Royalty payment "in kind." This provision does not cause problems if the Royalty relates to precious metals such as gold and silver, as long as the Royalty Agreement provides for how the permitted deductions are to be dealt with (i.e., usually a percentage of the minerals are withheld to cover the cost of the deductions), but could create problems when dealing with other minerals. Royalties on diamonds should not permit taking in kind, since they are highly individualistic and virtually impossible to divide equitably.[7]

Royalties do not become payable until commercial production commences, or sometime after commercial production in the case of NPI Royalties. Royalty Agreements can provide for advance Royalties which are payable periodically (usually, annually) until commercial production occurs, and are usually credited towards payments owing following production. Advance Royalties discourage an operator from "warehousing" the property (i.e., just holding the property and not exploring and developing it).

Royalty Agreements may also include minimum Royalties, which, although not paid until after the commencement of commercial production, guarantee a minimum payment per period (usually, per year) to the Royalty Holder. The amount of the minimum Royalty that exceeds what the Royalty Holder would otherwise receive under the Royalty Agreement may in some cases be credited against Royalty payments in future years, effectively reducing the payments made in those years.

Royalties may be capped at a certain fixed amount, so that Royalty payments will cease once the cap is reached. The operator may also have the right under the Royalty Agreement to buy the Royalty or a fraction of it

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[7] *See* Karl J. C. Harries, *Mineral Agreements and Royalties*, vol. 1, ch. 5 & vol. 2, at 648 (Can. Inst. of Mining, Metallurgy & Petroleum, spec. vol. 55, 2003).

back for a certain price set in the Royalty Agreement. Sometimes the right of the operator to buy back the Royalty is limited to a certain time period (e.g., before commencement of commercial production).

Sophisticated producers will typically engage in forward sales, future trading, commodity options trading and other hedging transactions to reduce their risk of loss. Royalty agreements should stipulate that the Royalty Holder will neither benefit from, nor participate in, any losses resulting from such hedging activities.

III. Streaming Agreements

As is the case with Royalties, there is no "standard form" Streaming Agreement, but the main concepts of such agreements are fairly standard. Generally, in a Streaming Transaction the operator agrees to sell, and the Purchaser agrees to purchase, a certain percentage (or all) of one or more minerals produced from a mining operation at a Fixed Price, which is below the market price and usually approximates the cost of producing and delivering the minerals purchased (typically between US$4 and US$6 per ounce of silver and US$400 per ounce of gold but may be higher for some operators). The duration of Streaming Transactions is usually long term (several decades) or life-of-mine. Typically, the mineral sold under a Streaming Agreement is a by-product of the mining operation, although this need not be the case. In exchange for the right to acquire the minerals, the Purchaser agrees to pay an up-front deposit (or make a series of payments based on achieving certain milestones), which may be large (several million to a billion or more dollars), and which can replace other forms of financing such as equity or debt. Such an up-front payment can be very attractive for a development company that is not yet in production, which is able to monetize the streamed minerals prior to extracting them and apply the funds towards development and construction of its mine. The Streaming Agreement will set out whether the operator may spend the deposit as it sees fit, or whether the deposit must be spent only for specific purposes. Like Royalty Agreements, Streaming Agreements are non-participating interests in the mining operation.

A Streaming Agreement usually requires a repayment of the deposit back to the purchaser upon termination of the agreement under certain circumstances, such as breach of the agreement by the operator. However, Streaming Agreements usually provide that if the Fixed Price paid by the Purchaser is less than the market price of the mineral, the difference between the market price and the Fixed Price is "credited" toward the deposit, effectively reducing the amount of the deposit that must be paid back upon termination of the agreement. In addition, Streaming Agreements usually provide that once the deposit has been credited down to zero, the Purchaser will continue to purchase the streamed minerals at the lesser of the Fixed Price and the market price for the remaining term of the Streaming Agreement.

A Streaming Agreement may require delivery of actual metal (e.g., gold or silver bars) or, more typically, a credit to the Purchaser's metal account. When the Streaming Agreement provides for the operator to credit the Purchaser's metal account, no actual metal must be delivered. Rather, the operator will need to purchase credits (such as gold credits or silver credits) on metals markets such as the London precious metals markets maintained by the London Bullion Market Association and transfer those credits to the Purchaser's account in lieu of delivery of actual metal. Usually, the Purchaser will then sell the credits without ever receiving the streamed minerals.

Unlike most Royalty Agreements, Streaming Agreements usually contain representations and warranties by each party to the other. Each party will typically represent and warrant that as a corporate entity (i) it is in good standing; (ii) it has complied with all required corporate acts and proceedings to approve the Streaming Agreement; (iii) it has all requisite corporate power, capacity and authority to enter into the Streaming Agreement; (iv) it has received all required third-party approvals to enter into the Streaming Agreement; (v) it has not suffered an insolvency event; (vi) entering into the Streaming Agreement will not conflict with any agreement, other obligation, or constitutional documents of the company, or violate any law, and (vii) the Streaming Agreement constitutes a legal and binding obligation of the company. The operator will usually further represent and warrant that (i) it is the legal and beneficial owner of the mining properties as described in the Streaming Agreement; (ii) no person has any right or option to acquire the mining properties or the streamed minerals; (iii) all outstanding taxes have been paid; (iv) the mineral properties are in good standing; (v) there is no outstanding judgment or pending or threatened claim that could materially affect its assets; and (vi) all documents and data provided to the Purchaser in due diligence regarding the mining properties and the operator's material contracts were true and correct. Of course, the parties may make other representations and warranties as well, depending on the circumstances.

Streaming Agreements also usually contain covenants from each party (First Party) to the other (Other Party), whereby the First Party agrees to indemnify the Other Party for losses incurred by such Other Party as a result of an inaccuracy in a representation or warranty or a breach of any obligation in the Streaming Agreement by the First Party. Streaming Agreements may also include provisions prohibiting solicitation by the Purchaser of the operator's employees, and standstill provisions prohibiting the Purchaser from acquiring any (or more than a set percentage) of shares of the operator. The operator also typically agrees to provide copies of all offtake agreements to the Purchaser and agrees to enforce them if there is any breach of the offtake agreement by the offtaker.

Streaming Agreements typically provide conditions precedent to payment of the deposit (or of any particular payment if the deposit is to be paid in stages over time), which may include delivery of an officer's certificate confirming that all representations and warranties made in the agreement are true and correct along with delivery of documents and legal opinions evidencing the truth and correctness of certain of the representations and warranties, delivery of security agreements, delivery of inter-creditor agreements (if required) and, if applicable, delivery of a commingling plan.

Streaming Agreements usually contain rights of each party to terminate the Streaming Agreement for breach of the agreement by the other party. In addition, the Purchaser may be given the right to terminate the Streaming Agreement if the conditions precedent to payment of the deposit (or of any particular payment if the deposit is to be paid in stages over time) are not satisfied.

A potential benefit of a Streaming Transaction is that the value of the by-product mineral(s) being sold may not be fully reflected in the operator's share price (especially true for by-product minerals) and may be more valuable in the hands of the Purchaser (streaming company), resulting in an arbitrage opportunity that could create value for both the Purchaser and the operator's shareholders. In addition, the operator receives a large up-front payment (or payments) that may be used to build or expand its mine without the requirements to make periodic payments of principal and interest, as with a debt transaction, or a dilution of the interests of existing shareholders, as may occur with equity financings. A Streaming Transaction may also be seen by the market as a "vote of confidence" by the streaming company in the operator or its mine. On the other hand, a Streaming Agreement may reduce the valuation of a mine if it is to be sold, if the value of the streamed mineral rises after the agreement is entered into.

IV. Provisions That Are Common to Both Agreements

Several provisions that are common in both Streaming Agreements and Royalty Agreements are discussed further below.

[1] Security

The rights of the Purchaser under a Streaming Agreement may be secured or unsecured. Usually, the rights of the Purchaser will be secured, unless the operator is a large, well established mining company unlikely to default in its obligations under the Streaming Agreement. The rights of a Royalty Holder under a Royalty Agreement may also be secured, although this is less common, particularly if the Royalty is granted as consideration for the acquisition of mineral tenures from a prospector or under an option or joint venture agreement.

Where such rights are secured, the agreement usually provides for the granting of a first charge security interest by the operator to the Purchaser or Royalty Holder over the mining property, project assets, produced minerals and proceeds thereof. Any subsidiaries of the operator that have an interest in the mine's assets may be required to guarantee the obligations of the operator under the security agreements. Where security is granted, the agreement may contemplate additional financing requirements by the operator by including an agreement of the purchaser to execute "inter-creditor" agreements with such new financiers in order to subordinate its first charge in some respects. Usually, operators in the development stage will anticipate substantial project financing and the requirement of such lenders to obtain a first charge on most mine assets, so the participation of the Purchaser in executing inter-creditor agreements will be essential in order for mine construction to be completed. Agreements entered into by operators with an operating mine may not need to contemplate additional financings, as project financing, if it was required at all, will have already been obtained and secured and any security taken by the Purchaser or Royalty Holder will be subordinated to the existing security of the project financing lenders.

The form of security will vary depending upon the local laws of the area in which the mine is situated. Assets of the mine that are interests in land (such as Crown Granted Mineral Claims in British Columbia) may be mortgaged; personal property, including future acquired personal property, may be subject to a general security agreement registered in the local Personal Property Registry; and property that is neither land nor personal property (such as mineral claims in British Columbia) may be subject to a general security agreement, which in the case of mineral claims should be recorded in the applicable mineral titles registry or mining recorder's office to provide notice of the encumbrance to any potential purchaser of the mineral claims. Alternatively, the operator may be required to grant a debenture, which will secure all of the assets of the mining operation, including real property, personal property, minerals, inventory, and other assets, and which can be filed in the various government registries.

[2] Periodic Reporting and Site Visits

Most Streaming Agreements and many Royalty Agreements provide for periodic (usually monthly and annual) reporting by the operator to the Purchaser or Royalty Holder on production from the mine, production forecasts for the next period and certain financial information. Notice of any events that may materially adversely affect a project, such as labour disruptions, legal actions and failures to obtain necessary regulatory approvals, may also be required.

In a Royalty Agreement, provision should be made to give the Royalty Holder the right to information that enables the Royalty Holder to verify the calculation of the Royalty payment. A Royalty Holder that contemplates selling his interest in the future may wish to seek a right to obtain broader access to information about the project, not just the financial information necessary to verify the Royalty payments, as this information will be useful to justify the value of a Royalty to a potential purchaser.

Much more information is usually required from the operator in a Streaming Transaction. The Purchaser will usually require monthly reports during construction and information relating to production, including mine operating plans, most recent reserve and resource estimates, budgets, production forecasts, feasibility studies, offtake agreements, technical reports and development programs in order to verify its current purchase obligations and estimate its future obligations and ensure the operator is complying with its obligations under the Streaming Agreement.

Closely related to the rights of the Purchaser and a Royalty Holder to receive periodic reports and access to information sufficient to confirm the Royalty calculations are rights of the Purchaser or Royalty Holder to inspect the mine at reasonable times, at such party's sole risk and expense. Such a provision is more common in a Streaming Agreement than in a Royalty Agreement, given the expanded obligations of the operator to the Purchaser under a Streaming Agreement.

Pursuant to National Instrument 43-101, *Standards for Disclosure for Mineral Projects* of the Canadian Securities Administrators (NI 43-101), an issuer in Canada is required, under certain circumstances, to prepare and file on the SEDAR.com website a technical report on a "mineral project" that is material to such issuer.[8] Subject to limited exceptions, the qualified person who prepares or supervises the preparation of the technical report must personally inspect the property subject to the technical report prior to completing the report. A "mineral project" is defined in NI 43-101 to include "a royalty or similar interest," which is considered to include an interest in a revenue or commodity stream from a proposed or current mining operation.[9] Section 9.2 of NI 43-101 provides certain limited exemptions from the requirement of a Royalty Holder or Purchaser to file a technical report, because it is recognized that the holder of a "royalty or similar interest" may not have a right to access the scientific and technical data on the property that is necessary to prepare a technical report, absent

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[8] Part 4 of NI 43-101 sets forth the circumstances in which a technical report will be required, which include (but are not limited to) the filing of a preliminary prospectus, annual information form, offering memorandum or proxy circular concerning an acquisition of a material mineral property where such documents contain scientific or technical information on a material mineral project.

[9] See section 9.2(1) of Companion Policy 43-101CP to National Instrument 43-101 Standards of Disclosure for Mineral Projects, of the Canadian Securities Administrators.

an express contractual right to demand such data from the operator. However, the exemptions generally require that either the operator has publicly disclosed all scientific and technical information that is material to the issuer or the issuer has requested but not received access to the necessary data and is not able to obtain it in the public domain. Accordingly, some Royalty Agreements and Streaming Agreements specifically include provisions that require the operator to use commercially reasonable efforts to assist the Royalty Holder or the Purchaser to obtain scientific and technical information sufficient for the Royalty Holder or the Purchaser to produce a technical report required by NI 43-101, and to grant the Royalty Holder or the Purchaser rights to access the property so that the qualified person preparing or supervising the preparation of the technical report may fulfil his or her obligations to conduct a personal inspection of the property, as required by NI 43-101.

[3] Operator Maintains Control over Decisions

Both Streaming Agreements and Royalty Agreements usually contain provisions that maintain the sole discretion of the operator over decisions in respect of exploration, development and mining of the property, although most Streaming Agreements will provide a qualifier limiting such discretion to circumstances where the operator is acting in a commercially reasonable manner and consistent with accepted mining practices. Neither a Purchaser under a Streaming Agreement nor a Royalty Holder under a Royalty Agreement is a joint venturer and accordingly should not be entitled to participate in such decisions. However, some Streaming Agreements, particularly those which involve smaller development or mining companies, may require the operator to use its commercially reasonable efforts to achieve or expand its production to certain minimum tonnages by certain dates in the future.

Usually it is assumed that the interests of the operator and the Royalty Holder or the Purchaser are aligned, but this may not always be the case. A prudent decision of an operator to maximize return on investment over recovery (e.g., choosing a heap leach operation over conventional milling for gold) may result in a reduction in the amount of the mineral recovered and therefore, a lower Royalty payable or less metal to be purchased under a Streaming Agreement. To avoid disputes about whether the operator has to take the interests of the Royalty Holder or the Purchaser into account when making such a decision, the agreement should clearly specify that all operational decisions are to be made by the operator, subject only to ordinary prudence.[10]

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[10] *See* Ralph W. Godell & Paul J. Schlauch, "Precious Metals Royalties," 35 *Rocky Mt. Min. L. Inst.* 10-1, 10-11 (1989).

[4] Commingling and Unitization

Often an operator will want to be able to commingle ores from the property subject to the Streaming Agreement or Royalty Agreement with ores from surrounding properties. In circumstances where a Royalty Agreement or Streaming Agreement only covers part of the property being mined, commingling may increase the efficiency of the mining operation, because ore from the property subject to the agreement will not have to be run through the mill separately from ore outside of such area. However, the Purchaser or Royalty Holder will want to ensure ore subject to its interest is not commingled with lower grade ore or different metallurgies from surrounding areas, so provisions for testing the ore from the different locations before it is processed are usually included in the agreements.

Unitization, which may be permitted in some Royalty Agreements, eliminates the need to account for production from the area subject to the Royalty and surrounding areas. Unitization allows accounting and operations to be based on an agreed specific percentage division of production from the property subject to the Royalty and surrounding properties from combined ores. It is a concept borrowed from the oil and gas industry, where liquids or gases can migrate from one property to another during extraction. Consequently, unitization is most appropriate for in situ leach operations (which can be used in uranium, copper and potash) if the grade and distribution is relatively stable across the entire project.[11] Given the minerals involved in in situ leach operations (which do not include precious metals), unitization is not likely to be relevant to Streaming Agreements.

[5] Confidentiality

If a Royalty Agreement or Streaming Agreement provides for periodic reporting of financial or project information to the Royalty Holder or Purchaser or site visits by the Royalty Holder or Purchaser, the agreement should contain confidentiality provisions, prohibiting the Royalty Holder or Purchaser, as the case may be, from disclosing such non-public information to third parties. There are always certain limited exceptions to the confidentiality obligation, which typically include where the information:

- is or becomes generally available to the public, other than as a result of breach of the confidentiality provision,
- was lawfully and in good faith obtained by the recipient from an independent third party without breach of the confidentiality provision,

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[11] Stan Dempsey & Randy L. Parcel, "The Evolution of the Mining Royalty," 53 *Rocky Mt. Min. L. Inst.* 30-1, 30-13 (2007).

- was in the possession of the recipient on a non-confidential basis prior to disclosure of such confidential information,
- is provided to the recipient's auditor, legal counsel, lenders, brokers, underwriters and investment bankers with which it is considering or intends to enter into a transaction for which the confidential information would be relevant, provided such third parties agree to maintain the confidentiality of the information;
- is provided to the recipient's and its affiliates' directors, officers, employees, representatives and agents who need to have knowledge of the confidential information, provided such third parties agree to maintain the confidentiality of the information; or
- is required to be disclosed pursuant to applicable securities or other laws, legal process or stock exchange rules or regulations.

Often, the confidentiality provision also prohibits disclosure of the existence of the agreement itself. However, if a public company is involved, disclosure of the existence of the agreement, and even filing of the agreement itself on SEDAR (Canada) or EDGAR (USA), publicly accessible websites, may be required. In Canada, the agreement will generally be required to be filed (although redaction of sensitive information is permitted) if the transaction is material to the company and the agreement is not entered into in the ordinary course of business.[12] Usually, a Royalty Agreement or Streaming Agreement is not entered into "in the ordinary course of business" for a mining company, but it would be "entered into in the ordinary course of business" for a streaming or royalty company. Therefore, the mining company would be required to file the contract on SEDAR, while the streaming or royalty company would not be so required.

[6] Rights of First Refusal

Royalty Agreements may contain rights of first refusal, and Streaming Agreements invariably contain them. Generally, a right of first refusal provides a party to an agreement the first right to acquire all or part of the other party's interests in the agreement on the terms offered by a third party, provided the offeror is willing to accept such third-party offer.

Royalty Agreements may contain a right of first refusal granted by the Royalty Holder to the operator, which gives the operator the right to acquire all or part of the Royalty Holder's Royalty interest for the amount of consideration offered by a third party. Such provisions usually require a Royalty Holder that has received an offer from a third party on all or part of its interests in a Royalty, which the Royalty Holder is willing to accept, to offer such interests to the operator on the same (or substantially similar)

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[12] *See* National Instrument 51-102, "Continuous Disclosure Obligations," § 12.2 (Can. Sec. Adm'rs).

terms. The operator is given a period of time (usually 30 to 45 days), within which it may accept the offer. If the operator does not accept the offer, the Royalty Holder is free to sell that interest in the Royalty to the third party on the same terms within a specified period of time (e.g., 90 or 120 days). Usually, a transfer of the Royalty interest will not be subject to the right of first refusal if the transfer is to an affiliate of the Royalty Holder. Other transfers of the Royalty interest may also be exempted from the right of first refusal, such as transfers to family members or transfers between multiple holders of the Royalty.

Streaming Agreements usually contain a right of first refusal granted by the operator to the Purchaser, which gives the Purchaser the right to acquire any Royalty or mineral stream, or a participating interest in, the minerals subject to the Streaming Agreement that are produced from the property for a price offered by a third party. A variation on the right of first refusal – the right of first offer – is sometimes used instead of a right of first refusal. In the right of first offer, the operator must first offer the Royalty, mineral stream, or participating interest that it wishes to sell, to the Purchaser for a certain price, and only if the Purchaser declines to exercise the right may the operator sell the Royalty, mineral stream, or participating interest to a third party for the same price. Under both the right of first refusal and the right of first offer, the Purchaser will be given a period of time (usually 30 to 45 days) to decide whether to exercise the right, and if the Purchaser does not exercise the right within such time period, the operator may sell the Royalty, mineral stream, or participating interest to a third party within a specified period of time. Usually, the agreement will specifically provide for greater certainty that the right of first refusal or right of first offer will not apply to hedging transactions, sales of all or substantially all of the property subject to the Streaming Agreement or assets of the operator, issuances of debt or equity of the operator, or to offtake agreements.

It may be useful to provide the operator the right to drop mineral tenures in order to reduce holding costs over parts of the property that the operator is not interested in exploring further. However, if such mineral tenures are dropped, it is likely that the Royalty or the Streaming Transaction will cease to apply to such tenures. Therefore, some Royalty Agreements and most Streaming Agreements contain a provision that permits the operator to terminate or let lapse mineral tenures, provided that the operator first offer such tenures to the Royalty Holder or Purchaser for no, or nominal, consideration.

[7] Agreements of Transferee to Be Bound

Both Streaming Agreements and Royalty Agreements should contain provisions that require an operator that transfers all or any part of the property, or its interest in the agreement itself, to a third-party transferee to require such transferee to agree in writing to be bound by the terms of the agreement. Some Streaming Agreements provide that the Purchaser may assign all or part of the Streaming Agreement without notice to the operator once the deposit has been paid to the operator.

[8] Dispute Resolution

Both Streaming Agreements and Royalty Agreements should contain dispute resolution mechanisms. Disputes may arise in Royalty Agreements with respect to calculation of the Royalty payments. This is particularly true in the case of NPI Royalties, where the calculation of the NPI Royalty is complex and may be subject to varying interpretations.

Under a Streaming Agreement, the Purchaser typically has rights to dispute a notice of delivery of metal (including the volume and price of metal to be delivered, if the Purchaser believes any of those figures are not in accordance with the agreement) or the amount of the outstanding uncredited balance of the payment deposit. In most cases, the dispute resolution mechanism involves the appointment of an auditor to verify the disputed calculations and prepare a report, if the parties are not first able to resolve the dispute among themselves. Usually, it is further provided that any subsequent dispute regarding the auditor's report can be resolved by binding arbitration.

V. Conclusion

Royalties in some form have been around for hundreds of years, whereas Streaming Agreements in their current form have only existed for approximately a decade. Royalties can be used as consideration or partial consideration for the sale of mineral tenures or as consideration for extinguishing a participating interest in a joint venture upon dilution. More recently, Royalties have been sold to finance exploration, development or mining endeavours, and some companies have emerged that specialize in acquiring Royalties and earning revenues from them.

Streaming Transactions are essentially long-term purchase agreements, targeted primarily at financing the construction or expansion of mines, and provide for a large upfront deposit in exchange for the right to acquire all or part of a particular mineral, which is usually a precious metal (gold or silver) of a base metal mine, at a low fixed cost. Unlike Royalties, which provide no payments from the Royalty Holder to the operator, Streaming Agreements do provide for payment of the streamed minerals as they are produced at a price that is intended to reflect the cost of producing such streamed minerals. However, neither the Royalty Holder nor the Purchaser are partners or joint venturers in the mining operation and therefore neither are required to contribute funding to the operation or are entitled to make operational decisions.

As a result of the downturn in commodities markets and the attendant difficulties in obtaining favourable debt or equity financing, Royalties and

Streaming Transactions have emerged as an attractive alternative to funding mining operations, especially development or expansion costs.