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New Regulations on Mineral Exploration in China

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by [Paul D. McKenzie](#), [George Y. Zhao](#)

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On July 18, 2008, the Ministry of Commerce (“MOFCOM”) and the Ministry of Land and Resources (“MOLAR”) jointly promulgated the *Measures for the Administration of the Foreign-invested Mineral Exploration* (*外商投资矿产勘查企业管理办法*) (the “Measures”). The Measures come into force on August 20, 2008. For the most part, the Measures consolidate existing rules governing the establishment and operation of foreign-invested exploration enterprises (“Exploration FIEs”) rather than creating a new regulatory framework. In some cases they clarify requirements. It may be that promulgation of the Measures signals the intention of regulators to give greater scrutiny to foreign investment in exploration, although this remains to be seen.

This memorandum briefly reviews provisions of the Measures of likely interest to foreign companies pursuing exploration projects in China. We would be pleased to discuss the specific implications of the Measures for your current and future investment projects. An English translation of the Measures is available upon request.

Background

The main piece of national legislation governing the mining sector is the *Law of the PRC on Mineral Resources* (*中华人民共和国矿产资源法*) (“Mineral Resources Law”), first promulgated in 1986 and revised in 1996. Among its key provisions, the Mineral Resources Law requires the registration of all entities engaged in exploration or mining activities in China and establishes a system for the application and granting of exploration and mining rights.

Under PRC law, all mineral resources belong to the State. Parties wishing to explore for or extract mineral deposits from a particular piece of land must apply to the government for permission to lease the relevant “mineral rights” (*矿业权*) for a fixed period of time. These rights are divided into “exploration rights” (*探矿权*) and “mining rights” (*采矿权*). Mineral rights may be obtained through application to MOLAR or its local counterparts. Mineral rights may also be transferred, mortgaged or leased to other parties, subject to certain conditions. Depending on the location of the site and the nature of the deposit, foreign investors may be restricted from participation, or required to work in concert with a qualified Chinese joint venture partner. Fewer restrictions apply to foreign-invested projects in the western regions of China.

In the last few years, the Chinese government has taken steps to further regulate foreign investment in China’s mining sector. One key regulatory document is the *Catalogue for Guidance of Foreign Investment in Industry* (*外商投资产业指导目录*) (“Foreign Investment Catalogue”). The Foreign Investment Catalogue and accompanying regulations classify industries into “encouraged”, “permitted”, “restricted” and “prohibited” categories. On October 31, 2007, the National Development and Reform Commission (“NDRC”) and MOFCOM jointly amended the Foreign Investment Catalogue in a manner that for the most part imposes further restrictions on foreign investment in mineral exploration and development activities. Morrison & Foerster has prepared a

separate memorandum on those amendments. In the wake of the amendments to the Foreign Investment Catalogue, the Measures serve to clarify and streamline the approval procedures for setting up Exploration FIEs.

Overview of Key Changes and Clarifications of the Measures

- The Measures reiterate the Chinese government's encouragement of foreign investment in mineral exploration by foreign investors with mining experience and access to capital and new technologies. This is consistent with the Chinese government's continuing efforts to target foreign investment that serves to transfer technology and management experience to China.
- General foreign investment rules require that a feasibility study report or equivalent document be prepared in connection with the establishment of a foreign-invested enterprise. Such a report traditionally includes information about the size and nature of the investment project, market and financial analysis, information about corporate governance, and safety information. The Measures specify that the feasibility study report for an Exploration FIE must include detailed discussions of the technology to be used in connection with the exploration project as well as the economic benefits, resource utilization, environmental protection, and utilization of human resources of the project. We anticipate that this requirement may be used by MOFCOM and MOLAR or their relevant local counterparts to more carefully scrutinize proposed investments.
- It has historically been difficult in practice for an Exploration FIE established to undertake an exploration program in one location to secure the permits and approvals to undertake exploration programs elsewhere. The Measures expressly provide that an Exploration FIE established in a particular location may apply for exploration rights in another location, subject to registration of a branch in that other location with the administrative department for industry and commerce.
- The Measures clarify the level of approval authority for exploration projects. Any new projects involving "restricted" minerals (such as gold, silver, etc.) under the Foreign Investment Catalogue now require MOFCOM approval, while minerals that are encouraged or permitted for foreign investment can be approved by MOFCOM's local counterpart at the provincial level.
- The Foreign Investment Catalogue lists certain minerals for which exploration or mining is prohibited for foreign investment. The Measures confirm that if the main mineral discovered by an Exploration FIE is a mineral prohibited for foreign investment under the Foreign Investment Catalogue, the Exploration FIE may transfer the exploration rights in connection with the deposit to eligible parties. The Measures also provide that if there are associated minerals that fall under the prohibited category, approvals from MOFCOM and MOLAR must be obtained for mining of those minerals.
- The Measures stipulate that for an Exploration FIE to increase total investment or registered capital, it must explain in related application documents the purpose and use of the capital increase, the source of funds, and the status of exploration. This is not an entirely new requirement. We nonetheless anticipate relevant authorities may use this provision to scrutinize proposed capital increases as part of the Chinese government's current efforts to stem currency speculation. The Measures also confirm that where a proposed capital increase is associated with a change of exploration plan, the Exploration FIE must submit the plan for re-approval to the authority that approved the original exploration license.
- The Measures also clarify approval procedures for the transfer of mineral rights owned by State-owned geological exploration agencies to Exploration FIEs. If the State-owned geological exploration agency uses the mineral rights held by its subordinate unit as a capital contribution or a contribution of conditions for cooperation, a letter of consent of the subordinate unit, signed by the unit's responsible person and affixed with its official chop, must be provided. If the State-owned geological exploration agency uses its own mineral rights as a capital contribution or a contribution of conditions, the approval of the authority in charge of the agency is required.
- The Measures provide that a foreign investor proposing to use the results of its mineral exploration activity in China as the basis for an overseas listing must file the information

pertaining to the listing with MOFCOM and MOLAR for the record. This is a new requirement and somewhat vague in scope. One question is whether foreign investors in Exploration FIEs that are already listed on an overseas exchange will be subject to reporting requirements with MOFCOM or MOLAR.

- In accordance with the Measures, Exploration FIEs may conduct exploration only in areas which permit access by foreigners. This requirement reaffirms existing travel rules for foreigners, but it highlights the Chinese government's desire to enforce restrictions on foreigners' travel inside China.

The discussion above represents an overview of one regulation of note to foreign companies considering an investment in China's mining sector. It should be noted, however, that China's legal system is highly complex, and regulations are subject to frequent revision and changing interpretation. Companies undertaking an investment will wish to engage counsel, and consult with relevant government authorities.