ISSUES TO CONSIDER WHEN INVESTING IN BATTERY MINERALS

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As the transition to the green economy accelerates, having a reliable access to battery minerals such as lithium, cobalt, copper, nickel and graphite is becoming more and more important for a number of companies. As Japan and other developed countries look to diversify their supply chains for battery minerals away from China to other less politically fraught sources, the completion for reliable sources of such minerals will intensify. This article will look at legal and business issues Japanese companies should consider and protect against when structuring a contract or business relationship to secure battery minerals.

One of the first questions is the type of contract and investment to be entered into. Broadly speaking, there are three levels of investment in battery minerals: purchasing what is needed on the open market, entering into a long-term offtake agreement with a supplier, or investing directly in a mining-company as part of a package to secure a long-term offtake.

1. Purchasing on the Open-Market

Buying battery minerals directly from traders on the open market is a good option for smaller quantities of materials. Prices from traders are subject to market fluctuations and higher than product bought directly from a producer so this is not economic for large-scale production. The quality of bulk commodities, such as copper or nickel, purchased from reliable traders can reasonably be assured and so is not a major issue. On the other hand, items that have more individual, detailed specifications, like graphite, are not readily available for spot market purchases.

a. Compliance with Sanctions and Ethical Business Acts

In any case, when purchasing from traders it is still important to consider proof of origin of the material to avoid issues with sanctions. A number of countries, including Japan, the US and the EU, have sanctions regimes in place against countries such as Iran, North Korea and Russia. In order not to fall afoul of these sanction regimes it can be necessary to establish that the components in an end product are not from a sanctioned country. As mineral resources are relatively fungible it is often not possible to easily physically identify material from a sanctioned country. Therefore, to protect against sanctions penalties it is important to include a clause in a purchase contract whereby the seller either warranties the actual source of the material, or, at a minimum, warrants that it does not come from a sanctioned country. The contract should also include suitable indemnities and penalties for a breach of this clause.

A similar issue arises with supply chain standards. Many developed countries have enacted legislation requiring companies that operate in them to ensure their supply chains comply with ethical business practices. A very recent example of this is the Canadian legislation that came into force on January 1, 2024 that prohibits the use of child labour and forced labour in a supply chain. While such legislation may not directly apply to a Japanese company; if it will be supplying parts or components with battery minerals to an end user in a country with such legislation the legislation will apply to the end user. Given this, it can be important to be able to certify that all appropriate ethical business standards have been followed, including in procuring the battery minerals. To this end including a representation in a purchase contract that the minerals provided by the supplier comply with ethical business practices, such as not involving child labour, forced labour or any other breach of UN conventions is good practice and can be a real business advantage.

b. Eligibility for Incentives under Green Legislation

The flip side of ensuring minerals supplied to a Japanese manufacturer do not have issues under sanctions or ethical business laws, is ensuring the material and products are eligible for incentives under green legislation, most notably the US Inflation Reduction Act and the EU Green Deal. Under the US act, there is a percentage of battery minerals that must have been extracted or processed in a country that has a free trade agreement with the US for consumers to be eligible for the acts subsidies. To ensure the ultimate end-user of a product made with battery minerals sourced by a Japanese company can benefit from such incentives it is necessary to ensure the battery minerals come from an approved country. As mentioned above, there is often no physical way to prove the source of minerals in an open market purchase from a trader, so including a warranty has to the source of the material is important.

2. Offtake Agreements

An offtake agreement is a long-term contract to purchase minerals directly from the mine or processing company. Offtake agreements typically have a three to five year term, but can be as short as a year or as long as the life of the mine. They commit the mine to supply a yearly quantity of material of an agreed specification and a price determined by a market formula. Because offtake agreements do not involve an intermediary like a trader, but are directly between the producer and the buyer they have favourable economic terms. However, because the offtake agreement is often a key element in financing the project, offtake agreements often include a take-or-pay clause requiring the buyer to purchase a minimum amount of material each year to ensure the mine has a steady cash flow.

a. Quality and Reliability

As an offtake agreement for battery minerals is directly between the company mining and processing the material the issues of ensuring the origin of the material identified in Part 1 are less important. However, as this will be a long-term contract committing the buyer to one supplier, ensuring their quality and reliability becomes extra important.

For the quality, not only do the product specifications need to be set out but the weighing and assaying procedures need to be clearly determined and, at a minimum, the buyer should have the right to witness these procedures. As battery technology is changing rapidly, another issue to consider in a long-term offtake agreement is how the buyer can change the specifications of the minerals to meet changing market demands. This can be an important right for buyers, but sellers will not want to agree to deliver material that must comply with an unknown future specification.

Reliability of supply is also a key issue; if the supplier cannot deliver the contracted material it can have a major impact on the buyer's production of batteries or other end products. Issues to consider here include a closely defined force majeure clause; ensuring priority for the buyer in case of production shortfalls; and the seller's obligation to make up a delivery shortfall, do they supply the missing material or is this left to the buyer to do at the seller's cost. A further issue if the supplier is a new mining project is how to manage the inevitable start-up period when production will be unreliable.

Ensuring the seller is operating in compliance with all applicable legislation and, in particular, all ESG requirements is also a concern in a long-term offtake. Failure to do so can lead to closure of the plant, either through government action or through blockades and other action by local communities. Though a buyer will not have direct responsibility for these items, because their negative impact can be so large, it is important to be confident in supplier's operation and compliance. This can be addressed through undertakings to comply with all applicable legislation, as well as reporting, such as providing Buyer a yearly sustainability report.

b. Equity Investments

Offtake agreements can generally be divided into two types, ones that are only purchase agreements and ones where the buyer is also making an equity investment in the seller's project. Equity investments by an offtaker usually come about as they are required by the producer as a condition to entering into the offtake. This is a common element of the funding for battery minerals projects. An equity stake can; however, also be beneficial for the offtaker. As an equity holder in the producer the Japanese company can argue for better economic terms in its offtake. Equity holders will also have access to otherwise confidential business information that can be useful in understanding the market for the minerals. Further, as part of due diligence before an investment and through a possible seat on the producer's board, or at least information rights, equity holders will also be in a better position to oversee and monitor the producer's operational performance and compliance with ESG requirements.

3. Conclusion.

This paper sets out at a very high-level issues Japanese companies should consider across a range of different types of contracts to secure access to battery minerals. Of course, the specific will very depending on the type of contract, the minerals in question and companies and countries involved, as well as a number of other factors. Our team can help you address all these concerns and secure a reliable and secure sources of these valuable minerals.

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