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Social License to Operate

Research Paper

The Relevance of Social Licence to Operate for Mining Companies

Rory Pike
ESG Analyst

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Executive Summary

In recent years there has been a significant increase in the number of production stoppages and confrontations at mines relating to Social License to Operate (SLO). It remains hard to discern whether this demonstrates increasing incidence of confrontations with local stakeholders, or whether coverage of the issues is just becoming more comprehensive. What is clear, however, is that there are numerous examples of mines and projects that have been threatened or are under threat because of an inability of companies and local stakeholders to come to agreement about how a mine should operate.

To understand the importance of SLO it is important to understand what we mean when we refer to it. We contend that it is the acquisition and on-going maintenance of the consent of local stakeholders to specific local projects. We believe that the relevance of SLO to Extractive Companies has increased over the last century in tandem with increases in the rights of indigenous populations, and the greater ease with which NGOs and other interested parties are able to access and spread information about specific confrontations.

We have examined a number of examples where there have been confrontations between Mining companies and local stakeholders over an inability to find common ground. Whilst it is clear that the nuances of each specific project require that SLO focus on micro level details rather than a higher level approach, we believe that there are a number of commonalities that are shared, and that investors can benefit from understanding how these risks can impact on the underlying projects.

We feel that understanding the following are especially important:

- Local Conditions
- Equitability of the distribution of benefits from the mine
- Land Rights
- Artisanal vs. Illegal Miners
- Environmental impact of the project
- The track record of the company

Therefore while it is impossible to say that SLO is being called into question more frequently than it was in the past it is clear that the evolution of indigenous rights and the development of increasingly global communications networks have meant that, for miners, relations with local stakeholders have become more important than ever. We believe that trying to understand individual mines and projects from the bottom up remains most effective way of integrating a measure of the risks that loss or failure to secure a social license can entail.

Social License?

What is "Social License to Operate"?

The World Bank suggests that a social license to operate is the acquiring of "free, prior and informed consent of local communities and stakeholders".[1] We would contend that this is part, but not the whole, of the social license. The whole consists of both the acquisition and on-going maintenance of the consent of the local stakeholders. The maintenance of consent is especially important as the criteria by which local stakeholders give their consent may change over time.

Why is it relevant to Mining Companies?

The acquisition and maintenance of a Social License to Operate (SLO) has always been relevant to mining companies, without the consent of the local stakeholders operating and developing a specific asset is exceedingly challenging. Over the last century the rights of local, and indigenous, populations proximate to mine sites have increased significantly and with these rights has come greater leverage over mining companies, though it remains extremely hard to find data regarding the incidence of production stoppages or protests related to social license to operate. Consequently ensuring that a mine project has the consent of the local population represents an effort to minimize project risk associated with the mine.

Further, the increasing ease with which geographically diverse groups can communicate means that while companies may be operating in remote locations it is now much easier for campaigners and NGOs to access information regarding any perceived violations of the social contract and consequently apply pressure to a company, and it is more likely that any confrontations will be reported in a wide variety of media.[2] Ernst & Young, in its analysis of key risks facing the Mining industry in 2012, suggested that the ability to retain social license to operate was the 4th most significant challenge mining companies face.[3]

Consequently we have decided to explore the nature of SLO and how its loss can impact on mining companies. We believe that there is little value in trying to create a risk analysis of individual companies based on the location and size of their assets, because of the importance of local issues in defining SLO. Rather, we have looked at a number of confrontations where social license has been lost and have attempted to draw out the key themes from these case studies.

License to Operate Before and During

While the difference between gaining and maintaining a social licence to operate may not appear large, they are profound and represent divergent impacts on the underlying business. The impact to a mining company if it is unable to mine an asset is self-evidently far greater after it has committed to investing capital which can no longer be easily recovered. While the impact is lower in the exploration and development phase, given that much less capital has been committed and investors tend to regard undeveloped deposits as options on top of the core valuation. However, failure to gain a social licence can lead to an inability to develop economically valuable assets. That said it is in the period before a mine begins operations that there is most work to be done in order to secure social licence to operate.

We have chosen to examine four examples which we believe highlight a number of key themes that are integral to an understanding of "Social License to Operate".

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[1] World Bank, *Striking a Better Balance: The World Bank and Extractive Industries* (2003)
[2] http://www.guardian.co.uk/global-development/poverty-matters/2011/dec/06/mining-economic-development-peru
http://www.santiagotimes.cl/chile/environment/23202-chilean-court-suspends-vote-on-xstrata-energy-project
[3] Ernst & Young, *Business Risks Facing Mining and Metals, 2011-2012* (2011)

Before

Newmont Mining – Minas Conga, Peru

The controversy surrounding Newmont Mining's Minas Conga project in Cajamarca, Peru, has been reported around the world.[4] The controversy was sparked by the apparent risk that the project poses to local watercourses, which contains a political element and further Minas Conga is not the first project with which Newmont has faced problems with the local community. The Minas Conga controversy highlights three separate themes that recur when we look at social licence to operate: the potential environmental damage that can be caused by mining pollution and accidents; the struggle between regional and central government; and the importance of having appropriate processes and understanding of the local situation.

The problems at Minas Conga have more than an echo of those encountered during its previous attempts to develop deposits in the Cajamarca region of Peru: violent confrontations with the local community; disagreement over the impact of the project on local water supply; and allegations that Newmont had failed to take into account the input of the local community. The key allegation of the local community is that the mine will pose irrevocable risk to a number of watercourses and lakes which provide irrigation for local agriculture. However, the context of the issues at Minas Conga highlights the risk of taking these sorts of issues at face value.

It is important to understand the issues at Minas Conga in the context of the political situation in Peru. Initially the environmental assessment at Minas Conga was accepted by the local community and government. However, in the aftermath on Humala's election there has been popular disappointment at the manner in which he seems to have sided with multinational mining companies.[5] For local governments one of the few points of leverage that they hold over the center is the influence that they can wield on mining projects. The protests against the project highlight this; one of the key agitators and leaders of the protest is the head of regional government.

Part of the challenge, from Newmont's perspective, is that a material element of the controversy is related to the relationship between central and regional government (a theme that will also be seen in relation to African Barrick Gold's North Mara mine). It is clearly challenging for a mining company to guarantee that taxes and rents which are paid to the central government will be redistributed regionally, or that even if money makes it to the regional level it will be invested in a manner consistent with the desires of local stakeholders. It is possible for miners to extract concessions from the government, in order to attempt to ensure that revenues form the mine will be reinvested appropriately, but this is no guarantee that they will be. And important as mining companies are at building infrastructure in isolated areas it is not feasible to expect them to take over the role of government entirely. However, this does not exonerate Newmont, or other mining companies for that matter, because it remains the case that modern mining requires operating in politically challenging regions and it is clear that if local stakeholders side with the miners there is little that the regional government can do to put pressure on the relationship.

In 2004 Newmont was forced to halt development work at its Cerro Quilish concession, near the current flashpoint of Minas Conga, and ultimately remove it from its reserves because of a number of clashes with the local community over risk to the local water supply and job creation. Newmont faced violent protests over the potential damage that could occur to the water supply and the fact that the mine was proposed on a mountain that held religious significance to the local community. Ultimately Newmont backed down and admitted that it had not always acted with the consent of the local community.[6] The case of Minas Conga is particularly interesting because Newmont has been able to successfully operate one asset in Peru (Yanacocha) for almost 20 years without significant problems, while it has had major problems with both the Cerro Quilish and Minas Conga projects, both of which are located close to Yanacocha. This seems to highlight both the importance of local issues with regard to license to operate and the challenge of adapting processes that may have been successful in the past to meeting the novel requirements of new locations.

[4] http://www.guardian.co.uk/global-development/poverty-matters/2011/dec/06/mining-economic-development-peru
[5] Naomi Mapstone, "Peru: Humala's Mining Migrane", *Financial Times* (November 2011)
[6] Goldman Sachs, "Newmont Mining Corp: Yanacocha tensions ease after Quilish permit revoked" (Nov 10, 2004)

Anglo American – Pebble Mine, Alaska

Since the mid 2000s the Pebble Mine project in Alaska (co-owned by Anglo American and Northern Dynasty) has been the site of a battle between the local population, determined to preserve the natural environment, and miners, central government and other Alaskans, who want to exploit the Pebble deposit for the benefit of wider society. In 2006 a poll of the local population suggested that some 70% of people were opposed to the mine, while across the state of Alaska 53% opposed the project with just 28% in favour.[7] The project illustrates the perception that large scale mining cannot be carried out without major environmental risk.

The Pebble deposit is thought to be one of the largest undeveloped gold deposits in the world[8] and likely to generate significant economic value for both Alaska and the local economy. The key challenges to the development of the deposit are that it would require both mining in the pristine natural environment and secondly that the mine and tailings ponds will be on top of the Bristol Bay watershed, the world's largest natural sockeye salmon fishery.[9] Locals and opponents argue that developing the deposit will both destroy the unique environment and that any environmental accidents will have disastrous impacts on the salmon fishery.

The Pebble Mine makes a particularly interesting case study for a number of reasons: opposition to the mine does not appear to have the political element of Minas Conga, rather it has remained fairly constant since the project was announced; and secondly, while it only represents a very small part of the valuation of Anglo American, it is the only asset that is owned by Northern Dynasty which consequently acts as a proxy for the probability of development of the deposit (fig.1). As the graph of share price indicates the market is currently pricing a fairly low probability of successful development, especially when you consider the rise in commodity prices over the last decade.

Fig. 1: Northern Dynasty Share Price

Performance shown is past performance. Past performance is not necessarily a guide to future performance. The value of investments can go down as well as up and is not guaranteed. The security/issuer mentioned does not necessarily constitute any current holding. No offer for sale of a security is intended by this illustration.

It does not appear that Anglo American and Northern Dynasty have been particularly successful in convincing stakeholders that the prosepective mine does not pose an extreme environmental risk. Jewllery companies have committed to boycotting the prospective output of the mine, Robert Redford has given his support to the

[7] The Cromer Group, *A Summary of State-wide Polling Results on Pebble Mine* http://web.archive.org/web/20061121004300/http://www.renewableresourcescoalition.org/cromer.pdf
[8] Northern Dynasty, *Factsheet* (Sept, 2011)
[9] Dave Chambers, Robert Moran and Lance Trasky, *Bristol Bay's Wild Salmon Ecosystem and the Pebble Mine: Key Considerations for a Large-Scale Mine Proposal* (2012)

opposition and the EPA has launched a study into the impact of largescale mining on the Bristol Bay watershed. In a sense the position of the Pebble Mine is very challenging because it appears that it will be almost impossible for Anglo American or Dynasty to convince local stakeholders who currently oppose the construction of the mine to support the project, and Anglo American's CEO has previously stated that the mine would not go ahead without local consent.[10] Those opposed to the project believe the risks to be unacceptable and that any environmental incident could irrevocably damage the Bristol Bay Watershed, given the environmental sensitivity of the area even a small amount of pollution, and opponents argue that despite best efforts most mines pollute, could be hugely damaging to the natural environment.[11]

The Pebble Mine demonstrates the challenge of securing social license to operate in environmentally sensitive geographies where the local population is committed to the environment. It is almost inconceivable that a mining company of the size of Anglo American can operate without some environmental incidents, which are then taken as evidence that Anglo American is not capable of operating the mine safely. Consequently we believe that it will be almost impossible for Anglo American and Northern Dynasty to secure the support of local stakeholders, though it may be possible on a state-wide basis, and consequently if the mine is to be developed it will be without broad local support.

During

African Barrick Gold – North Mara, Tanzania

Barrick Gold inherited the North Mara gold mine in its 2006 takeover of Placer Dome and subsequently spun it out into African Barrick Gold in 2010. Since the takeover from Placer Dome in 2006 there have been significant operational challenges at the mine, primarily resulting from social unrest and attempts by locals to illegally enter the mine. In 2008 around 200 people entered the mine and destroyed close to $15m worth of Barrick's equipment and property, ultimately ending in the death of one local. Tensions between African Barrick Gold's operations and the local population continued between 2008 and 2011 with 7 locals being killed in a 2 year period.[12] The clashes ultimately escalated until the 16th May 2011, when Tanzanian Police killed 7 intruders to the mine when under sustained attack from a group of around 800 people.[13]

African Barrick Gold faces two related but separate challenges at the North Mara mine: firstly, it is faced with a large group of artisanal, or formerly artisanal miners, who historically mined the area now considered North Mara; and secondly, there are criminal elements from southern Kenya and northern Tanzania who seek to expropriate the gold from the mine.

In countries where land rights are not particularly developed it is often the case that mining rights are sold without the express consent of those who have historically exercised control over the land or that previous landowners are not adequately educated or compensated for the sale of their livelihood. Most grievances that ABG faces are related to land issues, some genuine and some arising from confusion over the process of land acquisition. Consequently there remain locals who continue to believe that they retain the right to artisanally mine the deposit and their continued attempts to access deposits presents a risk to both themselves and ABG employees. ABG has stated that it is engaging in a program to try and create alternative livelihoods for miners, either through offers of access to waste rock areas or training for other careers, which will hopefully begin to tackle the problem.

The bigger risk to ABG is presented by the illegal miners, who have been responsible for the attacks on the mine in 2008 and 2011 which resulted in the police opening fire upon the attackers. ABG argues that the Tanzanian central government has long neglected the border area between northern Tanzania and southern Kenya, resulting in relatively widespread criminalisation. In a sense there is much less that ABG can do to proactively meet the challenge presented by illegal miners, because their grievance is not directly against ABG but against the government it cannot be expected that a mining company play the role of government in providing large scale infrastructure and investment. Rather the incentive is for ABG to enter into a dialogue

[10] http://www.cbsnews.com/8301-505125_162-31543705/dont-tell-cynthia-carroll-that-mining-is-mans-work/?tag=bnetdomain
[11] Our Bristol Bay, "The Risks of Pebble Mine" (2011)
[12] http://vijana.fm/2010/12/23/shooting-gold-diggers/
[13] African Barrick Gold, "Statement re NM Shootings" (May 17, 2011)

with the government to try and ensure that some of the rents/fees that it pays on the mine are reinvested back into the local area.

A further risk that ABG (and Barrick) have been exposed to is that because the North Mara mine was inherited as part of the acquisition of Placer Dome neither ABG nor Barrick were involved in the original process of engaging with local communities and ensuring social licence to operate. While it is clear that a multi-billion dollar acquisition will not be put off because of social risks at a small Tanzanian mine, there is a risk inherent in purchasing a mine without fully understanding the social context. While ABG (and before them Barrick) has struggled to get to grips with the specific challenges of the North Mara mine it appears that since the shock of the May 2011 incident there is now a concerted effort, along with greater support from the government, to try and tackle the problems of North Mara.

Rio Tinto/Bougainville Copper – Panguna, Bougainville, Papua New Guinea

The plight of Bougainville and the Panguna mine represents an extreme example of the consequences of the loss of social licence to operate. In 1988, after the mine had been operational for 16 years, Francis Ona and the New Panguna Landowners Association stole explosives from the mine and used them to destroy access and electrical supply to the site.[14] Ultimately Bougainville descended into a bloody civil war that raged until a peace agreement was signed in 2001, while the Panguna mine remains closed as of 2012.[15] Bougainville and the Panguna mine encompasses failures to adequately secure a social licence prior to operations beginning and a further destruction of any stakeholder goodwill that was possessed over the course of its operations, which helped precipitate the armed conflict.

While some commentators have argued that the existence of the Panguna mine caused the subsequent civil war[16] the reality is some what more complicated. It is fair, however, to contend that the mine certainly helped to precipitate the conflict. There are three key reasons that the Panguna mine failed to secure a long term social licence to operate: confusion and misallocation of land/land rights; on-going environmental damage; and lack of tangible benefit for Bougainvillians from the mine.[17]

Historically the indigenous populations of Bougainville existed in societies with a deep attachment to the land, however, this never corresponded to a structure of western style land ownership. Secondarily Bougainville has spent most of its history as part of Papua New Guinea, with which it shares little in the way of cultural and ethnic heritage. Thus when the Papua New Guinea constitution was signed after WWII surface land rights remained with the traditional landowners and mineral rights were transferred to the state. These mineral rights were subsequently sold to international mining companies in a process which left many of the local landowners feeling that they had not been adequately compensated.

To compound the problems that the land ownership structure created, the Panguna mine proceeded to dump vast quantities of chemicals and waste into local watercourses. This further damaged the value and livelihoods of Bougainvillians who inhabited the area local to the mine. The perception was that not only had the mine removed their ability to access land which had historically been theirs, but it was also actively destroying what land was left.

Finally, the mine exacerbated existing tensions between Bougainville and mainland Papua New Guinea. It was not hard to believe that the mine was being operated in the interests of people other than local Bougainvillians. 62% of profits went to the PNG central government, 33% went to foreign shareholders in the mining company, 4% went to the Bougainville provincial government and 1% went to local landowners.[18] Panguna represented the single largest source of revenue for the central PNG government, outside of aid from Australia, but beyond the expat community who came to work on the mine very few people in Bougainville benefitted financially from the mine.

Rio Tinto and Bougainville Copper should not be excused from blame for failure of the Panguna mine, it is clear that there was very little effort to build relations with the community and that the environmental record of the mine was very poor, however, it is also clear that they were caught in the crossfire of the tension between

[14] Mary-Louise O'Callaghan, "The Origins of the Conflict", in *Accord* (2002)
[15] Kramer Gillen, "For Bread and Dignity: Complicating the Bougainville "Resource Conflict" (2005)
[16] Michael T. Klare, *Resource Wars: The New Landscape of Global Conflict* (2001)
[17] Kramer Gillen, "For Bread and Dignity: Complicating the Bougainville "Resource Conflict" (2005)
[18] Idem.

Bougainville, which wanted independence and self-determination, and PNG which wanted to ensure its survival as an independent nation, for which it relied heavily on the revenues from the mine. The situation was one where none of the parties' incentives were aligned and which helped contribute to the tragic civil war that followed.

As of 2012 the Panguna mine remains unopened and under armed guard, although the further Bougainville moves towards independence the more likely it is that the mine will be reopened. However, it remains to be seen whether it will remain in the hands of Bougainville Copper and Rio Tinto or whether it be expropriated by the state and resold. The mine remains, however, a legacy of the failure of the mining companies and PNG to secure the licence to operate from the local Bougainvillian stakeholders.

How can social license insights be applied to help inform investment decisions?

What is abundantly clear is that it is very hard to create general rules from specific instances with regard to issues surrounding social licence to operate. Risk is really predicated on the specifics of the local situations, and challenging for an investor to have a strong view independent of that which is offered by the company itself. That said we believe that there are a few insights that we can draw and apply to new, and existing projects, which may help to better understand the risks inherent in specific mining projects:

- **Local Conditions:** Understanding the relationship between local and central government is one of the most important factors in trying to understand SLO risk in mining projects. It is often the case that mines are situated in otherwise impoverished areas distant from central authority and consequently there is little desire on the part of government to invest and the regional government is likely to have little leverage over the centre apart from the its mineral deposits.
- **Equitability of distributions of benefits from the mine:** This clearly follows from above. If conditions exist where central government and the mining company receive all the benefits from the mine, and there is little in the way of reinvestment back into the local community it is likely that tensions will exists and that these will be manifested against the mine rather than the central government.
- **Land Rights:** The majority of the world, especially developing countries, do not have systems of land rights which are as sophisticated and practical as those of the developed western world and consequently cases frequently emerge where mining companies purchase land where local stakeholders may believe that they have a residual claim to the land, and its mineral wealth, despite having no official title to it.
- **Artisanal vs. Illegal miners:** One of the major social challenges facing mining companies is how to deal with the issue of artisanal mining, which obviously becomes more lucrative and thus more of a problem as commodity prices rise. Understanding the differences between artisanal and illegal mining is vital to ensuring that the relationship between the mining company and local stakeholders is balanced.
- **Environmental Impact:** A key reservation that local communities have with regards to new mining projects is the environmental impact that they may have. As deposits become more remote and are situated in more physically challenging and environmental fragile areas the risk of a disaster and the impact that it would have increase. Historically the mining industry has been poor at managing the impact of its operations and there continue to be numerous spills and accidents which reinforce the belief that mining companies will not be able to keep their promises and operate assets safely.
- **Track Record of the Company:** Securing a SLO requires that a mining company convince local stakeholders that the project is of net benefit to the local community and that it can follow through with the promises that it makes. If it has a track record of failing to fulfill promises it only makes it harder to convince local stakeholders, and potential opponents such as NGOs, that it will be able to meet the criteria that it has set out.

Conclusion

It seems to be clear that SLO is becoming increasingly relevant for mining companies and their ability to ensure that local stakeholders remain supportive of projects. While commodity prices remain high, pressure from communities to receive adequate compensation for what they have given up to the mining companies will persist, which can produce tension between local and central government.

Attempting to incorporate the insight that License to Operate has become material to mining companies is challenging. We believe that it is important not to over-simplify the problem; it is not possible to assess risk through a top down approach towards the geography of a companies assets. The most effective approach is to look at specific projects and assets from the bottom up, adding on higher level layers. While this process is clearly more art than science it should help to better understand the risk inherent in specific projects and assets and how these impact valuation.

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