The Costs of Mining: Underwriting Mine Closure Risk

By David Chambers

In The Corporate Ethics Monitor, Volume 17, Issue 1, January-February 2005
Published By Ethicscan Canada Limited

Financial Assurance for a mine, commonly referred to as a 'bond,' is a financial instrument that guarantees the proper closure of a mine in the event that a mining company can't meet its closure permit obligations, usually as the result of financial insolvency.

Before the recent surge of metals prices, this was all too common an occurrence in North America. Examples include Royal Oak Mines in British Columbia, Pegasus Gold in Montana, Dakota Mining in Alaska and South Dakota, and Arimetco International in Nevada, among others.

Financial Assurance is important for several reasons. First, it protects taxpayers from paying for mine closure costs that can run from several million to several hundred million dollars per mine. Second, it protects the public from damage to public resources like environmental degradation, loss of recreational opportunities, and diminished property values for neighbors of the mine. Finally, maintaining an adequate financial assurance is one element of being a responsible corporate citizen by protecting the public from potential liability.

Today there are several problems with Financial Assurances for mines. The biggest one is that regulators and mining companies consistently underestimate the cost of closure for mines, resulting in significant costs for public agencies when mine bankruptcies occur. These significant costs affect taxpayers and the industry's reputation. An example of underestimation of closure costs is in Alaska, where the Center for Science in Public Participation (CSP²) analyzed the state's seven major mines. CSP²'s middle-of-the-road estimate is that the collective mine closure liability for these mines is approximately $230 million, while the actual surety amount being held by public agencies is only $84 million. There has been one major mine bankruptcy in Alaska, and the financial assurance held by the State for that mine was significantly underestimated.

Moreover, acquiring such a Financial Assurance instrument has become more difficult and costly for mining companies. Historically the most common instrument for a Financial Assurance has been a bond – an insurance policy. Most surety companies no longer provide this instrument to mining companies. The risk of payout was too great for the small number of insured mines that any one surety provider would handle. So, most surety providers just exited the business, rather than risk that one of the operations the surety company was covering would default.

As a result, mining companies have had to resort to other instruments, like letters of credit, to cover Financial Assurance obligations. However, unlike a bond from a surety company, these financial instruments adversely affect the cash and/or borrowing positions of a mining company. Another approach to replacing traditional bonds is for a

regulatory agency to accept a 'corporate guarantee' from the company pledging that it will meet its closure financial obligations. This places significant responsibility on the permitting agency to diligently monitor the financial health of the company to ensure that assets are both sufficient and available to cover full closure obligations. For midsized and small mining companies, such a corporate guarantee is probably not a viable option, even assuming that permitting agencies are performing adequate due diligence financial analysis.

There are ways to resolve these concerns. The fundamental problem with the lack of availability of closure bonds is that while the cost of any one mine failure was large (tens to hundreds of millions), the risk was being spread over too many surety providers. One solution is coordination between financial institutions and mining companies. Companies could jointly approach financial institutions to identify instruments that are readily available, reasonably priced, and provide a secure guarantee to the public, as well as not unreasonably encumbering the financial flexibility of mining companies. An alternate approach is for the industry to create and manage its own financial vehicle to provide this service.

A third solution is for government to step in and to provide a financial vehicle both as a service to the mining industry and to protect the public. However, such a public initiative would have to be undertaken at a national or international level, since managing the risk of a mine failure even at the state or provincial scale in North America would not provide an adequate number of mining clients to cover the costs of a large mine failure.

Providing adequate assurance for mine closure is important for protecting the public, enhancing corporate citizenship, and maintaining investor confidence. It is incumbent upon public agencies that provide operating permits for mines to not only adequately calculate liability but also see that the assurance provided by mining companies is reasonable, comprehensive and adequately funded. Mining companies and governments, with the support of the general public, may have to work together to provide adequate financial vehicles to meet these needs.

Dr David Chambers, President of the Montana-based Center for Science in Public Participation, can be reached at 406/585-9854.