



Toward Financial Responsibility in British Columbia's Mining Industry

May 2016



UNION OF BRITISH COLUMBIA INDIAN CHIEFS

Summary of Recommendations

1. Require Full Security for Mine Site Reclamation Costs

Require that mining companies post full security for mine site reclamation costs. For new mines full security to be posted at time of permit issuance; for mines that are operating, under care and maintenance or are closed, the province should require that companies post full security within three to five years.

2. Introduce Financial Assurances for Unexpected Environmental Harm Events

Require companies to hold sufficient financial assurances to meet the costs of likely environmental damage and third-party losses that arise due to mine related accidents. Establish a limit of liability where fault does not need to be proven, and require unlimited liability above the liability limit when fault or negligence exists. The level of sufficient financial assurances to be determined through risk assessment and to include insurance and other hard security instruments such as bonds or cash. Companies should provide proof on an annual basis that required financial resources are available.

3. Establish an Industry-Funded Pool

Levy a charge against volume of production from operating mines and make the fund available:

- a. at a fee for smaller mining companies that cannot access financial assurances through the banking sector;
- b. if actual reclamation costs at a mine site exceed estimated costs and a mine owner was unable to pay; and/or
- c. if an unexpected event, such as a tailings pond breach, exceeds the financial assurances required for such a loss (exceeds the limits of liability), no party were found to be at fault, or the polluter is unable to pay.

4. Establish a Claims Settlement Process

Create a claims process for compensable damage which is arms length from the mine operator and includes a process for review of disputes regarding claims adjudication which is outside the courts.

5. Introduce Transparency and Accountability

Require, on an annual basis, that site reclamation plans, reclamation cost estimates, and related security, by mine and in aggregate be publically reported. Make publicly available on an annual basis proof of security provided for unexpected environmental harm events by mine.

5. Financial Assurances

Terms and Definitions

5.1 Hard Security and Soft Security

There are two basic categories of security for financial assurances depending upon how liquid the financial instrument is and how certain its value when liquidated.

Hard Security is reasonably liquid and its value relatively certain. These types of security would include letters of credit, or cash. Soft Security is less liquid and its value less certain, such as parental guarantees or a pledge of assets. Soft Security generally falls in value as the need for security rises.

Hard Security gives greater assurance that funds will be available when, and as, needed. It assists the government in limiting the public's financial exposure in the event a mining company defaults on its obligations. Requiring Hard Security to wholly fund an estimated obligation means the financial assurances policy is transparent and consistent across companies. However, Hard Security is generally funded from a company's working capital impacting project economics and posing a greater challenge during mine start-up. The burden can be particularly evident on smaller mining companies—juniors—which are relatively significant in BC's mining industry structure.

Discretionary mine reclamation securities are attached as a condition of mine permits. The "permittee must post financial security in an amount and form acceptable to the Chief Inspector of Mines. This security is held by the government until the Chief Inspector is satisfied that all reclamation requirements for the operation have been fulfilled."¹²⁶ The Chief Inspector of Mines accepts Hard Security including cash, certified cheques, bank drafts, term deposits such as Guaranteed Income Certificates (GICs), Government of Canada bonds, and irrevocable standby letters of credit (ISLOCs).¹²⁷

The list provided by the Chief Inspector is not exhaustive. The Marsh Report on mining insurance states that BC has accepted surety bonds as security for financial assurances. "There are approximately 15 surety markets with capabilities in this space. Quebec, the Northwest Territories, and **British Columbia have all recently agreed to accept a surety bond as financial assurance for reclamation obligations** and Marsh Canada has been an integral part of these changes."¹²⁸ (emphasis added) As well, SnipGold states in its most recent annual report that the province has accepted mining equipment as partial security for its Johnny Mountain mine.¹²⁹ Imperial Metals also has mining equipment pledged as security.¹³⁰ Mining equipment is soft security.

¹²⁶ Ministry of Energy and Mines, [Reclamation Costing and Security](#).

¹²⁷ Ibid.

¹²⁸ [Mining Market Update](#), Marsh, February 2016, page 14. The Chief Inspector of Mines was requested to confirm Marsh's statement but at time of this report's release had not responded.

¹²⁹ SnipGold Corp., Annual Report 2015, Notes to Financial Statements, note 9, [Provision for Reclamation Obligations](#).

¹³⁰ [Imperial Metals Annual Report 2014](#), page 54.

5.6 Insurance

The purpose of insurance is to provide financial resources in the event of an accident—that is, for an incident that is an unintentional occurrence, but has a probability of occurring and, should it occur, brings with it financial consequence.

Any prudent business management approach should include an understanding of the suite of risks a business faces, and include a recognition of the risk the company is able to tolerate. Insurance is concerned with managing risk and providing financial compensation in the event of an unexpected loss. Insurance companies issue policies that promise to provide financial support for such losses.

Some insurance coverages have become mandatory. It is a legal requirement in BC that motorists carry a minimum level of auto insurance, while many lenders require property and casualty house insurance as a pre-condition for obtaining a mortgage. Most insurance coverage, however, is elective. The insured party makes the decision based on a trade-off between the perceived risk, their tolerance for that risk, and, if it is an insurable risk, the insurance premium.

Insurance is the art of managing risk, where risk is equal to probability times consequence. (Risk = Probability x Consequence)

The traditional insurance mechanism can be divided into four phases:

- risk assessment
- risk transfer
- risk pooling
- risk allocation (premium setting)

There is an important role for insurance to play in the management of environmental risk as it relates to unauthorized, or unintended, environmental harm events. However, since BC does not have a requirement for financial assurances related to unintended events before they happen, the reliance by mining operators on insurance policies to protect them from environmental damage losses is entirely discretionary. Information that is available regarding the propensity of mining companies in BC to insure against environmental risks suggests very little reliance on the insurance industry for financial protection.

Prudent business operators will develop an insurance program to protect their operations and shareholders from unintended events, including pollution events. Not only can adequate insurance provide financial resources to fund related costs, it can assist in preventing expensive court actions such as shareholder class action suits.¹³⁶ The main goal of putting a comprehensive program in place is to allow the entity to continue as a going concern if an unexpected event happens.

¹³⁶ During the third quarter of 2014, a securities class action lawsuit was filed against Imperial Metals Inc. and certain of its directors, officers and others in the Ontario Superior Court of Justice.

The need for mining companies to seek enhanced access to greater insurance limits and broader coverage for pollution related events is increasing. In recent years there have been a number of major incidents including Mount Polley's tailings facility breach, Grupo Mexico's sulphuric acid spill into the Bacanuchi River,¹³⁷ Sherritt International's Coal Valley Resources tailings pond spill contaminating two tributaries of the Athabasca River¹³⁸ and Samarco's mine spill in Brazil that led to the deaths of 19 people and more than \$5 billion (US) over 15 years for damages. Seven executives have been charged with murder related to the tragedy.¹³⁹

Tailings storage facility failures show a significant trend since 1960 toward a higher incidence of serious and very serious failures where their frequency and cost is increasing.¹⁴⁰ Companies do not appear to be taking steps on their own accord to incorporate the higher risk of failures into their risk management programs.

Mount Polley mine owner, Imperial Metals Inc., did not elect to hold insurance coverage sufficient to protect it from the financial consequences of its tailings pond breach. Rather, the risk Imperial Metals perceived to protect itself against was business interruption insurance in the amount of \$15 million and \$10 million in third party liability coverage. To September 30, 2015 an aggregate of \$62.4 million has been spent on rehabilitation. The September 30, 2015 third quarter financial statements include a provision for rehabilitation costs to be incurred in the future of \$5.0 million, bringing the estimated cost for the failure to \$67.4 million. As at September 30, 2015 the Company had received insurance recoveries to the limit of its coverage of \$25.0 million.¹⁴¹

Part of the response and remediation cost for the failure has been borne by the public. Imperial Metals recorded a loss due to the cessation of its operations because it failed to have sufficient insurance coverage or other financial security. This reported loss resulted in income and mining tax recoveries. "Income and mining tax recoveries have also been recorded in connection with these costs"¹⁴² (in the amount of \$67.4 million minus insurance recoveries of \$25 million resulting in tax recoveries related to a loss of \$42.4 million). Had Imperial Metals had adequate insurance coverage, and/or other forms of financial assurances, to fund its tailings facility failure, the public treasury would not have contributed to the remediation of the tailings facility breach through cash tax refunds.

137 [Mexico's Sonora State reports new mine spill](#), BBC, September 22, 2014

138 [Charges laid regarding October 2013 Obed Mountain Coal Mine spill](#), Alberta Energy Regulator, Press Release, October 16, 2015.

139 [Brazil police seek charges against Samarco officials for dam collapse](#), Wall Street Journal, February 23, 2016.

140 [The Risk, Public Liability & Economics of Tailings Storage Facility Failures](#), Lindsay Newland Bowker & David M. Chambers, July 21, 2015.

141 Imperial Metals, [Third Quarter Report, 2015](#), page 1.

142 *Ibid.*, page 2

6. Mining Corporate Culture and Business Law

Companies have a responsibility to their shareholders to seek legal ways and means by which to limit their liability and externalize capital and operating costs. They build these strategies into their decision making and corporate structure design. They engage in active lobbying to impress upon legislators the need to reduce “red tape” and “expedite” permitting. The concern of job losses to needy communities if environmental standards negatively impact revenues keep legislators at bay.

Mining companies in BC have had a significant degree of success in convincing legislators that their role is to be a facilitator of mining activity, not a regulator of it. This is regrettable. Not only does it send the wrong signals and result in an inefficient mining industry focussed on inappropriate means by which to reduce their costs—ultimately undermining the industry’s ability to compete internationally—it shifts costs that should be internalized to the mine site onto the public and the environment, instead.

When government buckles to industry pressure it reduces responsibility and accountability. Lenient regulations reinforce a belief within corporate cultures that the regulator is weak and incapable of staying ahead of the mine operator’s strategies to internalize benefits while externalizing costs. Through ineffective legislation and downsizing its administration, the Province of BC telegraphs to the industry that it is not serious about protecting the environment and BC residents, or ensuring the Polluter Pay Principle is effectively and extensively enforced.

The public—generally uninformed because the Province refuses to disclose important information—lacks a necessary understanding of the intricate legislative and regulatory framework. The public is bombarded with government communications that pretend protection of people and the environment is paramount and the Polluter Pay Principle is effectively enforced when there exist huge gaps in this purported protection.

The latest attempt to delude the public with a false sense of security is the Province’s announced “world-leading” spill preparedness and response regime. The regime is far from “world-leading” because it provides no financial assurances mechanism by which to effectively discipline corporate decision making behaviour, nor does it help to remove the systemic risk factors in companies that lead to major and catastrophic losses.

Without a financial assurances component that requires each mine site to hold adequate financial security to meet all authorized and unauthorized environmental harm events, the public will continue to be exposed to intolerable risk and continue to be required to bear costs they were promised by politicians they would not face.

6.1. How Companies Avoid Costs

Corporations engage in complex and sophisticated corporate structures to maximize and protect earnings. They also design corporate structures to minimize transparency and/or avoid liability, including tax liability.

Despite legal requirements that polluters pay for harm their operations cause, this may be thwarted when companies engage in pre-emptive corporate structures to avoid doing so.

Corporations can also rely on their relative degree of financial weakness to defer, or avoid, meeting their obligations. If a company is granted a permit without being required to provide full financial assurance and then is unable to fulfill its obligations, a regulator wishing to compel compliance may be deterred by the spectre of the company's insolvency.

Corporations rely on bankruptcy protection to circumvent the Polluter Pay Principle. Reliance on the courts to provide protection while companies restructure and re-arrange ownership as a way of avoiding environmental liabilities has led "counsel for MOEs (to suggest) the CCAA is in danger of becoming a "regulatory car wash," arbitrarily cleansing debtors of environmental obligations and leaving taxpayers to pick up the tab."¹⁵¹

Often many of the same executives—and assets—reappear under a fresh corporate structure, while past liabilities, whether environmental or not, have been reduced or shed altogether.

6.1.1 Coal Mine Owner Walter Energy Puts Taxpayers at Risk

Walter Energy Inc. was the US parent of a conglomerate that engaged in exports of metallurgical coal for the steel industry. Its mines operated in the US, Canada and the UK. The Canadian coal mine assets were acquired from Western Coal Corp. in 2011. The acquisition was undertaken during the height of the recent coal export boom. The purchase was facilitated by a complicated leverage buyout where Walter Energy incurred significant debt in order to purchase the Canadian assets.¹⁵²

Walter Energy relied on a complex web of Canadian partnerships and unlimited liability corporations (ULCs) in the structure of its operation. This structure was designed to facilitate an outflow of cash to its US parent in support of fees and charges related to management services and debt servicing provided by the US parent, as well as to avoid tax.¹⁵³

The complex set of transactions resulted in huge Canadian tax savings according to Walter Energy in a report to its US lender, Morgan Stanley.¹⁵⁴ Walter Energy's corporate culture was steeped in the

151 Lexpert Business of Law, [The difficult tightrope courts must walk in insolvencies](#), April 1, 2014.

152 [Deals and Developments](#), Lawson and Lundell

153 [First Affidavit of William G Harvey](#) Sworn December 4 2015, paragraph 129 and 130.

154 [Exhibit M](#), Second Part to the First Affidavit of William G Harvey Sworn December 4, 2015.

8. Toward a Financial Assurances System for Mining in BC

Environmental liability regimes should be aimed at achieving efficient levels of deterrence and compensation. In other words, applying economic theory to environmental policies, the introduction of a liability regime in response to planned and unplanned environmental harm needs to pursue two important and interrelated policy goals:

1. deterrence of inefficient activities which leads to the prevention of environmental harm, including pollution, because it is not cost justified; and
2. compensation from the polluter for environmental harm that satisfies clean up, restoration, remediation, reclamation and adequately settles claimants' commercial losses.

Efficient levels of deterrence arise when, for example, a mine operator decides to rely on a dry stacking technology for tailings because the reclamation and environmental accident related financial assurances under a dry stacking method are much less expensive over the life of the project. In this way, fewer tailings ponds failures result, because there are fewer tailings ponds. Certainly this goal is consistent with the expert engineers report whereby the report identified the need to reduce the number of tailings dams to reduce risk of breaches.

Both the deterrence and compensation functions are undermined if the polluter does not fear the spectre of being held accountable to pay and/or, if after the harm is done, has insufficient financial ability to compensate for the damage caused.

The Polluter Pay Principle is the guiding force behind the development of who pays, when, and how. Adopting this principle requires that measures be introduced to not only require that the polluter pay, but establish up front that the polluter actually can, and will, pay. A rigorous financial assurances mechanism fulfills this function.

8.1 Site Reclamation—Recommendations

The benefits from an effective financial assurances framework for site reclamation and remediation, which includes a requirement that companies provide full funding of their future obligations up front, go far beyond removing the threat that the public will pay. The benefits go beyond the assurance that the reclamation and remediation from permitted operations will be undertaken in a timely and efficient manner.

When a company is required to internalize the environmental cost of its production prior to commencing operations—costs it has agreed to pay as part of the permitting process—the project proceeds only if the company proves it can live up to its obligations. This reduces the likelihood of future insolvency and the negative impact mine failures have on the economy.

Internalizing costs also means that when projects advance they have a greater likelihood of success. There are far too many insolvencies and bankruptcies in BC's mining sector. Too often the same players, and the same assets, reappear and begin the cycle anew. Internalizing environmental externalities will help remove the boom and bust; rush and retreat tendencies of the mining sector bringing with it the benefits of a more stable and resilient mining industry.

As well, full funding of estimated future obligations means that if unexpected costs arise during the life of the project, or when it moves into its closure phase, the gap between the security the company has posted, and the unexpected costs is narrower, and easier for the company to bridge. If a company has \$50 million in reclamation security to meet \$50 million in expected costs and finds it needs an addition \$10 million it is a lot harder for the company to renege on its obligation than if it only has \$20 million as posted security. Full funding of reclamation makes it easier for companies to fulfill their promises.

An effective financial assurances framework for site reclamation and remediation:

1. enforces the Polluter Pay Principle by ensuring those who benefit from disturbing the land and contaminating it, pay to reclaim and remediate it;
2. requires full financial security at permit to ensure that the public is not left to pay if the company does not fulfill its obligations thereby removing the discretionary power for determining security from the Chief Inspector of Mines along with the inherent conflict of interest such discretionary power implies;
3. requires those who own operating, care and maintenance or closed mines, provide full security within a three to five year period;
4. creates a fund levied against volume of production which could be made available for a fee to smaller companies who may be able to pay for financial assurance instruments but are not able to gain access to them through the financial sector. The fund would also be available to provide financial resources for reclamation and remediation in the unlikely event a company was unable to pay;
5. provides full disclosure of reclamation plans, costs and types of security in place on an annual basis, along with an estimate of unfunded liability, if any;
6. allows among the types of financial instruments letters of credit and surety bonds, because these instruments have a built in regulatory element—the bank or insurance company reviews the company and its financial/operational risk as part of the entering into the contract. Parental guarantees and pledging of physical assets should not be permitted. Parental

guarantees are undesirable because of the difficulty which may arise if the parent experiences financial challenges, and physical assets are undesirable because they are illiquid and their value eroded over time.

8.2 Environmental Accidents—Recommendations

The benefits from a financial assurances framework for environmental accidents, which includes a requirement that companies prove access to adequate financial resources prior to an event, go far beyond removing the threat that the public will pay. It also goes beyond the benefits that are achieved from the assurance that the response will be efficient and effective.

When a company has adequate financial resources to meet the costs of a major or catastrophic event the threat of financial insolvency is removed. This is a benefit to the company, its shareholders, and if the mine is operating, its employees.

Ready access to adequate financial resources is also a benefit to the regulator. A company's deteriorating financial position after an accident can have an affect on regulatory decisions regarding clean up and remediation orders as well as affect the decision making process involved in permitting a mine operator to restart operations.

An effective financial assurances framework for environmental accidents:

1. enforces the Polluter Pay Principle by ensuring those who pollute, pay;
2. reaffirms that the liability of the company who operates the mine site is unlimited if an unintended environmental harm event occurs as result of their fault or negligence;
3. establishes a limit of liability on a no-fault basis—fault or negligence does not need to be proven. The limit of liability determined on the basis of risk related to the size of the mine, the relative degree of risk of its technologies (e.g. dry stacking is a less risky method of tailings management than wet), and other factors that speak to accident frequency and consequence;
4. requires that companies who operate mines maintain the financial resources necessary to pay the limit of liability amount that applies to them;
5. requires that companies who operate mines prove on a regular basis that they have the financial resources necessary to pay the limit of liability that applies to them, along with a requirement that if any change to their financial resources program occurs that the regulator must be notified and provided a plan as to how the capability to meet the limit of liability has been achieved;

6. establishes an industry funded pool for damages that might exceed limits of liability (for which there is no party who is found to be at fault) or if in the unlikely event, the polluter is unable to pay;
7. recognizes the full funding of legitimate claims for damages to the environment and people in other jurisdictions such as Alaska and Washington;
8. allows for the establishment of a claims process for compensable damage which is arms length from the mine operator who experienced the event along with a procedure for review of disputes regarding claims adjudication which is outside the courts; and
9. allows among the types of financial instruments insurance policies or certificates of insurance, letters of credit, and surety bonds, because these instruments have a built in regulatory element as the bank or insurance company review the company and its financial/operational risk as part of the entering into the contract. Parental guarantees and pledging of physical assets should not be permitted. Parental guarantees because of the difficulty which may arise if the parent experiences financial challenges, and physical assets because their value may be eroded from the event itself.