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27.17	38.72	6	28.54
38.70	28.93	287	21.95
28.92	21.96	5	29.47
21.95	29.47	272	488.06
29.46	488.19	3	117.02
488.07	117.02	9	20.84
117.00	20.84	370	21.31
20.83	21.32	126	31.66
21.31	31.66	69	34.51
31.65	34.52	19	33.43
4.51	33.44	32	29.79
33.43	29.82	10	21.35
29.78	21.37	3	35.87
21.34	35.87	17	95.72
35.85	95.76	3	

EDITOR

JONATHAN SOHN

AUTHORS

STEVEN HERZ

ANTONIDA VINA

JONATHAN SOHN

# DEVELOPMENT WITHOUT CONFLICT

## The Business Case for Community Consent

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## THE BUSINESS CASE FOR COMMUNITY CONSENT



*Editor*

JONATHAN SOHN

*Authors*

STEVEN HERZ

ANTONIO LA VINA

JONATHAN SOHN

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WORLD  
RESOURCES  
INSTITUTE

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**JOAN O'CALLAGHAN**  
*EDITOR*

**HYACINTH BILLINGS**  
*PUBLICATIONS DIRECTOR*

**MAGGIE POWELL**  
*LAYOUT*

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# FOREWORD

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The rather daunting title of this report is “The Business Case for Community Consent.”

But it’s really about common sense. Common sense in a world in which communications are virtually instantaneous and reputation has enormous global value. Almost 75 percent of the market capitalization of the companies in the Dow Jones Industrial Average is intangible—primarily a company’s brand and reputation.

This report examines the premise that the informed consent of a community affected by development projects, either public or private, makes good business sense. It argues that the risks created by not obtaining community consent are significant and quantifiable, as are the benefits obtained with meaningful consultation.

The principle of free, prior, informed consent is still evolving. This paper explores its many facets and the potential implications for the projects that corporations and governments undertake, especially in developing countries.

The process of consultation is not simple, nor is the meaning of consent obvious. In many cases, it is not even obvious who or what constitutes a community; as a consequence, the definition of consent and who can grant it requires careful discussion. But those discussions must acknowledge the ever-increasing expectations that communities have a say in projects that affect their future.

The examples this report presents illustrate the power of strongly mobilized public opinion. A community ignored or scorned can exact a significant financial price in the present and impose opportunity costs for a company in the future.

Many companies and governments still push projects through to completion without community consultation or approval. In many cases, they believe their actions are justified, perhaps even in the public interest. Yet, among affected communities the ripples from such action don’t dissipate quickly.

Even as we refine what this principle means in operation, there is no question that as a principle and as a practice, free, prior, informed consent is a key part of legitimacy.

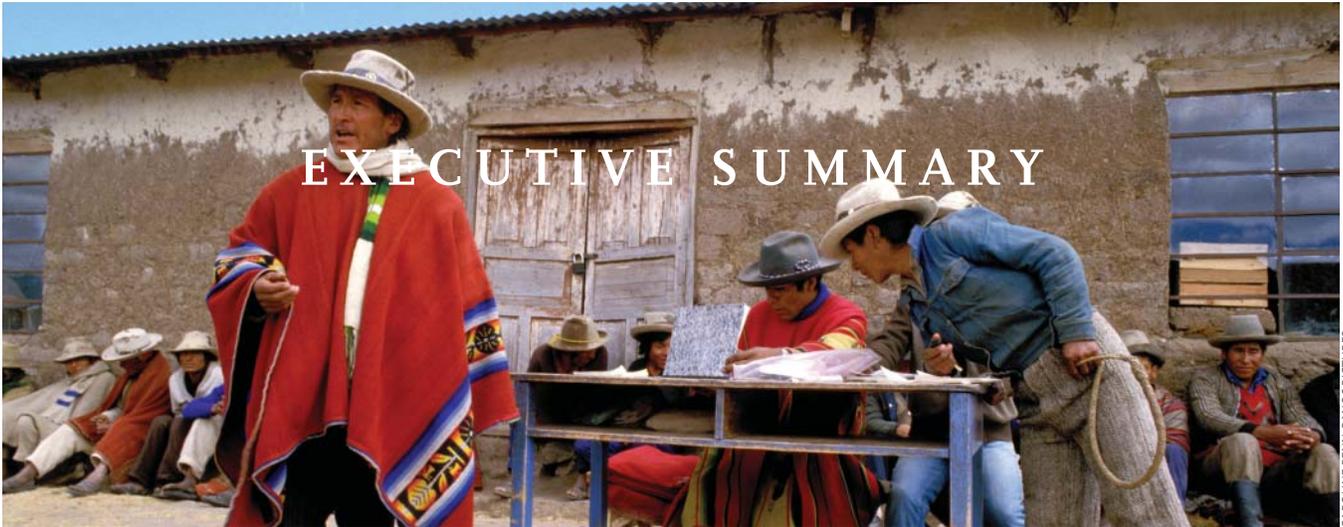
And if you wonder if that is true, simply ask this question: Is your company better off having the people in the communities where you operate with you or against you?

It is just plain common sense.

**JONATHAN LASH**

*PRESIDENT  
WORLD RESOURCES INSTITUTE*





CAROLINE PENN. PANOS PICTURES

## EXECUTIVE SUMMARY

While much has been written on the legal, normative, and development arguments for ensuring that host communities have the opportunity to provide their free, prior, and informed consent (FPIC) to a project, relatively little attention has been paid to the “business case” for FPIC. The argument is rarely made that it is in the financial interest of project sponsors and their financial backers to ensure that local communities have certain rights to provide or withhold their consent.

Most project sponsors and financiers tend to perceive the business case for community interaction in terms of “community engagement” or “consultation.” Operationizing FPIC is an evolving practice. As a result, when FPIC is considered, it is often regarded as being too difficult or ill defined to implement effectively, or as inconsistent with host country preferences or policies. In some situations, governments may conclude that the “national interests” in a project should override local concerns, or they may simply not be interested in ensuring the concerns of all stakeholders are addressed.

As a result, while many sponsors and financiers of high-risk projects require community *consultations* as part of their assessment or development procedures, they rarely require that *consent* be achieved as a key element for project development.

### THE CASE STUDIES

This report demonstrates the business case for incorporation of FPIC principles in large-scale development projects. Drawing on four case studies from

projects around the world, it illustrates how a company’s ability to gain the approval of the host community can affect the project’s success. In addition, it describes best practices and leading policy developments that provide practical guidance for implementing FPIC principles in global business practices.

The report includes four cases:

1. In the Philippines, the *Malampaya Deep Water Gas-to-Power Project* is the largest industrial development in the nation. The project extracts natural gas from below the seabed off the coast of Palawan Island and transports it more than 500 kilometers by undersea pipeline to a natural gas refinery plant in Batangas City on Luzon Island. It is a joint venture of the Royal/Dutch Shell subsidiary Shell Philippines Exploration (SPEX), Chevron Texaco, and the Philippine National Oil Company (PNOC).

Shell employed four strategies to gain community consent: (1) community outreach and interviews with key opinion leaders and decision makers; (2) information dissemination, education, and communication activities; (3) perception surveys and participatory workshops to introduce the project and validate initial survey results; and (4) participatory involvement in the formulation of environmental management plans.

Based on these activities, the project sponsors made significant changes to the project. Shell also recognized that the risks of community opposition can arise after the project has been implemented, and endeavored to maintain and cultivate its relationships with the affected communities during project operations. These efforts

have succeeded in gaining community support for the project and significant, documented financial savings to the company.

2. In Argentina, the *Esquel Gold Project* is a proposed open-pit mine project near the town of Esquel. Esquel's residents are well-educated and socially cohesive; many moved to the community from more urbanized areas to enjoy its natural amenities and alpine charm.

The Esquel project is owned by Meridian Gold, a mid-tier gold producer based in Reno, Nevada. Meridian hoped to develop an open-pit gold mine 700 meters above and 7 kilometers east of the town. From the earliest stages of project development, the company did not share critical information about the potential benefits and risks of the project, or engage with the community to understand and address its concerns before they became points of contention. Meridian reacted to gathering opposition mainly by initiating a public relations campaign that proved to be counterproductive. The mining project was overwhelmingly rejected in a public referendum in March 2003.

As a result, a project that the company once billed as "the next chapter" in its growth has never been developed. According to financial analysts monitoring the mining sector, the events in Esquel created significant concern with respect to Meridian's share price. In addition, in February 2006 Meridian was forced to write down the value of the property by US \$379 million. It remains to be seen whether Meridian will ever be able to gain access to Esquel's estimated US \$1.33 billion reserves.

3. In Thailand, the *Samut Prakarn Wastewater Management Project* (Samut Prakarn) was conceived by the Pollution Control Department of the Government of Thailand (PCD) in the early 1990s to address the severe water pollution problems in Samut Prakarn province.

Due to its strategic location on the Chao Phraya River just southeast of Bangkok, Samut Prakarn province had become one of the most heavily industrialized and rapidly urbanizing provinces in Thailand. But its rudimentary sanitation and water treatment facilities could not handle the large volumes of wastewater produced by its 1.2 million residents and over 4,000 factories.

Recognizing the severity of the problem, the Government of Thailand asked the Asian Development Bank (ADB) to assist in the development of a wastewater

management system for the province. The ADB recommended building two large central treatment plants, one on each side of the Chao Phraya River. Only one contractor submitted a final bid to build a single facility—not at the original east bank site, but rather at Klong Dan, more than 20 kilometers from the east bank of the river.

The residents of Klong Dan were not informed of the decision to relocate the wastewater treatment facility to their community. They objected to the nontransparent and nonparticipatory manner in which the change to the location was made, and to the fact that appropriate environmental or social assessments of the impacts at the new site were not conducted.

Community leaders also came to suspect that the decision to move the project was driven more by corruption and the desire to enrich a handful of politically well-connected landholders than by any considered assessment of the public interest. Thai authorities investigated and corroborated these allegations, and uncovered additional evidence of corruption.

Despite the fact that the project is 95 percent complete, all work on the project remains suspended as the PCD determines how to proceed. To date, the Government of Thailand has spent an estimated US \$650 million constructing the project, and will need to spend an additional \$140–\$180 million to complete the facility and bring it online. The value of the economic benefits attributed to the project has already been reduced by about \$1.27 billion, and the project is no longer economically viable under its original assumptions.

4. In Peru, the *Minera Yanacocha Gold Mine Project* (Yanacocha) is the one of the largest and most profitable gold mines in the world. Yanacocha is a joint venture of Newmont Mining Corporation (51 percent), Compañía de Minas Buenaventura of Peru (44 percent), and the International Finance Corporation, the private-sector lending arm of the World Bank Group (5 percent).

Yanacocha is a linchpin asset for each of its principal owners. Its six open-pit mines, five leach pads, and associated processing facilities sprawl across 160 square kilometers, five separate mountains, and four distinct watersheds. These existing facilities occupy only a small portion of the 1,725-square-kilometer concession on which Yanacocha owns exploration and development rights. After a relatively modest start in 1992, new discoveries led to rapid expansion.

By 1998, the mine was causing significant tensions between the company and the community. The situation worsened after a June 2000 accident involving the transportation of mercury that affected residents in several villages, and worsened further as a result of community opposition to the company's interest in mining Cerro Quilish, a 3.7-million-ounce deposit within the Yanacocha concession.

After a long legal battle that ultimately was won by the company, in September 2004 Yanacocha obtained a government permit to begin exploring Quilish and moved its drilling equipment onto the site. The public reaction was swift and intense. The protests culminated in a region-wide strike that included a mass mobilization of approximately 10,000 people in the public square in Cajamarca. The blockade was disbanded and protests were ended after local leaders and representatives of the Ministry of Mines negotiated an agreement with the company.

In early November, the company publicly apologized for its actions, formally requested that the Ministry revoke its permit to explore Quilish, and removed the Quilish project from its operations plans. Quilish's reserves are worth an estimated US \$2.23 billion, and could have brought in about US \$1.7 billion after production costs. Furthermore, the conflicts between Yanacocha and the community have placed more than just the Quilish reserves in jeopardy—other proposed expansions of the mine are now facing heightened scrutiny.

Based on these case studies, the report reaches a number of important conclusions:

- When businesses get it right, achieving consent can benefit both the community and the project.
- The business risks of going forward with a large-scale project in a community without its acceptance can threaten the viability of the project.
- Community opposition can arise from impacts that are generated at any stage in the project cycle.
- Addressing issues of community concern before the project begins is likely to be more successful and cost-effective than responding to community opposition later on.
- The risks of failing to achieve community consent are not borne exclusively by the project sponsor. Other stakeholders, such as shareholders, financiers, and host governments can also have their interests adversely

affected by conflicts that may result from the failure to achieve community support of a project.

- Engagement or consultation may not always be sufficient to fully address these risks. Consultations that do not resolve a community's reasons for opposition or achieve consent will provide little assurance against potentially costly and disruptive conflict.

## THE BOTTOM LINE

Taking these findings from the case studies into account, the report recommends that each stakeholder take specific, affirmative steps to ensure that the free, prior, and informed consent of project-affected parties is secured before and during project operations, recognizing the operational uncertainties surrounding "community consent."

Most important, it recommends that project sponsors and financiers incorporate community involvement and consent procedures and requirements into their project and investment decision making, planning, and operations at the very beginning, and that host governments incorporate such procedures and requirements into their permitting processes.

We recognize that achieving FPIC can be challenging. Implementation questions—such as who should be empowered to represent the community, through what processes is approval given, how to overcome difficult enabling environments, and how FPIC should be verified—can defy easy answers and may vary significantly with the particulars of the local context.

The four case studies suggest six principles that may assist project proponents in crafting and implementing consent procedures that will mitigate the business risks associated with projects that do not adequately involve the community:

**Information.** Affected communities should be provided sufficient information in local languages regarding the proposed project. Project proponents should work with communities to understand the types of information the communities need to make informed decisions, and must allow sufficient time for communities to review and discuss information provided to them.

**Inclusiveness.** All interested community members should be allowed and encouraged to take part in the FPIC process, including stakeholders affected by indirect or cumulative impacts.

**Dialogue.** Dialogue within an FPIC process should be formalized, continue throughout the lifetime of a project, and include government and local stakeholder representatives.

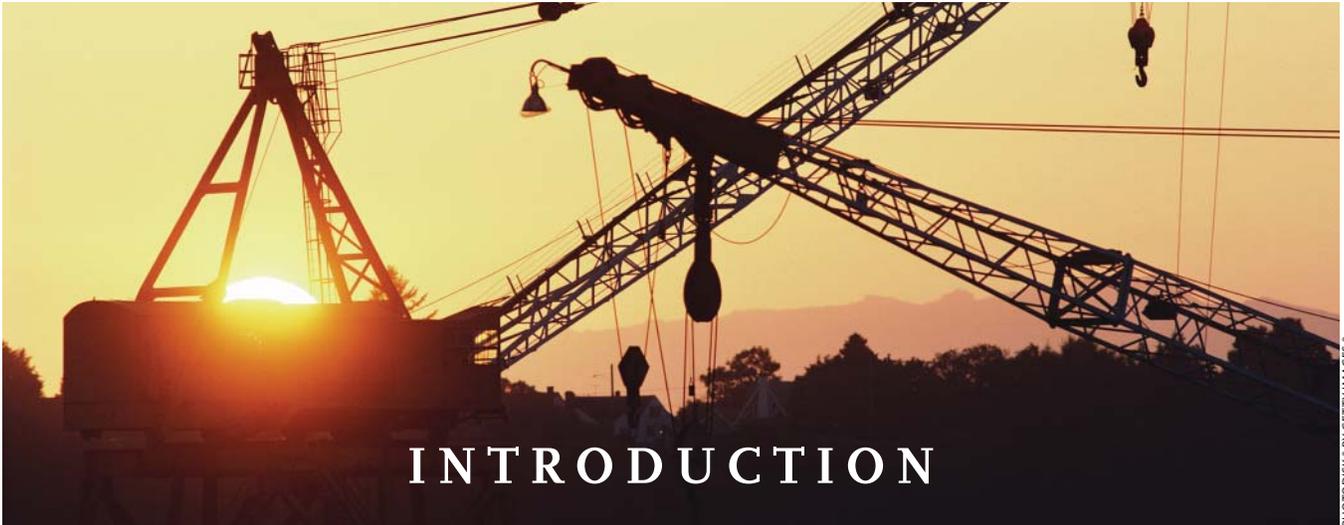
**Legal recognition.** FPIC should be formally recognized through binding negotiated agreements. There should be a sufficient period of time for community decision making prior to project commencement.

**Monitoring and evaluation.** Opportunities for appropriate and independent community monitoring should be put in place. Monitoring and evaluation should be supported by independent grievance

processes to ensure that community concerns are addressed throughout a project's lifetime.

**Corporate buy-in.** Project proponents should view FPIC as an inherent and necessary cost of project development. Where appropriate, developers should find constructive ways to channel funds to communities to maintain the integrity of the process and the independence of the community's role.

Community involvement and consent work best in a setting where the host country government recognizes these concerns as a matter of law or policy. Project proponents should work with governments to gain their endorsement and involvement in the FPIC process. To fully protect their legal rights and interests, proponents should develop with communities further procedures based on local conditions.



# INTRODUCTION

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Developing a large-scale industrial project can be one of the most complex business transactions that a company can undertake. To bring a project online, a project sponsor must successfully address a daunting array of issues, and must gain the consent and cooperation of many different actors, including project shareholders, bankers, insurers, operators, public permitting authorities, contractors, suppliers, workers, and, when appropriate, customers. Reconciling the different expectations and interests of these stakeholders often requires lengthy, and even intense, negotiations to clarify the rights, obligations, and expectations of the parties, and confirm their agreement to participate.

Yet ironically, the stakeholders that may have the greatest interest in the project—the host communities—may often be least likely to have the opportunity to negotiate their interests or consent to the project. For communities that host a large-scale project, unlike for most other stakeholders, project decisions can literally be life altering. Whether a project goes forward—and how benefits, costs, and risks are allocated over the project’s life cycle—can profoundly affect the lives, livelihoods, and development aspirations of communities, both positively and negatively, for years to come. While the interests of other stakeholders are subtly choreographed, host communities are often relegated to observer status.

“Free, prior, and informed consent” (FPIC, or “consent”) is the right of communities “to exercise control, to the extent possible, over their own economic, social and cultural development.”<sup>1</sup> Operationizing FPIC is an evolving challenge. The answers to questions like What defines a “community”? and What determines “consent”?

are debated. What is absolutely clear, however, is that the needs and concerns of a community that may be host to a project cannot be ignored or given short shrift.

There is a surprising lack of attention to the business case for community consent. Although the challenges of gaining consent can be considerable, the business case for not imposing a project on an unsupportive community is compelling. For one thing, the business risks of community opposition can be much greater, in both magnitude and likelihood, than many of the other project risks that project sponsors and financiers routinely seek to shift, mitigate, or insure against. The potential risks related to community opposition include:

- increased costs from delays in construction and operation;
- reduced demand for project outputs;
- reduced access to critical project inputs; and
- increased costs of mitigating environmental and social impacts.

Community opposition can also induce the government to halt operations, revoke permits, or impose costly fines on projects. In the worst case, the failure to properly manage these risks can threaten the project’s commercial success or financial viability. Moreover, the adverse impacts of community resistance can also transcend the specific project and affect corporate operations more broadly. Potential corporate impacts include brand and reputational harms and greater difficulty in future projects.

On the other hand, project sponsors that demonstrate the support of their host communities can find it easier to gain regulatory approval for future projects, efficiently bring their products to market, attract skilled employees, or market their products to the growing pool of customers who consider production conditions and corporate sustainability practices in their purchasing decisions.

This report seeks to fill the gap in the existing literature by suggesting the business case for sponsors of large-scale, high-impact projects to treat the consent of the host community as a requirement of project development. The business case argument is set out in four sections. The first section provides context by briefly reviewing the origins and evolution of the FPIC requirement in international law and development discourse. It argues that while community consent first emerged as an international norm applicable to indigenous peoples, it has come to be widely seen as integral to the fair treatment of all communities.

The second section addresses the business case for FPIC. It describes the potential risks associated with developing projects that lack the support of their host communities, and the benefits that may be achieved from obtaining consent.

The third section focuses on case studies. Through a series of real-world examples, it illustrates some of the ways in which the risks of community opposition can manifest themselves in both public- and private-sector projects and how dealing with community concerns can lead to a successful project. To the extent possible, based on publicly available information, each case study quantifies the financial impacts that community opposition (or its avoidance) has had on the project and its sponsor. This section also includes boxes that explore several other aspects of the business case for FPIC that are not fully discussed in the case studies.

The fourth section offers a set of potential conclusions and recommendations that emerge from the case studies. It describes the substantial business advantages that can be realized from securing broad-based community consent before making major project decisions, and at each stage in project development and operations. It therefore recommends that each stakeholder take specific, affirmative steps to ensure that the free, prior, and informed consent of project-affected parties is secured before project operations.

Finally, Appendix A provides a list of resources to assist those who seek further practical guidance and best practices on how to conduct a FPIC process.



JEREMY HARTLEY, PANOS PICTURES

## THE PRINCIPLE OF FREE, PRIOR, AND INFORMED CONSENT

While sometimes controversial, the principle that host communities should have the opportunity to grant or withhold their free, prior, and informed consent (FPIC) to projects located on their lands or that impact the resources upon which they depend is now widely considered to be an internationally guaranteed human right of indigenous peoples, and is increasingly being recognized in national law, international norms, and voluntary best practice standards and guidelines.<sup>2</sup> FPIC is also increasingly seen as critical to ensuring that all communities have the opportunity to control their own development destinies. This section defines the FPIC principle, and provides an overview of the ways in which it has been recognized in various international conventions and guidelines, and in the national law of a growing number of countries.

The International Labour Organization (ILO) defines FPIC as the right of communities “to exercise control, to the extent possible, over their own economic, social and cultural development.”<sup>3</sup> This right is held collectively by the community and does not give individuals the power to veto a project. FPIC requires that consent be freely given, obtained prior to final authorization and implementation of activities, and founded upon an understanding of the full range of issues implicated by the activity or decision in question.<sup>4</sup> It is more than a one-time event: “it involves a continuous, iterative process of communication and negotiation spanning the entire planning and project cycles....”<sup>5</sup> While this does not mean that all decisions are provisional or nonbinding, it does require that information be provided, and consent be obtained, with respect to:

- undertaking prefeasibility and feasibility assessments;
- conclusions reached by studies undertaken regarding community support;
- any negotiated resettlement plan and compensation settlement;
- any development plans associated with the project;
- means of benefit sharing;
- allocation of liabilities;
- means of redress;
- oversight mechanisms; and
- project closure and decommissioning issues.<sup>6</sup>

FPIC differs importantly from mere consultation in the way decision-making authority is exercised and legitimated. Consultation requires only an exchange of information among project sponsors, regulators, and affected communities. It therefore provides only a limited mechanism for the public to provide information to project decision makers, or to be apprised of decisions that have already been made elsewhere. Consultations do not involve sharing or transferring decision-making authority to those who will be directly affected. Furthermore, they do not necessarily facilitate more inclusive and collaborative decision making, and are rarely an empowering form of public engagement.<sup>7</sup>

On the other hand, FPIC processes allow host communities to meaningfully participate in decision-making processes, negotiate fair and enforceable outcomes, and withhold their consent to a project if

their needs, priorities, and concerns are not adequately addressed. By requiring consent, FPIC processes can give affected communities the leverage to negotiate mutually acceptable agreements under which the project may proceed, thereby ensuring that the projects stand a better chance of producing results that benefit them. In doing so, FPIC processes empower host communities by changing the basic terms of engagement, and can thereby help ensure that the poorest and most marginalized or disenfranchised groups are included in the decision making and receive an equitable share of project benefits.<sup>8</sup>

The legitimacy and practical benefits of the community right to FPIC have been recognized in a number of international conventions and standard-setting exercises, voluntary sectoral guidelines, and national laws. For the most part, these focus on the rights of indigenous communities—due to those communities’ unique circumstances and special status in international law. For example, ILO Convention 169 (1989) provides that indigenous and tribal peoples “shall have the right to decide their own priorities for the process of development as it affects their lives, beliefs, institutions and spiritual well-being and the lands they occupy or otherwise use, and to exercise control, to the extent possible, over their own economic, social and cultural development.”<sup>9</sup> Similarly, the United Nations (UN) draft Declaration on the Rights of Indigenous Peoples provides:

Indigenous peoples have the right to determine and develop priorities and strategies for the development or use of their lands, territories and other resources, including the right to require that states obtain their free and informed consent prior to the approval of any project affecting their lands, territories and other resources, particularly in connection with the development, utilization or exploitation of mineral, water or other resources.<sup>10</sup>

Other human rights conventions, such as the Convention on the Elimination of Racial Discrimination, the International Covenant on Civil and Political Rights, and the Convention on Biological Diversity, have been interpreted to require that the rights of communities to FPIC be recognized and implemented.<sup>11</sup> In addition, the UN Sub-Commission on the Promotion and Protection of Human Rights’ Norms on Transnational Corporations states that:

...transnational corporations and other business enterprises shall respect the rights of local

communities affected by their activities and the rights of indigenous peoples and communities consistent with international human rights standards.... They shall also respect the principle of free, prior, and informed consent of the indigenous peoples and communities to be affected by their development projects.<sup>12</sup>

Regional human rights systems have also supported the rights of indigenous communities to FPIC over the uses of their lands and resources. The Inter-American Commission on Human Rights has concluded that inter-American human rights law requires “special measures to ensure recognition of the particular and collective interest that indigenous people have in the occupation and use of their traditional lands and resources and their right not to be deprived of this interest except with fully informed consent, under conditions of equality, and with fair compensation.”<sup>13</sup> Similarly, the Organization of American States draft American Declaration on the Rights of Indigenous Peoples declares that states should obtain consent prior to the approval of any project affecting indigenous peoples’ lands, territories, and resources, particularly in connection with the development, utilization, or exploration of mineral, water, or other resources.<sup>14</sup> And the European Commission has recognized the right of indigenous peoples to “object to projects,” which includes the principle of free and informed consent.<sup>15</sup>

The principle of FPIC for indigenous peoples has also been recognized in several global standard-setting processes that have articulated “best practices” for specific high-impact industries. For example, the Forest Stewardship Council, a multi-stakeholder collaboration to establish norms for the forestry industry, recognizes that indigenous peoples have the right to control the forest resources on their lands, unless they delegate control with free and informed consent to other entities.<sup>16</sup> The World Commission on Dams similarly recognized the importance of respecting the rights of indigenous communities to consent to activities that impact their lands and resources.<sup>17</sup> And the World Bank’s Extractive Industries Review, an independent review of the development impacts of the World Bank’s oil, mining, and gas lending, also endorsed FPIC for indigenous communities, although the Bank ultimately adopted a slightly different standard (see Box 1).<sup>18</sup>

Some countries have incorporated community consent provisions in domestic law. In the Philippines, community consent is required by the general law applicable to

## BOX 1

## EMERGING STANDARDS OF CONSENT AND CONSULTATION IN THE PROJECT FINANCE SECTOR

The World Bank has begun to incorporate a community consent principle into its policy framework—at least for some of its highest-risk projects. In 2004, after an extensive independent review of its extractive industries portfolio (the Extractive Industries Review, or EIR), the Bank revised its policies to require that an extractive industry project must secure the “broad support” of affected communities through a process of “free, prior, and informed consultation” in order to be eligible for Bank financing.<sup>1</sup> The next year, the Bank revised its Indigenous Peoples policy to apply the same broad community support standard to projects that affect indigenous peoples.<sup>2</sup> The Bank has argued that this new standard not only will help to ensure that communities are better able to assert their interests in the planning process, but will also benefit project sponsors, since projects that are endorsed by their host communities tend to be more productive and less vulnerable to disruption, and often enhance the reputations of their sponsors.<sup>3</sup>

In March 2006, after a comprehensive review of its own environmental and social policies, the World Bank’s private-sector lending arm, the International Finance Corporation (IFC), extended the application of the broad community support standard to all projects that will have “significant adverse impacts” on affected communities. For projects that affect the lands of indigenous peoples, the IFC replaced the broad community support standard with a requirement that the project sponsor engage in “good faith negotiations” with the affected communities, and demonstrate the “successful outcome” of the negotiation.<sup>4</sup>

Both the World Bank and the IFC received substantial public criticism for failing to adopt the standard FPIC formulation. But it remains to be seen whether in practice the “broad

community support” or “good faith negotiation” requirements will prove to be any less protective of community preferences than FPIC. Each of these standards incorporates an element of community acceptance or approval into project decision making that should, if conscientiously applied, functionally approximate an FPIC requirement.

The approach recently taken by the Equator Principle banks—a coalition of more than 40 of the world’s largest private-sector project financiers that have agreed to harmonize their environmental and social policies with the IFC’s performance standards—does not fully incorporate the principles noted in the above paragraph. While the Equator Principle banks have adopted the “good faith negotiation” requirement for projects that affect indigenous peoples, they require only free, prior, and informed *consultation* with other adversely affected communities. They have not adopted IFC’s requirement that such consultations lead to broad community support. Without such a minimum standard for consultation outcomes, the Equator Principle does not require that public inputs actually influence project decision making, and does not ensure that individual projects and stakeholders of these projects can realize the benefits of consent-based decision making. Thus, there is opportunity for enhancing these new principles in practice by encouraging borrowers to seek the support of nonindigenous communities in high-risk, high-impact projects.

## Notes

1. World Bank 2004, p. 7.
2. World Bank, Operational Policy 4.10: Indigenous Peoples (July 2005).
3. World Bank 2004, p. 5.
4. IFC 2006, p. 30.

indigenous peoples (Indigenous Peoples Rights Act, 1997) and more specific laws, such as those that regulate mining and protected areas (Philippine Mining Act of 1995; National Integrated Protected Areas System Act of 1992). Similarly, community consent of local communities (other than indigenous peoples) is also required for bioprospecting and forestry, and is implied in all projects requiring an environmental impact assessment (EIA). For projects requiring EIAs, the principle of community consent is supposed to guide decision makers in approving or rejecting a project.<sup>19</sup> In the United States, federal law allows for a streamlined relicensing process

for operators of hydroelectric plants that can demonstrate they have the consent of affected stakeholders (see Box 2). FPIC has also been incorporated in the mining law in Australia’s Northern Territory for almost 30 years, and in the legislation of at least five other Australian states.<sup>20</sup> Russian law also recognizes FPIC as a right of indigenous people.<sup>21</sup>

Although the right to FPIC is more firmly entrenched for indigenous communities, there is a growing recognition that all communities should have a meaningful role in making decisions about projects

In the United States, federal law allows for a streamlined relicensing process for operators of hydroelectric plants that can demonstrate they have the consent of affected stakeholders. Pursuant to the Federal Power Act, the Federal Energy Regulatory Commission (FERC) authorizes “new” licenses and renewals for hydroelectric dams.<sup>1</sup> At least five years before a project license expires, the operator must notify FERC of its intent to seek a new license.<sup>2</sup> The licensee must prepare materials on project operations and future relicensing plans. This information serves as a basis for consultations with state and federal agencies, Native American tribes, nongovernmental organizations, affected property owners, and other members of the public to identify the actions needed to minimize adverse environmental and social impacts.<sup>3</sup> Based upon the inputs from these consultations, the licensee conducts further studies and proposes a set of licensing conditions for FERC’s consideration. Approval of these license conditions is a prerequisite for relicensing.<sup>4</sup>

This relicensing process can be quite time-consuming and expensive. However, licensees can significantly reduce the time and expense of gaining FERC approval by demonstrating stakeholder consent through a “settlement agreement” process.<sup>5</sup> Under this approach, local agencies and public stakeholders negotiate directly with the license applicant to develop proposed terms and conditions that include appropriate environmental and social mitigation commitments.<sup>6</sup> Once a settlement has been agreed upon, it is submitted to FERC with the request that all settlement terms and conditions be included as part of the official license. However, since FERC may delete or change some conditions of the agreement, many settlement stakeholders include terms in the settlement that make all settlement conditions legally

binding, regardless of whether they are included in the final government license.

FERC encourages the settlement process because it allows for a more efficient and less contentious relicensing process.<sup>7</sup> And stakeholders on all sides of the process like it because settlement agreements often yield outcomes for the riparian environment and the impacted communities that are superior to those that can be achieved in traditional relicensings.<sup>8</sup>

Trust and inclusion of all perspectives are seen as key elements of good settlement agreement processes. As a result, stakeholders often begin by negotiating protocols of engagement before addressing substantive issues. This allows them to establish a framework for long-term cooperation among all stakeholders and generally reflect the concerns of all parties in a relatively equitable manner. FERC notes that “when the process is successful, a common result is more local control and ownership of the licensing decision, and ongoing local participation during the term of the license.”<sup>9</sup>

#### Notes

1. FERC 2004.
2. *Id.*
3. <http://www.hydroreform.org/hydroguide/7-settlements-as-preferred-basis-for-licenses>.
4. *Id.* There are three relicensing processes: Three Step Traditional, Alternative Procedures, and a newer Integrated Licensing Process.
5. 18 CFR § 385.601 *et seq.*
6. For example, American Whitewater, “Stewardship Relicensing Overview.” Available at: [www.americanwhitewater.org](http://www.americanwhitewater.org).
7. *Id.*
8. *Id.*
9. FERC 2004, pp. 2–7.

that directly affect them, including the ability to refuse to host projects that do not provide adequate benefits or help them to realize their development aspirations.<sup>22</sup> For nonindigenous communities, the case for FPIC is based on (1) the right to meaningful participation in environmental decision making;<sup>23</sup> (2) the right to control access to their lands and resources;<sup>24</sup> (3) contemporary standards of public participation as a hallmark of legitimate governance; and (4) basic principles of equity and justice.<sup>25</sup> The World Commission on Dams concluded:

Public acceptance of key decisions is essential for equitable and sustainable water and energy resources

development. Acceptance emerges from recognizing rights, addressing risks, and safeguarding the entitlements of affected people, particularly indigenous and tribal peoples, women, and other vulnerable groups. Decision-making processes and mechanisms [should be] used that enable informed participation by all groups of people, and result in the demonstrable acceptance of key decisions.<sup>26</sup>

Similarly, the World Bank’s Extractive Industries Review recommended that the rights of local communities to FPIC be respected as a precondition to World Bank funding of extractive industry projects.<sup>27</sup> And the Mining,

Minerals and Sustainable Development project, an industry-led initiative to assess the contribution of the mining sector to sustainable development, concluded:

Land use decisions should be arrived at through a process that respects the principle of prior informed consent arrived at through democratic decision-making processes that account for the rights and interests of communities and other stakeholders, while still allowing for the negotiated use of renewable and non-renewable resources.<sup>28</sup>

While the principle of FPIC is increasingly recognized in both human rights and development discourse, substantial questions remain about how it should best be implemented. Achieving FPIC can undoubtedly be difficult, as significant implementation challenges often arise. But these challenges are not so daunting as to negate the rights and development cases for FPIC described in this section, or the business rationale discussed in the following sections.



CORBIS IMAGES



# THE BUSINESS CASE FOR COMMUNITY CONSENT

**T**his report identifies six principles that are critical components of crafting and implementing consent procedures:

**Information.** Affected communities should be provided sufficient information in local languages regarding the proposed project. Project proponents should work with communities to understand the types of information the communities need to make informed decisions, and must allow sufficient time for communities to review and discuss information provided to them.

**Inclusiveness.** All interested community members should be allowed and encouraged to take part in the FPIC process, including stakeholders affected by indirect or cumulative impacts.

**Dialogue.** Dialogue within an FPIC process should be formalized, continue throughout the lifetime of a project, and include government and local stakeholder representatives.

**Legal recognition.** FPIC should be formally recognized through binding negotiated agreements. There should be a sufficient period of time for community decision making prior to project commencement.

**Monitoring and evaluation.** Opportunities for appropriate and independent community monitoring should be put in place. Monitoring and evaluation should be supported by independent grievance processes to ensure that community concerns are addressed throughout a project's lifetime.

**Corporate buy-in.** Project proponents should view FPIC as an inherent and necessary cost of project development. Where appropriate, developers should find constructive ways to channel funds to communities to maintain the integrity of the process and the independence of the community's role.

Community involvement and consent work best in a setting where the host country government recognizes these concerns as a matter of law or policy. Project proponents should work with governments to gain their endorsement and involvement in the FPIC process. To fully protect their legal rights and interests, proponents should develop with communities further procedures based on local conditions.

Without these components, corporations run a dangerous risk that projects will not succeed or will fall below expectations. They also miss many significant benefits—in terms of cost savings; improved community, national, and international reputation; and ability to win acceptance of future projects. This section presents the business case for community consent, in terms of both the risks entailed in not following these principles and the potential benefits of gaining community consent.

## REDUCING RISK

Sponsors of international projects are usually experts at negotiating the multiple administrative processes required to secure the permits and licenses necessary to develop a project.<sup>29</sup> However, they are often less adept at recognizing that regulatory approval does not necessarily imply the consent of host communities. Official approval processes

often marginalize—or bypass entirely—host communities and other locally affected interests. And governments often lack the will or the capacity to help project sponsors negotiate agreements with host communities, or to enforce those agreements as the project moves forward. Host communities commonly complain that these processes do not adequately account for their concerns regarding the adverse environmental, social, and economic impacts of projects, or too readily allow them to bear a disproportionate share of the costs and risks of projects undertaken in the “national interest.”<sup>30</sup>

In response, host communities in many countries have become more proactive about asserting their interests and less willing to allow their governments to have exclusive control over the terms of their participation. Communities are increasingly demanding a more pluralistic approach to project development that affords them a decisive voice in decisions about how the lands they occupy and the natural resources on which they depend will be utilized.<sup>31</sup> More and more, they frame this demand by insisting on the opportunity to grant or withhold their consent to projects that directly affect them.<sup>32</sup>

The failure to respect a community’s right to FPIC may produce a strong public backlash, in the form of blockades, mass mobilizations, strikes, consumer boycotts, and litigation. In extreme cases, such conflict can lead to civil strife, violence, and human rights abuses. For example, efforts by the Philippine government in the 1980s to develop large infrastructure projects in territories indigenous peoples had occupied for centuries led to revolt, public campaigns, and significant project delays. Ultimately, the Indigenous Peoples’ Rights Act of 1997 was passed as a result of these and other organized movements.

For project sponsors and their financiers, community opposition can introduce significant risks. At the project level, these include:

- reduced access to capital;
- increased construction costs and delays;
- reduced access to critical project labor and material inputs;
- operational delays and increased production costs;
- reduced demand for products (particularly name brand consumer items); and
- increased costs of post-hoc mitigation of environmental and social impacts.

Community opposition can also cause the government to revoke permits, impose fines, or even halt operations. Moreover, community resistance can have adverse impacts on corporate operations beyond the scope of an individual project, including negative impacts on stock prices, brands, and reputations, and greater difficulty in securing financing, insurance, and community cooperation in future projects. Each of these risks is discussed below.

### **Financing Risks**

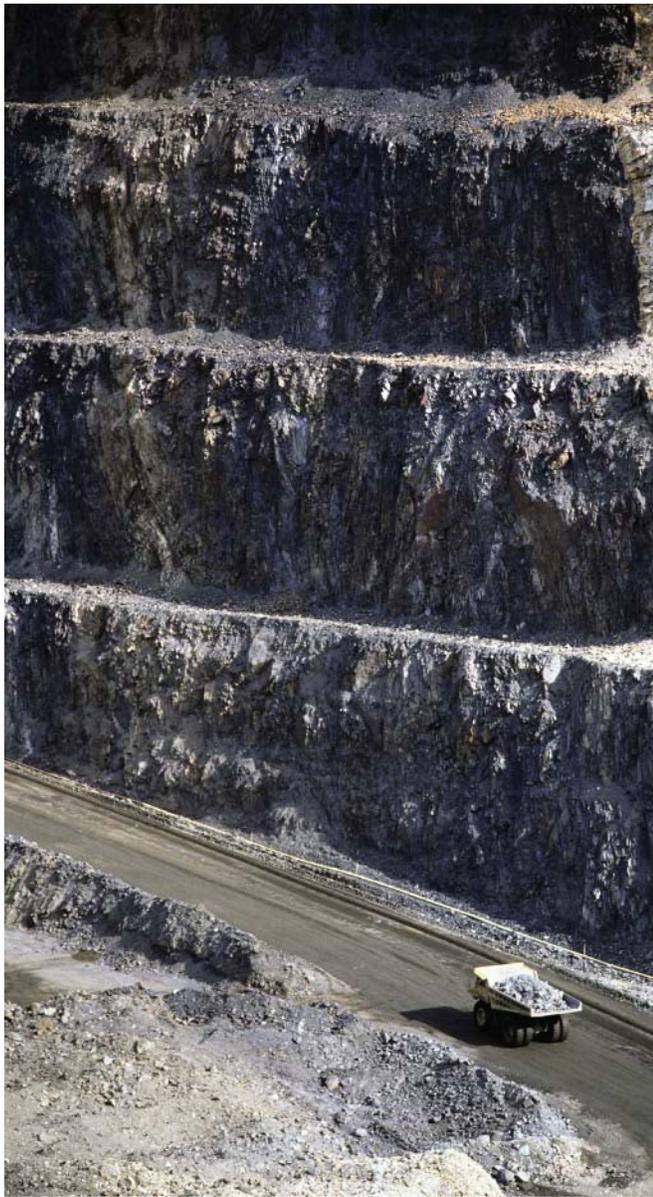
It may be far more difficult for project sponsors to attract cosponsors or to secure financing for projects that are opposed by their host communities. Investors and financiers may delay their involvement, require more lucrative terms as compensation for the additional risks, or simply decline to participate at all. For example, Manhattan Minerals was forced to abandon its plans for a mine in Tambogrande, Peru, after intense community opposition prevented the company from bringing a major partner into the venture.<sup>33</sup> Intense local opposition to a proposed US \$1.7 billion paper mill on the Argentina–Uruguay border recently prompted ING Group to withdraw its consideration of financing the project.<sup>34</sup>

### **Construction Risks**

Community opposition can significantly increase the risk that the project sponsor will not be able to complete the project on time, on budget, or at all. Blockades, work stoppages, and lawsuits can cause lengthy delays in the design, siting, permitting, and construction of the project, and can significantly raise the costs of construction. Construction delays can result in increased finance charges and contractual penalties for failure to deliver outputs. More important, major increases in up-front capital costs and delays in realizing expected revenue streams can significantly impact the project’s expected financial rates of return. For example, indigenous peoples on the island of Mindanao in the Philippines waged a campaign against the Philippine National Oil Company’s Mt. Apo geothermal plant, which delayed the project (and its revenues) for many years.<sup>35</sup>

### **Operational Risks**

Community opposition can also increase the risks that the project sponsor will not be able to produce a sufficient quantity of output, or sell it at a sufficient price, to justify the investment. Through blockades, protests, work stoppages, and litigation, community opposition can



raise production costs and impede the project’s ability to bring the product to market. And through boycotts or adverse publicity, it can reduce the demand for a project’s outputs. Similarly, community opposition can also increase the risks that the project will not have consistent access to sufficient, high-quality inputs for its operations. Community blockades can inhibit access to critical ecosystem service inputs, such as water supplies or timber reserves. And opposition can reduce the project sponsor’s ability to attract and retain qualified local workers, can induce strikes and work stoppages, and can raise tensions to the point where it becomes uncomfortable—or even

unsafe—for (particularly expatriate) management personnel to reside in the host community. Finally, community complaints can force the sponsor to incur additional costs to secure its facilities and develop and implement politically acceptable post-hoc environmental and social mitigation plans.

A particularly vivid illustration of how community opposition can disrupt operations occurred at Río Tinto’s Panguna copper mine in the Papua New Guinea province of Bougainville. One of the most productive copper mines in the world at the time, Panguna was forced to close in 1989 after accumulated local grievances with the mine helped ignite a secessionist civil war that claimed the lives of thousands of Bougainville residents. It has never reopened.<sup>36</sup>

### Reputation Risks

Reputation risk is “the current and prospective impact on earnings and capital arising from negative public opinion.”<sup>37</sup> Though difficult to quantify, community opposition to a project can have direct and potentially far-reaching impacts on the reputations of project sponsors and their financiers. By partnering with media-savvy transnational advocacy networks, aggrieved communities can alert the global public to the impacts of a company’s projects, even in the most remote corners of the world. As a result, the sponsor of a project that faces significant community opposition may find that other communities become much less willing to host its projects. And companies with global operations and high consumer visibility may find that their consumer brand identity can quickly be tainted by allegations that the company is coercive, predatory, and indifferent to social concerns. For example, in the early 1990s the threat of an international consumer boycott forced Scott Paper to abandon its plans for a US \$635 million Indonesian eucalyptus plantation and pulp mill that may have displaced thousands of local residents and decimated huge swaths of tropical rainforest.<sup>38</sup>

### Corporate Risks

Sponsors of projects that run into trouble due to community opposition can suffer a variety of collateral impacts on their balance sheets and their other operations. Reduced profitability and asset values of a project can decrease the company’s stock valuation, particularly for less-diversified companies. Manhattan Minerals, for example, suffered a huge decline in its stock market

valuation after the Peruvian government terminated its option to develop the mine when it could not find a major partner to cofinance Tambogrande.<sup>39</sup> In addition, the perception that a company cannot earn the support of host communities can adversely affect its ability to raise financing for future projects, or to negotiate acceptable terms and premiums for project insurance.<sup>40</sup>

### Host Government Risks

Host governments are typically critical players in the development and operation of large-scale projects. In their permitting and regulatory roles, host governments often have the primary responsibility for addressing adverse impacts on affected parties and ensuring that mutually beneficial outcomes are reached. They also have the primary role in creating the enabling conditions for effective FPIC processes. In many cases, however, host governments lack the capacity or political will to fulfill these roles effectively. For example, governments in some instances conclude that the “national interest” in a project should override local concerns, and are not interested in ensuring that the concerns of all stakeholders are addressed. In these circumstances, the affected communities often hold the project sponsors responsible. Thus, in Bougainville, at least some of the antipathy of the residents toward the Panguna mine was caused by the insensitivity of the Australian colonial government to the land claims of the local residents at the time the mine was being developed. The local landowners believed that the Australian authorities did not seek their permission to develop the mine. Instead, they imposed Australian property law, which granted the rights to subsurface minerals to the government, in contradiction to traditional property rules.<sup>41</sup>

Moreover, communities that are aggrieved by a project may petition their government for redress, and their advocacy efforts may induce the government to significantly alter the way in which it discharges its regulatory functions. In response to local concerns, a government may commence enforcement actions or impose civil or criminal penalties on sponsors, tighten regulatory or statutory requirements, or withhold or withdraw necessary permits and licenses. Host governments may also void their commercial arrangements, withhold payments, or even nationalize, or renationalize, private assets.

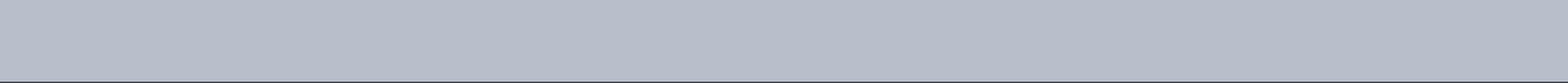
### Host Country Political Risks

Even if the government does not take action against a project’s sponsors, community opposition can create other political risks in a host country. Most importantly, similar grievances in different communities in a country or region can accumulate to the point where the business environment for a company or industry is degraded. For example, despite continued government support for the industry, the local political culture of Peru has become demonstrably less accommodating to mining projects as a result of a number of high-profile conflicts between mines and their host communities.

### RECOGNIZING THE BENEFITS

Aside from risk reduction, invoking a successful community consent process can produce significant benefits for the company, the region, and the environment. Community support can save time, which can yield significant monetary benefits.

For a large-scale infrastructure project, the total costs of engaging the affected communities and gaining their consent are likely to be extremely small relative to the total project costs. Moreover, a proven track record of harmonious community relations can make future interactions with government regulators much easier, and can help a project sponsor win public contracts for other projects. Thus, SPEX used its success with Malampaya to help convince the Philippine government that it was a suitable sponsor for a related project—the construction of an onshore pipeline from its natural gas refinery in Batangas to two nearby gas-fired power plants. SPEX was able to secure the support of the Philippine government for this project, even before it obtained the US \$5 million investment needed it. Shell’s success also has facilitated the company’s efforts to develop new projects elsewhere around the world.



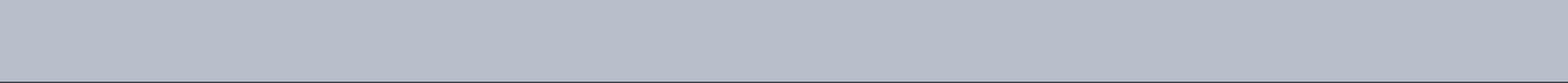
## CASE STUDIES



CURT CARNEMARK/WORLD BANK

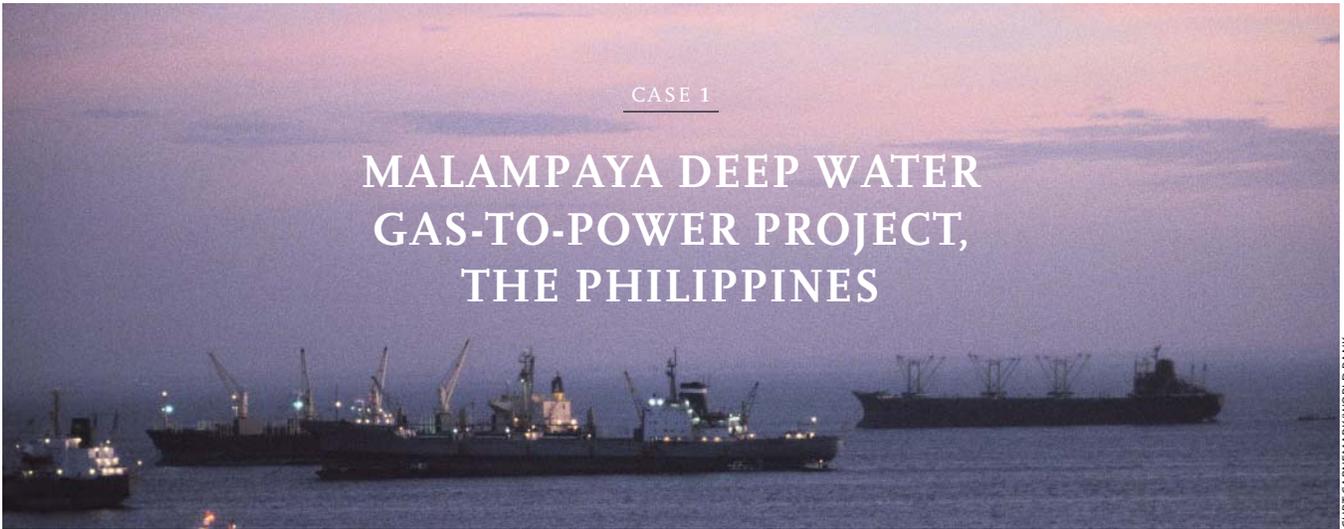
This section illustrates the “business case” for obtaining the consent of host communities by considering several case studies. First, it examines a more positive case study, the Malampaya gas project in the Philippines, in which the project sponsor avoided significant costs during project planning and implementation through early and consistent attention to FPIC issues. Then it considers three cases in which the sponsors suffered significant adverse business impacts due to the failure to secure or maintain community support: (1) the Esquel gold mine in Argentina, (2) the Samut Prakarn Wastewater Management Project in Thailand, and (3) the Yanacocha gold mine in Peru. These cases highlight some of the myriad ways in which community opposition can impede the development—or compromise the profitability—of large-scale, high-impact projects. Based on publicly available information, each case study attempts to quantify the financial impacts that community opposition (or its avoidance) has had on the project and its sponsor. In addition, this section includes several boxes that highlight other aspects of the business case for FPIC that are not captured in the case studies.

Projects that generate significant public opposition are, by definition, highly controversial, and the reasons for conflict are often in dispute. To ensure objectivity in describing the relevant events, we tried to solicit the help of the project sponsors or other key proponents in developing the case studies. However, with the exception of Shell Philippines in the Malampaya case, cooperation was not forthcoming, despite our best efforts. Shell’s participation enabled us to visit project sites, review project documentation, and interview a number of senior corporate officials. The other case studies did not benefit from such access—they were limited to desk reviews of primary and secondary source materials. To maintain balance in those cases, we emphasized public materials produced by the project sponsor or financiers, independent third-party investigators or dispute resolution mechanisms, and well-respected news sources.



CASE 1

## MALAMPAYA DEEP WATER GAS-TO-POWER PROJECT, THE PHILIPPINES



CURT CARMARKWORLD BANK

The Malampaya Deep Water Gas-to-Power Project (Malampaya)—a US \$4.5 billion joint venture of the Royal/Dutch Shell subsidiary Shell Philippines Exploration (SPEX), Chevron Texaco, and the Philippine National Oil Company (PNOC)—is the largest industrial investment in the Philippines.<sup>42</sup> The project extracts natural gas from below the seabed off the coast of Palawan Island and transports it more than 500 kilometers by undersea pipeline to a natural gas refinery plant in Batangas City on Luzon Island.

Malampaya began commercial operations in January 2002. With total reserves of 3 trillion cubic feet, the project is expected to produce 400–450 million cubic feet of gas per day for over 20 years.<sup>43</sup> The refined gas from the Malampaya project feeds a separate pipeline project that supplies three gas turbine power plants in Batangas province. These plants are expected to supply Luzon with a total of 2,700 megawatts of electricity—over 30 percent of the Philippines’ total power demand.<sup>44</sup>

SPEX and ChevronTexaco each owns and financed 45 percent of the project, and PNOC owns and financed the remaining 10 percent. The project sponsors expect to earn US \$6.7 billion from Malampaya—US \$3 billion each for SPEX and ChevronTexaco, and US \$0.67 billion for PNOC.<sup>45</sup> In addition, the Philippine government is expected to earn at least US \$10 billion through a “service contract” that entitles it to 60 percent of net project revenues.<sup>46</sup>

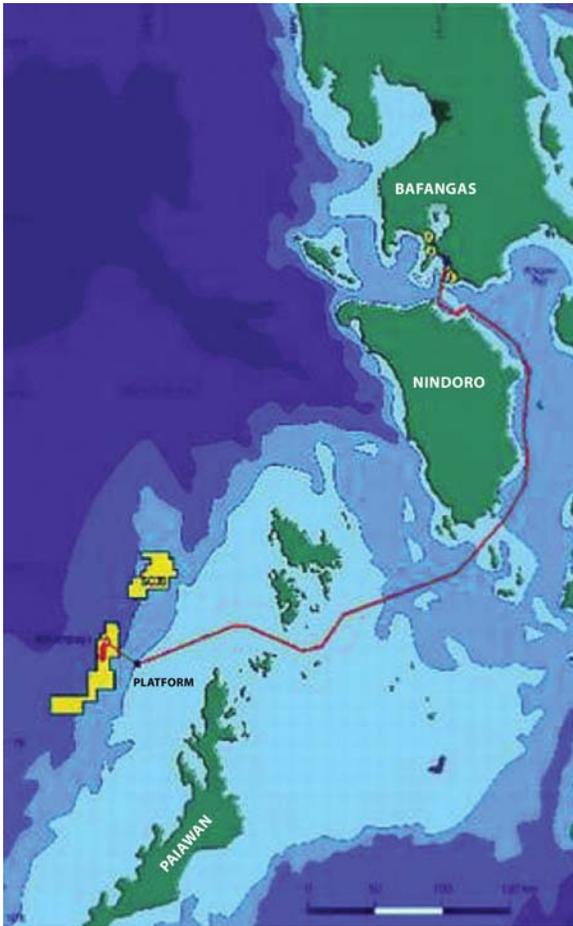
SPEX operates and manages the project on behalf of its partners, and was responsible for bringing the project online. Construction commenced in 1998 and entailed large-scale operations in four different provinces (see

Figure 1). First, it built a concrete gravity structure—the foundation of the offshore platform—in Sitio Agusuhin, Subic Bay, and Zambales. Second, SPEX installed the concrete gravity structure and platform at the offshore extraction site northwest of Palawan province. Third, SPEX laid the 504 kilometers of offshore pipeline under the waters around Palawan and Mindoro Islands.<sup>47</sup> Fourth, SPEX constructed a natural gas refinery plant to process the extracted gas in Batangas City.

### SHELL’S INTEREST IN OBTAINING COMMUNITY CONSENT

According to SPEX, Malampaya was the first project in the Philippines to actively undertake a community consent process as part of its Environmental Impact Study (EIS), even though it was not explicitly required to do so. Shell’s interest in engaging affected communities and obtaining their consent was influenced by several political, legal, and business-related considerations. First, Shell began to develop Malampaya in the mid-1990s, at a time when its record of environmental and social stewardship was being sharply criticized and intensely scrutinized. Activists had been criticizing Shell for its environmental and human rights record in the Delta region of Nigeria, and for its controversial decision to dispose of the Brent Spar oil terminal in the North Sea. Public reaction to Shell’s conduct led to organized campaigns, international protests, and consumer boycotts that damaged the company’s reputation and cost it millions of dollars in revenue.<sup>48</sup> Chastened by the public backlash, Shell began to develop a set of sustainable development policies and to rethink its approach to community engagement.<sup>49</sup> The company stated: “[W]e have learned that for some

FIGURE 1 | MAP OF MALAMPAYA PROJECT



Source: SPEX.

decisions, [public] approval is as important as the opinion of experts or the official consent of authorities.”<sup>50</sup> Shell designated Malampaya to be the first project to incorporate this new approach.

In addition, SPEX was well aware of the adverse affects of community opposition on other projects in the Philippines. In 1983, Shell Philippines had constructed a gas terminal facility in Biñan, Laguna Province, without consulting the local communities. Even after the project had secured environmental approval, local opposition mounted until the mayor of Biñan refused to approve other permits necessary for the continued operation of the facility. As a result, the project experienced lengthy delays and closed down entirely after a year in operation.<sup>51</sup> Similarly, other high-profile clashes between project

sponsors and their host communities in the Philippines, such as the Benguet Antamok Gold Operation (BAGO) pit mine,<sup>52</sup> the Calaca II Coal Fired Power Plant,<sup>53</sup> and the Mount Apo Geothermal Project<sup>54</sup> led SPEX to recognize the advantages of securing public acceptance.

Finally, the regulatory requirements of the Philippine government with respect to community participation were evolving as Shell was planning the project. When Shell first approached the Department of Environment and Natural Resources (DENR) to identify the requirements for its EIS in 1995, the Philippine Environmental Impact Assessment law did not mandate community engagement as part of the EIS process.<sup>55</sup> But shortly thereafter, the law was revised to require public participation. In 1996, DENR issued guidelines that defined public participation as “a transparent, gender sensitive, and community-based process involving the broadest range of stakeholders, commencing at the earliest possible stage of project design and development and continuing until post-assessment monitoring, which aims to ensure social acceptability of a project or undertaking.” The guidelines defined “social acceptability” as “the result of a process mutually agreed upon by the DENR, key stakeholders, and the proponent to ensure that the valid and relevant concerns of stakeholders, including affected communities, are fully considered and/or resolved in the decision-making process.”<sup>56</sup> In 1996, however, “social acceptability” did not necessarily require community consent; this came later, at least for indigenous peoples, with the passage of the Indigenous Peoples Rights Act of 1997. Box 3 provides the Administrative Order in the Philippines that guides obtainment of community consent necessary for environmental licenses to be issued from the Environment Ministry.

## SHELL'S APPROACH TO COMMUNITY RELATIONS

Shell began engaging community stakeholders in 1996, about two years before project construction began. Its outreach efforts were conducted through two Shell entities: (1) SPEX, the chief proponent of the project; and (2) the Pilipinas Shell Foundation, which included the social development arm of Shell Philippines (the Shell Foundation or PSFI)<sup>57</sup> and the External Affairs (EA) Division of Shell Philippines, the parent company of SPEX.<sup>58</sup> SPEX was assigned to deal with all the issues related to the environment, including permitting, while the foundation took charge of all social development issues directly and indirectly related to the project. The

### BOX 3 | PHILIPPINES MATRIX ON COMMUNITY CONSENT

The process of obtaining community consent and continuing to work with communities is complex and difficult. It is not always easy to measure or assess whether it is working well.

To help ensure that the process is succeeding, in 1996 the Philippine Government issued an administrative order requiring project sponsors to complete a matrix that discusses all community concerns and how they are being addressed by the sponsor. Government approval of this matrix was a prerequisite to obtaining an environmental license from the Environment Ministry.

The matrix identifies six different areas: ecological and environment soundness of the proposed project, effective implementation of the public participation process, resolution of conflicts, promotion of social and intergenerational equity and poverty alleviation, and proposed mitigation measures for adverse impacts and measures for the enhancement of positive impacts on people. For each of these areas, it suggests indicators or other evidence that can measure whether the area has been successfully addressed.

#### **Ecological and Environmental Soundness of the Proposed Project**

Examples of proof that this criterion has been met can include:

- Risk Management Plan, if applicable;
- Environmental Management Plan, with the commitment of the proponent to implement the proposed measures;

- municipal, *barangay* (township), or provincial resolution endorsing the project;
- endorsement letters from local nongovernmental organizations (NGOs) and community leaders;
- signed contract between the proponent and project contractor(s), incorporating all of the mitigating and enhancement measures in the terms of reference or scope of work of the contractor(s); and
- list of detailed specifications of raw materials and equipment to be used in the project, from the different suppliers showing that they are the product of environmentally friendly processes and substances.

#### **Effective Implementation of the Public Participation Process**

Examples of proof include:

- scoping report that has been signed by all key parties and stakeholders' representatives;
- matrix showing the manner of inclusion of the comments and suggestions of stakeholders in the various aspects of the EIA; and
- stakeholder letters signifying interest to participate in the monitoring of the project and/or implementation of the Environmental Management Plan.

*continued next page*

foundation also played an ongoing role in managing social development projects in the communities affected by the Malampaya project.<sup>59</sup>

Shell employed four strategies to gain community consent: (1) community outreach and interviews with key opinion leaders and decision makers; (2) information dissemination, education, and communication activities; (3) perception surveys and participatory workshops to introduce the project and validate initial survey results; and (4) participatory involvement in the formulation of environmental management plans.<sup>60</sup> As required by Philippine law, Shell held town hall meetings to provide a forum for Shell to hear and respond to community concerns, and public hearings were also held to present and discuss the results of the EIS report.<sup>61</sup> Perception

surveys conducted after the public hearings and town hall meetings showed that between 72 and 84 percent of respondents approved of the project.<sup>62</sup>

### **COMMUNITY CONCERNS AND SHELL'S RESPONSE TO GAIN CONSENT**

*Mindoro.* At the beginning of the engagements—before town hall meetings and public hearings—many community members opposed the project.<sup>63</sup> Opponents were concerned that the installation and operations of the offshore pipeline would have adverse environmental, health and safety, and economic impacts. The strong opposition in Mindoro also stemmed from previous negative experiences with other extractives projects. Protests were held in Mindoro, and commentators on

## BOX 3 | CONTINUED

### Resolution of Conflicts

Examples of proof include:

- Memorandum of Understanding between the parties to the dispute;
- negotiated agreements on conflicts formalized through a memorandum of agreement between the proponent, the government, and legitimate stakeholders;
- Resettlement and Compensation Plan, if applicable; and
- Social Development Program, if applicable.

### Promotion of Social and Intergenerational Equity and Poverty Alleviation

The project should promote social equity and answer the following questions:

- How could the benefits and burdens of the project be distributed among the different groups and classes of people affected?
- How could the project benefits be distributed more effectively among the poorer people in the intended beneficiary population?
- What might be done to lessen the burdens on project victims or benefactors, especially poor people?
- Are gainful employment and alternative sources of livelihood provided, particularly when vast tracts of

agricultural lands and/or fisheries are affected due to project operation?

- Do livelihood programs/projects involve women and other vulnerable groups?

### Proposed Mitigation Measures for Adverse Impacts and Measures for the Enhancement of Positive Impacts on People

The project should formulate or develop a mutually agreed-upon compensation scheme for resettled households.

- The project should respect and preserve the aesthetic value and cultural heritage of affected communities.
- Examples of proof include:
  - endorsement letters from the local NGOs and politicians;
  - municipal or *barangay* resolutions endorsing the project;
  - an Environmental Management and Monitoring Plan that includes a Social Development Program, Compensation and Resettlement Plan, and other relevant plans and that is signed by the proponent agreeing to implement and strictly abide by all of the proposed measures.

### References

- DENR Department Administrative Order No. 96-37, Philippines Department of Environment and Natural Resources (1996).  
Personal interview with Tony La Viña, former member of the Philippines Department of Environment and Natural Resources.

the local radio stations voiced their vehement opposition to the project.<sup>64</sup> In response, the PSFI group assigned to Mindoro held additional town hall meetings to address public concerns. Shell also conducted an intensive information, education, and communication campaign, including radio advertisements and an information exhibit with educational videos displayed in the city hall.<sup>65</sup> These efforts succeeded in allaying the environmental and safety concerns of the Mindoro stakeholders. Many of the stakeholders, however, were also concerned that the project would produce no direct benefits, since the pipeline would not directly pass through Mindoro. They therefore requested that Shell provide start-up funding for micro-finance and livelihood loans. Shell agreed to provide Mindoro a grant of about US \$1 million (Php 50 million),

which was distributed through seven Mindoro NGOs that presented project proposals and met PSFI grantee criteria.

*Sitio Agusuhin.* SPEX wanted to build a massive dry dock in Sitio Agusuhin in which to construct the concrete gravity structure for the platform. However, about 142 families of fisherfolk lived at the proposed site of the dry dock. Although many of these residents had lived there all their lives, the Philippine government considered them to be illegal squatters, since the land on which they lived was part of a U.S. military installation. The government exerted political pressure to expedite their eviction, and required them to abandon their homes with only a few weeks' notice. Predictably, the community reacted negatively to the government's decision to remove them in such a fashion. In the ensuing conflict, both the World

Bank and the local Roman Catholic Church intervened on behalf of the community to ensure that they were treated appropriately.<sup>66</sup>

The Shell Foundation was able to persuade the community to relocate beyond the perimeter of the facility by offering a package of monetary compensation and social programs. Some residents chose to leave the area entirely, while others remained near their former homes in Agusuhin. All of the families that were resettled were compensated according to the local government assessor's valuation of their dwellings. Several members of the community, however, were dissatisfied with the compensation package.<sup>67</sup> These residents organized protests that threatened to delay the project. In response, the Shell Foundation's community officers entered into negotiations with the aggrieved parties. The residents sought greater compensation for their lands, and preference in Shell's hiring of the 3,000 workers required to construct the gravity structures. In addition, the community was concerned that Sitio Agusuhin would experience a "boom and bust" cycle, as it had when the U.S. Navy left its base in nearby Subic Bay. It therefore viewed the project as an opportunity to build a more durable base of development for their community than a short-term construction project could provide. Toward this end, the community requested that Shell provide support for a high school, medical and dental services, employment and microfinance projects, and assistance in writing up an agreement with the local government for protection from future projects to be undertaken in the area.

While Shell agreed to most of these requests, it refused to increase the compensation package, insisting that compensation be based on the assessor's valuations. Problems also arose in Shell's implementation of some of its commitments. For example, a microfinance loan program was only set up toward the end of the Agusuhin construction project. The delay in the program's implementation concerned some residents, who believed that Shell did not leave enough time to build sustainable alternative livelihoods after the project. Moreover, SPEX's agreement to hire local workers was complicated by the shortage of residents with the requisite construction skills. The foundation worked to address this problem by training local residents in necessary skills, such as welding and masonry. Most of the women, however, did not undergo training, and were employed in cleaning and clearing activities. In the end, the majority of the residents were employed on a full-time basis.

Ultimately, the Agusuhin community was persuaded that the project could bring economic development to the area, and signed a memorandum of agreement accepting the compensation offer.<sup>68</sup> Some dissatisfaction over the compensation package persists, as some community members maintain that they did not understand how the assessment valuation was carried out.

*Batangas City.* In 1999, PSFI facilitated the formation of the alliance of affected *barangays* (townships) in Batangas, which they named TALIM Council—an acronym for the communities of Tabangao, Ambulong, Libjo, San Isidro, and Malitam. The council was formed to enable the different communities to unite in their common concerns and problems with regard to the Malampaya project. The council facilitated meetings of local leaders to discuss common problems and helped to resolve disputes between Shell and affected community members. The council also communicated Shell's response to its constituents.<sup>69</sup>

In Batangas City, ongoing concerns about the negative health and environmental impacts of an existing Shell oil refinery caused some local residents to be skeptical of the Malampaya project. SPEX and PSFI asked the community to focus on issues relating to the Malampaya project, and did not address the issues associated with the other Shell projects in its community engagements. Within these parameters, the communities sought to ensure that there would be priority hiring from among its residents, and that appropriate safety measures were in place.<sup>70</sup>

Almost all of the employment opportunities were available during the construction phase. Once the refinery was brought online, it needed only about eight people at a time for operation. To mitigate this boom-and-bust cycle, PSFI provided residents with training for employment opportunities at other companies located in Batangas City that need to hire staff with certain skills, such as animation and electronics. PSFI also set up a job placement program to help the trainees find work at other companies in need of their new skills.<sup>71</sup>

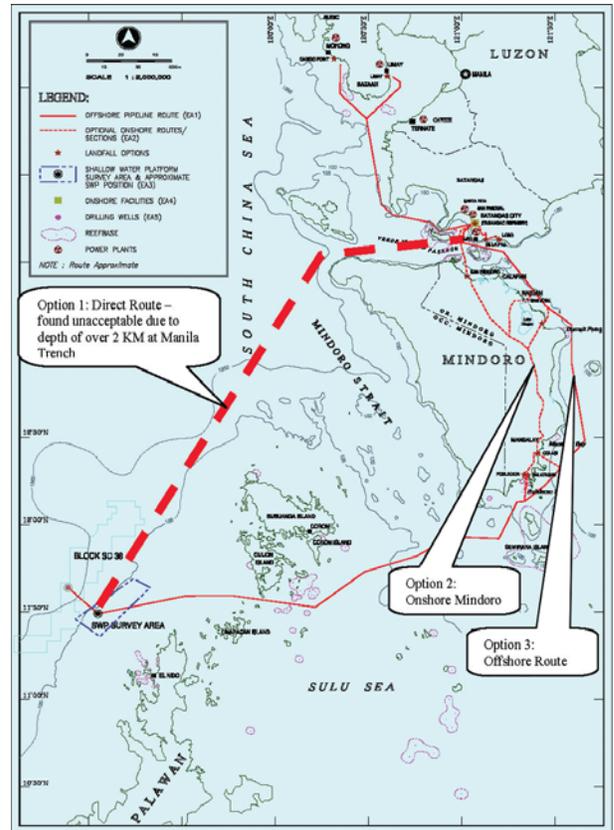
Not all of the affected communities in Batangas City were satisfied with the substantive outcomes of their engagements with Shell. But in general, most of the communities believed that Shell had addressed their most important concerns regarding employment, alternative livelihood, and health and environmental impacts. Recently, however, plant safety has become a concern. Although safety training sessions have been conducted

for the communities, there is continued apprehension with regard to whether this training is adequate. Some communities have requested more training, along with additional security to watch over the complex and pipelines. According to the communities interviewed in Batangas City, these requests are still pending Shell's response and action. Local community leaders, while generally satisfied with their relationship with SPEX and PSFI on the Malampaya project, still express their view that Shell needs to be more transparent and accessible.<sup>72</sup>

*Offshore Pipeline Route.* Three options were considered for the offshore pipeline route during the initial stages of the project (see Figure 2). Two options would have routed the pipeline entirely offshore; the third, least-expensive option, would have crossed Mindoro Island.<sup>73</sup> At first, the project sponsors preferred the third option for cost reasons. But as a result of initial environmental assessments and informal community interviews, Shell learned that the overland route through Mindoro would traverse and heavily impact some areas of rich biodiversity, and that one of the offshore routes would cross the ancestral waters of the indigenous Tagbanua tribe. Initial interviews with community members raised the environmental and social impacts of the other route options. Shell ultimately rejected these routes in favor of a mainly offshore route that avoided the most significant environmental and social impacts of the other two options, and therefore averted potential community pressure in the affected areas.<sup>74</sup> This route, however, was three times more expensive than the other two options.<sup>75</sup>

*When Things Go Wrong.* SPEX accounted for community concerns as they arose by revising its public engagement plan on an ongoing basis. For instance, SPEX initially failed to engage the Pearl Farmers' Association located around the project area in Palawan. Shell was aware of the association, but did not consult its members because Shell believed the farmers to be operating outside the project's zone of impact.<sup>76</sup> The pearl farmers were upset by Shell's failure to engage them, and their relationship was initially contentious. They expressed their opposition by challenging Shell's EIS results with respect to the anticipated impacts on their pearl farm business during the public hearing. They pointed to possible impacts from noise pollution and the environmental consequences of leakages. In response, Shell revised its engagement strategy and met with the association to explain and resolve the issues its members had raised during the public hearing.

FIGURE 2 | ALTERNATE PIPELINE ROUTES UNDER CONSIDERATION



Source: SPEX.

Similarly, the SPEX team originally failed to inform local fisherfolk that several fish-aggregating devices, locally known as *payaos*, would be destroyed during the laying of the offshore pipeline around Mindoro. As a result, the fisherfolk threatened to impede the pipe-laying activities in the area. Shell then met with the 50 affected fisherfolk and compensated them for the damages that they suffered, which amounted to US \$35,700 (Php 2 million).<sup>77</sup> No delays occurred due to community opposition.

### MAINTAINING COMMUNITY CONSENT DURING IMPLEMENTATION AND OPERATIONS

Shell recognized that the risks of community opposition can also arise after the project has been implemented, and endeavored to maintain and cultivate its relationships with

the affected communities during project operations.<sup>78</sup> As a condition for receiving environmental clearance from the government for the project, Shell agreed to form multiparty monitoring teams (MMTs) composed of local government representatives, NGOs, community leaders, provincial and community environmental officers, and other stakeholders to monitor the environmental and social impacts of the project during its implementation. In 2000, MMTs for the different provinces were set up.<sup>79</sup> While the memorandums of agreement for the MMTs did not require Shell to ensure community satisfaction and consent, the MMTs still potentially provide an important means for the public to participate in overseeing implementation and operations, and to raise concerns as they arise.

In addition, the Shell Foundation has played an active role in ensuring ongoing acceptance of the project during operations. PSFI meets with community representatives monthly to provide updates on project operations and impacts, and to allow the community to raise concerns and grievances.<sup>80</sup> It also operates sustainable development programs in each affected province that provide services requested by the communities—including job training, livelihood workshops, employment link-ups, scholarships, microfinance, health and safety workshops, and conservation activities.<sup>81</sup>

This ongoing engagement is markedly different from standard practice in the Philippines, in which relations with the community usually end once the EIS is finalized.<sup>82</sup> While no major issues have arisen since construction, there is a broad consensus among all community stakeholders on the importance of ongoing relations with the company. The continuous engagement with Shell enables the community to raise concerns—especially regarding health, safety, and environmental impacts. It also provides a mechanism for affected people to seek assistance with basic community needs that their local governments cannot provide, such as clean water, infrastructure, and microfinancing. Moreover, local leaders in Batangas City also report that the process of engagement with SPEX has produced an unanticipated benefit: it has empowered the community by increasing awareness of the potential of community action.<sup>83</sup>

## **COSTS AND BENEFITS OF GAINING COMMUNITY CONSENT**

The Malampaya project cost about US \$4.5 billion.<sup>84</sup> Shell estimates that its total costs of engaging the affected

communities and gaining their consent—including staff time, meetings, community compensation, changed plans, and other related expenses—was approximately \$6 million.<sup>85</sup> Taken together, then, the incremental costs of avoiding and mitigating adverse impacts and securing community consent amounted to a little more than 0.13 percent of total project costs.

Shell believes that the incremental costs of securing community consent during planning and implementation produced significant quantifiable benefits—particularly insofar as it allowed the company to complete the project ahead of schedule.<sup>86</sup> The company anticipated in its project planning that it might suffer 10 to 15 days of delay due to community concerns or opposition.<sup>87</sup> It estimated that each day of delay in laying the pipeline or constructing the concrete gravity structure would cost an additional \$400,000. The pipeline was completed ahead of schedule, and did not undergo any delays due to community concerns or opposition. This allowed the company to avoid US \$4–\$6 million in estimated delay costs. In addition, the absence of conflict in Sitio Agusuhin allowed Shell to complete the concrete gravity structure three months ahead of schedule, which saved the project US \$36 million in construction costs.<sup>88</sup> Finally, under the agreement with the power plant operators, Shell would have been required to pay US \$1–\$2 million for each day it failed to deliver the promised supply of gas after the agreed-upon start date. By completing the project on time, Shell avoided penalties of at least US \$10–\$30 million, based on the 10–15-day delay estimates.<sup>89</sup> In aggregate, avoiding these anticipated delays saved the project US \$50–\$72 million, producing a “return on investment” on its community consent efforts of as much as 1,200 percent (see Table 1).

In addition, the project spent about US \$1 million annually between 2002 and 2004 in ongoing community engagement, service provision, and other consent-related activities. During the same period, it earned revenues of US \$685.7 million.<sup>90</sup> Thus, the costs of maintaining community acceptance have amounted to 0.43 percent of project revenues.

The company’s community consent-related efforts have also yielded a number of benefits that are more difficult to quantify. SPEX’s ability to gain broad community support made its interactions with the Philippine government much easier, as it preempted any sustained political pressure on the government to hold up the project. In addition, SPEX used its success with Malampaya to help

**TABLE 1 | COSTS AND BENEFITS OF GAINING COMMUNITY CONSENT**

Activities	Costs (millions of US dollars)	Activities	Benefits/ Avoided costs (millions of US dollars)
General Community Engagement/Consultations (including compensation of relocations)	6	Construction ahead of schedule by 3 months	36
		Contractual penalties (avoided)	10–30
		Project delay from laying of pipelines (avoided)	4–6
<b>TOTAL Costs</b>	<b>6</b>	<b>TOTAL Benefits</b>	<b>50–72</b>

convince the Philippine government that it was a suitable sponsor for a related project—the construction of an onshore pipeline from its natural gas refinery in Batangas to two nearby gas-fired power plants. SPEX was able to secure the support of the Philippine government for this project, even before it obtained the \$5 million investment needed for it.<sup>91</sup>

Malampaya has also had broader reputational benefits for Royal/Dutch Shell. In response to a number of controversial projects, Shell has made a very public organizational commitment to sustainably manage its operations. Nevertheless, it has frequently been accused of failing to live up to these commitments and of being more interested in public relations than meaningful operational reform. Malampaya has provided Shell with tangible evidence that it can implement good practices with respect to community consent. The Malampaya project was awarded the World Summit Business Award for Sustainable Development Partnerships by the United Nations Environment Programme and the International Chamber of Commerce.<sup>92</sup> The Malampaya project is now being used as a training case study for other Shell projects worldwide.<sup>93</sup>

## CONCLUSION

The Malampaya project illustrates how a potentially controversial, high-impact infrastructure project can avoid costly community opposition through ongoing efforts to secure and maintain community consent throughout the project cycle. In Malampaya, the costs of gaining community consent proved to be minimal in comparison with total project costs. Even using conservative “base case” estimates of potential delays due to community opposition, the sponsors received benefits that were worth many times these costs. Moreover, the full benefits of SPEX’s efforts to gain consent may be even greater than this comparison would suggest. While it is impossible to quantify the costs associated with community opposition that did not materialize, the experiences of the other case studies suggest that had affected communities felt the need to mobilize in opposition to the project, the financial impacts on the project could have far exceeded these base case estimates.



CASE 2

## ESQUEL GOLD PROJECT, ARGENTINA

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The Esquel Gold Project<sup>94</sup> is a proposed open-pit mine project near the town of Esquel, Argentina. With 30,000 residents, Esquel is the largest town in the western Chubut province. Located in the scenic eastern foothills of the Patagonian Andes, the community and its surrounding region have a diverse economic base that includes forestry and ranching. However, its primary economic activity is tourism. The area is well known for its excellent skiing, trekking, and fishing. It is also the gateway to Los Alerces National Park, a mountain preserve of the rare *alerce* tree, a massive species unique to the region that can live to be 3,000 years old. Esquel's residents are well educated and socially cohesive; many moved to the town from more urbanized areas to enjoy the community's natural amenities and alpine charm.

The Esquel project is owned by Meridian Gold, a mid-tier gold producer based in Reno, Nevada. Meridian hoped to develop an open-pit gold mine (with possible subsequent underground operations) 700 meters above and 7 kilometers east of the town.<sup>95</sup> The project was expected to cover an area of approximately 189 hectares, including facilities for extraction, processing, and waste disposal. It would extract ore from one or more 180- to 200-meter deep pits, and process it using cyanide vat-leach technology.<sup>96</sup> The mine was predicted to have an operating life of 8–10 years, and to yield approximately 3 million ounces of gold.<sup>97</sup>

Meridian obtained the development rights to the mine in July 2002 by acquiring its previous owner, Brancote Holdings. This transaction was self-financed by Meridian—the company purchased all of Brancote's shares in exchange for US \$310 million in Meridian stock.<sup>98</sup>

### COMMUNITY OPPOSITION

Since the town of Esquel did not have any previous experience with industrial-scale mining operations, most residents were unfamiliar with the potential benefits and risks of a mining project for their community, and did not have strong preconceived notions about the project. They were primarily interested in obtaining more information about the potential impacts and risks, and in discussing the project with the sponsors to learn more about the potential effects before making up their minds.

At the time Meridian purchased the mine in July 2002, there was no clear community consensus about the project. On one hand, there were good reasons to anticipate stiff opposition to a large-scale mine. Many of the town's citizens had chosen to live in Esquel to take advantage of its abundant natural amenities, and were skeptical of any development initiatives that might radically alter its economy, mountain-community character, or the quality of its environment. These concerns were so deeply entrenched that community support for a large-scale mining project would most likely have been difficult (though not necessarily impossible) to obtain in even the best of circumstances. But those who shared these concerns had not yet organized in opposition to the project.

On the other hand, there was also reason to believe that the community could be persuaded to embrace the project. The community had recently completed an inclusive and widely supported long-term planning exercise called the *Plan Participativo de Desarrollo Local Social, Económica y Ambientalmente Sustentable* (SEAS), which articulated the residents' vision of how they wanted



LUCAS CHAPPE, EARTHWORKS

Esquel to develop. While emphasizing the importance of sustainably protecting the natural environment and mountain community attributes, the SEAS concluded that mining could be an important part of the community's development strategy.

Meridian did not fully understand how these considerations would affect community acceptance of the mine proposal during its pre-purchase due diligence investigations. Nor did it adequately reach out to the community or attempt to build a basis for constructive dialogue.<sup>99</sup> Rather than seeking to integrate its project objectives into the SEAS's agreed-upon vision of community development, project management publicly dismissed the SEAS as irrelevant to its concerns. Similarly, the company ignored two studies of the potential impacts of the mine project conducted by independent, locally respected institutions—one by a team at the local Universidad Nacional de la Patagonia San Juan Bosco, and the other by the Family Council, an organization that advises the local government on family and children's issues.<sup>100</sup>

Meridian's lack of responsiveness to community preferences and concerns carried over into the early stages of project development. The company consistently failed to share critical information about the potential benefits and risks of the project, or to engage with the community and address its concerns before they became points of contention.<sup>101</sup> An illustrative example was the company's response to concerns about the risks associated with the transport, use, and destruction of cyanide. In July 2002, the company set up a laboratory to sample the quality of the ore and test the use of cyanide. However, it made no effort to explain the purposes of the laboratory to the community, creating the impression that it wished to obscure the real dangers of cyanide in its operations. This led to the local public authorities' mistrust of the company.

Meridian sought to quell these concerns by having a representative of the cyanide manufacturer explain the use of cyanide in the mining process. Some residents were not satisfied with the representative's answers. They began to do their own research about the dangers of cyanide use in mining, and to publicly present their findings.

As key questions about the use of cyanide remained unanswered and perceived slights accumulated, latent community concerns hardened into organized opposition. In November 2002, a grassroots community group of "self-convenced neighbors" formally came out against the mine after it was unable to engage the company in a meaningful dialogue. This community group began to organize demonstrations, which drew large crowds, and anti-mining graffiti started appearing in town. Also at this time, residents opposed to the mine presented a plan to municipal authorities for a popular referendum on the mining project.

Meridian reacted to the gathering opposition mainly by initiating a public relations campaign. The company organized a counterdemonstration in favor of the mine that was sparsely attended. It also retained a Buenos Aires public relations firm to implement a political strategy for winning a public referendum. This proved to be counterproductive, as the firm's materials and outreach efforts were seen to be out of touch with community's sensibilities. Meanwhile, the company failed to respond to an offer by the Catholic Church to facilitate a dialogue between the company and the community.

By the end of February 2003, the mayor of Esquel recognized that political momentum against the mine was growing, and agreed to authorize a public referendum to be held on March 23, 2003. Three-quarters of eligible voters participated, 81 percent of whom voted against the mine proposal. This popular rejection had two immediate effects. First, Meridian suspended all operations at the project site and sought to figure out where its community interactions had gone wrong. Toward this end, it commissioned Business for Social Responsibility (BSR) to conduct a review of its interactions with the community.<sup>102</sup> Second, on April 9, the Chubut provincial government "legalized" the outcome of the referendum by banning open-pit mining and the use of cyanide throughout the province, except in specifically designated areas.<sup>103</sup>

In August 2003, after receiving BSR's highly critical review of the issues faced and handled by BSR, Meridian issued a public apology for its failures to listen to the

community's concerns and engage in open dialogue about the project. At the same time, it pledged not to move forward with the project until it could garner the support of the Esquel community.<sup>104</sup>

While the project has been stalled since the March 2003 referendum, Meridian continues to believe that it can persuade the community to embrace the project's development. The company is currently exploring the feasibility of a new underground mining plan and a re-engineered processing facility that it hopes will address the community's social, environmental, and technical concerns about the project.<sup>105</sup>

### CORPORATE EXPECTATIONS FOR ESQUEL

Meridian purchased the development rights to Esquel and 1,400 square kilometers of surrounding area in July 2002 for US \$310 million in company stock. At the time of the purchase, it expected to secure permits for the mine and begin construction in the second quarter of 2003, and to begin producing gold 12 to 15 months later.<sup>106</sup>

Meridian's management viewed the Esquel project as a central pillar of the company's future growth and profitability. In its 2002 *Annual Report*, the company's chairman and chief executive argued that the acquisition was "[u]ndoubtedly, the highlight of the year..."<sup>107</sup> They explained that Esquel's estimated 3 million ounces of extremely low-cost reserves (about \$100 per gold ounce) provided a "unique growth opportunity," and had the potential to nearly double the company's reserves, production ounces, and cash flow.<sup>108</sup> As a result, they argued that Esquel would represent the "next chapter" of corporate growth. It would help make Meridian a 600,000-ounce annual gold producer within the next two years, and would be a critical foundation of Meridian's medium-term objective of producing and replacing 1 million ounces per year by 2008.<sup>109</sup>

Meridian's confidence that Esquel was an extraordinary corporate opportunity is further evidenced by the fact that the company abandoned two longstanding corporate strategies to acquire it. First, Meridian had traditionally eschewed growth by acquisition in favor of expanding its operations through grassroots exploration.<sup>110</sup> As the company explained in its 2001 *Annual Report*, since "finding gold is cheaper than acquiring it," it would only pay an acquisition premium for particularly valuable properties—a high-quality discovery, a project that was ready to go, or a project that had significant geologic



potential.<sup>111</sup> For Meridian's management, Esquel seemed to meet all of these criteria. Second, prior to acquiring Esquel, the company was strongly disinclined to dilute equity to finance growth. Indeed, in the same 2002 *Annual Report* that describes the stock purchase of Esquel, the chairman and chief executive said that equity finance was "the most expensive form of cash," because "[d]ilution is forever."<sup>112</sup> Nevertheless, the company issued 22 million shares to acquire Esquel—increasing its outstanding shares by almost 30 percent.<sup>113</sup>

### THE FINANCIAL IMPACTS OF THE PROJECT'S COLLAPSE

Meridian's experience with Esquel had a dramatic impact on the company's balance sheet. Most obviously, Meridian expended considerable resources to acquire, assess, and manage the Esquel site. As of September 30, 2005, Meridian estimated the net carrying value of the Esquel project at US \$350 million: \$310 million in acquisition costs and \$40 million in pre-development costs.<sup>114</sup> In February 2006, accounting regulations forced the company to write down the value of the Esquel property to its fair commercial value without mineral resources. As a result, Meridian reduced the value of its Esquel

holdings by US \$542.8 million (\$378.9 million after tax adjustments), producing a net loss for fiscal year 2005 of US \$346.4 million.<sup>115</sup>

Meridian’s assets and reserves were also severely affected by the conflict in Esquel. At the end of 2004, Esquel represented approximately 53 percent of the proven and probable reserves, and 48 percent of the total reserves in the company’s portfolio.<sup>116</sup> While Meridian is working to earn community support for an underground project, there remains a very real possibility that these resources will never be developed. This represents a considerable loss of asset value. In 2002, Meridian assumed a price of US \$325 per ounce for Esquel’s estimated 3 million ounces of reserves.<sup>117</sup> At that price, Esquel’s reserves were worth about US \$1 billion. Since then, gold has sold at more than US \$720 per ounce<sup>118</sup> and averaged \$603 per ounce in 2006.<sup>119</sup> At this average price, Esquel’s reserves would be worth US \$1.81 billion.

The cessation of development activities at Esquel has already cost Meridian the opportunity to sell some of Esquel’s gold reserves at these extremely attractive market prices. When Meridian purchased the mine in early July 2002, it expected to begin producing gold some time around September 2004.<sup>120</sup> As Figure 3 illustrates, gold prices have risen dramatically since September 2004. Had Meridian reached its target of 300,000 ounces per year between September 2004 and February 2006, it could have brought in over US \$200 million in additional

Value written-off balance sheet	\$378.9 million
Value of lost reserves	\$1.81 billion (est.)
Value of lost revenue (9/04–2/06)	\$200 million (est.)
Value of lost profits (9/04–2/06)	\$160 million (est.)
Value of lost revenue going forward	\$13.75 million per month (est.)

revenue, based on the average gold price of US \$453 per ounce during that period.<sup>121</sup> After netting out estimated production costs of US \$100 per ounce, Meridian could have earned US \$160 million from operations in Esquel during that period.

Looking ahead, at the current gold price of US \$650 per ounce,<sup>122</sup> Meridian is foregoing an additional US \$13.75 million per month in net earnings, or about US \$165 million per year (see Table 2). To put this in perspective, in 2005 Meridian reported a total of US \$131.8 million in revenues, and US \$39.9 million in net earnings (excluding the Esquel write-down).<sup>123</sup> While many industry analysts believe that gold prices will continue to rise, periods of such high gold prices have historically tended to be unsustainable.

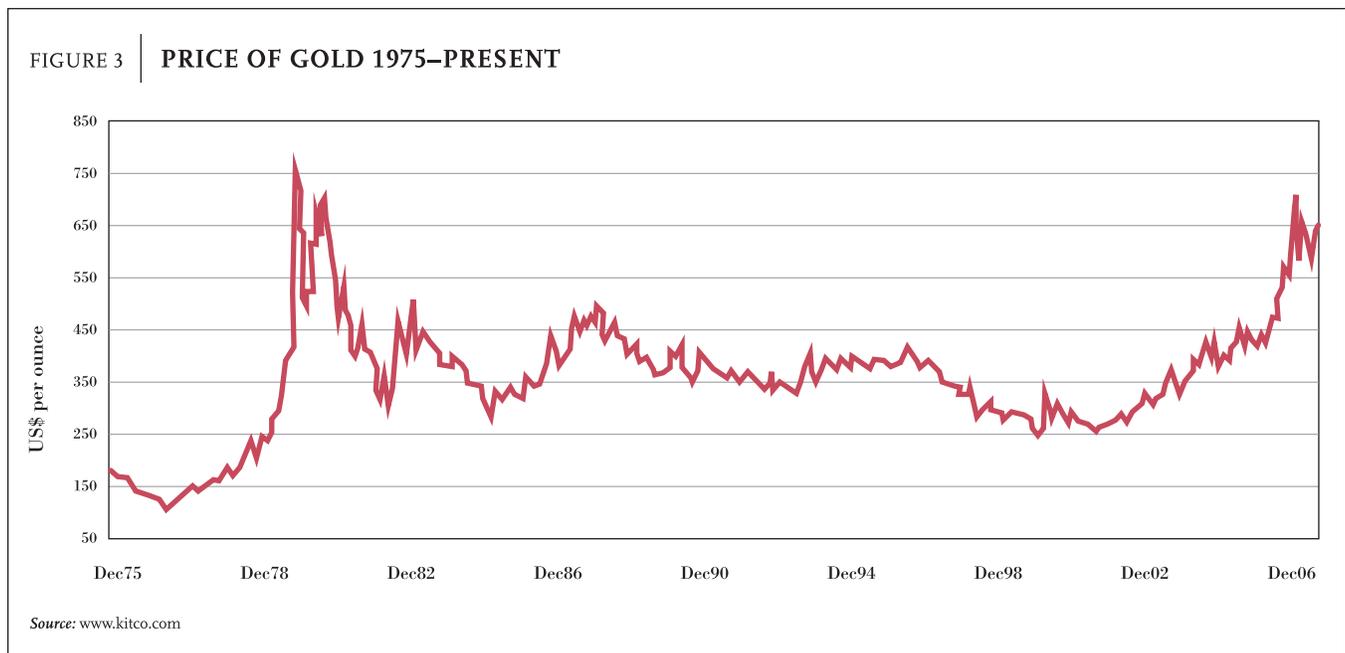
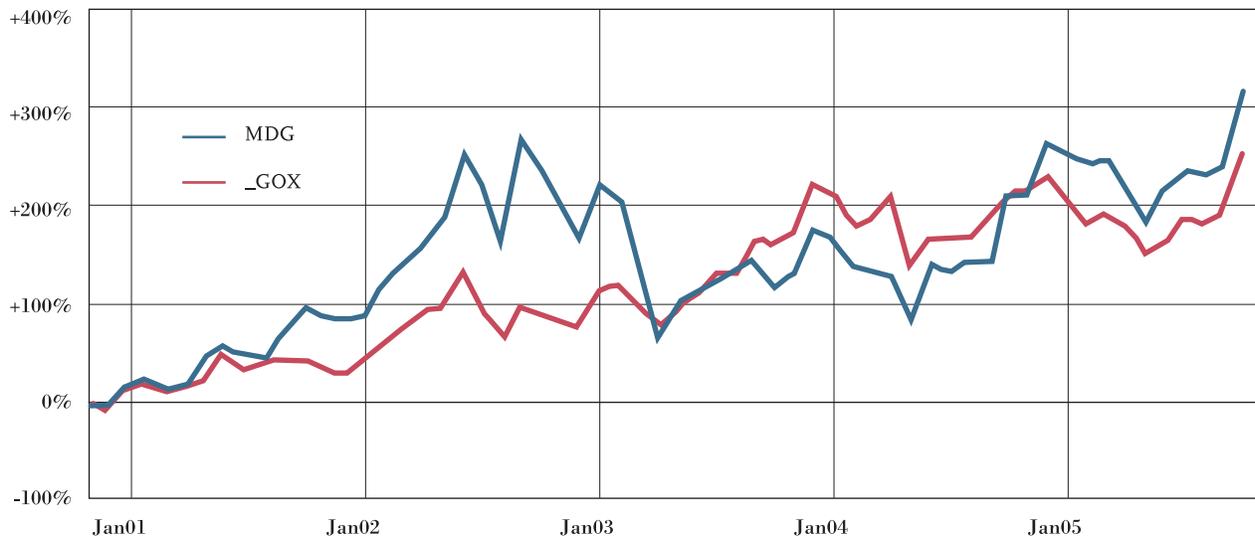


FIGURE 4 | SHARE PRICES OF MERIDIAN GOLD INC.



Source: Copyright 2005 Yahoo! Inc. <http://finance.yahoo.com>

Figure 4 shows how the company's share price fluctuated and then collapsed as the conflict unfolded in Esquel. Not all of the decline in Meridian's share price in the first quarter of 2003 can be attributed to the conflicts in Esquel. Share prices across the industry fell during this time, as the markets came to believe that gold had become overvalued in the run-up to the impending war in Iraq.<sup>124</sup> But even by industry standards, Meridian's stock performed poorly during this time. Figure 4 illustrates the decline in Meridian's performance in the wake of its involvement with Esquel by comparing Meridian's stock performance with that of the Chicago Board of Exchange Gold Index (GOX), an index of 12 leading global gold mining and production companies. As Figure 4 shows, Meridian began 2001 in rough parity with the industry index. But by late 2001, it had distinguished itself from its peers and posted gains that exceeded that of the index by 100–150 percent through 2002. By March 2003, however, Meridian's stock price had lost all of the gains it had made over the industry benchmark in the two previous years, and was actually underperforming its peers for the first time since January 2001. While Meridian's share price did rise over the remainder of the year, it was still off 17 percent for 2003—a year in which gold prices rose over 20 percent.<sup>125</sup> Meridian did not begin to consistently outperform the industry benchmark again until the end of 2004, after its market valuation doubled on the news

of the discovery of two new high-grade ore veins at its highest-margin facility.<sup>126</sup> Despite these promising new finds, Meridian has not beaten the industry standards by the levels it did before the conflict in Esquel.

A review of the contemporaneous assessments of Meridian's situation by Wall Street analysts confirms that community opposition in Esquel helped to drive Meridian's stock price decline during this period. For example, a January 2003 report by Deutsche Bank Securities explained that despite rising gold prices, the bank was reducing its net present value of the stock by almost 14 percent to reflect the risk that Esquel would not meet its development schedule. To support this assessment, Deutsche Bank noted the local concerns with the cyanide extraction processes and the deferment of public hearings related to the Argentine government's permitting process. The report concluded that any delays in construction would have further negative impacts on net present value and calendar year 2004 earnings estimates.<sup>127</sup>

Credit Suisse First Boston's (CSFB's) February 24, 2003, report on Meridian reached similar conclusions. CSFB devoted most of its report to the risks to company share price posed by Esquel.<sup>128</sup> CSFB stated: "[T]he risks of a delay in the development of Esquel appear to be very high. These risks, in our view, are not fully discounted

in Meridian's share price, despite their recent decline."<sup>129</sup> Noting that continued delays would cause the stock to fall even further, CSFB recommended a competitor of Meridian as a better value in the sector.<sup>130</sup> In two subsequent 2003 reports, CSFB's equity researchers remained "cautious" on the stock, due largely to the uncertainty related to the development of Esquel, declining earnings due to higher spending, and the significant event risk associated with a company so heavily invested in a single mine.<sup>131</sup>

Ultimately, despite optimistic self-reports on Esquel in its 2002 *Annual Report* and in dialogue with stock analysts, Meridian conceded in its 2003 *Annual Report* that its difficulties in Esquel caused its share price to underperform the industry and many of its peer producers.<sup>132</sup>

The conflict in Esquel also introduced volatility to its market valuation.<sup>133</sup> Because such a relatively high proportion of Meridian's reserves were held in its Esquel property, the company was particularly vulnerable to fluctuations in its stock price based on events in the community. In fact, volatility was most significant at the height of community protests and the public referendum against the Esquel project.<sup>134</sup>

In addition to these quantifiable balance sheet and stock valuation costs, Meridian endured significant unquantifiable management and reputation costs. Given what was at stake for the financial health of the company, it is reasonable to assume that Meridian dedicated substantial management resources into defusing the conflict in Esquel, repairing the relationship between the company and the community, and devising a new development proposal.<sup>135</sup> Meridian's reputation costs have also been significant. The Esquel controversy has become the focus of significant attention throughout Argentina and internationally. For example, Esquel is a

featured case study of the "No Dirty Gold" campaign in the United States.<sup>136</sup>

## CONCLUSION

Meridian's Esquel experience underscores the importance of gaining the consent of the host community from the earliest stages of project assessment and planning. Meridian did not initiate the kind of dialogue processes that could have alerted the company to the community's concerns, or that could have ultimately resulted in consent being granted. Indeed, Meridian has publicly conceded that its failure to listen to the community's concerns, or engage them in open and honest dialogue, led to the broad community opposition to the project.<sup>137</sup> Ironically, after this opposition manifested itself in the results of the referendum, Meridian adopted an FPIC approach and promised the community that it would not develop the project without the community's consent. So far, this approval has not been forthcoming.

This is not to say, however, that a better dialogue would have allowed Meridian to bring the project to fruition. Given the quality-of-life concerns of many residents, it is entirely possible that such dialogue would have helped the community to more fully understand its own values and priorities, and to conclude that industrial-scale mining was not compatible with its development aspirations. This suggests that project sponsors should not consider community engagement as primarily a mechanism for achieving consent. In many cases, it may have greater utility as a tool for assessing the political and social risks of proceeding with a project at all. Indeed, a dispassionate assessment of the Esquel community's preferences during pre-purchase due diligence could have informed Meridian's senior management that there were significant social obstacles to project development, and would have better enabled them to make reasoned judgments about the value of the mine and the wisdom of acquiring it.



## SAMUT PRAKARN WASTEWATER MANAGEMENT PROJECT, THAILAND

The Samut Prakarn Wastewater Management Project<sup>138</sup> (Samut Prakarn) was conceived by the Pollution Control Department of the Government of Thailand (PCD) in the early 1990s to address the severe water pollution problems in Samut Prakarn province. Due to its strategic location on the Chao Phraya River just southeast of Bangkok, Samut Prakarn province had become one of the most heavily industrialized and rapidly urbanizing provinces in Thailand. But its rudimentary sanitation and water treatment facilities could not handle the large volumes of wastewater produced by its 1.2 million residents and more than 4,000 factories. As a result, most residential wastewater in Samut Prakarn was being processed in cesspits or septic tanks that were inadequate for high-density development and that discharged effluent directly into the canals and drains that flow into the Chao Phraya. In addition, most of Samut Prakarn's industries were not adequately treating their wastewater, and were rarely in compliance with government-mandated effluent standards. And despite the heavy concentration of industry, no hazardous wastewater facilities were operating in the province.

The resulting pollution levels in the Chao Phraya and the local canals were taking a disastrous toll on human health and the natural environment. Waterborne pathogens and toxic substance concentrations far exceeded public health standards, causing an increase in water- and sanitation- related diseases. Moreover, many of the affected waterways, including the Chao Phraya itself, had lost the capacity to sustain aquatic life. The massive pollution loads in the Chao Phraya also threatened the ecological collapse of the outflow area in the Gulf of Thailand. Conditions were only expected to deteriorate

further with increased industrial expansion and related urban development.

Recognizing the severity of the problem, the Government of Thailand designated pollution control in Samut Prakarn as a national environmental policy priority, and sought assistance from the Asian Development Bank (ADB) in developing a wastewater management system for the province. ADB responded by commissioning a project feasibility study that identified and evaluated an array of project options.<sup>139</sup> Thirteen options were considered and evaluated for cost, environmental impact (based on an initial environmental examination), social impact, and technical merit. The study ultimately recommended building two large central treatment plants, one on each side of the Chao Phraya River, to be fed by a collection system of trunk, secondary, and tertiary sewers. According to the ADB, this approach was “the optimum long-term strategy because [it] represents the least-cost solution in economic terms, can achieve the desired water quality objectives, has minimal negative environmental and social impact, involves minimal resettlement, and is affordable.” Following the recommendations of the study, the PCD decided to pursue the “two-facility” option, and proposed to award a separate “turnkey contract”<sup>140</sup> for each facility, with the contractors selected through a process of international competitive bidding.

### THE SITE SELECTION PROCESS

While the PCD was seeking financing for the project from the ADB in 1995, it identified two abandoned rice paddies as suitable sites for the facilities. The turnkey contractors were given primary responsibility for actually

obtaining these lands, but since the lands were remote, uninhabited, and considered to have limited development potential, no particular problems or undue delays were expected in acquisition. To ensure that appropriate lands were obtained, the PCD also agreed to exercise its powers of eminent domain if the contractors proved unable to secure the necessary land.<sup>141</sup>

Despite these assurances, the two contractors that submitted proposals in the second round of the bidding process told the PCD that they were unable to secure suitable land for the west bank site.<sup>142</sup> Instead of asking the PCD to condemn the land, however, they persuaded the PCD to amend the bidding documents to allow alternative bids for a single treatment plant on the east bank.<sup>143</sup> Ultimately, only one contractor—the NVSPKG

joint venture<sup>144</sup>—submitted a final bid. The NVSPKG consortium proposed to build the single facility not at the original east bank site, but rather at Klong Dan, more than 20 kilometers from the east bank of the river. PCD accepted this proposal.<sup>145</sup> Figure 5 shows the Klong Dan location in relation to the primary service area of the project.

### CONFLICT WITH THE COMMUNITY OF KLONG DAN

The residents of Klong Dan were not informed of the decision to relocate the wastewater treatment facility to their community.<sup>146</sup> When they became aware of the nature of the project, they strenuously objected. They raised a number of concerns with the PCD, ADB

FIGURE 5 | MAP OF PROJECT SERVICE AREA AND KLONG DAN



Reproduced with permission from the Asian Development Bank from the ADB website, [www.adb.org/Projects/SamutPrakarn/default.asp](http://www.adb.org/Projects/SamutPrakarn/default.asp). For more information on development in Asia and the Pacific, see [www.adb.org](http://www.adb.org).

management and project staff, and ultimately with the ADB's independent Inspection Committee, about the site selection process and the negative impacts the facility would have on their environmental quality and economic well-being.<sup>147</sup> First, they objected to the nontransparent and nonparticipatory manner in which the change to the location was made, and to the fact that appropriate environmental or social assessments of the impacts at the new site were not conducted. Second, they noted that since the new site was in a less polluted and more environmentally sensitive area than the industrialized area that the treatment plant was intended to serve, it would have net adverse impacts on the area's ecosystem and resource base. In particular, the community was concerned that the discharge of between 525,000 and 1.8 million cubic meters of wastewater would have adverse impacts on the local marine and mangrove ecosystems, and therefore on its traditional shrimp, fish, and shellfish harvesting. Local residents were also concerned that since the facility was not designed to remove the heavy metals and other industrial pollutants in the wastewater, their coastal environment would be polluted by these toxic substances.<sup>148</sup>

## ALLEGATIONS OF CORRUPTION IN THE PROJECT

Community leaders soon came to suspect that the decision to move the project was driven more by corruption and the desire to enrich a handful of politically well-connected landholders than by any considered assessment of the public interest.<sup>149</sup> They pointed to a number of irregularities in the relocation of the project and acquisition of the Klong Dan site that, taken together, suggested that the siting decision was tainted by corruption. Among the allegations were that:

- The PCD agreed to scrap the original "two-facility" plan and move the project to Klong Dan without the requisite cabinet approval and without conducting any impact assessments or feasibility studies of the new site, as required by ADB policy and Thai law.<sup>150</sup>
- The PCD purchased the land for the Klong Dan site from politically powerful interests with close ties to relevant ministries.<sup>151</sup>
- The PCD grossly overpaid for the land, paying more than twice its assessed value at a time when land prices were depressed due to the East Asian economic crisis.<sup>152</sup>

- The purchase price exactly equaled the maximum purchase price allowed under the contract. This, along with the inflation of the purchase price, strongly suggested collusion between the buyer and seller.<sup>153</sup>
- The land was not well suited for the facility, as it was acidic, weak in structure, prone to subsidence, and often under water.<sup>154</sup>

As part of their advocacy efforts to stop the project, the community leaders filed a claim with the ADB's Inspection Committee and pressed the ADB and the Thai government to investigate the corruption allegations. Thai authorities investigated and corroborated these allegations, and uncovered additional evidence of corruption. Thai law enforcement authorities concluded that PCD officials, executives of the joint venture, and the owners of the Klong Dan property had conspired to inflate the purchase price of the parcels by as much as 1,000 percent.<sup>155</sup> Thai authorities also found that the property purchased by the PCD included publicly owned land that had been illegally titled through corrupt dealings with the land ministry,<sup>156</sup> and that executives of the joint venture owned shares in the company that had illegally obtained the land.<sup>157</sup> They accused the former head of the PCD of advising the bidders to propose the single-facility design in violation of a cabinet resolution that called for a facility to be built on each bank of the Chao Phraya.<sup>158</sup> Finally, Thai authorities accused the joint venture of deceiving the PCD in the bidding process by failing to disclose that a member of the consortium with critical expertise had withdrawn from the joint venture before the contract was awarded.<sup>159</sup>

A number of senior officials of the PCD, real estate developers, and executives of the joint venture have now been criminally charged as a result of these investigations. Four top officials of the PCD, including two former director-generals, have also been transferred out of the PCD in connection with the scandal.<sup>160</sup> As a result of the government findings of corruption, the PCD declared the turnkey contract void in February 2003 and in May 2004 sued the contractors for restitution of all monies it had disbursed under the contract. The court rejected this claim, and advised the PCD to resolve the matter through the contract's arbitration provisions.

Despite the fact that the project is 95 percent complete, all work on the project remains suspended as the PCD determines how to proceed. In early 2005, independent consultants commissioned by the PCD to conduct a review and options assessment of the project found

that the facility was poorly constructed and would most likely have adverse environmental impacts when brought online. It recommended that to avoid adverse environmental impacts, the PCD should extend the water-discharge pipeline from 3 kilometers to 10 kilometers offshore, upgrade the water treatment technology, and install a recycled-water distribution system. The report also argued that relocating the facility to a more suitable site could be considered as a second option.<sup>161</sup> Despite these recommendations, the Government of Thailand has expressed its intent to complete the project and bring it online.<sup>162</sup> Predictably, this has brought a renewed round of community opposition. As of this writing, it remains unclear whether the wastewater treatment facility at Klong Dan will ever be completed.

## PROJECT COSTS AND FINANCING

When the Government of Thailand originally sought financing for the project in 1995, it estimated that the wastewater treatment plant and its associated infrastructure would cost US \$507 million. To cover these costs, the Thai government earmarked US \$257 million from its central budget and US \$100 million from its Environment Fund. Of the Environment Fund, US \$70 million came from an existing loan from the Japanese Bank for International Cooperation. The Thai government secured a loan from the ADB for the remaining US \$150 million.

By the time the contract was signed in August 1997, however, the estimated costs of the project had escalated to US \$948 million. This 87 percent increase was caused by design changes in the project—including relocation of the treatment facility, the selection of a different treatment process, and the government's requirement that tunneling rather than open-trench technology be used to lay the collection infrastructure.<sup>163</sup> Then, when the baht declined dramatically against the dollar during the Asian financial crisis in mid-1997, there was a concomitant fall in the baht-denominated costs of the project, and the total estimated project cost fell to US \$687 million—\$240 million in direct foreign exchange costs, and \$447 million in indirect foreign exchange and local currency costs. Including the results of the currency devaluation, this represented a net foreign exchange cost increase of US \$180 million over the original cost estimates. To help cover these additional costs, the Thai government sought and received a supplemental US \$80 million loan from the ADB. Despite these increases in costs, the Government of Thailand still anticipated that user fees from the project would cover all recurrent expenditures

and depreciation, and would generate a small amount of additional revenue.

To date, the Government of Thailand has spent an estimated US \$650 million to complete 95 percent of the project.<sup>164</sup> However, finishing the project and bringing it online in accordance with the recommendations of the independent commission will require substantial additional expenditures—an estimated US \$140 million to complete and upgrade the facility, or US \$180 million to relocate it to a more appropriate site.<sup>165</sup>

## FINANCIAL AND ECONOMIC IMPACTS

The most important impact of the community conflicts and corruption controversy in the Samut Prakarn project has been the project's forgone economic, environmental, and public health benefits. The project was expected to achieve a number of quantifiable public benefits, including improved public health, increased rice production, avoided septic tank costs to households, industrial relocation cost savings, and factory-cost savings due to reduced on-site treatment. As part of its 1998 appraisal of the project, the ADB estimated that these quantifiable benefits would yield a 15.1 percent economic rate of return (ERR) over the project's 50-year life.

The project was also expected to deliver a number of other important, but less quantifiable, benefits, including the environmental benefits of improved water quality in the canals, Chao Phraya, and the Upper Gulf of Thailand; increased commercial value of fisheries and aquaculture currently affected by Chao Phraya river pollution; increased commercial value of fruit orchards; the retail value of wastewater sludge and treated effluent; and the elimination of wet areas around houses caused by on-site waste disposal. The ADB determined that these less quantifiable benefits were so significant relative to the quantifiable benefits that ADB's ERR calculations significantly underestimated the project's actual net benefits. For this reason, ADB asserted that the calculated benefits represent a low estimate of the true economic returns.

At the end of 2005, the delivery of these economic benefits had been delayed by 4.5 years from the projected commissioning in early 2001. These delays have had disastrous impacts on the project's economics. In net present value (NPV) terms, the people of Thailand have already lost more than US \$1.27 billion in quantifiable economic benefits as a result of this delay, and ERR has

## THE REVOLT OF THE RATEPAYERS: WATER SERVICE PRIVATIZATION AND THE IMPORTANCE OF CONSUMER CONSENT

The conflicts between projects and their host communities discussed in this section have generally arisen over what economists call “negative externalities”—incidental social costs that are imposed upon groups that were not parties to contracts with the project sponsors. But there is another important category of conflicts that have not been caused by the imposition of externalities, in which consumers of project services—the project’s putative beneficiaries—have organized community-level opposition. This dynamic has been most evident with regard to the privatization of water services. In a number of cases, water privatization plans have gone awry because of the failure of project sponsors to adequately account for the interests of the public as consumers—most notably, the willingness or ability of formerly subsidized ratepayers to pay the provider’s rates for privatized services.

The most spectacular collapse of a privatization scheme caused by onerous rate increases by the private-service provider occurred in the Bolivian city of Cochabamba. In 1999, the Bolivian Government granted a 40-year concession for the provision of water services to Aguas del Tunari, a subsidiary of the American engineering firm Bechtel.<sup>1</sup> Under the terms of the US \$2.5 billion deal, Aguas del Tunari was given control of the city’s water networks and exclusive rights to all the water sources in the district. Private water cooperatives that were not publicly created or subsidized would also have to pay user fees to Aguas del Tunari. In addition to being afforded a monopoly on water provision, the company was guaranteed a minimum 15 percent annual return on its investment.<sup>2</sup> In exchange, the company was expected to invest in capital improvements and upgrade and expand service delivery.<sup>3</sup>

As people began to fear that their existing facilities might be expropriated or their rates raised dramatically, their representative civil society organizations—neighborhood associations, water cooperatives, and labor unions—organized a broad coalition called the Coordinator for the Defense of Water and Life (La Coordinadora) to protest the deal. When the citizens of Cochabamba received their first monthly water bills from Aguas del Tunari in January 2000, many found that their bill had risen by 100 percent or more.<sup>4</sup> Many ordinary workers were faced with water bills that equaled a quarter of their monthly income.<sup>5</sup> As a result, La Coordinadora’s protests gained in size, momentum, and urgency, and by February the dispute had grown into what locals called *la guerra del agua*—the water war. Over the next couple of months, thousands of

protestors participated in demonstrations, shutting down the city’s streets and central plaza, and drawing violent reactions from law enforcement authorities. By April, it was apparent that the contract was no longer politically viable in the face of the civil unrest, and the government revoked the company’s concession. When Bechtel was unable to negotiate a settlement with the Bolivian Government, it sought more than US \$25 million in damages and lost profits in international arbitration. In January 2006, Bechtel abandoned this claim in exchange for a token settlement.<sup>6</sup>

The government, Bechtel, and protest leaders each has decidedly different views as to the cause of the failure of the Aguas del Tunari venture. But in retrospect, it seems clear that the public’s visceral reaction to steep rate hikes could have been anticipated (and probably avoided) had consumers been consulted on their willingness and ability to pay higher water tariffs in exchange for the prospect of improved or expanded services. Neither Aguas del Tunari nor the government undertook such a dialogue. And Bechtel’s officials in Cochabamba were predominantly engineers—not market researchers or social scientists—who did not fully appreciate the political environment in which they were operating.<sup>7</sup> On the other hand, Bechtel maintains that the municipal government failed to follow its recommendation to conduct an outreach campaign to inform the public of the costs and benefits of the private concession.<sup>8</sup> In any event, the failure to conduct this basic market research and public education exposed the project to political risks that would not be viable to its proposed tariff structure.

Other water service providers have also been forced to relinquish their concessions due to popular opposition to their tariff schemes. For example, in 1995 Aguas del Aconquija, a subsidiary of the French water company Compagnie Generales des Eaux (now Veolia) obtained a water concession in the Argentine province of Tucumán. Soon thereafter, it raised tariffs by more than 100 percent, and substantially altered its conditions of service delivery. Consumers, who considered this to be both a financial burden and a violation of their rights, resisted these increases by organizing sustained protests throughout the province. After three years of conflict between the company and its customers, the company was finally forced to give up the concession when consumer groups organized a payment boycott, and large numbers of customers refused to pay for water and sewerage services.<sup>9</sup>

*continued next page*

## BOX 4 | CONTINUED

Consumers have instigated popular backlashes that have scuttled water privatization schemes in a number of other countries. In Ghana and Malaysia, proposed privatizations have been suspended or reversed due to popular opposition. In Panama, public resistance to an attempted privatization contributed to the electoral defeat of the president.<sup>10</sup> Public opposition has also caused the cancellation of water privatizations in Lima, Peru, and Rio de Janeiro, Brazil, and has led to protests in numerous countries, including Sri Lanka, Indonesia, Pakistan, the Philippines, India, South Africa, Poland, and Hungary.<sup>11</sup> And in a public referendum in Uruguay, a majority of citizens voted to amend the constitution to define water as a public good and guarantee that it be supplied by public entities.<sup>12</sup>

These cases illustrate that the failure to gain the prior informed consent of ratepayers can have disastrous impacts on a water privatization scheme. In this respect, the market for water services differs dramatically from the typical market transaction, in which consumer consent is inherent in the agreement to purchase the goods or services for sale. Water concessionaires are typically monopoly providers of essential public services; there is usually no real competition or

alternative. Thus, in the absence of explicit consent, ratepayers must rely on government regulators to establish equitable rates and terms of service. But for reasons of politics, competence, capacity, or even corruption, the government may not be an effective agent of the public in negotiating the terms upon which water services should be delivered. These cases make clear that regulatory approval is not the same as popular assent, and water service providers that conflate these issues face increased risks.

### Notes

1. Johnson 2002.
2. Finnegan 2002.
3. Aston 2002.
4. Chang 2006; Eichenseher 2005.
5. Nicholson-Lord 2005.
6. Johnson 2002; James 2002; Environmental News Service 2006.
7. Finnegan 2002.
8. Bechtel Corporation 2005.
9. Giarracca 2006; Tagliabue 2002.
10. Finnegan 2002.
11. Finnegan 2002; Tagliabue 2002.
12. InterPress News Agency, Nov 1, 2004.

been reduced to about 9.34 percent. If the project is not brought online until the beginning of 2008, the NPV of the reduction in benefits will be US \$1.42 billion, and the ERR will be reduced to 8.84 percent.<sup>166</sup> Since the project initially assumed an opportunity cost of capital of 10 percent, the delays have meant that the project is no longer economically viable under its original assumptions.

The direct project financial costs of the delays, while less important than the broader economic costs to the country, have also been significant. During project appraisal, the ADB calculated that a 3-year delay in the project would result in a loss of US \$48 million in user fee revenue. Since tariff rates, collection rates, and the volume of treated wastewater were all expected to rise significantly over time, the unrealized anticipated revenues from the project for 2004, 2005, and beyond are considerably higher.

## CONCLUSION

Samut Prakarn teaches two essential lessons about the importance of achieving community consent in large

infrastructure projects. First, it shows that the patina of popular legitimacy that may surround a public project does not necessarily insulate it from community opposition—public-sector projects may be just as vulnerable to risks of community conflict as private-sector projects. Second, it shows that community involvement can be critical to exposing corruption. Projects that proceed without community involvement and consent may be exposed to greater risks of the kind of corruption that can compromise their public purposes. Together, these lessons provide an important corrective to the facile assumption that projects that are designed and approved through political or bureaucratic planning processes need not also provide meaningful opportunities for public involvement in oversight and decision making.

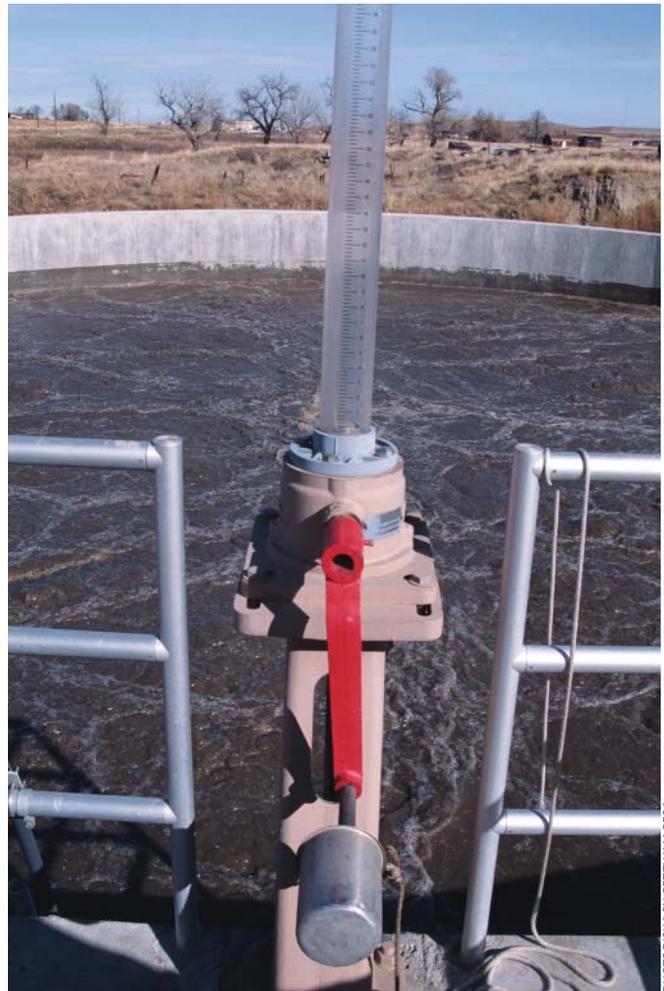
By all accounts, Samut Prakarn was designed to deliver critical public benefits. There was a broad consensus that water quality in the region had deteriorated to the point where it posed a danger to the regional environment and public health, and that a governmental response was required. Because they viewed Samut Prakarn as a “good environmental project,” the PCD and ADB acted as if they

had broad license to site the project in any community that would receive some of the benefits.<sup>167</sup> This proved to be a misapprehension of local preferences. As it happened, the communities that were forced to shoulder most of the economic and environmental costs of the treatment facility were not mollified by the fact that they would also receive some of the benefits, and they refused to accept a siting decision that did not adequately include their inputs or account for their preferences.

Since the revelations of serious corruption ultimately caused the project to founder, it may be tempting to ascribe responsibility to the alleged corruption of key decision makers in the Thai government and the consortium. Focusing on the sensational allegations of corruption, however, would tend to obscure the importance of broader governance problems to the failure of the project. The exclusion of Klong Dan residents and political leaders from the site-selection process created the conditions in which corrupt officials could arrogate their own pecuniary interests over the public good. Indeed, it was members of the community—not government or ADB officials—who uncovered the corruption in the land transaction. Had the community been involved in the process from the time the consortium first identified it as a potential site, it may have uncovered the irregularities sooner, perhaps in time for the government to pursue other options.

Anticorruption experts are increasingly recognizing the importance of this kind of public role in fighting corruption.<sup>168</sup> They note that citizens and user groups are often the most motivated watchdogs and most effective advocates for the proper use of project resources.<sup>169</sup> And members of the public generally have the most nuanced understanding of the nature of local corruption, and can provide invaluable information on where corruption may be occurring, and how to design and implement projects to minimize it.<sup>170</sup>

Researchers at the World Bank have found that mobilizing the public to “audit” and oversee government operations can be an effective antidote to weak government capacity to implement its own fiduciary controls. Indeed, public participation can be even more effective in combating corruption than more conventional public-sector management tools, such as increasing



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civil service wages or strengthening internal oversight and enforcement. According to the Bank’s researchers, “corruption [usually] has been reduced not so much by overarching visions of good government as by the growing ability of people and groups outside the state to defend themselves against official abuse and to check the unfair advantages of others.”<sup>171</sup> For citizens to defend their interests in this way, however, they must be empowered through adequate mechanisms of transparency, accountability, and public voice.

Box 4 considers how consent challenges can impact the success of plans to privatize the delivery of social services by examining efforts to privatize water services in Bolivia.



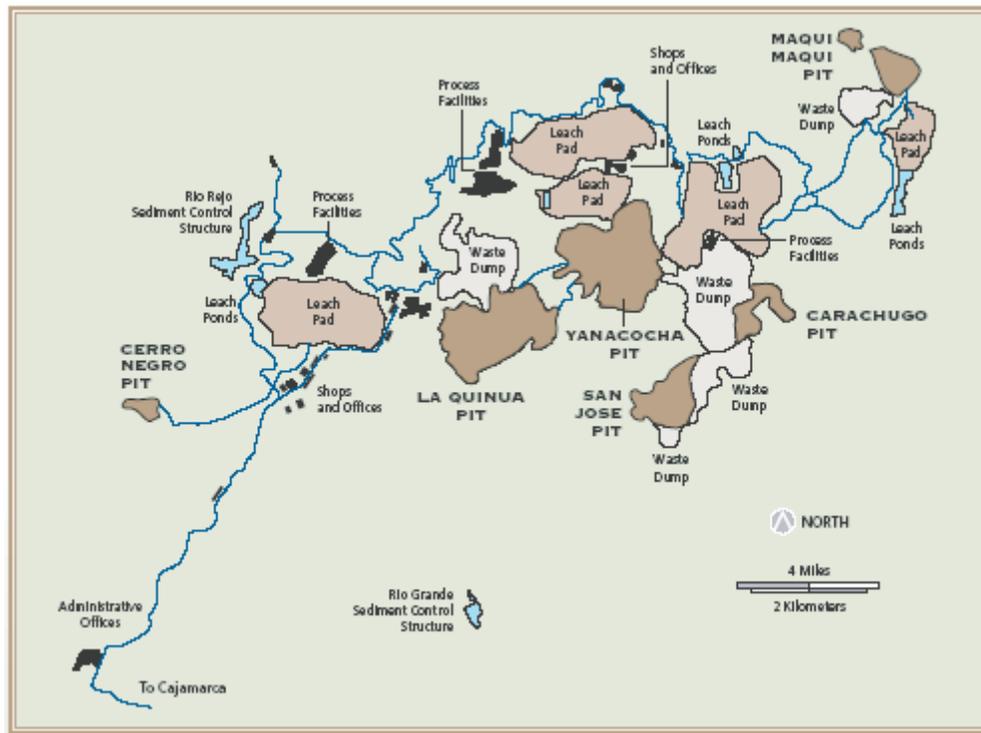
Located high in the Andes of northern Peru, Minera Yanacocha (Yanacocha) is the one of the largest and most profitable gold mines in the world.<sup>173</sup> Yanacocha is a joint venture of Newmont Mining Corporation (51 percent), Compañía de Minas Buenaventura of Peru (44 percent), and the International Finance Corporation (IFC), the private-sector lending arm of the World Bank Group (5 percent). Yanacocha is a linchpin asset for each of its principal owners. For Newmont, the world’s largest gold producer, Yanacocha is the crown jewel of its global operations, and represents 18 percent of its total global reserves.<sup>174</sup> The mine is even more important to Buenaventura—it is by far that company’s most significant asset, representing 94 percent of the company’s reserves.<sup>175</sup> And while Yanacocha does not represent a large percentage of the IFC’s overall portfolio, it is the IFC’s largest investment in the mining sector, and an important test of IFC’s assertion that it can help ensure that the mining projects it finances deliver sustainable and equitable development benefits to their host communities.

Yanacocha extracts massive quantities of gold from ore using a “cyanide heap leach” process. Heap leaching involves piling crushed ore in enormous heaps and spraying it with a dilute cyanide solution, which percolates through the pile and bonds with tiny flecks of gold. The solution is then collected in a rubber pad beneath the heap, and the gold is separated from the effluent in a processing plant. While cyanide heap leaching is a cheap and effective means for extracting minute amounts of gold from low-grade ore, it carries a high risk for contaminating nearby water sources with cyanide by-products and other toxic chemicals.

Everything about the Yanacocha facility is titanic in scale. Its six open-pit mines, five leach pads, and associated processing facilities sprawl across 160 square kilometers, five separate mountains, and four distinct watersheds (see Figures 6 and 7). Yet these existing facilities occupy only a small portion of the 1,725-square-kilometer concession on which Yanacocha owns exploration and development rights (see Figure 8).<sup>176</sup> The project has excavated about



FIGURE 7 | THE SCALE OF YANACOCCHA



Source: September 2005 Information Handbook — Newmont

570 million tons of earth so far, and will most likely move a billion tons before it closes.<sup>177</sup>

Yanacocha’s wealth is as enormous as its facilities. When Yanacocha began operating in 1992, the company believed that it held only modest reserves that would take 5 or 6 years to develop. After a series of extraordinarily rich discoveries, however, the mine has actually produced more than 19 million ounces of gold—worth more than US \$7 billion.<sup>178</sup> In 2004 alone, the mine produced 3.1 million ounces.<sup>179</sup> With the addition of 8.7 million ounces from the proposed Minas Congas pit, Yanacocha closed in 2004 with 32.2 million ounces of reserves.<sup>180</sup> At US \$445 per ounce, the average price of gold in 2005,<sup>181</sup> these reserves are worth about US \$14.2 billion. And this does not include the resources of several other areas that Yanacocha is actively considering developing. The company anticipates it will continue to profitably mine the concession for the next 35 to 50 years.

Yanacocha has also been a significant source of public revenue. In 2003, Minera Yanacocha paid more than \$140 million in taxes, half of which was earmarked to be distributed to the local government under Peru’s mining law.

### COMMUNITY OPPOSITION

When Yanacocha commenced operations in 1992, it was a substantially smaller project than it is now. In its first year of operations, the project produced only 81,000 ounces of gold (compared to 3.1 million ounces in 2005). In the early stages of the project, few if any residents of the Cajamarca valley anticipated the potential for intense conflict between industrial-scale mining operations and the region’s traditional foundations of agricultural and dairy farming, and there was no organized opposition to the project.<sup>182</sup> Rather, many residents were hopeful that Yanacocha would bring much-needed jobs and improved roads.

FIGURE 8

### MAP OF YANACOCHA EXPLORATION AND DEVELOPMENT RIGHTS



Source: September 2005 Information Handbook — Newmont

However, as the mine dramatically expanded in scale, it came to exert a kind of gravitational force on all spheres of life in the area. By 1998, the mine was causing significant tensions between the company and the community. While many residents in the community believed that the mine was delivering substantial economic benefits, many others complained that it was causing considerable economic, environmental, and social harm to the region. The mine's industrial operations were widely seen as undermining the region's traditional agricultural and pastoral identity, and disrupting traditional social structures and land and labor markets. With a workforce of more than 7,000 employees (including subcontractors), an enormous consumer presence, and other extensive economic activity, the economic clout of Yanacocha appeared to overwhelm the community. Moreover, many residents blamed the mine for creating class divisions between the thousands of *campesinos* who had landed well-paying jobs with the mine, and the tens of thousands who had not.<sup>183</sup> In the town of Cajamarca (population 120,000), residents complained that the immigration of people seeking employment brought overcrowding, rising crime, violence, alcoholism, and prostitution. In the surrounding rural areas, farmers and ranchers alleged that Yanacocha engaged in coercive land purchases, and that decreasing water quality and quantity in local streams and irrigation ditches had reduced their yields. Throughout the region, residents objected to the danger and nuisance of the stream of large trucks going to and from the mine. Given these negative impacts, and the extraordinary riches that

Yanacocha was taking from the region, many residents became convinced that the company was not investing its fair share in the affected communities.

Public discontent was exacerbated by the perception that Yanacocha enjoyed unrivaled economic and political clout, and chose to exercise its power in an arrogant, unilateral, and opaque manner.<sup>184</sup> In many minds, the company did not act with appropriate candor, responsibility, or deference to traditional decision-making processes, and was widely criticized for its lack of transparency and failure to consult with affected communities. Local authorities came to believe that Yanacocha did not respect their traditional role in local decision making, and did not value their inputs. And the public came to believe that the mine preferred to shun disclosure and consultation in favor of backroom deals. Even where Yanacocha did provide assistance to affected communities, its efforts were often dismissed because it unilaterally decided what to do for the communities, rather than seeking to identify and incorporate community preferences through meaningful dialogue.<sup>185</sup>

In June 2000, an accident involving the transportation of mercury, a by-product of the mining process, brought simmering discontent with Yanacocha to full boil. A mine contractor spilled 330 pounds of mercury along a stretch of road through the towns of Choropampa, Magdalena, and San Juan. Children in the villages collected and played with the luminous liquid metal. Many adults, believing that the mercury was mixed with gold, brought it home and even cooked it on their stoves.<sup>186</sup> Over 1,000 villagers claimed to suffer from acute mercury poisoning or other ill effects from the contact with the mercury, including skin rashes, vomiting, vision problems, nervous system disorders, respiratory ailments, and kidney problems.<sup>187</sup> The mine delayed reporting the accident to Peruvian authorities,<sup>188</sup> and allegedly exacerbated the public health impact of the spill by paying villagers to collect the spilled mercury without providing proper protective clothing.<sup>189</sup>

In March 2001, hundreds of residents of Choropampa and surrounding areas protested the company's inadequate response to the health problems in their community by blockading the road between Cajamarca and Lima—thereby preventing truck traffic between the capital and the mine.<sup>190</sup> Ultimately, an independent review commissioned by the IFC concluded that Yanacocha bore considerable responsibility for failing to implement appropriate policies for the handling and transporting hazardous wastes from the mine.<sup>191</sup> A group of people

who were sickened by the spill have sued Newmont in U.S. court, seeking compensation for their ailments. Moreover, local residents often cite the accident at Choropampa as an example of Yanacocha's indifference to the negative impacts of the mine, and it remains an ongoing source of conflict between the company and surrounding communities.

## FURTHER CONTROVERSY OVER THE PROPOSED EXPANSION AT CERRO QUILISH

Even as its relationship with the surrounding communities deteriorated, the company's ambitions for the Yanacocha mine continued to grow. A critical element of Yanacocha's expansion was its plan to mine Cerro Quilish, a 3.7-million-ounce deposit within the Yanacocha concession.<sup>192</sup> However, as the communities came to believe that existing operations were poisoning the local watercourses, and as they grew increasingly skeptical of the company's assurances that mining Quilish would not adversely affect water quality, they became concerned with the prospect of Quilish's being developed. For many in the region, Quilish was considered to be sacred land, and the primary source of freshwater for Cajamarca and some of the surrounding communities and farms. In October 2000, Cajamarca passed a municipal ordinance declaring Cerro Quilish to be a protected area and off-limits to mineral exploration. In turn, Minera Yanacocha sued the city to overturn the declaration and preserve its rights to explore and expand.<sup>193</sup> In 2003, the Peruvian Supreme Court ruled in the Yanacocha's favor, holding that the declaration exceeded the authority of the municipal government.<sup>194</sup> Nevertheless, the company maintained that it would not try to expand into Quilish over community opposition. These assurances did not assuage concerns about the development of Quilish, and the prospect that Yanacocha might develop Quilish lingered as an ongoing point of contention in the relationship between the company and its host communities.

In September 2004, Yanacocha obtained a permit from the Ministry of Energy and Mines to begin exploring Quilish, and moved its drilling equipment onto the site. The public reaction was swift and intense. On September 2, hundreds of *campesinos* blockaded the road from Cajamarca to the mine. The government responded by deploying several hundred armed police officers. Many protestors were arrested, including a number of women, children, and elders.<sup>195</sup> The blockade forced Yanacocha to helicopter its workers to the mine, and to scale back operations. On September 15, the protests culminated in



a region-wide strike that included a mass mobilization of approximately 10,000 people in the public square in Cajamarca. The blockade was relinquished, and protests were quelled two days later, after local leaders and representatives of the Ministry of Mines negotiated an agreement with Yanacocha. In early November, the company publicly apologized for its actions, formally requested that the Ministry revoke its permit to explore Quilish, and removed the Quilish project from its operations plans.<sup>196</sup>

## FINANCIAL IMPACTS

The indefinite delay in developing the Quilish reserves is probably the most severe financial impact of the conflict so far. Yanacocha had hoped to begin exploiting Quilish's reserves in 2007 to partially offset the production depletion of its existing pits.<sup>197</sup> But in part because the development of Quilish has been delayed indefinitely, the company now says that Yanacocha's production may fall 35 percent or more in two years.<sup>198</sup> Assuming a gold price of US \$603 per ounce (the average price in 2006), Quilish's 3.7 million ounces of reserves are worth about US \$2.23 billion.<sup>199</sup> If these reserves could be recovered at the same production costs of \$145 per ounce as the rest of Yanacocha, this amounts to more than US \$1.69 billion in lost earnings for the company.<sup>200</sup> For Buenaventura, the Quilish reserves represent more than 20 percent of the company's total gold reserves.<sup>201</sup> For Newmont, the loss of Quilish represents only about a 2 percent decrease in its overall reserves—though Yanacocha is one of Newmont's lowest-cost and most profitable producers.<sup>202</sup>

The conflicts between Yanacocha and the community have placed more than just the Quilish reserves in jeopardy. In the current political environment, any proposed expansion of the mine will face heightened scrutiny. There has been strong public resistance to the exploration and development of portions of the San Cirilo deposit.<sup>203</sup> And Yanacocha's other proposed developments—Chaquicocha (slated to begin production in 2006), Corimayo (2010), and Minas Conga (2011)—will face similar scrutiny. Together, these deposits hold an estimated 14.5 million ounces of reserves, worth US \$8.74 billion at average 2006 prices.<sup>204</sup> Therefore, securing community consent to explore and develop these deposits is a long-term imperative for Yanacocha, as its continued viability ultimately depends upon its ability to replenish depleted assets. In the existing political environment, it is difficult to see how Yanacocha will obtain that permission.

Yanacocha's troubles in the Cajamarca valley have spilled over to other Newmont–Buenaventura projects in the region. Two months after the conflict over Cerro Quilish, a group of local *campesinos* entered a prospecting camp at La Zanja, a planned open-pit mine six hours from Cajamarca, and destroyed rock samples and equipment.<sup>205</sup> As a result, Newmont and Buenaventura are also reevaluating this mine proposal, which has reserves of 563,000 ounces of gold and 3.8 million ounces of silver.<sup>206</sup> Worse, the conflict in Yanacocha has set the tone for a number of confrontations between mining companies and their host communities throughout Peru (see Box 5). According to Father Marco Arana, a leader of the Cerro Quilish protests: “[I]f Yanacocha does things better, it will open the door to all mining projects in the north of Peru. If it doesn't, it will close the door to these projects.”<sup>207</sup>

Yanacocha's poor relationships with local communities have also increased Newmont's share price volatility. Newmont's stock fell 7 percent during the two weeks of protest over Cerro Quilish. Investor concerns over the situation in Yanacocha, and another Newmont mine in Indonesia, contributed to Newmont's loss of 8 percent in 2004, despite huge run-ups in the price of gold through the year. Reflecting on Newmont's 2004 performance, a Bear Stearns analyst commented: “[T]here's been a lot of noise over the past three months about [Newmont's] Indonesian and Peruvian operations.... [I]t's been a lot of environmental and local discourse that has kind of restrained Newmont's performance.”<sup>208</sup> Some of Newmont's large institutional investors—such as the New York State Common Retirement Fund—have

concluded, and have begun to press the company on its environmental and social practices.<sup>209</sup>

## CONCLUSION

The central lesson of the Yanacocha case is that for large-scale, long-term projects, community consent is a life-cycle issue. While securing a “social license to operate” during project preparation is critical, that license is only temporary and contingent; it must be constantly renewed and is always subject to revocation during implementation.

When Yanacocha began operations in 1993, it enjoyed substantial support within the surrounding communities. Many local residents believed that the project could supplement the region's traditional economic activity, and bring well-paying jobs and improved infrastructure. But few, if any, residents anticipated how the mine would dominate the valley's economic, social, and political life. Over time, as the project grew in scale and its negative impacts began to overshadow its benefits in the minds of many residents, early support for the mine eroded into suspicion, recrimination, and ultimately, opposition. Yet Yanacocha proved unable to meet the public's expectations of transparency, meaningful participation in decision making, and good corporate citizenship. These accumulated grievances ultimately found expression in the blockades and mass mobilizations that prevented the exploration of Cerro Quilish.

As in the Esquel case, it is not clear that even a perfectly harmonious relationship with the surrounding communities would have allowed Yanacocha to secure consent to mine Cerro Quilish. Given Quilish's sacred status and its importance as a watershed, local communities would have had strong reservations about its development under any circumstances. But it is clear, at least in retrospect, that Yanacocha would have been well advised to fully explore the communities' concerns about the development of Quilish, respect their preferences regarding its development, and (if necessary) redirect its ambitions for expansion to other, mutually agreeable areas. Box 5 provides an overview of the consequences of broader governance challenges to the Peruvian mining sector.

Conflicts between project sponsors and their host communities generally arise out of very specific and localized grievances, but they rarely occur in isolation. Poor governance, or the government's inability to resolve community complaints in a politically acceptable manner, can create the conditions in which similar conflicts may arise in a number of different communities. And conflict in one community can, in turn, have a demonstration effect that reverberates through the regional or even national political culture. Eventually, a tipping point may be reached in which a company's—or even an entire industry's—ability to do business is fundamentally impaired.

This kind of transformation of the national investment climate recently occurred in Peru's mining sector. Peruvian mining has undergone a historic boom since the early 1990s, when the government privatized and liberalized the industry to facilitate foreign investment. Between 1993 and 2003, foreign mining companies invested about US \$6.7 billion in mines in the country, and projects involving potential investment of more than US \$10 billion are currently being considered.<sup>1</sup> As a result, production of gold, silver, copper, zinc, molybdenum, and other precious metals has expanded dramatically. With this growth, gold and copper are now Peru's biggest exports, and mining now accounts for half of Peru's foreign earnings.<sup>2</sup>

The Peruvian government and its international donors, however, could have done more to balance efforts to attract foreign investment with appropriate steps to ensure that environmental and social impacts were minimized or that traditional property interests were respected. Indeed, in some cases it took steps in the opposite direction. For example, the government offered large-scale miners "stabilization agreements" that precluded the government from strengthening environmental requirements for their facilities for 10 to 15 years.<sup>3</sup> Over the objection of the local landowners, it rolled back protections for collectively held *campesino* land titles by creating *servidumbres* (easements) that allow miners to gain access to subsurface mineral deposits.<sup>4</sup> Moreover, the government did not embed strong community participation requirements into its environmental assessment procedures,<sup>5</sup> and did not sufficiently scale up its regulatory and enforcement capacity to deal with the multiplying demands created by the investment boom.

The mining companies were also insufficiently attentive to environmental and social concerns. In the rush to invest and expand, they did not always take care to ensure that community preferences were respected, adverse impacts avoided, or benefits broadly shared. In response, affected communities have become increasingly sensitive to the negative social and environmental impacts of mining operations, and increasingly assertive about demanding a broader and more equitable distribution of benefits through political action, mass mobilization, and civil disobedience.<sup>6</sup> In 1999, as a result of conflicts, such as those at Antamina and in Vicco, Ilo, and La Oroya,<sup>7</sup> communities affected by mining united under the banner of the National Coordinator of Mining-Affected Communities (CONACAMI) to coordinate their advocacy efforts and campaign at the national level. This union enabled the affected communities to expand capacity, substantially increase the scope and effectiveness of their individual political advocacy efforts, and build political momentum against the mining industry.<sup>8</sup>

The conflicts between the Yanacocha mine and the communities of Cajamarca and Choropampa in 2000 and 2001 exacerbated the growing anti-mining sentiment, and helped shape the political dynamics in a number of equally contentious conflicts in other Peruvian communities.<sup>9</sup> For example, in June 2002, an ongoing conflict between the residents of Tambogrande and Manhattan Minerals of Canada over a proposed US \$405 million copper and gold mine came to a head when the community held a public referendum and rejected the project by a wide margin. As a result of the referendum and a sustained local campaign supported by national civil society organizations and the Catholic Church, the company could not find a partner for the venture and could not meet the terms of the option to develop the site that it had received from the Peruvian state mining company. Citing losses of US \$60 million on the venture, Manhattan Minerals was forced to abandon its plans for the mine, and subsequently renounced any intention to invest in Peru ever again.<sup>10</sup>

By late 2002, the World Bank and Inter-American Development Bank (IDB) were warning that the conflicts between communities and large mining concerns were beginning to affect the broader political culture in which companies operate. They noted that:

*continued next page*

**BOX 5 | CONTINUED**

... the environmental record of the mining industry has begun to impede private sector development. Even when controls existed on paper, they are seldom implemented in practice. Social and political conflicts that were mainly triggered by accidents impacting the environment or the social fabric of the local community, such as spills or resettlement issues, have threatened the ability of companies to pursue mining permits or to continue to run their already existing operations.<sup>11</sup>

If anything, however, the World Bank and the IDB underestimated what was to come. By mid-2004, the political culture in Peru had turned strongly against the mining industry, and communities became markedly less willing to endure the negative impacts associated with hosting a large mining facility. A number of high-profile conflicts ensued in rapid succession. In September 2004, the disputes over Cerro Quilish culminated in mass protests that resulted in Newmont's withdrawing from Quilish and renouncing any intention to develop it without community support. Two months later, a group of local residents entered an exploration camp at La Zanja, a proposed open-pit mine also owned by Newmont and Buenaventura, and destroyed rock samples and equipment.<sup>12</sup> Then, in December, mining protestors conducted a two-day strike that shut down three provinces in the area.<sup>13</sup> In May 2005, protestors occupied BHP Billiton's Tintaya copper mine in southern Peru, the third largest copper mine in the country. The protestors, who demanded that the company invest US \$20 million in local community development projects, were dispersed only after authorities interceded with tear gas. The dispute forced the mine to close for a month.<sup>14</sup> And in July 2005, Río Blanco, a proposed \$800 million copper mine near the Ecuadorian border, became the latest center of conflict. While the project is still in the exploratory stage, its sponsor, Monterrico Metals, claims that the mine will become Peru's second largest copper mine when it opens in 2008, and will increase Peru's copper production by over 20 percent. Local residents, however, are concerned that the mine will contaminate an aquifer that feeds the rivers that provide critical water sources for the villagers and their farms and supports important natural habitats. At least one protestor was killed and 40 were injured after 3,000 campesinos entered the company's exploration camp on July 28.<sup>15</sup> In addition, there have been a number of less

visible conflicts: the Peruvian government reported at least 12 serious disputes between mining companies and their host communities in July 2005 alone.<sup>16</sup>

Taken together, these conflicts have the potential to significantly affect the Peruvian mining industry. The Peruvian National Society of Mining, Petroleum and Energy (SNMPE) estimates that these protests have placed at least US \$1.1 billion in investments at risk.<sup>17</sup> SNMPE also points out that these protests may affect privatization and investments in the Quellaveco, Michiquillay, La Granja, and Toromocho copper projects, and the development of a major new copper mine at Granjas. The SNMPE conservatively estimates the value of those projects at over US \$3 billion.<sup>18</sup>

**Notes**

1. *The Economist*, Feb 3, 2005.
2. Bury 2005, p.224; Environmental News Service, Aug 9, 2005; Reuters, Aug 8, 2005a.
3. Mainhardt-Gibbs 2003, p. 20.
4. De Echave and Torres 2005, p. 44.
5. Christian Aid 2005, p. 41.
6. Compliance Advisor/Ombudsman of the International Finance Corporation 2005, p. 5.
7. The conflicts in Cerro de Pasco and La Oroyo actually involved smelters rather than mines, but were widely perceived as part of the mining-metalurgy sector.
8. De Echave et al. 2005, p. 12.
9. *The Economist*, Feb 3, 2005.
10. Business News America, Feb 7, 2005a.
11. World Bank and Inter-American Development Bank 2002, p. 143.
12. *The Economist*, Feb 3, 2005.
13. *Id.*
14. Reuters, Aug 4, 2005b.
15. Environmental News Service, Aug 9, 2005; Reuters, Feb 7, 2005a.
16. Weitzman 2005.
17. Reuters, Aug 4, 2005b.
18. *Id.*



## CONCLUSIONS AND RECOMMENDATIONS

ALEX BALUYUT/WORLD BANK

### ACKNOWLEDGING THE RISKS

The cases demonstrate that many businesses have not fully appreciated the risks entailed in failing to obtain community consent. The business risks of imposing a large-scale project on a host community without its consent are multiple and profound, and can potentially threaten the project's financial viability. A few lessons are particularly evident:

- Community opposition can arise from impacts that are generated at any stage in the project cycle. As a result, FPIC must be ongoing and iterative if it is to be an effective risk management strategy.
- Addressing the risks of community opposition before the project begins is likely to be much more successful and cost-effective than responding to community opposition later on.
- Other stakeholders—such as shareholders, financiers, and host governments—can also have their financial interests adversely affected by conflicts that result from the failure to obtain consent. This implies that these parties have an independent fiduciary interest in ensuring that consent is achieved and maintained in the projects that they support.
- Mere engagement or consultation may not be sufficient to fully address these risks. Consultations that do not resolve a community's reasons for opposition or achieve consent will provide little assurance against potentially costly and disruptive conflict.

Due to community opposition, Esquel, Yanacocha (Cerro Quilish), and Samut Prakarn each suffered lengthy construction delays. The development of Cerro Quilish

has been postponed indefinitely, while the sponsors of Esquel and Samut Prakarn are grappling with how to reconfigure their projects to garner public approval years after they were expected to come online. Conversely, Malampaya was able to proceed on an expedited construction schedule by reaching mutually acceptable agreements regarding site selection and construction impacts early in the planning process.

Community resistance often has collateral impacts on the sponsor beyond the specific project under dispute. Meridian Gold, the sponsor of Esquel, saw its stock price fall precipitously and was required to write off most of the property's development value. Newmont and the IFC, the lead sponsor and key financier of Yanacocha, have suffered reputational harm due to their handling of community concerns. This has complicated Newmont's efforts to win approval for projects in other communities. In contrast, Shell enjoyed a significant public relations boost for its handling of Malampaya.

Community opposition can arise at any stage of the project cycle. In particular, sponsors should not treat consent given at the outset of a project as a kind of blanket immunity from subsequent opposition. In practice, the sponsor's relationship with the community, like its relationship with other stakeholders, must be attended to throughout the project cycle. Communities should not be expected to consent to the project in its totality. Rather, they should accept specified impacts over a given phase of development and be fully notified up front of cumulative project impacts. When unexpected impacts arise, or when the next set of critical project decisions is to be made, public expectations and concerns must continue to be addressed.

Project financial stakeholders other than the project sponsor can also be adversely affected by public resistance. For example:

- Shareholders may be at significant risk when relatively undiversified companies encounter community opposition. Meridian's shareholders, for example, incurred substantial losses when the financial markets factored public opposition to the Esquel project into Meridian's share price.
- Government entities that expect to reap taxes, royalties, or user fees generated by the project also have interests at risk. Cerro Quilish, for example, would have generated significant tax payments for the Government of Peru.
- Institutions that provide limited-recourse financing to projects may bear even greater risks that the projects they finance will fail to meet their financial projections due to community opposition. These lenders rely primarily on the revenues generated by the project for repayment and as security for their exposure.<sup>210</sup> Samut Prakarn was financed in part by US \$230 million in loans from the Asian Development Bank, but the loan was guaranteed by the Thai government. Since Samut Prakarn has not been brought online, and has yet to earn any revenues, these sovereign guarantees are the sole basis of debt repayment.

Moreover, as the example of the mining sector in Peru illustrates, conflict at one project can adversely influence the political dynamic at nearby projects. As a result, project sponsors and their financial supporters may bear the risks of conflicts that arise in projects that are not directly related to their own. And governments that lack the capacity or political will to ensure that conflicts do not spin out of control and metastasize may find that their efforts to promote investment are undermined by a grassroots backlash.

The business risks of community opposition cannot be fully mitigated through consultation. In many of the projects we examined, the sponsor or a key financier professed to have a firm commitment to community consultations as part of its established due diligence procedures. In most of the cases, some kind of consultations with the affected communities were undertaken—though in Esquel and Samut Prakarn, consultations were of such inferior quality as to be little more than a gesture. But with the exception of Malampaya, these consultations were not successful in

averting conflict or in securing popular consent for the project. These cases suggest that even if consultations are well run, they are unlikely to be an effective risk mitigation strategy unless they invoke the FPIC process. This is because consultations require only that sponsors listen to external perspectives on the project. They do not change the basic decision-making paradigm giving project sponsors and public authorities the power to make decisions without popular assent. Only by relinquishing some measure of control over decision making can a project sponsor expect to achieve politically durable agreements.

Finally, the cases suggest that the host government has an important role to play in creating the enabling conditions that can help facilitate mutually agreeable outcomes. In Samut Prakarn and the mining sector of Peru, inadequate public participation procedures and weak regulatory and enforcement regimes contributed to the disastrous outcomes. Conversely, the more rigorous participation requirements in the Philippines helped to create an environment in which Shell's community engagement efforts could produce mutually beneficial negotiated agreements.

Given the costs and risks associated with the failure to secure FPIC, obtaining FPIC from host communities can be an indispensable risk mitigation strategy for large-scale projects. Moreover, if, as these examples suggest, the ability to discern and accommodate community preferences is a key determinant of project success, project sponsors that develop the ability to do it well will enjoy a strong competitive advantage over their industry peers. These companies may be able to reduce project costs below their competitors' costs, or develop projects that would be too risky for a sponsor with a less sophisticated understanding of how to achieve community support.

The case studies suggest six principles that may assist project proponents in crafting and implementing consent procedures that will mitigate the business risks associated with local opposition:

**Information.** Affected communities should be provided sufficient information in local languages regarding the proposed project. Project proponents should work with communities to understand the types of information the communities need to make informed decisions, and must allow sufficient time for communities to review and discuss information provided to them.

**Inclusiveness.** All interested community members should be allowed and encouraged to take part in the FPIC process, including stakeholders affected by indirect or cumulative impacts.

**Dialogue.** Dialogue within an FPIC process should be formalized, continue throughout the lifetime of a project, and include government and local stakeholder representatives.

**Legal recognition.** FPIC should be formally recognized through binding negotiated agreements. There should be a sufficient period of time for community decision making prior to project commencement.

**Monitoring and evaluation.** Opportunities for appropriate and independent community monitoring should be put in place. Monitoring and evaluation should be supported by independent grievance processes to ensure that community concerns are addressed throughout a project's lifetime.

**Corporate buy-in.** Project proponents should view FPIC as an inherent and necessary cost of project development. Where appropriate, developers should find constructive ways to channel funds to communities to maintain the integrity of the process and the independence of the community's role.

Community involvement and consent work best in a setting where the host country government recognizes these concerns as a matter of law or policy. Project proponents should work with governments to gain their endorsement and involvement in the FPIC process. To fully protect their legal rights and interests, proponents should develop with communities further procedures based on local conditions.

## HOW KEY ACTORS CAN HELP

Each stakeholder should take specific, affirmative steps to ensure that the FPIC of project-affected parties is secured before and during project operations. Most importantly, project sponsors and financiers should incorporate community consent procedures and requirements into their project and investment decision making, planning, and operations, and host governments should incorporate such procedures and requirements into their permitting processes. These are the things the following actors can do:

## Project Sponsors

- Develop clear, binding operational policies and procedures for disclosing information and securing FPIC. These policies and procedures should provide for an ongoing, iterative process of communication and negotiation throughout the entire planning and project cycles.
- Ensure that community consent is achieved before project construction begins and is maintained at each stage of project decision making.
- Adopt FPIC procedures that result in culturally appropriate, legally enforceable negotiated agreements that address the full range of issues of concern to host communities, and that can be renegotiated if necessary as the project evolves.
- Adjust planning, assessment, and decision-making timelines and procedures to allow for full local involvement and community input. Sponsors should recognize that communications and transportation difficulties, iterative community consensus building processes, or other logistical demands of incorporating an FPIC principle may increase the time and resources necessary for project decision making.
- Fully disclose to investors and potential investors the financially material risks of community opposition to projects.

## Project Financiers and Investors

- Mitigate the risks of community opposition by assessing, as part of due diligence procedures, (1) host community preferences; (2) whether project sponsors have the capacity to successfully engage communities in FPIC processes, and the commitment not to proceed if consent is not achieved; and (3) whether other critical enabling conditions for FPIC exist, such as the capacity of the host country to implement and enforce negotiated agreements.
- Request independent third-party audits to ensure that project sponsors have achieved community consent.<sup>211</sup>
- Refrain from supporting projects that do not have the consent of the host community, or that raise significant concerns that the sponsor will not be able to maintain consent over time.

### **Host Governments**

- Develop legislation and implementing regulations that incorporate clear FPIC procedures and requirements into all stages of the planning and permitting process.
- Develop the capacity to help orchestrate and enforce negotiated outcomes of FPIC processes with the support of the international donor community.
- Ensure that all affected citizens, including those who are critical of the project, have the right to freely express their views.

### **Corporate Lenders and Shareholders**

- Mitigate risks by assessing the company's community consent procedures as part of due diligence procedures.

### **Public Securities Regulators**

- Issue specific guidance requiring project sponsors to disclose the risks and adverse impacts of community opposition as part of their obligation to disclose financially material information.
- Bring enforcement actions against companies that do not comply with their disclosure obligations.

### **Financial Equity Research Analysts**

- Consider how community opposition to important projects, and the sponsor's ability and commitment to address community concerns, may affect the sponsor's stock price and volatility.

### **International Development Donors**

- Incorporate FPIC considerations into financial analyses of companies and sectors with a high risk of community consent concerns (for example, mining).
- Assist host governments to expand their capacity to implement and enforce FPIC procedures.

### **The United Nations**

- Fully endorse and adopt by consensus the draft U.N. Declaration on the Rights of Indigenous Peoples, which recognizes the right to free, prior, and informed consent.

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# NOTES

1. ILO 1989, Article 7(1). Consent does not require unanimity among all the members of a community. Rather, consent should be determined pursuant to customary law and practice, or in some other way agreed upon by the community.
2. See World Commission on Dams 2000, p. 215; World Bank 2004, vol. 1, p. 50; Mining, Minerals, and Sustainable Development 2002, p. 25; WRI et al. 2005, p. 72; and Colchester and MacKay 2004.
3. ILO 1989, Article 7(1). Consent does not require unanimity among all the members of a community. Rather, consent should be determined pursuant to customary law and practice, or in some other way agreed upon by the community.
4. See Sena 2005.
5. See World Commission on Dams 2000, p. 281.
6. See Warhurst 2005, pp. 151-168; Mehta and Stankovitch 2001.
7. See World Bank 1994.
8. For more on operationalizing FPIC, see Mehta and Stankovitch 2001, p. 29.
9. ILO Convention 169 Concerning Indigenous and Tribal Peoples in Independent Countries, Article 7. ILO 169 has been ratified by 17 countries. See <http://www.ilo.org/ilolex/cgi-lex/ratific.pl?Cr69>. ILO 169 explicitly provides for FPIC in exceptional cases where relocation of indigenous peoples is necessary (Article 16).
10. See UNHCR 1994, Article 30.
11. See UNHCR 1965; UNHCR 1966. For example, within the last several years, the Committee interpreting CERD issued Recommendation XXIII, which calls for all Parties to the Convention to obtain the informed consent of indigenous peoples in all decisions that may concern their rights or interests. In 2002, Botswana was censured for failing to ensure that FPIC was secured prior to resettlement of indigenous communities. In March 2003, the Committee censured Ecuador for “falling short” of meeting FPIC requirements for indigenous communities, finding that in the context of resource exploitation on traditional lands, mere consultation was insufficient. Similarly, the Human Rights Committee, interpreting the ICCPR, found that enjoyment of the right to culture “may require positive legal measures of protection and measures to ensure the effective participation of members of minority communities in decisions which affect them....” Finally, in several recent cases in the Inter-American System of Human Rights, including *Mayagna (Sumo) Awas Tingni Community v. Nicaragua*, *Maya Indigenous Communities v. Belize*, and the *Moiwana Village v. Suriname*, it was determined that the rights of indigenous peoples and tribal communities were violated by a failure to ensure that FPIC was obtained prior to activities that deprived the peoples and communities of their land and other natural resources. The Convention on Biological Diversity (CBD) requires that “[e]ach Contracting Party shall, as far as possible and as appropriate . . . respect, preserve and maintain knowledge, innovations and practices of indigenous and local communities . . . and promote their wider application *with the approval* and involvement of the holders of such knowledge, innovations and practices and encourage the equitable sharing of the benefits arising from [their] utilization” (Article 8(j)) (emphasis added). Recent discussions at the CBD have focused on the rights of indigenous peoples and other local communities to PIC. See Convention on Biological Diversity, Decision VII/19, Conference of the Parties 7 (Kuala Lumpur, Malaysia: CBD 2004), at <http://www.biodiv.org/decisions/default.aspx?m=COP-07&id=7756&lg=0>. See also CIEL 2006.
12. See UNHCR 2003, para. 10(c).
13. Inter-American Commission of Human Rights, *Report No. 75/02*, Case No. 11.140, Mary and Carrie Dann (United States), December 27, 2002. OEA/Ser.L/V/II.116, Doc. 46, para. 131. See, also *Report No. 96/03, Maya Indigenous Communities and Their Members (Case 12.053 Belize)*, October 24, 2003, para. 116.
14. See IACHR 1997, Articles XIII, XVII, XVIII, and XXI.
15. See European Union 1998; Colchester and MacKay 2004.
16. See Forest Stewardship Council 2004.
17. See World Commission on Dams 2000.
18. See World Bank 2004; MacKay 2004b.
19. See Cooper and Elliott 2000, pp. 339–367.
20. The Aboriginal Land Rights (Northern Territory) Act of 1976 provides traditional aboriginal owners with the right to consent to explorations on their land, which includes the right to veto any such explorations, as well as the right to negotiate agreements and timeframes for such exploration. See MacKay 2004a.
21. Article 8 of Federal Law 82-FZ (April 30, 1999); Article 7 of Federal Law 104-FZ (June 20, 2000); Decree 397 of the President of the Russian Federation (April 22, 1992); Federal Law 49-FZ (May 7, 2001); The Land Code of the Russian Federation 136-FZ (October 25, 2001); Federal Law 174-FZ “Environmental Assessment” (November 23, 1995); Regulation 372 on evaluation of the effect of proposed economic activity or other activity on the environment (May 16, 2000).
22. See WRI et al. 2005, p. 72.

23. Rio Declaration on Environment and Development, Principle 10, 31 I.L.M. 874 (1992).
24. *Moiwana Village v. Suriname*, Inter-American Court of Human Rights, Judgment of June 15, 2005, pp. 54–55.
25. See WRI et al. 2005, p. 72.
26. See World Commission on Dams 2000, p. 215.
27. See World Bank 2004, p. 50.
28. See Mining, Minerals, and Sustainable Development 2002, p. 25.
29. See IFC 2001.
30. See Petkova et al. 2002, p. 8. For a discussion of the relationship of PIC to the “national interest” in the context of protected areas, see Perrault, Herbertson, and Lynch forthcoming.
31. See WRI et al. 2005, p. 72.
32. See UNPFII 2005; 2006 personal interview with Tony La Viña, Senior Fellow, World Resources Institute.
33. See Business News America, Feb 7, 2005a.
34. See Environmental Finance, Apr 20, 2006.
35. See Arquiza 1997, pp. 211–219.
36. See McIntosh 1990, pp. 174–177; Mining, Minerals, and Sustainable Development 2001, pp. 3–5.
37. See Bankers Online 2006.
38. See Stern 2003.
39. See Business News America, Feb 7, 2005a.
40. See Center for Human Rights and Environment 2006, pp. 11–12.
41. See Parliament of Australia 1999, p. 18.
42. See Energy Information Administration 2006.
43. See World Bank 1997, p. 23.
44. See WCI 1997, p. 2–1; Lomotan 2005, p. 2.
45. Calculation based on the 60 percent revenue share of the Philippine government; Ding Roco, Managing Director, SPEX, personal interview, October 10, 2005, Manila, Philippines.
46. See Lomotan 2005, p. 2.
47. See Lomotan 2005, p. 2.
48. See Solleza and Barns 2003, pp. 2–3.
49. See Solleza and Barns 2003, p. 3.
50. See Schwartz and Gibb 1999, cited in Solleza and Barns 2003, pp. 3–4.
51. Ding Roco, Managing Director, SPEX, phone interview, January 23, 2006, Manila, Philippines.
52. UN, E/CN.4/Sub.2/1994/40. “Discrimination against Indigenous Peoples.” June 15, 1994. Available at: <http://www.unhcr.ch/Huridocda/Huridoca.nsf/o/99e2c75ca19e564680256761004c0562?Opendocument> (last accessed December 12, 2005).
53. See Castro 1997, pp. 98–104.
54. See Arquiza 1997, pp. 211–219.
55. Presidential Decree 1586: Establishing an Environmental Impact Statement System, Including Other Environmental Management Related Measures and for Other Purposes, June 11, 1978.
56. Departmental Administrative Order 1996-37 (DAO 96-37).
57. Pilipinas Shell Foundation, Inc., is a different entity from The Shell Foundation, which is funded by Shell UK.
58. Daday de León, Sustainable Development Manager, PSFI, personal interview, October 12, 2005, Batangas, Philippines.
59. Daday de León, Sustainable Development Manager, PSFI, personal interview, October 12, 2005, Batangas, Philippines; Ding Roco, Managing Director, SPEX, personal interview, October 10, 2005, Manila, Philippines; Benny Veran, Mindoro Project Manager, PSFI, personal interview, October 12, 2005, Mindoro, Philippines.
60. See Carpio and Molina 2003, p. 10.
61. DAO 96-37. Revising DENR Administrative Order No. 21, Series of 1992, To Further Strengthen the Implementation of the Environmental Impact Statement (EIS) System, 1996.
62. See WCI 1997, pp. 7–10.
63. Ding Roco, Managing Director, SPEX, personal interview, October 3, 10, 2005, Manila, Philippines; Mel Aguilera, Batangas and Subic Bay Project Manager, PSFI, personal interview, October 11, 2005, Manila, Philippines.
64. Benny Veran, Mindoro Project Manager, PSFI, personal interview, October 12, 2005, Mindoro, Philippines.
65. Personal Interviews by WRI with local people in Mindoro, especially the local fishermen’s group, attested that numerous consultation meetings were held around Mindoro for them to air their grievances.
66. Ding Roco, Managing Director, SPEX, telephone interview, October 3, 2005, Manila, Philippines.
67. The exchange rate between USD and Php in 1998 was USD 1= Php 42.
68. Agusuhin Neighborhood Association (ANA), personal interview, October 11, 2005, Zambales, Philippines; Mel Aguilera, Batangas and Subic Bay Project Manager, PSFI, personal interview, October 11, 2005, Manila, Philippines.
69. TALIM Council Barangay Heads Assembly, personal interview, October 12, 2005, Batangas, Philippines.
70. TALIM Council Barangay Heads Assembly, personal interview, October 12, 2005, Batangas, Philippines; Mel Aguilera, Batangas and Subic Bay Project Manager, PSFI, personal interview, October 11, 2005, Manila, Philippines.
71. Daday de León, Sustainable Development Manager, PSFI, personal interview, October 12, 2005, Batangas, Philippines.
72. TALIM Council Barangay Heads Assembly, personal interview, October 12, 2005, Batangas, Philippines.
73. David Greer, former SPEX Managing Director, interview on The Malampaya Project DVD, 2003.
74. David Greer, former SPEX Managing Director, interview on The Malampaya Project DVD, 2003.

75. While data on exact costs are unavailable, this represents SPEX's best estimate.
76. See Carpio and Molina 2003, p. 14.
77. See Barro 2005, p. ii; Lomotan 2005, p. 2.
78. Ding Roco, Managing Director, SPEX, personal interview, October 10, 2005, Manila, Philippines; Pons Carpio, Health, Safety and Environment Advisor, SPEX, personal interview, October 10, 2005, Manila, Philippines.
79. Pons Carpio, Health, Safety and Environment Advisor, SPEX, personal interview, October 10, 2005, Manila, Philippines; Ding Roco, Managing Director, SPEX, personal interview, October 14, 2005, Manila, Philippines.
80. Mel Aguilera, Batangas and Subic Bay Project Manager, PSFI, personal interview, October 11, 2005, Manila, Philippines.
81. Daday de León, Sustainable Development Manager, PSFI, personal interview, October 12, 2005, Batangas, Philippines.
82. Daday de León, Sustainable Development Manager, PSFI, personal interview, October 12, 2005, Batangas, Philippines.
83. TALIM Council Barangay Heads Assembly, personal interview, October 12, 2005, Batangas, Philippines.
84. Ding Roco, Managing Director, SPEX, personal interview, October 3 & 10, 2005, Manila, Philippines.
85. Ding Roco, Managing Director, SPEX, personal interview, October 3 & 10, 2005, Manila, Philippines.
86. Ding Roco, Managing Director, SPEX, personal interview, October 3 & 10, 2005, Manila, Philippines; Pons Carpio, Health, Safety and Environment Advisor, SPEX, personal interview, October 10, 2005, Manila, Philippines; Mel Aguilera, Batangas and Subic Bay Project Manager, PSFI, personal interview, October 11, 2005, Manila, Philippines.
87. Shell estimated 10 days of delay as its base case estimate. A 15-day delay was considered to be the upper limit of acceptability—beyond that, the bonuses of project management would have been adversely affected. Ding Roco, Managing Director, SPEX, personal interview, October 3 & 10, 2005, Manila, Philippines.
88. Pons Carpio, Health, Safety and Environment Advisor, SPEX, personal interview, October 10, 2005, Manila, Philippines; Mel Aguilera, Batangas and Subic Bay Project Manager, PSFI, personal interview, October 11, 2005, Manila, Philippines; calculation is WRI's, based on Ding Roco's estimations.
89. Pons Carpio, Health, Safety and Environment Advisor, SPEX, personal interview, October 10, 2005, Manila, Philippines; Mel Aguilera, Batangas and Subic Bay Project Manager, PSFI, personal interview, October 11, 2005, Manila, Philippines; calculation is WRI's, based on Ding Roco's estimations.
90. Calculation based on the project net revenues of the Malampaya consortium. In the service contract with the Philippine government, it was agreed that for the first 5–7 years 70 percent of the gross revenues would go to the investors' cost recovery of \$2 billion, while the remaining 30 percent would go toward net revenue. This 30 percent is further divided between the Philippine government (60 percent) and the Malampaya consortium (40 percent). This 40 percent constitutes the project's net revenues.
91. Pons Carpio, Health, Safety and Environment Advisor, SPEX, personal interview, October 10, 2005, Manila, Philippines.
92. See [http://www.malampaya.com/admin/H\\_nus3.php?id=45](http://www.malampaya.com/admin/H_nus3.php?id=45).
93. Daday de León, Sustainable Development Manager, PSFI, personal interview, October 12, 2005, Batangas, Philippines.
94. Except where specifically noted, this case study relies on Business for Social Responsibility's (BSR's) report, "Minera El Desquite Report, Esquel, Argentina" (August 2003). Meridian Gold commissioned the non-profit organization BSR to conduct an independent review of the events in Esquel to help the company better understand why the community had come to oppose the project so strongly. See <http://www.bsr.org/AdvisoryServices/Industries/Extractives.cfm> for additional information.
95. See Moran 2003, p. 1.
96. See Moran 2003, p. 1.
97. See Meridian Gold 2002, p. 6.
98. See Meridian Gold 2003, p. 23.
99. Edward Colt, President, Minera El Desquite, and Executive Vice President, Meridian Gold, Letter to the Citizens of Esquel, August 12, 2003. Available at: [http://www.meridiangold.com/pdf/08-11-03\\_Response-English.pdf](http://www.meridiangold.com/pdf/08-11-03_Response-English.pdf).
100. See BSR 2003, p. 16.
101. See BSR 2003, p. 6.
102. See BSR 2003.
103. Chubut provincial law 5000/2003, April 9, 2003.
104. Edward Colt, President, Minera El Desquite, and Executive Vice President, Meridian Gold, Letter to the Citizens of Esquel, [http://www.meridiangold.com/pdf/08-11-03\\_Response-English.pdf](http://www.meridiangold.com/pdf/08-11-03_Response-English.pdf), August 12, 2003.
105. See Meridian Gold 2005a.
106. Meridian Gold 2003, pp. 21, 23.
107. Meridian Gold 2003, p. 12 (Statement of David S. Robertson, Chairman of the Board, and Brian J. Kennedy, CEO).
108. Meridian Gold 2003, p. 6.
109. Meridian Gold 2003, pp. 6, 12.
110. Meridian Gold 2003, p. 12.
111. Meridian Gold 2002, p. 4.
112. Meridian Gold 2003, p. 13.
113. Meridian Gold 2003, pp. 18, 32.
114. See Business News Americas 2005b.
115. Meridian Gold 2006, pp. 20–21.
116. See Meridian Gold 2005b, p. 45.
117. Meridian Gold 2003, p. 42.
118. See Kitco 2006c.
119. See Kitco 2007.
120. Meridian Gold 2003, p. 23.

121. See Kitco 2006a.
122. See Kitco 2006d.
123. See Meridian Gold 2005b, p. 18.
124. See Larkin 2003.
125. Meridian Gold 2004, p. 8.
126. Meridian Gold 2005b, pp. 2-3, Chart 3.
127. See Deutsche Bank Securities 2003.
128. See Credit Suisse First Boston Equity Research 2003a.
129. See Note 142.
130. See Note 142.
131. See Credit Suisse First Boston Equity Research 2003b and 2003c.
132. Meridian Gold 2004, p. 8.
133. Volatility is the measure of the range of an asset price about its mean level over a fixed period of time. See Abken and Nandi 1996, pp. 21-35.
134. See Figure 1B.
135. Meridian alludes to these efforts in its 2003 annual report, but does not describe them in detail. Meridian Gold 2004, p. 11.
136. See No Dirty Gold 2006b.
137. Edward Colt, President, Minera El Desquite and Executive Vice President Meridian Gold, letter to the citizens of Esquel, August 12, 2003. Available at: [http://www.meridiangold.com/pdf/08-11-03\\_Response-English.pdf](http://www.meridiangold.com/pdf/08-11-03_Response-English.pdf).
138. Except where specifically noted, this case study relies upon internal reports and evaluations of the management of the Asian Development Bank (ADB). See ADB 1995, 1998, 2001a, 2001b, 2004.
139. See ADB 1993.
140. Under a “turnkey contract,” a private-sector entity agrees to design and build the facility using state-provided investment capital. The facility must meet agreed-upon performance criteria over a designated operating period before it is turned over to the government agency. Here, the joint venture was required to operate the facility for three years following initial commissioning. See ADB 1995, p. 13.
141. The Government of Thailand and the PCD assured the ADB that “[i]n the event that the turnkey contractors are unable to acquire all land required, Government expropriation procedures will be initiated.” See ADB 1995, p. 29; ADB 2001b, p. 16.
142. See ADB 2001a, p. 5. The Inspection Panel was unable to verify whether the consortium really did have trouble obtaining the land. See ADB 2001b, p. 17.
143. See ADB 2001b, p. 4; ADB 2001a, p. 5.
144. The joint venture originally consisted of North West Water International of the U.K., and five Thai companies—Prayoonvisava Engineering, Krung Thon Engineers Co. Ltd., Vihitbhan Construction Co. Ltd., See Sang Karn Yotah Co. Ltd., and Gateway Development Co. Ltd. North West Water withdrew from the project in late 1997.
145. For its part, ADB treated this change as a routine matter of project administration that did not require additional management review or Board approval. See ADB 2001b, pp. 17-19.
146. Narong Khomklom et al., Letter to the Inspection Committee of the Asian Development Bank, pp. 14, April 5, 2001.
147. Narong Khomklom et al., Letter to Tadao Chino, President of the Asia Development Bank, November 24, 2000.
148. Narong Khomklom et al., letter to the Inspection Committee of the Asian Development Bank, April 5, 2001.
149. Narong Khomklom et al., letter to the Inspection Committee of the Asian Development Bank, April 5, 2001, p. 14.
150. Narong Khomklom et al., letter to the Inspection Committee of the Asian Development Bank, April 5, 2001, Annex II. The ADB policies on environmental assessments then in force required that an initial environmental examination (IEE) of the Klong Dan site be conducted. If the IEE found that there would be negative environmental impacts, ADB policies required a more thorough environmental impact assessment (EIA). See ADB 1992 (policy in force at time of initial approval) and 1997 (policy in force at time of approval of supplementary loan). Thai law also required an environmental assessment of the site. See Royal Kingdom of Thailand. 1992. *Enhancement and Conservation of National Environmental Quality Act (NEQA)*; Constitution of Royal Kingdom of Thailand, §56, ¶2 (1997).
151. Narong Khomklom et al., letter to the Inspection Committee of the Asian Development Bank, April 5, 2001, Annex II.
152. Narong Khomklom et al., letter to the Inspection Committee of the Asian Development Bank, April 5, 2001, Annex II; Bangkok Post, “Credibility Leak in Wastewater Project,” May 28, 2000 cited in Narong Khomklom, et al., letter to the Inspection Committee of the Asian Development Bank, April 5, 2001, p. 15.
153. Narong Khomklom et al., letter to the Inspection Committee of the Asian Development Bank, April 5, 2001, Annex II; Bangkok Post, “Credibility Leak in Wastewater Project,” May 28, 2000 cited in Narong Khomklom, et al., letter to the Inspection Committee of the Asian Development Bank, April 5, 2001, p. 15.
154. Narong Khomklom et al., letter to the Inspection Committee of the Asian Development Bank, April 5, 2001, Annex II.
155. Bangkok Post, “Klong Dan Wastewater Plant Scandal: Vatana, Nine Others Accused, Graft Report Names VIPs, Senior Officials,” June 11, 2002.
156. Bangkok Post, “Klong Dan Wastewater Plant Scandal: Vatana, Nine Others Accused, Graft Report Names VIPs, Senior Officials,” June 11, 2002; Bangkok Post, “Klong Dan Wastewater Plant Scandal: State Could Reclaim Illegally Sold Land: Reselling Pushed Price to Bim a Rai,” June 12, 2003.
157. Bangkok Post, “Firms’ Bosses to Hear Land Scam Charges: Police Due to Issue Summonses Today,” August 29, 2003.

158. Bangkok Post, "Klong Dan Wastewater Plant Scandal: Vatana, Nine Others Accused, Graft Report Names VIPs, Senior Officials," June 11, 2002; Bangkok Post, "Klong Dan Wastewater Plant, Pollution Dept. Under Fire Again: Cabinet Ignored, Blueprint Changed," June 20, 2003.
159. Bangkok Post, "Klong Dan Wastewater Plant: Police to Lay Charges against Consortium: Graft Case against Officials, Politicians," August 28, 2003.
160. Bangkok Post, "Klong Dan Wastewater Plant Scandal: Vatana, Nine Others Accused, Graft Report Names VIPs, Senior Officials," June 11, 2002; The Nation, "Making the Case for Graft at Klong Dan," July 18, 2003.
161. Bangkok Post, "The Pollution Control Department Wants Klong Dan to Go Ahead," March 31, 2005.
162. Bangkok Post, "Klong Dan to Go Ahead," May 12, 2005.
163. See ADB 2001b, p. 4.
164. This estimate is based upon expenditure of 95 percent of the estimated project cost of US \$687 million. See ADB 1998, p. 8.
165. Bangkok Post, "The Pollution Control Department Wants Klong Dan to Go Ahead," March 31, 2005.
166. These NPV and ERR calculations are based on project data provided by the Asian Development Bank (see ADB 1998). Following the ADB, we used constant 1998 prices and a conversion rate of 41 baht to the U.S. dollar, and assumed an operational life of the project of 50 years and a 10 percent economic cost of capital. We then adjusted ADB's schedule of costs and benefits to account for project delays, since the ADB assumed a starting date in 2001. In addition, our calculations assumed that (1) the fixed costs maintain the same schedule as in ADB's calculations, since the project is nearly complete; and (2) the variable costs and benefits will be realized in the same year after operations begin as projected in the original schedule (i.e., year 1 costs and benefits will be carried forward and realized in the first year of actual operations).
167. See ADB 2001b, pp. 13, 24.
168. See Pope 1999, p. 98; Klitgaard 1998, pp.3-6; Kaufman 1998, p. 144; Thomas et al. 2000, p. 165; Rose-Ackerman 1999, pp. 143, 162; Stapenhurst 2001, p. 1; and World Bank 2001.
169. See United States General Accounting Office 2000, p. 27.
170. See Klitgaard 1998, pp. 3-6.
171. See Johnston and Kpundeh 2002.
172. Except where specifically noted, this case study relies upon the work of the International Finance Corporation's Compliance Adviser/Ombudsman (CAO). The CAO is a quasi-independent office of the IFC that assists in addressing complaints by people affected by projects IFC finances. In response to complaints by local residents, the CAO attempted to mediate some of the conflicts around Yanacocha. See Compliance Adviser/Ombudsman of the International Finance Corporation 2001a, 2001b, 2005.
173. See *The Economist*, Feb 3, 2005.
174. See Newmont Mining Corporation 2005, p. 4.
175. See Compañía de Minas Buenaventura S.A.A. 2005, p. 27.
176. See Newmont Mining Corporation 2005, pp. 2-3.
177. See Perlez and Bergman 2005.
178. See Perlez and Bergman 2005.
179. See Newmont Mining Corporation 2005, p. 2 (based on 1.6 million equity ounces).
180. See Newmont Mining Corporation 2005, p. 4; Compañía de Minas Buenaventura S.A.A. 2005, p. 12.
181. See Kitco 2006a.
182. Interview with Rev. Marco Arana in Perlez and Bergman 2005.
183. See Perlez and Bergman 2005.
184. See Compliance Adviser/Ombudsman of the International Finance Corporation 2001b, p. 2.
185. See Compliance Adviser/Ombudsman of the International Finance Corporation 2001b, p. 2.
186. See Perlez and Bergman 2005.
187. See Koza 2004; Boyd 2003.
188. See Perlez and Bergman 2005.
189. See Boyd 2003.
190. See Boyd 2003.
191. Compliance Adviser/Ombudsman of the International Finance Corporation 2005, p. 6.
192. See Compañía de Minas Buenaventura S.A.A. 2005, p. 12.
193. See Koza 2004.
194. Peruvian Supreme Court (Tribunal Constitucional de Perú) Decision No. 300-2002-AA/TC decided on April 7, 2003 <http://www.tc.gob.pe/jurisprudencia/2003/00300-2002-AA%2000301-2002-AA%2000302-2002-AA.html> (Spanish only).
195. See Perlez and Bergman 2005.
196. See Riley and Griffin 2004.
197. See Bloomberg News, Nov 5, 2004.
198. See Perlez and Bergman 2005.
199. See Compañía de Minas Buenaventura S.A.A. 2005, p. 12.
200. Newmont Mining Corporation 2005, p. 3.
201. See Compañía de Minas Buenaventura S.A.A 2005, p. 27.
202. See Newmont Mining Corporation 2005, p. 3.
203. See Reuters, Aug 4, 2005b.
204. See Newmont Mining Corporation 2005, pp. 11-16.
205. See *The Economist*, Feb 3, 2005.
206. See Planet Ark, Nov 18, 2004.
207. See *The Economist*, Feb 3, 2005.
208. See Associated Press, Jan 20, 2005.
209. See Associated Press, Jan 20, 2005.
210. See Basel Committee on Banking Supervision 2004.
211. For a discussion of critical enabling conditions, see Colchester and MacKay 2004 and Rosenthal 2003.

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## ABOUT THE AUTHORS

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**Jonathan Sohn** is a Senior Associate in the Institutions and Governance Program and leads WRI's Financial Flows Objective. He works with commercial banks and public financial institutions to identify environmental and social risks and opportunities. Jon's career has focused on the environmental policies and risk management practices of financial institutions, with an emphasis on energy and climate change. His experience includes monitoring project finance deals in developing countries in the power and extractive industries sector, working with renewable energy companies for clean energy funding mechanisms and advocacy before the OECD, US government and a number of international financial institutions. Prior to working in the environmental NGO community, Jon was the Counsel and Environment/Labor Program Officer for the United States Overseas Private Investment Corporation (OPIC). His work with OPIC involved the establishment of environmental policies in consultation with industry and non-governmental organizations.

**Steven Herz** is a lawyer and independent consultant who advises civil society organizations on the environmental and social standards of international financial institutions, international environmental and human rights law, and sustainable development policy. Mr. Herz's recent publications include an analysis of the environmental and social policies of private-sector banks, an assessment of public participation in World Bank decision-making, and a critique of the Asia Development Bank's anti-corruption policy and its implementation. Mr. Herz previously worked as an international policy analyst at Friends of the Earth. He can be reached at [steve.herz@sbcglobal.net](mailto:steve.herz@sbcglobal.net)

**Antonio LaViña** is Dean of the Ateneo School of Government in the Philippines and Country Representative of Ashoka: Innovators for the Public. Previously, Mr. LaViña spent seven years as Senior Fellow and Director of the Biological Resources Program (now People and Ecosystems Program) at WRI. An environmental and human rights lawyer with a focus on governance, Tony led WRI's work on trade and agriculture, the impact of globalization on poor communities, genetic engineering and bio-safety, and environmental governance in Southeast Asia and China. Before joining WRI in 1998, Tony was an Environment Undersecretary of the Philippines, playing a critical role in getting the Philippines to recognize the land and ancestral domain rights of indigenous peoples and developing the concept of "social acceptability" as integral to environmental impact assessment. Tony was also Chief Negotiator for the Philippines in the implementation of the Conventions on Biological Diversity and Climate Change from 1996-1998 and was a key participant and spokesperson for developing countries in the negotiation of the Kyoto and Cartagena Protocols. Tony obtained his LLM and JSD from Yale Law School and his first degrees from universities in the Philippines. In 1988, straight from law school, he co-founded the Legal Rights and Natural Resources Center-Friends of the Earth Philippines, where he worked for seven years.

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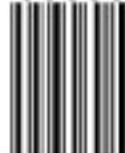
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10 G Street, NE  
Suite 800  
Washington, DC 20002  
[www.wri.org](http://www.wri.org)

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