

CMPA Submission: Extractive Sector Rehabilitation Bonds

Introduction

The foundation of the CMPA in 1999 was largely built on the egregious nature of rehabilitation bonds imposed on the industry at the time, and the financial pressure being placed upon industry participants with a rise in rehabilitation bonds from 1995 to 1999 of approximately \$5million to \$20.2 million. Now some 11 years down the track with rehabilitation bonds now approaching \$70 million, it seems little has changed.

The rehabilitation bond system was originally established to ensure that worked out licensed areas were left in a safe and stable condition and the financial risk to the community and environment was covered. It has become increasingly obvious to the CMPA that this original objective has expanded over time imposing unjustifiable costs upon the industry. Recent increases in the bonds for many CMPA members have destroyed their capital acquisition activities as the DPI-perceived liability has tied up assets in security for the bank guarantee. It is also creating a financial impediment for entry into the industry by new applicants.

It needs to be recognised early in this debate that there are many fundamental differences between the extractive and mining sectors. There is clear evidence that extractive sites which are terminal or unviable are acquired by others as they have further commercial life. This is supported by the limited number of calls on rehabilitation bonds being made by the DPI for the extractive sector since the inception of the EIDA in 1966. To then link the extractive industry is to the mining industry to justify the present rehabilitation bonds being placed upon them is neither accurate nor justified.

The question must be asked – why is the government nominating itself to be the final port of call to undertake the rehabilitation of extractive sites when the government has had no financial association or return with the activity throughout the site's life whilst there are many other parties who have had financial interests but who are presently not drawn to account (i.e. land owner/manager, and any others who have a vested financial interest)?

The CMPA is concerned that both its members and the government is tying up significant resources in managing, reviewing and negotiating the rehabilitation bond and there is no evidence that this process is delivering a cost efficient return to the community. The MRSDA presently has given the DPI powers to ensure that on-going rehabilitation occurs and that is where the risks should be managed.

The CMPA's is concerned that ever increasing and unpredictable rehabilitation bond are placing unsustainable financial pressures upon its members. Despite numerous studies conducted by Government and organisations such as the CMPA we still have not sorted out a system that is a win/win for all. To impose a system that currently ties up both bureaucratic systems and capital which could be used to upgrade plant equipment, to enhance a business and industry by employing more staff and generally benefit the community beggar's belief.

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Essential Points for Balanced Regulation

- Because a bank guarantee is regarded by a bank as a contingent liability of the business it reduces the holder's future access to credit. With recent spiralling bond levels, it may bring about the early failure of the business.
- Relinquishment of a Work Authority without completion of full rehabilitation is rare and over the last 20 years only 5 operations had their bond 'called in'.
- Despite this outstanding performance, over the 10 years to 2009 the value of rehabilitation bonds in the extractive industry has increased by 184% while the overall inflation rate was 43%.
- Five recent bond reviews have seen increases from \$480,000 to \$2,900,000 (504%); \$12,000 to \$78,000 (550%); \$95,000 to \$1,200,000 (1163%); \$12,000 to \$187,000 (1458%); and \$64,000 to \$1,021,000 (1495%).
- The Government spent \$18,000 of bond funds in rehabilitating the five sites over the last 20 years. However, in only the last 10 years there has been in aggregate \$420.7 million tied up in bonds or on average \$42.7 million pa.
- There appears no justification for the presently used bond system. The industry is being severely punished with this high-cost instrument despite having achieved an extraordinarily good rehabilitation record and leaving a very small environmental footprint.
- Bond levels are inconsistently applied and unpredictable.
- More targeted inspections would minimise any 'risk' to Government of un-rehabilitated sites.
- The payment of a bond should be payable when evidence of a risk is shown.
- The rehabilitation bond calculator is flawed as it presently picks up responsibilities that the government should not be held accountable for infrastructure (i.e. roads, water, sewage and power connection, buildings and dams) that remain when a site is depleted.
- The rehabilitation bond calculator is unwilling to recognise the financial value of the Work Authority
- Merging with the MRSDA has removed the availability of the insurance option for the extractive sector due to the now-open dated nature of the rehabilitation bond.

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The Present State of the Rehabilitation Bonds

Costs and charges

Rehabilitation bonds are payable as part of the Work Authority approval process. The bond provides an assessed level of funds to carry out any incomplete rehabilitation of the site when a Work Authority holder relinquishes responsibility for the site. That is, the bond system theoretically acts as insurance for the Government against the costs of rehabilitating failed sites.

The DPI requires that the rehabilitation bond be in the form of a bank guarantee. Bank guarantees provide surety to the Government that should an authority holder fail to meet the rehabilitation requirements funds will be available for the Government to undertake the rehabilitation required for that particular site. A bank typically requires security for a bank guarantee from either cash or property. For small extractive operations this often requires family assets to be offered as security and/or the holder or applicant to enter into a loan arrangement with the bank (i.e. a term deposit) to cover the amount of the required security.

Where land is offered as security, typically the bank will only provide surety for approximately 70% of the land value. That is, for a bond of \$100,000 the land value will need to be \$140,000. For holders who operate on leased land a mortgage over the lease can provide security, however this requires the landlord's agreement. In addition the bank will charge an annual service fee of between 2-6% depending on the level of exposure involved.

A bank guarantee is referred to as a 'contingent liability' and the level of the bond is regarded as a debt of the business. This reduces the holder's future access to credit and can be a catalyst for business failure. Ironically, the bank guarantee along with the annual costs of servicing it might have the effect of restricting funds of the business being devoted to fulfilling the rehabilitation plan and may bring about the early demise of the business.

Unreasonable response to good performance

Over the last ten years 110 Work Authorities have completed operations and the full bond has been returned to the holder. Relinquishment of a Work Authority without completion of full rehabilitation is rare and over the last 20 years only 5 operations were completed that involved calling on the bond. Over this period only \$18,000 was called on for rehabilitation purposes.

Notwithstanding this outstanding industry performance there has been a recent surge in the level of bonds following review.

Industry-wide bond adjustment effects

Table 2 shows the dollar value of rehabilitation bonds for the extractive industry in Victoria over the last 10 years (2000-2009). The raw data was accessed from the DPI website. The data shows over the period the value of rehabilitation bonds debt in the extractive industry has increased by 184%. The overall inflation rate for this period was 43%. The Table also aggregates the value of bonds over the period and adjusts this to account for bank charges and interest that would have been earned.

The question to be asked is: *How does the increase in the overall bond level reflect the Government's increased liability over this period when over this period less than \$18,000 has been called up for rehabilitation purposes? How was this change in risk determined?*

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Table 2 - Rehabilitation bonds in extractive industries (2000-2009) (\$ millions)

Year	Total bond \$ (Million)	Change (%) from previous year	Total Interest Foregone (\$)*
Jun-00	22.8	-	1.9
Jun-01	31.4	27.4	2.6
Jun-02	34.5	9.0	2.8
Jun-03	37.5	8.0	3.0
Jun-04	39.2	4.3	3.2
Jun-05	47.5	17.5	3.8
Jun-06	49.4	3.8	4.0
Jun-07	57.5	14.1	4.6
Jun-08	58.8	2.2	4.8
Jun-09	64.9	9.4	5.2

The MRSDA Act (s 83) allows the Minister to rehabilitate land that has been left in an un-rehabilitated state. It does not bestow an obligation on the Minister to rehabilitate land. Therefore, as at June 2009 a total of \$64.9 million had been locked up in case the Minister decided the Government should require some rehabilitation to be undertaken! Moreover, interest forgone by Work Authority holders on bank guaranteed bond money totalled \$35.4 million over the ten years when only \$18,000 was spent in rehabilitation! This is a completely unjustifiable waste of financial resources that benefits no one except the banking system.

Individual bond adjustments

Re-assessment of a bond level is undertaken by a DPI Mines Inspector and the italicised text in Box 1 repeats verbatim a letter recently received by a Work Authority holder. The effect on the Work Authority holder can only be imagined! It means the holder will need to obtain an additional bank guarantee for \$2.4 million above the existing bond level of \$480,000! The operator would have arranged his/her financial position around existing commitments and debt levels.

The impact of this re-assessed bond level is likely to be catastrophic for this small business. If the bank would give a further guarantee, and there are additional costs and charges associated with a re-calculated bank guarantee, it is unlikely that it would allow any increased contingent liability. This therefore severely limits the business' credit ability and is likely to therefore curtail any plans for further development of the site and may even limit funding of the rehabilitation plan. It is, however, more likely that the bank would not give the guarantee in this particular case and this would bring about the demise of the business and thus the loss of jobs, community access to the resources and possible closure of the work authority necessitating rehabilitation.

Box 1 - Letter from a Mines Inspector to a Work Authority holder, August 2010

I am writing to advise you of a proposed change to the bond for the above operation.

The current bond is \$480,000 and an increase of \$2,411,000 is proposed. The total revised bond would be \$2,900,000.

This assessment results from a review of the operation.

In accordance with section 80 of the Mineral Resources (Sustainable Development) Act 1990, before serving notice of a requirement for a further rehabilitation bond the Department must consult with the holder of the Work Authority.

Should you wish to comment on the bond assessment or discuss the matter further please contact me within 28 days of the date of this letter.

Signed by the Mines Inspector

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The above illustration is not an isolated case. A recent survey conducted by the Association of eighteen (18) Work Authority holders shows massive increases for several of the holders. Notable cases include increases of bond from \$95,000 to \$1,200,000, \$12,000 to \$187,000, \$64,000 to \$1,021,000. That is, the level of bonds for these five cases has risen by 1163%, 1458% and 1495% respectively. **Some of these will have a devastating impact for the business!**

Table 3 provides the detail of this survey. It also shows that almost half of the adjustments remain un-finalised and are subject to ‘negotiation’. That is, whilst a common formula and Bond Calculator is used there remains room for adjustment. While at one level this is positive it adds further uncertainty and illustrates that the system is far from precise.

Table 3 - Survey of Work Authority holders with recent bond reviews

Site	Bond last reviewed	Bond level	Initial bond level proposed by the DPI after review	Variation	Final bond level figure for which a bank guarantee was required
1	Apr-10	\$480,000	\$2,900,000	504%	Still negotiating
2	2005	\$40,000	\$116,000	190%	Still negotiating
3	2005	\$12,000	\$78,000	550%	Still negotiating
4	Feb-04	\$12,000	\$187,000	1458%	Still negotiating
5	Apr-10	\$8,500	\$42,500	400%	Still negotiating
6	Apr-06	\$233,000	\$592,000	154%	Still negotiating
7	2009	\$160,000	\$262,000	64%	\$236,000
8	2009	\$77,000	\$131,972	71%	\$130,000
9	2009	\$114,000	\$162,623	43%	\$114,000
10	2010	\$95,000	\$1,200,000	1163%	Still negotiating
11	Aug-10	\$120,000	\$170,000	42%	\$170,000
12	2010	\$80,000	\$380,000	375%	\$320,000
13	Jul-07	\$84,000	\$233,000	177%	\$123,000
14	Sep-10	\$140,000	\$810,000	479%	Still negotiating
15	2006	\$50,000	\$80,000	60%	\$80,000
16	Nov-01	\$50,000	\$134,000	168%	\$134,000
17	Apr-07	\$25,000	\$39,500	58%	\$39,500
18	2005	\$64,000	\$1,021,000	1495%	Still negotiating

Issues for the industry

Rationale for bonds

Box 2 provides a discussion of the rationale for bonds. It shows there is very little risk for the Government in extractive operations being left un-rehabilitated. The Government spent \$18,000 of bond funds in rehabilitating five sites over the last 20 years. However, from Table 2 in only the last 10 years there has been in aggregate \$462.7 million tied up in bonds or on average \$46.2 million pa.

Unpredictability

Notwithstanding the methodology and the Bond Calculator, the level of a bond following a review is unable to be predicted. It is like a lottery. It depends on the inspector involved. Evidence of this is seen in Table 3 where seven of the 18 bond assessments are still being negotiated. Because of this unpredictability, some Work Authority holders challenge a bond assessment. While this costs money in consultant’s/legal fees it can be successful. For example, one initial assessment was \$233,000 and following appeal it was set at \$123,000. However, most small operators do not have the resources to challenge the assessments. This illustrates how the system is inequitable.

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Unequal bond levels

Information from DPI's database shows that one operation that extracts 1.5-2m tonnes pa pays a \$2.4m bond while a smaller operation of 0.4m tonnes pa pays \$2.9m. While it is recognised that the bond system is based on the level of risk not production, clearly a small operation will have proportionately lower levels of risks than a larger producing operation. What then is the reason for this large discrepancy? It again points to an unequal system.

Box 2 - Rationale for the bond system -

No Government risk but massive burdens for industry - Punishment without a crime

Requiring a Work Authority holder to pay a rehabilitation bond provides insurance cover for the Government in case the extractive industry site which is the subject of a Work Authority is left un-rehabilitated. This occurs extremely rarely but might occur where the Work Authority holder has quit the property because either the site is no longer viable, has been exhausted or the material being extracted is no longer in demand. About half Work Authority's are on leased land (either Crown or private land) and a Work Authority holder may quit because the lease has not been renewed or there may be some dispute with the leaseor.

Irrespective of the reason for the site being abandoned, where the land is being leased it can be expected that any rehabilitation responsibility would pass to the owner of the land. After all, the landowner has agreed to the activity; has been rewarded for the arrangement by being paid rent and royalty payments; and understands the regulatory requirements for rehabilitation. That is, the landowner understands the risks.

The DPI therefore would have cause to pursue the landowner to rehabilitate the land. The local council may also have powers to pursue the landowner to rehabilitate the land under its own jurisdictional powers. These matters may be escalated to litigation where a Court may issue a direction.

If the Government considers immediate action is required, it could have the site rehabilitated at its own expense and pursue the landowner for the costs. The value of the land if sold may indemnify against these costs. **What then is the risk for the Government?**

In the case where the abandoned land is owned by the Work Authority holder, it can be expected that the only risk for the Government would occur where the site has been exhausted of its extractive material. That is, when there would be no interest to operate the site by another party. Given the very limited number of new Work Authority's being issued in recent years and the continuing 'sterilisation' of available land, it can be confidently anticipated that all vacated extractive sites would be closely examined for potential continued operation by other extractive operators or like activities.

Also, in the metropolitan area there is a high demand for 'air space'. Demand for solid inert space is valued at \$7-\$8/cu metre while for household waste it is approximately \$10/cu metre. That is, an un-rehabilitated extractive site of 1million cu metres can be expected to have value of between \$7-10 million.

Notwithstanding this, theoretically where a site is exhausted of its material and is abandoned without being rehabilitated the DPI would have cause to pursue the landowner for any rehabilitation. As before, the local council may also have cause to pursue and these matters may be finalised in a Court.

While Court action is not a preferred regulatory response, in the circumstances where there are negligible instances where sites are left in an un-rehabilitated state (5 in 20 years!) the value of the bond system is very questionable. The level of many bonds and their attendant debilitating costs for the operator is clearly unreasonable given there are no or very limited risks for the Government.

In addition, the Work Authority holder has an obligation for ongoing rehabilitation of the site as indicated and the DPI inspector should check for this progress. This process itself provides insurance for the Government.

Conclusion

There appears no justification for the presently used bond system. The industry is being severely punished with this high-cost instrument despite having achieved an extraordinarily good rehabilitation record and leaving a very small environmental footprint.

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More targeted inspections

The MRSDA Act gives inspectors wide-ranging powers over the industry to ensure compliance with Work Authority conditions including the rehabilitation plan. An inspector has power of entry, power to inspect and examine documents, require documents, seizure, take photographs, or take samples, issue a search warrant (authorised by a magistrate), require name and address and give a direction.

As the DPI encourages 'progressive rehabilitation' it is incumbent on the inspector to inspect ongoing compliance by the operator with the approved rehabilitation plan. The Act (s95D) requires the inspector to provide a report of any inspection of a site to the occupier. However, these reports do not cover progressive rehabilitation and assessment of the 'terminal face'.

The escalation in the level of bonds therefore reflects on:

- The inadequate supervision by DPI of 'progressive rehabilitation'; and
- A complete lack of understanding of the adequacy of the bond levels relative to the risk.

Were the reporting requirements on the inspector to include a detailed assessment of progressive rehabilitation including the level of expenditure incurred on rehabilitation over the period since the previous inspection (this shows the commitment by the holder), a better assessment of rehabilitation liability and therefore overall bond level should be made.

Payment of bonds

Payment of the bond is required as part of the approvals process. Until the site is working, why is it necessary to pay the bond and commence paying the associated bank charges up front? Many Work Authority's are created before production is required, some do not start working for 5 years. This is done for a variety of reasons including planning for future demands and planning for existing supplies to be exhausted. Given its unpredictability, proceeding through the Work Authority and planning approvals processes is a sound business practice. The payment of the bond should be left to when evidence of a risk is shown and the Work Authority commences operation.

Bond Calculator

The rehabilitation bond is the tool for managing the government's perceived financial risk. It is established from a recently developed generic calculator which picks up responsibilities that the government should not be held accountable for (such as removal of hard stand areas, plant and equipment, maintenance of fencing, pest animal and plant control etc). At the same time it is unwilling to recognise that there are financial values created as a result of the issued Work Authority and accompanying planning permit that a willing purchaser would pay for (i.e. remaining rock reserves, the generated airspace, the location with respect to the local community, and future potential planning flexibility). The existing calculator does not establish the future risk well.

Insurance

Under the EIDA the Minister had to return any unused portion of the bond as soon as possible after the end of a period of 6 years after the WA ceased. Under the MRSDA, the timeframe has been removed. This has had the undesired effect of limiting the ability of the industry to utilise an insurance scheme to cover this risk as the insurance market has problem with the open dated nature of the rehabilitation bonds.

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Essential points

- A bank guarantee is referred to as a ‘contingent liability’ and reduces the holder’s future access to credit.
- Relinquishment of a Work Authority without completion of full rehabilitation is rare and over the last 20 years only 5 operations had their bond ‘called in’.
- Over the 10 years (2000-2009) the value of rehabilitation bonds debt in the extractive industry has increased by 184% while the overall inflation rate was 43%.
- Five recent bond reviews have seen increases from \$480,000 to \$2,900,000 (504%); \$12,000 to \$78,000 (550%); \$95,000 to \$1,200,000 (1163%); \$12,000 to \$187,000 (1458%); and \$64,000 to \$1,021,000 (1495%).
- The Government spent \$18,000 of bond funds in rehabilitating five sites over the last 20 years. However, in only the last 10 years there has been in aggregate \$420.7 million tied up in bonds or on average \$42.7 million pa. There is no benefit to the State in tying up these funds.
- There appears no justification for the presently used bond system. The industry is being severely punished with this high-cost instrument despite having achieved an extraordinarily good rehabilitation record and leaving a very small environmental footprint.
- Bond levels are inconsistently applied and unpredictable.
- More targeted inspections would minimise any ‘risk’ to Government of un-rehabilitated sites.
- The payment of a bond should be left to when evidence of a risk is shown.
- The rehabilitation bond calculator is flawed as it presently picks up responsibilities that the government should not be held accountable for infrastructure (i.e. roads, water, sewage and power connection, buildings and dams) that remain when a site is depleted.
- The rehabilitation bond calculator is unwilling to recognise that the financial value of the Work Authority.
- Merging with the MRSDA has removed the availability of the insurance option for the extractive sector due to the now-open dated nature of the rehabilitation bond.

Proposed changes

The Association sees great benefit to both the government and the industry if the following three conclusions were brought forward as key discussion points and a definitive position established by the government for the extractive sector before any further decisions are made.

1. The land owner/manager needs to be jointly accountable with the Work Authority holder for rehabilitation risks, thereby lowering the risk upon the government
2. The assessment tool should be restricted to ensuring the site is left in a safe and stable condition
3. The value of the site with respect to rock reserves, generated airspace, position, and permits held should also be taken into consideration within the assessment tool as offsets

In conclusion, the CMPA sees this ever increasing and unpredictable rehabilitation bond in its present format placing unsustainable financial pressures upon its members. Despite numerous studies conducted by Government and organisations such as the CMPA we still have not sorted out a system that is a win/win for all. To impose a system that currently ties up both bureaucratic systems and capital which could be used to upgrade plant equipment, to enhance a business by employing more staff and generally benefit the community beggar’s belief.