Mining Toromocho and Resettling Morococha

Introduction

A State of Emergency

It's August 2013, and the Mining and Metallurgical Geological Institute of Peru (INGEMMET) is considering issuance of a report declaring the Morococha district a high-risk zone. Purportedly, the area is threatened by geological hazard from potential mass movements, landslides, and rock falls due to seismic vibrations generated by detonations in the nearby Toromocho copper mine, operated by Chinalco Mining Corporation International (Chinalco International). Such a declaration would likely prompt an executive order, signed by the nation's president Ollanta Humala, calling for a state of emergency and evacuation of the native population. The order would be enforced by the Institute of Peruvian National Civil Defense (INDECI). <u>A declaration of hazard would give legitimacy to government efforts to clear residents from the area in order to allow smooth development of the mine, yet it would risk causing violent confrontation with the very people it would be supposedly designed to protect.</u>

The Tradeoffs

Susana Vilca, president of INGEMMET, knows that issuance of the declaration could carry a high social cost. Morococha is currently inhabited by about 300 families who refuse relocation to the nearby New Town of Morococha, the site to which Chinalco International has been moving residents of the old town since late 2012. Morocochans resisting relocation express dissatisfaction with the location and conditions of the new town, in addition to an allegedly unfair resettlement process. Vilca must consider local reaction to the probable evacuation order that would follow a hazard report by INGEMMET, and the possibility of carrying out evacuation without causing social unrest. A violent encounter between inhabitants of Morococha and the INDECI would be disastrous. Morocochans are not reputedly violent. Yet they are not reticent.

Antonio Mena conducted interviews and prepared this case under the supervision of Francis Fukuyama of Stanford University. *This case was developed solely as a basis for class discussion. It is not intended to serve as a historical record, a source of primary data, or an illustration of effective or ineffective management.*

They have continually expressed frustration and refused compliance with the resettlement process. The international press is closely monitoring events. What was supposed to become the baseline for Latin American community resettlements is now mired in corruption, violence, and accusations of human rights violations.

Allowing delay of the resettlement, on the other hand, could have serious economic and political repercussions for Humala's administration, of which Susana Vilca is a supporter. In fact, Vilca belongs to the Peruvian Nationalist Party, founded and led by the president himself. About two weeks ago, Humala publicly expressed concern at the stark decline in mining royalties and new mining investments,[1] attributing decline not only to informal and illegal mining, but also to the recent increase in registered social conflicts that hinder development of several mining projects. Humala's administration, by contrast, advocates promotion of a favorable and competitive environment for Foreign Direct Investment (FDI). To maintain Peru's rapid growth, Humala hopes to promote exploration and extraction activities in the mining industry. The government's inability to facilitate smooth operation of Chinalco International, a special purpose vehicle created for the exploitation of Toromocho, may signal a weak investment environment and lead to further deferrals of FDI in the Peruvian economy as well as a decline in economically crucial mining activity (Appendix A).

Underlying Drivers

The development of Toromocho is currently on schedule and, since mining operations would not affect the town of Morococha until seven years after commencement of production, completion of resettlement is not essential to the start of commercial production. However, failure to conclude the resettlement is a looming problem. If additional resistance arises in the local community, protests and violence could follow, resulting in delays or prompting a government halt to activities.

The Environment

Political and Socio-Economic Trends

The federal government of Peru is made up of three separate branches as established in the country's political constitution: an executive, a legislative, and a judicial branch. The executive branch is elected by popular vote every five years. The most recent elections were held in June 2011 when Ollanta Humala took office. Non-consecutive re-election is permitted under current law.

Peru's population is roughly 30 million, of which approximately 28% resides in Lima, the country's capital. The Peruvian currency is the Nuevo Sol; under Humala's tenure, it initially showed a short but significant period of appreciation, propelled by strong domestic demand and increased expectation of foreign investment. The initial rally, however, was offset during the following two years as capital inflows and FDI in Peru waned.

Nonetheless, Peru has advanced significantly in macroeconomic performance over the past few years. The GDP has grown by an average of 5.6% from 2009 to 2013.[2] This high growth (and low inflation) environment is primarily driven by an investor-friendly market, rising domestic consumption, and the government's aggressive strategy of trade liberalization.

Although Peru's rapid economic development has enabled a reduction in the poverty level (as calculated by domestic standards) from 58.7% in 2004 to 23.9% in 2013, the benefits of economic growth have gone mostly to urban and coastal Peruvian communities, bypassing Afro-Peruvian, indigenous, native, and poor populations in the mountain regions. Although Ollanta Humala's campaign strongly championed a more equitable distribution of mining royalties as well as social inclusion, these goals have not been achieved. Data from the World Bank shows that wealth distribution in Peru has worsened since he took office.[3] Not all Peruvians have enjoyed the benefit of growth.

The country's growth is also constrained by its poor infrastructure, most particularly its underdeveloped transport network. A known precondition for realization of Peru's full economic potential is an efficient means of connecting businesses and communities and allowing goods and services to move across large geographic regions. Susana Vilca understands Toromocho's importance for the country, as the mine is commonly seen as synonymous with ancillary infrastructure spending by Chinalco International. In fact, the project includes additions of new power lines, state highway expansions, state railway improvements, and major investments in the Port of Calloa, a major sea port.

The Mining Industry and Peru's Mineral Wealth

Peru is a leader in global mining. It is the second-largest copper producer in the world, and the third-largest producer of silver, tin, and zinc. Dating back to the pre-Columbian era, its mining tradition has helped the country develop a dynamic and capable mining community. Peruvian mineral wealth is well recognized. It has 13% of the world's copper reserves and 22% of the silver. Although Peru has several mineralized belts and provinces, and a wide variety of ore deposits, it is estimated that only a fraction of the country's territory has been explored. In that sense, the country's production is minimal compared to potential rates. Furthermore, with easy freight access to both Asian and North American markets, Peru's location is favorable for trade and transportation of commodities.

Mining is the country's primary economic sector, accounting for nearly 14% of GDP and approximately 60% of exports. China is its leading export partner in mining, receiving 26% of Peru's mining exports. (Copper makes up about 43% of these products). Revenue from mining exports totaled US $25 billion in 2012,[4] and mining also attracts the most Foreign Direct Investment.[5] Last year, FDI in Peru reached a total of US $12.24 billion, with mining representing the main share (24%). Peruvian officials are well aware that FDI in mining is showing downward trends, threatening to depress economic growth (Appendix B). Consequently, Humala's administration is under pressure to stimulate and promote mining projects.

Mineral activities, the backbone of Peru's economy, accounted for over half of national Corporate Income Tax revenue between 2007 and 2010. Mining is the fundamental source of fiscal revenue, and in spite of its tendency to be capital-intensive relative to other types of investment, mining also creates numerous sources of ancillary revenue for the Peruvian population and contributes to the creation of thousands of jobs. The integration of mining with other sectors of the national economy is important and inevitable. The Peruvian Institute of

Economics recently stated that for every billion of exports in the mining industry, a billion and a half of additional economic activity is generated in other industries.

Toromocho is a project of particular importance, even if considered in isolation. The project is expected to contribute to the Humala's administration's revenue with over US $200 million per year in Corporate Income Tax alone, plus an additional US $80 million in other mining royalties.[6] If Toromocho goes into full operation, tax revenue from the mine could constitute as much as 15% of the total fiscal collection from mining activities in the future. Peruvian officials realize that delaying full operation of Chinalco International in Toromocho may take an important toll on their administration's finances and on the country's economic outlook for the upcoming years.

The Concession System in Peru

Natural resources, including all subsurface resources, renewables and non-renewables, are property of the Peruvian State. The private sector, however, may exploit those resources under Peru's concession system. The right to explore, process, trade, or produce minerals in Peru is granted by the government through INGEMMET, directed by Vilca. A Mining Concession grants the right to exploit existing mineral deposits in a specific area ranging from 100 to 1,000 hectares. However, the mineral deposit is separate "real estate" from the land surface above it. In fact, the concession law explicitly excludes both ownership and occupancy rights to the land or territory where the concession is located. It is the concessionaire's responsibility to secure lawful ownership or occupancy rights (through private agreements with the land owners) above the area of its concession.

Concessions are granted indefinitely and irrevocably, as long as the concession holder complies with all legal obligations. Under the General Mining Law, concession holders are required to comply with several obligations, such as the payment of a US $3/hectare validity fee to INGEMMET and achievement of an annual minimum target of production.

Social License to Operate and the Law of Prior Consultation

Achieving a social license to operate is commonly cited as the single most important challenge faced by the mining industry in Peru. In recent years, several mining mega-projects have been postponed because of environmental concerns, community protests, or labor strikes. According to a study published by "*Defensoría del Pueblo,*" a prominent Non-Governmental Organization (NGO) protecting citizen rights, the number of registered socio-environmental conflicts in Peru grew from 23 in 2007 to 149 in 2012. Among the most commonly identified sources of conflict were: (1) the population's fear and uncertainty concerning potential pollution and (2) the native population's perception of exclusion and discrimination, and their belief that the profit margins of private mining companies are unfair. The keys to achieving and maintaining social license to operate are transparent communication, social responsibility, and implementation of systems for sharing the benefits of operations. Community support is closely tied to regional economic participation and inclusion.

In this regard, President Humala promulgated Law No. 29785 as one of his first actions related to mining. The law was ratified in the Peruvian legal system as the International Labor Organization Convention (ILO) No. 169, requiring a prior consultation procedure with indigenous and tribal populations on any administrative procedure (e.g. a mining concession) directly or indirectly affecting them.

Mining Taxes, Duties, and Royalties

Formerly, holders of Peruvian concessions were required to pay the government an annual royalty based on a percentage of the project's "mineral concentrated value" (ranging from 1% to 3%). However, Humala has made numerous changes and amendments to the mining royalty requirements in his two years as president, changes consistent with his campaign promises to levy more aggressive taxes on the mining sector and distribute the proceeds in a more equitable manner. On October 1, 2011, he enacted Law No. 29788, stating that mining royalties would henceforth be based on a company's quarterly operating income, applying an effective rate that ranges from 1% to 12%. In addition, Humala championed and approved the creation of a "Special Mining Burden," adding a tax levy of 4% to 13.12% on a company's quarterly operating income. These new regimes were accompanied by provisions of inapplicability for projects for which stability agreements between the concessionaire and INGEMMET had already been reached.

Industry Overview

Copper Value Chain

Copper, an industrial metal used in various industries, is a soft, malleable, and ductile material with very high thermal and electrical conductivity. The copper production process consists primarily of mining and extraction. Open-pit mining, as in Toromocho, requires less capital expenditure and is less risky than underground mining. Although copper is specifically found in both sulfide and oxide based ores, nearly 80% of the world's current copper output is extracted from sulfide-based ores through a process known as "pyromettalurgical extraction." During this process, ores are crushed, ground, and concentrated to produce a concentrate that typically contains about 30% copper, the *copper concentrate.* Subsequently, the copper concentrate is fed into a smelter to produce another commodity known as *blister copper,* which contains approximately 98% copper. Blister copper is then refined using an electrolytic process to produce a copper cathode or *refined copper,* the common copper commodity traded in international markets.

Supply and Demand of Copper

Ollanta Humala understands that the Toromocho project is potentially an economic bonanza both for Peru and for Chinalco International. The macroeconomic trends for copper appear to be in favor of the mine.

Globally, during the past two years (2011-2013), the electrical and electronic appliance industry, together with the building construction industry, accounted for 31% and 25% respectively of refined copper consumption. Growth of both these industries, along with demand for refined copper, is expected to continue at least through 2016 at a Compounded Annual Growth Rate (CAGR) of 4.4%, according to CRU Group, a leading global metals consultant retained by Chinalco International.[7] On the supply side, global production of refined copper grew at a CAGR of only 2.4% during the preceding years of slowdowns in new project development that resulted from the global financial crisis. Global supply for refined copper, however, is expected to increase to about 5.7% CAGR through 2016.

China's refined copper consumption, driven mainly by domestic housing and infrastructure construction, accounted for roughly 39% of global consumption. Chinese demand is expected to continue through 2016, making China the world's leading consumer of refined copper in the world, an outlook particularly significant for Toromocho. Chinalco International's close ties to the Chinese market and its extensive distribution networks throughout China enable strong business relationships that can be leveraged to ensure project profitability.

On a similar note, recent studies of the Chinese economy show current shortfalls in the domestic supply of copper concentrates and heavy reliance on imports from trading partners in order to meet demand. China clearly realizes that it must look overseas for a stable supply of copper. In fact, imported copper concentrate from Peru to China grew at a CAGR of 14.3% from 2006 to 2015; at the same time, Peru ran a trade deficit with China due to a high level of manufactured imports. This trade situation exemplifies the commonly criticized Chinese Development Strategy: capital-intensive investments are made in commodities and extractive industries (as well as in the infrastructure needed to move exports to China) by the PRC in Latin American countries like Peru, while China floods these markets with more expensive, value-added products. China's adherence to western developmental standards in economic, social, and environmental realms continues to be questionable.

Copper Pricing

The London Metal Exchange (LME) is one of the main metal markets in the world and normally sets the benchmark prices for refined copper. Copper prices plunged in 2008 as a result of the global financial crisis (Appendix C) but have since recovered, even reaching historically high levels when Humala took office. The rise in copper price was primarily driven by demand from growth in emerging markets.

In the short term, copper consumption is expected to outpace supply at least for the next couple of years. In contrast, it is expected that as new projects are approved in late 2015, a sizable trade surplus will develop. On a longer horizon, however, CRU suggests several factors that will preclude global copper production from meeting demand: nationalism in relation to global resources; environmental movements; an increasing number of social conflicts; and rising capital costs (Appendix D). This outlook benefits long-term copper prices and the economic prospects of Toromocho.

Chinese Activities in Peru's Mining Industry

China is Peru's largest foreign investor. Although difficult to trace precisely, the magnitude of Chinese FDI is estimated at about an annual $2 billion by Peruvian authorities. Chinese investments have traditionally concentrated on extractive industries such as minerals, fisheries, and hydrocarbons. Primary production of copper, in contrast to mining of iron and gold, has not seen extensive Chinese activity. Chinese-owned enterprises—both public and private—have been diligent at tendering copper concessions in Peru since 1992, yet none of these have progressed beyond exploratory work. Toromocho would be the first Chinese-backed copper mine to operate in Peru. This fact further pressures the Humala administration to facilitate Chinalco International's operation. The country is expected to see a pipeline of copper projects worth up to $40 billion by 2020. Chinese firms' strong balance sheets, in addition to their capacity to commit long-term financial resources, render China an important partner in achievement of Peruvian plans to incentivize the mining industry.

The Deal

Toromocho Economics

Located in Central Peru, the Toromocho Project belongs to the Morococha district of the Yauli Province, approximately 80 miles east of the country's capital (Appendix E). According to a report by the CRU Group, deposits in the Toromocho project are estimated to contain 7.3 million tons of refined copper, as well as 290,000 tons of molybdenum and 10,500 tons of silver. The Toromocho project has an estimated mine-life of 36 years. Actual ore production is expected to last for the first 32, while the last four years will be used to process recovered ores. A technical report prepared by Behre Dolbear for Chinalco International (hereafter termed the Competent Person's Report[8]) also suggests that the project might have additional minable resources within surrounding lands of the planned mining pit, estimated to contain at least an additional 2.7

million tons of refined copper. The project is easily accessible through existing transportation networks, such as paved central highways and railway networks, to the major export port of Callao.

The economics of the project look promising. Based on estimates by the Competent Person's Report, the total capital costs of the project will amount to US $3.5 billion, and the average annual operating expenses to about US $444 million. Chinalco International plans to produce approximately 865,000 tons of copper concentrate per year (about 200,000 tons of refined copper), which, according to cash flow projections shown in the report prepared by Behre Dolbear, will translate to an average annual revenue of around US $1.3 billion upon project stabilization. Net cash flows from operations—shown in detail in the same report—suggest that Chinalco International is looking at a project with an Internal Rate of Return (IRR) of 20%. Toromocho will be highly profitable for Chinalco International, and the Morocochans realize this. The potential of high profits opens up old social wounds within the native population. Morocochans feel they are not sharing in the value generated by their lands. Some even claim to have received below-market compensation for their properties during the resettlement process. Above all, they repeatedly and clearly protest that Chinalco International must not be the only party benefiting from Toromocho. "We all have to gain something,"[9] says a former inhabitant of Morococha.

A Closer Look at Chinalco International

In April 2003, Peru Copper Syndicate Ltd. (the entity that would eventually become Chinalco International), was incorporated in the Cayman Islands as an exempted company with limited liability for the sole purpose of bidding for the Toromocho Option Contract. In May 2003, the Company was awarded the bid and entered into an Option Contract with CENTROMIN, a Peruvian state-owned mining company and the holder of the Toromocho mining concessions.[10]

A year after being assigned the bid, each of the company's private shareholders transferred their entire shareholdings to Peru Copper Inc., a publicly traded company in the Toronto Stock Exchange. Canada BC Holdings, a wholly owned subsidiary of Chinalco (state-owned Chinese Company), made a tender to buy all the issued and outstanding common shares of Peru Copper in 2008. The offer was unanimously recommended by the Board of Directors of Peru Copper

Inc. Subsequently, Canada BC Holdings transferred its entire shareholding to Chinalco Overseas (COH)—a wholly owned subsidiary of Chinalco.

This series of transactions caused significant controversy in Peru, particularly among regional and local leaders, due to the fact that Peru Copper Inc. was not required to pay capital gains taxes on the transfer of their shares, (pursuant to current tax laws in Peru at the time). Nonetheless, the sale was perceived as unfair, contrary to national interest, and inequitable to the local population. For a full corporate organizational chart of Chinalco International, see Appendix G.

Chinalco International Subsidiaries

Chinalco Peru was incorporated in May 2003, with the corporate purpose of managing the construction and start-up of the Toromocho mine. The incorporation of a local subsidiary by Chinalco International to take on the riskier phases of Toromocho development could be viewed as an effort to distance itself from allegations of abuse and environmental damage, or even as an established strategy of defense against potential litigation in Peruvian courts.

As means to the full exploitation and development of Toromocho, Chinalco Peru made a number of important acquisitions and equity investments in Peruvian companies that owned mining concessions. On October of 2006, Chinalco International acquired the company Centenario, a Peruvian mining company that owned fourteen mining concessions in Toromocho grounds. In 2011, Chinalco International acquired stakes in the company Pesares, a Peruvian mining enterprise that owned three mining concessions essential for the Toromocho project. Chinalco International also helped establish three additional companies of which they took ownership: Cal del Centro, Transportadora Callao, and Pomacocha Power. Transportadora Callao became the selected concessionaire for the design, construction, and operation of a specialized transfer conveyor belt, a ship loading facility, and a dock for mineral concentrates located in the Callao Port. Pomacocha Power was designed for the purpose of constructing power transmission lines that connect the Toromocho mine to the main grid. As of 2013, Chinalco International reports close to 466 full-time employees based in Peru, more than 80% of whom are Peruvian citizens.

Option Contract Details

Chinalco International was allegedly selected as the holder of the option contract upon winning the "International Public Bidding" process (PRI-079-2003) organized by the Private Investment Promotion Agency of Peru (PROINVERSION). Details of the public bid, however, are scant. Upon Chinalco's exercising the Option Contract and meeting certain stipulated conditions satisfactorily, CENTROMIN would transfer the Toromocho project concessions, land ownership, buildings, and water rights to Chinalco International. Among the lands included in the ownership agreement were "Lots 2A and 2B Pucará," where Morococha is located (Appendix F). The transfer included both surface and subsurface rights. The option contract evidences that from the outset, both Chinalco International and the Peruvian State knew that full exploitation of Toromocho would require resettlement of the adjoining town of Morococha. No record of a prior consultation with local residents was found before completion of the option contract between INGEMMET and Chinalco International.

The original term for exercising the option was one year. Nonetheless, the contract stipulates that the term may be renewed yearly for up to five consecutive years, during which the activities of the option holder are limited to exploration and technical studies. To execute the option, Chinalco International must sustain the fulfillment of certain technical and financial requirements, as well as presenting a feasibility study. The feasibility study must specify a minimum investment requirement, determined by a third party, for economic development of the Toromocho concessions. Chinalco International would subsequently agree to invest at least 70% of the third-party-determined amount during the first five years of the project.

Upon exercise of the option, Chinalco International would be obliged to pay CENTROMIN a mining royalty based on a percentage of net sales. This biannual fee would be based on the average copper price (according to the LME) during the six months when the sales took place, and would be calculated as follows:

- For a copper price below US $0.8 per pound, a 0.51% royalty (which would be the minimum biannual royalty).
- For a copper price between US $0.8 and US $1.1 per pound, a royalty based on the following formula: [4 x Copper Price] (%) – 2.69%.

- For a copper price above US $1.1 per pound, a 1.71% royalty.

The contract also stipulates that the payments, once the option is exercised and the project is operating, will not be inferior to 70% of the royalties forecast in the production schedule of the feasibility study.

Finally, Chinalco International would commit two create two social and environmental funds. The first would require an initial payment of US $1 million and be destined for remediation of the environment. The second would require an initial payment of the same amount, but also include biannual payments of US $100 thousand upon the start of operations. The latter monies would be applied to social infrastructure, improvement of the economic environment surrounding the concession, and financing of community support programs.

A Loan from Chinese EXIM Bank and the Execution of the Option

On April 7, 2008, Chinalco International exercised the option to acquire the rights of Toromocho's mining concessions. Under the transfer agreement, they committed to investing no less than US $1.5 billion over the first five years. On December 10, 2010, in order to fund the development of the project and to comply with the investment commitments, Chinalco International and the Export-Import Bank of China (EXIMbank) executed an unconditional loan agreement under which EXIMbank committed to Chinalco International a loan facility of US $2 billion on a 15-year term. The banking facility was structured on an adjustable-rate mortgage basis, with an annual interest rate of 6-month LIBOR plus 1.85% spread. Chinalco International is also required to pay a 1% commission fee for each drawdown. The covenants in the loan agreement stipulate that the facility is secured by all property, plant, and equipment pertaining to the Toromocho project should Chinalco International's financial standing deteriorate. The unconditional loan raised concern in the international press, which questioned whether the Chinese multinational could have raised the monies so quickly had the conditionality of funds been subject to western standards. After all, Toromocho's feasibility should be subject to the successful relocation of the town currently sitting above the planned mining pit. Local leaders worried that China's unconditional aid could undermine the rights of the Morocochan population that must be relocated.

Over the following years, Chinalco International secured additional credit facilities with China Development Bank for an aggregate US $118 million, bearing a six-month LIBOR plus a 3.5% interest rate spread over a ten-year term. In March 2013, the EXIM bank chipped in with an additional US $419 million loan facility, this time bearing an interest rate of LIBOR plus a 3.5% spread per annum and the same commission fee for each drawdown. In 2013, Chinalco International raised US $362 million by selling 15% of the company equity in the Hong Kong Stock Exchange.

Commercial Structures

Chinalco International intends to leverage its close ties to the Chinese market and its distribution network to trade the commodities produced by the project. In fact, the Aluminum Corporation of China (Chinalco), a state-owned enterprise of the People's Republic of China, agreed to partner with Chinalco International and become its core platform for the future acquisition, investment, development, and operation of non-ferrous and non-aluminum mineral resources, even providing a non-competition agreement in favor of Chinalco International's core business.

Additionally, Chinalco International entered into four binding offtake agreements committing 60% of the project's production of copper concentrates. These agreements have definitive pricing terms reflecting a mechanism typical of the copper industry, as a percentage of the LME benchmark price. The initial term of the offtake agreements is five years, but the agreements include stipulations for renewal. The largest off-taker is Trafigura Beheer BV, a multinational Singaporean commodity trading company that owns the rights to 25% of the production. Following Trafigura, both Tongling Group and Hongfan International (the two have close ties to China) have ownership of production rights for 15% and 10% respectively. The contract currency is US dollars. Chinalco International has not entered into any binding offtake agreement with Chinalco.

New Tax Requirements for Chinalco International

In theory, holders of mining concessions may enter into "Stability Agreements" with INGEMMET to freeze tax, royalty, and regulatory regime stipulations in the face of changing statutory requirements in the mining arena. Chinalco International entered into a stability agreement with INGEMMET in 2009, under which a tax and royalty regime was defined. Shortly after taking office, President Humala, as noted earlier, made important changes to the mining royalty stipulations, notably including the creation of a “Special Mining Burden” tax—designed to share the economic bonanza of mining activity with local communities. Historically, Chinalco International has cooperated with Peruvian officials regarding these new mining regimes. In 2011, the company voluntarily undertook to make the special mining contribution and enter the new—considerably higher—royalty framework.

The Resettlement of Morococha

Social Capital Group

The resettlement of Morococha, a town of 5,000 inhabitants within the planned mining pit, has so far been one of the most problematic facets of the project for Chinalco International and Humala’s administration. Yet the need for the resettlement was undoubtedly clear to both parties at the time the concession was granted.

Morococha—by objective standards—was a town with precarious social, environmental, and infrastructural conditions. Fewer than half of the households were equipped with potable water or sanitation facilities. Communal water stations were reportedly contaminated with heavy metals to an extent unfit for human consumption. Education levels were alarmingly low, with over 47% of the population having completed only basic education. Eager to share the benefits of the Toromocho project, Morocochans originally welcomed Chinalco.

In 2006, Chinalco engaged Social Capital Group (SCG), an international consulting firm that specializes in social issues and risks associated with private investments, to manage the resettlement of Morococha. According to the Environmental Impact Assessment (EIA) prepared by Knight Piesold Consulting for Chinalco International, SCG first conducted a baseline survey to determine who qualified as a resident of Morococha.[11] (The town had a large itinerant population of mining workers, making it difficult to determine residency.) Following the survey, SCG reportedly organized and held meetings, and conducted surveys to determine Morocochans’ willingness to resettle. The results ostensibly showed a relatively high acceptance rate of 72% in favor of moving to a new town, while 8% were indifferent and another 9% opposed.

Theoretically, Chinalco International would choose the location of the New Town of Morococha—and the resettlement strategy—based on the work done by SCG. The consulting group reports that in 2009 they organized community workshops, conducted house visits, and ensured participation of all Morocochans. Reportedly, SCG went above and beyond expectations during the process, even offering child care services for mothers wanting to attend day workshops. SCG reported that out of the 848 inhabitants attending the workshops, 69% showed preference for Carhuacoto as the location of the New Town of Morococha.

In the meantime, since 2008, Marcial Salome, then mayor of Morococha, had been calling for the establishment of a dialogue table to negotiate terms—including the location—for the resettlement of Morococha. It was not until April 2010, however, that the Dialogue Table for the Resettlement of Morococha (DTRM) was officially recognized by Peruvian authorities in Ministerial Resolution No. 131-2012-PCM. (Dialogue tables are a common mechanism in Peru to bring together actors in the public, private, and social arena in order to provide a formal space for negotiation and dialogue.) The work of the DTRM was initially well received. They engaged a well-respected NGO, the Roundtable for the Fight Against Poverty, as the dialogue table leader. The group selected and engaged eleven civil organizations of Morococha in a lengthy process that lasted through 2012.

Despite an apparently well-planned strategy, the DTRM faced harsh criticism. Mayor Salome suddenly pulled out of the DTRM, accusing its members of misrepresenting the true intentions of Morocochan inhabitants. Mayor Salome insisted that the process was biased in favor of Chinalco International. The mayor charged that before the DTRM had reached a formal agreement with Morococha, Chinalco International had already decided to locate the New Town in Carhuacoto, allegedly based on the work done by SCG. Morocochans felt cheated. Not only do they contend they had no voice in the selection of the location, they are unhappy with the location itself. The area is considered a wetland and some are worried about the humidity of the environment. The Morococha area remains politically unstable, with formation of several groups opposing Chinalco International.

Social Unrest

Chinalco International finished construction work for the new town in the third quarter of 2012. The company gave all property owners (of the physical facilities, since the land was owned by Chinalco International) and renters with at least one year of proven residency the right to own a house in the New Town of Morococha. As additional compensation, Chinalco International provided property owners with adequate financial compensation for the value of their homes. The New Town of Morococha features—apart from the new homes—contemporary educational, healthcare, and public administration facilities. Objectively viewed, the new environment represents conspicuous improvement (Appendix G).

Amid accusations of unfairness, corruption, favoritism, and abuse, the resettlement process began in the fourth quarter of 2012 when 75% of the beneficiaries voluntarily moved. During the next quarter, another 15% of the beneficiaries moved. The remaining 10%, however, resist leaving Morococha, insisting they need more than just a new town. They want compensation for the loss of their town's history and a formal long-term commitment from Chinalco International securing services, jobs, and social benefits for residents of the New Town of Morococha. Led by the mayor, the opposition demands acknowledgment of a document they call the "Unified Framework Agreement (UFA)," an adjusted version of the agreement that was to have been produced by the DTRM upon completion of its work. Chinalco International has dismissed Salome's UFA, refusing to acknowledge its legitimacy.

Social conflicts are pervasive in the Morococha region during the following months. The opposition groups organize protests not only in the outskirts of the Toromocho project, but also outside the Chinese embassy, and outside Humala's office in Lima. They repeat claims of favoritism in the selection of beneficiaries,[12] and of poorly built and overly small houses. They emphasize the undesirable location of the New Town of Morococha in an area with geological and environmental problems, including excessive humidity. The general perception of Chinalco International is of intransigence and insensitivity. The remaining 10% who refuse to leave Morococha claim that the resettlement process was unfair, skewed in favor of Chinalco International.

A Choice Never Given

Morocochans' feelings are neither baseless nor unreasonable. In reality, Chinalco International one-sidedly chose the location of the New Town of Morococha. The company bought the lot at Carhuacoto in December 2008, four months before the sessions organized by SCG were held. (It was during these SCG sessions that the location of the New Town of Morococha was to have been designated). Construction of the new town commenced at the same time as official recognition of the DTRM. The Morocochans could witness Chinalco International's insincerity simply by looking at the construction work underway down the road.

Chinalco International did not follow the International Labor Organization (ILO) Convention 169 in establishing a prior consultation procedure with indigenous populations whose collective rights may be affected by administrative procedures. Although the convention was not formally included in Peruvian law until 2011, it had been fully subscribed in the Peruvian Constitution since 1994, and valid since 1995. Existing precedents[13] make clear that the absence of specific regulation in Peruvian law (i.e. Law No. 29785 in 2011) cannot be a valid argument for its inapplicability.

Throughout the process, however, Chinalco International has maintained that the activities have not impacted any indigenous communities, since Morococha dwellers are simply peasants engaged in mining. While Chinalco International's argument may have validity from a strictly legal perspective, negating the native and indigenous component of Morococha is absurd. Former Morococha inhabitants could be easily observed as sharing cultural behaviors, festivities, diet, educational backgrounds, and ways of living typical of indigenous communities in Latin America.

An additional worrying factor in the location of the New Town of Morococha is contamination of the soil, both apparent and documented. Levels of arsenic and lead levels in the resettlement area are reportedly well beyond what is deemed appropriate for residential use.[14] A well-respected news source has published reconstructed arsenic and lead concentration maps (Appendix H), based on data from soil testing stations and published in the publicly available project EIA. The data shows that inhabitants of the New Town of Morococha are threatened by arsenic and lead levels eight to ten times the allowed limits.

The Decision

Susana Vilca is well aware that the Toromocho project is economically crucial for her political party and for the country's president. Full exploitation of the mine could account for as much as 1% of the country's GDP in the years to come. Peru hopes to maintain its economic growth, and to do so, leaders must display a business climate strongly favorable to investment. Chinalco International aims at smooth production activities in the Toromocho mine. Although the footprint of the mining pit will not swallow Morococha until year eight of operations, the presence of residents in Morococha impedes seamless operations—and places civil society at risk. Protests and bad press further exacerbate the situation.

What price are Peruvian officials willing to pay for Toromocho's bounty? Should Vilca ignore the will of Morocochans who refuse to leave their town and prompt Humala to declare a state of emergency? Or should she seek that Chinalco International halt operations until a full resettlement is negotiated?

Endnotes

[1]Humala: “La crisis llegó al Perú y por eso hemos tenido bajón en el canon.” http://elcomercio.pe/economia/peru/humala-crisis-llego-al-peru-eso-hemos-tenido-bajon-canon-noticia-1617534

[2]The World Factbook. https://www.cia.gov/library/publications/the-world-factbook/geos/print_pe.html

[3]Poverty and Equity. Peru. http://povertydata.worldbank.org/poverty/country/PER

[4] 2013 Minerals Yearbook

[5] Foreign Direct Investment. http://perureports.com/foreign-direct-investment-fdi/

[6] Economic Analysis of Chinalco Toromocho Project. Prepared for Chinalco International by Behre Dolbear & Co. October 2012.

[7] Chinalco Mining Corporation International Global Offering. Prepared by Morgan Stanley, BNP Paribas, CICC, et al. 2013

[8] Toromocho Independent Technical Review Update Report. Prepared by Behre Dolbear Mineral Industry Advisors. 2012.

[9] Morococha, un Tesoro en los Andes, Chinalco, Toromocho. https://www.youtube.com/watch?v=XDHs1_TGOlE

[10] Option Agreement between Peru Copper Syndicate S.A. and CENTROMIN

[11] Estudio de Impacto Ambiental, Reporte Final. Prepared by Knight Piesold Consulting. 2009

[12]Interview with Morocochan resident.

[13]Sentencia del Tribunal Constitucional sobre el Expediente No. 00022-2009-Al. Fundamentos 10-12.

[14]Nueva Morococha, Peru: Las Consecuencias de Reasentamiento. http://ladobe.com.mx/2016/07/nueva-morococha-peru-las-consecuencias-del-reasentamiento/