FINANCIAL REVIEW

SE Companies and Markets

HD Negligence claims need answers

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WC 1366 words
PD 12 November 2015
SN The Australian Financial Review
SC AFNR
ED First
PG 36
LA English

LP The apparently informed claims by a Brazilian official that negligence and human error sit central to the deadly collapse of the Fundao tailings dam in Minas Gerais raise critical questions about when and if BHP Billiton was aware of risks that were identified to mining regulators in 2013.

As has been made clear often enough over recent days, BHP and Brazilian iron ore kings Vale each own 50 per cent of Samarco, which in turn operates the iron ore mines that require a three-tiered tailings dam complex.

TD On Thursday last week the top tier of that complex - the Fundao dam - collapsed, swamping local communities in mine waste, mud and water. There are reports that six are dead and 22 are missing.

A second downstream dam, Santarem, was badly damaged by Fundao but was not catastrophically breached. The integrity of the third dam, Germano, is being kept on understandably close watch by Samarco. But, according to an environmental prosecutor for the state that hosts Samarco, Minas Gerais, the dam breaches and their results were predicted in a 2013 review of the licensing process.

The technical review was made in the wake of approvals that allowed for, among other things, increased water levels in the Fundao dam. The experts' report identified several points where the dam made contact with tailings dumps as points of risk that had not been fully assessed in the approvals process. They appear to have identified, too, that requests had been made for better understanding of these stress points from as early as 2008.

The report recommended further studies be conducted to assess whether these contacts points increased the risk of groundwater saturation that would see normal rainfall leach much more quickly than planned into the dams.

According to a translation of the report we have seen, it suggested this could result in "several collapses at different levels of the slopes and create a flow of material with massive sterile [waste dumps] moving downstream towards the dam body of Fundao and surroundings". This would seem to be Gardening 101, and it is very hard to believe that either BHP or Vale could have been aware of this potential and not prevented its apparently obvious implications.

I am always left just that little bit uncomfortable by the habitual blame game that is triggered by situations as deadly and complicated as those facing BHP management right now, just as there is ever a danger in rushing to judgment about events that occur so far away from our sight lines.

So sure, no one yet knows what made Fundao collapse, and no one will know for sure for a long time yet.

But the allegations aired on Brazilian television this week, and the evidence that appears to support them, would seem to demand something more of BHP and Samarco than the requests for patience implicit in their public statements so far.

It would seem more than appropriate that we know whether or not BHP was aware that state-appointed experts has raised questions about the design of Samarco's dam and whether or not the findings of that review prompted an adequate response from the operator or its owners.

Close but no cigar

The enriching sale of a minority share of Santos' stake in Papua New Guinea's sector-leading liquid natural gas project sat at the cornerstone of the $3.5 billion South Australian's unnecessarily controversial recapitalisation process until early last week.

But the deal, whose price had been reset in September, was scuttled when the buyer - speculated to be Japan's Marubeni - returned early November seeking a second price revision.

What has been described as a "robust negotiation" settled on a buyer and a firm price in May and the terms were successfully revisited at the buyer's request in September. But the potential owner came once too often to the reset well two weeks ago and, just eight days ago, the negotiations were terminated in the name of the core discipline that guided the all-options process executive chairman Peter Coates had launched in August.

The strategic review, called Project Solo, was managed by Coates, newly appointed strategy boss James Baulderstone and long-standing chief financial officer Andrew Seaton. And their basic rule of thumb for an acceptable asset sale was a price based on an $US80 a barrel long-term oil price.

Through early November The Australian Financial Review Street Talk team was reporting that Santos had earned a $2 billion bid from Japan Inc for a minority portion of its minority stake in the ExxonMobil-operated PNGLNG project. It was also reported that Brookfield-backed Quadrant Energy had made a $1.5 billion play for Santos' WA assets and that it had received a $500 million offer for its 35 per cent share of a Bass Strait project called Kipper.

If just the PNG and Kipper deals had been done, along with the market-premium-priced $500 million placement of 7 per cent of Santos to China's Hony Capital, then there would have been no need for the $2.5 billion capital raising that has so disappointed some of Santos' owners.

Santos made it plain on Monday the asset sales process had disappointed because most shoppers had come looking for bargains and with prices built on a $US60 oil price.

So, in the end, while Santos collected serious offers for a suite of its core and non-core assets, only Mitsui's $520 million offer for a 35 per cent share in the Kipper project cleared the Project Solo hurdles.

To digress for one moment, it needs to be understood that the Kipper deal remains subject yet to pre-emptive rights retained by the project's other owners, Exxon and BHP Billiton. If those rights are exercised competitively, then not only could Santos' customer change but the final price might yet rise a bit.

This same potential was just one of the reasons why setting a competitive price on the PNGLNG stake always seemed such an attractive idea. Exxon, Oil Search and Nippon Oil are partners in PNG's debut in the LNG game and each would have calls on any interest that Santos was prepared to sell.

The other big positive would have been that a price acceptable to Santos would likely have announced a higher look-though value on both the 10 per cent of PNGLNG it retained and on the project as a whole than is currently assessed by the market.

If the speculated $2 billion price tag for a 3.6 per cent stake in PNGLNG was anywhere near correct, then that imputed a $7.7 billion value for the whole of Santos' 13.5 per cent position. And that is well north of the valuation implicit in Woodside's $11.6 billion offer for Oil Search.

The Woodside numbers supported a $6.5 billion look-through value for the Santos share of PNGLNG and, as we noted at the time, that was about $2 billion more than Santos' then market capitalisation. Those numbers alone inform the certainty of the Santos board's view that Scepter's $7.1 billion opening gambit was nowhere near enough to buy the privilege of due diligence.

It is accepted wisdom that the rights issue and Hony placement has likely exhausted Scepter's interest in further pursuit of Santos. And as the spectre retreats, there is emerging dissonance in the narrative around the discussions between the spurned bidder and its target.

Team Scepter reckons Santos had urged it to wait on developments in the asset sale process before coming back with a revised offer. But this is not how Santos people now recall events.

Outside of requesting a recovery of normal protocols of communication (Santos' advisors were informed of the approach by email before senior management were made aware), Santos advised Scepter that due diligence required a price that reflected net asset value and the average equity market view of NAV sat above $9.

And far from advising Scepter to wait on developments, Santos recommended haste, given that the results of the strategic review were rapidly approaching finalisation and announcement.

CO bkhlp : BHP Billiton Ltd | bltplc : BHP Billiton PLC

IN i211 : Metal Ore Mining | imet : Mining/Quarrying | ibasicm : Basic Materials/Resources

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AN Document AFNR000020151111ebbc00019