‘A Successful Offloading of What Has Been a Difficult Asset’: ESG-inspired Disinvestment and the Communities Left Behind

By:

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I Introduction

Proponents of market-based solutions to social injustice argue that environmental, social, and governance integrated investing (‘ESG investing’) has been able to achieve what courts and legislatures worldwide have not: catalyse the rapid disinvestment from extractive industries infamous for human rights abuses. Critiques of ESG investing primarily make predictions about its impact on corporate conducts in the future. Little research exists linking ESG investing to contemporary community struggles for justice over past and continuing harms. Drawing on my work as a paralegal for the South African social movement Mining Affected Communities United in Action (MACUA), and specifically my efforts supporting the Phola Community in its claims against multinational mining giant South32, I argue that ESG investing may decrease the likelihood that communities who have suffered due to corporate misconduct will have their livelihoods and homes restored or receive comparable redress.

II ESG Investing

ESG investing is a practice whereby traditional financial analysis techniques, used to determine the best corporations to invest in, are supplemented with indicators that measure the contribution of corporations to environmental sustainability, social wellbeing, and corporate good governance.

ESG investing operates in three broad ways:

1. *Disinvestment*: Shares in corporations that violate ESG standards are sold (divestment), or capital expenditure towards those corporations is reduced, allowing for the re-allocation of resources toward ESG-compliant corporations.
2. *Shareholder activism*: Investors retain their shares in problematic corporations and use their position as shareholders to push corporations to adopt better practices.
3. *Impact investing*: Investors seek out corporations that contribute toward an outcome consistent with their ethical commitments and invest in those.

Disinvestment is most prevalent because of its compatibility with the preferred type of investment—passive investment—where investors' money is pooled and used to buy shares in corporations listed on an index of well-performing funds. Conventional investment indices are easily skewed towards ESG-complaint companies and away from corporations deemed objectionable and regarded as 'sin stocks.'

Corporations have had to adapt quickly to the rapid rise in disinvestment—either selling the assets that may render them ESG-incompatible or rushing to comply with regulatory standards that help attract positive ESG ratings. It is predicted that by the end of 2021, two-thirds of all listed assets could be 'ESG'. The strong financial performance of ESG funds has aided this trend, which has been heralded as evidence that market-based incentives can curtail problematic corporate conduct while avoiding the inefficiencies associated with rights-based litigation at the national and international level; government regulation; or civil society activism.

Some, though, are sceptical of this promise. They illustrate that the metrics used to assess ESG compliance are often inadequate, dependent on self-reported efforts, and focused on steps taken rather than outcomes achieved. Furthermore, the plethora of ratings—each with different indicators, methodologies and minimum thresholds—means that corporations could 'shop around' for rating systems that will portray their shares in a positive light. Unlike these dominant critiques, which address the structural influence that ESG investing is likely to have on the investment landscape in the future, this post addresses its impact on a community that has already suffered at the hands of an ESG-noncompliant corporate entity.

III SOUTH 32 and the Phola Community

In October 2020, despite industry-wide disruptions caused by the Covid-19 pandemic, South32 reported surprisingly strong global production for the preceding quarter, due in large part to 'a ramp-up of mining at the South African Energy Coal operations.' Also in October 2020, communities surrounding those coal operations suffered devastating destruction to their land, their homes, and their health, as South32 continued to blast randomly, without warning or concern for the lives of those in the area. Blasting regularly causes severe damage to the homes and property of host communities and leaves dangerous levels of dust in the air. Random blasting, in particular, is responsible for chronic stress amongst community members, who must nervously anticipate the almost-daily blasts and the repercussions thereof. While mines are required by law to notify communities before a blast, South32 reportedly never does. Complaints of damaged property at times spur South 32 or government-led 'investigations' but rarely any action. Pollution from mines also renders soil and water unfit for subsistence farming and leaves the air unsafe to breathe.

While South32 is often unresponsive to community attempts to engage, the nearby Phola Community has established itself as a formidable voice in the mining landscape of Mpumalanga. As she stood outside after the latest destructive round of blasting, community leader Millicent Shungube watched panic erupt in her village as community members took stock of broken windows, cracked walls and collapsed ceilings. Responding to a barrage of photographs and pleas sent her way, she wrote once again to South 32, beginning: ‘As I am writing this email, a cloud of black dust is coming to cover our once beloved township.’ Shungube relayed the various meetings and commitments that had not been met by South32 and expressed frustration that South32 continues to deny or ignore what community members know to be true: ‘We have evidence of falling structures and falling tombstones, we have continuously witnessed the breaking of windows and no one is coming to the party.’

As Shungube pushed for a response in the weeks that followed, she was met with a silence that was unusual even for her. When researching another issue, I learned that South32 was selling its South African coal operations—in a rush, for a hugely discounted price. ESG investing has meant that coal is no longer a lucrative investment. Selling its coal assets, while continuing to collect 49 per cent of the cash flow generated by the mines until 2024, allows South32 to pass ESG screenings while simultaneously continuing to profit off the coal operations whose sustainability it has, as recently as 2017, poured billions of Rands into. Commenting on the sale, one financial analyst wrote: ‘[A] successful offloading of what has been a difficult asset will boost earnings quality and shrink the overall workforce meaningfully.’

IV Ramifications of the Sale

(i) *Side-lining communities*

The first ramification to hit the Phola Community was the fact that years of attempting to build a relationship with South32 and to secure justice for water contamination, infrastructure damage, and dust-related respiratory illness, may have been in vain.

Already in 2014, 61.3 per cent of the total land surface area of Mpumalanga Province was under a mining right or a prospecting right application. Absent the right to Free, Prior and Informed Consent (FPIC) over the granting of mining licenses, mining-affected communities in South Africa must rely on mandated ‘consultation’ during the mining right application process to express concerns about proposed mining. No such consultation requirement exists for the sale of mining operations—leaving communities excluded at the outset from the new mine's operations and forced to fight anew for recognition as meaningful stakeholders on their own land.

Mining operations in South Africa change ownership frequently. For example, the Wolvekrans Middelburg Complex, one of the three mines that make up South32's coal operations in South Africa, has had at least fourteen different owners since it was opened in 1982, including Shell, BP, and BHP Billiton. Despite the frequency of sales and the lack of consultation requirements during the sale, the legislation is vague on whether, and how much, environmental and social commitments can be changed during the process.

While the sale of South32's South African coal operations to Seriti Resources was always spoken about by both corporations as a certainty, their websites confirm that they are nevertheless awaiting Department of Mineral Resources and Energy (DMRE) approval of Seriti's rehabilitation guarantees in place of those of South32. There is no further assurance that the content of the rehabilitation guarantees will remain the same; that Seriti will repair the homes and restore the livelihoods of the communities who have been harmed by South32; or that Seriti will undertake to complete the projects that South32 committed to in its legally-binding Social and Labour Plans (SLPs).

There is a risk that—because of the discounted sale, the depressed expected returns, and Seriti's relative inexperience compared to South32—Seriti will be able to negotiate with the DMRE for the approval of less cost-intensive social and environmental commitments. Furthermore, paltry oversight from the DMRE means that South32's alleged non-compliance with previous SLP commitments remains unacknowledged and therefore unaddressed in the terms of the sale.

The community members that I spoke to in Phola stated unequivocally that, were they asked, they would have opposed the sale. They have unfinished business with South32.

(ii) *Alternative sources of funding*

Even when the terms of a sale ensure that the social and environmental commitments attached to the original mining license stay the same, the purchaser of discounted sin stocks is often less likely to fulfil them, due to a lower risk of reputational harm should they fail to do so.

The impact of ESG investing is dependent on the public listing of companies, and the availability of information about their sustainable development performance. South32 claims to be an industry leader in standards of transparency, consultation and accountability, and its listing various stock exchanges ensures some level of transparency around its operations.

However, corporations purchasing sin stocks—for which there is still high current and expected demand in countries like South Africa—are incentivised by ESG-inspired disinvestment to look beyond funding via stock market listings and banks to other industries. Seriti has been approached by heavy earth-moving equipment suppliers who are willing to fund their mining operations as a way to ensure long-standing contracts for the use of their machinery. Another popular alternative funding model is the use of streaming and royalty agreements—where funders provide capital for mining operations in exchange for a guaranteed share of the product mined or the profits made from selling the product.

Since the above methods are contract-based and do not involve funders buying a stake in the corporation itself, funders have no power to agitate for changes in ESG compliance measures. They also appear to be less concerned about whether mining corporations are fulfilling the Black socio-economic empowerment and racial transformation quotas set out in South Africa's Mining Charter. Speaking at the South African Coal Export Conference in 2018, corporate lawyer Brandon Irsigler said of these alternative, contract-based, funding solutions: 'As these deals care only about the operating asset, that somewhat removes them from the [Mining Charter] debate, the equity debate and empowerment issues.'

One prominent data set lists 169 coal mines in South Africa, only 63 of which are owned by companies that are listed on a stock exchange. As such, the fast and effective investor backlash against corporations that harm the environment and livelihoods appears to have inadvertently propelled other funding models forward—ones that may be less susceptible to the reputational risks involved with fossil fuels, and less likely to respond to pressure to repair past harms.

(iii) *Black (dis)empowerment*

The sale of South32 to a Black-owned South African mining company, Seriti Resources, is being hailed as a victory for Black empowerment in South Africa. This messaging is misleading, however. As the South African state, and South Africa's public electricity utility, Eskom, have progressively increased the required percentage of Black ownership of mining corporations, South32 has correspondingly shifted its ownership of its South African coal mining operations, in an apparent effort to avoid scrutiny over its failure to promote Black ownership.

More importantly, the messaging masks a much more pernicious reality. Through collective court challenges and powerful public messaging, mining corporations have acted in unison to effectively threaten to leave the country should the South African government introduce more wide-ranging social, environmental and transformation regulations.

By selling its coal operations, after publicly disparaging the 'depressing' regulatory environment in South Africa, South32 contributes to an environment of regulatory chill wherein lawmakers seem more concerned with appeasing mining corporations than protecting communities. In this context, the likelihood that the South African government will sanction mines for failing to repair the damage done is reduced even further. Far from empowering Black South Africans, the sale further disempowers majority-black rural communities, whose demands for justice are always weighed against the corresponding risk that transnational mining corporations will move their operations elsewhere.

V Conclusion

While South32 has been publicly negotiating the sale of its coal operations since at least 2018, the Phola Community has yet to be told of it. It is hard not to feel like the commitments that the community has secured since, after persistent protest, were never intended to be fulfilled.

With the sale, the Phola Community is side-lined further as they were not even given the opportunity to consult with South32 or Seriti on the proposed sale or to demand that the responsibility for repairing past harm or compensating for losses will be carried over to Seriti. Seriti, a company that is not listed on a stock exchange and will likely source funding for its newly acquired coal mines through contractual agreements, will be less susceptible to reputational shock and thus more likely to renege on commitments and violate ESG standards. South32 is unlikely to repair the damage it has done, as the sale alone will be effective in boosting its ESG rankings. Finally, the sale may further discourage the South African government from enforcing regulatory standards—weary that foreign mining corporations are already fed up with their ‘interference’.

The experience of mining-affected communities thus provides lessons for ESG investing: ‘Solutions’ to environmental degradation, social injustice and corporate misconduct that assign only a passive role to ‘local beneficiaries’ often entrench community disempowerment and are unlikely to disrupt the radical power imbalances that facilitate corporate impunity for human rights abuses.

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