



RiR 2017:34

The relocation of Kiruna and Malmberget

– the Government and LKAB had inadequate decision-support data

Summary and recommendations

The state-owned Luossavaara Kiirunavaara Aktiebolag (LKAB) is one of Europe's largest producers of iron ore pellets. In 2008, the company decided to establish new main levels in its underground mines. The new main levels KUJ 1365 and MUJ 1250 were a condition for continued mining in Kiruna (Kiruna municipality) and Malmberget (Gällivare municipality), but cause land deformations that make it necessary to move some of the infrastructure, municipal premises and housing in both cities.

Under its articles of association, LKAB has a strictly commercial remit and justifies its commitment to the relocation in terms of the provisions of the Minerals Act concerning compensation for damage and intrusion. Mining in the new main levels and subsequent relocation of parts of Kiruna and Malmberget, is associated with major risks. Deficient risk analysis may give rise to additional costs for the company and the surrounding community. Lack of clarity in the division of responsibility and financial commitment between the company, the State in its roles other than company owner, and the municipalities may have a negative impact on the company's long-term financial performance. It may also lead to ineffective implementation to the detriment of other parts of society.

Purpose of the audit and audit questions

The audit aims to assess whether the Government's and LKAB's planning of new main levels, causing the relocation of two communities, took into account the division of responsibility and risks in such a way as to ensure a sound value increase in the LKAB holding and enable assessment of the economic impact. The audit also aims to document lessons learned for corresponding central government decisions on future investments.

Audit questions:

1. Did the LKAB board ensure that there was appropriate decision support data for the Government's assessment of the investment risks and their consequences for the company's financial performance?
2. Did the Government carry out a financial analysis and a cost-benefit analysis aimed at evaluating LKAB's decision-support data for the decision to establish new main levels?
3. Did the Government make clear the company's and other actors' responsibilities in the community relocation at the planning stage on the basis of the Minerals Act and other relevant legislation?
4. Did the Government report to the Riksdag on the planning of the investment, the company's responsibility under the Minerals Act and the commercial remit, as well as the consequences of the investment for the company's financial performance?

Audit findings

The audit shows that the Government's planning in relation to the new main levels in Kiruna and MalMBERGET did not provide LKAB or other parties with sufficient clarity regarding the rules of operation for the community relocation. Neither the effects from cost-benefit analyses and the delimitation of the public commitment, nor the division of responsibility between central and local government and the company were clarified. This has led to an ineffective planning process that risks having an unjustified impact on the company's performance for an unjustified amount of time, at the same time as risking that effects on other parties involved will not be dealt with appropriately.

An efficient and effective planning of the relocation process would be of benefit for all parties involved, including the company and the Government, central government agencies, reindeer husbandry, the municipalities involved and their inhabitants. Effective planning in line with the Riksdag's objectives could have given LKAB better conditions for minimising the negative impact of the community relocation on the company's performance.

The LKAB board should have ensured fully adequate financial decision support data

The audit shows that the financial estimates and risk analyses ahead of the LKAB decision to establish new main levels in 2008 were not sufficiently developed to provide the board with data to assess the consequences of the investment. In addition, at that time, LKAB did not comply with international industry standards of financial reporting in the mining industry. The costs of community relocation were not sufficiently researched and were underestimated.

In the opinion of the Swedish NAO, the board's decision-support data was complex, difficult to assess and made it difficult to evaluate the investment. Given LKAB's market position and importance in the state business portfolio, the company's board should have imposed higher requirements for professional decision-support data.

LKAB's board did not initiate a dialogue with the Government on the matter until later in the planning process, despite the fact that the investment in new main levels was expected to have a significant impact on both the company and the community. In this respect it must be observed that at that time there were no formal guidelines on shareholder coordination.

The Government has not ensured adequate decision-support data from financial and cost-benefit analysis

Despite the importance of LKAB in the state business portfolio and the significance of iron ore deposits to Swedish growth, the Government refrained from analyses and from obtaining a second opinion of the company's financial analysis ahead of the investment. Nor has the Government initiated any independent cost-benefit analysis of the community relocation. The division at the Ministry of Enterprise and Innovation responsible for mining policy has to some extent facilitated the process by initiating working groups and tasking relevant agencies with facilitating the planning. The analyses carried out did not foresee the risks of the community relocation. The analyses pointed out potential problems with the community relocation but did not propose how they should be avoided within the current institutional framework. The results of the analyses were not coordinated with the ministry division responsible for the governance of LKAB.

Since the Government did not fully clarify the total impact of the investment on the company and surrounding community there is insufficient analysis for identifying any

central government or municipal commitments in addition to LKAB's legal and commercial commitment for relocating the community.

Risks of community relocation and LKAB's mining could have been foreseen with the help of cost-benefit analysis

The audit shows that several of the risks that may have had significant impact on the company's future performance were not identified when planning the investment. One risk that has not been sufficiently taken into account is that parts of the community of Kiruna may have to be moved again for future mining. With the help of more detailed analysis and planning the Government could have ensured the optimal localisation of the town of Kiruna for the company and for the community.

The community relocation has been more expensive for LKAB than the company initially estimated. The investment is a major event in the company's operations and carries inherent risks that are difficult to predict, and that are often associated with exaggerated optimism. Several of the risks realised when implementing the community relocation could have been foreseen through more relevant planning. Consequently, relevant calculation methods should be used to reduce risks as far as possible, thus avoiding overestimation of benefits and underestimation of costs. The purpose of including risks in the calculation is to avoid investment decisions based on decision-support data that is biased in its representation of benefits and costs.

According to the Swedish NAO there was a high probability that investment in new main levels in Kiruna and Malmberget would be profitable from a cost benefit perspective. The compensation may have distributional consequences, however, if compensation levels differ in time or between different groups of interested parties. Another risk is that relevant economic effects are not identified, such as welfare losses for tenants and business operators due to the company not being obliged to stimulate into being an efficient construction market and efficient trading during the community relocation. A cost-benefit analysis would have increased the possibility of identifying risks at an early stage.

According to the Swedish NAO, cost-benefit analysis of investments that have a major social impact would provide the central government with a better opportunity to assess the economic benefits of the investment as well as its effects on the environment, labour market, property, reindeer husbandry, municipal service etc. When provided with a solid base of information, the Government can improve the chances of assessing welfare losses, regardless of whether the company is state-owned or private. It may also be the first

basis for taking any corrective measures to manage the external effects of the operation, in addition to the company's obligations under legislation and its remit.

The Government did not plan for appropriate division of responsibility

LKAB has taken great responsibility for the community relocation. The company is responsible for compensating property owners under the compensation provisions of the Minerals Act and its commercial remit. But the municipalities also have a responsibility for the functioning of the local community and local planning. In turn, the Government governs LKAB, is responsible for governing the country and is the responsible authority for the government agencies involved. There is both a national and local interest in implementing mining investments that lead to growth and jobs. All in all, this means that LKAB, the Government and both the municipalities share the responsibility for implementing the community relocation effectively.

The Government assumed that the community relocation would be planned within the framework of current legislation and the company's commercial remit. The Government's planning and facilitation of the community relocation took place via working groups, such as the Malmfälten group. According to the Swedish NAO this is a form of informal planning through working groups that was not effective either for LKAB, the municipalities or agencies. No binding and coordinated decisions can be made from such informal settings.

The audit shows that the Government did not identify the total effects of the investment on the surrounding community and the responsibility of central and local government in addition to LKAB's remit and legal obligations. The Government has been passive in its planning and, in practice, delegated the entire central government responsibility for the community relocation to LKAB. Nor did the Government clarify the central government responsibility in relation to local government responsibility. No analyses were made to assess whether this is the most effective way of implementing community relocations, regardless of the ownership of the company. According to the Swedish NAO there are indications that this is not an appropriate way of managing the project. For example, the levels of compensation to municipalities and the Swedish Transport Administration remained unclear for a long time, and has become more expensive for LKAB than estimated. Moreover, LKAB has acted as construction client and commissioner to produce sufficient housing and contribute to an efficient construction market.

According to the Swedish NAO the Government has not carried out any analyses of whether the company is obliged to compensate in excess of new building standard, for

example in the form of extraordinary standard improvements, continual municipal service, extraordinary extension of roads and railways. Nor has the Government taken a positive position on judicial review in the courts of the limits to the company's compensation levels, which indicates that LKAB's circumstances differ from those of private companies. Moreover, the Government did not initially observe that the community relocation may entail a housing shortage and mean that the company to a great extent needs to move outside its core activities, for the purpose of being able to offer replacement housing. Recently the Government has regarded some measures for a functioning construction market to be a central government responsibility, outside the company's responsibility, and thus introduced measures such as special investment support. LKAB thus has not been given adequate appropriate rules for how the company should plan the community relocation, and this is a hindrance to the company in achieving the economic targets.

The division of responsibility for major community relocations should be analysed

To the extent central government commitments may be relevant for major community relocations, the Swedish NAO considers that it is the Government's duty to clarify the total effects of the investment, the types of welfare losses that are to be compensated under the public commitment and who bears the responsibility. Specially determined public policy mandates (where the Riksdag calls on a state-owned enterprise to serve the public interest and not just maximise profits) to state-owned enterprises would not be an alternative according to the Swedish NAO, since this solution would not be applicable to private companies. The Swedish NAO considers that the legal analyses presented by the Government do not sufficiently clarify whether the existing regulatory code is appropriate for ensuring effective management of situations with major effects on the surrounding community. Legal analyses could form the basis for planning the limits of the public commitment and the division of responsibility between central government, municipalities and any companies in similar situations, for example when there is a risk of major flooding due to climate or in the event of major infrastructure projects. Central government agencies and municipalities would also benefit from legal guidance on how decisions should be made that are adapted to the needs of the community relocation.

The Riksdag has not been given a complete presentation of the investment and its consequences

The Riksdag has expressed that the Government must communicate an annual report to the Riksdag with an appropriate presentation of the state-owned enterprises. The audit shows that the Government has presented information in brief on the consequences of LKAB's investment in new main levels in its annual communication on state-owned enterprises. The government communication on state-owned enterprises contains scanty information on LKAB's investments in new main levels and does not provide either insight into the company's planning process, the investment's risks or the long-term effects on the company of the community relocation.

In the opinion of the Swedish NAO, establishment of new main levels, and the community relocation these give rise to, implied such risks to LKAB's long-term value creation that separate reporting to the Riksdag would have been motivated ahead of the investment decision and during the planning. Since the Government has not given the Riksdag a clear picture of risks and divisions of responsibility, in the opinion of the Swedish NAO, the Riksdag has not had sufficient insight into the Government's and LKAB's planning of the investment.

Recommendations

To the Government for future events of a similar nature

- Consider obtaining a second opinion on state-owned enterprises' financial analysis ahead of major investments to obtain adequate decision support data.
- Consider implementing a cost-benefit analysis ahead of events with major social impact, for example large investments, for the purpose of identifying the total external effects of the event on the surrounding community and the economic benefit.
- Consider giving permanent instructions to an agency to perform cost-benefit analyses in connection with concession applications for mining that affect the surrounding community. The analysis can be used as initial decision-support data for decisions on any corrective measures to deal with the external effects of the mining in addition to the company's obligations under the Minerals Act and its commercial remit.

- Consider conducting a legal analysis for the purpose of assessing whether existing legislation is appropriate for clarifying the limit to the public commitment and division of responsibility ahead of events with a major impact on the surrounding community.

To the Government in the current case with LKAB

- Clarify for other parties involved in the community relocation that LKAB does not have any specially determined public policy mandate and can only compensate private property owners, municipalities and agencies under the provisions of the Minerals Act and its commercial remit.
- Clarify the extent of the central and local government commitment in the community relocation in addition to LKAB's legal and commercial commitment and divide the responsibility within the Government Offices and to agencies and initiate a dialogue with the municipalities concerned.
- Coordinate the role of shareholder with the responsibility in other policy areas that have a bearing on the community relocation.
- Present to the Riksdag a clear picture of the divisions of responsibility and risks of community relocation and give an account of how the Government ensures long-term return from the company.

To the board of LKAB

- Take clearer responsibility for the design and relevance of decision-support data ahead of major investment decisions.
- Ensure compliance with international industry standards for financial reporting and valuation in mining.

Initiate shareholder coordination at an early stage to discuss divisions of responsibility in future community relocations in accordance with the Riksdag's requirements for efficiency, return and structural adjustment.