



Mediating to avoid high financial risk

Mediation as an innovative tool to combat high risk in project finance facing repeated Social Conflict in Peru

IMI and **Mediators Beyond Borders** are proudly collaborating on a new series, *Mediation 360°*, in which experts address the question *“What would be the prospects of your organisation/industry/society/areas of study if the language of conflict was replaced by the language of collaboration?”*. We plan to share stories that depict the power and possibilities of mediation in a range of situations—some perhaps unexpected. This first piece, from Carlos José Valderrama and Elise Groulx Diggs, considers the power of mediation vis-à-vis project finance risks and social conflict in Peru.

Foreign and local investors in Peru have been facing, for many years, the high risk of seeing their operations disrupted by social conflict. About 50% of “big footprint projects” in mining, oil, forestry and infrastructure are permanently affected by social unrest and related violent protests. This situation creates so much risk that investment in these strategic economic sectors is in constant danger of declining and even of coming to a halt in some cases. Both domestic and foreign banks are concerned about excessive levels of social risk in Peruvian project finance.

It is in this context, in 2015, that the **Peruvian Banking Authority** issued **Resolution SBS 1928-2015** recognizing that risks to project finance banks were increasing because major development projects were constantly blocked by conflicts with communities and indigenous peoples. In a bold move, the Banking Authority decided to require that Banks, prior

to securing credit and granting finance for such projects, ensure that companies and project consortia perform community consultations and social risk assessments. Such consultations were framed in the Regulation as a measure designed to prevent and/or mitigate social conflicts in order to reduce financial risk to the projects, the investments and reduce the risk to the economy.

Unfortunately, social risk assessments and community consultations are not by themselves enough to prevent or mitigate community conflict. As the [SBS Document N. 01-2015](#) points out, social conflict can ignite and spread in contagious forms that are very difficult to assess and control.

How do we get from Banking Regulation to developing a Mediation Process?

The Peruvian Banking regulation does not specify how to conduct consultations. Nevertheless, we suggest that the basic requirement for community consultation can be used to encourage productive forms of engagement by communities (and other affected stakeholders) with project consortia, investors and project finance banks. Ideally, the aim would be ambitious—not simply to “consult” stakeholders but to actively earn a “social license to operate” from the affected communities. While this may appear time consuming to project managers, we believe it is significantly less risky and costly than moving ahead in the face of community opposition to the project.

How do we move forward and institute such a process?

The first step in designing a successful consultation, in our opinion, is to create safe space and start a process of engaging with all stakeholders, taking the time to understand their needs, desires, interests and complaints. Listening and hearing out are key success factors. Engagement means transformation, ensuring that communities understand the proposed project, how it is going to change their lives and accept it. Then, and only then, they are in a position to grant the company the coveted social license to operate legitimately and preserve it as we ensure the process is set up to be reactivated and kicks in when needed.

Next steps to build mediation

This can be achieved by building a mediation process to govern relations with communities that may be affected by a specific project or investment. This type of mediation can prevent ongoing conflict and enable the development of dialogue and trust over time. This is what we call transformative mediation, taking the time to understand the conflict and decoding what makes it flare, where anger is gradually replaced by constructiveness moving forward. Communities when they accept the project and understand how they can benefit from it can become partners of the project instead of angry opponents.

In many cases, we suggest the joint appointment by both parties of an independent, impartial and neutral mediator to build and conduct a process to help identify current and potential litigious points of dispute. These issues could be compiled in an ‘Agreement’, where both parties carefully include every claim it holds against the other, and spells out rights and concessions each is willing to negotiate and open to grant to the other party.

In other words, the whole set of agreements between the project developer/investor and the affected community would be contained and regulated by the ‘Agreement’. Every time circumstances change and/or any of the parties considers that new matters should be discussed and/or relevant agreements should be revised, the ‘Agreement’ would be reopened, negotiations would unfold and the Mediator organize a “live dialogue” process between the parties.

We believe a significant benefit flowing from the process described above is to offer the parties opportunities to identify, list and frame their potential differences in a well-documented and mutually agreed project, the ‘Agreement’ (or Contract), achieved with the support and guidance of a professional mediator. This ongoing dialogue process, kept alive by the Mediator, offers community leaders the use of an established channel to resolve disputes in a constructive manner, steering them away from the option of violent protest and social unrest. As the process proves its value, trust builds between the parties over time. Consequently, the temptation to move away from active dialogue and towards conflict lessens.

We also believe that a well negotiated and drafted ‘Agreement’, including a robust process for dealing with breaches and imposing penalties; may offer banks and the financial system in Peru evidence that social risks are being taken seriously and accurately assessed, offering robust guarantees to avert, prevent and mitigate social conflict.

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