Annex 3
The Mining Contracts

Analysis of the Contracts

Background

From independence to 1995 mineral rights could only be held by the State through various state owned companies such as Gecamines, MIBA, Sominki, or Okimo. In 1994/95, in face of the inability of the state companies to maintain production, the government made the policy decision to allow the companies to enter into partnerships with private companies. The agreement or "convention" entered into by the state company and the private partner put the mineral right at the disposal of the partnership and also specified the investments and internal management of the partnership as well as the modalities of exploration, development, mining and commercialization.[70] Notable contracts entered into during the 1995 - 2000 period include: Gecamines and the Lundin group for the development of the Tenke Fungarume copper deposit, Gecamines and the Forrest-Outokumpo group (GTL-STL) for the processing of scories in Lubumbashi, Gecamines and Anvil Mining (Australia) for the Dikulushi copper deposit, Okimo with Mindev and Barrick for development of gold deposits, Sominki with Banro Resources for the development of polymetalic deposits, and MIBA and Senegamines for diamonds. This was a period of civil war in the country and it is alleged that some of these and other contracts were awarded under opaque and suspect circumstances[71]. Also, given the high political risks at the time, certain of the partnership contracts contain tax exemptions and allowances in favor the private partner. Now that peace has returned, these may be perceived as excessively generous and out of line with international best practice.

Other contracts have been entered into or renegotiated by state owned mining enterprises and private companies since 2001 when most of the country returned to peace. These include, inter alia:

Gecamines with:

- Kabambankola Mining Company (KMC), Tremalt ltd, 2001
- Mukondo Mining, 2004, related to KMC
- Tenke Fungurume (Lundin Holdings and Phelps Dodge/Freeport McMoran) TFM-CMAR, renegotiated 2005
- Kingamyambo Musonoi Tailings (KMT), Adastra Mining/First Quantum, 2004
- Kinross-Forrest, KCC-Kamoto, 2005
- Global Enterprises Corporation (GEC), 2005\
- Compagnie Miniere du Sud Katanga (CMSK)-Luiswishi, 2004

MIBA with :

[70] Negotiations were undertaken and, in some cases, conventions signed during this period with the following private foreign companies: Swipco (Swiss), Lundin group (Canada), Cluff Mining (UK), Banro (Canada), Mindev (Belgium-Canada), Barrick gold (Canada), South Atlantic Resources, SAR (Canada), Union Miniere (Belgium), Anvil Mining (Australia), Gencor-Iscor-Broken Hill (South Africa). Source: Lutundula Commission Report, p. 6.

[71] The Lutundula Commission singles out the MIBA-Senegamines contract in this respect, stating that it has evolved on the margins of the law with numerous irregularities. Global Witness cites the case of the conflict of interest involved in the granting of a mineral right for cobalt owned by Gecamines to Congo Cobalt Corporation, a company controlled by Mr. Billy Rautenbach who at the same time was chief executive officer of Gecamines. However, the Lutundula Commission finds that the CoCoCo is functioning normally and in accordance with the law.

- DeBeers, 2005
- Dan Gertler International (DGI), 2005
- Nizhne-Lensoye, 2005
- BHP-Billiton, in negotiation

Okimo with :

- AngloGoldAshanti, takeover of Kilomoto Mining International assets, 2000

On the Processes Followed

A number of weaknesses can be identified in the manner in which the agreements were negotiated.

There has been a relative **lack of transparency** with respect to the negotiations and approval of some contracts. In the turmoil and confusion of the civil disturbances period this is perhaps understandable, however lack of disclosure leads to public suspicions that contracts have been negotiated in secret to serve special interests. Disclosure of the terms and conditions of these contracts, with possible excising of company confidential data related to personnel or proprietary technology, may help to restore confidence. To the extent that the foreign company is listed on a major stock exchange, material terms and conditions may be disclosed in conformance with the requirements of the exchange.

In most instances **no competitive bidding process** has been followed nor has any rational attempt been made to package the assets so as to maximize their value. An open tender to select the appropriate partner is the preferred approach when conferring mineral rights for deposits which have been well explored and for which substantial geological data exists and/or known production has taken place. This was, in fact, done in the case of the Gecamines-Lundin contract for the development of Tenke Fungurume. But, it was apparently not done in the case of other contracts. However, there is nothing inherently wrong with negotiating on a one-on-one basis with a specific partner. Indeed, this is the more frequently used approach for hard rock minerals by the international industry. This approach can work provided that the government has the technical, financial and legal expertise to negotiate a contract to best protect the State's interest. It is questioned in some cases whether the government negotiating teams possessed the requisite expertise. Also, whether they were rushed to conclude a deal because of the underlaying weak financial position of the company.

In most instances, **no appraisal and valuation was done of the mineral assets** to be granted to the private company. If such an appraisal had been done a divestiture plan could have been prepared to package the assets so as to maximize the value to State. In particular, it appears that the government was too eager to conclude contracts even though an appraisal and valuation had been recommended by the International Mining Consultants in their report of 2003.

It is **difficult to determine whether the government received a fair market value** for the mineral assets. The payments ("pas de porte") which the private companies have paid to the State enterprise for the mineral asset have been frequently criticized in the local and international price as unrealistically low. Also, in some cases, mineral assets were granted to private companies in exchange for debts owed to the private company by the State enterprise. Valuation of mineral assets is difficult and subject to numerous factors including geological risk, price risk, operating and technical risk, and political risk. Given these uncertainties it is difficult and perhaps not very useful to attempt to go back in time and guess "what-might-have-been". There is also considerable mis-understandings regarding the value of *in situ* mineral resources. It is not simply a matter of calculating the reserves and applying an international market price. Mineral resources must be extracted, beneficiated, and processed at great capital investment and operating cost. Thus, simple comparisons of the assumed value of mineral resources in situ which does not take into account these costs and the various risk factors above do not reflect the real market value of the asset.

The size of the mineral resources transferred to private companies may be too large for a single company to rationally exploit given time and financial considerations. This question has been directed particularly towards the very large copper reserves at Tenke Fungurueme which have been given to the Lundin group. However, it should be noted that this partnership was the result of an international tender and the successful bidder was selected on the basis of a development plan which at the time was deemed appropriate. In the interim, this contract has been under a state of force majeure and development has not taken place.

There **has not been a proper review of the legal and financial terms and conditions** of the contracts before their signature. Such reviews were, in fact, underway when authorization to sign some of the contracts was granted by the government before the results of the reviews were known. It is unclear whether such legal and financial reviews have been conducted for other contracts.

<u>On Conformity with the Mine Law of 2002</u>

While the Mining Law requires financial and technical competency in order to grant an exploitation license, in some cases the financial and technical **capabilities of the companies to fully honor their contractual obligations is open to question.** Ideally, a thorough review by the government of the financial and technical bonafides of companies is conducted before entering into negotiations. This does not seem to have occurred. However, for many of the contracts the companies appear to have no problem raising the funds necessary to develop deposits or to hire the technical experts required to supervise the projects. Thus, at this juncture, it is preferable to put the emphasis on monitoring the progress the companies are making in their investments and to ensure compliance with contract obligations.

Various **encumbrances existing on the mineral assets may not have been fully disclosed** and/or plant and equipment**.** There may be competing claims for the same mining rights, as is possibly the case of Iscor (Kumba Resources on Kamoto). As well, various supplier liens and encumbrances may exist on mining rights and/or plant and equipment which are subject of the contract. Finally, in some cases the validation of the mining rights in accordance with the Mining Law of 2002 needs to be ascertained.

<u>On the Terms and Conditions of the Contracts</u>

In all of the contracts the **state enterprise has a minority shareholding position,** generally around 20%. This minority shareholding position is not unusual in terms of international practice. The Mining Law requires that 5% of shares in the exploitation company be reserved for the State. Any additional shareholdings for the State enterprise is negotiated with the partner. Other countries have found that while State shareholdings in mining companies may be a palliative for political sensitivities they rarely produce significant dividend streams. This is because the minority shareholders do not control dividend policies of the partnership enterprise and, in any event, at least during the initial years of the venture revenues will be directed to reducing debt. Gecamines right to dividends is illusory since it is unlikely that dividends will occur in the early years of the project given debt reimbursement requirements as well as lack of control over dividend policy

Internal governance procedures need to be specified and/or improved in the partnership contracts. There are a number of dispositions which are missing in most of the partnership contracts which, if present, would improve the protection of the minority partner. These relate principally to clauses to protect minority interests, specification of voting procedures and organizational structures, decision making rules, mandates of officers and directors, accounting and financial management procedures and others. These types of dispositions are entirely normal in partnership agreements and can be added without detriment to the overall terms and conditions of the agreement. In particular, it would advantageous to specify certain key actions, such as dissolution of the partnership or cession of mineral right, which would be subject to unanimous decision, so as to protect the minority interest of the State company. It is noted that achieving clarity on these issues through the addition of new dispositions in the contracts could be a condition of the partnership to access international funding.

In the case of many of the contracts, **management and operating agreements are absent**. Generally, these agreements specify the duties of the operator, budgeting and approval processes, the scope and limitations on authority, the percentage and base for remuneration, and other matters pertaining to the internal operation of the partnership. . It is entirely normal in a partnership for the managing partner or operator to be remunerated for services rendered but basis of this remuneration needs to be clearly specified.

Some performance obligations of the partner are specified in the partnership contract, generally submission of a feasibililty study or minimum investment. It is entirely possible that some of the contractors are (or will be) in **default of their performance obligations** which could open the door for renegotiation by Gecamines. This presents the best option legally for Gecamines to renegotiate the terms and conditions or to simply cancel the contract. In this respect, the Bank is providing funding to Gecamines to provide expert legal advice and counsel to monitor compliance with contracts.

Transfer pricing is a concern in some of the contracts, particularly GTL/STL. In the absence of explicit Congolese legislation on transfer pricing one would have to rely on some notion of international best practice. In the specific case of the GTL/STL contract, more detailed reporting requirements could be put into place to ensure that the government is not disadvantaged by Outkumpo's sale of the mineral product.

Environmental liabilities have not been fully evaluated and responsibilities for them not defined. The contracts are not sufficiently clear on the distinction between pre-existing liabilities and those which may occur during the operation of the transferred assets. Best practice normally requires an audit of the pre-existing environmental liabilities prior to conclusion of investment contracts. Also unclear are the responsibilities of the companies to produce environmental impact statements and management plans.

Gecamines remains responsible for the financial liabilities attached to the transferred mineral and producing assets. Normally, some form of compensation or assumption of these liabilities by the companies would be specified in the contracts. In fact, the contracts specify exactly the opposite: the financial liabilities remain with the Gecamines even though Gecamines may no longer have an asset to produce revenues to meet its financial obligations.

There are significant conflicts of interest in the contracts whereby the partners may also be suppliers and/or vendors of goods and services. Not only does this preclude any form of competitive bidding and prudential procurement procedures it will also attract management and supplier fees as noted above.

Shareholder loans, "carry" of Gecamines shares of the venture, interest rates, and other financial terms and conditions **may pose significant conflicts of interest and be on terms highly unfavorable to Gecamines.** Gecamines generally retains a 17% - 25% share of the joint venture but this share may be subject to a number of financial conditions which are onerous and unclear.

Financial contributions (equity instead of loans) of the private companies to the joint venture are unclear and ambiguous. In fact, the companies appear to commit themselves only to producing a feasibility study. The funding of development work and operations is left vague in the contracts. The mineral assets and productive plant and equipment are reasonably well known. Under normal practice, it would appropriate to require firm commitments for phased investments (e.g., feasibility study, development, and operations) backed up by appropriate performance guarantees. It is noted, however, that many contractors are, in fact, investing in rehabilitation and other activities.

Gecamines may not be able to recover its mineral right in case of dissolution of the joint venture. It would have been preferable to "lease" the mineral assets rather than transfer them into the name of the joint venture.