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Memorandum

20 February 2006

To the Attention of:

Ministers of Foreign Affairs of the Member States of the International Committee of Support for the Transition in the DRC (*Comité international d'accompagnement de la transition en RDC* - CIAT)

Members of the DRC's Transitional Government

Mr. Paul Wolfowitz, President, World Bank Group

Subject:

Good governance and transparency in the mining sector in the Democratic Republic of the Congo

Annexes:

Fasken Martineau DuMoulin (Pty) Ltd., Analysis of the Joint Venture Agreement dated February 2004 between *La Générale des Carrières et des Mines* and Kinross Forrest Limited with respect to the Kamoto Mine, the Dima- Kamoto concentrator and the Luilu hydrometallurgical plant, 19 February 2006, 10 p.

Fasken Martineau DuMoulin (Pty) Ltd., Analysis of the Joint Venture Agreement dated 9 September 2004 between *La Générale des Carrières et des Mines* and Global Enterprises Limited for the exploitation of the open pit mine of KOV and the Kananga and Tilwezembe deposits, 19 February 2006, 10 p.

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Introduction

The reconstruction of the Democratic Republic of the Congo (DRC) after the elections can only be achieved with the contribution of the mining sector. The immense natural riches must be rapidly put at the service of the country's development. Recent political declarations by eminent members of the International Committee of Support for the Transition in the DRC (CIAT) promoting good governance and transparency in the mining sector on the one hand, and Transitional Government's creation of the National Committee for the Extractive Industries Transparency Initiative (EITI) on the other, might be seen as encouraging signs. However, such declarations and gestures need to be backed by concrete actions that will put an end to the poor governance and the lack of transparency that still prevails in the DRC's mining sector.

This memorandum highlights bad governance and the lack of transparency with respect to the mining conventions that have been supported by the Transitional Government. It sets out urgent measures that need to be implemented immediately to remedy the situation. In the absence of such measures, the fairness of the elections and the reconstruction of the DRC following the elections will be seriously compromised.

1. Joint Venture Agreements between Gecamines and Kinross Forrest Ltd (KFL) and Global Enterprises Corporate Ltd (GEC)

On 15 July 2005, the Transitional Government gave its support to two joint venture agreements, which were concluded in February and September 2004 respectively by Gecamines with Kinross Forrest Ltd (KFL) and Global Enterprises Corporate Ltd (GEC). These joint ventures were for the exploitation of the mines and ore bodies of Kamoto, Kamoto Oliviera Virgule (KOV), Kananga and Tilwezembe as well as the concentrators and metallurgical processing plants situated in the Kolwezi and Likasi regions.

On 4 August 2005, President Joseph Kabila issued a presidential decree ratifying these agreements. According to experts, the KFL and GEC contracts (plus the Tenke Fungurume concession that has been awarded to Phelps Dodge and also approved by the Transitional Government) cover 70 per cent of the DRC's known copper reserves. The ore bodies and their installations represent the most important part of Katanga's mineral resources.

Our organizations received a copy of the following documents:

- *Convention de joint venture entre la Générale des carrières et des mines et Kinross-Forrest Ltd relative à l'exploitation de la filière Kamoto (Mine)-Dima-Kamoto Concentrateur-Usines Hydrométallurgiques de Luilu, N°632/6711/SG/GC/2004, février 2004.*
- *Convention de joint venture entre la Générale des carrières et des mines et Global Enterprises Corporate Ltd relative à l'exploitation de la mine à ciel ouvert de KOV et des gisements de Kananga et de Tilwezembe, N°656/6755/SG/GC/2004, 9 septembre 2004.*

Please refer to the note concerning the authenticity and content of these contracts the end of this document. According to the Official Journal of the DRC, the GEC contract was modified

by agreement signed by the parties on December 13, 2004. We have not had access to this agreement, and we are not aware of other amendments to the aforementioned contracts.

2. Fasken Martineau DuMoulin's Analysis

Our organizations approached the mines and mining finance department of the internationally-known law firm, Fasken Martineau DuMoulin (www.fasken.com), and requested they undertake a detailed analysis of the joint venture contracts. Their analysis compares the contracts with current practice in the mining sector in Africa and the provisions that one would normally expect to appear in conventions of this kind.

Contributions of the Parties to the Share Capital and Asset Base of the Joint Ventures

In the contracts, Gecamines is attributed a 25 per cent free carried participation in the joint ventures. The other parties – KFL and GEC – each have a 75 per cent stakeholding.

According to Fasken Martineau, the usual practice is to carry out an audit and evaluation of the contributions in kind after which the share capital is attributed on the basis of the contributions of each of the parties. Fasken Martineau draws attention to the fact that, in the KFL and GEC contracts, the contributions of the parties have been assessed before a feasibility study has been carried out and no methodology is established on which the distribution of share capital is based. Fasken Martineau is of the opinion that it is impossible to ascertain that Gecamines' contribution in kind, which includes equipment, infrastructure and the ore bodies, has been fairly assessed. Further more, Fasken Martineau questions the value of KFL's and GEC's contribution: "How should the cash advances or loans fully remunerated, obtained from related parties and fully guaranteed by assets contributed to the Joint Venture by Gecamines, be evaluated?" (KFL contract); "How can GEC's contribution be evaluated before the financing is put in place?"

Gecamines' Remuneration

According to Fasken Martineau, Gecamines bears all the risks of the joint ventures. It is reasonable to assume that the private parties will have been totally reimbursed in capital and interests of all loan and advances prior to Gecamines receiving any remunerations on its contributions and then only on the condition that the available cash is sufficient to meet the priorities set by the joint ventures.

The contracts envisage a remuneration for the attribution of exclusive exploitation rights and the rent to be paid for the rented equipment and installations is an amount equal to 2 per cent of the 'NET Sales Revenues' for the first three (in the case of KFL) or the first four (in the case of GEC) years and 1.5 per cent of the same net sales revenues thereafter. Fasken Martineau finds that these provisions are not in conformity with the usual practice in mining contracts in Africa. The royalty collected by the State is generally from 1.5 per cent to 3.5 per cent calculated on GROSS revenues from the sales of the products in order to guarantee a fair value for its resources. A payment based on net profits or net sales revenues is speculative and in this case the percentage used for calculation of such a payment would normally be higher, between 10 per cent and 15 per cent. But in the case of the KFL and GEC contracts, Fasken Martineau finds this risk is higher because all operations are controlled by the party who will be paying the royalty. According to Fasken Martineau:

> It is reasonable to assume that Gecamines will not receive any payments…given that amounts otherwise payable will be fully loaded with expenses related to every stage of the transformation of the product, its commercialisation, transportation, insurance, remuneration of the Manager, a related party accounting for its own profits and that of related companies.

Fasken Martineau highlights various other anomalies that reduce the level of the remuneration that Gecamines would normally have been entitled to expect. These include reductions from amortization and depreciation credits; the absence of any remuneration for the expenses incurred by Gecamines for the preparation of the contracts; in the loan agreement included in the GEC contract, Gecamines may be liable to pay additional amounts in relation to the Environmental Adjustment Plan and the reimbursement of the loan.

Fasken Martineau's Conclusions

According to Fasken Martineau, these contracts relate to "extensive assets, part of the national wealth of the [DRC], which are being transferred to be used by the private sector without an evaluation and assurance that the country will be appropriately remunerated for the privilege granted to a private concern". Fasken Martineau finds it reasonable to assume that KFL and GEC, "will have been totally reimbursed in capital and interests of all loan and advances and will have derived substantial benefits from the control exercised on the operations prior to Gecamines receiving any remuneration on its contributions" and that the remuneration for the rented equipment and installations and the royalties for the lifetime of the project "will be minimal, if any".

3. *IMC Group Consulting Ltd*

Commissioned by the World Bank, IMC Group Consulting Ltd carried out in 2003 an audit (Phase 1) and then to draw up a recovery strategy (Phase 2) of Gecamines. The KFL and GEC contracts have been signed, violating the IMC's recommendations. The following extracts are taken verbatim from the Executive Summary of IMC's final report, which was submitted to the World Bank in November 2003.

> The mineral reserves that Gecamines brings to a project must correspond to the production that the partner commits to achieving within a normal period, generally 20 years. To give much longer would be to dispose of national assets in a fire sale, to freeze reserves that might be the subject of other partnership agreements.

We note that the GEC contract runs for 35 years. As regards the joint venture with KFL, then in the course of negotiation, IMC writes:

> The Group West KCC project, to meet the envisaged production target of 3 Mt, would freeze 18 Mt and prevent the development of the potential of these other world class ore bodies" (Executive Summary. 1.7.3.1).

IMC criticized the fact that "all the projects are financed by loans reimbursable by the project itself" and recommended:

> When a partner brings its ore body into a joint venture the counterpart must be the capital put up by the other party to finance the investment… When partners wish to invest by means of raising loans, Gecamines should not enter into an association but proceed either by means of a management agreement…or by means of a lease agreement for the ore body, Gecamines [is then] remunerated by "take or pay royalties" [and] has a regular income, rather than speculative dividends…or by means of the sale of an ore body in exchange for a binding commitment for the effective realization of a suitable investment.

These recommendations have not been followed. The KFL and GEC contracts envisage joint ventures that will be entirely financed by loans reimbursable by the project (Executive Summary al. 1.7.3.3). According to IMC:

> The partnership agreements authorise the partners to bill functions over the project for management and marketing fees, advice, studies, works, raising interests on loans… After adding these charges to the interests and repayments of the loans…one may ask what will remain to pay a dividend to Gecamines and taxes to the State. The general rule of good management must be that joint ventures must manage themselves, that the partners do not receive any other remuneration than the dividends…Only in this way can fair treatment of the partners, the protection of minority shareholders, the absence of conflict of interests, the dividend and the taxes for the State be guaranteed.

Here again, the KFL and GEC contracts are in flagrant violation of these recommendations given that KFL and GEC are remunerated as managers of the project, for the marketing and sales of the products and for other services such as arranging the financial package for the project. Apart from this, KFL and GEC pay their contributions into offshore bank accounts that are totally under their control, whereas IMC recommended that "the partners guarantees should not come from tax havens" (Executive Summary 1.7.3.4).

In conclusion, IMC called for "an immediate halt to all negotiations" and for "rapid preparations for the renegotiation of the partnerships". Within three months, the KFL contract was signed; the GEC contract was signed six months later.

4. Recommendations of the Congolese Special Parliamentary Commission Charged with Examining the Validity of Economic and Financial Agreements Signed during the War (Lutundula Commission)

The presidential decree of 4 August 2005 ratifying the KFL and GEC contracts provoked strong reactions in many different sectors of Congolese society. According to some organizations, the contracts bore the hallmarks of a 'fire sale' of national assets. Many Congolese have questioned the power of the Transitional Government to conclude new mining conventions and to dispose of valuable State assets for decades to come. The power of the Transitional Government needs to be measured against the resolution of the Inter-Congolese Dialogue, which called on the Transitional Parliament to set up "without delay" a special commission charged with examining the validity of economic and financial agreements signed during the war (Resolution n°DIC/CEF/04). It was by virtue of this resolution that the Lutundula Commission was established. The Commission submitted its report to the Office of the National Assembly at the end of June 2005. Its release was delayed for eight months.

The Transitional Government's decision to ratify the KFL and GEC contracts clearly flouts the Lutundula Commission's recommendations:

> The Special Commission recommends the following:
>
> 1. To regulate Private-State partnerships by the adoption of a law fixing the terms to be respected in order to guarantee the interests of the Republic and to safeguard fairness.
> 2. To select partners on the basis of international invitations to tender.
> 3. To draw up charges and terms of reference appropriate for each project that should be available to experienced, world class mining companies capable of mobilising finance.
> 4. To envisage contractual obligation to guarantee the financing within a set time frame in order to prevent ore bodies being frozen.
> 5. To adapt the level of production to the size of the ore body in order to prevent inactivity.
> 6. Projects should be allocated to partners on the basis of open competition to avoid the creation of private monopolies.
>
> **In order to set in motion the above recommendations, in order to avoid Gecamines being deprived of its installations and ore bodies, which form the backbone for its recovery and to allow the choice of a partnership within the vision of a global framework that is appropriate for Gecamines' structure, it is recommended to stop all current negotiations which seek to create partnership projects for the following units of production and ore bodies:**
>
> 1. **Kamoto Mine;**
> 2. **Kamoto concentrator;**
> 3. **Kipushi Mine;**
> 4. **Luilu installations;**
> 5. **Shituru installations; and**
> 6. **Ore bodies of Kamoto, Kov, Mastaba (East and West) and those of Kananga.**[1]

5. Conclusions and Recommendations

From the analysis of an internationally renowned law firm with specialised expertise in the area of mining, it would appear that the KFL and GEC contracts have gravely damaged the interests of the DRC. Indeed, according to Fasken Martineau:

> These joint ventures have transferred national assets to the private sector "without an evaluation and assurance that the country will be appropriately remunerated for the privilege granted to a private concern".

[1] National Assembly – Special Commission charged with the study of the validity of all economic and financial contracts that were concluded during the wars of 1996-1997 and 1998, Report of the work sessions, 1st part, pp 175-176.

Moreover, the contractual provisions go completely against the recommendations of the IMC, which had been commissioned by the World Bank to draw up a recovery strategy for Gecamines. On this basis, we conclude that these conventions will gravely compromise the reconstruction of the country after the elections.

The KFL and GEC contracts have been ratified by the Transitional Government and have alienated a large part of the country's natural resources for decades to come. Governmental approval has been given with complete disregard for the explicit recommendations of the Lutundula Commission, which was established in conformity with the agreements governing the transition. Consequently, we conclude that the Transitional Government has acted without taking into account the interest of the Congolese people and the framework of the transition. Furthermore, in view of the economic importance of these contracts and of the absence of rules concerning funding of political parties, we find that the process of negotiation and ratification has lacked transparency and precisely how the projects will be executed is unclear. All of these factors put the fairness of the impending elections at risk.

Recommendations to CIAT

In order to preserve the fairness of the elections and the ability of the government to rebuild and develop the country thereafter, the CIAT members should:

- demand total transparency from the Transitional Government with respect to mining conventions and their amendments, feasibility studies, economic models, financial plans and the remuneration obtained;
- nominate an independent group of experts to examine the legality of all the mining contracts signed by the Transitional Government against the terms of the agreements governing the transition, Congolese law and international law; and
- call for a criminal investigation by the appropriate law enforcement bodies in the DRC and other concerned countries in instances where there are indications of coercion, fraud or corruption in the negotiation or the execution of mining contracts signed by the Transitional Government.

Recommendations to the Transitional Government

The Transitional Government should consider, in consultation with CIAT and the World Bank, revising the terms of reference of Gecamines' International Management Committee to bestow it the power, as IMC recommended, to revoke contracts concluded in violation of the new Mining Code and the Mining Regulations or which seriously damage the interests of the country.

Recommendations to the World Bank

The World Bank should conduct an internal inquiry to determine:

- the reasons why the IMC's recommendations have not been acted upon;
- the World Bank's own responsibility in having allowed some of the DRC's most important copper and cobalt reserves to be awarded without an international invitation to tender and even before the International Management Committee had been put in place to oversee the restructuring Gecamines; and

- the measures that have been put in place to ensure the newly established Validation Commission for Mining Titles (*Commission de validation des titres miniers*) succeeds when its predecessors have failed.

Appendices

- Fasken Martineau DuMoulin, "Comments on the Joint Venture Agreement dated 9 September 2004 between La Générale des Carrières et des Mines and Global Enterprises Limited together for the exploitation of the open pit mine of KOV and the Kananga and Tilwezembe deposits", 19 February 2006.

- Fasken Martineau DuMoulin, "Comments on the Joint Venture Agreement dated February 2004 between La Générale des Carrières et des Mines and Kinross Forrest Limited with respect to the Kamoto Mine, the Dima- Kamoto concentrator and the Luilu hydrometallurgical plant", 19 February 2006.

Note concerning the authenticity and the content of the contracts

- Joint Venture Agreement dated February 2004 between *La Générale des Carrières et des Mines* and Kinross Forrest Limited with respect to the Kamoto Mine, the Dima- Kamoto concentrator and the Luilu hydrometallurgical plant N°632/6711/SG/GC/2004.

On page 51 of this document dated [?] – 02 – 2004 (the precise day is difficult to read) and signed on the one hand for Gecamines by Nzenga Kongolo, Deputy General Manager (Administrateur Délégué Général) and Twite Kabamba, Chair of the Board and on the other for KFL by Malta David Forrest, board member and Arthur Ditto, Chairman. Each page is initialed by the parties; in places the edges of the copy have been cropped making some initials not visible on some pages. The body of the contract is complete; it contains a cover page, a table of contents, a preamble, and 22 articles on 51 pages. Article 1.3 of the convention makes a reference to two annexes: Annex A (map of the concession, list of the mines, description of the mines, surface rights of the properties and the mining zone) and Annex B (description of the treatment plants). Annex A is missing.

- Joint Venture Agreement dated 9 September 2004 between *La Générale des Carrières et des Mines* and Global Enterprises Limited for the exploitation of the open pit mine of KOV and the Kananga and Tilwezembe deposits N°656/6755/SG/GC/2004.

On page 65 of this document dated 9 September 2004 and signed on the one hand for Gecamines by Nzenga Kongolo, Deputy Managing Director (Administrateur-Délégué Général) and Twite Kabamba, Chairman of the Board, and on the other for GEC by Dan Gertler. Each page is initialed by the parties; the edges of the copy are cropped making some initials not visible on some pages. The body of the contract is complete; it comprises a cover page, a table of contents, a preamble, and 22 articles on 65 pages. Article 1.3 of the convention refers to four annexes : Annex A (map of the mining zone and the mining zone of the project, coordinates of the mines, the tailings zones, KZC, Luilu ER, Luilu HM, Shituru, SKM), Annex B (detailed map of Group West), Annex C (description of the treatment plants), Annex D (list of Gecamines' employees). The cover pages of the annexes are included, but they refer to maps, files and separate documents initialed by the parties for identification. Included are the map of Gecamines' mining zone and of project's mining zone, the coordinates of the perimeters of the KOV, Kananga, Tilwezembe mines as well as the extent and "location of the tailings zones to be defined by means of the feasibility study".