Civil Society follow-up briefing on the Badakhshan and Balkhab mining contracts

November 26, 2018

Afghan and international CSOs have raised a number of major concerns around the Badakhshan and Balkhab mining contracts, which the Afghan government signed in early October in Washington. We welcome the government's response to our concerns around the Badakhshan and Balkhab contracts, in the form of a press statement from Presidential Advisor Ajmal Ahmady and a press conference by Minister of Mines Nargis Nehan, and the eventual publication of the contracts on November 3.

We appreciate the acknowledgement in the press statement that CSOs are trying to fulfil their function of providing independent input into critical governance issues. **In this spirit, we are releasing this technical note to respond to the government's points in turn, and to explain why we continue to have deep concerns that the contracts are in clear breach of Afghan law**.

In doing so, we are making the following requests to the government to help resolve these concerns:

- Amend Article 74 of the draft 2018 law to clarify that all transparency, governance and community benefit measures in the law will apply to any contract, not just those signed after the law is ratified.
- Reinstate into the 2018 law the protections in Article 16.2.9 of the 2014 law barring *all* disqualified individuals (not just PEPs) from being major shareholders or board members of a company holding a mining license.
- Amend the draft 2018 law to further clarify that a Politically Exposed Person is prohibited from *beneficial ownership* of a mining project, as well as *'ownership'* (although the meanings overlap).
- Publish the beneficial ownership of the contract holders.
- Publish details of the financing of the projects, and in particular any financial or investment guarantees provided by the companies.
  Publish the security plans for the mines (excluding any genuinely sensitive elements)

1. Conflict with Article 16.5 of the 2014 Minerals Law

The core of CSOs concerns is whether the contracts are in breach of Article 16 of the mining law, and in particular two clauses, 16.5 and 16.2.9, which seek to exclude politically-connected individuals from holding licenses. Article 16.5 states:

> *(5) Any person stipulated in Section 1 and 2 of Paragraph (2) of this Article may obtain a License or Contract stipulated in this Law, five years after termination of their term [of tenure in an official position].*

Article 16.2 lists individuals excluded from obtaining licenses, including "The President, Vice-Presidents, Ministers, Chief Justice and members of Supreme Court, Attorney General, members of the National Assembly, Heads and members of the Independent Government Commissions (…) and their relatives up to the second degree of consanguinity or by marriage." However, sub-clause 16.2.9 adds to this:

> *Any legal person in which one or more of its major shareholders, member of executive board or member of its board of directors would be legally disqualified.*

Article 16 is an appropriate and important safeguard against political interference in the allocation of contracts. It is designed to reduce the most obvious type of interference, and to strengthen public

confidence in contracts. In general, there is a genuine risk of Ministers abusing their position to push for a contract to be approved when it should not be, or for better terms for the contract-holder.

The government has made several arguments in response to the concerns we have raised. In brief summary, they are:

- The Law does not prohibit a Minister from having a contract if it is in the name of a company the Minister owns, rather than their individual name.
- The contract was 'obtained' in 2012, before Mr Naderi became a Minister.
- The 2009 Minerals Law applies rather than the 2014 Law, as it was in force when Mr. Naderi's consortium was declared the preferred bidder. The 2009 does not restrict Ministers from obtaining contracts after they leave office.

The government says they asked for advice from their legal counsel on the legality of the contracts under Article 16.5. We understand that this came from more than one law firm, and that the most recent input clearly stated that the contracts appeared illegal under Article 16.2.9. This raises a major question of why this advice was ignored.

'Indirect ownership is not ownership'

The government's first point is that the law does not explicitly prohibit a former Minister from having *direct or indirect benefits* in mining contracts. This hinges first of all on the definition of the word 'obtain' in Article 16.5.

Mr. Ahmady's press statement implies that they are making an argument that Sadat Mansour Naderi is *benefitting* from the contracts but does not have *ownership* of them. This seems incorrect, as Naderi owns 100% of the Afghan Krystal and that company clearly has a substantial ownership stake in the contracts – 51% in the case of the Balkhab contract, and almost 25% in the case of the Badakhshan contract.

The government may be arguing that this *very slightly indirect* ownership structure – i.e. with the contract in the name of a company rather than an individual – would not constitute 'obtaining' a contract under Article 16.5. **This interpretation would render Article 16.5 virtually meaningless, as larger contracts are always owned through companies rather than individuals**. Indeed, under Article 49 the only contracts that are granted in the names of individuals and not companies are for artisanal mining – all others are granted to 'legal persons' (i.e. companies). It defies logic that the law would bar former Ministers from holding an artisanal contract but not a much larger exploitation or exploration contract.

That would in our view be a deeply perverse interpretation of the Law, and clearly against its letter as well as spirit . If this is indeed the government's position, we would see this as having alarming implications for their intent to uphold the substance of anti-corruption measures in the law. We believe Article 16.5 should naturally be interpreted to bar any Minister from obtaining any share in a contract. Indeed, the new Minerals Law should further clarify that senior officials are barred from *beneficial ownership* (i.e. any significant ownership or control whether informal or formal), although there is already significant restriction through the prohibition on 'ownership'.

But even if Article 16.5 is interpreted as the government has implied, **the contracts appear to be in breach of Article 16.2.9.** It is not disputed that Mr. Naderi as an individual would be disqualified from holding the contract, as he is a former Minister who resigned less than 5 years ago. But he is also indisputably a major shareholder in the consortium that was awarded the contract. On the face of it, this makes it very difficult to see how the Law could be interpreted to allow his company to

legally remain as a partner in the contract. Neither the government nor the company has addressed this point in their response.

'The contract was obtained in 2012'

Secondly, the government says that *"the purpose of [Article 16.5] was to prohibit senior officials from negotiating a contract and immediately winning a bid upon leaving office. This is not the case here. Mr. Naderi's consortium was clearly selected as the preferred bidder prior to the establishment of the current government. Even so, both Mr. Naderi and his father resigned from Parliament to ensure that there were no further perceptions of a conflict of interest."*

The key question here is again the meaning under the law of 'obtained'. The argument of both the company and the government is that the contract was 'obtained' in 2012, when Mr. Naderi's consortium was named as preferred bidder. But that rests on an assertion that preferred bidder status is the same thing as having a signed contract, and by extension that nothing significant was negotiated after 2012. That is not supported by the facts.

Preferred bidders are just that - bidders. There is significant negotiation, review and oversight still to come – processes which touch directly on the interests of the preferred bidders and which therefore raise the risk of interference (or the perception of interference) if they take place while one of those preferred bidders is a Minister (or has just left office). If a preferred bidder was to try to begin operations or otherwise assert any control over the mining area, they would be clearly breaking the law. Indeed, a reserve bidder was named for both the contracts in question to take over if the negotiations at any stage ceased making progress. If the government is really saying the two things are the same *in the eyes of the law*, then this would have drastic, destructive, and irrational implications for the whole structure of mining in Afghanistan.

It might be a little easier to make this argument if the contract negotiation and review was essentially 100% complete before Mr. Naderi became a Minister in 2015. But there have indeed been very substantive changes made to the deals since then. These have included a significant reduction in the royalty rate for the contracts, from 11% to 9.5% and 8.5% for the Balkhab and Badakhshan contracts respectively. Arrangements for security have been changed. We also have some indication that as of June 2018, the companies were offering significantly weaker guarantees for the financing of the project than they had in place when they won the contract (although it is unclear to is if this remains the case). All this leaves aside the critical elements of oversight and review which took place, including review by the National Procurement Committee and the Cabinet.

The point here is not whether the changes that were made were justified or not. That is an entirely separate issue, which we can consider below**.** The point is that it appears to us to be very difficult to make the case that the contract was in 'awarded' in 2012. Rather, **a contract in which a Minister had a direct ownership interest had significant elements (re-)negotiated and significant oversight completed while he was in office or shortly after.** That inevitably creates doubt over whether the changes reflected political interference. **This is exactly the situation which Article 16.5 was rightly designed to avoid, and why we believe it applies.**

Critically, that is the case *whether or not such undue influence actually took place*. We do not make any allegation either way in relation to that. But the Law is rightly and deliberately designed to apply whether or not there is any evidence of wrongdoing. There is a critical point of principle here that needs to be upheld if the government is to be a credible defender of the law.

While it is a welcome gesture and may well have been done in good faith, it is also irrelevant to the legality of the contracts that Mr. Naderi resigned as Minister in June 2018, as the Law (again quite

correctly) has a cooling-off period before a former official is able to obtain the contract. In any case, there is evidence elements of the negotiation and bidding process took place while he was in post.

'The 2009 law, not the 2014 law, should apply'

Thirdly, the government's argument is that the 2009 rather than the 2014 law applies seems to be difficult to make, for two reasons. First, applying the 2009 law would have significant implications for the contract. The 2009 law has does not set out a process for obtaining both an exploration and exploitation license simultaneously, for example. While it is subject to some ambiguity, this could potentially have significant implications for the consortium's ability to transition from exploration to exploitation.

Secondly, there is no stabilisation clause in either of the contracts, rather Articles 1.1 and 32 of both documents clearly states that they are subject to 'applicable law'. In addition, Article 74.2 of the draft 2018 law states that:

> *Subject to Article 74(11), a Transitional Licence shall continue in force in accordance with the law under which it was granted*

This clearly implies that the 2014 law will apply, if the 2018 draft is confirmed in parliament.

Incidentally, this measure raises a serious question about the draft 2018 law. Article 74 means that a number of the transparency and governance provisions in the law – including the requirement for publication of beneficial ownership – will not apply to existing contracts – in other words, to the vast majority of contracts for the foreseeable future. Ideally the Law would apply to existing contracts, but at least we would expect it to specify that Articles relating to transparency, governance and community rights would apply to all contracts, even if other Articles would not.

In fact, the law DOES specify that four specific clauses (13.4, 13.5, 17.4, and 17.5, as well as Article 74 itself) will apply to existing contracts. Those clauses include a useful anti-corruption measure in 13.4, and in 17.4 and 17.5, which require companies to declare changes of ownership to the government. But it is deeply unclear why only these clauses should have been excepted – and not all the transparency provisions. A company which would be negatively affected by this requirement should arguably not be holding a license in the first place.

We also note that Article 74.10 states that:

> *(10) A bidding process initiated prior to but not completed prior to the commencement of this Law shall, subject to Article 74(11), be conducted and a contract awarded in accordance with the Minerals Law which was applicable to that bidding process prior to the commencement of this Law, unless the bidding process is terminated by the Ministry.*

This clause, which only appeared in the very final stages of the drafting, after all consultation had ended, raises serious concerns. It appears to be against normal practice, which is for either the current law, or possibly the law at the time of signing to apply – but not the law at the time of bidding. As the Badakhshan and Balkhab contracts have been signed, it appears to be designed to apply to other contracts which could be said to be currently under negotiation. It is not at all clear why they should be treated this way.

2. Conflict with restrictions on license size

The contracts appear to be in breach of the requirement in the 2014 laws (Article 49) that an exploration license can cover a maximum area of 250 km^2, and must be in contiguous blocks. The

Badakhshan contract covers an area of almost 1000km^2, in four blocks of almost 250 km^2 each, while the Balkhab contract covers an area of 457 km2, but in two non-contiguous blocks.

The Ministry of Mines has asserted that a contract may be awarded to multiple licenses. While the law appears unclear on this point, we believe there is a strong argument against this interpretation. The law refers to licenses made up of multiple blocs, but there is no reference to contracts being made up of multiple licenses. The implication is that an area or more than 250 km^2 should be subject not just to a separate license but to separate tender and bidding process.

3. Points in relation to the renegotiation of the contract

Royalty rates

Mr Ahmady's response states that "CSOs allege that the changes to the royalty rate were given to the consortiums to the detriment of the GoIRA." While we cannot answer for other members of civil society, **we do not take a position *either for or against* these changes** at this stage. There are certainly arguments either way. The lower royalty rates in themselves clearly benefit the contracting companies – but as Mr. Ahmady points out, there are certainly some good arguments against unrealistically high royalty rates, and so lowering them may well benefit Afghanistan as well.

But much depends on the wider deal. If the royalty rates were lowered to reflect the fact that company was taking over the security costs, this provides some justification, but it also raises the possibility that the country may be better off if it waited until security had improved before tendering the contracts. This particularly applies to the Badakhshan contract. There may be some justification for concessions to help generate a positive example for other investors, but it is questionable whether multiple large contracts should be used for this, given the cost of such concessions.

Again, the central point we are making is not that the lower royalty rates are necessarily a bad thing, but that they **clearly constitute a major change in the contracts which inevitably raises concerns given a principle beneficiary was a Minister at the time the discussions were happening.** A change this substantial also raises the question of whether it would have been better to simply retender the contracts, even if this this would have involved some delay.

Financial guarantees

We understand that the contracts as originally agreed in 2012 included guarantees for investment finance around both contracts. While the contracts have been released, it is unclear to us whether those guarantees are still in place. These guarantees are critical to the financial health of the projects, and we ask the government to clarify what changes have been made.

Pressure on the Afghan government to agree contracts

The government rejects CSO concerns that the deals might reflect pressure to agree new contracts as a way of ensuring continued international engagement and support to the Afghan government. Our concerns are based in part on the fact that the 'Kabul compact' includes the 'resolution' of the contracts as one of the benchmarks for US engagement in Afghanistan. In addition, it is based on the fact that in September 2017, President Trump and President Ghani agreed to "*help American companies develop materials critical to national security while growing Afghanistan's economy and creating new jobs in both countries, therefore defraying some of the costs of United States assistance as Afghans become more self-reliant."* We note that the contracts were signed in the United States, although we understand that the main non-Afghan company involved (Centar) was UK-based, at

least until recently. In their press-release the company was described as 'US-based', although we the contracts only mention a base in Guernsey.

This raises the further issue of the company's ownership. At present, the contracts publish the shareholders of Centar, but a great number of these are nominees for shell or intermediary companies, meaning the actual owners are hidden. While we appreciate that publication of the beneficial owners of companies is not a requirement under the 2014 law, it is required under the draft 2018 law. As noted, it is disturbing that the draft 2018 law excludes existing contracts (or even contracts currently under negotiation) from publication of beneficial ownership. But the Articles of the draft 2018 law that do still apply to the contracts (specifically 17.4 and 17.5) require the company to declare its owners to the government. It is not specified that this list must then be published, but nor is it prohibited. **We strongly urge the government to ask the company to declare its beneficial ownership.**

Security

On the security issue, we make no claims to having any exceptional expertise on security matters. But it is clearly legitimate to ask how they will be addressed, as we do have direct information on the very high level of Taliban penetration of the Badakhshan gold mining area in particular. We would welcome the publication of the security plan Mr. Ahmady refers to. As we noted above, the fact that the company has been made responsible for security costs under Article 16.2 of the contracts is broadly positive, but still leaves open the question of whether the contract should have been re-tendered after security improves. And of course, it should be remembered that security costs will be deductible from any taxable income the company receives, reducing the tax revenue generated by the mines (although of course the government's security costs would also be reduced, and royalty revenue would be unaffected).