

The Inspection Panel

Report and Recommendation

on

Request of Inspection

Re: Request for Inspection from Swissbourn Diamond Mines (Pty) Ltd. & Others-Lesotho: Lesotho Highlands Water Project (Loan No: 4339-LSO)

A. The Project

1. On April 26 1999, the Inspection Panel (the "Panel") received a second Request for Inspection (the "Request") dated April 14, 1999 (Annex 1) related to the Lesotho Highlands Water Project (the "Project"). The Project is a common undertaking of the governments of the Kingdom of Lesotho and the Republic of South Africa agreed upon between themselves by way of a treaty dated October 24, 1986 (the "Treaty"). The Project basically consists of a large water scheme involving the construction of a series of dams and tunnels required for the storage and delivery of water from Lesotho to South Africa.

2. The Project's feasibility phase was financed by IDA through the Lesotho Highlands Water Engineering Project, Credit No. 1747-LSO, dated December 15, 1986. The Project's Phase 1A was financed through Loan No. 3393-LSO, dated September 16, 1991. Granted to the Lesotho Highlands Development Authority (LHDA), it provided part of the financing for the Katse dam and reservoir and associated works for the delivery of water to South Africa. The reservoir inundated land over which the Requesters claim to have a mining lease. The Project's Phase 1B was financed through Loan No. 4339-LSO, dated December 18, 1998. It was granted to the same borrower, LHDA, and was guaranteed by the Kingdom of Lesotho (GOL) and the Republic of South Africa (RSA). Now in progress, this Phase consists mainly of the building of a third dam in the Mohale area plus a diversion tunnel at Matsoku to channel additional waters into the Katse dam towards the intake and transfer tunnels for delivery to South Africa.

B. THE REQUEST

3. The Requesters are companies registered in the Kingdom of Lesotho and South African nationals who have interests in their mining rights. The RSA nationals are shareholders in the Lesotho companies and have invested in the mining rights in Lesotho.

4. The Requesters claim that, "as a direct result of the implementation of the Lesotho Highlands Water Project, the Requesters' interests and investments (rights) in Lesotho have been unlawfully expropriated by the Government of Lesotho. No compensation has been offered or paid by the Lesotho Highlands Development Authority ("LHDA") and/or the Government of Lesotho ("GOL") and/or the Government of the Republic of South Africa ("RSA") and/or the Trans-Caledon Tunnel Authority

("TCTA").¹ The expropriation has occurred with the knowledge, support and concurrence of the World Bank ("*the Bank*") which has funded both Phase 1 A and (more recently) Phase 1 B of the Project."

5. The Requesters also claim that "they have suffered harm – and continue to suffer harm - as a result of failures or omissions in the appraisal, monitoring and implementation by the Bank of Phase 1A and 1B of the Project." They maintain that they "have been deprived of their property rights and their entitlement to prompt, effective and adequate compensation. That deprivation would not have occurred if the Bank had complied with its Policies and Procedures." Specifically, the Requesters claim "that they have lost the ability to carry out mining activities pursuant to the leases granted to them in 1988. They have been deprived of their property and their livelihood. They have suffered financial damage including loss of profit."

6. The Requesters further allege that the Bank proceeded with financing of the project even though it had full knowledge of the expropriation and disputes between the Requesters and the GOL, RSA, LHDA, and TCTA. They claim that the Bank failed to take steps to ensure that the Requesters' rights were duly respected before proceeding to the appraisal and financing of Phase 1A and 1B of the Project and that that "constitutes complicity in the acts of expropriation and in the disputes, and violates its operational policies and procedures...." Specifically the Requesters claim they have been harmed as a result of Bank failure to observe:

- Operational Policy ("OP") 7.40 on Disputes over Defaults on External Debt, Expropriation and Breach of Contract.
- Bank Procedure ("BP") 7.40 on Disputes over Defaults on External Debt, Expropriation and Breach of Contract.
- BP 17.50 on Disclosure of Operational Information

7. The Requesters also claim that "the Bank violated UN Resolutions (economic and trade sanctions) imposed against RSA during 1991 by participating in a scheme to accommodate RSA's financial obligations in respect of the water transfer component of the Project, using Lesotho and, more specifically, LHDA as the vehicle therefore." This claim is clearly outside the mandate of the Panel.

¹ According to Paragraph 4 e) of the Project Appraisal Document (the "PAD"), TCTA "has been designated by RSA as the authority responsible for ultimately bearing all projects costs and for servicing the Project debt".

C. The Process

8. On May 14, 1999 the Panel notified the Executive Directors and Bank President of receipt of the Request (meaning “Registration” under the Panel’s *Operating Procedures*).² On June 15, 1999 the Panel received Management’s reply to the Request. (Annex 2)

9. Since the Panel was not satisfied that the Response provided evidence of compliance or intent to comply with Bank policies and procedures as required by paragraph 18 of the Resolution³ and 33 of the Panel’s *Operating Procedures*, the Panel, on June 30, 1999, requested Management “[t]o provide evidence of the Bank’s compliance with BP 17.50, OP 7.40 and especially with BP 7.40 which is referred to in detail in the Request of Inspection.” In response, the Country Director for Lesotho and South Africa sent a memorandum to the Chairman of the Panel on July 6, 1999 (Annex 3) which included thirty-three attachments.

10. The Panel proceeded to determine whether the Request meets the eligibility criteria set out in paragraphs 12 to 14 of the Resolution. To this end, Messrs. Jim MacNeill and Edward Ayensu, on behalf of the Panel, carried out an initial field visit.⁴ They met with the Requesters, with representatives of the GOL and RSA, and with senior officials of the LHDA and the TCTA. The Panel also consulted with Bank officials in Washington and Pretoria and with the staff of the Executive Director representing Lesotho and South Africa.⁵

D. ELIGIBILITY

11. Paragraph 9 of the 1999 Clarifications⁶ mentions certain “technical eligibility criteria” and the Panel concludes as follows:

- a) The Panel is satisfied that the affected party consists of two or more persons with common interests or concerns and who are in the borrower’s territory.
- b) The Request does assert in substance that a serious violation by the Bank of its operational policies and procedures has or is likely to have a material adverse effect on the Requester.
- c) The Request does assert that its subject matter has been brought to Management’s attention and that, in the Requesters’ view, Management has failed to respond adequately to it, thus demonstrating that it has followed or is taking steps to follow the Bank’s policies and procedures.

² See The Inspection Panel, *Operating Procedures* (August 1994) at paragraph 36.

³ Board Resolution Nos. IBRD 93-10 and IDA 93-6 that established the Inspection Panel (the “Resolution”).

⁴ Assisted by Mr. Eduardo G. Abbott, the Panel’s Executive Secretary.

⁵ The Panel wishes to thank the Country Director and staff and especially staff of the World Bank office in Pretoria for arranging meetings with government officials and project authorities in Lesotho and South Africa and for providing logistical support during the field visit. The Panel also wishes to thank the Executive Director for South Africa and his staff for their helpful comments and guidance.

⁶ The 1999 Clarifications to the Resolution are contained in the “Conclusions of the Board’s Second Review of the Inspection Panel” dated April 20, 1999.

- d) The matter is not related to procurement.
- e) The related loan has not been closed or substantially disbursed.

The Panel is satisfied with the *prima facie* evidence about the existence of a dispute over expropriation of mining leases in Lesotho throughout the appraisal and implementation of the project and that one of the main subjects of this dispute concerns a mining lease over an area included in the project area.

The Request refers to IDA Credit 1747-LSO and Bank Loans 3393-LSO and 4339-LSO. Since Credit 1747-LSO was closed on December 30, 1990 and Loan 3393-LSO was closed on March 31, 1999, --both before the submission of the Request, --the Panel will deal exclusively with matters related to Loan 4339-LSO pursuant to the provisions of paragraph 14(c) of the Resolution.

- f) The Panel has not previously made a recommendation on the subject matter.

12. The Panel is therefore satisfied that all the technical eligibility criteria referred to in the 1999 Clarifications have been met.

13. In its Response, Management “[d]raws the attention of the Panel to the decision taken by the Board of Executive Directors on July 6, 1995, in connection with the Inspection Panel case relating to the Papassinos property in Ethiopia. That request related to the application of the provisions of OMS 1.28, the precursor policy statement of OP 7.40. In that connection, the Executive Directors decided on June 8, 1995, with respect to OMS 1.28 (now OP 7.40 in substance) that the Resolution does not include a mandate for the Panel to review the consistency of Bank or IDA actions with respect to any of their policies and procedures, but only with those policies and procedures that relate to the design, appraisal, and/or implementation of any project financed by them. Management believes that this previous Inspection Panel case is relevant to the determination of the eligibility of the Request.”

14. The Panel notes that the above-referred Board decision concerns a series of memoranda sent by Management to the Board and an exchange of memoranda between the then Chairman of the Inspection Panel and the then Senior Vice President and General Counsel. The first memorandum (reference IDA/R 95-83) from the President *ad interim* (which was submitted to Board approval on a non-objection basis) stated that “[n]either the Requesters’ claim, nor OMS 1.28, which is the basis of the Requesters’ claim, covers any matters related to the design, appraisal and/or implementation of any project financed by the Bank or IDA” and concluded that “[t]he correct reading of the Resolution makes this particular request inadmissible irrespective of whether or not it meets the eligibility criteria set forth in the Resolution.”

15. In the case presently before the Panel, however, unlike the Papassinos case, the Request for Inspection does refer to a specific project and to specific provisions of OP and BP 7.40 that, according to the Requesters, Management violated in the appraisal, submission to the Board for approval and implementation of this particular project causing them material harm. The Requesters’ statement that at “all material times since July 1991 the Bank had actual knowledge of the expropriation and the disputes”

has been confirmed by Management's statements and the Panel's own review of the Requesters' correspondence and project files. The Requesters' allegations and Management's Response are discussed below.

E. Management's Compliance with Bank Policies and Procedures

16. In the Panel's view, there is *prima facie* evidence that Management has failed to comply with some of the relevant policies and procedures of the Bank.

17. Paragraph 2 of BP 7.40 states that: "[i]f, at the time a loan is presented to the executive directors for approval, there are any substantial amounts in dispute between the borrowing country and suppliers or lenders to, or investors in, that country, the matter is mentioned in the Memorandum and Recommendation of the President/President's Report."

18. In the Panel's opinion, at the time Loan 4339-LSO was submitted for Board approval (April 30, 1998) the Bank was aware of the existence of an ongoing dispute over the expropriation of rights over certain mining leases and that the amounts in dispute were substantial. Furthermore, the area of one of these mining leases (known as the Rampai lease) extends over at least half of the catchment area of the Katse Dam, which is part of the project.

19. At that time, a ruling of the Court of Appeals of Lesotho dated January 13, 1995 was in effect. This ruling stated, *inter alia*, that the Revocation Order of the Lesotho Government that dispossessed the Requesters of all their mineral rights "invades the protection of property without any compensation and without any reason asserted to support such invasion." Also at that time an application by LHDA to have the Rampai lease declared invalid, because of alleged procedural irregularities in the granting of the lease, was before the Lesotho High Court. Only on April 28, 1999, Lesotho's Honorable Chief Justice upheld LHDA's claim and set aside the Rampai lease. The Requesters are currently appealing this judgement before the Lesotho Court of Appeals and it may well be at least several months before this dispute is settled.

20. The amounts claimed by the Requesters in 1991 ranged from a "conservative" Rand (R) 81,654,540 to R 620,698,545 (well over one hundred million dollars) plus monetary adjustment and interests. Both TCTA (since 1994) and LHDA (since 1996) have reflected this dispute as a contingent liability in their annual financial statements, although in the widely varying amounts of R 507 million and R 81 million respectively.

21. On February 10, 1998 the Requesters delivered a letter to the Bank accusing it of direct or indirect participation in the "unlawful dispossession of SDM's [the Requesters'] lawful rights" and mentioning "possible legal proceedings to be instituted against the World Bank" and others.

22. In other words, regardless of the merits of the legal disputes which are to be decided by the Courts, there is no doubt that at the time Loan 4339-LSO was “presented to the Executive Directors for approval” there were substantial amounts in dispute between LHDA (the borrower), GOL, RSA and TCTA, and the Requesters. Furthermore, such disputes related in part to the project area and the Bank was being threatened with a lawsuit. In spite of the foregoing the PAD did not mention the dispute. Management behavior on this matter seems to be in clear violation of the above-referenced paragraph 3 of BP 7.40.

23. Paragraph 1 of BP 7.40 contains other specific procedural provisions to be followed by Management in cases of disputes over expropriation. Said paragraph establishes the procedure to be followed to allow the Regional Vice President to decide on the Bank's position on the matter. Although Management's Response and a review of project files do not provide a clear description as to how the decision was made, it is clear that the Bank decided to continue lending to Lesotho, because in Management's opinion, the borrower was making reasonable efforts to settle the dispute by submitting matter to the Courts and the dispute was not substantially harming the country's international credit standing.

24. Compliance or non-compliance with the provisions of OP 7.40 is more difficult to ascertain since the OP seems to provide considerable latitude to Management when establishing how reasonable are a country's efforts to settle a dispute over expropriation and to what extent such dispute may be affecting its international credit standing. In this case, Management is satisfied with GOL's, LHDA's and TCTA's assertions that they will abide by the Courts' rulings on the matter and that the dispute is not affecting their international credit standing. The Panel did not find any *prima facie* evidence of facts or factors that would indicate that Management's position on this matter could be regarded as unreasonable.

25. Concerning BP 17.50, paragraph 5 states that “[i]f an interested party requests additional technical information about a project under preparation, the country department director releases factual technical documents, or portions of such documents, after consulting with the government to identify any sections that involve confidential material or that could compromise relations between the government and the Bank.” According to information provided by Management however, it simply referred the Requesters to the InfoShop. The Panel is not satisfied that Management has complied in full with the provisions of this paragraph.

F. CONCLUSION

26. The Panel is of the opinion that Management has failed to comply with some of the applicable policies and procedures as explained above. In its judgment, however, there seems to be no direct link between any actions and/or omissions of the Bank and the harm claimed by the Requesters.

27. As for alleged harm, the Panel notes that the Requesters are currently appealing the April 29, 1999 High Court judgment in the Lesotho Court of Appeals, and therefore have not exhausted all of the possible legal remedies available to them.

G. RECOMMENDATION

28. *Based on the foregoing, the Panel does not recommend an investigation into the matters alleged in the Request.*

ANNEX 1

REQUEST FOR INSPECTION

Request to the World Bank Inspection Panel
lodged by Swissbourgh Diamond Mines (Pty)
Ltd & Others 14 April 1999

REQUEST FOR INSPECTION

To the WORLD BANK INSPECTION PANEL
1818 H Street, NW, Washington, D.C. 20433,
USA

INDEX TO REQUEST

Volume 1A	Pages A1 to A15	The Request
Volume 1B	Pages B1 to B144	Annexure 1
Volume 2	Pages 1 to 322	Attachments 1 to 5
Volume 3	Pages 323 to 566	Attachment 6 to 23
Volume 4	Pages 567 to 870	Attachments 24 to 31
Volume 5	Pages 871 to 946.28	Attachments 32 to 37
Volume 6	Pages 94 7 to 1295	Annexures 2 & 3

Swissbourgh Diamond Mines (Pty) Ltd &
Others

P O Box 1313
BEDFOROVIEW 2008
Republic of South Africa
Tel: +2711 450-2433
Fax: +2711 450-1545

REQUEST FOR INSPECTION

TO THE WORLD BANK INSPECTION PANEL
1818 H St, NW, Washington, D.C. 20433, USA

This request for Inspection is brought by:

THE REQUESTERS

1	Swissbourn Diamond Mines (Pty) Limited	First Requester
2	Matsoku Diamond (Pty) Limited	Second Requester
3	Patiseng Diamonds (Pty) Limited	Third Requester
4	Orange Diamonds (Pty) Limited	Forth Requester
5	Motete Diamonds (Pty) Limited	Fifth Requester
6	Rampai Diamonds (Pty) Limited	Sixth Requester
7	Josias van Zyl	Seventh Requester
8	Josias van Zyl Family Trust	Eighth Requester
9	Burmilla Trust	Ninth Requester

Together "*the Requesters*"

The Request comprises this Request to which is incorporated **Annexures 1 to 3 and Attachments 1 to 37**.

The Requesters are companies registered in the Kingdom of Lesotho and South African nationals who have interests in the rights. The RSA nationals are shareholders in the Lesotho companies and have invested in the mining

rights in Lesotho. As a direct result of the implementation of the Lesotho Highlands Water Project ("*the Project*") the Requesters interests and investments ("rights") in Lesotho have been unlawfully expropriated by the Government of Lesotho. No compensation has been offered or paid by the Lesotho Highlands Development Authority ("*LHDA* ") and/or the Government of Lesotho ("GOL "), and/or the Government of the Republic of South Africa ("RSA") and/or the Trans-Caledon Tunnel Authority ("TCTA "). The expropriation has occurred with the knowledge, support and concurrence of the World Bank ("*the Bank*") which has funded both Phase 1A and (more recently) Phase 1 B of the Project.

The Project consists of the water transfer component (which constitutes about 95% of the total costs) and the hydro-electric power generation component. RSA is responsible for the financing of the water transfer component and GOL is solely responsible for financing the hydro power portion. RSA assisted GOL in certain of its finance obligations in respect of the hydro power component of the Project.

Beyond its financial support, the Bank provides monitoring of total project execution. The Bank has at all times had actual knowledge of the unlawful expropriation and the disputes which ensued. It has failed to take any steps to remedy, alternatively to ensure that Lesotho and/or South Africa remedy the situation. The factual details are set out in **Annexure 1** to this Request. A detailed chronology of the events is set out in **Annexure 2**.

1. The Requesters present this Request for Inspection because they have suffered harm - and continue to suffer harm - as a result of failures or omissions in the appraisal, monitoring and implementation

by the Bank of Phase 1 A and 1 B of the Project. Specifically, the Requesters have been deprived of their property rights and their entitlement to prompt, effective and adequate compensation. That deprivation would not have occurred if the Bank had complied with its Policies and Procedures.

1.1 **List of failures or omissions the Requesters believe are the Bank's responsibility**

In order to implement the Project GOL has expropriated the Requesters rights in the Rampai area of Lesotho and elsewhere: see Attachments 1 & 8. It has done so without paying any compensation, in a manner described by the then President of the Lesotho Court of Appeal as invading "*the protection of property without any compensation and without any reason asserted to support such invasion*" and purporting "*to effect such invasion without any recourse to any court of Law*" (see **Annexure 1**, para 58).

The Bank has proceeded to appraise, monitor, implement and finance the Project even though it has had - at the time it financed Phase 1A and 1B of the Project - actual and direct knowledge of the Requesters' rights and interests, the expropriation and the disputes between the Requesters and GOL, RSA and LHDA. Before deciding to proceed to the appraisal and financing of Phase 1A (in 1991) and Phase 1B (in 1998) the Bank should have taken steps to ensure that the Requesters' rights were duly respected, fully protected and the disputes resolved. The failure of the Bank to do so constitutes complicity in the acts of expropriation and in the disputes, and violates its operational policies and procedures by proceeding to participate in the Project in full knowledge of the expropriation and the disputes the Bank has contributed in a material and direct way to the violation of the Requesters' rights. It is responsible for that violation, which would not have occurred if its policies and procedures had been followed.

The Bank violated UN Resolutions (economic and trade sanctions) imposed against RSA during 1991 by participating in a scheme to accommodate RSA's financial obligations in respect of the water transfer component of the Project, using Lesotho more specifically LHDA as the vehicle therefore. The Bank's conduct in this regard was during March 1994 protected when the then apartheid regime granted various organisations within the Bank immunities and privileges against civil and criminal prosecution in the South African courts (see **Annexure 1** para 51).

1.2 **Description of the damage or harm resulting from the failures or omissions**

As a result of the Bank's failures and its contribution to implement and support the unlawful expropriation, the Requesters have been deprived of their rights to peaceful enjoyment of property, including the right to fair, full and prompt compensation. Specifically, the Requesters have lost the ability to carry out mining activities pursuant to the leases granted to them in 1988. They have been deprived of their property and their livelihood. They have suffered financial damage including loss of profit. These losses are directly attributable to the Bank, which co-financed the Project and clearly approved of the implementation procedures and unlawful expropriation methods employed and thereby indicated to GOL and RSA that expropriatory acts of this kind and human rights abuses of the kind referred to by the then Chief Justice, His Lordship B P Cullinan (as quoted in **Annexure 1**) will not preclude the involvement of the Bank.

1.3 **List or description of the Bank policies and procedures which have not been observed**

The Bank has explicit policies and procedures dealing with expropriation situations of this kind. It failed to follow them in 1991 and thereafter in respect of Phase 1 A of the Project, and again in 1998 and thereafter in respect of Phase 1 B of the Project. The following operational policies and procedures pertain to the design, appraisal, monitoring and/or implementation and/or execution of a project financed by the Bank, *inter alia*:

- Operational Policy 7.40 (*Disputes over Defaults on External Debt, Expropriation, and Breach of Contract*),
- Bank Procedure 7.40 (*Disputes over Defaults on External Debt, Expropriation, and Breach of Contract*), and
- Bank Procedures 17.50 (*Disclosure of Operational Information*)

At all material times since July 1991 the Bank had actual knowledge of the expropriation and the disputes. If it had followed the requirements of these Policies and Procedures the rights of the Requesters would have been respected and protected. Specifically, under these Policies and Procedures the Bank was required *inter alia* to:

- suspend the disbursement of any financial resources in relation to Phase 1 A of the Project, in particular the \$US 110 million facility approved on 16 September 1991;
- suspend forthwith the disbursement of any further financial resources in relation to Phase 1 B of the Project, in particular the \$US 45 million facility approved on 4 June 1998 and subsequently in a further funding agreement concluded between the Bank, GOL and RSA on or around 18 December 1998;
- consider whether to continue lending for and/ or sanctioning new projects in Lesotho
- not appraise Phase 1A of the Project whilst the dispute as to expropriation was pending;
- not appraise Phase 1B of the Project whilst the dispute as to expropriation was pending;
- seek to improve communications between the Requesters and GOL and RSA;

- promote a prompt and adequate settlement of the disputes;
- perform the various steps required under Bank Procedure 7.40 (with a view to ensuring that its financial and other acts did not contribute to and/or condone an unlawful expropriation);
- provide the Requesters with copies of all Project information Documents and Staff Appraisal Reports in relation to them and in relation to the Project (including Phases 1 A and 1 B and such other phases in respect of which the Bank sanctioned and is contemplating the provision and/or sanctioning of further financial support);
- assist the Requesters in achieving a prompt and adequate settlement of the disputes between GOL and RSA and the Bank.

It has failed to take any of these steps.

2 The Requesters' complaints have been raised with the Bank's staff by correspondence and efforts to meet with its representatives.

2.1 As set out in **Attachment 2** to this Request, the Requesters have written to the Bank in Pretoria and at headquarters in Washington DC to complain about its conduct (acts) since 1993, as well as the acts of GOL, RSA, LHDA and TCTA. The chronology of the correspondence is referred to in **Attachment 2**, copies of the communications themselves are already in possession of the Bank.

2.2 The Bank's responses were not substantive, it has failed and/or refused to provide documents and information, or to seek to resolve the disputes (see e.g. letter dated 25 March 1998 **Attachment 2** [SDM ref 2059.131]). It has acknowledged receipt of some of the correspondence (confirming its actual knowledge of the expropriation and the disputes). And by a letter of 19 January 1999 it has claimed immunity from legal action in the national courts of Lesotho in relation to this matter: see **Attachment 3**.

2.3 By letter dated 1 July 1993 Mr Josias van Zyl (the Seventh Requester) wrote to the then President of the Bank enclosing a Press Statement issued by SDM, drawing attention to the unlawful expropriation and interference with the Requesters' property rights and the refusal of RSA and GOL to hold independent inquiries: see **Attachment 22**. The Press statement *inter alia* refers to the decree (the Revocation Order) by which the First and Sixth Requesters' rights had been expropriated without compensation. [The Bank did not respond].

2.4 By letter dated 10 February 1998 the Requesters provided the Bank with all relevant documentation pertaining to the expropriation and the disputes with GOL and RSA: see **Attachment 2** [SDM ref 990.1 - 990.3 enclosed thereto volumes 1 to 4 ref 989.1 to 989.818]. The documentation included the constitutional request for

access to state documents from RSA President Dr Nelson Mandela together with Annexures in which all the facts, allegations and supporting documentation were submitted. Furthermore, the Annexures included the decisions of the Lesotho court of first instance and appeal court in relation to the striking down of the Revocation Order. [The Bank did not respond.]

2.5 By letter dated 26 February 1998 the Requesters wrote to Mrs Judith Edstrom in Pretoria (with a request to copy the letter to the President of the World Bank in Washington) requesting copies of and access to all documents exchanged between the Bank, GOL, RSA, LHDA and TCTA involving and/or relating to and/or concerning and/or affecting the First Requester and its rights in respect of the LHWP for the period 1991 to 1999: see **Attachment 2** [SDM ref 2059.73 to 2059.75]. Mrs Edstrom responded in a letter dated 26 February 1998 directing the request to Mr Arnaud Guinard, task team leader of the LHWP in Washington. [The Bank did not respond to the request and other allegations made in the Requesters' letter]

2.6 By letter dated 13 March 1998 the Requesters wrote to Messrs. Guinard and Roome as Task Team Leaders of the LHWP Project at the Bank, requesting the Bank to act as mediator in the dispute over expropriation: see **Attachment 2** [SDM ref 2059.91 to 2059.111]. The letter identified the various claims for damages on the part of each of the Claimant companies. (The Bank in a letter dated 25 March 1998 declined to act as mediator: see **Attachment 2** [SDM ref 2059.131])

2.7 By letters dated 27 March and 22 April 1998 the Requesters again wrote to the Bank's Task Team Leaders, calling on the Bank to take action to halt LHDA efforts to maintain the claim to lawful expropriation: see **Attachment 2** [SDM ref 2059.112 and 2059.113 to 2059.130]. Full documentation was provided.[The Bank did not respond].

2.8 By letters dated 10 May, 13 May, 29 September and 15 October 1998 the Bank was further kept fully informed of developments as to the dispute over the expropriation: see **Attachment 2** [SDM ref 2059.144 to 2059.229]. [The Bank did not respond].

2.9 By a Rooth & Wessels letter dated 21 December 1998 addressed to the President of the Bank, the Requesters notified the Bank that proceedings in Lesotho against LHDA (for unlawful expropriation) had been instigated (case CIV/T/348/98): see **Attachment 2** [SDM ref 2073.1 to 2073.48]. The Bank was provided with a copy of the summons. The Particulars of the claimants' claim were provided to the Bank's Pretoria office. The Claimants further requested documentation in relation to the case and outlined the allegations against the Bank [The Bank did not respond.]

2.10 By a further letter of 14 October 1998, the Requesters asked for copies of World Bank Appraisal Reports on the Project for the period 1990 to 1998 be forwarded to them: see **Attachment 2** [SDM ref 2059.219]. [The Bank did not respond.]

2.11 By a Rooth & Wessels letter dated 16 February 1999: see **Attachment 2** addressed to the President of the Bank the Requesters invited the Bank to explain its position, and specifically:

1. to suspend forthwith the disbursement of any further financial resources in relation to Phases 1 A and 1 B of the Project, in particular the \$US 45 million facility approved on 4 June 1998 and further funding subsequently agreed on or around 18 December 1998;

2. To explain *inter alia* how the Bank has complied with the requirements of Operational Policy 7.40, including the obligations:

- to consider whether to continue lending for new projects in Lesotho,
- to not appraise Phase 1 B of the Project whilst the dispute as to expropriation was pending,
- to improve communications between the Claimants and the Government of Lesotho,
- to promote a prompt and adequate settlement of the disputes, and
- to perform the various steps required under Bank Procedure 7.40.

3 to provide the Claimants with copies of all Project Information Documents and Staff Appraisal Reports in relation to the Project (including Phases 1A and 1B and such other phases in respect of which the Bank is contemplating the provision of further financial support); and

4 to assist the Claimants in achieving a prompt and adequate settlement of the outstanding disputes with GOL. The Requesters indicated to the Bank that they would be willing to meet with its representatives to discuss the above, and that in the absence of a substantive response to the letter by 26 February 1999 they would commence proceedings against the Bank. The Bank's response was not substantive, it did not address the issues raised and was unacceptable to the Requesters.

3 In addition, the Requesters have taken steps to resolve their disputes with GOL, RSA, LHIDA, TCTA and the Bank as to the expropriation and the failure to provide compensation. As set out in **Annexure 1** (at paras. 46, 49 & 66), legal proceedings have been commenced against GOL, LHIDA, RSA and TCTA. The Requesters have reserved their right to bring proceedings against the Bank, and are first filing this Request in the spirit of reaching an appropriate resolution of the disputes.

4 The Bank, during the period April 1991 to the present, *inter alia* unlawfully and intentionally participated in and supported the unlawful expropriation of the Requesters' rights and investments in the Kingdom of Lesotho in the execution of the LHWP, and the failure to compensate the Requesters.

5 The Requesters request that the Inspection Panel recommend to the Bank's executive directors that an investigation of the violation by the Bank of its policies and procedures be carried out. The investigation to include its financing, appraisal, monitoring and implementation of the Project and the expropriation of the Requesters' lease rights. As advised in your Operating Procedures, this Request for Inspection is brief. A detailed factual summary is set out at **Annexure 1**, together with Maps and Attachments, to which is incorporated **Attachments 1 to 37 and Annexures 2 and 3**. The Requesters will be pleased to provide the Inspection Panel with more information as required and to meet with the Panel as necessary.

6 The Requesters' rights to institute such proceedings against the Bank and/or any person or entity in any forum in the world as they may be advised and to supplement and amplify this request for inspection, are expressly reserved.

7 The Requesters authorize and request the Inspection Panel to make this request public.

8 Communications in respect of this Request should be addressed to Dr Dawie Botha, c/o Rooth & Wessels, First National Bank Building, Church Square, P.O. Box 208 Pretoria, 0002, Republic of South Africa, telephone +2712/325-2940, fax +2712/323-0344.

ANNEX 2

MANAGEMENT'S RESPONSE

OFFICE MEMORANDUM

DATE: June 14, 1999

TO: Jim MacNeill, Chairperson, Inspection Panel

FROM: Shengman Zhang, Managing Director

EXTENSION: 80242

SUBJECT: **Lesotho: Lesotho Highlands Water Project (Phase 1B)
Management Response to the Request for Inspection**

1. Reference is made to the Memorandum, dated May 14, 1999, to the President of International Bank for Reconstruction and Development (the Bank), by which the Chairman of the Inspection Panel requested Bank Management to provide the Panel with written evidence that it has complied, or intends to comply, with the relevant policies and procedures in the implementation of the Project referenced above.

I. Summary Account of the Request

2. The Request is filed by a group of nine mining companies registered in the Kingdom of Lesotho. The Requesters allege that they hold mineral lease rights located within a geographic area encompassing land that was inundated as a result of the construction of the Katse dam and more specifically known as the Rampai area. They claim that the said rights "have been unlawfully expropriated by the Government of Lesotho" without any compensation in order to further the implementation of Phase 1A of the Lesotho Highlands Water Project (LHWP) which has been financed by the Bank through Loan No. 3393-LSO, dated September 16, 1991, and granted to the Lesotho Highlands Development Authority (the Borrower). They further allege that the said expropriation is a direct result of the Bank's failure to have followed its operational policies and procedures when it agreed to finance the initial phase of the LHWP (Phase 1A) in 1991. Furthermore, the Requesters allege that they have been further harmed by the Bank's failure to follow its operational policies and procedures when the Bank decided to finance the following phase of the LHWP, known as Phase 1B, through Loan No. 4339-LSO, dated December 18, 1998, and granted to the same Borrower.

3. Specifically, the Requesters allege that the Bank has violated OP 7.40, Disputes over Defaults on External Debt, Expropriation and Breach of Contract, and BP 17.50, Disclosure of Operational Information.

4. The Management response to the alleged violations is structured as follows:

First, the Response provides a brief background of the Lesotho Highlands Water Project. Second, it confirms that the Bank has fully complied with the requirements of OP 7.40 and BP 17.50. Finally, it provides information to be taken into account by the Panel in determining the eligibility of the Request.

II. Background information on the Lesotho Highlands Water Project

5. The Lesotho Highlands Water Project is a common undertaking of the governments of the Kingdom of Lesotho and the Republic of South Africa agreed upon between themselves by way of a treaty dated October 24, 1986 (the Treaty). Basically, the LHWP consists of a large water scheme to be developed progressively in five successive phases. The initial phase, known under the Treaty as Phase 1A was initiated in 1986 and was financed by IDA through the Lesotho Highlands Water Engineering Project, (Credit No. 1747-LSO dated December 15, 1986) to carry out the required feasibility studies. Subsequent to the successful conclusion of those studies, a consortium of international lenders, including the Bank, was mobilized to provide the funding needed to finance the construction of the initial series of dams and tunnels required for the storage and delivery of waters from Lesotho to South Africa. The total amount of funds raised for the purpose was about \$ 2.5 billions of which the Bank provided \$ 110 million through Loan No. 3393-LSO, dated September 16, 1991. The implementation of Phase 1A has been fully completed and the related Bank Loan was closed on March 31, 1999. In accordance with their obligations under the Treaty, Lesotho and South Africa are now proceeding with the implementation of Phase 1B of the LHWP, which consists mainly of the construction of a third dam in the Mohale area plus a diversion tunnel at Matsoku to channel additional waters into the Katse dam towards the intake and transfer tunnels for delivery to South Africa. The total amount of funds mobilized for Phase 1B from international lenders is about \$1.5 billion of which the Bank is providing \$ 45 million through Loan No. 4339-LSO, dated December 18, 1998. The Bank Loan for Phase 1A was guaranteed by the Kingdom of Lesotho, with additional security arrangements in the form of a deed of trust entered into between the lenders and the Republic of South Africa. The Bank Loan for Phase 1B is guaranteed by both the Kingdom of Lesotho and the Republic of South Africa.

III. Compliance by the Bank with requirements of OP 7.40 and BP 17.50

6. The Bank Management wishes to confirm that it has fully complied with the requirements of OP 7.40 and BP 17.50, as detailed below.

7. With respect to the alleged violation of OP 7.40, it should be noted that the requirements of the said policy are that when the Bank considers lending for a country with ongoing disputes relating to expropriation of property of aliens, the Bank must form for itself an opinion as to whether the concerned country is making reasonable efforts to settle the disputes and as to whether the said disputes are substantially harming the country's international credit standing. In this regard, the Management submits to the Panel that throughout the implementation of Phase 1A and, subsequently, during the preparation of Phase 1B, the Bank had asked the Borrower to advise it of the steps being undertaken to settle the expropriation dispute between the Borrower and the

Requesters. The Borrower provided the Bank with its legal position on the dispute by indicating in substance the following: (i) in the Borrower's best informed opinion, the disputed mineral lease had been granted illegally; (ii) the dispute had been submitted to the relevant courts; and (iii) the Borrower was prepared to abide by any final decision to be rendered in the case by the relevant courts. Finally, on May 1, 1999, the Borrower delivered to the Bank a copy of the latest judgment rendered in the case by the High Court of Lesotho on April 28, 1999; the said judgment has declared against the Requesters by pronouncing the disputed mining lease to be null and void from its inception on the legal ground that it was granted in flagrant violation of the procedures prescribed by the relevant provisions of the Mining Rights Act No 43 of 1967. Indeed, the final disposition of the judgement reads as follows: "In summary the Counter-Application is granted in terms of prayers 1 and 2."; those prayers read as follows:

"1. Declaring mining lease registered under No. 21044 in the Deeds Registry, in Maseru, on 26 October, 1988, entered into between the Basotho Nation and Swissbourgh Diamond Mines (Pty) Limited in respect of the Rampai Area, void ab initio and of no force and effect;

2. Canceling the entry in the register of the Registrar of Deeds, Maseru, relating to the aforesaid mining lease; ..."

8. In light of all the circumstances described above, the Bank's informed opinion throughout the processing of both Phase 1A and Phase 1B projects has been that the Borrower was making reasonable efforts to settle the dispute with the Requesters in a manner consistent with the requirements of OP 7.40. In addition, the Bank also concluded that the expropriation dispute at hand was not substantially harming Lesotho's international credit standing. Indeed, the Bank's judgment with respect to Lesotho's international credit standing has been confirmed by the fact that Lesotho has continued to enjoy substantial financial support from international credit markets as is abundantly evidenced, *inter alia*, by the mobilization of the required funding for Phase 1A and 1B of the LHWP in an aggregate amount equivalent to more than \$ 4 billion.

9. With respect to the alleged violations of the requirements of BP 17.50, it should be noted that BP 17.50 was adopted by the Bank in September 1993; therefore, its requirements were not in effect when Loan No. 3393-LSO was granted for LHWP Phase 1A. With respect to Loan No. 4339-LSO, the Requesters had asked the Bank to submit to them any and all information and documents in the Bank's files as they pertain to the LHWP. The disclosure requirements stipulated under BP 17.50 do not require the Bank to provide open and full access to the Bank's project files to the public or to the Requesters, as they had claimed. In keeping with the letter and spirit of BP 17.50, the staff advised the Requesters to contact the Public Information Center (now the Infoshop) to obtain all information pertaining to the Project that was available for release to the public in accordance with the provisions of BP 17.50.

10. Management is of the opinion that it has complied in full with the actions expected from the Bank under OP 7.40 and has also fully complied with BP 17.50. Indeed, with respect to BP 17.50, the information pertaining to Loan No. 4339-LSO is still available at the Infoshop.

IV. Eligibility of the Request

11. The Bank Management would like the Panel to take the following into account in determining the eligibility of the Request.

12. As the Requesters themselves stated, the alleged expropriation of the disputed Rampai mineral lease was carried out by the Government of Lesotho in 1988 during the time when the Lesotho Highlands Water Engineering Project (Credit No. 1747-LSO) was being carried out. This credit has closed and the subsequent Loan made by the Bank on September 16, 1991 (Loan No. 3393-LSO), closed on March 31, 1999. Thus, if one were to argue that the alleged violations of Bank policies took place at the time of the expropriation (of lands to which the granting of mineral rights has now been declared null and void by the Lesotho courts) in 1988 and of the related Bank-financed operation, the Request appears to be debarred. As provided in the Resolution and the clarifications, "requests filed after the Closing Date of the loan financing the project with respect to which the request is filed or after the loan financing the project has been substantially disbursed" may not be heard by the Panel.

13. Management also draws the attention of the Panel to the decision taken by the Board of Executive Directors on July 6, 1995, in connection with the Inspection Panel case relating to the Papassinos property in Ethiopia. That request related to the application of the provisions of OMS 1.28, the precursor policy statement of OP 7.40. In that connection the Executive Directors decided on June 8 1995, with respect to OMS 1.28 (now OP 7.40 in substance) that the Resolution does not include a mandate for the Panel to review the consistency of Bank or IDA actions with respect to any of their policies and procedures, but only with those policies and procedures that relate to the design, appraisal, and/or implementation of any project financed by them. Management believes that this previous Inspection Panel case is relevant to the determination of the eligibility of the Request.

14. It should also be noted that in compliance with the provisions of OP 7.40, the Bank has not interfered with or passed any judgment on the dispute between the Requesters, the Borrower, and the Government of Lesotho, which is before the courts in Lesotho. It is clear from paragraph 7 above that the matter is being resolved through the courts, and both the Government of Lesotho and the Borrower have indicated their willingness to abide by any final decision rendered.

V. Conclusion

15. Bank Management concludes that it has complied in full with the provisions of OP 7.40 and it has responded in full in accordance with its policies as set forth in BP 17.50 with respect to the request for information by the Requesters.