

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 Swissbough 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.