



USAID FIRMS PROJECT

Review and Recommendations on Regulatory/ Institutional Framework and Business Processes

June, 2014

This publication was produced for review by the USAID. It was prepared by Vitelli and Associates for an assignment commissioned by Chemonics International under the USAID Firms Project.



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Data Page

Contract Number:	GBTI II Task Order No. EEM-4-07-07-00008-00
Contractor Name:	Chemonics International, Inc.
Name of the Component:	Business Enabling Environment (BEE)
USAID Technical Office:	Office of the Economic Growth and Agriculture; USAID Pakistan
Date of Report:	June 15, 2014
Document Title:	Review And Recommendations On Regulatory/ Institutional Framework And Business Processes
Author's Name:	Vitelli and Associates
Editing:	Zehra, M
SOW Title and Work Plan & Action ID:	Support for Development of Subsidiary Legislation: KPK Mining, Work Plan Level 33000, Action ID number 7240
Project Area:	Khyber Pakhtunkhwa, Pakistan
Key Words:	Contract, Minerals, Mines, Khyber Pakhtunkhwa, Policy

Abstract

This document is the first of six to be delivered under the consultancy to provide assistance to develop a modern mineral market in Khyber Pakhtunkhwa (KP) Province. Included under the Scope of Work, Task 2A the following work has been conducted¹.

- a. Evaluate the regulatory regime governing the mining sector of the province ensuring the recommendations of the recently formulated Minerals Policy Framework Report are adhered to.
- b. Propose strategies for the efficient management, regulation and promotion of the Minerals Sector of the KP province.
- c. Conduct a review and analyze the existing regulatory and institutional framework governing the mining industry in KP including but not limited to Draft Policy Framework for KP (prepared under USAID FIRMS Project), 2013 National Minerals Policy, 1995 National Mineral Policy, the Regulation of Mines and Oil Fields and Mineral Development (Government Control) Act 1948, the 2005 Mining Concession Rules of NWFP².

In addition, in order to provide the USAID FIRMS Project Team sufficient time to review proposed documents during the course of this consultancy, an outline of an illustrative draft mine contract template and a draft international tender process template are also provided that will be detailed under later deliverables. Because this work is being conducted in tandem with the amending of the 2005 KP Mining Concession Rules, where useful, reference to where the content of the rules will be amended bracketed. “[]”

Consultant worked under the supervision of Mr. Farhan Shah (BEE Specialist). Appreciative thanks to the Secretary of the Mines and Minerals Development Department of Khyber Pakhtunkhwa, for sharing objectives and goals on developing the KP mineral sector and significant insights on sector operations.

¹ In order to present a logical flow of information, these items are presented in the report as (a), (c), and (b).

² Note: this sub-task also referenced Balochistan which has been earlier reviewed; the focus of this consultancy is KP.

Acronyms

BEE	Business Enabling Environment
CDA	Community Development Agreement
EITI	Extractive Industries Transparency Initiative
GIS	Geographic Information System
GSP	Geological Survey of Pakistan
KP	Khyber Pakhtunkhwa
MMDD	Mines and Minerals Development Department
MWG	Minerals Working Group
MSI	Multi-Stakeholder Initiative
NGO	Non-governmental organization
QEIT	Qualified Extractive Industry Taxpayer
US	United States
USAID	United States Agency for International Development

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Executive Summary

KP is host to a large array of minerals; primary mining/quarrying in the province is marble and granite, coal (ranging from lignite to bituminous), limestone, and artisanal gemstone mining. KP is also host to oil and natural gas. KP divides its minerals into five categories:

1. Dimension Stone
2. Gemstones
3. Industrial Rocks (i.e., rock salt, limestone, phosphates, gypsum, soapstone)
4. Fuel Minerals
5. Metallic Minerals (southern province, i.e., coal, base metals, lead) and construction materials.

KP Mineral Categories	
1.	Dimension Stone
2.	Gemstones
3.	Industrial Rocks
4.	Fuel Minerals
5.	Metallic Minerals

The Government of KP regards mining as a priority sector and has recently submitted a KP Minerals Policy to be adopted by the province. The population for Khyber Pakhtunkhwa (KP) is approximated at 18 million, an estimated 10-13% of the Pakistan population.

The KP Minerals Policy is comprehensive and covers all key aspects for the development of the Minerals Sector including objectives, legal and regulatory aspects, institutional roles, license and lease types, social and environmental protection issues and revenue management. Ensuring that the regulatory and institutional support required to implement the policy objectives presents the next significant reform challenge.

Incomplete Market

The KP Minerals Sector is conducted in the context of an incomplete market where legal and regulatory frameworks are being revised, mine operators are not yet held to international mining standards, and civil society engagement is minimal. Despite clear and transparent criteria by which to monitor mineral investments, actual governance of the investments and general compliance reflect an incomplete set of modern market measures and in some cases, absence of any.

KP Mineral Regulatory Regime

While regulatory guidance is in place, the underlying legal, regulatory and financial frameworks are not yet sufficiently in place to facilitate a modern minerals market that ensure transparent operations, optimize revenue generation, and require citizen, worker, and environmental protections. An important first step in defining KP mineral operations to be regulated is the establishment of a viable cadastre system— whether computer based (i.e., “Flexi-Cadastre”) or paper-based.

Government is correctly focusing on amending the 2005 Mining Concession Rules in order to facilitate a modern and competitive mining market in KP. This will include publishing clear process for how mineral rights will be awarded including eligibility criteria for investors. For large-scale international tenders, a two-stage tender methodology,³ increasingly used throughout global mining markets, is being introduced. The two-stage tender allows for the tender to be “paced” over two phases rather than one, and provides stop-gaps that allow KP to identify the most qualified bidder to mine its limited resources.

While it is important to ensure that a legally sufficient tender and award of mineral rights process is in place, it is just as important that local capacity is firmly in place to monitor and

³ Pre-qualification for short list and final award using technical and financial bid submissions.

evaluate the implementation of those rights. Removal of discretion in how operations are awarded and monitored is essential. Where tenders may be prepared and implemented by outside experts without adequate local participation, the risk of inadequate monitoring of how those rights are administered greatly increases.

As part of the KP Minerals Policy, Government committed to the development of a “Revenue Management Program” to ensure that fees, royalties and penalties collected as a result of mining in KP are equitably shared for the benefit of the province’s citizens. This may include contributions to budget, infrastructure development, education, capacity building and targeted mine community support. As part of regulatory strengthening, a reassessment of the royalty schemes in place and overall fiscal framework in which KP mining is operating is needed.

Institutional Arrangements

In order to establish a modern minerals market in KP, some restructuring of the Mines and Minerals Department (KPMMD) will be useful. In particular, greater distinction amongst process (filings) and operational (i.e., monitoring) aspects of licenses/leases and improved clarity on the role of the survey function of the KPMMD. Targeted capacity building on cadastre and related mapping and registry will also be important.

Beyond KPMMD operations, increased emphasis on the role of other KP departments relevant to mineral development including environment, industry, land, and labor must be given. Inter-departmental relations are important as mining impacts overall economic and social development. Also essential to modernizing how the sector unfolds will be increased and regularized participation of district governments, civil society and mine operators.

Strategies for effective regulation, management and promotion of the KP Minerals Sector

Establishing clear functions and operational capacity at the KPMMD as well as other KP departments is important to build local and outside investor and citizen confidence that the sector is being properly managed. In order to achieve this, regularized outreach to mine communities in KP and the mine investment community in Pakistan and abroad is important. Demonstration of, for example, web-based information, model contracts and clear rules of operation will promote KP as a viable mining destination that is transparently implemented and can have real financial return.

Perhaps foremost to any strategy for development of KP minerals is the definition of rights, selection and award of investors to mine KP resources. Presently “large-scale” mining is defined as a \$3 million investment which in the global market is typically categorized as small- to medium-scale. Investor eligibility must also be well-defined so as to capture legitimate and experience investors to develop KP minerals. Internationally comparable definitions as well as clear and predictable rights and obligations of investors, communities and the KP Government must be in place.

The 2014 KP Minerals Policy emphasizes value-chain development and integration of KP mining into provincial development, for example through resource/development corridor strategies. These approaches encourage thoughtful regulation that addresses not only mining but the broader development impacts of mining that can result in job creation, infrastructure construction and overall improved quality of life. Building the capacity and regulatory frameworks for non-mining institutions is underway.

In order to promote the sector both within and without KP, information exchange must be regularized amongst all key stakeholders including those most remotely located but impacted by mining. If to attract foreign capital in a highly competitive global mining market,

publication about KP minerals, what and where they are, doing business in KP and other basic investment information must be made available to the international mining community.

Quality investors need to know that whatever work they conduct, that they have security of tenure and that the award of rights is transparently conducted. Investor incentives are helpful to develop nascent mineral markets but should be clearly legislated for consistent application to all relevant investors. Legitimate investors will appreciate and be committed to worker protection and safeguarding human rights as inherent to conducting mining operations in KP.

Section I

1. Regulatory Regime Governing KP Mining

1.1 Recommendations of KP Mineral Policy Framework Report

Key mineral policy framework recommendations for KP have emphasized the need for a strengthened mineral regulatory regime. In order to ensure that these recommendations are adhered to, Government has initiated the formal process for the adoption of the first KP Minerals Policy, is preparing a KP Mining Act and amended KP Concession Rules. These actions are significant toward establishing a clear and predictable regulatory regime for the development of minerals in KP.

Table 1 Mineral Policy Framework Recommendations

Mineral Policy Framework Recommendations	Actions to Support Regulatory Strengthening
<ul style="list-style-type: none"> Comprehensive approach linking “upstream” and “downstream” aspects 	<ul style="list-style-type: none"> Promotion of value-chain investments as part of tender criteria preference
<ul style="list-style-type: none"> Geo-science data may be enhanced 	<ul style="list-style-type: none"> KPMMD emphasis on strengthening in-house geo-science capacity, technology
<ul style="list-style-type: none"> Sector Frameworks may be strengthened and clarified 	<ul style="list-style-type: none"> Inclusion of departments beyond KPMMD, i.e., industry, environment, labor to harmonize regulatory requirements, institutional roles Clarified fiscal terms, i.e., formula for surface rent Enhanced environment, social, land frameworks
<ul style="list-style-type: none"> Preparation of amended Mining Concession Rules 	<ul style="list-style-type: none"> KPMMD preparing by August, 2014
<ul style="list-style-type: none"> Modernization of mining practices 	<ul style="list-style-type: none"> KPMMD initiation of “extension service” programs to expose operators to modern practices, technology, methodologies
<ul style="list-style-type: none"> Greater distinction amongst mining types and mining phases 	<ul style="list-style-type: none"> Concession Rules will introduce clarity in phases of mining, definitions of mine/size types
<ul style="list-style-type: none"> Revenue Management Program needed 	<ul style="list-style-type: none"> KPMMD working with Finance Department to develop a revenue management/sharing program
<ul style="list-style-type: none"> Improved public information and transparency 	<ul style="list-style-type: none"> KPMMD establishment of public information and investment promotion office, drafting protocols for information sharing
<ul style="list-style-type: none"> Integration of mining into provincial development 	<ul style="list-style-type: none"> Inclusion of district governments, departments beyond KPMMD, i.e., industry, environment, labor, and increased private sector linkages; preference for investors that link mining with provincial development
<ul style="list-style-type: none"> Sector capacity building 	<ul style="list-style-type: none"> KPMMD introduction of training, skills development, outside expertise

Mineral Policy Framework Recommendations	Actions to Support Regulatory Strengthening
<ul style="list-style-type: none"> Financing Mineral Policy activities 	<ul style="list-style-type: none"> KP MMDD working with private sector to identify needs; introduction of international tender process

1.2 Current Khyber Pakhtunkhwa (KP) Mineral Regulatory Framework

The primary regulatory instruments guiding Minerals Sector development in KP are the 2005 Mining Concession Rules, Health and Safety Regulations and Licensing Regulations. The foundations of regulatory guidance are in place but no longer reflect best practices or modern mineral operations.

1.2.1 Mineral Rights

In today's KP minerals market, there are two types of mineral rights⁴:

Current KP Mineral Rights
898 Prospecting Licenses
431 Mining Leases

- Prospecting License – 898 issued.
- Mining Lease – 431 issued

Criteria for determining “eligibility” for investors to hold rights are not fully in place [The new Mining Concession Rules will include language on investor eligibility]; refined definitions of mine sizes is also needed [The new Mining Concession Rules will also address]. Current sizing is:

Table 2 Current Mine Sizes

Illustrative definitions of Mine Size	Issue
<ul style="list-style-type: none"> 200 acre for size of license/lease area 	2. This is excessive, notably for small-scale
<ul style="list-style-type: none"> 5 acre size for gemstones mining area 	3. Issues of overlapping acreage should be addressed so as not to lock up mining areas
<ul style="list-style-type: none"> Large-scale” mining is defined as a Rs.300,000,000 investment (approximately \$US3 million). 	4. Internationally this is not considered large-scale; typically “small-“or “medium-scale”.

1.2.2 Award of mineral rights and monitoring of Licenses/Leases.

KP has recently issued an “Expression of Interest” for ten “large-scale” mines. A tender process is described but not formalized. To date, in accordance with the Concession Rules, minerals rights have primarily been by application and by auction. Once a license/lease is awarded and issued, the Office of the Director General for Licensing monitors implementation. Two issues have been raised with respect to monitoring:

- Government is concerned that there is no provision to “force” license/lease holders to implement their license/lease and in fact, many choose not to mine but to hold on to the rights. [The amended Mining Concession Rules will include language on “use it or lose it” to encourage mining once a license/lease is issued]
- Miners are concerned that the process to cancel their licenses/leases is discretionary and somewhat politicized particularly in the

This regulatory approach results in an unpredictable setting in which a license may be cancelled and more formalized processes are needed.
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⁴ Confirmed by KPMMD Secretary

appeal process.

- i. The Assistant DG has inspection authority to cancel licenses;
- ii. Licenses can be cancelled by the KPMMD but cancellation may be appealed to the Secretary in which case KPMMD managers note high levels of politicization whereby licenses are reinstated. This regulatory approach results in an unpredictable setting in which a license may be cancelled and more formalized processes are needed.

1.2.3 Monitoring Licenses/Leases

The Department of Mines and Minerals is mandated to grant mining licenses and leases, collects fees and royalties, implements inspections and maintains master plans. In KP the Master Plan includes mapping that shows:

- the locations
- of all exploration licenses and leases granted,
- the renewal assignments and surrender of mineral titles, and
- any relinquishment of acreage.

All regular publication of complete details is published in the Official Gazette.

1.2.4 Royalties

The royalty system in KP is established and may be made current. KPMMD has a fixed royalty for 42 minerals that are occasionally reviewed. Marble is a fixed royalty of 30 rupees/ton. It appears that the “fixed royalties” should be increased to reflect international standards. In addition to royalty is an “excise duty” called a “CESS” and is 3-5 rupees per ton. These funds are collected by the MMDD and used for social issues such as housing, disability and other social support.

1.2.5 Land Use and Access

Land regulations in place do not address the specifics of mining or adequately address broader issues of resettlement and compensation. Each of the 25 KP districts has a “Surface Rent Committee” that deals with (a) rents to be paid by mine operators to landowners and (b) address land disputes. The auctioning of “minor minerals” (construction materials) is also administered at this district level.

1.2.6 Social and Environment

Presently there are no regulatory provisions specific to social and environmental impacts of mining in KP.

1.3 Strengthening the KP Mineral Regulatory Regime

Conditions and procedures to attract sustained private investment in the minerals sector need to be competitive in the context of the current global mining market. Notably in South, West and Central Asia, there is increased interest in an array of resources as well as from investors beyond Asia’s borders. Regulatory regimes supporting mineral sectors are typically complex - this does not mean that complex regimes are essential. It does mean that

Regulatory regimes supporting Minerals Sectors are typically complex – this does not mean that complex regimes are essential.

mineral regulatory regimes continue to evolve but should provide fundamental regulatory safeguards that investors have come to expect.

An approach that may be taken in reviewing the KP regulatory regime and how it may be divided into areas for improvement follows the “Minerals Value Chain” prepared by the World Bank:

<p>Minerals Value Chain</p> <ol style="list-style-type: none"> 1. Award of Contracts and Licenses 2. Regulation and Monitoring of Operations 3. Collection of Taxes and Royalties 4. Revenue Management and Allocation 5. Implementation of Sustainable Development Policies and Projects

1. Award of Contracts and Licenses
2. Regulation and Monitoring of Operations
3. Collection of Taxes and Royalties
4. Revenue Management and Allocation
5. Implementation of Sustainable Development Policies and Projects

Perhaps the most fundamental measures that may be supported to strengthen the KP Mineral Regulatory Regime are to improve investor eligibility requirements and to re-define the categories of mineral rights currently used to better reflect international norms. Some areas where the KP Mineral Regulatory Regime may be strengthened are described below (Note: much of the regulatory strengthening suggested below may be expected to be addressed in the new KP Mining Act as well as the amended KP Mining Concession Rules).

Investor Eligibility. Mining is a long-term investment and investors operate throughout the world; once KP opens its doors to outside investors, they may be expected to be working in the province for decades. It is essential that appropriately rigid regulatory criteria for investors [will be included in the amended Mining Concession Rules] and good due diligence on these investors as well as KP/Pakistan investors is in place so that Government will not have an influx of bankrupted or historically fraudulent investors working in its sector.

<p>...with the emergence of new mining markets, issuance of “artisanal mining” licenses has become an important aspect of mineral regulatory regimes that should be considered in KP.</p>

1.3.1 Categories of Mineral Rights.

Investors expect an array of licensing possibilities to conduct their business but fundamentally will expect to be able to explore and to exploit resources. Typical categories of mineral rights in the global mining market are included in the current Mining Concession Rules and include:

- i. Reconnaissance
- ii. Prospecting/Exploration
- iii. Exploitation/Production
- iv. Retention

Within these categories may be specified the size and categories of mine types in order to regulate the specific nature of the market, for example, reference to “small-scale” or “large-scale” licenses. In addition, with the emergence of new mining markets, issuance of “artisanal mining” licenses has become an important aspect of mineral regulatory regimes that should be considered in KP.

Additional areas where information important to mine

<p>Mineral Regulatory Regime</p> <ol style="list-style-type: none"> 1. Investor Eligibility 2. Categories of Mineral Rights 3. Requirement to Mine 4. Predictability 5. Cadastre System 6. Mineral Rights’ Registry 7. Security of Tenure 8. Clear Institutional Roles 9. Transparency 10. Transferability 11. Standardization 12. Stability 13. Mining Fiscal Regime 14. Address Illegal Mining

categories may be strengthened through clarified regulatory guidance [these will be addressed to some extent in the amended Mining Concession Rules]:

- Remove reference to “major” and “minor” minerals. This terminology is not in line with international best practices and does not necessarily reflect the minerals of KP. “Minor minerals” refers to “construction materials”.
- Definitions. The majority of mining in KP is quarrying dimension stone (i.e., marble, granite) and what in industry terms may be categorized as “artisanal” and “small-scale mining”. The definition of “large-scale” mining is not in line with industry terms.
- Mineral Sales. “Middlemen” often purchase minerals and resell; there is no licensing or other standard in place to guide this segment of the business. These buyers often stockpile resources awaiting higher prices and also purchase from illegal operations. It is not clear whether “salting” (adding non-mineral elements to the actual minerals) is an issue. MMDD notes that the Board of Investment would be the regulatory body for this activity.

1.3.2 Requirement to Mine

A common problem in KP and other mining markets occurs when the mine operator delays commercial production. This delay results in delayed revenue generation and job creation that will benefit mine communities and KP. As part of either the new KP Mining Act or supporting regulations, some conditionality should be placed on licenses/leases that require commercial production in a certain timeframe or that KPMDD may cancel the license.

- “Commercial Production” is typically deemed to have commenced on the date upon which Minerals mined from the mine property are first delivered to a purchaser on a commercial basis, or on the date upon which concentrates or other products derived from the minerals are first delivered to a purchaser on a commercial basis, whichever date is earlier.

1.3.3 Predictability

A critical next step in improving the regulatory regime in KP is minimizing the use of discretion in all processes. The more clear and predictable the regulatory regime, the more likely to attract credible investment. Investors want to understand at the beginning of their investment what are their rights and their obligations. Examples of important regulatory guidance:

- Obligations. Under the current concession rules there is a mix of information concerning obligations to maintain the mineral title (process) and obligations to conduct operations (functional implementation). These obligations must be clarified [and will be in the amended Mining Concession Rules]. Any obligations with respect to environmental safeguards must be not only published, but understood by investors and should include clear monitoring and enforcement processes.
- Fees and penalties including surface rent, land access and other payments must be published and consistently applied.
- Handling of social impacts including resettlement, compensation, etc. should be known to the investor up-front and in consultation with mine communities.

1.3.4 Cadastre system

Investors want to know that their mineral rights are clearly recorded following a published map-based process (i.e., using cadastral blocks), and that this information is secure (cannot be

changed), transparent and available for public review. KP is in the process of installing additional GIS equipment; strengthened GIS capacity is needed.

- a. Mineral Rights' Registry. Establishing a user-friendly "Register" that clearly records each and every submission for a mineral right and change to a license or lease will improve transparency and accuracy for future awards. Most countries post the registration information online.

1.3.5 Security of Tenure

The international trend has been to regulate "exclusivity" of mineral rights; this assurance is essential to an investor's ability to finance its operations using "third party" financing (i.e., bank loans). This also means that license/lease terms should be sufficiently long to allow investors to obtain return on their investment and that land rights and access are secure. Finally, cancellation of a license/lease should be a difficult process that follows a clearly published set of criteria and processes.

- Award of Mineral Rights. There is considerable discretion in the award of mineral rights in KP; MMDD indicates that 95% of licenses are at the review of the DG while 5% are actually evaluated by the licensing department. While the appropriate institutional arrangement is in place, the allocation of actual authority internally in the MMDD should be assessed.
- Information. Geological, financial, and overall sector information may be improved for Government, investors, workers and citizens. Greater emphasis on geo-science data (i.e., by hiring more geo-scientists and relevant equipment) as well as a formalized system for information exchange will assist Government to understand critical issues and manage citizens expectations.
- Environment. KP mining includes marble, granite and precious gems that are not necessarily being produced using best methodologies. As a result, product quality is diminished and environmental degradation comes along with poor mining practices. Institutional oversight of environmental issues is required to preserve water, soil and other natural resources, optimize minerals' value, and to safeguard communities.

1.3.6 Land Rights, Compensation

It is important that "decentralization" of surface rights and land issues has already taken hold in KP; what will next be of regulatory benefit is harmonizing and clarifying land rights for impacted communities (landowners and land users) and providing a formula for surface rent and compensation that is consistent throughout the province. "Standard Operating Procedures" for the district surface rights' committees that include information on community participation and information exchange may be prepared.

1.3.7 Clear Institutional Roles

An important part of the KP regulatory regime is ensuring the clarity of roles for provincial, district and federal government in mining investments; lessons are to be learned from almost two decades of experience in Balochistan (iron ore, copper) that differences between provincial and federal government concerning mining investments can ultimately stall and even deter investment. Investors need to clearly understand the role of the State in the mining sector and authority of national, provincial and district authorities. For KP this specifically means:

- Will the KP Government have an investment role in mining such as being a shareholder in a government-owned mine company? Or other company?

- What will be the issues that federal government will have a role, i.e., taxes, etc.?

1.3.8 Transparency

Any appearance of discretion whether by political or other players will diminish the credibility of the sector. Investors are prepared for Government requirements that include reporting, monitoring, audit and other measures to which they must comply during the life of their license/lease. As part of the “Minerals Value Chain”, three critical areas are considered toward promoting sector transparency:

- Accountability - the extent to which citizens can hold governments, political leadership and private companies responsible for performance and conduct; transparency and participation;
- Capability - the ability of governments and public organizations to take decisions and get things done through effective policies and programs. Mobilizing and managing human and financial resources, deploying information and management systems; and
- Inclusiveness - ensuring that all stakeholders are consulted to ensure that rules apply equally to everyone in society and how the use of finite revenue from the sector is governed.

Use of the Extractive Industries Transparency Initiative (EITI) has proven to be an effective start toward engaging various stakeholders for improved mineral sector transparency (See Appendix 2).

1.3.9 Transferability

Particularly for large-scale mining, investors expect that they are able to easily transfer their license/lease rights. This is possible in the current KP context but may be further clarified with respect to (1) eligibility and qualification of the transferee, and; (2) tax and other implications – transferring license/lease rights can result in tax avoidance if regulations do not address the issue (“transfer tax”).

1.3.10 Standardization

The National Minerals Policy speaks of mine contracts/mineral agreements which for KP may be useful for large investments however on the whole use of standard terms and conditions included in the KP Mining Act and Concession Rules ensures that Government is streamlining how it approaches mining. The risk with contracts is that absent expert preparation, terms and conditions may considerably vary contract to contract making (1) investors leery about how transparent the sector is; and (2) make it complicated for the MMDD to adequately monitor and enforce all contracts.

1.3.11 Stability

Investors typically seek (and Governments typically are hesitant to provide) standardized terms and conditions by law notably on fiscal matters such as tax percentages. As part of its 2009 tax laws, Afghanistan adopted an impressive “Qualified Extractive Industry Taxpayer” (QEIT) stability provision that is worth review. (See Appendix 4) Importantly any stability benefits for investors should require that the investors must commit to an “investment program” of a certain amount and that if they fail to meet that program, penalties shall be applied.

Factors to model into Project

- Price that may be obtained per ounce/ton for the mineral
- Debt incurred to run the project
- Depreciation of project assets
- Capital costs to start project
- Taxes (income, profit)

1.3.12 Mining Fiscal Regime

A closer look at regulatory strengthening to support a consistent and realistic fiscal regime for KP minerals is needed.

- “Fiscal Discipline” refers to the system through which the overall financial framework supporting minerals is structured and operating. CESS” and is 3-5 rupees per ton. These funds are collected by the MMDD and used for social issues such as housing, disability and other social support.
- “Fiscal Incentives” refers to those benefits that the KP Government is prepared to offer mineral investors to entice them to invest in KP now and for the long-term. Under the National Minerals Policy and KP Policy reference to incentives is given (i.e., tax) but in practice, the royalty, customs and tax rates included by law should be reviewed if to be competitive in the global mining market. This is a complicated task that requires modeling of investment projects (See Text Box) to understand best options for designing the fiscal incentives investment package.

1.3.13 Addressing illegal mining

Through ensuring realistic regulatory provisions and public information may be achieved. An example of unrealistic regulatory guidance is found under Mining Concession Rule 173 which requires payment by any illegal mine operation of the “mine-pit value” of resources produced. KPMDD managers agree that this penalty is so unrealistically high that it is impossible to enforce. This rule also says that any unauthorized mining or obstruction would result in 3 months to 3 years in prison and 1-10 lakh fine issued by the Court of competent jurisdiction; in fact, this provision is never enforced. In comparable mineral markets, gradual engagement between Government and illegal mine operators to determine mutual benefits from formalizing illegal operations through simple regulatory requirements has proven successful.

Section II

2 Institutional Arrangements supporting the KP Minerals Sector

2.1 Current Institutional Arrangements

The KP Mines and Minerals Department (KPMMD) is the government agency responsible for policy-making and regulatory oversight of the minerals sector in the province. (Note: the second Summary Findings Report under this consultancy, Deliverable 6 will address KPMMD restructuring issues). Under the Rules of Business the KP MMD portfolio covers six areas:

- i. Licensing;
- ii. Development of Mineral Resources;
- iii. Land;
- iv. Regulations and Royalties;
- v. Geological Survey; and
- vi. Health and Safety.

KPMMD Summary

- 200 staff in Peshawar
- 6 regional offices (20 staff each)
- 3 new offices

To implement its mandate, the MMDD includes three core departments: (1) Labor Welfare; (2) Director General (licensing and exploration promotion), and (3) Inspectorate.

2.1.1 Mines Committee

In KP, a “Mines Committee” (See Text Box) operates as the licensing authority. The committee is described to some extent in the Concession Rules but more detail in the form of operating guidelines is needed. Typically investors will expect to follow very rudimentary licensing/leasing rules and involvement of a committee should be clearly guided with published protocols that include monitoring and public information requirements. It is recommended that review of (a) the role of the Mines Committee as well as (b) the composition of the committee (i.e., inclusion of environment officials) is needed.

KP Mines Committee

- Director General, Chair
- Director of Licensing
- Deputy Secretary of MMDD
- Finance Department
- Social Welfare Department
- 1-2 Private Sector

2.1.2 Mineral Investment Finance Authority

(MIFA) was created under earlier National Minerals Policies; in KP the Chief Minister oversees all mining affairs. More clarity on the role of MIFA and rules for operation is needed.

2.1.3 Mine Inspectorate

By law, throughout Pakistan the Mine Inspectorate function for mining is an independent one, however, in KP this function operates under the KP MMDD.

2.1.4 Innovative institutions

In the past, a “coal army” in FATA secured a coal storage yard and ensures quality control. KP MMDD has considered establishing a “Board of Management” as a public-private operation that would manage a warehouse for marble/granite and/or other minerals to monitor mineral quality and from which sales would be made. Consideration of establishing “Economic Protection Zones” (EPZs) and development of a dedicated Mining Chamber of Commerce was also considered.

2.2 International Best Practice

Each country has developed specific institutional arrangements to optimize mineral development. No matter the levels of Government, the most critical functions of government’s mining institutions include:

- a. A Cadastre Office (commonly referred to as the Cadastre) maintains a register of licenses/leases and activities related to licenses and leases (“cadastre”), using a cadastral map that is a comprehensive register of the metes-and-bounds of mines. The cadastre includes details of the ownership, license terms, and increasingly, the precise location (i.e., GIS coordinates) of the mines. License/lease holders are obligated to report to the cadastre as part of their license/contract terms and typically the cadastre is a fundamental source of data in disputes and lawsuits between landowners.
- b. A Geological Survey is an institution charged with the systematic investigation of the geology of a country and/or province and for maintaining the country/province’s geological map. Geological Survey maps are available for investor and public review although survey. Core mineral and rock samples are maintained, where possible, by the Geological Survey.
- c. A Mine Inspectorate (commonly referred to as the “Inspectorate”) is an essential institutional component in the minerals sector. It is charged with the implementation and oversight of health and safety of the mines. This includes mine safety, worker health and safety, and some poorly defined environmental and social aspects. Regulatory drafting should be an inherent part of the Inspectorate work, technical certification and enforcement power to stop mining operations that are not in compliance with operating requirements.

In the present institutional structure, these functions are basically in place in KP although different terminology is used for some descriptions which can be confusing for investors.

Table 3 KP Mining Institutional Structure

Mine Institution	General Function	Status in KP
Cadastre	Licensing/leasing; cadastral map	“Licensing Department”
Geological Survey	Geological investigation & survey work	National function (Quetta HQ) and KP “Exploration Promotion” Department
Mine Inspectorate	Health & safety, technical compliance	Independent function operating as part of KP MMD

2.3 Institutional Strengthening to support the KP Minerals Sector

2.3.1 Strengthening KPMMD

Deliverable 3 will address in greater detail opportunities to revise KPMMD but initial observations are as follow.

- a. Modify Department Names. The names of the functions described in Section 2.2 above should be modified to reflect modern mining institutional structures so that the terms “cadastre” and “geological survey” are introduced to replace “licensing department” and “exploration department”.
- b. Introduction of Dedicated Departments. To reflect the reality of the KP mineral sector, the introduction of a dedicated artisanal mining department and a dedicated quarry department is recommended. Through these departments extension services (training, support) may be specifically targeted to these types of mine operators.
- c. Legal Capacity. The introduction of a strong legal department is needed to consolidate contracts, coordinate legal requirements and possibly contribute to regulatory drafting.
- d. Project Finance Modelling. Capacity to conduct basic mine project modelling so that KPMMD can understand the “pros” and “cons” of how various mine investments are structured.

KPMMD Strengthening

- ✓ Rename “licensing department” as Cadastre, break out functions
- ✓ Rename exploration department to be Geological Survey
- ✓ Introduce dedicated Artisanal Mining and Quarrying Departments
- ✓ Build Legal and Project Finance modeling skills

2.3.2 Clear Distinction of Government-Mining Company

In today’s market, if government opts to conduct any type of mining business through a government-owned company, in order to avoid any appearance of conflict of interest, that company should be a stand-alone, corporatized entity (i.e., under the Companies Ordinance, 1984) and should operate as a viable business concern, responsible for all costs, subject to independent audit and not entitled to government subsidy.

- a. KP Mining Company. Some discussion has been given to the establishment of a KP Mining Company. In most countries the establishment of a government-owned mining company has been problematic primarily because of financing. Government typically has to subsidize operations and is not able to leverage lending to run a modern mining operation.
- b. KP Survey Company. Another company proposed would be specifically dedicated to field services and survey work. In this instance, countries have had some success but again, capital investment in equipment and technical capacity building is expensive. It is standard practice for government to use its geological survey function to conduct initial survey work, drilling and mapping but not to fully explore and never to exploit mineral resources.

2.3.3 Address Institutional Gaps.

Table 4 Institutional Issues and Gaps

Issue	Institutional Gaps	Need for Strengthening
Inspection of Mines	Investor, Government and public understanding of inspectorate may be improved	Inspectorate at MMDD, regularization of inspections, strengthened enforcement power
Land rights	Some clear policies on land use and land access for mining may be developed	Forestry, Land, and Environment Departments capacity building to better understand mining nexus
Resettlement/ compensation	Existing law and institutions may not be sufficient to address modern mining needs	Land Department to develop rules on resettlement, compensation, grievance mechanisms
Environment	Virtually not addressed; URGENT issue!	Environment Protection Dept to prepare specific regulations
Dispute/Conflict Resolution	Formal guidelines, institutions for various disputes not clear	KPMDD can play some role District governments and Mine communities also have a role
Foreign Investment	How federal-provincial agencies are to interact with investor	Financial and foreign investment institutions must develop clear policies and protocols
Public Information	Formal, regularized communication program not in place; media training on mining will be useful	KPMDD can play a role but perhaps outsource this work and build on community networks
Stakeholder participation	Nascent civil society must be supported to build citizen participation	KP government may more actively and regularly include citizens in mining issues
Worker protection	Inactive union/worker associations	KPMDD and Labor Department can focus more attention here
Skills training, education	No structured or strategic training in place for provincial residents – institutes, schools, university curriculum needed	KPMDD can start with regulatory drafting work and survey work
Financing sector reform	KP “Minerals Sector Reform” initiative may be supported to bring together key stakeholders	KPMDD can work with provincial government, donors to develop modeling skills
Downstream mining aspects	Downstream issues are not formalized or consistently addressed	KPMDD has a role but Industry Department and private sector collaboration/capacity also needed

Section III

3 Strategies for the Efficient Management, Regulation and Promotion of the KP Minerals Sector

Mining is different from other industries and requires specific strategies to ensure efficient development. KPMMD has already taken an essential first step toward adopting the province's first Minerals Policy in which strategic objectives for sector development are clearly published. As will be discussed in upcoming Deliverables, commitment to transparent mineral tender processes and improved KPMMD governance will promote KP as a viable mining destination.

3.1 Value-Chain Development

3.1.1 Clusters

Some consideration of how KPMMD may work with existing artisanal and quarry operators (illegal and not) to formally "cluster" operations so that they remain as stand-alone business entities but can benefit from sharing of resources such as electricity, transportation and equipment. "Clustering" is a common notion in African artisanal mining and in some cases "cooperatives" have been formed so that operators sell their product to one sales center in order to achieve fair and consistent pricing. Mine operators are typically resistant to this model but once in place, the financial benefits are usually apparent.

Table 5 Pros & Cons of Clusters

"Pros" of Cluster	"Cons" of Cluster
<ul style="list-style-type: none"> • Sharing of limited infrastructure 	<ul style="list-style-type: none"> • May result in "mafia" cluster operations
<ul style="list-style-type: none"> • Saving costs by sharing equipment 	<ul style="list-style-type: none"> • Stalled development with no skills' improvements
<ul style="list-style-type: none"> • Regional cooperation can promote stability 	<ul style="list-style-type: none"> • Infrastructure still too limited to adequately service cluster

3.1.2 Midstream Development

Throughout KP there is considerable business opportunity in transportation and storage of mineral products. Presently these "midstream" businesses are conducted per mine and are not sufficiently formalized to themselves generate revenue for KP. Assistance to formalize these operations, provide safe passage and possibly to assist in establishing warehousing and storage will help mine operators and can create "black market" jobs.

3.1.3 Downstream development

The KP Minerals Policy emphasizes the need to link mineral production with downstream activities (i.e., cutting, processing). Here, leveraging private sector will be essential to "share the

risk” of investments required to support downstream activities. Environmental issues as well as quality control are two areas where KPMMD can lead regulatory reform.

3.2 Resource/Development Corridor

The KP Minerals Policy commits to the development of minerals while promoting development of related infrastructure such as electricity, roads, etc. KPMMD may lead other departments in taking a holistic look at the KP province and identifying opportunities for immediate resource corridor development. An example is most likely to start around the marble/granite quarries where road and power improvements will assist quarry operators.

3.2.1 Information Exchange

In order to effectively manage and promote KP minerals, a variety of informational activities may be undertaken to ensure broad-based understanding of sector developments.

- a. Upgraded KPMMD website. An immediate measure that may be taken is the upgrading of the KPMMD website to present an overview of KP minerals, an inter-active “questions and answers” page for interested investors, civil society forums and other information that will build outsiders’ understanding of the province, available minerals, and conditions for doing business in KP.
- b. Inter-Department Minerals Commission. KP has established an inter-department mines committee. Building the “know how” and sector understanding of members of that committee may commence with an “Induction package” that simply includes basic information about mining, comparative international experience, and basic policy documents. The regularization of meetings will provide an opportunity for KPMMD to present on specific topics at each meeting, i.e., one on royalties, one on health and safety, one on environment and mining, etc.
- c. Community Engagement. Rather than await conflict, KPMMD can take the lead to formalize engagement with mine communities to identify critical issues and develop practical responses to them. In most mine communities, issues of compensation for land use and access, job creation, and community financial and development benefits of mining are typical issues. KPMMD may introduce a community liaison officer as part of its field offices that will link to other field offices toward preparing a consistent approach toward community engagement.
 - Community Development Agreements. As mining investments increase and the scale of mining is larger, use of the “Community Development Agreement” (CDA) as a formal tool to link the mine operator and community for the life of the license/lease may be considered. The CDA is increasingly being used for large-scale foreign investments to ensure that the rights and responsibilities of the mine operator and the community are clear.
- d. Regularized mine operators and investor meetings. KP has an established mine operators group primarily engaged in quarrying and artisanal mining; this is a useful place to formalize communications and information exchange. It will also be useful to regularly engage with the Chamber of Commerce and other business groups. In fact, as international tenders are being conducted, it may be helpful for KP to include in the tender documents a list of the existing mine operators and interested KP investors for foreign bidders to be aware of and with whom to possibly partner.

- e. Minerals Working Group. Informally a Minerals Working Group (MWG) was established in 2012 in order to join federal and all provincial Government stakeholders together to assess and address mining issues in Pakistan. The concept of the MWG has been successfully implemented in other mining countries and should be pursued. More formalization of the group is recommended⁵ including the appointment of rotating leadership, scheduled meetings, and publication of key work.

3.2.2 Capacity Building

Effective regulation will only come via effective regulatory drafting and implementation which means considerable capacity building relevant to modern mining. Understanding the basic market operations for minerals (e.g., pricing methodologies as illustrated in Appendix 5) is essential to preparing a practical and competitive regulatory regime. In order to provide a practical scope of work toward strengthening capacity, KPMMD may take the following measures.

- a. Conduct a web-based “regulatory literature review” of comparable mining markets to learn about how various countries regulate this sector.
- b. Develop a regulatory drafting schedule (primary and secondary regulations)
- c. Develop supporting procedural framework and drafting (the guidelines and processes for implementing regulatory requirements)
- d. Develop Cadastre, Inspectorate, and Legal capacity (to understand and enforce modern mineral regulatory requirements)

3.3 Transparency

3.3.1 Information Sharing

The information exchange actions illustrated in Section 3.3 above will help to promote transparency in how KP is conducting its mineral business. Examples of information that will promote confidence that the KP Minerals Sector is being conducted in a transparent manner include:

- Establishment of clear rules for use of license registries including public access as well as publication of key license/lease terms.
- Defined royalty system, ideally published as part of law or regulations.
- Publication of license and investment information. Standard mine contract and publication of terms in provincial gazette. Formalized procedures for public access to cadastre and mine contract information

3.3.2 Reduced Discretion and Conflict of Interest

The historic nature of mining in KP is that there are familial, clan and tribal affiliations that are not necessarily compliant in a modern mining market. Discussion between KPMMD and these operators is important to identify whether action is required and what action will have meaning to ensure that these traditional operations abide by new market rules. Other areas to be addressed include:

- Participation of community elders in sector decision making may continue but this role should be clearly defined for all to understand;

⁵ World Bank funding for the MWG is scheduled to stop June 30, 2014; the Asian Development Bank has discussed taking over the funding; to be confirmed.

- Government officials should not be permitted to hold licenses or to even invest in mining until at least one year after leaving office; and
- Reduced discretion of licensing authority may be achieved through more defined rules and enforcement on award, suspension, cancellation of mineral rights which will be addressed in the amended Mining Concession Rules.

3.3.3 Annual sector “stock-taking”

It is time for KP to take stock of existing investments; this will require the collection of information from operators that is not only financial in nature but includes records of accidents, problems encountered by the operator in implementing the license/lease, mine community issues, level of miner pay, and other indicators of mine performance. Baseline data may be collected initially in key mine and quarry areas and be annually updated. Analysis of the information should be conducted by KPMMD toward generating improved policies and support where needed.

3.3.4 Extractive Industries Transparency Initiative (EITI)

In addition, the KP Minerals Policy cites the Extractive Industries Transparency Initiative (EITI) which is formal mechanism in which KP can participate. EITI is a global standard established in 2003 for monitoring revenue generated from the exploitation of natural resources. To date, the EITI has primarily been a federal government initiative but there is no restriction for KP to apply for EITI membership. (See Appendix 2)

3.4 Human Rights.

Various donors including the World Bank are promoting increased use by governments and mine operators of the “Voluntary Principles” which were established in 2000 as a multi-stakeholder initiative including governments, mine companies, and non-government organizations that guide mining, oil and gas companies on providing security for their operations in a manner that respects human rights. (See Appendix 3).

Section IV

4 International Tender Process

NOTE: This section is provided as draft in preparation of Deliverable 3.

4.1 Overall Market Context

4.1.1 The KP Market Context

The Government of KP seeks to immediately address the shortcomings in the sector framework in order to facilitate tenders, nonetheless, some caution must be taken toward ensuring that the necessary foundations are in place to prevent later commercial, financial, social, environmental and other disaster. Some reference may be given to the award of the Balochistan iron ore rights which have been stalled and have raised concern amongst the international mining investment community.

4.1.2 The Global Market Context

A strong tender is designed to attract superior developers, who in turn have access to capital markets having the “carrying capacity” to finance, i.e., up to 80% of the project debt.

After eight years of global market disruption, there is still limited depth of capital for mining investments around the world. The available capital is further limited depending on country portfolio limitations. Some of the world's most favorable mine projects (i.e. iron ore in Simandou in Guinea and Pilbara) are being held back by:

- Initial capital requirements that exceed capital available in the financial market, for which governments have not unbundled mega-mine development into staged, incremental investments over time;
- Poorly specified Requests for Proposals (RFPs) having policy gaps regarding roles and responsibilities; and
- Insufficient legal and regulatory clarity on which large investments must rely.

4.2 Pre-Tender Consultations

Increasingly, inadequate local consultation and clear mechanisms for sharing benefits generated from mining projects are negatively impacting project profitability. Addressing these issues before contract award can prevent such negative financial results. Financiers are showing a strong preference for investment opportunities that will achieve contractual close quickly – this quick close is directly correlated to the time and attention given to up-front project preparation of the bid package, closing the policy, legal and regulatory gaps, and demonstrating adequate attention to consultation and community support.

Financiers are showing a strong preference for investment opportunities that will achieve contractual close quickly...

4.3 Building Investor Confidence

The present legal and regulatory framework in KP and in Pakistan does not provide necessary clarity for investors or Government to appropriately implement and manage a large-scale mining project for the benefit of Pakistan. This does not mean that KP cannot seek investors but it does mean that more “up front” work is to be done. Where the legal and regulatory framework is not

sufficiently in place, investors will expect to enter into a clear contract in which all rights and responsibilities are clearly agreed. Including the draft contract terms as part of the RFP typically provides investors an opportunity to review the terms and conditions and to ask questions.

4.4 KPMMD Tender Actions

4.4.1 Policy Review

Before a final legal and regulatory regime may be prepared on which a Mineral Development Agreement would be based, there are certain policy considerations that must be made by Government. These policy decisions require consultation amongst different Government agencies as well as with stakeholders that include the general public. Some of the policy considerations required before this or any mineral tender include:

- a. Government role in the project (i.e., holder of equity, regulator, infrastructure partner).
- b. Objective of this mine development (i.e., revenue generation, job creation, expanded exploration, enhanced steel production, export).
- c. Requirement for sale of mine production to the domestic market (as earlier proposed).
- d. Participation of Pakistan citizens (i.e., as workers, as community beneficiaries, as recipients of revenues generated via increased budgetary spending).
- e. Revenue management of the funds generated from mining and related activities.
- f. Storage and removal of waste; resale possibilities.
- g. Water and electricity use, diversion.
- h. Environmental protection and mine closure requirements.

4.4.2 Review of Legal and Regulatory Regime

The legal basis for investment in large-scale mining in KP is relatively clear, however, legal and regulatory guidance for implementation and monitoring of exploration and mining activities is insufficient. This insufficiency will not only impact investors but is likely to greatly diminish the potential return for Government. KPMMD is working with the FIRMS Project to prepare new Mining Concession Rules but investors will also consider other legislation officially on the books at both the provincial and federal level. Harmonization of this legislation is important.

4.4.3 Application of Appropriate Law in Tendering Mineral Rights

It is very important that KP government, notably the Law Department and citizens understand that the tendering of mineral rights should not be a topic under the public procurement law. This is a common initial approach in many countries new to large-scale mining but one that cannot be used if to optimize development of mineral resources and safeguard the people and environment of KP. The tender should be guided by the Mining Concession Rules and tender procedures that are included in the Request for Proposal.

It is very important that KP government, notably the Law Department and citizens understand that the tendering of mineral rights should not be a topic under the public procurement law.

4.5 Proposed Tender Methodology

4.5.1 Open international tender

Investors are looking for world-class and significant reserves that deserve the attention of the global market. Government should consider ensuring adequate time for potential bidders to visit the actual site, attend road shows in key cities around the world (i.e., Dubai, London, Toronto), and to publicize in well-known mining journals.

4.5.2 Two Stages

In light of the potential wealth and extent of development offered by certain KP deposits, consideration of a two-stage tender process in which a (i) pre-qualification of interested bidders is followed by a (ii) full-scale proposal round with pre-qualified bidders, is recommended. This approach has become the international standard and provides Government will necessary time and resources to conduct due diligence on bidders as well as for potential investors to understand the mining issues and to develop better plans for implementation.

4.5.3 Requirements of Each Stage

While the pre-qualification stage requires less information than the final qualification phase, it is important not to take the pre-qualification stage lightly. This is an opportunity for investors and Government to understand the investment potential of the deposit and to provide both technical and financial information that is useful. It is also a chance for Government to learn more about the social and environmental performance of the bidders.

4.6 Project Structure

It is often useful for the tender documents to include a preference for how the project will be structured but to leave options should investors have additional approaches that they believe are viable. Considerations for Government to include in a project structure include:

4.6.1 Exploration License and Mining Lease

Award of the contract will not only include award of the Exploration License but, presuming that the company conducts all of its requirements under the Contract, upon commercial finding, award of the Mining Lease as well. This exclusive right is essential for an investor who can be expected to spend millions of dollars during the investment phase of its work. KP MMDD reports that proposed tenders will incorporate these exclusive rights.

- An issue to be discussed is the extent to which associated minerals, tailings are included in these licenses.
- If Government expects that processing of mineral would be part of the mine contract, some discussion of this must be made in the tender documents.

4.6.2 Composition of Project Ownership

No requirement of project ownership is recommended; this is an internal company decision and investors are better equipped to design project ownership.

- Unless, Government seeks to hold a share of the mining investment in which case this offer should be clearly stated. Note that some companies are less likely to invest when they are forced to partner with Government companies.

4.6.3 Upstream and Downstream Expectations

Now is the time for Government to consider whether it will agree with the export of minerals produced or would prefer, as a matter of policy, for some use in country or a mix. Government may indicate its preference and respond to investor feedback. Some discussion about tailings is useful.

4.6.4 Financial Structure

While Government may propose certain preferences for how a project is financed and structured, allowing investors to respond with their expert approaches will provide Government with options for how to best develop this deposit.

- Fiscal incentives were useful in Thar coal to attract investors but considerable time and effort went into building provincial and federal institutional collaboration in the form of the Thar coal and energy board to ensure that these incentives were real and possible.
- There are a variety of fiscal models that can generate revenue for Government; some financial modeling on behalf of the Government is recommended to ensure an option that will provide optimal benefit.

4.6.5 Ancillary Arrangements

A clear understanding of not only the mine opportunity but ancillary activities that may include construction of roads, rail, port facilities, development of community programs, education and health improvements, energy development/sharing must be set out as part of the expected project structure.

Examples of ancillary agreements:

- Energy - it can be expected that the investor at a large deposit will either use coal-fired power or diesel power (the latter is very costly). Whatever energy source, will excess power be made available to KP at cost?
- Secondary Roads – necessary for transport of ore and workers, the investor is likely to contribute to the development of roads (i.e. widening roads); will community and third parties have free access to them?

4.7 Community Development Agreements (CDAs)

In today's emerging markets it is also becoming more common to require "Community Development Agreements (CDA)" as part of large-scale – and even medium and small-scale mining contracts. The CDA is between the mine company and the community and discusses the responsibilities of both parties for the life of the project.

Section V

5 Minerals Development Agreement

KP has requested a template for a Mine Contract which is increasingly referred to in the global market as a Minerals Development Agreement particularly for a “large-scale” investment in KP. As noted, in KP “large scale” mining is defined as a \$3 million or more investment which globally is more reflective of a small-medium mine investment.

5.1 Mine Contract/Minerals Development Agreement

In 2009 the World Bank commenced the “Extractive Industry Technical Facility” (EI-TAF) that included a legal consultancy conducted by the International Bar Association to prepare a template for an internationally standard Minerals Development Agreement. A copy of this template is provided as part of this report; it is a complex contract (approximately 200 pages).

5.2 Illustrative Mine Contract Template Outline

For practical purposes, a template is provided herein that will be expanded upon as part of Deliverable 4 under this Consultancy to provide guidance to KP officials as to standard format and content where mining contracts are sought.

The KPMMDDD seeks to improve the approach and implementation of mine contracting. In an effort to promote clear and useful contracting, special attention is being given to large-scale mine contracts. Some important background notes:

- (a) “large-scale” mine definition in KP is \$3 million investment which in most mining regions is considered small or medium-scale mining; the template provided is in support of a \$5-10 million investment; the Minerals Development Agreement referenced above in Section 5.1 may also be used but will require considerably expert legal and financial review.
- (b) KPMMDDD seeks practical legal tools to guide investments; this template has been prepared with that in mind. In order to keep the Contract short, draft procedures have been developed and are attached to the Contract as appendices.
- (c) For this size investment, it is important that financially viable companies not individuals are signing these contracts.

Rationale to not have individuals sign exploitation contracts: (1) individuals are less likely to be structured to pay the legally required employee taxes; (2) less likely that an individual will be able to leverage increased financing (at least traditional financing through banking institutions) for improved mine operations which may become an issue where unexpected costs arise (e.g., environmental or health & safety violation penalties and remediation costs).

6 Appendices

Appendix -1

Considerations in Preparing Tender

1. WHO? Can anyone invest?

a. Whom does Government seek?

- ✓ International or domestic or any firm?
- ✓ Individuals?
- ✓ Only companies with specific mineral experience or any mining company?
- ✓ Companies with track records or newly-established if well-financed companies?
- ✓ Only Mining Companies or Steel-making and other related firms?

b. With whom is the investor going to work?

- ✓ Mines and Minerals Development Department?
- ✓ Ministry of Petroleum and Natural Resources or other federal body?
- ✓ The local community?
- ✓ Others?

2. WHAT? What is being offered? What do Government and potential investors expect from this offer?

a. What is being offered?

- ✓ Above ground? Underground?
- ✓ Location, near port? Near rail? Near roads?
- ✓ Entire deposit or blocks? How many blocks can a bidder bid on?
- ✓ I.e., Iron Ore and Associated Metallic Minerals (or all Associated Minerals?); Coal and tailings?
- ✓ Is there an annual expenditure requirement and over how many years? (i.e., the company must spend at least \$ 5 million in first three years of contract)
- ✓ Is it expected that following successful exploration, a Mining Lease will be granted to this same investor? (should be yes)
- ✓ Opportunity only to mine or to also hold a “vertically integrated facility” such as steel making, ore processing, etc.

b. What does Government want?

- ✓ A world-class mining firm with specific experience mining the type of mineral being offered (i.e., coal, iron ore, marble) that will work with Government and the community.
- ✓ A phased approach over a certain time period?

- ✓ An approach that will immediately or ultimately include processing of the mineral?
- ✓ If several blocks, that the companies should agree to cooperate with other license holders
- ✓ Energy production
- ✓ Job creation
- ✓ Integration of the mining development to other development (i.e., resource corridor, infrastructure, PPPs)
- ✓ Highest possible revenue generation in the form of rent, fees, taxes, royalties

Recommendation – some discussion is required with technical experts to determine the viability of attracting mining firms in today’s global market to conduct both mining and processing at the site. It is essential that the development of be linked with other development; this expectation and even Government preferences must be clearly stated in tender documents.

c. What do Bidders expect to receive?

- ✓ Entire deposit, known and unknown (ideally this is what they will seek)
- ✓ Opportunity to bid on more than one block
- ✓ Commercially reasonable fiscal package
- ✓ Full ownership of the project
- ✓ Ease of access working in and around the country, shipping equipment, etc.
- ✓ Affordable, reliable and skilled local staff
- ✓ Clear institutional counterparts
- ✓ Very good return on investment

Recommendation – depending on the size of the potential deposit, for transaction purposes, tendering blocks will provide Government with an opportunity to diversify investors in the mineral market rather than giving the rights to the entire deposit to one investor. This said, the blocks must be of commercially interesting size for the investor to bid. Companies will always want certain elements of the project to which Government cannot agree/will not agree – as much as Government can state in its tender documents will reduce uncertainty at negotiations.

3. HOW – how is the tender designed?

- ✓ Using procurement law? Other legal basis? (**NO to procurement law!!!**)
- ✓ One stage? Two stage?
- ✓ Each block requires a separate bid submission
- ✓ Winner will be least cost or best financial package or standards based or other?
- ✓ According to international best practice?

Recommendation – The tender should be designed to select the most qualified bidders who demonstrate the greatest benefit to KP for the development of minerals at and in accordance with international best practice. **Least cost approach is not recommended.** The procurement law should not in any way be used as a basis for mineral tenders and appropriate legal basis is essential.

Least cost approach is not recommended. The procurement law should not in any way be used as a basis for mineral tenders and appropriate legal basis is essential.

4. WHEN – how quickly or slowly can this process be expected to take?

- ✓ 30 days to respond? 90 days?
- ✓ Any requirement for stakeholder consultation before submission?
- ✓ How much time is needed for Government to conduct good due diligence?
- ✓ Must respond before or after site visit?
- ✓ Must respond before or after road show?

Recommendation – This tender seeks an investor to develop a non-renewable resource for decades. It is important that the tender period be sufficiently long for Government to conduct good due-diligence and for the investor to truly know the scope of work ahead and for investors to do their “homework” to ensure rational investment.

5. WHERE – is this a KP and/or Pakistan-based effort or beyond?

- ✓ Will investors be permitted to visit the site as often as they wish?
- ✓ Will opening of bid submissions take place in Peshawar?
- ✓ Any road shows or investor forums?

Recommendation – True or untrue, media reports link war-related events of recent years in Afghanistan to Pakistan; in order to build investor confidence and for Pakistan to attract serious, legitimate mine companies, some international forums are required. A combination of road shows and investor forums will help to build interest, provide real information beyond media hype, and “take the temperature” of the investment market. Government may informally gather information to gauge investor needs and interests that will assist in preparation of final tender documents.

Appendix -2

The EITI Principles (Adopted 2003)

1. We share a belief that the prudent use of natural resource wealth should be an important engine for sustainable economic growth that contributes to sustainable development and poverty reduction, but if not managed properly, can create negative economic and social impacts.
2. We affirm that management of natural resource wealth for the benefit of a country's citizens is in the domain of sovereign governments to be exercised in the interests of their national development.
3. We recognize that the benefits of resource extraction occur as revenue streams over many years and can be highly price dependent.
4. We recognize that a public understanding of government revenues and expenditure over time could help public debate and inform choice of appropriate and realistic options for sustainable development.
5. We underline the importance of transparency by governments and companies in the extractive industries and the need to enhance public financial management and accountability.
6. We recognize that achievement of greater transparency must be set in the context of respect for contracts and laws.
7. We recognize the enhanced environment for domestic and foreign direct investment that financial transparency may bring.
8. We believe in the principle and practice of accountability by government to all citizens for the stewardship of revenue streams and public expenditure.
9. We are committed to encouraging high standards of transparency and accountability in public life, government operations and in business,
10. We believe that a broadly consistent and workable approach to the disclosure of payments and revenues is required, which is simple to undertake and to use.
11. We believe that payments' disclosure in a given country should involve all extractive industry companies operating in that country.

In seeking solutions, we believe that all stakeholders have important and relevant contributions to make – including governments and their agencies, extractive industry companies, service companies, multilateral organizations, financial organizations, investors, and non-governmental organizations.

www.eiti.org

Appendix -3

Voluntary Principles

Established in 2000, the Voluntary Principles on Security and Human Rights (Voluntary Principles) is a multi-stakeholder initiative (MSI) involving governments, companies, and non-governmental organizations (NGOs) that promote the implementation of a set of principles that guide oil, gas, and mining companies on providing security for their operations in a manner that respects human rights. Specifically, the Voluntary Principles guide companies in conducting a comprehensive human rights risk assessment in their engagement with public and private security providers to ensure human rights are respected in the protection of company facilities and premises.

Overview of the Voluntary Principles:

- MSI composed of multinational oil, gas, and mining companies, governments, and key international non-governmental organizations
- Practical guidelines to help extractives companies manage risk effectively at the international, national, project level
- Platform for mutual learning, joint problem solving, and building best practices on security and human rights challenges with companies, governments, and NGOs
- Framework to build capacity of key players to address these issues in complex environments.

Why Implement the Voluntary Principles?

While the duty to protect human rights rests with governments, businesses have a responsibility to respect human rights as outlined in the UN Guiding Principles on Business and Human Rights,¹ by acting with due diligence to avoid harming people and addressing adverse impacts with which they are involved. Extractives companies often operate in complex environments with little guidance on the ground on how to observe their human rights responsibilities. The Voluntary Principles helps companies identify human rights risks and take meaningful steps to address those risks in a manner that helps ensure respect for human rights in their operations.

The Voluntary Principles provide a framework for companies to manage risk effectively by:

- Conducting a comprehensive assessment of human rights risks associated with security
- Engaging appropriately with public and private security service providers and surrounding communities in complex environments
- Instituting human rights screenings of and trainings for public and private security forces
- Developing systems for reporting and investigating allegations of human rights abuses

www.voluntaryprinciples.org and <http://www.state.gov/j/drl/>.

Appendix -4

Qualified Extractive Industry Taxpayer (QEIT) Provision

Income Tax Law 2009 Islamic Republic of Afghanistan

CHAPTER 12 TAXATION RULES FOR QUALIFYING EXTRACTIVE INDUSTRY TAXPAYERS

Article 77 Definitions

(1) In this Chapter:

1. a "hydrocarbons Contract" means an Exploration Contract or Service Contract described in any applicable law affecting hydrocarbons in . Hydrocarbons are petroleum, gas, and other derivatives therefrom;
2. a "Mining Authorization" is a permission letter that is issued by Ministry of Mines in accordance with the Mines Law, for exploration of quarries, constant utilization of quarries, utilization of previously explored idle materials, professional utilization, business, process, transfer, and processing of minerals;
3. a "Mining License" is a document issued in accordance with the Mines Law for exploration or utilization of mines;
4. "QEIT" means a Qualifying Extractive Industries Taxpayer and refers to a person that holds a mining License or mining Authorization or is party to a hydrocarbons Contract;
5. a "QEIT asset" is an asset that –
 - has an effective life of more than 12 months; and
 - is constructed or acquired to be used directly in the business stated in the mining License, mining Authorization or hydrocarbons Contract.

(2) A well that is drilled by a QEIT for the purpose of exploring for, developing, or producing hydrocarbons shall be deemed to be a QEIT asset and all costs incurred in the course of drilling the well, contracting with another person to drill the well for the QEIT, or closing a well shall be treated as the cost of acquiring the well. Where the drilling or contracting costs for drilling are incurred over more than one tax year, the QEIT shall be treated as acquiring separate QEIT assets in each year with a cost for each asset equal to the drilling or contracting costs for drilling incurred in that year.

Article 78 Precedence of Chapter 12 The Articles in the Chapters of this Law apart from this Chapter apply to a QEIT in the same manner they apply to a taxpayer that is not a QEIT unless they are changed by an Article in this Chapter.

Article 79 Tax obligations of QEIT (1) A QEIT shall be treated as a separate taxpayer in respect of each mining Authorization, mining License, or Contract for hydrocarbons.

(2) If a QEIT is party to more than one hydrocarbon Contract or holds more than one mining License, or mining Authorization, or any combination of these, the person shall be treated as if it were a separate perso² in respect of the business operations related to each hydrocarbon Contract, mining License, or mining Authorization.

(3) If a hydrocarbon Contract, mining License, or mining Authorization is renewed, the renewal shall be treated as part of the original hydrocarbon Contract, mining License, or mining Authorization for the purpose of this Article.

(4) If a QEIT is party to more than one hydrocarbon Contract or holds more than one mining License, or mining Authorization, or any combination of these and incurs expenditure in relation to more than one hydrocarbon Contract, mining License, or mining Authorization, the expenditure shall be apportioned between the different parts of the business on the basis of the application of the expenditure.

Article 80 Business receipts tax The business receipts tax imposed under Chapter 10 of this Law shall not apply to:

1. receipts of a QEIT from the sale of mineral substances (as defined in the Minerals Law, 2005) that are subject to a mining License or mining Authorization;
2. receipts of a QEIT from the sale of hydrocarbons that are subject to a hydrocarbons Contract; or
3. receipts of a QEIT from the sale or transfer of a mining License or mining Authorization or a hydrocarbons Contract.

Article 81 Depreciation deductions (1) Contrary to sub-paragraph 7 of paragraph (1) of Article 18 of this Law, a person that is a QEIT and that incurs an expense to acquire a QEIT asset other than a building or rights to occupy a building may deduct the cost of acquiring the asset for a year on a straight-line basis over the lesser of:

1. the effective life of the asset; and
2. five years commencing with a deduction in the year in which the asset is acquired.

(2) Contrary to sub-paragraph 7 of paragraph (1) of Article 18 of this Law, a person that is a QEIT and that incurs an expense other than annual rent to construct or acquire a QEIT asset that is a building or to acquire rights to occupy a building may deduct the expense on a straight-line basis over 15 years, commencing with a deduction in the year in which the expense is incurred.

(3) A person that is a QEIT that incurs an expense to acquire a mining Authorization or mining License or hydrocarbons Contract may deduct the cost of acquiring the Authorization, License or Contract on a straight-line basis over the period to which the Authorization, License or Contract applies.

(4) The depreciated value of a QEIT asset at any time shall be the original cost less any deductions for the cost of constructing or acquiring the asset that were allowed under this Article. Where a person that is a QEIT disposes of a QEIT asset for more than its depreciated value, the excess of sale proceeds over depreciated value shall be included in the person's income for tax purposes. Where a person that is a QEIT disposes of a QEIT asset for less than

its depreciated value, the excess of depreciated value over sale proceeds shall be deductible in the year of sale.

Article 82 Cost of constructing roads (1) This Article applies to a person that is a QEIT and that incurs an expense to construct a road that will be used to carry on a business that is subject to a mining License or mining Authorization or a hydrocarbons Contract.

(2) A person described in paragraph (1) of this Article may deduct the cost of constructing the road described in paragraph (1) of this Article over a period of fifteen years commencing with a deduction in the year in which the road is completed.

(3) This paragraph applies where a person that is a QEIT sells its rights under a mining License or mining Authorization or hydrocarbons Contract to another person and as a result of that transfer the person making the sale will no longer use a road described in paragraph (1) of this Article and the person acquiring the mining License, mining Authorization or hydrocarbons Contract will use the road. In this situation, the person acquiring the mining License, mining Authorization or hydrocarbons Contract asset shall be entitled to deduct the undeducted cost of constructing the road over the remaining deduction years. For this purpose, the remaining deduction years for the road shall be calculated as 15 minus the number of years during which the previous owner or owners were entitled to deductions under this Article.

(4) Where paragraph (3) of this Article applies to a road described in paragraph (1) of this Article, the person who sells its rights under a mining License, mining Authorization or hydrocarbons Contract shall not be entitled to any deductions under this Article for the cost of constructing the road the year in which the rights under the mining License, mining Authorization or hydrocarbons Contract are sold or in any later year.

Article 83 Pre-production costs (1) Notwithstanding Article 18 of this Law, a person that is a QEIT may only deduct an expenditure that is a pre-production cost on a straight-line basis over the pre-production cost recovery period where –

1. a "pre-production cost" is any expenditure that is incurred by a QEIT prior to commencing commercial production of minerals in the course of business related to a mining License or mining Authorization or a hydrocarbons Contract. However, a pre-production cost does not include the cost of acquiring a QEIT asset or the cost of constructing a road;

2. the "pre-production cost recovery period" for a mining business carried on by a QEIT in an area defined in a mining License or mining Authorization shall be the lesser of –

15 years; and

the number of years remaining in the License or Authorization.

3. the "pre-production cost recovery period" for a hydrocarbon business is the number of years remaining in the Contract.

(2) A QEIT shall be treated as commencing commercial production of minerals or hydrocarbons in the earlier of:

1. the year in which the Ministry of Finance and the Minister of Mines and Industries issue to the QEIT a written notification that the Ministries jointly accept a written submission by a QEIT that it has commenced commercial production, and

2. in the case of a QEIT that holds a mining Authorization, the year in which the proceeds from the sale of minerals exceeds 6 percent of the pre-production costs incurred by the QEIT prior to that year,

3. in the case of a QEIT that holds a hydrocarbons Contract, the year in which the proceeds from the sale of hydrocarbons exceeds the threshold percentage of the pre-production costs incurred by the QEIT prior to that year where the number in the threshold percentage is determined by dividing 100 by the number of years of the hydrocarbons Contract.

(3) Where a person that is a QEIT sells its rights in a mining License or mining Authorization or hydrocarbon Contract to another QEIT, the first QEIT may add to the cost of acquiring its rights in the License, Authorization or Contract any pre-production expenses it incurred that have not been previously deducted under paragraph (1).

Article 84 Deduction for contributions to a fund for environmental and social obligations

A person that is a QEIT may deduct any amount that is required to be paid in respect of environmental and social obligations under Article 82 of the Minerals Law, 2005 or pursuant to a plan required by any applicable law affecting hydrocarbons provided –

1. the amount is paid to an entity that has no direct or indirect connection to the person claiming a deduction under this Article;
2. the person provides, through a financial institution approved for this purpose by the Da Bank, a bank guarantee for payment to the Ministry of Finance of the deductible amount in the event the entity holding the amount deposited does not apply the funds as specified in the governing Minerals Regulations or pursuant to a plan required by any applicable law affecting hydrocarbons.

Article 85 Loss carry-forward and stability agreements (1) Article 42 of this Law, which imposes a limit on the recognition of net operating losses, shall not apply to a QEIT. Where a QEIT incurs a net operating loss as defined in Article 47, the loss may be treated as a deductible expense in the following year.

(2) Subject to paragraph (3) of this Article, the Ministry of Finance shall apply to a QEIT the provisions of this Law as they stood at the time the QEIT became party to a mining Authorization, mining License, or hydrocarbons Contract for a period of:

1. 5 years, in the case of a QEIT holding a mining Authorization, commencing with the year in which the QEIT begins to hold the Authorization;
2. 8 years, in the case of a QEIT holding a mining License, commencing with the year in which the QEIT begins to hold the License; or
3. the period of the hydrocarbons Contract, in the case of a QEIT that is party to a hydrocarbons Contract.

(3) The Ministry of Finance shall only apply the provisions of this Law to a QEIT as set out in paragraph (2) where the QEIT has agreed in writing that taxable income of the QEIT shall be subject to an income tax rate of 30 per cent for the years in which the provisions of this Law are applied by the Ministry of Finance on the basis of this Article without regard to subsequent changes.

End of Relevant Section

Appendix -5

Illustrative Pricing Methodologies

Mineral	Illustrative Pricing Methodologies
Aluminum	London Metals Exchange, standard grade aluminum, minimum 99.7 percent purity, spot price. Cash seller and settlement price.
Coal	Coal is readily available from a wide variety of sources in a well-supplied worldwide market. International coking coal trade is limited; for Pakistan, coking and lignite (“steam”) coal are in great demand; imports come from Indonesia, Australia, Afghanistan, etc. Coking coal is typically much more expensive than steam coal. Internationally, transportation costs typically account for 40% or more of the total delivered price of coal, therefore international trade in steam coal is effectively divided into two regional markets: (i) the Atlantic import market (i.e., Western Europe) and (ii) the Pacific market (Asian importers). Sellers and Buyers determine pricing.
Copper	The international copper markets are London Metal Exchange (LME) and New York Mercantile Exchange (NYMEX); the LME is commonly used (Grade A copper). (Note: Copper Concentrate pricing follows its own methodology not discussed here)
Gold	The London afternoon gold price fixing (“London PM fix” is like an auction) is used as a reference (spot) gold price around the world. There is also a London morning fixing, but as the afternoon fixing takes place when both the US market and the European (e.g., Zurich), Middle Eastern and African markets are still trading; typically busiest time of day. (World Gold Council, www.gold.org , London Bullion Market Association, www.lbma.org.uk).
Iron Ore	Two iron ore price lists, one for prices of ore to Europe and the other for prices to Japan are widely published. Note: these prices are usually set through negotiations between Brazilian iron ore producers and German steelmakers and between Australian producers and Japanese steelmakers. Pricing agreements had been annual but are now typically quarterly.
Lead	The London Metals Exchange (99.97% minimum purity lead) spot price.
Nickel	London Metals Exchange (primary nickel of 99.8% minimum purity) spot price.
Tin	London Metals Exchange (standard grade tin) spot price.
Zinc Concentrate	The main world reference spot price for zinc is the London Metals Exchange (high grade 98% percent pure zinc) price as if delivered to UK ports.

Appendix -6

Illustrative Draft Mine Contract Template Outline

Khyber Pakhtunkhwa (KP) Minerals: Best Practice Frameworks

Mine Contract Template

Illustrative Draft for Review

OUTLINE to be completed as part of Deliverable 3

BACKGROUND NOTE

About this Illustrative Draft Mine Contract Template

- 1. What this Contract is:**
 - a. It is a Mine Exploitation (Mining Lease) Contract
 - b. It includes Contract Terms that are attached to the License
- 2. What this Contract is not:**
 - a. It is **not** a substitute for the Minerals Law or Mining Regulations or Concession Rules
 - b. It is **not** an Exploration Contract; this contract is based on the presumption that sufficient exploration has occurred and that the phase of work now being discussed is mine development.
 - c. It is **not** a community level Contract (that would be done directly between the mine company and the community with MoM oversight)
- 3. What this Contract does cover:**
 - a. Lease Terms
 - b. Key License Provisions
 - i. Financial Requirements
 - ii. Tenure of Mine Property
 - iii. Commencement of Mining operations requirements
 - iv. Parties' Rights and Obligations
- 4. What this Contract does not cover** (it could but would be a much longer Contract):
 - a. Warranties and Representations
 - b. Project Finance estimates and terms of Project Finance
 - c. Indemnification
 - d. Sovereign Immunity
 - e. Severability
 - f. Specific penalties for non-performance
- 5. Areas for Policy Consideration**
 - a. Should KP Government always hold any percentage of mine project equity?
 - b. Specific penalties for non-performance must be developed

Royalty: Insert
Performance Bond: Insert
Term of Contract: XX years
(Must coordinate with new Law terms and license/lease terms)

3. Mine Contract Terms

- 3.1 Financial Terms
- 3.2 Tenure
- 3.3 Rights and Obligations of the Company
- 3.4 Rights and Obligations of KP Government

4. Application of Ministry of Mines Procedures

5. Application of Legal Requirements for the Implementation of Mine Exploitation

6. Other Terms

- 6.1 Transfer or Assignment
- 6.2 Authorized Representative
- 6.3 Applicable Law
- 6.4 Governing Language

This Contract including its Appendices shall constitute the entire agreement between the Parties.

The Parties affirm that they are duly authorized to enter into this Contract as authorized representatives on the ____ day of _____ 201__.

Khyber Pakhtunkhwa Mines & Minerals
Development Department as "KPMMD"

Name of Company as "Company"

By: _____
Name:
Title:
Date:

By: _____
Name:
Title:
Date:

APPENDIX 1 (to Mine Contract)

MINING LEASE

LEASE NO. _____

APPENDIX 2 (to Mine Contract)

**SAMPLE Special Mine Contract Provisions
(Illustrative terms that may or may not be useful to include in mine contracts)**

1. Water
2. Waste
3. Weed Control
4. Cultural Artifacts
5. Traffic

APPENDIX 3 (to Mine Contract)

SAMPLE MINE PROCEDURES TO BE INCLUDED AS PART OF CONTRACT

1. Definitions and Acronyms
2. Parties' Mutual Understanding of Commercial Terms
3. Financial Procedures
4. Labor and Social Terms
5. Use of Contractors, Subcontractors, Consultants and Other non-Party Affiliates
6. Events of Default and Remedies
7. Prohibited Areas
8. Explosives
9. Health and Safety
10. Force Majeure and Suspension of Operations for Market Conditions
11. Dispute Resolution and Arbitration
12. Modification, Waiver and Amendment
13. Surrender, Transfer and Termination
14. Notices

OTHER APPENDICES THAT OTHER KP DEPARTMENTS WILL NEED TO DEVELOP

1. Requirements of Environment Department
2. Requirements of Finance Department
3. Requirements of Forestry Department
4. Requirements of Law Department
5. Requirements of Agriculture/Land Department
6. Requirements of Security Department
7. Requirements of Cultural/Heritage Department

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