DIGEST

Kumtor report raises corruption concerns

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In the summer of 2012, the Kyrgyzstan government entrusted two Israel-based investigative firms, Muszkat Consultants and Barlev Investigative Auditing, to explore - in Muszkat Consultants' words - "legal ways of increasing the profitability of the Kumtor project for the people of Kyrgyzstan and for the Kyrgyz government to get compensation" for possible wrongdoing.

Kumtor, a mine with the largest open gold deposit in Central Asia, has long been mired in political and environmental controversy and has sparked repeated political crises - particularly in the past five years - due to public protests over alleged corruption. Kumtor is important as it accounts for "7.7% of Kyrgyzstan's economic output, 24% of industrial production and 36.5% of all exports", according to Reuters. The mine is located more than 4,000 meters above sea level in the Tian Shan Mountains, in the eastern Issyk Kul province of Kyrgyzstan.

In February 2014, after months of heated political debate between the parliamentary opposition and Kyrgyz President Almazbek Atambayev over Kumtor's share ownership, lawmakers rejected calls to nationalize the project and approved a "draft deal with Centerra Gold on forming a 50-50 joint venture to run the gold mine." Work on the deal between the two sides continues.

The first general framework agreement for the exploitation of Kumtor mine dates back to December 4, 1992. The agreement was signed by the Kyrgyz Republic and Canadian mining and energy giant Cameco when Kyrgyzstan had been an independent state for little over a year under the leadership of its first president, the academic-turned-politician Askar Akayev. That deal created Kumtor Gold Company, giving 67% of the company to Kyrgyzaltyn, a state-owned concern, and 33% to Cameco. In 1996, Cameco created Cameco Gold Inc as a fully owned subsidiary to administer its interests in Kumtor Gold Company. Operations at the mine started on January 7, 1997.

$4 million question

Muszkat's legal analysis and Barlev's economic evaluation raise questions regarding Cameco's alleged bribery of foreign government employees, a crime that - if confirmed - carries up to 14 years of imprisonment, according to Canada's 1998 Corruption of Foreign Public Officials Act. In a June 19, 2013 letter to the Kyrgyz Parliament, Muszkat Consultants expressed a readiness to collaborate with the Kyrgyz Government to bring a lawsuit against Cameco for damages of as much as US$3.5 billion. Cameco has denied any wrongdoing.

Copies in Russian of the Muszkat and Barlev expert reports have been obtained by the authors. In one of the reports, Barlev said that $4 million was transferred from Cameco to Kyrgyzaltyn in September 2002, a time when the parties were negotiating the restructuring of the Kumtor agreement. In a September 25 letter to Bernan Michel, the chairman of the board of directors of Cameco, the then-Kyrgyz Minister of Finance Bolot Abildaev confirmed receipt of that sum as an advance payment for the restructuring of Kumtor Gold Company, on condition that the deal be finalized by December 1, 2002. Failing that, the ministry committed itself to returning the sum from "concessional payments and other taxes of Kumtor Gold Company". The $4 million transaction does not appear in Cameco's 2002 Annual Information Form, at least not in the form of advance payment.

The $4 million features again in a June 11, 2003 letter to the Ministry of Finance from Cameco Gold Inc. President Leonard Homeniuk, where - according to Muszkat's report - the sum is described as for "future taxes" of Kumtor Gold Company. This is in line with the previous agreement, as the two sides had failed to meet the December 2002 deadline.

However, in parallel to this, Jesse Grant Hester, a director of Eckerd Ltd, a British Virgin Islands offshore company, reached out to Kyrgyzaltyn on May 27, 2003, on the recommendation of the Kyrgyz Ministry of Finance, offering his company's help to extinguish the $4 million debt owed by the government of Kyrgyzstan to Cameco. Hester featured in a 2012 BBC Panorama investigative report exposing the use of nominee directors as often being a sham "to hide funds by creating an offshore structure". He was "the director for an Irish entity, Candonly Limited, which an official inquiry later found was used by the regime of Iraqi dictator Saddam Hussein to cheat the United Nations' Oil for Food Program."

On July 5, 2003 after a preliminary meeting at Hotel Athenaeum in London between Hester and Kyrgyzaltyn President Kamchibek Kudaybergenov in the previous month, Kyrgyzaltyn struck a deal with Eckerd. According to the terms of the agreement, Eckerd would acquire the $4 million debt obligation in exchange for two-thirds of the insurance payment owed to Kyrgyzaltyn in compensation for a July 8, 2002 accident at Kumtor mine, which resulted in the death of one Kyrgyz employee and significant material losses.

The 2003 Kumtor restructuring

That the $4 million now figured as a "debt obligation" raised suspicions. Muszkat stated in a report that "the $4 million deal as found in the Eckerd agreement is a falsification," with the insurance payment constituting "a cover for bribery". Muszkat described Eckerd as "an offshore company whose real owners were presumably linked to former President Akayev". Hester had not responded to a request for comment at the time of publication.

Barlev concluded that "the $4 million was part of a corruption scheme to receive payment from Cameco for activities unrelated to Kumtor mining operations." What could these activities be? The reports suggest that the answer may be found in the 2003 Kumtor restructuring agreement.

In the course of the 2002 negotiations, Cameco Gold Inc put forward two options for the restructuring deal. Consequently, Kyrgyzaltyn engaged two foreign companies, Blake, Cassels & Graydon LLP - one of Canada's top business law firms - and Standard Bank London Limited - a branch of the South African-based global financial services company - to study the proposals. According to Muszkat's report, Standard Bank London "first recommended that Kyrgyzaltyn acquire 38% of Centerra's shares, and then, in reviewing the negotiations, it stated that a 33% share was reasonable." The revision brought the ownership percentage in line with one of Cameco's proposed alternatives.

On December 31, 2003 the Agreement on the Restructuring of Kumtor was finally signed by Cameco, Cameco Gold Inc, Kyrgyzaltyn and Centerra Gold Inc. Terms included the transfer of all the shares of Kumtor Gold Company held by Kyrgyzaltyn (67%) and Cameco Gold Inc (33%) to Centerra Gold Inc, the latter a Canadian company established on November 7, 2002 and headquartered in Toronto. According to the restructuring, Kyrgyzaltyn would own 28.8% of Centerra's shares, whereas Cameco Gold Inc would hold 58.5% of Centerra's shares. Not only did this represent an "effective erosion" in Kyrgyzaltyn's ownership position, as Muszkat puts it; it was also less than advised in the Standard Bank report. Furthermore, Muszkat said that the $4 million payment was written down as "government debt" and assigned by Cameco to Centerra as creditor, while Kyrgyzaltyn would take a "debt" on its account.

Was the corruption scheme meant to effectively invert the previous ownership ratio that saw Kyrgyzaltyn, and by extension, the Kyrgyz government, as the majority shareholder in Kumtor project? Muszkat Consultants recommend that the matter be addressed to the competent Canadian authorities, namely the Ontario Securities Commission and the Canadian police.

Centerra Gold's Vice President for Investor Relations, John W Pearson, commented on the allegations via email on August 7, 2014: "Centerra and Kumtor have never engaged in corrupt conduct. Our employees adhere to a strict anti-corruption policy, and adhere to all applicable anti-corruption laws and to international anti-corruption standards. We have repeatedly asked the Kyrgyz authorities for evidence of such alleged conduct and none has ever been provided. As far as I am aware no investigation by the Kyrgyz Republic or any of its advisors has produced any credible evidence of any wrongdoing by Kumtor or Centerra. If there is any evidence then it should be provided."

Cameco's Manager for Media Relations, Rob Gereghty, commented on the allegations via email on August 8, 2014: "We expect all Cameco employees and representatives to conduct themselves ethically and obey the law in dealing with foreign officials and do not believe there was any inappropriate or criminal conduct by Cameco or its representatives during the 2003 restructuring. The 2003 restructuring that resulted in the creation of Centerra was a fully transparent transaction that had the support and authorization of the Kyrgyz government, and the Kyrgyz government had capable professional advisors throughout that process."

Bribery allegations

On June 30, 2004, Centerra Gold Inc was launched as a growth-oriented gold company with the largest gold initial public offering (IPO) on the Toronto Stock Exchange since 1994. The IPO included an irrevocable purchase stock option from Cameco Gold Inc. to Kyrgyzaltyn in the amount of $11 million. The option was not exercised within the 30 day deadline. Instead, the $11 million was transferred to a third party as part of what Barlev calls a "complex corruption scheme' of bribery and money laundering. Centerra Gold denies any wrongdoing.

Shares in Centerra Gold were first traded on the Toronto Stock Exchange between June 22 and June 30, 2004, with the launch of an initial public offering (IPO) and secondary offering totaling 16.3 million shares. Of those, 7.5 million were sold by Kyrgyzaltyn, bringing its ownership of Centerra Gold to 16.1%, down from 28.8%. The IPO included an irrevocable purchase stock option of Cameco Gold Inc's Centerra-held shares in favor of Kyrgyzaltyn for $11 million, with a 30-day deadline. This option was never used. In preparation for the option to be exercised, however, Centerra had transferred $11 million to Blake, Cassels & Graydon LLP - a Canadian law firm that had evaluated options for the 2003 Kumtor restructuring agreement on behalf of Kyrgyzaltyn.

In a June 22, 2004 letter, Kyrgyzaltyn President Kamchibek Kudaybergenov asked David G Glennie at Blake, Cassels & Graydon LLP to credit the $11 million to a bank account at Barclays Bank plc in New York, in the name of Standard Bank London Limited - which had also advised Kyrgyzaltyn on the 2003 Kumtor restructuring agreement. The Muszkat report asserted the belief that this is as an anomaly, as neither the 2003 agreement nor the Centerra Shareholders' Agreement mention any such financial transaction through Blake, Cassels & Graydon LLP. "[T]he Centerra Shareholders' Agreement contains provisions for the use of this option, but gives no instruction regarding the return of this sum of money in case Kyrgyzaltyn decides not to use it," Muszkat said in a report seen by the authors.

On June 28, 2004, at Kyrgyzaltyn's request, Standard Bank wired the $11 million to a bank account at Aizkraukles Bank in Riga, Latvia, whose beneficiary was Eckerd, the same company that Kyrgyzaltyn had reached an agreement under which Exkerd would acquire Kyrgyzaltyn's $4 million debt to Cameco in exchange for two-thirds of an insurance payment on the failure of a pit wall at Kumtor in 2002. (Aizkraukles Bank was at the center of the Magnitsky case over money laundering operations, along with several other Latvian banking institutions. Its name also surfaces in a report about a major money laundering scandal involving a bank in Kyrgyzstan, Asia Universal Bank.)

Following the transfer, in a July 15, 2004 letter to Standard Bank, Kyrgyzaltyn claimed that Centerra's initial $11 million payment to Blake, Cassels & Graydon LLP was intended as insurance compensation, rather than as payment for the stock purchase option. The letter also stated that, in turn, Kyrgyzaltyn had transferred the amount to Eckerd in accordance with their previous agreement. In reality, however, Muszkat Consultants assert that the debt agreement with Eckerd is "a falsification to receive a bribe for the amount of $11 million", adding that this sum "could be impounded as money meant to be laundered".

Instead, the actual insurance proceeds accrued to Kyrgyzaltyn only in 2006, rather than in 2004 as claimed in the letter. The 2006 Kumtor Gold Company financial report, found in Barlev, clearly states that '[i]n 2006 a settlement with insurers was concluded in regards to the pit wall failure. The Kumtor Gold Company has recorded $13.6 million of insurance proceeds received during the year in the income statement." The precise amount appears in the company's balance sheet as $13,579,994, two-thirds of which is $9,053,329 - rather than $11 million. This, according to Muszkat Consultants, is "yet another falsification".

Under the 2003 restructuring agreement, as the stock option was never executed, Kyrgyzaltyn was entitled to compensation for $1.25 million from Cameco Gold. This was confirmed in a July 27, 2004 letter in which Kyrgyzaltyn asked Cameco to transfer this amount to its bank account in Kyrgyzenergobank in Bishkek, Kyrgyzstan. Barlev could not find any record of this transfer, raising questions as to whether Cameco/Centerra hold a $1.25 million debt to Kyrgyzaltyn.

Centerra Gold's Vice President for Investor Relations, John W Pearson, commented on the allegations in his August 7, 2014 email: "As for the negotiations in connection with the 2003-4 and 2009 transactions, [1] they were open and transparent and all the agreements are on the public record. The Kyrgyz Republic was advised during those negotiations by independent international legal and financial advisors in those transactions. Again, I reiterate that no evidence or information supporting the allegations of improper behavior by Centerra or Kumtor has been produced and we have called on the Kyrgyz authorities to stop making such unfounded allegations."

In conclusion, the $11 million was first described as payment for the stock option, but the option was never used. The sum was later claimed as insurance money, but - in Muszkat Consultants' words - Kumtor received such compensation "only in 2006, whereas Eckerd banked a bribe in the form of insurance payment two years before it had been actually paid by the insurance company". Therefore, Barlev Auditing concludes that these transactions were "part of a complex corruption scheme including Cameco and Centerra".

The same question arises with regard to the $4 million payment: were these transactions part of a corruption scheme aimed at inverting the previous ownership ratio that saw Kyrgyzaltyn, and by extension, the Kyrgyz government, as the majority shareholder in Kumtor project? Effectively, by June 2004, Kyrgyzaltyn's share had dropped from 67% to 16.1%, whereas Cameco's had increased from 33% to 54.1%.

There are suspicions that, in Muszkat's words, "the sums of $4 million and $11 million were 'recorded' in such a way to justify the payments to Eckerd, an offshore company whose real owners were presumably linked to former President Akayev. These sums were in reality bribes and for money laundering."

Muszkat Consultants recommended that the matter be addressed to the competent Canadian authorities, namely the Ontario Securities Commission and the Canadian police.

Note:

1. This report is specifically based on findings of the Muszkat Consultants and Barlev Auditing investigation into 2003 restructuring agreement and does not examine a 2009 restructuring deal between Kyrgyz Government and Centerra which is alluded to here.

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Phone +996 (312) 66-01-88 advertising and PR +996 (312) 68-08-51 email info@24.kg