



## PALADIN ENERGY LTD

ACN 061 681 098

12 June 2015

Ms Nuria Molina  
Director of Policy, Advocacy and Campaigns  
ActionAid UK  
33-39 Bowling Green Lane  
London EC1R OBJ  
United Kingdom

Dear Ms Molina

### **TAXATION PAYMENTS – PALADIN (AFRICA) LIMITED**

I refer to your letter of 08 June 2015 concerning royalty and taxation payments made to the Government of Malawi (**GoM**) by the Paladin Energy Group of Companies (**Paladin**) through its Malawian-incorporated subsidiary company, Paladin (Africa) Limited (**PAL**), in which the GoM has a 15% equity stake. You have asked for Company comment on two matters: the royalty rate applicable to the Kayelekera Mine (**KM**), owned and operated by PAL; and the withholding tax contribution of PAL to the GoM.

#### **Royalty Rate**

Respectfully, we regard the fundamental premise of your supposition that Malawi has foregone revenue as a result of the royalty rate applicable to KM to be flawed. You assume that Paladin's US\$620M investment, including the initial US\$300M development of the Kayelekera Project (**the Project**), further capital expenditure and working capital funding, would have proceeded if a 5% royalty had been in place. This is a false assumption.

If a 5% royalty had applied, the Project would not have proceeded. Such a royalty rate was an economic disincentive to investment and was recognised as such by the government of the day. Unless the royalty had been reduced to 3%, the Project would not have reached an economic threshold for investment. The royalty rate was reduced and, as a result, Malawi enjoyed the economic benefits arising from this significant investment – the first such major investment in the country's resources sector and the only one to date.

It is a fact that when Paladin invested in Malawi, no other company had contemplated a level of investment on this scale – in the resource sector or any other. It has entered Malawi mythology that the negotiation with Paladin was asymmetrical and thus unfair.

This overlooks the following inconvenient facts:

1. The Finance Minister at the time, Hon. Goodall Gondwe (who serves in that role in the current government), is a highly respected economist and was a former director of the Africa Division for the International Monetary Fund (**IMF**).

2. Ministry of Finance officials were supported by an experienced British economist, Mr. Keith Hammond, seconded to Malawi from the UK Ministry of Finance throughout the period of negotiation of the KM Development Agreement. Mr. Hammond was involved in supporting and advising his Malawian counterparts in this process.
3. The GoM sought and received advice and assistance from the IMF and the World Bank and consulted neighboring governments for their advice and input.
4. The GoM was provided with a full economic model of the Project and was able to do its own modeling to establish the viability or otherwise of the project under various fiscal regimes.
5. The terms and conditions were discussed in Full Cabinet on numerous occasions under the chairmanship of the then President, the late Dr Bingu wa Mutharka, himself a noted economist and former executive of the African Development Bank (**ADB**).

It is unfair to those able Malawians to suggest that they were incapable of negotiating an appropriate Development Agreement to serve the best interests of their country. Indeed, the fact that the GoM is the only party to have made any money to-date from the development of KM is testament to their negotiating skill and foresight. State Agreements for mining development which outline competitive conditions for start up of fledging mining industries are used by all countries. In fact the now fabulous iron ore mining industry of Western Australia was nurtured by State Agreements to encourage foreign investment and overcome risks which were associated with establishing a new industry. This is a time - proven successful model from which Malawi has also benefited.

If the Project had not proceeded, revenue loss to the GoM would have been US\$10,479,717, which is the total amount paid in royalties by PAL to the GoM in the period 01 April 2009 to 30 April 2015. The GoM would also have foregone some US\$38,170,424 in payroll tax, withholding tax and non-residence tax during this period.

The criticality of setting an appropriate royalty rate is evidenced by the situation involving the Kanyika Niobium Project of Globe Metals & Mining Limited (**Globe**). Malawi's proposed second major resource development project has been the subject of protracted approval negotiations, with GoM intransigence on royalty rate being a major point of differentiation. The Kanyika Project has now been delayed for more than two years, during which time development costs have doubled to US\$450M and the international investment climate for resource projects has deteriorated significantly.

Additionally, it should be recognised that KM's royalty rate is not unusually low. At 3%, it is the same as Namibia's for uranium. At the time Paladin was negotiating its Project Development Agreement with the GoM, the average royalty rate in Africa was 3% of sales value, including neighboring SADC countries. Malawi's current royalty rate of 5% is high and a disincentive to investment. The GoM is currently revising the country's mining code and the draft legislation – which obviously has yet to be adopted - provides for the royalty rate to be set on a case-by-case basis.

### **Withholding Tax**

In response to your comments on Paladin Netherlands BV (**PNBV**), we wish to make it clear that PNBV was established for commercial reasons and plays an important role in the overall international ownership, management and financing structure of the Paladin Group.

We have set out below, in detail, the background to its role and reasons for that role.

### ***Establishment of Paladin Netherlands BV***

- As part of its considerations around financing the Project for PAL, Paladin considered it appropriate for a range of commercial, legal and regulatory reasons to incorporate and use a special purpose vehicle (**SPV**) for part of the debt financing.
- As a result of those considerations, Kayelekera Netherlands Finance BV, now known as Paladin Netherlands BV (**PNBV**), was incorporated in April 2007.
- Specifically, PNBV was established for the following reasons:
  - It was intended that PNBV would act as the Paladin Group's international holding company for Malawi, as well as other non-Australian assets of the group. This was subsequently evidenced by the company's acquisition of the Canadian assets of the Aurora Energy Resources group in 2011, which are held by PNBV. Its use as a holding company was also considered as part of a number of other potential acquisitions that did not proceed.
  - Incorporation in the Netherlands was preferred for a variety of reasons, including being in the same time zone as Malawi (both GMT +2), its proximity to key European and North America energy markets and customers and its favourable legal, fiscal and immigration regimes. The Netherlands is a commonly chosen location for entities carrying out the broad "holding and financing" role that PNBV was established to carry on.
  - The transfer of the shares in PAL to PNBV has not occurred to date for a variety of commercial, corporate and regulatory reasons unrelated to tax, however the intended transfer of the shares in PAL was another key consideration in establishing PNBV in 2007 (as part of its international holding company role).

### ***Management Services Agreement***

- As part of the development of the Project, PAL also entered into a management services agreement (**MSA**) with PNBV, effective from July 2007.
- The MSA required PNBV to provide PAL with certain services required to develop the Project. Services under the agreement included but were not limited to geological services, engineering and design, project management, legal, finance, human resources and government and community liaison.
- The MSA was required because PAL was unable to source from third parties or maintain on its own account many of the required specialist services in Malawi. As mentioned, Paladin's investment in Malawi was the first major investment in the resources sector and Malawi did not have any modern resource projects operating in the country. There was therefore a lack of appropriate skills and expertise for a modern complex uranium mine. The MSA provided the flexibility of allowing PNBV to procure services globally on behalf of PAL, when needed, from the most appropriate service providers.
- To enable PNBV to meet its obligations under the MSA, some of the underlying activities were carried out by employees of Paladin in Australia, whilst others were procured from and provided by third party contractors from multiple jurisdictions. This was a necessary part of PNBV being able to provide the services to PAL.
- The activities outlined above are the basis for the identified charges between Paladin and PNBV and PNBV and PAL.

- It is important to note also that it was intended that PNBV would procure and provide services in a similar manner for other international operations of the Paladin Group. This remains the case, however for a number of commercial reasons, including the structures of various projects, this has not occurred to date.
- The MSA was reviewed by and approved by the GoM before its execution.

***Other relevant factors***

- At the time of its establishment, Paladin also intended to utilise PNBV as its European and North American sales and marketing entity for uranium produced by the group, including from KM. This included establishing an office and employing Dutch-based sales and marketing executives and business development teams.
- To achieve this, PNBV intended to acquire the resources to undertake these functions over time and when commercially expedient. This intent was first developed in 2007, at a time when uranium oxide had a spot price of US\$135 per pound.
- In years following, the uranium oxide price dropped significantly, causing Paladin to reassess its global projects, exploration programs and acquisition opportunities, including the Project.
- In a weakened uranium market, which has continued to the present time, and for a variety of commercial reasons, including cost and access to appropriate expertise, Paladin chose instead to continue to provide these marketing functions from Australia under the MSA, rather than establishing and developing them directly within PNBV.
- Due to the continued weak uranium prices, production at KM was suspended and the Operation placed into care and maintenance in May 2014. As a result:
  - Services provided to PAL under the MSA; and
  - Interest charges on the loans between PNBV and PAL and PNBV and Paladin were suspended with effect from 31 December 2013.
- Pursuant to the Development Agreement, the GoM holds a 15% interest in the project through share ownership in PAL. These shares give the Malawian government 15% of any income or gains arising from the development of the Project at no cost to the Government or the people of Malawi.
- All capital invested in or lent to PAL (i.e. equity as well as third party project debt and loans from PNBV) was negotiated and approved by the relevant Malawian government agency, including the Ministry of Finance, Economic Planning and Development (**MFEPD**), the Reserve Bank of Malawi (**RBM**) and the Ministry of Natural Resources, Energy and Mining (**MNREM**).
- All entities in the Paladin Group are subject to full corporate tax in their relevant jurisdiction (including PNBV in the Netherlands) and do not operate under any form of concessions or exemptions.

In summary, the establishment and operations of PNBV were driven by commercial rationale and, while interest and management fee charges from PNBV to PAL were not subject to Malawi withholding tax, this was a direct consequence of the ordinary application of the long standing Dutch-Malawi Double Tax Agreement to the group's operations.

Paladin's activities in Malawi are totally transparent to the GoM, as evidenced by the provision on a monthly basis of a full reconciliation of physical product movement and revenue flows, supported by copies of the Company's bank statements during the entire period of production. These are provided to the MFEPD, MNREM and RBM. The Paladin Group is also a supporting company of the Extractive Industries Transparency Initiative (**EITI**) and publishes details of its royalty and taxation payments to the Governments of Malawi and Namibia. Given that Paladin has interests in various projects around the world, its corporate structure is not complicated or unusual and, being totally transparent, is available on Paladin's website.

Thank you for the right of reply. I trust that this explanation will clarify the position of the Company for you.

Yours sincerely  
Paladin Energy Ltd



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