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MEMORANDUM **July 6, 2015**

TO: Jeffrey Brown, Recommendation Follow-up Coordinator Special Inspector General Audits Office of the Special Inspector General for Afghanistan Reconstruction (SIGAR)

FROM: Anne Dix, Acting Director, Office of Economic Growth and Infrastructure (OEGI) a m l d

SUBJECT: 60-days Status Update to SIGAR Report titled "Afghanistan's Mineral, Oil, and Gas Industries: Unless U.S. Agencies Act Soon to Sustain Investments Made, $488 Million in Funding is at Risk" (SIGAR Report 15-55)

REF: A) SIGAR Transmittal email dated 04/25/2015

As requested in referenced email, provided below is a status update and actions taken on recommendations Nos. 1 and 3 pertaining to USAID under the subject audit report.

In order to better inform current and future efforts to develop Afghanistan's extractive industries, we recommend that the USAID Administrator:

1. Conduct a review and document the incomplete TFBSO initiatives that have been transferred to the MoMP and, to the extent feasible, assist in the conclusion of those initiatives that fit within the USAID development strategy and the agency's ongoing programs.

Actions Taken/Planned:

As indicated in our response to the SIGAR draft report, the Task Force for Business and Stability Operations (TFBSO) initiatives was not transitioned to USAID and USAID is unable to liberally assume other federal agency projects without commensurate allocation of funding of the annual budget passed by the U.S. Congress. Nonetheless, we have conducted a review in coordination with the Ministry of Mines & Petroleum (MoMP) of the incomplete TFBSO initiatives which was transferred to MoMP. The specific details of the projects were reviewed and the results are provided as follows:

TFBSO Mineral Projects
As of mid-June 2015, MoMP negotiated four copper-gold exploration projects (Badakhshan, Balkhab, Shaida and Zarkashan) that were offered for tender in December 2011 with TFBSO assistance. We believe but cannot confirm that, the four contracts were negotiated with the preferred bidders and received all necessary GIRoA approvals, except for signature of the Afghan President.

Nevertheless, GIRoA stated over the past several months that they do not plan to promptly sign any of the four contracts. A very high probability exists that the MoMP and GIRoA will seek an independent legal review of the terms and structure of the contracts prior to finalizing them. At the same time, it became known that the Aynak copper contract won by the Chinese parastatal company Metallurgical Corporation of China (MCC) had taken priority, and the Ministry's attention was focused on arranging an independent legal review of the contract with MCC. The independent legal review of the contract is likely to be conducted by Columbia University Law School prior to beginning renegotiations under the contract. It is our understanding that the Badakhshan, Balkhab, Shaida and Zarkashan agreements may not be signed until the Aynak contract renegotiations are completed.

The projected costs and staffing required to complete the four pending copper-gold contracts may be estimated as follows:

* If contracts are accepted and signed in their current negotiated version, no material costs or labor costs are envisioned;

* If MoMP opts for independent review, the costs associated with the review are estimated at $50,000 - $75,000 per each contract reviewed. Additionally, renegotiations depending on the scope of each contract may require over $100,000 per contract. For renegotiation purposes Mining Investment and Development for Afghan Sustainability (MIDAS) staff may include one ex-pat attorney and one local national attorney for an estimate of up to two months to review each contract. Any staff commitments for renegotiation are difficult to estimate at this time;

* If MoMP and any of the preferred bidders fail to reach an agreement, or the bidder is unable to complete the terms of the contract, this has a very high probability on at least two of the pending contracts, then the costs for re-tendering including marketing, site visits, legal and financial advisory services, travel and administrative costs may equal about $500,000 per project to replicate the work previously done by TFBSO. USAID cannot fund this.

1. TFBSO Cement Projects

Concerning the cement projects, three projects were offered for tender in September 2013 by MoMP and TFBSO. However, these tenders received little interest from investors culminating in three offers only received in May 2014 for two of the three cement operations: Herat and Jabal Seraj. The Ghori III area tender was withdrawn, and ultimately, no preferred bidder was selected for the Herat area cement operations.

It is believed that negotiations have not been concluded for the Jabal Seraj cement project, and that the proposed transaction still requires Interministerial Council (IMC) and Council of Ministers approvals.

No further information is available as to the status of the negotiations between the preferred bidder and MoMP, so it not possible to provide a reasonable estimate of the costs and manpower that could be required to assist the Ministry in either closing the transaction or re-tendering some or all of the government-owned cement assets.

2. USAID on TFBSO Energy Infrastructure Projects

Incomplete TFBSO projects include the following:

* Repair of the existing 90 km gas pipeline from the area of the Yatimtaq and Khoja Gogerdak gas fields to the Northern Fertilizer Power Plant (NFPP) in Mazar-e-Sharif;

* Construction of a new, parallel gas pipeline to the fertilizer factory;

* Installation of a small scale gas treatment unit dehydration units and compressors at the beginning point of the two pipelines;

* Promotion of 50MW power plant in Mazar-e-Sharif.

As for the Gas Line Rehabilitation project, TFBSO asserted that the rehabilitation was complete, but, despite numerous requests from the US Embassy and serious concerns about the safety of un-replaced segments, the line was not tested before being turned over to MoMP. Additionally, replacement section six of the pipeline has never been completed due to security concerns. The safety and sustainability of the line are questionable, especially in view of expert reports from as early as 2004 stating that the line could not be repaired economically. Despite the safety issues, the Ministry is using the line at low pressure. Moreover, the complete environmental review and permission required under Afghan law has never been obtained. Finally, every study of the NFPP over the past number of years has concluded that it cannot be made economically sustainable, even at the cost of the gas that has currently subsidized sale price of $34 MCM (the commercial price paid by MoMP's privately operated compressed natural gas (CNG) provider is $150 MCM).

For the purpose of the New Gas Pipeline project, TFBSO imported pipes for the proposed new line, but has not started the construction, completed design, or obtained environmental permits. The pipes were transferred to MoMP and are stored in two locations (Mazar and Sheberghan).

For the Gas Treatment and Compression project, TFBSO procured and shipped in a small scale (maximum of 960 MCM/day) amine gas treatment unit at a reputed $24 million along with dehydration unit and compressors. Upon TFBSO's departure, this equipment was transferred to MoMP without having been commissioned for use and without any funding for operations and maintenance. The gas processing unit is of limited use due to its design that does not allow removal of corrosive contaminants from the high-sulfur natural gas comprising the great majority of the gas produced in the area, and does not have sufficient capacity. Sweeter gas is not available to cover the demand that is much higher than the capacity of the fertilizer plant. Sheberghan's production of sweeter gas is in rapid decline and it is technically impracticable and environmentally harmful for the amine plan to flare the more plentiful and also higher contaminated gas, which constitutes the bulk of Afghanistan's remaining gas reserves.

MoMP does not have either the funds or the technical or management ability to complete or to operate any of the above projects, and is unlikely to receive any funding for operations or technical support from Afghan government sources. The only concrete estimate for the cost of the above operations is an approximately $6 million proposal from the private firm, Quimex, to commission and operate the small gas processing unit for one year. Adequate testing and proper further work on the existing gas line would cost millions of U.S. Dollars. Proper installation of a new parallel high-pressure pipeline (using the pipe imported by TFBSO) by a reputable and experienced pipeline contractor is estimated to cost between $15M and $20M.

The incomplete TFBSO initiatives were not USAID projects and USAID does not have funding to assist in concluding the incomplete initiatives that have been transferred to the MoMP. Therefore, we request SIGAR to close this recommendation.

To ensure technical capacity building is sustained at MoMP and its component organizations after SGGA and MIDAS initiatives are completed, we recommend that the USAID Administrator require ECC, the MIDAS implementing partner, to:

(3) Update the MIDAS performance management plan by August 1, 2015 to include plans for the sustainment and transfer of its activities.

Actions Taken/Planned:

USAID implementing partner for MIDAS project is working on update of the performance management plan and will provide documentation by August 1.

Target Closure Date: August 31, 2015

cc: Walter Hammond, OFM
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