

AGREEMENT
ON PHASE II OF THE LESOTHO HIGHLANDS
WATER PROJECT

BETWEEN
THE GOVERNMENT OF THE
KINGDOM OF LESOTHO
AND
THE GOVERNMENT OF
THE REPUBLIC OF SOUTH AFRICA

TABLE OF CONTENTS

PREAMBLE

ARTICLE 1	Interpretation and Definitions	2
ARTICLE 2	Purpose of the Agreement	8
ARTICLE 3	Relationship with the Treaty	8
ARTICLE 4	Implementation of the Agreement	8
ARTICLE 5	Domestic Implementation and Enforcement	9
ARTICLE 6	Institutional Arrangements and Governance	10
ARTICLE 7	Operational Arrangements	12
ARTICLE 8	Hydropower Arrangements	13
ARTICLE 9	Electricity Supply to the Project	14
ARTICLE 10	Procurement of Goods and Services	14
ARTICLE 11	Recruitment of Personnel	15
ARTICLE 12	Cost Allocation Process	16
ARTICLE 13	Financing Arrangements	17
ARTICLE 14	Taxes	20
ARTICLE 15	Compensation	26

ARTICLE 16	Anti-Corruption Measures	27
ARTICLE 17	Operational Investigations and Disputes	27
ARTICLE 18	Settlement of Disputes.....	30
ARTICLE 19	Additional Annexures	33
ARTICLE 20	Amendment.....	33
ARTICLE 21	Depositary	34
ARTICLE 22	Entry into Force	34
ANNEXURE I	Phase II Project Description	36
ANNEXURE II	Cost Apportionment Schedule of Project Features.....	40
ANNEXURE III	List of Dues and Charges.....	45
ANNEXURE IV	Income Tax Arrangements	46
ANNEXURE V	Minimum Quantities of Water for the Calculation of Royalties	58
LESOTHO HIGHLANDS WATER PROJECT PHASE II MAP	59

PREAMBLE

WHEREAS the Government of the Kingdom of Lesotho and the Government of the Republic of South Africa (hereinafter referred to as “the Parties” and in the singular as “a Party”) have concluded the Treaty on the Lesotho Highlands Water Project (hereinafter referred to as “the Treaty”) on 24 October 1986 and have implemented Phase I thereof;

AND WHEREAS the Treaty allows for the further implementation of the Project subsequent to Phase I;

AND WHEREAS the Treaty requires subsequent Phases of the Project to be subject to the consent of each Party prior to implementation;

AND WHEREAS the Parties are desirous to implement Phase II of the Project;

AND WHEREAS the Parties are mindful of the need to effectively manage the social and environmental consequences of the Project;

NOW THEREFORE the Parties hereby agree as follows:

ARTICLE 1

INTERPRETATION AND DEFINITIONS

- (1) This Agreement between the Parties (hereinafter referred to as "this Agreement") shall include Annexures I to V to this Agreement, as well as any Annexures subsequently adopted by the Parties in accordance with Article 19 and shall include all amendments in accordance with Article 20 in whichever manner effected.
- (2) All such Annexures and amendments shall form an integral part of this Agreement.
- (3) The terms used in this Agreement shall have the same meaning as provided for in the Treaty, unless differently defined in this Agreement or if the wording or context of this Agreement otherwise requires. In the case of an inconsistency, the meaning provided for in this Agreement shall prevail with respect to the interpretation of this Agreement and not to the interpretation of the Treaty.
- (4) Unless the context indicates otherwise, the following definitions as well as those contained in Annexure IV to this Agreement shall apply:

"Chargeable Business Income" means the business income, including interest and other investment income in connection with Phase II received by a Contracting Party as reduced by any deductions allowed under the Income Tax Act, No. 9 of 1993, which relate to the production of that income;

“Contract” means a contract entered into with the Lesotho Highlands Development Authority, the Trans-Caledon Tunnel Authority or the Lesotho Highlands Water Commission, as the case may be, in connection with the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II;

“Contracting Party” means a natural or legal person who or which has entered into –

- (a) a Contract or a Sub-Contract to such a Contract with the Lesotho Highlands Development Authority; or
- (b) a Contract or a Sub-Contract to such a Contract with the Lesotho Highlands Water Commission or the Trans-Caledon Tunnel Authority as a result of which such person is subject to Lesotho tax legislation;

“Expatriate” means a resident individual, other than a Lesotho National, who, in relation to services provided in Lesotho, is solely employed with respect to or engaged in activities in connection with the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II;

“Facilitate” means the Government of South Africa shall provide an enabling environment by way of bilateral agreements, regulatory mechanisms and other means to assist the Government of Lesotho in entering into commercial arrangements with entities in South Africa and beyond for the purchase of electricity from the pump storage scheme in the Lesotho Highlands Water Project. The commercial arrangements will, to a large extent, depend on the scheme’s price competitiveness and the reliability of the power supply;

“Lesotho” means the Kingdom of Lesotho;

“Lesotho Highlands Development Authority” means the institution provided for in Article 7 of the Treaty as amended by Protocol VI;

“Lesotho Highlands Water Commission” means the commission established in terms of Article 9 of the Treaty as amended by Protocol VI;

“Lesotho National” means:

- (a) any citizen or permanent resident of Lesotho other than an Expatriate; and
- (b) any legal person, partnership, association or other entity deriving its status from the law of Lesotho but shall exclude:

- (i) an external company registered under the Lesotho Companies Act, No. 25 of 1967 and operating in Lesotho mainly for purposes of the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II;
 - (ii) an international or a South African company, including its subsidiaries, operating in Lesotho mainly for purposes of the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II;
 - (iii) a joint venture or consortium operating in Lesotho mainly for purposes of the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II; and
 - (iv) a partnership or trust formed or registered in Lesotho and operating therein mainly for purposes of the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II;
- Provided that:

- (aa) an entity listed under (i) to (iv) above shall be deemed to be mainly operating for the purposes of the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II where at least 85% of the Lesotho sourced Chargeable Business Income of the entity in a year of

assessment arises from Contracts or any Sub-Contract to such Contracts;

- (bb) Lesotho shall be entitled to retain all income taxes collected on the non-Project related Chargeable Business Income of such entity;
- (cc) a person or entity referred to in paragraphs (a) and (b) above remains a Lesotho National if such person or entity is a shareholder, partner or trustee of the entities listed under (iii) and (iv) above in relation only to its share of Lesotho sourced Chargeable Business Income of such entity;
- (dd) a prospective Contracting Party may be required to register as an External Company under the Lesotho Companies Act No. 25 of 1967, to exclusively undertake work in connection with the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II;

“Lesotho Revenue Authority” means the Lesotho Revenue Authority established in terms of the Lesotho Revenue Authority Act, No. 14 of 2001;

“Operational Dispute” means a dispute referred to in Article 17 of this Agreement;

“Operating Rule” means the prescribed regime, agreed to by the Parties, for regulating the storage of water in Project reservoirs and the delivery thereof within the integrated Vaal-Orange/Senqu River System in order to reconcile water availability from that system with anticipated water requirements for a specified period of time and adjusted from time to time;

“Phase I” means the first phase, consisting of Phase IA and Phase IB, of the Project already completed, namely the water delivery and hydropower generation system

comprising the Katse Reservoir on the Malibatso River, the Mohale Reservoir on the Senqunyane River, the Muela hydro-electric complex including the Muela Reservoir situated on the Nqoe River, the Matsoku diversion weir situated on the Matsoku River, a water conveyance tunnel connecting Mohale Reservoir and Katse Reservoir, a water conveyance tunnel connecting the Matsoku diversion weir and Katse Reservoir, a water conveyance tunnel connecting Katse Reservoir with the hydro-electric complex, a delivery tunnel connecting the Muela Reservoir with the Designated Outlet Point, access roads to the Project sites, camps, power transmission lines and administration centers, including social and environmental projects and programmes;

“Phase II” means the second phase of the Project to be implemented in terms of this Agreement in two distinct systems, namely a water delivery system to augment the delivery of water to South Africa and a hydropower generation system. The water delivery system comprises Polihali Reservoir on the Senqu River, a water conveyance tunnel connecting Polihali Reservoir with Katse Reservoir, access roads to the Project sites, camps, power transmission lines and administration centers, including social and environmental projects and programmes as detailed in the Project Description in Annexure I to this Agreement. Phase II shall include a pump storage scheme, associated transmission lines and appurtenant works by utilising the existing Katse Reservoir as the lower reservoir and a new upper reservoir in the Kobong Valley, or any other similar scheme, as contemplated by Article 8 of this Agreement;

“Project” means that water delivery project ultimately delivering seventy cubic metres of water per second consequent upon the implementation of the phases provided for in Article 5(1) of the Treaty as well as the concomitant hydro-electric power project identified in Annexure I of the Treaty;

“Project Management Unit” means the unit provided for in Article 6 of this Agreement;

“**Protocol**” means an international legal instrument designated as such and adopted as part of the Treaty or subsequently negotiated and adopted as part of the Treaty and forming an integral part thereof, including amendments to such a protocol;

“**South Africa**” means the Republic of South Africa;

“**System Analysis Technique**” means the stochastic simulation technique used to assess risks and curtailment requirements associated with water supply from integrated resource systems, as applied within the Vaal-Orange/Senqu River System;

“**Sub-Contract**” means:

- (a) in relation to a Contract providing for the construction of physical works or for services as defined therein, a contract entered into with the Contracting Party to perform the construction of any part of such works; or
- (b) in relation to a Contract providing for the provision of consulting services as defined therein, a contract entered into with the Contracting Party to perform any part of such services;

“**Trans-Caledon Tunnel Authority**” means the institution provided for in Article 8 of the Treaty, as amended by Protocol VI;

“**Treaty**” means the Treaty on the Lesotho Highlands Water Project concluded between the Parties on 24 October 1986, as amended. It includes the Protocols, Annexures and Annexes adopted as part of the Treaty or subsequently adopted by the Parties as well as all amendments thereto agreed by the Parties; and

“**VAT**” means value added tax levied in accordance with the Lesotho Value Added Tax Act, No. 77 of 2001 as amended.

ARTICLE 2

PURPOSE OF THE AGREEMENT

The purpose of this Agreement is to provide the legal basis for the implementation of Phase II as well as for the operation and maintenance of Phases I and II of the Project.

ARTICLE 3

RELATIONSHIP WITH THE TREATY

The provisions of the Treaty shall remain in force unless expressly or by implication amended by this Agreement and everything undertaken or done in accordance with the Treaty shall remain valid unless otherwise determined under this Agreement.

ARTICLE 4

IMPLEMENTATION OF THE AGREEMENT

The Parties shall implement, operate and maintain Phase II of the Project as provided for in this Agreement and the Treaty. They shall execute all their obligations under this Agreement and the Treaty in good faith.

ARTICLE 5

DOMESTIC IMPLEMENTATION AND ENFORCEMENT

- (1) The Parties shall ensure that their domestic legislation is consistent with their obligations under this Agreement and the Treaty and shall, whenever necessary to give effect to the terms of this Agreement or the Treaty, enact new domestic legislation, amend existing domestic legislation or establish or modify relevant or affected domestic institutions or authorities, procedures and practices.
- (2) Any reference in this Agreement to legislation or to an authority or institution of a Party shall include applicable subsequent amendments or changes to such legislation, as well as any new legislation adopted, or a new authority or institution established to regulate or govern materially the same matter.
- (3) The Parties shall inform each other, the delegations and the Lesotho Highlands Water Commission of any changes in their legislation or administrative procedures and practices impacting on the implementation of this Agreement or the Treaty and shall, in this regard, also comply with the requirements of Article 21 of this Agreement.
- (4) The Parties shall ensure that all ministries, departments, authorities and statutory bodies involved in or affected by the execution of tasks or the implementation of obligations related to this Agreement and the Treaty are informed about and comply with the relevant provisions of this Agreement and the Treaty.

- (5) The Parties shall ensure that all ministries, departments, authorities and statutory bodies promptly process all applications for work and travel permits as well as related documentation and issue such permits required for the implementation of this Agreement or the Treaty. Nothing in this Agreement shall be construed to prevent the adoption of measures necessary to secure compliance with laws which are not inconsistent with the provisions of this Agreement or the Treaty, subject to the requirement that such measures are not applied in an arbitrary manner or constitute discrimination or disguised restrictions.

- (6) The Parties shall adopt and implement all trans-border measures necessary for the expeditious movement and transfer of people, goods, equipment and vehicles across national borders as required for the implementation of this Agreement and the Treaty.

ARTICLE 6

INSTITUTIONAL ARRANGEMENTS AND GOVERNANCE

- (1) (a) The Board of the Lesotho Highlands Development Authority shall establish a Technical Sub-Committee to advise and assist the Board with regard to technical, engineering, environmental and social matters relating to the implementation of Phase II. The Technical Sub-Committee shall be chaired by a member of the Board and comprise members of the Board and external specialist members appointed by the Board in consultation with the Lesotho Highlands Water Commission.

- (b) Delegates and alternate delegates to the Lesotho Highlands Water Commission may attend all meetings of the Technical Sub-Committee as ex-officio members.
 - (c) The terms of reference for the functioning of the Technical Sub-Committee shall be formulated by the Lesotho Highlands Development Authority and approved by the Lesotho Highlands Water Commission.
- (2) (a) The Lesotho Highlands Development Authority shall establish, as part of its institutional arrangements, a Project Management Unit to oversee and manage the implementation of Phase II and shall delegate to it the powers necessary for this purpose.
- (b) The Project Management Unit shall be staffed by professionals with experience in the construction and implementation of large water resource and hydropower projects, who shall be competitively procured through an open tendering process.
 - (c) The Project Management Unit shall report to a Divisional Manager (Phase II Implementation) in the Lesotho Highlands Development Authority and shall consist of various components, including Engineering, Financial, Social, Environmental and Communications.
 - (d) The Project Management Unit established in accordance with paragraph (a) shall be dissolved once Phase II has reached substantial completion.

- (3) The annual audit of the Lesotho Highlands Development Authority shall be performed by an independent external firm of internationally recognized chartered accountants.

ARTICLE 7

OPERATIONAL ARRANGEMENTS

- (1) The Parties shall within twelve months, or such other period agreed by the Parties after entry into force of this Agreement, determine the Operating Rule for the operation of Phase II. Such Operating Rule shall be incorporated in an Annexure to this Agreement in accordance with Article 19.

- (2) The Operating Rule shall be determined by applying the System Analysis Technique and by:
 - (a) ensuring optimal water security for South Africa;
 - (b) ensuring the most advantageous options for the long term energy security of Lesotho without diminishing the benefits derived from the water delivery system;
 - (c) providing for compensation for the loss of benefits from the hydropower facility, either in kind or in monetary value; and
 - (d) ensuring that Lesotho is not disadvantaged with regard to benefits accruing from the provisions of the Treaty in respect of royalty payments.

- (3) The Operating Rule shall be jointly implemented from the date that the Annexure referred to in this Article enters into force.
- (4) Royalty payments shall be calculated in accordance with Article 12 of the Treaty, but where the actual water deliveries are less than those stipulated in Annexure V to this Agreement, the quantities stipulated in Annexure V shall be used for the calculations.

ARTICLE 8

HYDROPOWER ARRANGEMENTS

- (1) The Phase II hydropower generation system shall comprise the Kobong pump storage scheme consisting of a hydropower station, the existing Katse Reservoir as the lower reservoir, a new upper reservoir in the Kobong valley, or any other similar scheme, and an interconnecting tunnel as well as transmission lines and appurtenant works between the scheme and the designated connection point at the border with South Africa.
- (2) The implementation of the Kobong pump storage scheme is subject to agreement on the outcome of a joint feasibility study.
- (3) South Africa shall facilitate the sale of peak electricity from the Kobong pump storage scheme and the purchase of electricity for the pumping requirements of the scheme.

ARTICLE 9

ELECTRICITY SUPPLY TO THE PROJECT

- (1) Lesotho shall supply all electricity required for the implementation, operation and maintenance of Phase II of the Project.

- (2) Lesotho may obtain such electricity in accordance with Article 17(4) of the Treaty or from any other source.

ARTICLE 10

PROCUREMENT OF GOODS AND SERVICES

The Lesotho Highlands Development Authority shall, in the procurement of all goods and services, apply and give effect to the following procedures:

- (a) all procurement processes shall foster competitiveness, transparency, cost effectiveness and quality;
- (b) preference shall be given to suppliers of goods and services, including consultants and contractors, in Lesotho, South Africa, the Southern African Development Community member states and then internationally, in that order: Provided that the provisions of paragraph (a) shall always be satisfied;
- (c) consultants and contractors registered in Lesotho and in South Africa shall share the value of all infrastructure works on an equal monetary basis, taking into account, amongst other things, their shareholding and operational experience;

- (d) Article 6(17) of the Treaty shall apply to all components other than infrastructure. Consultants registered in Lesotho may enter into joint ventures with external firms to make up its fifty percent share thereof;
- (e) joint ventures shall be formed on a voluntary basis;
- (f) in the adjudication of tenders, preference margins may be considered for companies, including joint ventures, registered in Lesotho and in South Africa to encourage capacity building and economic growth. Preference margins shall be determined by the Lesotho Highlands Water Commission;
- (g) unless otherwise agreed by the Lesotho Highlands Water Commission, the Party requesting the preference margin shall bear the cost of any increase in the contract price; and
- (h) in instances where international funding agencies insist on applying their own procurement rules and procedures, both Parties shall negotiate with such agencies to adapt such rules and procedures to conform as much as possible to the provisions of this Article.

ARTICLE 11

RECRUITMENT OF PERSONNEL

- (1) In addition to the requirements of Article 7(17) of the Treaty, the following provisions shall be applied with respect to the recruitment of personnel by the Lesotho Highlands Development Authority:
 - (a) preference shall be given to nationals of Lesotho, South Africa and Southern African Development Community member states, in that order: Provided that the required skills and experience levels are met;

- (b) services shall be outsourced whenever feasible to avoid any significant increase in cost or the personnel complement;
 - (c) appropriate staff performance and development policies shall be adopted by the Lesotho Highlands Development Authority for approval by the Lesotho Highlands Water Commission; and
 - (d) development of individual employees shall be effected through normal on the job training and not by counterpart appointments.
- (2) The consultant firm(s) constituting the Project Management Unit provided for in Article 6 of this Agreement shall be competitively procured through an open tendering process. The Unit shall have at its disposal all the skills required for the implementation of Phase II, including at least those required for the components mentioned in Article 6(2)(b). The consultant firm(s) may outsource services when necessary.

ARTICLE 12

COST ALLOCATION PROCESS

- (1) The Lesotho Highlands Development Authority shall compile an Annual Cost Allocation Report which shall indicate the cost allocation percentages applicable to each item of cost. This report shall be compiled on the basis of the cost apportionment schedule contained in Annexure II to this Agreement.
- (2) Where an account has been utilized for the payment of costs incurred for both hydropower and water delivery, the Lesotho Highlands Development Authority shall compile an Annual Cost-to-Funding Reconciliation Report for each financial year in respect of each item of cost paid by it during that financial

year. The Annual Cost-to-Funding Reconciliation Report shall contain inter alia:

- (a) schedules indicating the transaction flows on each bank account;
 - (b) an indication of the cost allocation percentage applicable to each transaction, including financing charges;
 - (c) schedules indicating the share of each Party in respect of accounts with a credit balance at year end; and
 - (d) schedules indicating the obligations of each Party in respect of accounts with debit balances at year end.
- (3) The Annual Cost-to-Funding Reconciliation Report shall, in order to take effect, be submitted to the Lesotho Highlands Water Commission for approval.

ARTICLE 13

FINANCING ARRANGEMENTS

- (1) The Parties shall apply the following principles in financing Phase II:
- (a) The most cost effective and efficient financing available shall be used;
 - (b) The most favourable funding opportunities available to either Party shall be explored and utilized. Both the Lesotho Highlands Development Authority and the Trans-Caledon Tunnel Authority shall endeavour to optimize the funding sources available to either Party for the benefit of the Project; and
 - (c) The treasury function of the Project shall be managed with the minimum personnel required.

- (2) The Lesotho Highlands Development Authority shall, in consultation with the Trans-Caledon Tunnel Authority, prepare a funding strategy for Phase II to be approved by the Lesotho Highlands Water Commission.

- (3) In accordance with the first proviso to Article 11 of the Treaty the conclusion of any agreement regarding loans, credit facilities or borrowings relating to water delivery to South Africa shall be subject to the prior consent of South Africa and the conclusion of any agreement regarding loans, credit facilities or borrowings relating to the generation of hydropower shall be subject to the prior consent of Lesotho.

- (4) The existing funding arrangements for the Lesotho Highlands Development Authority introduced from 1 April 2005 by way of the Memorandum of Understanding between the Lesotho Highlands Development Authority and the Trans-Caledon Tunnel Authority on the Operating Framework for the Common Monetary Area facility, signed on 10 June 2005 by the Lesotho Highlands Development Authority and the Trans-Caledon Tunnel Authority and approved by the Lesotho Highlands Water Commission, shall continue to apply. In accordance with this Memorandum of Understanding, the Lesotho Highlands Development Authority shall keep two separate bank accounts (one designated for Lesotho and another designated for South Africa) in which the Parties shall timeously deposit their monthly contributions.

- (5) Where Lesotho is able to raise concessionary finance in excess of its own requirements, such finance shall be made available to South Africa subject to the following conditions:

- (a) International Bank for Reconstruction and Development rates shall be the upper limit;
 - (b) The benchmark shall be the terms and conditions available to South Africa where South Africa can raise concessionary finance from the same source; and
 - (c) The applicable International Bank for Reconstruction and Development terms and conditions shall be the maximum requirement for grant funding. Grant funding shall be converted to a Rand base and the actual terms and conditions shall be negotiated for each individual case.
- (6) The Lesotho Highlands Development Authority shall keep all unutilized funds in an interest bearing account.
- (7) South Africa may continue to use the South African capital market as a secondary financing source to refinance all water delivery related debt and may use it to finance Phase II.

ARTICLE 14

TAXES

General Provisions

- (1) On the date of entry into force of this Agreement the provisions of Protocol V to the Treaty shall no longer be of any force and effect. The relevant provisions of this Agreement shall apply to the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II.
- (2) South Africa shall not be liable for any dues, taxes or charges levied by Lesotho in respect of services, goods, materials, plant and equipment and related items required for the implementation, operation and maintenance of that part of the Project relating to the delivery of water to South Africa, except as provided for in this Article.
- (3) Dues and charges levied by Lesotho and paid by the Lesotho Highlands Development Authority, the Lesotho Highlands Water Commission or Contracting Parties regarding the implementation, operation and maintenance of that part of the Project relating to the delivery of water to South Africa shall be paid by Lesotho to South Africa in accordance with the provisions of this Article. Annexure III contains a list of Dues and Charges to which this Article applies.
- (4) VAT levied by Lesotho and paid by the Lesotho Highlands Development Authority on activities relating to the implementation, operation and maintenance

of that part of the Project relating to the delivery of water to South Africa shall be paid by Lesotho to South Africa in accordance with the provisions of this Article.

- (5) Income taxes levied by Lesotho and paid by the Lesotho Highlands Development Authority, the Lesotho Highlands Water Commission or Contracting Parties relating to the implementation, operation and maintenance of that part of the Project relating to the delivery of water to South Africa shall be paid by Lesotho to South Africa in accordance with the provisions of this Article.
- (6) Lesotho shall be entitled to retain a thirty percent administration fee on all amounts collected by Lesotho and due to South Africa in terms of this Article in respect of income tax.
- (7) All amounts paid by Lesotho in accordance with the provisions of this Article shall be utilized to reduce the cost of the Project to South Africa.
- (8) Where South Africa is liable for part of the costs of a Contract by way of cost related payments and Lesotho for the other part, the provisions of this Article shall apply to the whole Contract, provided that the re-compensatory arrangements shall only apply to the part for which South Africa is responsible.
- (9) Lesotho shall timeously implement all necessary legislative, administrative and other measures to give effect to the provisions of this Article.

- (10) The Lesotho Highlands Water Commission shall, in consultation with the Lesotho Highlands Development Authority and the Lesotho Revenue Authority, adopt procedures to give effect to the re-compensatory arrangements with a view to an expeditious and efficient execution of such arrangements.
- (11) The provisions of this Article shall not be used to increase the liability of a Contracting Party for Lesotho tax over that which would otherwise be payable under the applicable legislation.
- (12) In the event of the tax liability of a Contracting Party, other than a Lesotho National, being increased beyond that provided for in this Article by reason of a change in the applicable legislation subsequent to the date of entry into force of this Agreement, such increase shall not constitute a cost to South Africa as contemplated in Article 10(1) of the Treaty and shall be paid to South Africa in full, without any administration fee.

Income Tax Arrangements

- (13) Lesotho shall levy income tax and shall grant exemptions in respect of Contracting Parties in accordance with the provisions of this Article and Annexure IV.
- (14) Lesotho shall be entitled to retain all income taxes levied on a Lesotho National.

- (15) A Contracting Party or an Expatriate employee of such a Contracting Party shall be liable for Lesotho income tax in accordance with the applicable legislation, as modified and supplemented by the applicable provisions of Annexure IV to this Agreement.

Recompensatory Arrangements

- (16) Lesotho shall reimburse South Africa in respect of the following:
- (a) Seventy percent of the income tax amounts levied and received by Lesotho in accordance with Article 14(13) above together with any amount of interest and penalties, including additional tax;
 - (b) All Dues and Charges levied and received by Lesotho as provided for in this Article; and
 - (c) All VAT levied and received by Lesotho as provided for in this Article.
- (17) Payments shall be made to the Lesotho Highlands Development Authority, the Trans-Caledon Tunnel Authority or the Lesotho Highlands Water Commission on the submission of a claim for payment by the relevant Authority or Commission, as the case may be. Where payments are made later than forty five days after submission of an uncontested claim, Lesotho shall pay interest at the rate of ten percent per annum: Provided that uncontested parts of the claim shall be paid without delay.

Obligations of the Lesotho Highlands Development Authority, the Trans-Caledon Tunnel Authority and the Lesotho Highlands Water Commission

- (18) The Lesotho Highlands Development Authority shall take all appropriate measures to ensure that it complies with the provisions of this Article, as well as its obligations under the applicable legislation of Lesotho.
- (19) The Lesotho Highlands Development Authority, the Trans-Caledon Tunnel Authority and the Lesotho Highlands Water Commission shall within ten working days after entering into a Contract notify the Lesotho Revenue Authority of such Contract.
- (20) The Lesotho Highlands Development Authority shall ensure that when a tender is issued such tender shall include a clause to the effect that:
- (a) a Contracting Party shall disclose with each payment certificate the full amount of taxes paid, including any corporate taxes, withholding taxes, VAT and Dues and Charges, paid by the Contracting Party separately for local staff and expatriate staff; and
 - (b) in the event of failure to so disclose, such failure shall constitute sufficient ground for the Lesotho Highlands Development Authority to terminate the Contract.
- (21) The Lesotho Highlands Development Authority shall, upon request by either delegation to the Lesotho Highlands Water Commission, provide such

delegation with all information as may be reasonably practical to obtain from its records with regard to Contracting Parties.

- (22) In the event that either delegation to the Lesotho Highlands Water Commission has reason to believe that the provisions of this Article are not being complied with, such delegation may refer the matter to the Lesotho Highlands Water Commission which shall within thirty days of such referral appoint a working group to conduct an investigation. The working group shall within ninety days of its appointment present a written report to the Lesotho Highlands Water Commission containing its findings with regard to such suspected non-compliance and the Lesotho Highlands Water Commission shall make a final ruling on the matter. If the Lesotho Highlands Water Commission fails to make a final ruling, the matter may be dealt with as an Operational Dispute in terms of Article 17 of this Agreement.

Procedures for Additional Tax Arrangements

- (23) If a Party is of the opinion that an area of taxation not specifically governed by this Article should be so governed, that Party may request the Lesotho Highlands Water Commission to appoint a working group to conduct an investigation. The working group shall be appointed within thirty calendar days after such a request is received and shall submit a written report and its recommendations to the Lesotho Highlands Water Commission within ninety calendar days after the date of its appointment.

- (24) The Lesotho Highlands Water Commission shall consider this report referred to in Article 14 (23) above and shall within thirty calendar days of receipt of such report take a decision on its recommendations. This decision shall be signed by the two delegations and the Secretary to the Lesotho Highlands Water Commission and be sent to both Parties with a recommendation for further action. If the Lesotho Highlands Water Commission fails to make a final ruling, the matter may be dealt with as an Operational Dispute in terms of Article 17 of this Agreement.

ARTICLE 15

COMPENSATION

- (1) The Lesotho Highlands Development Authority shall effect compensation in accordance with the provisions of Article 7(18) of the Treaty and the principles contained in Article 15 of the Treaty.
- (2) Compensation shall be effected in accordance with the Phase II compensation policy and procedures to be developed by the Lesotho Highlands Development Authority and approved by the Lesotho Highlands Water Commission.
- (3) The Phase II compensation policy shall be developed taking into account the compensation policy for Phase I as well as the Phase II Feasibility Study recommendations.

- (4) Compensation shall be implemented in a fair and prompt manner.

ARTICLE 16

ANTI-CORRUPTION MEASURES

- (1) The Lesotho Highlands Water Commission shall develop and adopt a comprehensive anti-corruption policy for the Project, having regard to the experiences of Phase I and the worldwide best anti-corruption practices developed for major international construction projects.
- (2) The Parties shall implement all measures, including reviewing and expanding existing legislation, to prevent, uncover and prosecute any corrupt practices in respect of the Project.
- (3) The Parties shall assist each other and the Lesotho Highlands Water Commission in investigating and prosecuting any suspected corrupt actions relating to the Project.

ARTICLE 17

OPERATIONAL INVESTIGATIONS AND DISPUTES

- (1) If in the view of either delegation there is an indication of an irregularity or malpractice regarding any operation, procedure or activity, including a financial transaction, of the Lesotho Highlands Development Authority or the Trans-

Caledon Tunnel Authority, as the case may be, such delegation may request the Commission to fully investigate the matter within fourteen days.

- (2) In the course of such investigation the Lesotho Highlands Water Commission shall request the Lesotho Highlands Development Authority or the Trans-Caledon Tunnel Authority to provide the required information or submit a full report in relation to the matter under investigation within fourteen calendar days.
- (3) In the event that the Lesotho Highlands Development Authority or the Trans-Caledon Tunnel Authority fails to provide such information or a report so requested, or in the judgment of either delegation, the information so provided is insufficient or the report submitted does not fully address the matter, the Lesotho Highlands Water Commission shall request further information or a factual report or take appropriate action within fourteen calendar days. After receiving such further information or report, the Lesotho Highlands Water Commission shall discuss it and shall, if necessary, conduct further investigations or take appropriate actions and monitor compliance.
- (4) In the event that the Lesotho Highlands Water Commission fails to act in terms of this Article, either delegation may declare an Operational Dispute and invoke the provisions of this Article for the resolution of such dispute. For the purpose of this Article an Operational Dispute means any dispute involving the regularity or correctness of any operation, procedure or activity of the Lesotho Highlands Development Authority or the Trans-Caledon Tunnel Authority, as

well as any dispute emanating from Article 14(22) or Article 14(24) of this Agreement.

- (5) An Operational Dispute shall be resolved amicably and in a spirit of reconciliation and shall not impair the implementation, operation or maintenance of the Project.
- (6) A delegation declaring an Operational Dispute shall formally notify the other of such a dispute and the nature of the dispute in writing. The Lesotho Highlands Water Commission shall within seven days of such notification take appropriate action in an effort to resolve such a dispute or may appoint an expert group to assist in the investigation and analysis of a dispute and make recommendations.
- (7) Such expert group shall be appointed bearing in mind the nature and scope of the dispute and the Lesotho Highlands Water Commission shall determine the terms of reference and the time frames for completing such an engagement. Members of the Lesotho Highlands Water Commission shall not serve as expert group members.
- (8) When the expert group has submitted its recommendations in a report, the Lesotho Highlands Water Commission shall consider the report and the recommendations and make a decision in an effort to resolve such a dispute.

- (9) During the existence of an Operational Dispute, the Lesotho Highlands Development Authority and the Trans-Caledon Tunnel Authority shall be entitled to institute, each within its own sphere of responsibility, and after prior notification to the Lesotho Highlands Water Commission, the minimum action required to safeguard the integrity of the Project.

- (10) In the event that the Lesotho Highlands Water Commission fails to resolve an Operational Dispute or to take appropriate action within a period of four weeks after receipt of the report referred to in Article 17(8) above, either delegation may declare a dispute in terms of Article 18 of this Agreement.

ARTICLE 18

SETTLEMENT OF DISPUTES

- (1) For the purpose of this Article “dispute” shall mean any dispute between the Parties concerning the interpretation or application of this Agreement or the Treaty, including a dispute declared in terms of Article 17(10) of this Agreement. Such disputes shall be dealt with in terms of the provisions of this Article.

- (2) The Parties shall pay due regard to the overriding consideration that any dispute shall be resolved in a spirit of conciliation and that any impairment of the implementation, operation and maintenance of the Project shall be avoided.

- (3) While a dispute is being dealt with in terms of this Article, the Chief Executive of the Lesotho Highlands Development Authority and that of the Trans-Caledon Tunnel Authority shall have the power to institute, each within his or her own sphere of responsibility and after prior notification to the Lesotho Highlands Water Commission, the minimum action required to safeguard the integrity of the Project until such time that the dispute is finally resolved.
- (4) Either Party or the Parties jointly may request the Commission to conduct an investigation into a matter relating to the interpretation or application of this Agreement or the Treaty and to present a written report containing its findings and recommendations to both Parties.
- (5) If the Lesotho Highlands Water Commission fails to present a written report within three months of receiving a request in terms of Article 18(4) above or if a Party is dissatisfied with the report or recommendations, the Parties shall at the request of such Party enter into direct negotiations in order to resolve the matter. If the Parties fail to resolve the matter within a reasonable time, either Party or the Parties jointly may declare a dispute and submit the dispute for arbitration in accordance with the Optional Rules for Arbitrating Disputes between Two States, and the procedures provided for therein, of the Permanent Court of Arbitration based in The Hague, Netherlands.
- (6) The Party submitting a dispute for arbitration shall notify the other Party and the Lesotho Highlands Water Commission in writing in terms of the Optional Rules for Arbitrating Disputes between Two States and the procedures provided for therein, of the Permanent Court of Arbitration.

- (7) Arbitration shall be undertaken by an arbitral tribunal consisting of three arbitrators which shall perform its functions in accordance with the Optional Rules for Arbitrating Disputes between Two States of the Permanent Court of Arbitration.
- (8) The award of the arbitral tribunal shall be final and binding on the Parties, and the Parties shall duly and expeditiously give effect thereto. Any dispute between the Parties as to the meaning and scope of an award or with respect to the measures required to comply with an award shall be dealt with in accordance with the applicable rules and procedures provided for in the Optional Rules for Arbitrating Disputes between Two States of the Permanent Court of Arbitration.
- (9) The arbitral tribunal shall apply the provisions of this Agreement and the Treaty, as well as other rules of international law not incompatible with this Agreement and the Treaty, including the Vienna Convention on the Law of Treaties, (1969).
- (10) At the conclusion of any arbitration proceedings all records and documents relating thereto shall be deposited with the Lesotho Highlands Water Commission for safekeeping.

ARTICLE 19

ADDITIONAL ANNEXURES

- (1) The Parties may adopt additional Annexures as necessary to implement the Agreement.

- (2) Such Annexures shall be deposited in terms of Article 21 of this Agreement.

ARTICLE 20

AMENDMENT

- (1) This Agreement and its Annexures may be amended at any time by written agreement between the Parties.

- (2) Such amendments shall enter into force as agreed by the Parties.

- (3) All instruments of amendment shall be deposited in terms of the provisions of Article 21 of this Agreement.

ARTICLE 21

DEPOSITARY

- (1) This Agreement, all Annexures thereto, all notifications referred to in Article 22 of this Agreement and all amendments to this Agreement or its Annexures shall be deposited with, in the case of Lesotho, the Ministry of Foreign Affairs and International Relations and, in the case of South Africa, the Department of International Relations and Cooperation, as well as with the Lesotho Highlands Water Commission.

- (2) The Parties shall deposit all domestic legislation, applicable to the implementation of this Agreement and the Treaty, and amendments thereto with the Lesotho Highlands Water Commission upon the entry into force thereof.

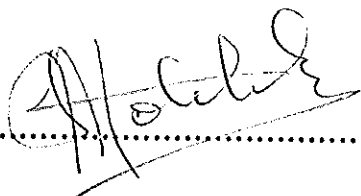
ARTICLE 22

ENTRY INTO FORCE

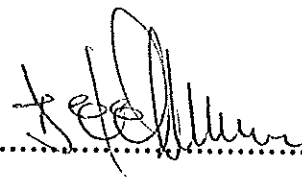
This Agreement shall enter into force when the Parties have notified each other in writing through the diplomatic channel that their respective constitutional requirements necessary for entry into force of this Agreement have been fulfilled, the effective date being the date of last notification.

IN WITNESS WHEREOF the undersigned, being duly authorized by their respective Governments, have signed and sealed this Agreement in triplicate in the English language, all texts being equally authentic.

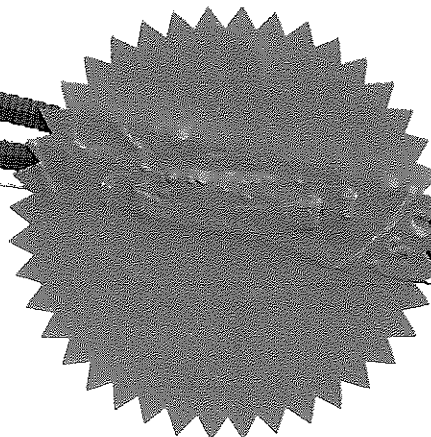
DONE at ...*MASEAU*... on this ...*11th*... day of August in the year 2011



FOR THE GOVERNMENT OF
THE KINGDOM OF LESOTHO



FOR THE GOVERNMENT OF THE
REPUBLIC OF SOUTH AFRICA



ANNEXURE I

PHASE II PROJECT DESCRIPTION

Phase II shall consist of the following components: Provided that any such component may be modified by agreement between the Parties.

1. POLIHALI DAM

The Polihali Dam will be constructed downstream of the confluence of the Senqu and Khubelu Rivers and will be a 163.5 metres high concrete faced rock-fill embankment dam wall. The crest length will be 915 metres with a full supply level of 2075 metres above sea level (MASL). A 49.5 metres high saddle dam will also be constructed as well as a side channel spillway.

2. POLIHALI TO KATSE TUNNEL

The 38.2 kilometres long, 5 metres diameter Polihali to Katse Dam Tunnel will be constructed to transfer water from the Polihali Reservoir to Katse Dam. The tunnel is sized to convey a peak power generation flow of 35 m³/s. Water will be abstracted from the Polihali Reservoir through two separate concrete bell-mouth intakes on the western side of the Polihali Reservoir in the Khubelu River, 3 kilometres upstream of the confluence with the Senqu. Water will be transferred through the Lower and Upper Intake Tunnels to the Intake Gate Shaft. Both of these tunnels will be constructed by drill-and-blast methods and will be fully concrete lined. Hydraulic control will be effected by the valves in the intake structures. The Polihali Intake Gate Shaft will only be used for maintenance and water quality control functions.

3. HYDROPOWER FEATURES

A pump storage scheme of approximately 1000 megawatt utilizing Katse Reservoir as the lower reservoir and a new upper reservoir near the Kobong headwaters, or any other similar scheme, may be built as part of Phase II, subject to agreement on the outcome of a joint feasibility study.

4. ADVANCE INFRASTRUCTURE

Where possible, the existing infrastructure constructed in Phase I will be used. This includes access roads, power supply, telecommunication systems and camps.

At Polihali

The Polihali Intake site will utilize the infrastructure required to construct Polihali Dam and the Tunnel. This includes feeder roads and bridges around the reservoir to connect affected communities, power supply systems, construction camps and communications.

At Ha Lejone

The facilities at Ha Lejone may be used for hydropower purposes. A new labour camp may be required at Ha Lejone for the works at the Kobong site. The consultants and construction management teams will be housed in the

existing facilities handed over to the Government of Lesotho. Improvements to the water and sewage treatment plants, the school and clinic will be undertaken.

At Ha Katse

The facilities at Katse Dam will be used for the Polihali to Katse tunnel construction. Housing for the consultants and construction management teams will be provided in the existing facilities. Improvements to the water and sewage treatment plants, clinic and Lodge will be undertaken. A primary school will be built.

At Mphorosane

The existing camp for construction workers at Mphorosane may be refurbished to be used by the Polihali to Katse tunnel contractors. A new camp for construction workers will be built for the Kobong pump storage contracts. Improvements and expansions to the existing water and sewage treatment plants will be required. Other ancillary services will be constructed as determined during the design phase. A satellite police station and accommodation facilities will be built and manned by Lesotho.

At Mamohau Mission

The upgrading of the existing hospital facilities at the Mamohau mission will be investigated and implemented to serve as a jointly managed Project hospital if found to be feasible.

5. OTHER INFRASTRUCTURE

Other access roads, feeder roads, management and labour camps, telecommunication system and construction power systems will be built in addition to those detailed in previous paragraphs.

Where possible, the existing infrastructure constructed in Phase I will be used. This includes access roads, power supply, telecommunication systems and camps.

6. ENVIRONMENTAL MEASURES

Environmental mitigation measures including environmental flow matters and baseline studies will be implemented, the full extent is to be agreed by the Parties during implementation.

7. SOCIAL DEVELOPMENT PROGRAMMES

Social development programmes and mitigation measures, resettlement requirements, baseline studies and public relations and awareness campaigns will be implemented, the full extent to be agreed by the Parties during the implementation.

A detailed description of the above-mentioned components is provided in Annexure II.

ANNEXURE II

COST APPORTIONMENT SCHEDULE OF PROJECT FEATURES

The cost sharing principles relating to the different features are shown in the tables below.

The following abbreviations are used in this Schedule:

- WT - (Water Transfer)** being that part of the Project relating to the delivery of water in respect of which South Africa is responsible for the costs, including construction risks and escalation.
- HP - (Hydropower)** being that part of the Project relating to the generation of hydropower in respect of which Lesotho is responsible for the cost, including construction risks and escalation.
- TBA - (To be apportioned)** where the allocation of the cost responsibility between the respective Parties is still outstanding and shall be determined at a future date based on the best information available at that stage.

LHWV PHASE II : COST APPORTIONMENT SCHEDULE OF PROJECT FEATURES

ITEM	DESCRIPTION	APPORTIONED NOTES
Foilhail Dam Construction Costs	A 163.5m high concrete faced rockfill embankment dam with and ancillary works to be constructed downstream of the confluence of Sengou and Khaboua Rivers. The crest length will be 915m with a full supply level of 2075m a.s.l. A 49.5m high saddle dam and a side channel spillway will also be constructed. Environmental mitigation measures included.	WT
Foilhail to Kasee Dam Tunnel Construction Costs	The 38.2 km long 5.2 m diameter Foilhail - Kasee Dam tunnel will be constructed to transfer water from the Foilhail Reservoir to Kasee Dam. The tunnel is sized to convey a peak power generation flow of 35 cubic metres per second. Water will be abstracted from the Foilhail Reservoir through two separate concrete bell-mouth intakes on the western side of the Foilhail Reservoir in the Khaboua River, 3 km upstream of the confluence with the Sengou. Hydraulic control will be affected by the valves in the intake structures. The Foilhail intake Gate Shaft will only be used for maintenance and water quality control functions.	WT
Kobong Krabe Pumping/Storage Scheme	<p>Kobong dam Underground powerhouse/generation chamber Tunnel and shaft connecting Kobong Dam to Kasee Dam Kasee Dam outlet Power lines and Substations Labourers camp at Mphorwane Camp improvements at Ha Lesone Telecommunication at camps and work sites Infrastructure : Pre-Construction Engineering Cost Infrastructure : Construction Design And Supervision Engineering Cost Main works : Construction Design And Supervision Engineering Cost Environmental mitigation measures Social compensation, mitigation and development programs</p>	HP
<p>Infrastructure Costs</p> <p>Access Roads (Option 1) Reconstruction of Oxbow to Sene Road Rehabilitation of Sene to Maphohlang Road Construction of Dam and Tunnel Access Road Bridge at Maphohlang Bridge at Khaboua River Bridge at Sengou River</p>	<p>Alignment</p> <p>Existing alignment Existing alignment Existing alignment New alignment</p> <p>13.5km</p> <p>3.5m line + 1.5m shoulder 3.5m line + 1.5m shoulder 3.5m line + 1.5m shoulder 3.5m lines + 1m shoulder 8m deck width 8m deck width 8m deck width</p> <p>Reseal with 19mm & 9.5mm aggregate 30mm asphalt Reseal with 19mm & 9.5mm aggregate Seal with 19mm & 9.5mm aggregate</p>	<p>WT WT WT WT WT WT WT WT</p>
<p>Access Roads (Option 2) Construction of Ha Sesele to Foilhail Dam Road including bridges Decker Roads and Bridges Phoha to Kemeruff Road Ntlohololeane to Ha Legama Road Chaha Li Makete to Mowemng Road Maphohlang and Khaboua Re-alignment Sengou Re-alignment Bridge at Thakoa Bridge at Chaba-Li Makese Bridge at Makhohlang River Bridge at Mabelelang</p>	<p>New alignment</p> <p>4.08km 20.58km</p> <p>3.5m lines + 1m shoulder 4m wide road 6m wide road 4m wide road 4m wide road 4m wide road 6m deck width 4m deck width 4m deck width 4m deck width</p> <p>30mm asphalt Gravel surface Gravel surface Gravel surface Gravel surface</p>	<p>WT WT WT WT WT WT WT WT WT WT</p>
<p>Footbridges at Phoha Footbridge at Mabelelang</p>	<p>2m deck width 2m deck width</p>	<p>WT WT</p>

Notes:

1. Two alternative access routes to the Polihali Dam area are under consideration. The one route follows an alignment along the existing route from St Peters, via Oxbow and Mapholaneng to Polihali Dam. The second route follows the alignment from Ha Seshote in a north easterly direction directly to Polihali Dam. The cost of the preferred route is allocated to South Africa with a ceiling commitment of the route from St Peters to Polihali Dam.

2. Power supply for the construction of Polihali Dam, Tunnel and camp areas will be sourced from either the existing substation at Kao that serves the diamond mines in the area or from the upgraded Phase 1A system linking into the powerline from Ha Lejone to Katse Dam at the Matsoku substation. Any future links into the Lesotho Highlands Development Authority system from Kao to Polihali or on the line from Matsoku to Polihali will be subject to an agreement with the Lesotho Highlands Development Authority.

3. The allocation of all Engineering Costs will be the same allocation as that of the relevant construction feature.

4. The allocation of all environmental monitoring, mitigation projects and specific studies related to the implementation of a specific feature will be the same allocation as that of the relevant construction feature.

5. The allocation of all Social Impact Assessment Costs will be the same allocation as that of the relevant construction feature.

6. The allocation of all social monitoring, social development and mitigation projects, and specific studies related to the implementation of a specific feature will be the same allocation as that of the relevant construction feature.

7. The allocation of the Project Management Unit will be based on the ratio of the Water Transfer and Hydropower costs to the Total Cost of the implementation of (i) Polihali Dam, (ii) Polihali to Katse Tunnel, (iii) Kobong Pump Storage Scheme works, (iv) Environmental Costs and (v) Social Mitigation and Development Costs.

ANNEXURE III

LIST OF DUES AND CHARGES

- (a) a charge on the cross border conveyance of explosives;
- (b) a charge on cross border conveyance of goods other than explosives;
- (c) a tollgate tax on cross border motor vehicle traffic;
- (d) a fee for a certificate of employment;
- (e) a fee for a resident permit;
- (f) a licence fee for motor vehicles;
- (g) a charge levied on the supply of materials;
- (h) a charge levied on the bulk importation of fuel by a Contracting Party or a Sub-contractor to a Contracting Party;
- (i) a charge levied on the importation of any plant, materials or equipment not paid into the common revenue pool of the Southern African Customs Union; and
- (j) any other dues and charges not specifically listed here charged on the supply of goods, materials or services for the implementation of the Project and not paid into the common revenue pool of the Southern African Customs Union.

ANNEXURE IV

INCOME TAX ARRANGEMENTS

1. DEFINITIONS

- 1.1 The terms defined in the Lesotho Income Tax Act, No. 9 of 1993, as amended, shall apply unless otherwise defined in this Annexure.
- 1.2 In this Annexure, unless inconsistent with the context –

"Chargeable Business Income" means the business income, including interest and other investment income in connection with Phase II received by a Contracting Party as reduced by any deductions allowed under the Income Tax Act, No. 9 of 1993, as amended, which relate to the production of that income;

"Contract" means a contract entered into with the Lesotho Highlands Development Authority, the Trans-Caledon Tunnel Authority or the Lesotho Highlands Water Commission, as the case may be, in connection with the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II;

"Contracting Party"

means a natural or legal person who or which has entered into:

- (a) a Contract or a Sub-contract to such a Contract entered into with the Lesotho Highlands Development Authority; or
- (b) a Contract or a Sub-contract to such a Contract with the Lesotho Highlands Water Commission or the Trans-Caledon Tunnel Authority, as a result of which the Contracting Party is subject to Lesotho tax legislation;

"Construction Site"

means all places where the Phase II construction activities are carried out or any other place specifically designated in Contracts or any Sub-contracts to such Contracts, as forming part of such Sites and includes any camp specifically constructed or designated for the purpose of providing housing for individuals engaged on Phase II regardless of where the construction activity is carried out, provided that Maseru may not be so designated;

- "Expatriate"** means a resident individual, other than a Lesotho National, who, in relation to services provided in Lesotho, is solely employed with respect to or engaged in activities in connection with the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II;
- "Income Tax Act"** means the Lesotho Income Tax Act, No. 9 of 1993, as amended;
- "Lesotho Highlands Water Commission"** means the commission established in terms of Article 9 of the Treaty as amended by Protocol VI;
- "Lesotho Highlands Development Authority"** means the institution provided for in Article 7 of the Treaty as amended by Protocol VI;
- "Lesotho National"** means:
- (a) any citizen or permanent resident of Lesotho other than an Expatriate; and
 - (b) any legal person, partnership, association or other entity deriving its status from the law of Lesotho but shall exclude:

- (i) an external company registered under the Lesotho Companies Act, No. 25 of 1967 and operating in Lesotho mainly for purposes of the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II;
- (ii) an international or a South African company, including its subsidiaries, operating in Lesotho mainly for purposes of the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II;
- (iii) a joint venture or consortium operating in Lesotho mainly for purposes of the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II; and
- (iv) a partnership or trust formed or registered in Lesotho and operating therein mainly for purposes of the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II,

Provided that:

- (aa) an entity listed under (i) to (iv) above shall be deemed to be mainly operating for the purposes of the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II where at least 85% of the Lesotho sourced Chargeable Business Income of the entity in a year of assessment arises from Contracts or any Sub-Contract to such Contracts;
- (bb) Lesotho shall be entitled to retain all income taxes collected on the non-Project related Chargeable Business Income of such entity;

- (cc) a person or entity referred to in paragraphs (a) and (b) above remains a Lesotho National if such person or entity is a shareholder, partner or trustee of the entities listed under (iii) and (iv) above in relation only to its share of Lesotho sourced Chargeable Business Income of such entity;
- (dd) a prospective Contracting Party may be required to register as an External Company under the Lesotho Companies Act, No. 25 of 1967 to exclusively undertake work in connection with the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II;

"Local Staff" means citizens of Lesotho employed or engaged on the Project who are required to work and live at a Construction Site;

"Lesotho Revenue Authority" means the authority established in terms of the Lesotho Revenue Authority Act, No. 14 of 2001;

"Sub-Contract" means -

- (a) in relation to a Contract providing for the construction of physical works as defined therein, a contract entered into with the Contracting Party to perform the construction of any part of such works; or
- (b) in relation to a Contract providing for the provision of consulting services as defined therein, a contract entered

into with the Contracting Party to perform any part of such services.

"Trans-Caledon Tunnel Authority" means the institution provided for in Article 8 of the Treaty, as amended by Protocol VI.

- 1.3 A Contracting Party or the Lesotho branch of a Contracting Party shall be taxable under this Annexure only to the extent of income derived in connection with the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II.

2. CORPORATE TAXES

Rate of taxation

2.1 Chargeable Business Income for a year of assessment of a resident company which as a Contracting Party is engaged in connection with the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II, shall be taxed either at a rate applicable to Other Income as prescribed by the Third Schedule to the Income Tax Act or twenty-five percent, whichever is the lower.

2.2 Branch profit repatriations of a Lesotho branch of a non-resident company, which branch is engaged on the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II, from income derived there from in respect of Contracts and subject to Lesotho tax, shall be

taxed at rate of ten percent or at the rate prescribed in the Income Tax Act in relation to branch profits, whichever is the lower.

3. WITHHOLDING TAXES

3.1 General payments to non-residents

3.1.1 Dividends paid by a resident company engaged on the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II to a non-resident out of income derived there from in respect of Contracts and subject to Lesotho tax, shall be taxed at the rate of ten percent or the rate prescribed in the Income Tax Act in relation to dividends, whichever is the lower.

3.1.2 A management charge paid by a person solely engaged on the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II in respect of Contracts, to a non-resident shall be liable to withholding tax at a rate not exceeding fifteen percent on the gross amount of the charge.

3.2 Payments to resident contractors

3.2.1 The Lesotho Highlands Development Authority shall be exempt from the obligation to withhold tax on -

- (a) the first advance payment made to a resident contractor under a Contract; and

(b) any other payment made to a resident contractor under a Contract, provided such contractor holds an Exemption Certificate issued by the Lesotho Revenue Authority.

3.2.2 A qualifying resident contractor engaged on the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II, shall be issued with an Exemption Certificate in terms of the Income Tax Act by the Lesotho Revenue Authority in such form as it may determine within 30 days of such contractor applying to the Lesotho Revenue Authority for such certificate. Such certificate shall remain valid unless the Lesotho Revenue Authority notifies the Lesotho Highlands Development Authority and the contractor in writing of the decision to withdraw such certificate.

3.3 Payments of interest to non-residents

3.3.1 Interest payments to a non-resident by a Contracting Party engaged on the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II, shall be subject to withholding tax at a rate not exceeding ten percent on the gross amount of the interest.

3.3.2 A non-resident lender shall be exempt from Lesotho tax in respect of interest income paid or payable by the Lesotho Highlands Development Authority on loan funds used by the Lesotho Highlands Development Authority in connection with the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II.

4. PERSONAL INCOME TAX

4.1 Tax rate with regard to Expatriates

The tax rate on that portion of the chargeable income of an Expatriate which represents compensation for services rendered in respect of a Contract or any Sub-contract to such a Contract shall be limited to twenty- two percent.

4.2 Tax rate with regard to non-resident persons

The gross remuneration of a non-resident person who is present in Lesotho for a period or periods not exceeding in the aggregate 182 days in any period of twelve months employed by a resident Contracting Party for the provision of services in connection with the operation and maintenance of Phase I and the implementation, operation and maintenance of Phase II shall be subject to tax at the rate of twenty-two percent.

5. FRINGE BENEFITS TAX

5.1 A Contracting Party shall be exempt from fringe benefits tax in respect of accommodation, utilities, meals and transport fringe benefits provided to Local Staff.

5.2 A Contracting Party shall be exempt from fringe benefits tax in respect of housing, utilities and transport fringe benefits provided to Expatriates.

5.3 Expatriates and Local Staff shall be exempt from Lesotho tax in respect of fringe benefits which are exempt from fringe benefits tax under paragraphs 5.1 and 5.2.

6. DETERMINATION OF THE VALUE OF PAYMENTS AND BENEFITS TO EXPATRIATES

The following reliefs and exemptions shall apply in the determination of the taxable value of payments and benefits to Expatriates.

6.1 Housing and utilities

The discharge or reimbursement of the first M10 000 per month paid in respect of housing and utilities shall be exempt from Lesotho tax. The exempt amount of M10 000 shall be subject to periodic review by the Minister responsible for Finance upon the recommendation by the Lesotho Highlands Water Commission.

6.2 School fees

The discharge or reimbursement of school fees payable or paid in respect of a recognised educational establishment for the education of children aged 18 years or younger of an Expatriate, shall be exempt from Lesotho tax to the extent that the amount of such discharge or reimbursement does not exceed in respect of each child an amount equal to the fees that would be payable in respect of a child of an Expatriate attending Machabeng High School.

6.3 Home leave travel

The discharge or reimbursement of the cost of travel and transport of an Expatriate, the spouse of an Expatriate and the children aged 21 years or younger of the Expatriate, in respect of one home leave visit or one visit to Lesotho within each year of employment or assignment within Lesotho, shall be exempt from Lesotho tax. The period of employment or assignment of such Expatriate shall commence from the date the Expatriate first reports for duty in Lesotho in terms of his contract of employment or assignment.

7. RELIEFS AND EXEMPTIONS WITH REGARD TO INCREASED TAXATION

7.1 Exemption from the provisions of the Income Tax Legislation of Lesotho

A Contracting Party, in respect of a Contract, shall be exempt from a provision of the income tax legislation of Lesotho to the extent that such provision serves to increase the tax liability in Lesotho of such Contracting Party over that which would be payable on the date of the Contract.

7.2 Exemption from the provisions of this Annexure

A Contracting Party shall, in respect of a Contract, be exempt from a provision of this Annexure to the extent that such provision would serve to increase the tax liability of such Contracting Party over the amount of

the liability to pay Lesotho tax under income tax legislation of Lesotho in force in the tax year applicable to the relevant transaction or transactions.

ANNEXURE V

MINIMUM QUANTITIES OF WATER FOR THE CALCULATION OF ROYALTIES

YEAR	VOLUME
1995	57
1996	123
1997	190
1998	258
1999	327
2000	398
2001	470
2002	543
2003	618
2004	695
2005	772
2006	780
2007	780
2008	780
2009	780
2010	780
2011	780
2012	780
2013	780
2014	780
2015	780
2016	780
2017	780
2018	780
2019	899
2020	913
2021	927

YEAR	VOLUME
2022	941
2023	954
2024	968
2025	982
2026	996
2027	1010
2028	1024
2029	1037
2030	1051
2031	1065
2032	1079
2033	1093
2034	1107
2035	1120
2036	1134
2037	1148
2038	1162
2039	1176
2040	1190
2041	1203
2042	1217
2043	1231
2044	1245

LESOTHO HIGHLAND WATER PROJECT

PHASE II

