## 2.29 Mining Company Investment

### Introduction

The Department of Innovation, Trade and Rural Development (the Department) provides funding and assistance to businesses operating in the Province in its efforts to strengthen and diversify the economy on a Provincial and regional basis. The Department has defined programs and services, each with set criteria, such as the Seed Capital Equity Program and Economic Diversification and Growth Enterprises (EDGE) Program.

In June 2003, the shareholders of a mining company approached the Department, requesting a grant or loan guarantee from the Provincial Government for $750,000 to address its working capital deficiency. The company had been in operation for two years and had experienced profits but could not maintain sufficient working capital to continue operations. The $750,000 request was part of a $1.15 million program to fund operations for six months, from June 2003 to December 2003. The remaining portions were to be provided by other financial sources. In March 2004, the Department responded by providing a $400,000 repayable equity investment.

### Scope and Objectives

We completed our review in November 2004. Our objectives were to:

- review the process used by the Department in providing an equity investment of $400,000 in the mining company;
- determine what processes the Department has in place to monitor its investment; and
- review any prior involvement the Department may have had with the shareholders of this company and whether the Department considered the results of this involvement in the evaluation of the request for funding.

### Conclusions

Contrary to the conclusion of the Department of Innovation, Trade and Rural Development and the recommendation of Treasury Board Secretariat, the Department was directed by the Premier's Office to provide an investment in a mining company. In September 2003, a letter of offer for a $400,000 equity investment was issued to the company. Details of issues relating to this investment are as follows:

- The Department's review was not as thorough as is normally performed on funding requests. For example, the company's business plan was incomplete, there was no evidence on file that officials had analyzed the plan, and the only financial information on file consisted of unaudited financial statements and other company prepared information. The Department did, however,

have an independent credit risk analysis which suggested that the new mining company had a high credit risk with a high probability of severe delinquency in meeting its financial obligations. Based on this information, the Department concluded that no funding should be provided. However, based on a directive from the Premier's Office, funding was provided.

- In 2000, the Province wrote off a $2.8 million investment in a previous mining company owned by the same major shareholder who created the new mining company.

- On 7 August 2003, Treasury Board Secretariat recommended that the proposal be rejected and forwarded the matter to Treasury Board which deferred the matter to Cabinet for consideration. Officials could not find any record of a Cabinet decision on this matter.

- Although the original request from the company in June 2003 indicated that the funding was required on an urgent basis to fund operations from June 2003 to December 2003, the funding was not made available in trust to the company until 31 March 2004, with the last amount not being drawn down until November 2004.

## Findings and Recommendation

In June 2003, after a meeting at the Premier’s Office, the shareholders of the mining company approached the Department of Innovation, Trade and Rural Development seeking funding of $750,000 through either grants or loan guarantees. The funding was requested on an urgent basis to address anticipated shortfalls in working capital from June 2003 to December 2003. It was indicated that although the new company maintained a profit position for two consecutive years, poor receivables and sales management resulted in the company having a deteriorated working capital position. The company needed funding totaling $1.15 million and indicated that the remaining $400,000 would be obtained from other sources.

Our review of the action taken in response to the request for funding indicated the following:

- The company making the request was created in 2000 by the same major shareholder in a previous mining company. As a result of the closure of the former company, the Province wrote off a $2.8 million investment.

- In June 2003, officials at the Department performed a review of the funding request. As a result of the urgency, officials indicated that they were directed to perform a timely review. Officials also indicated that the request from the mining company did not fall within the guidelines of the programs offered and that there was no set process in place to evaluate requests of this nature. We found that the review performed was not as thorough as is normally performed on funding requests. For example, the company's business plan was incomplete, there was no evidence on file that officials had analyzed the plan, and the only financial information on file consisted of unaudited financial statements and other company prepared information.

- As part of the review, an independent credit risk analysis was obtained by the Department which suggested that the company had a high credit risk with a high probability of severe delinquency in meeting its obligations.

- Although the Departmental official conducting the review concluded that the Province could not support this company under the current situation, officials at the Department indicated that as a result of a directive from the Premier's Office an investment would be provided to the company.

- On 21 July 2003, the Department determined that it would offer the company a repayable equity investment of $400,000 for Class B non-voting common shares. These shares were repayable in that shares could be redeemed by the company at $10,000 per new job created and maintained over a five year performance period, above the current 40 jobs that existed. Also, the company would be required to establish a trust account and hold in trust an amount equal to 25% of its annual available cash flow for a 10 year period to be used to repay the Province in the event that the company does not meet its job creation targets.

- In order for the Department to provide the funding to the company, a transfer of funds was needed within the Department. Treasury Board authority to transfer the funds and proceed with the investment was requested on 29 July 2003.

- On 7 August 2003, Treasury Board Secretariat recommended to Treasury Board that the Department's proposal be rejected for the following reasons:

- The poor history of the previous company caused the Province to lose its $2.8 million investment.
- The company only operated for two years before seeking Government assistance.
- No security was available and the shareholders were not willing to provide personal guarantees.
- An investment like the one proposed may set a precedent for other similar requests.
- Ongoing management of the company was a major concern due to the death of the company's president (i.e. the majority shareholder).
- Due to the inadequacy of the financial information available (i.e. unaudited financial statements) Treasury Board Secretariat was unable to offer an opinion on the viability of the company.

- On 19 August 2003, Treasury Board deferred the matter to Cabinet for consideration. Officials could not find any record of a Cabinet decision on this matter.
- On 29 September 2003, despite not having approval from Treasury Board or Cabinet to proceed with the investment, the Department made an offer of a $400,000 repayable equity contribution to the company. This offer was accepted by the company on 23 October 2003. The company used this investment as leverage to secure the contributions of the other investors totalling $750,000.
- On 24 March 2004, a legal opinion was obtained from the Department of Justice which stated that the letter of offer made by the Department to the company was legally binding and the Province was therefore liable to the company to provide the funding. Furthermore, the legal opinion stated that the Province could be liable for damages to the company in excess of $1.15 million if the other investors decided not to provide financing based upon the Province's withdrawal.

- On 31 March 2004, Treasury Board reconsidered the funding request, and in light of the legal opinion, authorized the Department to make the $400,000 investment in the company.

- Although the original request from the company in June 2003 indicated that the funding was required on an urgent basis to fund operations from June 2003 to December 2003, the funding was not provided until 31 March 2004. The investment funds were released to a trust account maintained by the Department's lawyer and was disbursed to the company in two payments - $372,700 in April 2004 and the remaining $27,300 in November 2004.

**Legal Dispute**

During our review, Department officials indicated that there is an ongoing dispute between the estate of the company's major shareholder and the Department of Natural Resources over the ownership of the minerals at the mine location and the right of the Province to collect royalties on the minerals mined. The Province maintains that the surface rights and not mineral rights were issued to the shareholder. The decision of ownership is currently before the courts.

**Recommendation**

*The Department should ensure that all requests for funding are subject to the Department's normal review process and that all analytical procedures normally performed on a request of this type are completed prior to any funding being provided.*

**Department's Response**

*The Offer of Financing was issued on September 29, 2003 under the previous administration. This administration obtained a legal opinion which determined that the Offer of Financing was a legal contract and that the Department should honour the commitment or face possible legal implications of greater consequences.*

*A full review was conducted by the Department of Innovation, Trade and Rural Development. Significant discussions on all issues were held with the company and the company's independent accountant. Government's offer was subject to the proponent securing additional financing from other lenders, who were carrying out their own due diligence. These other parties also provided financing.*

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*In referring to normal process, the Auditor General is referring to the Department's Seed Equity Program, governed by the Business Investment Corporation (BIC). This situation is outside the current mandate of the BIC.*

*The Department notes the comments of the Auditor General and will take these comments into account with respect to any future requests of a similar nature.*