



BRE-X: The Battle for Busang (A)

On November 12, 1996, Canadian entrepreneur, David G. Walsh, knew he was in serious trouble. The Indonesian Minister of Mines and Energy was applying intense pressure on him to cut a deal with another Canadian mining company, Barrick Gold Corporation, giving them production rights over a mine site, known as Busang, which Walsh had staked a claim to three years earlier. The minister had already revoked Walsh's exploration permit. Until he agreed to the pact, permission to exploit the mine would be withheld.

Since Walsh's penny stock exploration company, Bre-X Minerals, began finding deposits of gold in a rugged, overgrown rain forest on the island of Borneo, interest in his stock grew. Between 1993 and 1996, the share price rose from under \$.02 cents to over \$200 a share.¹ What initially had been described as a "decent strike" of about two million ounces of gold, eventually came to be touted as the largest mine of its kind in the world with an estimated 200 million ounces of the precious metal worth some \$70 billion. Barrick, which was the world's third largest gold producer, needed Busang if it were to become the industry's leader. After unsuccessfully trying a friendly takeover of Bre-X a year earlier, Barrick's CEO Peter Munk had decided it could still achieve its goal by using its political clout in Canada and the United States to curry favor in the corridors of power in Jakarta.

Walsh, who owned 90 percent of the stake, objected to the proposed arrangement which would leave him and his 13,000 shareholders only 22.5 percent of the equity in the mine, while turning over 67.5 percent to Barrick and 10 percent to the Indonesian government. Even though Barrick was prepared to pay \$1.5 billion for its stake in Busang, Walsh was convinced that Bre-X shareholders could do better if the tender for a production company went to an open auction. From 1993 to 1996, many ordinary people who had risked a few hundred dollars of their savings on Bre-X became millionaires almost overnight. As the company listed on the major stock

¹ All monetary figures in this case are in US dollars.

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exchanges in Toronto and New York, it had become the darling of institutional investors worldwide.

Much to his dismay and certainly beyond his control, Walsh found that political intrigue had begun to dominate economic considerations. New parties with vested interests within the Indonesian government and business community had emerged during the negotiation process and tried to capitalize on the potential fortune. After months of positioning, a deal was finally struck. It was an outcome, neither party anticipated.

From Riches to Rags and Back Again

Playing the markets was in David Walsh's blood. His grandfather was a stockbroker, so was his father. Walsh grew up comfortably in Westmount, an affluent area of Montreal. He joined the Eastern Trust Co., a small trust firm, straight out of high school in 1963, working the investment desk and taking finance and accounting classes at night school. In 1969 Walsh became head of the firm's investment department. Seven years later, he moved to Midland Doherty Ltd., which became Midland Walwyn Capital Inc. in 1990, becoming a vice president in its institutional equity sales department in Montreal. By the early 1980s, his annual commissions ran well into six figures.²

In 1982, Midland Doherty asked Walsh to set up an institutional department in Calgary, Alberta. Unfortunately, he moved west just as the oil boom in Canada was waning. As his commissions dried up, Walsh became increasingly disenchanted and left the firm by the end of that year. He decided to become an entrepreneur.

Like many Canadians, Walsh had a fascination with the country's abundant natural resources. Canada's history was full of tales of prospectors who went from rags to riches from just one lucky find. In the modern era, this path to wealth often began by investors putting a tiny sum of money in penny stock offerings, which were then used by fledgling mining firms to raise funds for exploration. Most owned plots of dirt that would never earn a dime, but the few that would prove successful would gush dollars. Statistically, small firms had uncovered 75 percent of the world's biggest mineral deposits.³ Capitalizing on this market mentality, Walsh and a few partners set up Bresea Resources Ltd., and listed it on the Vancouver Stock Exchange in 1984.⁴

Bresea used the proceeds from the initial stock offering to acquire some minor oil-and-gas properties in Louisiana. But there too, the petroleum industry had taken a nosedive. The business was a nonstarter. Life became increasingly hard for Walsh, his wife, and two boys. Their only

² *Canadian Business*, March 1997.

³ *Far East Economic Review*, December 19, 1996.

⁴ *Newsweek*, May 5, 1997. The Vancouver Stock Exchange was nicknamed by locals as "The Scam Capital of the World."

steady source of income came from his wife's secretarial job, but that was less than \$14,000 a year. Most of their income came from playing the markets. In one year, Walsh made \$22,000 flipping stocks.⁵

But Walsh was a survivor. He was constantly scrambling, putting deals together. In 1985 he created a new company, Ayrex Resources Ltd., which bought up 324 claims in the gold fields of northwestern Quebec. He then rolled Ayrex into a joint-venture with Bresea and went looking for new funding on the Montreal Stock Exchange. Once again, his timing was lousy. He listed the company one month after the October 1987 stock crash. Despite coming up short, Walsh decided to regroup again and incorporated as Bre-X Minerals Ltd., with himself and Bresea as principal shareholders.

Walsh quickly bought up 41 mineral claims in Canada's Northwest Territory (NWT) and listed Bre-X on the Alberta Stock Exchange, where junior mining companies like his made up 18 percent of the firms traded.⁶ But he failed to raise the necessary exploration capital. Within three years the company was moribund. Between 1989 and 1992, the stock averaged 0.19 cents and at one point fell to 0.2 cents.⁷ Walsh had written down the value of the Quebec gold field claims which were held in conjunction with Bresea, and let his claims in the NWT expire.

By early 1993, Walsh's total family income was down to about \$700 a month. He owed \$41,650 to 15 different credit card companies and department stores. His bank account was overdrawn by more than \$10,000 and had reached its credit limit. Despondent, constantly hassled by debt collectors,⁸ and seemingly out of luck, Walsh and his wife filed for bankruptcy. More than a decade had passed since Walsh left the relative security of Midland Doherty and struck off on his own. He was 47 years old and all he had to show for his efforts were a languishing penny-stock outfit, a mortgaged split-level home, and a '79 Buick.

Walsh may have been down, but he wasn't out. He decided that if he was going to stay in the mining business he would half to hook up with someone whom he thought was tops in exploration. In March, just a few weeks after he was legally declared destitute, Walsh scrapped together the last of his ready cash and flew down to Jakarta, Indonesia in search of a man named John Felderhof.

Walsh first crossed paths with Felderhof almost 10 years to the day earlier, in 1983. Walsh and a friend had gone to Australia to meet some people in the mining business there. In Sydney, Walsh was introduced to the craggy-faced, energetic geologist with unconventional

⁵ *Canadian Business*, March 1997.

⁶ *Newsweek*, May 5, 1997.

⁷ *Canadian Business*, March 1997.

⁸ *Ibid.* In February 1991, an Alberta court ordered Walsh to pay back RBC Dominion Securities \$28,500 for shares mistakenly credited to his account, which Walsh was aware of, and sold anyway. When the brokerage firm realized its mistake and asked Walsh to return the money, he refused.

theories about gold deposits. He had a theory that gold and other precious metals could be found along intersecting fault lines in the earth's crust—a process referred to tectonomagmatism.⁹ A native of the Netherlands, Felderhof moved to Canada, and settled in Halifax, Nova Scotia with his family in 1952, when he was 12. He went to school there and graduated from Dalhousie University with a geology degree. By the time Walsh first met him, he had spent more than 20 years searching for minerals, roaming from northern Quebec to southern Africa and, finally to southeast Asia. He co-discovered the vast Ok Tedia copper/gold mine in Papua New Guinea, the first of a string of successes he would enjoy in the region.¹⁰

Felderhof had told Walsh about some interesting properties in the Indonesian provinces of Kalimantan, on the island of Borneo.¹¹ Legend had it that the name Kalimantan meant "rivers of gold and diamonds." Small deposits of the precious metal and the gem had, in fact, been found in old riverbeds that ran out from the coast onto the ocean floor. Still, the region remained largely unexplored, a result of its horrible terrain and climate. Borneo was covered with thick, dense vegetation, making overland travel extremely difficult. Some areas received about 180 inches of rain a year. Summers were fiercely hot and suffocatingly humid. Malaria was common. The pair spent 12 days stomping around the jungle. Despite his interest at the time, however, Walsh didn't believe that he could raise money in Canada for an exploration project so far away.

Indeed, in the early 1980s, the vast majority of interest in Indonesia's natural resources was coming from neighboring Australia.¹² Similar to the way things operated in Canada, dozens of Australian companies were staking mineral claims which drove a stock market boom until the sudden global crash of October 1987. The Indonesian government had issued almost 130 mining licenses to foreign companies, but only a handful of large mines ended up in production. By 1993, the few Australian companies that were left were still thinking about pulling out.

Felderhof had been busy assessing a number of properties in East Kalimantan for the Montague Gold Company of Perth, Australia who wanted his opinion on whether to sell the properties, abandon them or farm them out to another company. One of the sites was a hilly, 37,000 acres of rain forest about 18 miles from the fabled Mahakam River. The area was remote, populated by only a few hundred Dayak rice farmers.¹³ They called the place Busang.

⁹ *The New York Times*, March 31, 1997.

¹⁰ *Far East Economic Review*, March 6, 1997.

¹¹ *Canadian Business*, March 1997. From 1980-82, Felderhof worked for the Sydney-based A.C. Howe Consulting Group, identifying four different gold deposits as he worked his way from West to East across the center of Borneo, building an invaluable data base as he went.

¹² *Ibid.* The Indonesian government issued about 130 mining licenses in the 1980s, but only a handful of large mines ended up in production.

¹³ A name given to a member of any of several Indonesian peoples of the interior of Borneo.

Felderhof hired a Filipino geologist, Michael de Guzman, who spent a week collecting ore samples around Busang and submitted a positive report indicating that there was possibly around a million ounces of gold in the ground. De Guzman had known Felderhof since 1986, when they walked Busang for the first time. A geology graduate of Manila's Adamson University, the 40-year old de Guzman later went on to pioneer in-depth studies into the occurrence of gold deposits at the junction of fault lines—part of an overall theory of how mineralized fluids are transported to the earth's surface. After that trip, Felderhof applied for a contract of work on the basis of potential sources of gold the two identified in what was later to be known as the Central Zone. He canceled it when he learned that boundary conflicts were involved.¹⁴

Felderhof's 1993 recommendation failed to impress the cash-strapped management of Montague Gold who decided sell the property.¹⁵ Over several months, a dozen companies inspected the site, but no one showed any interest. When Felderhof met up with Walsh in Jakarta in March 1993, he told his Canadian friend that the area, along with two other sites on the islands of Sumatra and Sulawesi, were available at the bargain basement price of \$80,000 for an option to purchase, exercisable at another \$100,000 in a year's time. Walsh was excited. He believed that Felderhof still had the Midas touch. Montague Gold agreed to give Walsh six weeks to come up with the money. He had one problem—Bre-X was broke.

That didn't deter Walsh. He and his wife had 512,000 Bre-X stock options, ranging from 7 cents to 14 cents a share. First, he got approval from the Alberta Stock Exchange to raise the strike price for each share to 0.28 cents.¹⁶ Then he convinced some close friends to buy them, explaining that the money would go towards acquiring three Indonesian properties, including Busang, as well as funding a basic exploration program. Through sheer persistence, Walsh raised \$140,000 and closed the deal with the Australians in July 1993. In the process, he inherited two Indonesian partners, each of whom held a 10 percent interest in the venture.

Between May 1993 and May 1994, Walsh raised more than \$700,000 by "free trading"¹⁷ Bre-X shares out of Bresea's position. In September 1993, Bre-X did its first drillings. Felderhof was convinced that there was up to two million ounces of easily recoverable gold. Walsh now knew that his luck had finally turned. Within two years he reckoned, Bre-X would be taken over by a major mining company for \$2.80—\$3.50 a share. By the age of 50, he would retire a millionaire.

¹⁴ *Far East Economic Review*, March 6, 1997.

¹⁵ *Far East Economic Review*, March 21, 1996.

¹⁶ T.A. Cumming, president of the Alberta Stock Exchange, interview with author, May 5, 1997. Under the Securities Act of Alberta, Walsh was granted permission to buy his stock options and resell them at virtually the same time as freely tradable shares at a higher price through private placement transactions. The practice was allowed to help small firms raise needed investment capital.

¹⁷ As Walsh was a director of both companies, he was in a position to authorize the sale of Bresea Resources Ltd.'s holdings in Bre-X. As Bresea was listed on the Montreal Exchange and Bre-X on the Alberta Exchange, Walsh was required by law to inform both exchanges of such transactions to avoid charges of insider dealing.

The Dream Turns Real

Walsh didn't have too wait long before Bre-X was targeted by a major player. A month after Felderhof's first drilling, the head of exploration for the Barrick Gold Corporation, paid a visit to the Busang mine. Barrick, a Toronto-based company was the biggest gold producer outside of South Africa. It was run by one of Canada's most daring and cocky business executives, Peter Munk. Walsh offered Munk a private placement of 14 percent of Bre-X for \$350,000 or 0.29 cents a share.¹⁸ Barrick's CEO countered with a proposed 50/50 joint-venture arrangement, but getting a 60 percent chunk of the property.¹⁹

In January 1994, Walsh strategically issued a press release that Barrick had made his company an offer and stock market analysts began paying more attention. Two weeks later, Walsh tersely announced that the "deal" was off, and that no further discussions were contemplated. Bre-X contended that the deal collapsed after Barrick sought to make a last minute change that it clearly hoped would be overlooked. Walsh was appalled by Munk's arrogance. "Just because you're small, some people think you are stupid," he said of Barrick.²⁰

Walsh continued to look for cash to fund further exploration of the mine. In March, Robert van Doorn, a mining analyst for the Toronto brokerage firm of Loewen Ondaatje McCutcheon Ltd., met with Felderhof. The two Dutch men immediately hit it off. Felderhof explained his novel theory that Indonesia contained unique geological formations called Maar-diatreme domes. The domes were raised pockets of volcanic rock formed over millions of years which could contain large, easily recoverable deposits of gold. Felderhof had yet to confirm the existence of a dome at Busang, but he convinced van Doorn. Two months later, Loewen Ondaatje handled a \$3.15 million private placement for Bre-X.

Finally, Bre-X and its team of explorers had some serious funds to work with. They spent the rest of 1994 drilling 106 holes into the property, slowly improving their estimates of the amount of gold in the ground. By the time they reached the property's western border, they figured they could prove about three million ounces. Felderhof had found his dome. It ran northwest to southeast, the shape of a cigar 7.5 miles long, 3.7 miles wide. Although the protrusion was visible from the air, it went unnoticed until a bulldozer uncovered the telltale rock formation. Bre-X quickly and quietly extended its claim in the direction the formation seemed to heading. In September, Walsh entered into a joint-venture agreement with PT Askatindo Karya Mineral, one of its Indonesian partners in the original area. Bre-X retained a 90 percent stake in the new area, dubbed the Southeast Zone. They called the original site the Central Zone. Its new partnership not only gave Bre-X access to the land, but the rights to explore it.

¹⁸ *Canadian Business*, March 1997.

¹⁹ *Far East Economic Review*, December 19, 1996.

²⁰ *Canadian Business*, March 1997.

Business Indonesian Style

Indonesia is a cultural tapestry of over 195 million people from 200 different ethnic groups, on 13,000 islands stretching 3,100 miles from east to west. Globally, it ranks fourth in total population and is the largest Muslim nation in the world, but also has large Hindu and Christian populations.

The country declared its independence from 344 years of Dutch colonial rule two days after the end of World War II.²¹ From its founding, the country's Constitution provided for a powerful presidency and created a dominant, permanent role for the military by guaranteeing the armed forces a bloc of 20 percent of the seats in the ruling People's Representative Council. In its 52 years, Indonesia had been dominated by the leadership of two charismatic military officers—Sukarno, the country's first president from 1945-65 and Suharto, who overthrew his predecessor and became the country's leader in 1967. On May 31, 1997, Suharto planned to run unopposed for president for a seventh, five-year term.

The post-war Sukarno government was based on a coalition of Communists, Muslims and the military. Its foreign policy was decidedly anti-western and the economy was managed along socialist-oriented lines. By January 1959, the treasury was bankrupt, exports dropped, debt and inflation soared, the per capita income was \$50, and the economy all but ground to a halt. Sukarno dissolved the national assembly, abrogated the constitution, waived human rights, and placed the military in power under a program called "Guided Democracy."

On the evening of September 30, 1965, a group of leftist army officers kidnapped and killed six generals and a lieutenant. The rebels claimed they were trying to preempt a planned coup by a Council of Generals, which did not formally exist. The next morning, Major General Suharto, who headed the strategic reserve command, took control of the armed forces. Order was restored in less than 30 hours.

The events surrounding the fall of Sukarno and the ascendancy of Suharto was shrouded in mystery as claims made by both sides were largely unsubstantiated. Blaming the coup on the Communist Party, the army used the opportunity to vanquish their political opponents and unleashed a nationwide vengeance campaign exploiting social tensions that had been building for years between Muslims and ethnic Chinese. In the end, an estimated 400,000 Indonesians were killed in a matter of months. Tens of thousands of others were forced from their homes. On March 11, 1966, an ailing Sukarno effectively relinquished control of the government to Suharto. A day

²¹ Sukarno declared independence on August 17, 1945, but it took four more years and a bitter war with the Dutch before Indonesia became a truly independent nation. Colonial rule formally came to an end on November 2, 1949 with the signing of the Hague Agreement.

later, Suharto banned the Indonesian Communist Party and its affiliates. The New Order began.²²

The New Order brought increased economic prosperity and political stability. Using a series of five-year economic plans and a pro-western outlook, Suharto shifted the economy which was 80 percent dependent on revenues from oil exports in 1988, to one that was more evenly balanced with 30 percent of its national income coming from manufacturing, 18 percent from agriculture, 17 percent from the service sector, 10 percent from mining, and only 25 percent dependent on petroleum revenues by 1996. In the same year, the economy grew at an average rate of over 7 percent a year and the per capita income was \$821. With an end to foreign exchange controls, a free floating currency since the late 80s and deregulation of foreign investment in the 1990's, international trade accounted for nearly 50 percent of the GNP.

The regimes of both Sukarno and Suharto were known for their autocratic rule based on traditional Javanese feudalism. Political opposition was not tolerated.²³ Direct criticism of the president was punishable with a 30-year jail sentence, and nepotism and corruption were endemic. In addition, the vice president and most of the government's top cabinet ministers were drawn from the elite officer corps of the army. Yet Suharto was affectionately referred to by his countrymen as "The Bapak"—father.

Foreign investors had two main concerns about Indonesia: succession of the president and corruption. Succession was the top priority because Suharto, who was 75 in 1997, was the architect and driving force behind the New Order. An entire generation had known only one leader, so it was hard for them to visualize control of the country in someone else's hands. While Suharto campaigned for another five year term, they knew that, despite their devotion to the man, nature would eventually force a transition.

Many potential investors also were disconcerted by the active involvement of members of the first family, with the exception of the president, in industry and commerce. A report by Britain's prestigious Economist Intelligence Unit cited "official" corruption as "a major disincentive to foreign investment."²⁴ It had been estimated that the wealth of the immediate members of the Suharto family, his wife,²⁵ and six children, was second in Asia only to the fortune amassed by the Sultan of Brunei.²⁶ While none of their gains had been made illegally, few would deny that they had benefited handsomely from their close proximity to power. For

22 Samuel Passow, *Indonesia: 50th Anniversary*, *Institutional Investor Magazine*, New York, August 1995.

23 There were only three groups legally permitted to contest elections in Indonesia. Suharto's Golkar Party, the Muslim-oriented United Development Party, and the Indonesian Democratic Party. Golkar took 68 percent the vote in the last election in 1992.

24 Economist Intelligence Unit Report on Indonesia, presented at a private conference of foreign investors in Jakarta in March 1995. The EIU is part of the *Economist Magazine*.

25 Elizabeth M. Wood, managing director Bear Stearns, Asia, interview with author, Jakarta, March 1995.

26 Suharto's wife, Tien, who died in April 1996, was caustically referred to by Indonesians as "Mrs. Ten Percent."
26 *Asia Inc. Magazine*, April 1995.

this reason, the sensitivity to the succession issue continued to arise, as many in Indonesia and abroad questioned the long-term viability of business concerns and development projects that involved the Suharto family once the president left the scene. Another added worry, was the fact that since 1967, only 48 percent of the government's memoranda of understanding with foreign investors were ever implemented.²⁷

Under Indonesian law, a foreign mining company must have an Indonesian partner. Once that is in place, the Indonesian partner may apply for a "KP," which allows some exploratory drilling and sampling to proceed within a small defined area. The next step is to apply for a preliminary investigation permit (SIPP), which further opens up the exploration area, and a contract for work (COW) which sets timelines for exploration, environmental assessments, and construction and production schedules. COWs also address issues such as tax rates and employment standards. They are binding, locking a company into development for decades. Without a COW, approved by Suharto himself, a company cannot mine.

The permits to start a mining operation in Indonesia were granted by the minister of mining and energy. This secondary cabinet position traditionally went to a technocrat with a background in regulatory matters. However, with the prospect of Suharto's succession growing, the vice president, General Try Sutrisno—the former chief of the armed forces—wanted a senior military man named to what could prove to be a sensitive post. In 1993, he appointed Ida Bagus Sudjana—a former army officer and a member of Bali's highest Hindu caste. Sudjana appointed as his "personal" economic advisor Adnan Ganto, a civilian with strong ties to the military. Educated in Holland, Ganto had established a wide net of international business contacts while he was an associate director at Morgan Grenfell (Asia) Ltd., a leading British merchant bank in Singapore in the 1980s. After returning to Indonesia, he was appointed to an unspecified job with the Ministry of Defense and Security. It is reported that he helped "speed up" the purchase of Skyhawk fighter jets from the UK.²⁸

By November 1996, Sudjana was facing allegations of large-scale corruption in his department. A cover story in the popular Indonesian magazine *Gatra*,²⁹ reported an accusation that the state-owned coal company, PT Tambang Batubara Bukit Asam, had transferred the equivalent of \$16.5 million to Sudjana's personal bank account.³⁰ High profile Indonesians were

27 Hartarto, coordinating minister for industry and trade, interview with author, May 1995.

28 *Canadian Business*, March 1997.

29 *Gatra* was owned by Indonesian billionaire Mohamad (Bob) Hasan.

30 *Canadian Business*, March 1997. In 1994, Sudjana allegedly wrote a letter to the president of the state-owned coal company demanding he transfer 50 billion rupiah (\$20.5 million) to Sudjana's personal bank account. The note allegedly explained that Sudjana intended to create a fund to "improve the welfare" of his staff. Tambang's directors reportedly turned down the demand, saying "it was against regulations" According to the account in the press, they later relented, and transferred 40 billion rupiah to a bank in Jakarta. After raising objections and reporting the transaction to government auditors, the directors were allegedly sacked by Sudjana. In a government inquiry in December 1996, Sudjana told a Parliamentary committee that the funds had been transferred from the coal company to his private bank account in order to "salvage state funds" from wasteful bureaucrats.

also complaining to the media that their multi-million dollar contracts had allegedly been rewritten by the minister and handed to Ganto's friends.

A True Capitalist Hero

In October 1995, Bre-X announced that the Busang mine had reserves of 10 million ounces of gold and company officials talked about proving 30 million ounces within 12 months. The estimates were done by independent engineering firms, but based on Bre-X data. On February 12, 1996, an Indonesian mining official said there were an estimated 40 million ounces to be mined, making it potentially the largest gold claim in the world. Bre-X became one of the heaviest traded stocks in Canada. In the span of one year, the share price rose from \$1.40 to over \$140. The company did a 10-for-1 split, and the stock still kept rising. Bre-X was listed on the NASDAQ exchange in New York³¹ and was bought up by 63 US mutual funds.³² On paper, Walsh was now one of the richest men in Canada. But to the surprise of many seasoned market players who had expected Bre-X to gather up its profits and sell, Walsh hung in.

The one time penny stock huckster was now being hailed as a true capitalist hero from the boardrooms of corporate America to the kitchens of small-town Alberta. *The New York Times* ran a headline: "Bre-X Has a Cinderella Story to Tell." The company's meteoric rise created dozens of grateful millionaires in Canada. St. Paul, an isolated town of 5,200 that sits 125 miles northeast of Edmonton, claimed over 100 Bre-X investors.³³ People all over the country called or wrote Walsh to thank him for helping them to secure their futures.

In February 1996, Bre-X raised another \$21 million in a private placement, the value of which was slightly more than 1 percent of the company's total stock, and moved its base of operations from basement of Walsh's home into its own office building in downtown Calgary. In April, Walsh hired Rolando (Roly) Francisco, formerly the chief financial officer of Goldcorp Inc. and Lac Minerals Ltd., who brought some desperately needed big-league experience to Bre-X.

The company moved its shares off the penny-exchange in Alberta and listed on the country's main equity bourse in Toronto.³⁴ As the shares became sensitive to institutional block buying and rumors that large companies such as Barrick were plotting a takeover, Bre-X launched a series of preemptive strikes including a shareholders rights plan and a poison pill provision for the management.

³¹ "ABC News Nightline," May 13, 1997 noted that the Bre-X 10K submission to the US Securities and Exchange Commission did not contain information on gold estimates.

³² *Time*, May 19, 1997. Fidelity, the largest US mutual fund had 15 million shares invested in Bre-X and was the largest single investor in the company.

³³ Harvey Faucher, interview with author, May 8, 1997. Mr. Faucher was a resident of St. Paul and had the local Century 21 real estate franchise there. He was also an investor in Bre-X.

³⁴ *Reuters*, May 5, 1997. The Toronto Stock Exchange listing began on April 23, 1996. Within minutes of the opening bell, the stock rose \$3.50 to \$134.75 a share.

But by May 1996, Walsh and his team knew that if they were to keep their house of cards standing, they needed a partner who could secure the foundation. Bre-X was an exploration company.³⁵ It knew nothing about production. It was only a matter of time before the stock market would demand that the promise of riches be converted into tangible evidence. The question was who and at what price. Bre-X thought \$1.4 billion dollars for 25 percent stake in the company sounded right. Walsh opened the bidding in public at the annual general meeting.

The Nightmare Begins

Unbeknownst to Walsh, a major play for Bre-X had already been set in operation by Barrick's high rolling CEO, Peter Munk. Munk had been making and losing fortunes since his early 30's. A native of Hungary who immigrated to Canada in 1948, his business interests ranged from running a consumer electronics firm in Canada to a hotel chain in the South Pacific. In 1981, he set up Barrick Petroleum Corp., made a number of poorly timed investments, and within two years lost about \$70 million. Like others in the resources industry, he turned his attention from oil to mining. He assembled some of the top talent in North America and went looking for good properties. In 1987, he purchased a gold mine with reserves of 600,000 ounces in Goldstrike, Nevada for \$62 million. Within three months of the sale, Barrick discovered recoverable gold reserves of 28 million ounces, making it the largest find of its kind in North America.³⁶

Within the span of a just over a decade, Munk built Barrick into the third largest gold company in the world with a market value of \$10 billion, an annual cash flow of \$502 million and 43.3 million ounces of recoverable gold in reserves. The company's success attracted an international advisory board which included such high-profile political insiders as former US President George Bush and former Canadian Prime Minister Brian Mulroney.³⁷

Munk was determined to make Barrick the largest gold producer in the world. Getting control of Busang would do just that. It didn't appear to matter to him that Bre-X had rebuffed his previous advances, or that Walsh no longer returned his calls. Barrick would find another way to its goal—through Jakarta's corridors of power.

In May 1996, Munk saw his chance. An ownership dispute blew up between Bre-X and Jusuf Merukh,³⁸ one of the two Indonesian partners in Busang. Suharto decided that no COW would be issued until the dispute had been settled. Without a COW, Bre-X was vulnerable and unable to continue talks it had entered into with at least two major mining companies earlier

³⁵ *Canadian Business*, March 1997. In 1995, Felderhof was named "Prospector of the Year" by the Prospectors and Developers Association in Canada.

³⁶ *Business Week*, December 16, 1996.

³⁷ *Canadian Business*, March 1997. Mulroney, a Barrick director, was reportedly given stock options on 500,000 shares of the company.

³⁸ *Far East Economic Review*, November 14, 1996. Merukh claimed options on the two most promising properties in Busang which would give him a 40 percent stake.

that year. In mid-June, after Merukh threatened to drag out his claim against Walsh in court, Munk and his executives called on Sudjana and made a formal presentation to the minister and some of his key officials. Barrick said it was willing to put up \$1.5 billion to develop the mine. It had the expertise, and could move fast.³⁹

In late June, Sudjana, and his department's top technocrat, Kuntoro Mangkusubroto,⁴⁰ were on a visit to Canada to promote his country's mining industry. During a stop in Toronto, Barrick's Executive Vice President of Development, Alan Hill, allegedly gave Sudjana a letter written by former Prime Minister Mulroney which outlined Barrick's interest in Busang. The note reportedly claimed that Erlangga Hartarto, the son of Indonesia's powerful coordinating minister for industry and trade—one of the top ranking cabinet posts in the government, and a close personal advisor to the president—was working on Barrick's behalf to negotiate a deal.⁴¹

Hartarto, a close friend of Sudjana's principal advisor, Ganto, met with Sudjana in Jakarta in July. Following that encounter, officials in the Department of Mines were told that Barrick's Indonesian group included two of the country's most influential power brokers: Siti (Tutut) Hardiyanti Rukmana⁴² and Dharma Yoga. Tutut was Suharto's eldest daughter; Dharma, who controls interests in mining, was Sudjana's son.

Hartarto then met with Bre-X's Felderhof, who by this time was a senior vice president. He reportedly told the geologist that it was taking his company too long to find a production partner and that Barrick was ready to do a deal. Hartarto indicated that the Indonesian government expected Bre-X to comply. Whether it was a comic misunderstanding or a cultural gap, Walsh didn't get the hint.⁴³

Hartarto arranged another meeting later that month. It pitted Felderhof and Francisco for Bre-X against Randall Oliphant, Barrick's chief financial officer and Pat Garver, the company's legal counsel. The two sides discussed a joint venture agreement. Hartarto, reportedly gave the impression that he thought a deal should be signed right then. When Bre-X stalled,

³⁹ *Far East Economic Review*, December 19, 1996.

⁴⁰ *Canadian Business*, March 1997. Kuntoro was educated at Stanford, taught engineering at Indonesia's prestigious Bundung Technological Institute before serving five years as an economic development advisor in the state secretariat. Regarded as a scrupulous, modern administrator, Kuntoro was credited from turning a bloated state-owned tin company into one of the nation's most profitable enterprises.

⁴¹ *Ibid.*

⁴² *Ibid.* Tutut's holding company Citra Lamtoro Gung Persada, had interests in electronics, broadcasting, toll roads, and construction. Her assets in 1996 were reportedly worth \$400 million. Most important, perhaps, is the influence she wielded within Indonesia's ruling party. Tutut was chair of Golkar's central board, and was considered a potential presidential candidate after her Father died. *Business Week*, December 16, 1996. Following an introduction from Hartarto, Barrick had agreed to give Tutut's construction company the lucrative contract for developing the Busang mine if it became Bre-X's partner.

⁴³ *Ibid.*

Hartarto mentioned in passing that Barrick had enlisted Tutut's support. In Felderhof's words: "Heavy-duty pressure had started."⁴⁴

Barrick and its backers started to up the ante in the high stakes game. Sudjana ordered Kuntoro to revoke Bre-X's COW application, which had been approved by Parliament and the investment review panel, but still held up by Suharto. Kuntoro balked. Such action he told the minister would be illegal. But as pressure on the technocrats increased,⁴⁵ Kuntoro agreed to cancel Bre-X's year old Letter of Permit for Preliminary Surveys, the document the firm had used to establish security of tenure with North American stock exchanges.⁴⁶ It was as far as he would legally go to satisfy his minister. On October 17, Sudjana issued Ministerial Decree No. 1409, stripping Kuntoro's office of its responsibility to process all COW applications, a duty it had carried out for 30 years.⁴⁷

Back in North America, Munk got former president Bush to write to Suharto, with whom he had a close working relationship as a world leader, extolling Barrick's virtues and recommending it be allowed to develop Busang. Bush wrote that Barrick had "the resources and assets to do a reputable job."⁴⁸

Bre-X Regroups

Bre-X knew it had to act fast. In September 1996 it announced that it would consider merging with, or selling a controlling interest in Busang to, a major mining company. Walsh's ambition was to hold an open auction among the world's top mining companies where he could rightly expect a price equal to the firm's trading position at the time of between \$18 and \$21 a share.⁴⁹ If Barrick won that auction, fine. But Walsh felt that a shotgun marriage, such as the one the Indonesian government seemed to be proposing, would almost certainly result in shareholders getting less than full value for their shares.

44 Ibid.

45 Ibid. Hartarto reportedly confronted Kuntoro directly after Bre-X turned down the Barrick joint-venture offer.

46 *Far East Economic Review*, November 28, 1996; March 6, 1997; and April 10, 1997. *Canadian Business*, March 1997; *Reuters*, May 5, 1997; and *Time*, May 19, 1997 noted that Walsh, Felderhof, de Guzman, and 13 other Bre-X managers and geologists, who in total were worth an estimated \$1 billion on paper, added more than \$60 million to their private bank accounts between April and October 1996 through the sale of share options. Most of the sales occurred shortly after Bre-X learned that its preliminary exploration license had been canceled by the Indonesian government, a development the company did not reveal publicly until October 1996. Walsh and his wife were worth \$225 million. They cashed in \$20 million worth of their stock and bought a home in Nassau, the Bahamas. They paid off the mortgage on their Calgary home and sold it to their sons for \$1,000. Felderhof and his Australian wife took a profit of \$29 million and used \$2.9 million to buy a seaside home on Grand Cayman Island as well as a 44-foot motor cruiser. He also bought two other properties in the Cayman Islands totaling \$1.68 million. On June 6, 1996, Felderhof transferred ownership of all the properties to his wife.

47 *Canadian Business*, March, 1997.

48 *Far East Economic Review*, December 19, 1996.

49 *Business Week*, December 16, 1996.

Walsh hired J.P. Morgan & Co. and Republic National Bank as financial advisors and strategic planners. Negotiations began with the Vancouver-based mining firm, Placer Dome, Inc. who proposed a \$5 billion merger with Bre-X.⁵⁰ Talks were also held with Barrick who reportedly proposed a 50/50 split on Busang with some accommodations for minority parties.

But Bre-X's financial advisors refused to sign off on any of the deals. By the end of October, Bre-X had secured its own direct pipeline to the Indonesian government when it negotiated a "strategic alliance" with PT Panutan Duta, a company controlled by Suharto's eldest son, Sigit Harjojudanto.⁵¹ Bre-X agreed to pay Panutan \$1 million a month over 40 months, in exchange for assistance in "administrative, technical, and other support matters within the Republic of Indonesia." Panutan would also receive a 10 percent interest in both the Central Zone and Southeast Zone of Busang.⁵²

With little warning, Sudjana called Bre-X and Barrick to a meeting in his office in Jakarta on November 12. Walsh, Francisco, Felderhof, and representatives from J.P. Morgan and Republic Bank turned up for Bre-X. Barrick was represented by Munk, Garver, Oliphant and Neil MacLachlan, the company's executive vice president for Asia. Neither party knew what was on the agenda. Sudjana was joined by Ganto, Kuntoro, and Umar Said, the mining department's secretary general.

The atmosphere at the meeting was tense. Reading from a prepared statement in halting English, Sudjana said that a deal on the development of Busang was in the national interest of Indonesia. Barrick, he said, would have 75 percent of Busang, while Bre-X would have 25 percent. He added that the government would "appreciate" a 10 percent interest. He did not elaborate. He simply got up and left. After a few seconds of stunned silence, Said spoke up, telling the two parties that they had eight days to work out the details regarding Busang's Indonesian interest.⁵³

The deadline passed with no agreement. So did another one on December 4. Said got furious. He told local reporters that a deal had to be done, but denied that Sudjana ever mentioned a 75/25 split. On December 11, Sudjana found himself before a House of Representatives committee answering allegations about the transfer of funds from a state-owned company into his private bank account. They also asked questions about the cronyism that went

⁵⁰ Ibid., January 27, 1997. Bre-X was valued at around \$5 billion in the fall of 1996.

⁵¹ *Far East Economic Review*, November 14, 1996. Sigit Harjojudanto had a much lower profile than his sister Tutut. In 1993, his economic interests were reportedly worth \$450 million. In the early 1990s, he helped create a national sports lottery fund. The lottery attracted heavy criticism from Muslim groups across the country, and was eventually banned in 1993. His interests include the Central Bank of Asia, the largest private bank in Indonesia.

⁵² Ibid.

⁵³ Ibid.

on in his department,⁵⁴ as well as allegations about Busang. Since he issued his November ultimatum on Busang, negotiations on 68 other mining operations in the country came to an abrupt halt.⁵⁵ Sudjana defended his actions regarding the mine, noting that an "arranged marriage" between Bre-X and Barrick was in Indonesia's national interest. "I want that our people get at least 10 percent. It's only a recommendation," he said. As he stormed out of the committee room, Sudjana told a *Reuters* reporter that Bre-X's COW application was to be nullified. "We cancel it. The Bre-X contract of work will be processed from the beginning."⁵⁶

Bre-X seemed resigned to the fact that they had no alternative to the government's plan. As originally requested, both companies submitted proposals to Sudjana on how they could work together. Barrick would get 67.5 percent of the operation, Bre-X 22.5 percent and the Indonesian government 10 percent.⁵⁷

As news of the meeting spread back to Canada, it became clear that Bre-X had been completely outmaneuvered. Walsh was portrayed in the Canadian press as a country bumpkin and Munk was glorified as the consummate boardroom warrior. Bre-X stock dropped 25 percent. While word in Toronto was that Barrick had it in the bag, many of Bre-X's 13,000 investors got busy forming alliances, consulting lawyers, fighting back. Greg Chorny, a retired lawyer from Aurora, Ontario organized a rights committee to stop the Barrick/Bre-X deal. His group, which he said held 5 percent of Bre-X stock, demanded that Indonesia allow Bre-X to choose its own partner, and hired lawyers in Canada, the US, and Jakarta.⁵⁸ Another group, furious over the way they felt Barrick was trying to claim-jump, met with Freeport-McMoRan Copper & Gold Inc.'s CEO, James R. (Jim Bob) Moffett, and urged him to use his political muscle in Indonesia and get involved in the project.⁵⁹

Freeport and Moffett had a long history in Indonesia. The first major foreign investment in under Suharto's New Order had been Freeport's 1967 mining operation on the remote island of Irian Jaya. Freeport spent over \$3 billion over a 20-year period developing almost all the infrastructure and major commercial projects on the island. It even ran its own airline to connect the population with the other main islands in the archipelago. But more importantly, it was the largest corporate taxpayer in Indonesia.

54 *Canadian Business*, March 1997. Sudjana reportedly told the committee that if certain construction contracts had been torn up and handed to others, it was because of his desire to have them "spread among the younger generation." He claimed that he didn't know that his son, Dharma Yoga, had won contracts to build electricity transmission lines and supply meter boxes. Such contracts that came from the department of mines and energy.

55 *Business Week*, March 3, 1997.

56 *Canadian Business*, March 1997.

57 *Far East Economic Review*, February 19, 1996.

58 *Canadian Business*, March 1997.

59 *Far East Economic Review*, February 27, 1997.

PT Freeport Indonesia, the Indonesian subsidiary of the New Orleans-based company, owned the largest gold reserve of any mine in the world at its Grasberg open-pit operation⁶⁰ in Irian Jaya. Its investment was secured with a government backed lease guaranteeing production rights until 2041.⁶¹ The company was one of Suharto's favorite foreign operators, and its relationship with the government was viewed by many in Indonesia as a text book example, not only of the way foreign investors could thrive, but of the future conditions under which companies would be allowed to operate.⁶²

The Turning Point

The fight for control over the mine was becoming public affair with factions aligned to Suharto's eldest son and daughter openly bickering through the media, threatening to derail the entire venture even before it ever got started. Suharto, acutely aware of an impending succession battle after his death, worried that such squabbles could dangerously weaken the clan just when its rivals would be maneuvering for power. He turned for advice to his old friend, Mohamad (Bob) Hasan, with whom he played golf twice a week. Something had to be worked out.

At age 65, Hasan was worth over \$1 billion.⁶³ Like many Asian tycoons, he had an extremely wide ranging business empire encompassing financial services and trading. His main business was timber—the Kalimantan Group controlled over 7,700 square miles of prime concessions in Kalimantan, on Borneo Island. Hasan's friendship with the president stretched back over 50 years, to the days when the latter was a junior army officer in central Java, and Hasan was a major supplier of provisions. It was through Hasan that the future president got to know senior officers in Jakarta. When Suharto took power in 1966, he repaid his debt to Hasan through a

⁶⁰ Craig Saperito, Freeport-McMoRan Investor Relations Department, interview with author, April 1997. As of December 31, 1996, the Grasberg mine was producing 1.7 million ounces of gold a year as a by product of its copper mining operation. Total recoverable gold reserves were estimated at 55.3 million ounces.

⁶¹ *Institutional Investor*, August 1995. In March 1996, Freeport-McMoRan sold 10.4 percent of its equity to Britain's RTZ, the world's biggest mining company, and a 40 percent stake in its future development of mines in Indonesia for \$1.3 billion.

⁶² *Ibid.* In December 1991, when Freeport's lease for its Irian Jaya mine was up for renewal, the Indonesian government stipulated that in return for the concession, the US firm was responsible for the construction and operation of a \$550 million state-of-the-art copper smelting plant at Gresik on Java before the year 2,000 so that the country could meet the metal needs of its growing industry and substantially cut back on foreign exchange outflows by reducing its imports. In a 70-10-20 percent joint venture with Mitsubishi Materials Corp. of Japan and Fluor Daniel of the US, Freeport had nearly completed building the plant by February 1997 which was due to be operational by mid-1998. Financing the project were a consortium of international lenders arranged by Freeport, the majority of whom were US banks. PT Freeport Indonesia had kept a very low profile in Indonesia since the spring of 1996 when four indigenous people died in a riot which occurred during protest demonstration at its mine. The incident touched off a wave of international environmental criticism that Freeport dumped millions of tons of mine tailings from its open-pit copper mine operation into rivers on Irian Jaya, completely distorting the ecological balance of one of the world's largest natural rain forests.

⁶³ *The Economist*, March 29, 1997. Like many of Asia's billionaires, Hasan is of Chinese descent. But he enjoyed an unusual advantage over his peers in Indonesia because he became a converted Muslim in the early 1950s.

myriad of government concessions.⁶⁴ Since the death of Suharto's wife in April 1996, Hasan became Suharto's closest confidant and was often asked by the aging patriarch to mediate arguments among his six children.⁶⁵

On December 1, at one of his regular meetings with Suharto at the president's cattle ranch outside of Jakarta, Hasan brought along Freeport's CEO, Jim Bob Moffett.⁶⁶ A larger-than-life personality who flew around the world in his private Boeing 757 jet, Moffett cautioned Suharto that Sudjana's proposed deal for Bre-X would effectively kill foreign investors' confidence in Indonesia. Hasan was more blunt. Even though he was aware of the minister's military connections, he reportedly told Suharto that Sudjana had deceived him in order to get the president's approval for the November edict.⁶⁷ In addition, publicity surrounding the pay-off scandal had made him an embarrassment to the government. Instead of coming to his minister's defense, Suharto said nothing.⁶⁸ Suharto wanted a way out of the stalemate that wouldn't embarrass the government. Realizing the process couldn't be reversed, Moffett reportedly suggested that it be allowed to play itself out while ensuring that enough conditions were in place to prevent a deal from happening.⁶⁹

Using an investment company he controlled called Nusantara Ampera Bakti (Nusamba),⁷⁰ Hasan quietly bought controlling interest of an Indonesian firm that had a 9.4 percent stake in Freeport-McMoRan's \$3 billion operation in Irian Jaya in January.⁷¹ He then made himself a principal player in the Busang venture by buying a 50 percent stake in PT Askatindo, Bre-X's minority Indonesian partner in the Southeast Zone.

64 Ibid. For example, Hasan's Kalimantan Group dominates the 'downstream' part of the timber industry through a string of saw-milling and plywood operations. At the same time, he heads the Indonesian Wood-Panel Exporters Association (Apkindo), a government-sanctioned cartel that regulates the country's \$3.7 billion worth of plywood exports.

65 *Business Week*, February 17, 1997. In October 1996, Hasan intervened in a squabble between Suharto's sons Hutomo Mandala Putra (Tommy) and Bambang Trihatmodjo who were fighting for control of a national program to make cars. Hasan used Nusamba to invest millions of dollars in a production facility both sons agreed to use.

66 Paul Murphy, director of PT Indonesia, interview with author, May 1995. Moffett knew Suharto well. The two had directly negotiated the copper-smelting plant deal in December 1991.

67 *Far East Economic Review*, December 19, 1996.

68 *Canadian Business*, March 1997.

69 *Far East Economic Review*, February 27, 1997.

70 *Business Week*, February 17, 1997. Through Nusamba, Hasan controlled 140 companies with assets valued conservatively at \$5 billion. Some 80 percent of Nusamba was owned by three charitable foundations controlled personally by Suharto. The remaining 20 percent was equally divided by Hasan and Suharto's eldest son, Sigit.

71 *Business Week*, December 17, 1997. Analysts speculate that political pressure to sell was applied to Indonesian tycoon Aburizal Bakrie, who had fallen afoul of Suharto.

On January 14, Jusuf Merukh filed a \$1.5 billion lawsuit in Canada against Bre-X over the Busang title dispute.⁷² Six days later, on January 20, many of the on-site records relating to the mineral findings at Busang were apparently destroyed in a fire at the mine's base camp.⁷³

Through the end of January and early February, Suharto allowed Sudjana to remain the focal point of media attention and speculation as the minister blustered about yet another new deadline for a Barrick-Bre-X deal, with the threat of expropriation if a deal was not signed by February 15. A day later, after it was pointed out that such action would be illegal, Sudjana recanted by suggesting that there were "still possibilities for other companies, including North America's Placer Dome" to get involved.⁷⁴ Barrick was losing its grip on Busang.

In fact, three days before Sudjana's last deadline, Moffet met with Bre-X executives in an afternoon meeting to talk over a possible joint venture. Later that night at the president's suburban Menteng residence, Suharto, Hasan, and Moffett sketched in the outlines of the deal. Freeport had two conditions: that it would not be embroiled in any ongoing ownership row, and that it would not take a majority stake—at least not in the near future.⁷⁵ Meanwhile, Felderhof claimed that the final estimates for the mine would exceed 200 million ounces of gold. At a trading price of \$350 an ounce, the lode would have a value of \$70 billion.⁷⁶

The wheeling and dealing in Jakarta came to an end on the morning of February 17, 1997. Suharto summoned Sudjana to the presidential palace and informed him of the new plan. By noon, the Department of Mines had announced that a new consortium, Indonesian Busang Gold JV, had been formed and approved by the government.

Hasan, through PT Askatindo and another Indonesian company his investment firm Nusamba controlled, would hold a 30 percent stake. The Indonesian government would get 10 percent. Freeport-McMoRan was given 15 percent, and would be the sole operator of the mine after verifying the gold estimates with its own sampling. The US mining company also agreed with the Indonesian government to spend \$400 million of its own cash to construct the mine, along with another \$1.2 billion which it promised to raise through major financial institutions.⁷⁷ Freeport's equity payment reflected a Bre-X share price of only \$16.⁷⁸

⁷² *Reuters*, May 5, 1997.

⁷³ *Far East Economic Review*, April 10, 1997. De Guzman was the leader of a closely knit team of eight Filipino metallurgists and geologists, who spent almost all of their time on the Busang site and were entrusted with the day-to-day operations of Bre-X's 350-person local work force. Like de Guzman, most of the Filipinos had started out together at the Benguet and Philex mining companies in the Philippines.

⁷⁴ *Canadian Business*, March 1997.

⁷⁵ *Far East Economic Review*, February 27, 1997.

⁷⁶ *The New York Times*, March 31, 1997 and *Reuters*, May 5, 1997 noted the evolution of Bre-X gold estimations: October 1995, 10 million ounces; July 1996, 46.92 million ounces; December 1996, 57.33 million ounces; February 1996, 70.95 million ounces.

⁷⁷ *Reuters*, May 5, 1997. Freeport stipulated that it would not turnover any money to Bre-X until a full due diligence survey of the property was carried out.

⁷⁸ *Far East Economic Review*, February 27, 1997.

Bre-X ended up with 45 percent of Busang. That was only half its previous stake in the deposit, and investors reacted with alarm. Bre-X shares fell 14 percent the next day as analysts debated exactly how much 45 percent of the new partnership would be worth, as under the terms of the deal, the Indonesians would not put up any money for their stake.⁷⁹

Through Nasumba, the Suharto family's stake was conveniently assured. In addition, Sigit would continue to earn his million dollar a month "consulting" fee from Bre-X, while Tutut's construction companies were expected to end up with the multimillion dollar contract to clear the jungle roads and help Freeport develop the Busang site.

⁷⁹ *Business Week*, March 3, 1997. Analysts were also worried that because the mine operator would be a minority share holder, it would deter other major firms, which were perhaps more cash rich, from pursuing a piece of the action.





BRE-X: The Battle for Busang (B)

Less than a month after Indonesia Busang Gold JV was set up, Freeport began its due diligence of the Bre-X operation. From the start, Freeport found something amiss. Holes that Bre-X indicated were chock-full of gold were coming up almost empty. In some samples, Bre-X reported finding four or five grams a ton. Freeport found only 0.01 gram. In addition, the US firm found "visual differences" between the bits of gold evident in their findings and the samples that Bre-X reported. The discrepancy suggested that gold had been slipped into Bre-X's samples, a process used to exaggerate results called "salting."¹

Freeport's Vice President of Exploration David Potter was utterly bewildered. Bre-X had collected core samples totaling over a 100 miles of the earth's core and the sheer logistics of tampering with such an extensive range of material was seemingly impossible. Potter sent for the one man who could offer some explanation, Bre-X's Chief Geologist Michael de Guzman.

De Guzman flew out to the mine on March 19. But 17 minutes after the helicopter took off, the pilot reported that he felt a sudden gust of wind. He looked back to the passenger section and saw an open door. The Filipino had fallen out 800 feet to his death. It took four days to find his body in the dense jungle swamp. In Jakarta, Indonesian police produced a suicide note that mentioned an incurable illness.²

When rumors first emerged in the Indonesian newspapers linking de Guzman's alleged suicide with talk of Freeport's disappointing drilling results, Bre-X shares lost \$583 million in value before staging a modest recovery. Walsh insisted that someone was trying to destroy the company. "I personally believe that there's been a hidden agenda coming up for 10 months now."

¹ *New York Times*, March 31, 1997.

² *Ibid.* De Guzman was known to have had malaria 14 times since 1986 and there were reports that he had liver damage resulting from hepatitis B. De Guzman's brother contended that an autopsy by the police forensic lab would show that the geologist did not commit suicide. The results of that investigation were never released.

This case was written by Samuel Passow, research associate at the Center for Business and Government for Michael D. Watkins, associate professor of public policy at the John F. Kennedy School of Government, Harvard University. (0697)

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Asserting that Bre-X would be vindicated, he said, "I guess we will just have to play this out."³ To Walsh, whoever was behind the effort to discredit Bre-X was ultimately trying to squeeze the company out of the picture and eliminate any claim to what was once considered to be a vast gold deposit.

But back in North America, the combination of de Guzman's death and the official release of Freeport's preliminary findings indicating "insignificant amounts of gold" caused panic on the stock exchanges in Canada and the United States. For the first time Bre-X officials admitted that some of their test samples from the Busang site could have been overstated.⁴ Trading of Bre-X shares on the Canadian bourse was halted for a day. When it resumed on March 27, 7 million shares changed hands in 15 minutes. The share price plunged almost 80 percent from \$7.85 to \$1.36 before being suspended again. Bre-X had lost nearly \$2.1 billion in value.

For the Canadian financial markets, the collapse of Bre-X had far reaching implications. The speculative stock had been included in the all-important Toronto Stock Exchange Index—the TSE 300. Like the Dow Jones index on Wall Street, the TSE-300 was frequently used by investors as an indicator to minimize risk.⁵ The Ontario Securities Commission, which oversaw the Toronto Stock Exchange launched an investigation into Bre-X's disclosure records and the possibility of over \$60 million worth of insider trading by Walsh and the company's management. A similar examination was begun in New York where the mining company's shares were traded on the Nasdaq.⁶

With its stock rapidly becoming worthless, Walsh was determined to show the markets that the investment was basically sound. As Freeport had only drilled seven holes in a few weeks against over 260 that Bre-X sunk over several years, Walsh convinced regulators to allow him to hire an independent minerals testing company, Toronto-based Strathcona Minerals Services, to drill new core samples and explain the conflicting results.

On April 5, President Suharto fired Kuntoro Mangkusubroto, the director-general of the Indonesian Department of Mines. He was replaced by Ajat Sudradjat, the former director-general of geology and mining. Mining Minister Sudjana described the change as "routine."⁷ On April 29, just days before the Stathcona report was due, an Indonesian newspaper, *Harian Ekonomi Neraca*, quoted unnamed sources who said: "If not mistaken, it (the audit) only states that

³ Ibid.

⁴ *Reuters*, March 26, 1997.

⁵ Craig Hurl, manager of Index Operations for the Toronto Stock Exchange, interview with author, May 8, 1997. Bre-X was listed on the TSE-300 index on December 16, 1996. It was one of 10 exploratory mining companies on the index. According to Hurl, the TSE is meant to be a "broad market indicator." The exchange chooses the 300 biggest stocks based on market capitalization and liquidity.

⁶ *Wall Street Journal*, May 7, 1997. Nasdaq's management was looking into de-listing Bre-X.

⁷ *Boston Globe*, April 8, 1997.

Busang contained gold grades whose prospects were cheerful." Neraca also reported that Canada's Place Dome would replace Freeport if the US mining giant pulled out of the project.⁸

Nervous investors continued to trade Bre-X shares right up until the weekend that the Strathcona report was due. On Friday May 2, the stock closed on the Toronto Stock Exchange at \$2.34, up 0.14 cents on the previous day.⁹

Meanwhile, scientists at Strathcona had completed a closely supervised six-hole core drilling program totaling 4,851 feet. In all, 175 core samples from 1,155 feet of core were assayed. More than 11 tonnes of ore from the Busang property were flown under tight security to labs in Australia for testing.¹⁰ During its audit, Strathcona also examined a feasibility review by Kilborn SNC-Lavalin Inc. and a metallurgical study performed by Austalia's Normet Pty., Ltd. Both studies were commissioned by Bre-X.

On May 3, the auditors wrote to Walsh. They concluded "that an economic gold deposit has not been identified in the Southeast Zone of the Busang property, and it is unlikely to be." Not only did the report dash any hope of Bre-X's recovering its fortune, it outright accused the company's management of fraud. "The magnitude of the tampering with core samples that we believe has occurred and resulting falsification of assay values at Busang,¹¹ is of a scale and over a period of time and with a precision that, to our knowledge, is without precedent in the history of mining in the world."¹² (For complete letter see Exhibit 1.)

The Strathcona report noted that the gold particles found in the Bre-X samples were not consistent with Busang's geology. It confirmed that Normet had previously reported back to Bre-X, that 90 percent of their samples were consistent with alluvial, or river, gold. Busang was considered a bedrock deposit. The auditors also suggested that very precise additions of "foreign gold" were added to the Bre-X samples at a secret laboratory in or near the Borneo city of Samarinda before they were sent to Indo Assay Laboratories in Balikpapan for independent analysis.

Within hours of the released 150-page findings, both Freeport McMoRan and the Nusamba Group, neither of whom had paid any money to Bre-X, withdrew from the joint venture. For his part, Walsh said in a statement from Bre-X's headquarters in Calgary, Alberta: "We share the shock and dismay of our shareholders and others that the gold we thought we

⁸ *Reuters*, April 29, 1997.

⁹ *Ibid.*, May 2, 1997.

¹⁰ *Ibid.*, April 15, 1997.

¹¹ *Financial Times*, May 7, 1997 and *Reuters*, May 6, 1997.

¹² *Dow Jones News Service*, May 4, 1997.

had at Busang appears not to be there." He vowed that investigators would "get to the bottom" of the scandal.¹³

John Felderhof issued a fax statement from his beach front home¹⁴ in the Grand Cayman Islands saying: "I know that I was not involved in a fraud. Based on all of my work,¹⁵ and my 35 years experience as a geologist, I personally still believe that there are significant amounts of gold at Busang."¹⁶ The eight other geologists who worked with him and de Guzman flew back to the Philippines.

The Toronto Stock Exchange suspended trading of Bre-X shares on Monday, May 5, to allow the market time to absorb the news. The next day, more than 58 million shares changed hands—an exchange record for a single stock.¹⁷ By the end of trading, a share of Bre-X was worth .06 cents.¹⁸ There were 219 million outstanding shares.¹⁹

In Indonesia, the state-owned mining company, PT Aneka Tambang, took control of operations at Busang.²⁰ "After all, it is our property," said Sudjana.²¹ The minister announced that the government would take legal action if its laws had been violated in the Busang affair. But he noted, that before any action was taken, it would be discussed with President Suharto.²² The Department of Mines went ahead and issued 65 mining contracts for the exploration of metals ranging from gold to copper to nickel. Most of the exploration firms were small Canadian firms who were riding the wave of interest created by Bre-X. At the same time, the department issued a regulation requiring all new mining ventures to set aside 10 percent of their stake for the government. "Ten percent isn't too much to give," said Sudjana.²³

The day after the Bre-X joint venture consortium folded, the US firm, Newmont Mining, which was about to proceed with the \$1.9 billion construction of its Batu Hijau gold deposit on

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- 13 *Reuters*, May 5, 1997 and *Financial Times*, May 6, 1997 reported that Bre-X had engaged accountants Price Waterhouse and Forensic Investigative Services to work with Strathcona to determine how "the data on which Bre-X relied in its prior public statements about Busang could have been generated."
- 14 *Reuters*, May 7, 1997. Felderhof and his wife arrived in the Grand Cayman Islands from Canada on April 22 and applied for permanent residency. Cayman law granted such status to investors who spent more than \$250,000 on real estate or property there. Permanent residency would give the Felderhof's some protection against any criminal cases or civil lawsuits in North America. They could not be deported from this British colony without an extradition hearing.
- 15 *International Herald Tribune*, May 23, 1997. Felderhof agreed to return the "Prospector of the Year" award given to him by the Prospectors and Developers Association of Canada.
- 16 *Ibid.*
- 17 *Wall Street Journal*, May 7, 1997.
- 18 *International Herald Tribune*, May 7, 1997.
- 19 *New York Times*, March 31, 1997.
- 20 *Financial Times*, May 7, 1997. The Indonesian government banned Bre-X and affiliated companies from the country. The license awarded in 1995 was canceled.
- 21 *International Herald Tribune*, May 8, 1997.
- 22 *Financial Times*, May 6, 1997.
- 23 *Bloomberg News*, May 6, 1997.

the eastern Indonesian island of Sumbawa,²⁴ refused to comply with the new regulation. They were not impressed that President Suharto's eldest daughter, Siti (Tutut) Hardiyanti Rukmana, had expressed interest in a stake as well. Newmont had a 45 percent share of the Batu Haijau mine, Sumitomo Corp. of Japan held 35 percent, and the other 20 percent belonged to PT Pukuafu Indah, which was controlled by the Indonesian executive, Jusuf Merukh.²⁵ The company's contract of work was withheld by Suharto.²⁶

Barrick's chairman, Peter Munk, who lost in his bid to take over Walsh's company said the saga had tarnished the reputations of both Canada and Indonesia among foreign investors. "This Busang affair. The Bre-X affair. Now more a soap opera belonging to the movies than to the boardrooms, has created an awful lot of backlash."²⁷

The controversy generated political fallout for the government of Canadian Prime Minister Jean Chretien, who was seeking reelection. The opposition Reform Party leader, Preston Manning, demanded a judicial inquiry. "It is not only the fraud aspect that is worrisome, but it does damage to the capacity of the resource industry and the mining industry to raise capital," he said.²⁸

Seven class action law suits were filed by Bre-X shareholders—six in the United States and one in Canada²⁹—in the hope of recouping \$4 billion to \$5 billion, Bre-X's market value during its peak in the middle of 1996. Two of the class action suits named Kilborn, the Canadian firm which calculated Busang's resources based on the samples provided by Bre-X. Questions were raised about the role of J.P. Morgan, Bre-X's financial advisors, and Peat Marwick, the company's accountants, but neither had been named in lawsuits. The sheer size of the damages being sought ranked the Busang affair among the biggest financial scandals in recent history.³⁰

24 *Financial Times*, May 9, 1997. With an estimated 14.7 million ounces of gold, this would be the second largest gold mine in Indonesia after the Freeport Irian Jaya mine. Newmont had already invested \$140 million at the mine site. According to a clause in the contract of work Newmont signed with the government in 1986, the company was required to divest a percentage of the project only between the sixth and eleventh years of production.

25 *International Herald Tribune*, May 8, 1997.

26 *Financial Times*, May 6, 1997.

27 *Reuters*, May 1, 1997 and *Business Week*, May 19, 1997 noted that on April 25, Munk raised \$500 million in 10-year bonds and boosted his war chest to nearly \$2 billion. Barrick was now on the prowl for companies with rich gold deposits whose stock had been depressed by Bre-X.

28 *Reuters*, May 6, 1997 and *Business Week*, May 19, 1997 noted that following the Bre-X collapse, the Toronto Stock Exchange's bellwether Gold & Precious Metals Index was down 35 percent from its 1996 high. Exploration stocks were hit even harder.

29 Harvey Faucher and Rhonda Noyce, interview with author, St. Paul, Alberta, May 8, 1997. Faucher noted that "while some investors stayed with the stock until the very end, there were a lot of people in town who cashed out for a profit during the last year either as it reached its high or after the stock split." According to Rhonda Noyce, editor of the *St. Paul Journal*, there had been advertisements from law firms seeking investors to join a class action suit, but there were no reports of anyone in the town participating in them.

30 *Financial Times*, May 6, 1997.

Exhibit 1

Strathcona Mineral Services Limited
12th Floor, 20 Toronto Street
Toronto, Ontario, Canada M5C 2I38

May 3, 1997

CONFIDENTIAL
Mr. David Walsh
President and Chief Executive Officer
Bre-X Minerals Ltd.
114 Street NW
Calgary, AB T2N 1Z6

Busang Technical Audit - Interim Report

Dear Mr. Walsh:

Enclosed is our report covering that portion of the technical audit of work on the Busang property that we have completed to date including the very conclusive assay results from 175 core samples. We very much regret having to express the firm opinion that an economic gold deposit has not been identified in the Southeast Zone of the Busang property, and is unlikely to be.

We realize that the conclusions reached in this interim report will be ~ great disappointment to the many investors, employees, suppliers and the joint-venture partners associated with Bre-X, to the Government of Indonesia, and to the mining industry everywhere. However, the magnitude of the tampering with core samples that we believe has occurred and resulting falsification of assay values at Busang, is of a scale and over a period of time and with a precision that, to our knowledge, is without precedent in the history of mining anywhere in the world.

Yours sincerely,

G. Farquharson

Exhibit 1 (cont.)*Summary*

The Busang property in the Province of Kalimantan in Indonesia has been under exploration by Bre-X Minerals Ltd. (Bre-X) with core drilling results since *mid-1995* on the Southeast Zone of the property giving rise to expectations that the Busang property could host one of the largest single gold deposits ever discovered. In February 1997, Freeport McMoRan Copper & Gold Inc. (Freeport) commenced a due diligence program prior to becoming a participant in the further development of the Busang property. The Freeport program included core drilling and in mid-March, Freeport advised Bre-X that gold values comparable to those from the Bre-X drilling were not being realized.

As a consequence, Strathcona Mineral Services Limited (Strathcona) was engaged by Bre-X to carry out a technical audit of the work done by both Bre-X and Freeport. As part of that technical audit, we have completed a closely supervised six-hole core drilling program with 1470 meters drilled. Because of the intense interest in the Busang property and the consequences for many parties arising from any conclusions reached in our audit, we have made the decision to select an initial 350 meters of core for assaying that would allow us to issue an interim report on our findings, rather than wait for several more weeks before all core has been assayed and all investigations completed.

The 350 meters of core and the resulting 175 samples were selected so as to provide the best chance of confirming the presence of gold as indicated by the Bre-X core samples. The sample treatment procedures and assaying were carried out at laboratories in Australia, Indonesia and Canada, with all results received just prior to our issuing this interim report. The assay results have been quite conclusive, and along with work done by Freeport, results from recent drill core samples submitted by Bre-X, and other investigations and observations we have made, we are able to express without reservation the following opinions and conclusions concerning the main area of interest on the Busang property, the Southeast Zone I South, and to which we anticipate no changes in our final report when all the drill core from our audit program will have been assayed.

1. Only trace amounts of gold have been found in the samples assayed, and there were no samples that gave gold values of economic interest.
2. As a consequence, we believe there to be virtually no possibility of an economic gold deposit in the Southeast Zone I South of the Busang property.
3. The assaying of the samples from the Busang property submitted by Bre-X to Indo Assay Laboratories in Balikpapan, Indonesia has been of a good standard, and the gold values reported have reflected the gold in the samples delivered to the laboratory.

4. The due diligence program conducted by Freeport has been very thorough and of a high professional standard in all respects.
5. The gold recovered in samples submitted by Bre-X has originated from a source other than the Southeast Zone of the Busang property and has resulted in falsification and misrepresentation of many thousands of samples with consequent and subsequent erroneous estimates of gold resources.

We therefore make the following recommendations to the Board of Directors and management of Bre-X Minerals:

1. Those authorized and qualified to carry out investigations into the fraudulent activities that we believe to have occurred should be contacted immediately and requested to pursue the matters that we are bringing to the attention of Bre-X and any other parties concerned. We are ready to assist in whatever manner we can in carrying out these investigations.
2. All core and samples that have not yet been assayed and all documentation pertaining to the Busang property should be placed under tight security until the investigations recommended are completed.
3. All exploration work on the Southeast Zone at the Busang property should cease immediately.

Unless we receive further instructions to the contrary, we shall continue with the completion of our audit program although we do not feel it necessary that assaying of the remaining core samples be carried out at all three laboratories.

Source: Press release from Bre-X Minerals Ltd., Calgary, Canada.