OPTIMUM
COAL
MINE

WITHOUT PREJUDICE

SUBJECT TO CONTRACT

CONFIDENTIAL

Eskom Holdings SOC Limited
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Cliffe Dekker Hofmeyer
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17 September 2015

Dear Sirs

OPTIMUM COAL MINE (PTY) LTD (IN BUSINESS RESCUE) : SETTLEMENT PROPOSAL

We refer to our recent discussions regarding a resolution of the current disputes between Optimum Coal Mine (Pty) Ltd ("**OCM**") and Eskom SOC Limited ("**Eskom**") relating to the coal supply agreement between OCM and Eskom ("**CSA**"). As we have advised previously, Eskom is a key stakeholder in the business rescue proceedings of OCM and no rescue of OCM is possible unless there is a resolution of the outstanding disputes between OCM and Eskom including the hardship and penalty disputes. We do, however, appreciate Eskom's position that it has a binding agreement with OCM with certain accrued rights and that it cannot simply forego all of these rights in order to rescue OCM.

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Accordingly, we have, together with the management of OCM, sought to develop a proposal which meets Eskom's key requirements while at the same time ensures that OCM is able to emerge from business rescue as a sustainable long-term supplier to Eskom.

This proposal consists of three components:

- an extension of the CSA which is designed to secure a long-term source of supply for Eskom and allow for a price averaging which will provide some short-term relief for OCM until 2019;
- a reasonable settlement of the alleged penalties which Eskom believes it has accrued against OCM; and
- the implementation of a new black economic empowerment transaction to make OCM a majority black owned company.

1. Extension of the CSA

We trust that Eskom and its advisers have now had sufficient time to consider the substantial financial information that was delivered to Eskom's attorneys on the 1st and 2nd of September 2015 and that it is clear to Eskom that OCM is suffering severe financial hardship as a result of the Eskom contract. We fully appreciate that even if Eskom accepts that OCM is suffering financial hardship, this is not necessarily a justification for Eskom to agree to any amendments to the CSA as Eskom believes that it has a binding contract that it is entitled to enforce.

We do, however, believe that Eskom cannot ignore the fact that the contract has a hardship clause which provides in its opening clause that it was the parties' intention that the agreement shall operate between them with fairness and without undue hardship to any party. While we accept that some level of subsidy from OCM's export operations was contemplated in the CSA, it could never have been contemplated that OCM would suffer such an extreme level of hardship or that the agreement would result in OCM suffering billions of Rands of losses over the term of the agreement.

Accordingly, Eskom would be acting in accordance with the principles set out in the CSA if it agrees to an accommodation in favour of OCM in order to ensure that OCM can emerge from business rescue and remain a long-term sustainable supplier to Eskom. Obviously, any such accommodation should insofar as possible also be in Eskom's standalone interests. Accordingly, after discussions with management and the shareholders of OCM, we wish to make the following indivisible proposal to Eskom which we believe meets these requirements:

- the duration of the CSA will be extended until 2023 to match the remaining useful life of the Hendrina power station;
- the tonnage to be delivered during such extension will be 27.5 million tons (i.e. 5.5 million tonnes per annum);
- the price for the coal delivered during the extension will be R630 per ton at a CV of 23 Mj/kg (moisture free) (subject to agreed inflationary adjustments with effect from 1 October 2015). We believe that this price is consistent with what Eskom could expect to achieve in a standalone new negotiation with OCM for this quantity of coal at this quality in 2019;
- the price for the coal for the period from 1 October 2015 to 31 December 2018 will remain unchanged, however, in order to provide some relief to OCM during the period until 2019, the price for the remainder of the CSA will be averaged out so that Eskom will pay a weighted average price of R443 per ton at a CV of 23 Mj/kg (moisture free) (subject to agreed inflationary adjustments with effect from 1 October 2015) for the

remainder of the CSA from 1 October 2015 to 31 December 2023. This average has been calculated on R156 per ton for the remaining 3.25 years (i.e. 17 875 000 tons) and then R630 for the next 5 years (i.e. 27 500 000 tons). The weighted average price of R443 per ton would still be less than OCM's average cash cost of production over the remainder of the extended CSA; and

- the specifications and price adjustment regime for the remaining coal to be delivered under the CSA will be amended to be consistent with the penalties and price adjustment regime agreed during the previous settlement discussions between OCM, the Eskom negotiating team and the Hendrina power station. These are set out in Annexure A for your ease of reference.

2. Penalties

Eskom has instituted claims against OCM for alleged non-compliance with the specifications set out in the CSA (and the addenda thereto), in amounts aggregating to approximately R2.2 billion. As you are aware, OCM disputes this amount and we believe that there is no reasonable basis to justify a penalty of this amount having regard to the history and background circumstances surrounding the imposition of penalties arising out of the CSA and that Eskom has no reasonable prospect of recovering this amount in an arbitration (this is separate from the issue as to whether OCM would, in fact, be able to settle such penalties if an award was made against it). In this regard, we note the following:

- the CSA includes a renegotiation clause in terms of which if at any time either party is of the view that the specifications in the CSA are no longer properly and/or realistically representative of the coal which OCM could reasonably expect to produce from its resource, it could request a renegotiation of the specification following which the parties would be required to enter into discussions and negotiations in good faith regarding the amended specification;
- in April 2013, OCM advised Eskom that the mine could no longer produce coal meeting the specifications and triggered the renegotiation clause;
- following the service of such notice, OCM and Eskom engaged in a process whereby OCM sought to demonstrate to Eskom that it was unable to meet the specification. This process endured until January 2014 during which time OCM provided significant information to Eskom regarding the difficulties it was having. Eskom has never disputed the technical reasoning put forward by OCM as to why it cannot meet the sizing specification. Eskom explicitly refrained from imposing any penalties regarding sizing during these negotiations in recognition of the fact that OCM had triggered the renegotiation clause;
- this renegotiation process was eventually subsumed into the broader settlement discussions which culminated in the signing of the Co-Operation Agreement in May 2014 which suspended all penalties. During the settlement discussions, there were extensive negotiations on the specifications with primary energy and the Hendrina power station and ultimately a specification was agreed in relation to sizing which matches that which OCM delivered during the period from 2012 to 2015. If this is a specification that the power station was capable of accepting, then clearly the delivery of coal meeting that sizing specification during most of 2012 to 2015 could not have caused any meaningful damage to the power station;
- if the Co-Operation Agreement had not been signed, and Eskom had not agreed to amend the specification, it is very likely that the dispute regarding the sizing specification would have, at that time, been referred to arbitration for dispute

resolution. If that had happened, Eskom would not have been able to impose the historical penalties for sizing;

- if the sizing penalty is excluded, then the sole basis for imposing a penalty would be in relation to ash and CV. As the Eskom negotiating team is aware, there is significant disagreement between Eskom and OCM regarding the imposition of the ash and CV penalties and the wording of the agreement does not support the penalties imposed by Eskom; and
- the factors set out above would present compelling defences in relation to any claim for penalties together with other defences such as the Conventional Penalties Act, waiver, estoppel etc.

In summary, we do not believe that any penalty is justifiable, but as part of an overall settlement, OCM would be willing, on a without prejudice basis, to pay a reasonable amount in full and final settlement of all penalties and/or damages alleged to be owing by OCM and/or its affiliated entities under or in connection with the CSA as at the date of signature of the amended CSA (including any alleged damages arising during the business rescue proceedings). We propose that once we have agreement on the balance of the proposal set out in this letter, we have a discussion regarding an appropriate settlement figure. As part of this discussion, we would also like to discuss the amounts withheld by Eskom for coal delivered during July and August 2015.

Obviously, OCM will not be in a position to settle any agreed settlement amount in cash, and therefore we would like to propose two options to Eskom as a method of settling such settlement amount.

- **Issue of equity**

  The first option is that Eskom be issued an equity stake in OCM in order to settle the agreed settlement amount. The exact percentage will need to be discussed and agreed after agreement on the settlement amount. We believe that this would be a reasonable solution for Eskom in that it provides significant upside if export prices rally and it recognises that requiring OCM to settle the penalties in cash will impair OCM's ability to become a sustainable supplier to Eskom.

  We understand that Eskom has expressed a reluctance to hold equity interests in mines, but Eskom would in due course be able to dispose of such stake or it could nominate a third party to acquire such shares, subject to OCM's agreement.

- **Reduction of price**

  The second option is that Eskom be afforded a reduction in price on the coal purchased for the remainder of the term of the CSA in order to settle such penalties. This reduced price would obviously provide more certainty to Eskom but would not allow Eskom to participate in any upside in OCM.

3. Black Economic Empowerment transaction

The indirect major shareholders of OCM, Pembani Group Pty Ltd (which merged with Shanduka Resources Pty Ltd) ("Pembani") and Glencore Plc, have agreed a new BEE transaction in order to increase the black ownership of OCM to above 50% in line with Eskom's stated policy of sourcing coal from majority black-owned suppliers.

We note that as Pembani will be increasing its existing stake in OCM, they have requested to be directly involved in the negotiations of the proposal. They therefore have requested to participate in all future meetings in relation to this proposal.

Conclusion

We believe that this proposal represents a compelling offer for Eskom which allows Eskom to:

- secure a long-term sustainable supply of high quality coal for the remainder of the useful life of the Hendrina power station from a majority black supplier;
- ensure that Eskom continues to obtain the benefit of its existing low price CSA by using such price to reduce the price payable for the coal for the post 2018 period; and
- be compensated at a fair level for the penalties which it believes it has accrued.

This proposal will obviously also ensure the long-term sustainability of the OCM business and prevent the negative consequences that would arise for all stakeholders from a liquidation of OCM.

As you will appreciate, we have significant time constraints during the business rescue proceedings and if we are to finalise this proposal before the deadline for the publication of the business rescue plan (i.e. 30 October 2015), we need to receive Eskom's feedback as soon as possible. Accordingly, we request that Eskom respond to this proposal by Friday, 25 September 2015. If Eskom is willing to accept this proposal, we and the management of OCM are prepared to dedicate all necessary resources to ensure that the proposal is implemented as soon as possible.

Please contact us if you have any queries.

We look forward to hearing from you.

Yours faithfully

IP

Piers Marsden

Peter Van den Steen

Joint Business Rescue Practitioners for Optimum Coal Mine (Pty) Ltd (In Business Rescue)

Clinton Ephron

Chief Executive Officer

Optimum Coal Mine (Pty) Ltd (In Business Rescue)

Annexure A – Specifications and Price adjustments

Quality Parameter	Unit	Expected Quality Parameter	Quality Parameter Limit	Measurement basis	Measurement	Rejection and Penalties
Calorific Value	MJ/kg	23	<21.65	Moisture Free	Monthly Weighted Average	Adjustment through price (i.e. through the fact that the price is calculated based on the GJ delivered) and ultimate rejection for < 21.65 – no other adjustment
Ash	%	27.5	>31.5	Moisture Free	Monthly Weighted Average	Adjustment through price (i.e. through the fact that the price is calculated based on the GJ delivered) and ultimate rejection for > 31.5 – no other adjustment
Moisture	%	9%	>12%	As Received	Monthly weighted Average	There will be no adjustment or rejection but Eskom will have the right to request Optimum to stop supplies as per below
Abrasive Index (Eskom Mining House Method)	mgFe/kg	700	> 700	Moisture Free	Monthly weighted average	Penalty for > 700 as per below No rejection
Sulphur	%	1.5 %	> 1.6%	Moisture Free	None	Rejection No penalty
Volatiles	%	22.4%	< 20.5%	Moisture Free	None	Rejection No penalty
AFT (Initial deformation)	ºC	1,300≥	None	N / A	None	None
Sizing				N / A	Monthly weighted	Penalty for >20% - 0.81mm only as per

Quality Parameter	Unit	Expected Quality Parameter	Quality Parameter Limit	Measurement basis	Measurement	Rejection and Penalties
< 6mm <2.38mm <0.81mm	% % % %	≤ 55% ≤ 35% ≤20%	None None >20%		average	below No rejection

1 The Parties agree that in respect of AFT (initial deformation), the Expected Quality Parameter sets out the quality which OCM expects to deliver. However, if OCM does not meet the Expected Quality Parameter, there will be no rejection, penalty or adjustment and OCM shall not be liable for any claim and/or damage.

2 If a consignment of coal on a particular day is rejected due to the weighted daily average not meeting the CV, Ash, Sulphur or Volatiles Quality Parameter Limit, then -

2.1 Eskom shall not pay for such consignment of coal and such consignment of coal will not reduce the Total Contract Quantity; and

2.2 such consignment of coal shall not be included in the calculation of the monthly weighted average for Abrasive Index and Sizing (i.e. the relevant weighted average shall be calculated in respect of the coal delivered over the balance of the days in the relevant month).

3 In the event that monthly weighted average Abrasive Index level of coal delivered by OCM in a month is > 700 mgFe/4kg, OCM will be liable to pay a penalty to Eskom in respect of each ton of coal delivered during that month, calculated on the following basis:

> 700-800	R 4.92 per ton
> 800-850	R 6.15 per ton
> 850-900	R7.38 per ton
> 900	R11.07 per ton

4 In the event that the monthly weighted average size distribution of coal delivered by OCM in a month contains more than 20% of coal with a size of 0.81mm, OCM shall be liable to pay Eskom a penalty as follows:

$$A = B \times (C - 20\%) * D$$

where:

A = the sizing penalty to be calculated;

B = the total number of tons of coal delivered by OCM during the relevant month;

C = the weighted average percentage of coal delivered during the month with a sizing of less than 0.81mm;

D = 50% of the price per ton paid by Eskom for the coal delivered during the month.

5 OCM shall notify Eskom if the coal being delivered is above the Quality Parameter Limit for moisture and shall stop delivering such coal and request Eskom if they want OCM to continue delivering such coal which does not meet the Quality Parameter Limit in respect of moisture. Eskom shall then within one hour advise OCM whether it wishes to accept delivery of such coal. If Eskom elects to receive such coal, then, notwithstanding the moisture parameters of such coal being above the Quality Parameter Limit, the price of such coal shall be paid by Eskom and such coal shall be deemed delivered and reduce the total contract quantity.