

FAT MANAGEMENT FEES FOR NTT

The privatisation of Sri Lanka Telecom Ltd., by the Public Enterprise Reform Commission [PERC] had been hailed and trumpeted as the deal of the year last year. The media blitz was heralded by none other than the PERC Chairman, Dr. P.B. Jayasundera, himself. Notwithstanding the high profile policy by the Peoples' Alliance Government on the commitment to uphold public transparency and accountability in all its transactions, it had time and again been revealed, that PERC appears to be acting regardless of such high profile government policy, making a sheer mockery of such policy.

On the privatisation of Sri Lanka Telecom Ltd., PERC through its media blitz lulled the public of this country into believing that this was one of the best deals that it had concluded. At that time, PERC released to the media a brief note on the Shareholders' Agreement and the Management Agreement to espouse the position and make belief in the public mind, as to what a good deal, the privatisation of Sri Lanka Telecom Ltd. had been. PERC, however, at that time did not take the public into full confidence and make disclosure of all aspects and facets of this major privatisation transaction of a vital economic infrastructure and public utility facility of telecommunications.

As a consequence of the analytical exposures, the business and bureaucratic circles are agog with disbelief, as to how this major privatisation of a very valuable national asset had been held out to be one of the best deals? Ought not PERC Chairman, Dr. P.B. Jayasundera, an economist, himself, have considered several aspects that have been hitherto analytically exposed? Had he done so? If not, why? Had Deutsche Morgan Grenfell and Development Finance Corporation of Ceylon, who had prepared the Information Memorandum on Sri Lanka Telecom Ltd., advised on the evaluation and negotiations of the privatisation deal? If not, why?

EXPEDITIOUSLY PACKAGED ?

Tiruchelvam Associates of Kynsey Terrace, Colombo 8, had been the local lawyers to the purchaser, Nippon Telegraph and Telephone Corporation of Japan [NTT], as stipulated in the Share Purchase Agreement between the Government and NTT signed on August 5, 1997. Would it imply that Neelan Tiruchelvam, Member of Parliament, himself, had been associated and/or involved in the privatisation of Sri Lanka Telecom Ltd., looking after the interests of NTT? If so, as a Member of Parliament, would he also not be duty bound to have protected the interests of the public of this country? How does one reconcile such interests? Neelan Tiruchelvam is also known to be a close confidante of Justice & Constitutional Minister, G.L. Peiris, vis-a-vis, the controversial political package.

It was no doubt a shocking revelation to the public of this country, that the final bid proposals for the privatisation of Sri Lanka Telecom Ltd., had been received only on June 28, 1997 and that bid evaluation and all contractual commitments and agreements had been finalised and concluded by August 5, 1997 – that is approximately within a period of one month. The cogent question is posed, as to how many other countries in the world had concluded their telecommunications privatisation transactions, within a period of just one month? Why and how had such a major public utility privatisation transaction been carried out so hastily? Do not the analytical exposures reveal, that it would appear that several important aspects and facets of this major privatisation transaction of Sri Lanka Telecom Ltd., had not been given due and adequate consideration by PERC?

A probe and examination of the number of man hours, that had been put in by the various resource persons, who had been involved in the evaluation, negotiation of contractual commitments and conditions, and the finalisation of all relevant documentations, during such a short period of one month, would reveal the dedication, commitment and the seriousness of the efforts, that had gone into carrying out the privatisation of such a major and vital public utility, affecting the day to day life of the people of this country and a very valuable public property. Would not those who carried out this privatisation transaction of Sri Lanka Telecom Ltd., be responsible to be so accountable to the public of this country? It is even more so grave, when one considers the fact, that PERC is said to be a project funded by the World Bank? Would not the World Bank auditors, require the examination of the deployment of such man hours by the several resource persons, who had carried out such privatisation transaction? What would the answers be?

QUESTIONABLE ISSUES?

The analytical exposures have revealed that the privatisation deal concluded with NTT had been on the basis of governmental commitment to increase the local telecommunication revenues by a guaranteed annual minimum of 25%, 25%, 20%, 15%, 15% respectively, on an year on year basis, in relation to the immediately preceding year, for the respective years 1998, 1999, 2000, 2001, 2002, with no cap on limiting price increases in relation to the cost effectiveness of the telecommunication service and a reasonable rate of return on the capital employed, to protect the interests of the consumer public, in conformity with known and established international practice. On the contrary, such guaranteed annual minimum revenue increases, by Clause 18.6 of the Shareholders' Agreement between the Government, NTT and Sri Lanka Telecom Ltd. had been stipulated to be deemed, as if they were fully set out in the Licence, that is statutorily issued by the Telecommunications Regulatory Commission of Sri Lanka? How could this have been done?

Ought not such material and cardinal condition have been made known publicly, as a condition, that the government of Sri Lanka was agreeable to, prior to have having invited offers for the privatisation of Sri Lanka Telecom Ltd.? Would it then have not attracted very many others to bid for the privatisation of Sri Lanka Telecom Ltd., thereby enhancing the competition on a level playing field, to have obtained the best deal for the country? On the contrary, the Information Memorandum made available to pre-qualified bidders stipulated a condition of price control – "The method used for tariff control will continue to be that of 'price-cap' control. The operator will be expected to set tariff in accordance with a formula which incorporates previous price levels and current inflation". Why was such condition abandoned and a deal struck with NTT devoid of such cardinal condition?

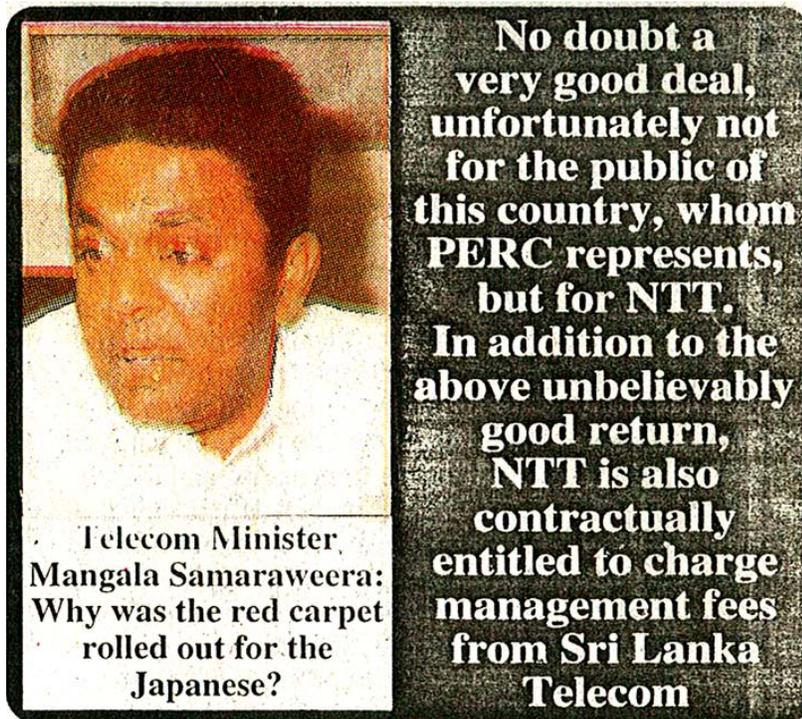
Such analytical exposures have also revealed that such guaranteed minimum annual local revenue increases in the context of the five year monopoly status afforded to Sri Lanka Telecom Ltd., in the privatisation deal with NTT, would have enhanced the valuation to have been placed on the shareholdings of Sri Lanka Telecom Ltd. The Government Chief Valuer in November 1996 had valued such shareholdings of Sri Lanka Telecom Ltd., on the basis of the net present value of its potential profit and cash-flow projections. After having received the proposal from NTT with such guaranteed minimum annual price escalation condition with a monopolistic status, ought not the Government Chief Valuer have been required to evaluate and determine the valuation of the shareholdings of Sri Lanka Telecom Ltd., on the basis of such condition, prior to having concluded such deal?

JUSTIFICATION OF VALUATION?

Could PERC Chairman, Dr. P.B. Jayasundera and/or Secretary Ministry of Telecommunications, K.C. Logeswaran, who had functioned as the Chairman of the Technical Evaluation Committee, that had evaluated the bids for the privatisation of Sri Lanka Telecom Ltd., enlighten the public of this country, as to whether such a valuation was obtained from the Government Chief Valuer? If not, why? And if such a valuation from the Government Chief Valuer had not been obtained, as to how it had been decided that the US \$ 225 Mn. that is SL Rs. 13,200 Mn. purchase consideration by NTT for a 35% shareholding of Sri Lanka Telecom Ltd., had been the correct value of the purchase consideration?

In the absence of such adjusted valuation by the Government Chief Valuer, the analytical exposures have revealed, that the valuation of the shareholdings of Sri Lanka Telecom Ltd., based on the favourable scenario that had been given previously by the Government Chief Valuer, adjusted for the guaranteed minimum annual local revenue increases would be Rs. 76,185 Mn., that is a valuation of Rs. 26,665 Mn. for the 35% shareholding of Sri Lanka Telecom Ltd. No doubt this is a valuation model, but nevertheless in the given circumstances, how did the Members of Technical Evaluation Committee, who evaluated the NTT bid for the sale of 35% shareholding of Sri Lanka Telecom Ltd. and the Members of PERC, who carried out such transaction, justify the purchase consideration of Rs. 13,200 Mn for a 35% shareholding of Sri Lanka Telecom Ltd., on the basis of such agreed condition to guaranteed minimum annual local revenue increases, that too, holding out to the public of this country that it was one of the best deals ?

WHAT A DEAL!!



No doubt a very good deal, unfortunately not for the public of this country, whom PERC represents, but for NTT. In addition to the above unbelievably good return, NTT is also contractually entitled to charge management fees from Sri Lanka Telecom

Telecom Minister,
Mangala Samaraweera:
Why was the red carpet
rolled out for the
Japanese?

Such discounted net present value of the potential profit and cash-flow projections, adjusting the very same model that had been formulated by the Government Chief Valuer, only by the guaranteed minimum annual local revenue increases, indicates such valuation of Rs. 26,665 Mn., for a 35% shareholding of Sri Lanka Telecom Ltd., that too discounted at 18% p.a. Would this not mean that after earning a return of 18% p.a. over the projected 5 year period, the return of capital of such 35% shareholding of Sri Lanka Telecom Ltd., would be Rs. 26,665 Mn., which in effect would mean that the purchase consideration of Rs. 13,200 Mn. was only 50% of such valuation or on the other hand, that the purchase consideration of Rs. 13,200 Mn. paid could be recouped in a period of only about 2 ½ years, after earning 18% p.a. interest. Indeed a very good deal no doubt, unfortunately not for the public of this country, whom PERC represents, but for NTT, whose local lawyers have been Tiruchelvam Associates!

In addition to the above unbelievably good return, NTT is also contractually entitled to charge management fees from Sri Lanka Telecom Ltd., as per Condition No. 5 of the Agreement for the Provision of Services and the Procurement of Personnel signed between Sri Lanka Telecom Ltd. and NTT also on August 5, 1997.

**AGREEMENT FOR THE PROVISION OF SERVICES AND THE
PROCUREMENT OF PERSONNEL**

1. Definitions

(F) "EBITDA" means, in respect of any financial period, the consolidated earnings before interest, tax, depreciation and amortisation of SLT and its subsidiaries for such financial period as shown by the audited consolidated accounts of SLT and its subsidiaries for such financial period;

5. Fees and Expenses

5.1 SLT shall pay in Sri Lankan Rupees to NTT a fee equal to the aggregate of 0.5% of EBITDA and 1.2% of Revenues for each period for which audited accounts of SLT are prepared less:-

(A) any amounts to be deducted on the basis set out in Schedule 2;

(B) in the case of any period for which audited accounts have been prepared, any fee previously paid to NTT in respect of any part of such period; and

(C) in the case of the period for which the first audited accounts after the date hereof are prepared, an amount equal to the product of:-

$$A \left(1 - \frac{B}{365} \right)$$

where A equals to the aggregate of 0.5% of EBITDA and 1.2% of Revenues for the period for which such audited accounts have been prepared and B equals the number of days from the date of this agreement to the date to which audited accounts have been prepared.

5.2 The fee shall accrue on a daily basis, shall be determined annually and shall be payable within 30 Business Days after the production of the audited accounts for the financial period to which it relates.

5.3 The salaries, costs and other employment benefits of the personnel incurred by NTT in providing the Services to SLT shall be refunded to NTT by SLT in US Dollars, such refunds to be made, subject to the provisions of such clause 5.4 below, net of any withholding or deduction on the ground of taxation or otherwise, provided that those salaries and benefits and other expenses are reasonable by reference to prevailing international standards (including NTT's policies and practices) and of reasonable amounts and evidenced in such manner as SLT may reasonably require and have been approved in writing by SLT (such approval not be unreasonably withheld or delayed in the light of such evidence).

- 5.4 In the event that NTT shall be liable to turnover tax levied by any governmental or municipal authority of the Democratic Socialist Republic of Sri Lanka ("Sri Lankan Turnover Tax") in respect of those salaries, costs and expenses referred to in clause 5.3 above, SLT shall reimburse NTT for any sum payable by NTT in respect of Sri Lankan Turnover Tax subject to receipt by SLT of evidence satisfactory to SLT that any such sum has become due and payable.
- 5.5 For the avoidance of doubt:-
- (A) in no circumstances will the deductions set out in Schedule 2 lead to the fee payable hereunder in respect of any period being a negative figure requiring repayment of any sum to SLT by NTT; and
 - (B) SLT's obligations under this clause 5 shall continue notwithstanding any event of Force Majeure.

As set out in the said conditions the fees have been stipulated to be 1.2% of Revenues and 0.5% of Earnings before interest, tax, depreciation and amortisation. On the basis of the adjusted profit and cash-flow projection model referred to above, such fees could amount to Rs. 358 Mn., Rs. 473 Mn., Rs. 611 Mn. Rs. 768 Mn. Rs. 973 Mn. for the years 1998, 1999, 2000, 2001, 2002 respectively, a total of Rs. 3,471 Mn. The fees to be paid to NTT by Sri Lanka Telecom Ltd. is in addition to the reimbursement of foreign expatriates and other related costs incurred by NTT. Ofcourse such fees are subject to the achievement of certain quantitative and qualitative targets and there is no reason to doubt their achievement.

FOOLING THE PUBLIC?

It should be noted that the Government Chief Valuer's model has been adjusted only by the guaranteed minimum annual local revenue increases. In the absence a 'price-cap' control formula, could not revenue increases even be much more? Why had Deutsche Morgan Grenfell and Development Finance Corporation of Ceylon, who had prepared the Information Memorandum on Sri Lanka Telecom Ltd. not been required to formulate a pricing formula in conformity with international practice? Since the agreement to guarantee minimum annual local revenue increases had been contractually deemed to be part of the Licence, what control could the Telecommunications Regulatory Commission of Sri Lanka enforce in the future?

No doubt these figures are based on a model and are only indicative. Nevertheless, ought not the Technical Evaluation Committee headed by Secretary, Ministry of Telecommunications, K.C. Logeswaran and PERC headed by Dr. P.B. Jayasundera have taken into reckoning, a computation of such fee commitment in addition to a reckoning of the valuation of the 35% shareholding of Sri Lanka Telecom Ltd., given the scenario of the guaranteed minimum annual local revenue increases in a monopoly status? Had this been done? If not, why? In such circumstances, could the public of this country now accept that the privatisation of Sri Lanka Telecom Ltd., carried out by PERC had been one of the best deals for this country and the public ? It is left to the public to decide.

Though it had been held out that 6 out of 10 Directors of the Board of Directors of the privatised Sri Lanka Telecom Ltd., would be appointed by the Government of Sri Lanka and only 4 Directors would be appointed by NTT, Section 6 of the Shareholders' Agreement between the Government, NTT and Sri Lanka Telecom Ltd., also signed on August 5, 1997 clearly stipulates that all 6 Government Directors would be Non-Executive Directors, whilst all 4 NTT Directors could be Executive Directors. NTT would appoint one of their Directors, as the Chief Executive Officer of Sri Lanka Telecom Ltd., whilst a Government Director, would be the Managing Director of Sri Lanka Telecom Ltd., and as stipulated, such Managing Director is only to serve

as an Adviser to the NTT Chief Executive Officer! What a status for a Managing Director and why have such nomenclature at all? Is it to fool the public ?

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