

BY FAX / COURIER

16th October 2006

IMPORTANT / URGENT

His Excellency Mahinda Rajapakse
President of the Republic of Sri Lanka / Minister of Finance
President's House
Janadhipathi Mawatha
Colombo 1.

Your Excellency,

'Proposed Settlement with LIOC'

I refer to the telephone conversation had with me, *inter-alia*, on the LIOC divestiture, and my subsequent Letter dated 23.6.2006. The telephone call was consequent to the exposure on the LIOC divestiture, which I caused to be published in the *Daily Mirror* of 13.6.2006; in the light of misleading media exposures, *vis-à-vis*, the controversial 'subsidy claims' made by LIOC from the Government.

I have come to know from the media, that a 'Settlement Agreement' is in the process of being signed by the Government and LIOC to the "Share Sale & Purchase Agreement for 100 Filling Stations", which had been signed by the Government and LIOC on 30.12.2003.

The said 'Settlement' proposed is as a consequence of the 'subsidy claims' made by LIOC from the Government, under the aforesaid Agreement, payments in respect of which were estopped due to Opinions given by the Hon. Attorney General and a respected President's Counsel, as a consequence of issues, which were raised by me, as then Chairman, PERC. *If not for which, Government would have had to make all payments, as claimed as 'subsidies'.*

I understand from media reports, that in the proposed 'Settlement', the provision for the '5% profit margin' on a 'cost plus basis' in the 'pricing structure' for the computation of the 'subsidy claims' has been proposed to be reduced to '1 ½ %'.

I draw attention to the following issues, which ought also to be reckoned in a 'Settlement', which issues had been highlighted in the aforesaid exposure in the *Daily Mirror* of 13.6.2006:

1. IOC had been selected '*sans* any transparent competitive bidding process'; but had been 'simply selected'.
2. IOC had agreed to bring in US \$ 75 Mn. in foreign exchange as their 'investment'. Cabinet Memorandum of 8.10.2003 had specifically stated that 'the purchase consideration should be in foreign currency and should not be raised through local banks'. Cabinet Memorandum had also noted that a further Rs. 2 – 3 billion had been committed by IOC to be invested and that 'this downstream investment together with the upfront consideration adds to around US \$ 100 Mn'.
3. Nevertheless, for the consideration of US \$ 75 Mn. to be paid to the Government for 100% Shareholding of LIOC (having 100 Filling Stations) and 33 1/3% Share of CPSTL (CUF Company), IOC had brought in only US \$ 40 Mn., whilst US \$ 35 Mn. had been 'raised from local Banks'. This is in contravention of the stipulations in the Cabinet Memorandum.

Hence, any 'cap' on a Government subsidy ought be in relation to a just, fair and equitable return on the investment of US \$ 40 Mn., subject, however, to what is noted herein.

4. The consideration of US \$ 75 Mn., had been based on the 'business valuation' of US \$ 71 Mn., which had been reckoned by Ernst & Young, in respect of the above two Shareholdings. Ernst & Young had been engaged as 'Financial Advisors' to the Government on this divestiture.
5. Furthermore, Ernst & Young had also added a 'premium' upto a maximum value of US \$ 30 Mn. 'for the right' to market access to enter into arrangements with 'Franchisee Filling Stations' i.e. other than CPC Filling Stations.

Nevertheless, 'without any additional consideration paid therefor', Condition 3.1.2.(i) (e) of the said Agreement titled - "Share Sale & Purchase Agreement for 100 Filling Stations", stipulated thus - *quote*:

"The GOSL shall ensure that CPC shall not preclude LIOC from entering into suitable arrangements with dealers pertaining to Franchisee Filling Stations, subject to the settlement mechanism reflected in Clause 2.3.1 (b)."

Consequently, in addition to the 100 Filling Stations of LIOC, it had expanded its operations by entering into arrangements with a further 70 'Franchisee Filling Stations'.

Therefore, the question arises, 'as to whether any Government subsidy ought be applicable to the operations of LIOC via additional 70 'Franchisee Filling Stations', the 'right to access' to which had been granted 'without any consideration', regardless of the 'valuation placed on such right' by Ernst & Young. *If the turnover of such expanded operations is meant to be excluded, then it ought be expressly so stated, inasmuch as the Agreement is 'titled' to be in respect of 100 Filling Stations.*

6. Also, interest payments in respect of borrowings of US \$ 35 Mn. from local banks to pay for the consideration to the Government, in violation of the stipulation in the Cabinet Memorandum, could not be reckoned as 'costs' for Government subsidy consideration.
7. LIOC had also been engaged in other business areas, such as sale of lubricants, operation of 'mini-super markets' and Oil Tanks in China Bay, Tincomalee, in addition to the expanded 70 'Franchisee Filling Stations', in respect of which there would be operational, as well as refurbishment, 'costs', which ought not be 'admissible costs' to be subsidised by Government.
8. The 'pricing structure', *in itself*, is in question, in that, the actual 'marketing & distribution costs' for the year ended 31.3.2005 had been reported to be 10.2 Mn. and for the 9-Month period ended 31.12.2005 had been reported to be 26.0 Mn., whilst 'subsidy claims' from the Government, in terms of the 'pricing structure' had included a recovery component as 'marketing & distribution cost' of Rs. 230.9 Mn. and Rs. 187.7 Mn., respectively, for the said two periods.

Notwithstanding the foregoing, the 'subsidy claims' made on the Government had been certified by PricewaterhouseCoopers, Auditors of LIOC, and not by independent Auditors.

I am aware, that you are strenuously focused on endeavours for the resolution of the north-east conflict, but nevertheless, the foregoing being of national importance involving 'billions of rupees' of public funds, which are 'held in trust for the people', ought not go by default, even in such circumstances.

Yours truly,



Nihal Sri Ameresekere

cc: Mr. Lalith Weeratunga, Secretary to His Excellency the President