NO PRICECAP ON SLT CAPRICE

The privatisation of Sri Lanka Telecom Ltd., was one of the major privatisations carried out by the Peoples Alliance Government, handled by the Public Enterprise Reform Commission [PERC]. Telecommunications is an integral part of economic infrastructure and a vitally important public utility. The provision of such economic infrastructure is the prime responsibility of government to support the national development and growth of the country.

Telecommunications is a public utility, not only used by the affluent business sector, but also by all sectors of society, including the ordinary public to communicate in circumstances of personal needs, distress, grief and emergencies. Hence the costs of such public utility should not be a burden to the public. Whilst privatisation of public utilities, be it telecommunications or otherwise, is carried out in several developed and developing countries, such privatisation takes into cognisance the responsibility of the government to provide such public utility service at an affordable price to the consumer, ensuring the reliability of the continuity of service without a breakdown. The private sector service provider is not permitted to hold the consumer public to ransom. In the context of telecommunications sector, national and public security considerations also become important factors that comes into play.

To ensure the discharge of and/or conformity to such duty and obligations of government, in the privatisation of economic infrastructure, particularly public utilities, a regulatory framework and a regulatory authority are established – the privatised public utility services being required to operate within the parameters of such regulatory framework enforced by such regulatory authority. One of the key issues is to ensure a proper balance between the cost effectiveness of such public utility service and the cost to the consumer public, affording a reasonable rate of return on capital employed to the privatised service provider – providing also for adequate re-investment in maintenance and growth to ensure the continuity of a reliable public utility service, that would cater to the growth of consumer demand.

CONSUMERS FLEECED?

PERC having blundered in relation to this crucially important issue vis-a-vis the pricing of LP gas to the consumer public in the privatisation of the Colombo Gas Co. Ltd., that then created a public controversy in such regard, appears to have also forsaken the need to protect the interest of the consumer public in carrying out the privatisation of Sri Lanka Telecom Ltd. Quite clearly, PERC had agreed to the guaranteeing of minimum annual tariff increases, on a year on year basis, on the privatisation of Sri Lanka Telecom Ltd., with Nippon Telegraph & Telephone Corporation of Japan [NTT], agreeing to minimum annual tariff increases of 25%, 25%, 20%, 15%, & 15% in respect of the years 1998, 1999, 2000, 2001, & 2002, respectively, on the levels of local service revenues, that is excluding international services – such annual increases being in relation to the levels of local service revenues in respect of the immediately preceding year. Furthermore, curiously and questionably it had been agreed that there would be no cap placed on such annual increases.

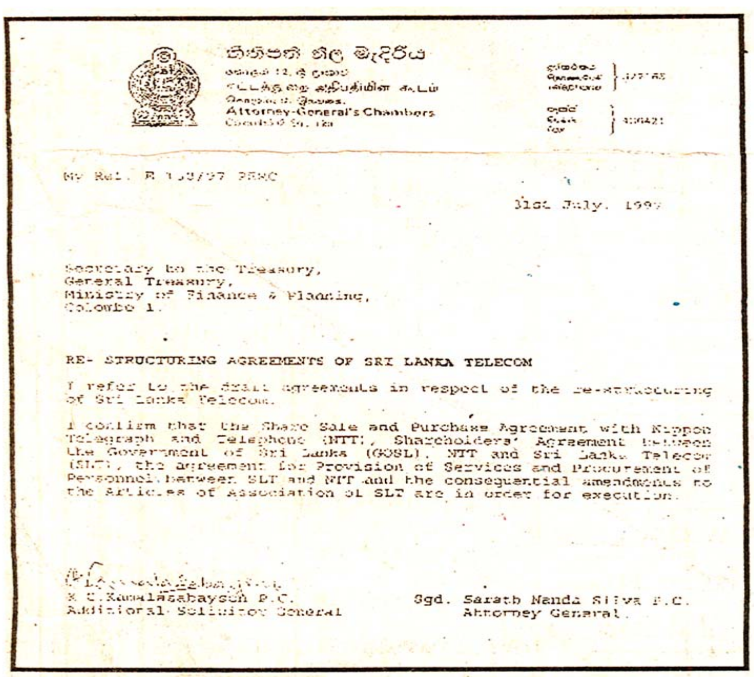
The cogent question was posed, as to why PERC had abandoned, what had been stipulated in the Information Memorandum dated October 14, 1996 prepared by Deutsche Morgan Grenfell and Development Finance Corporation of Ceylon, that had been afforded to the pre-qualified bidders on the privatisation of Sri Lanka Telecom Ltd.? The Information Memorandum had clearly stipulated that – "The method used for tariff control will continue to be that of 'price-cap' control. The operator will be expected to set tariffs in accordance with a formula which incorporates previous price levels and current inflation". In fact in agreeing to price increase formulae in respect of privatised public utility services, such formulae take into cognisance the cost effectiveness of such privatised public utility service.

The privatised public utility provider is not permitted to incur unwarranted and/or unlimited and/or unrelated and/or uneconomic costs and seek to recover such costs from the consumer public. Such objective is achieved by a well designed and structured formula. In the privatisation of Sri Lanka Telecom Ltd., curiously and questionably such essential and basic pre-requisite does not appear to have been deemed necessary by PERC. Why? What safeguards and/or mechanism has PERC put in place to protect the interests of the consumer public vis-a-vis the privatisation of Sri Lanka Telecom Ltd.? What safeguards and/or mechanism has PERC put in place to ensure the cost effectiveness of the telecommunication tariffs and that the privatised Sri Lanka Telecom Ltd., having been afforded a monopoly, will not make unconscionable profits exploiting the consumer public, beyond the realms of reasonableness ?

LEGAL AGREEMENTS

The legal agreements in relation to the privatisation of Sri Lanka Telecom Ltd., had been entered into on August 5, 1997. These agreements comprised i). Share Purchase Agreement between the Government and NTT signed by B.C. Perera, then Secretary to the Treasury and Jun-ichiro Miyazu, President NTT ii). Shareholders' Agreement between the Government, NTT and Sri Lanka Telecom Ltd., signed by by B.C. Perera, then Secretary to the Treasury and Jun-ichiro Miyazu, President NTT and H. Fernando and R. D. Somasiri, Chairman and Managing Director, respectively, of Sri Lanka Telecom Ltd. iii). Agreement for the Provision of Services and the Procurement of Personnel between Sri Lanka Telecom Ltd., and NTT signed by H. Fernando and R. D. Somasiri, Chairman and Managing Director, respectively, of Sri Lanka Telecom Ltd., and Jun-ichiro Miyazu, President NTT. Chairman PERC, Dr. P.B. Jayasundera has signed as a witness to the Share Purchase Agreement and the Shareholders' Agreement.

The Attorney General by letter dated July 31, 1997 addressed to the Secretary to the Treasury had confirmed that the aforesaid legal agreements were in order for execution. As disclosed in the Share Purchase Agreement, the lawyers for NTT have been Tiruchelvam Associates, Kynsey Terrace, Colombo 8, Sri Lanka and Morrison & Foerster LLP, 2000 Pennsylvania Avenue, NW Washington DC, USA.


නීතිපති නිල මැදිරිය

Attorney-General's Chambers

My Ref. R [illegible]/97 PERC

31st July, 1997

Secretary to the Treasury,
General Treasury,
Ministry of Finance & Planning,
Colombo 1.

RE- STRUCTURING AGREEMENTS OF SRI LANKA TELECOM

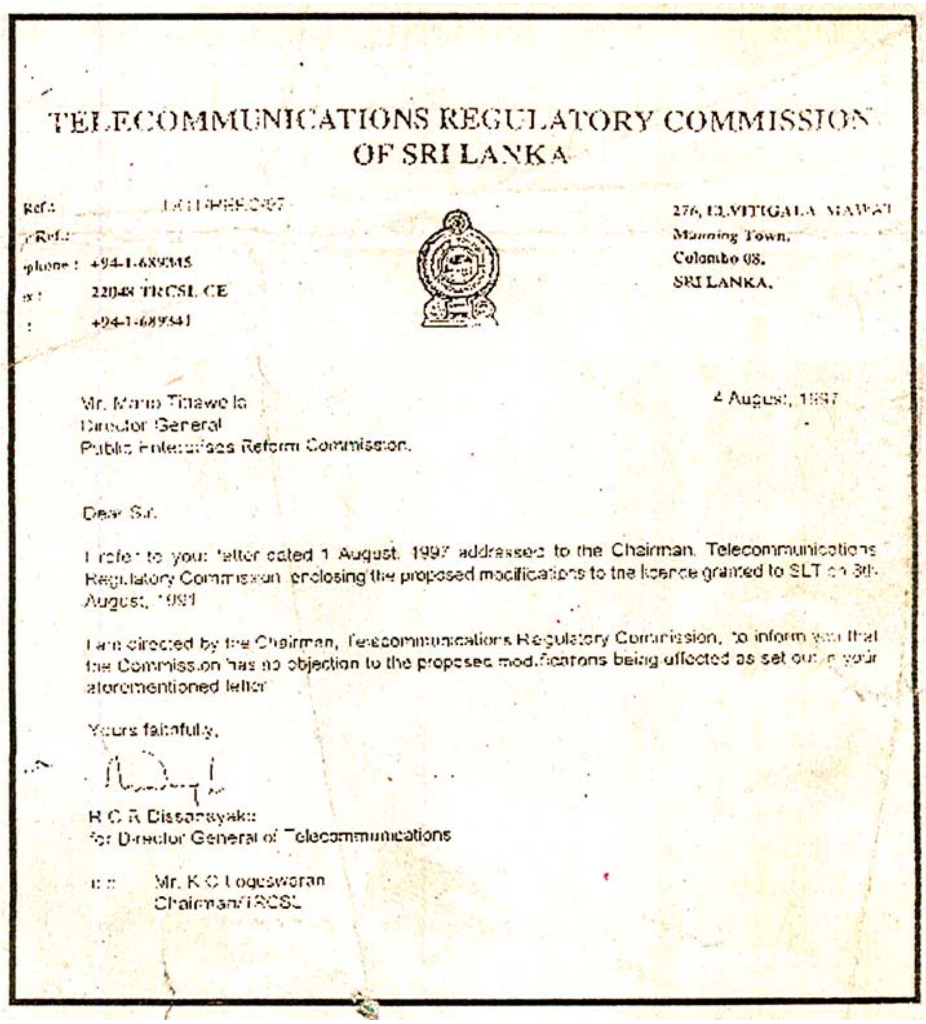
I refer to the draft agreements in respect of the re-structuring of Sri Lanka Telecom.

I confirm that the Share Sale and Purchase Agreement with Nippon Telegraph and Telephone (NTT), Shareholders' Agreement between the Government of Sri Lanka (GOSL), NTT and Sri Lanka Telecom (SLT), the agreement for Provision of Services and Procurement of Personnel between SLT and NTT and the consequential amendments to the Articles of Association of SLT are in order for execution.

K. C. Kamalasabayson P.C.
Additional Solicitor General

Sgd. Sarath Nanda Silva P.C.
Attorney General.

In addition to the aforesaid legal agreements, i). the Ministry of Finance & Planning had issued to NTT a disclosure letter dated August 5, 1997 signed by B.C. Perera, then Secretary to the Treasury ii). the Telecommunications Regulatory Commission of Sri Lanka had issued to Director General PERC, Mano Tittawella, a letter dated August 4, 1997 signed by R.C.R. Dissanayake for Director General of Telecommunications, confirming that the Commission had no objection to the proposed modifications effected to the licence that had been granted to Sri Lanka Telecom Ltd., on August 8, 1991 – the modifications to the licence granted to Sri Lanka Telecom Ltd. have been set out in an annexure thereto iii). Furthermore, amendments to the Articles of Association of Sri Lanka Telecom Ltd., had also been effected on August 5, 1997.



TELECOMMUNICATIONS REGULATORY COMMISSION
OF SRI LANKA

Ref.: [illegible]
Ref.:
phone : +94-1-689345
x : 22048 TRCSL CE
: +94-1-689341

276, ELVITIGALA MAWATHA
Manning Town,
Colombo 08.
SRI LANKA.

Mr. Mano Tittawella
Director General
Public Enterprises Reform Commission.

4 August, 1997

Dear Sir,

I refer to your letter dated 1 August, 1997 addressed to the Chairman, Telecommunications Regulatory Commission enclosing the proposed modifications to the licence granted to SLT on 8th August, 1991

I am directed by the Chairman, Telecommunications Regulatory Commission, to inform you that the Commission has no objection to the proposed modifications being effected as set out in your aforementioned letter

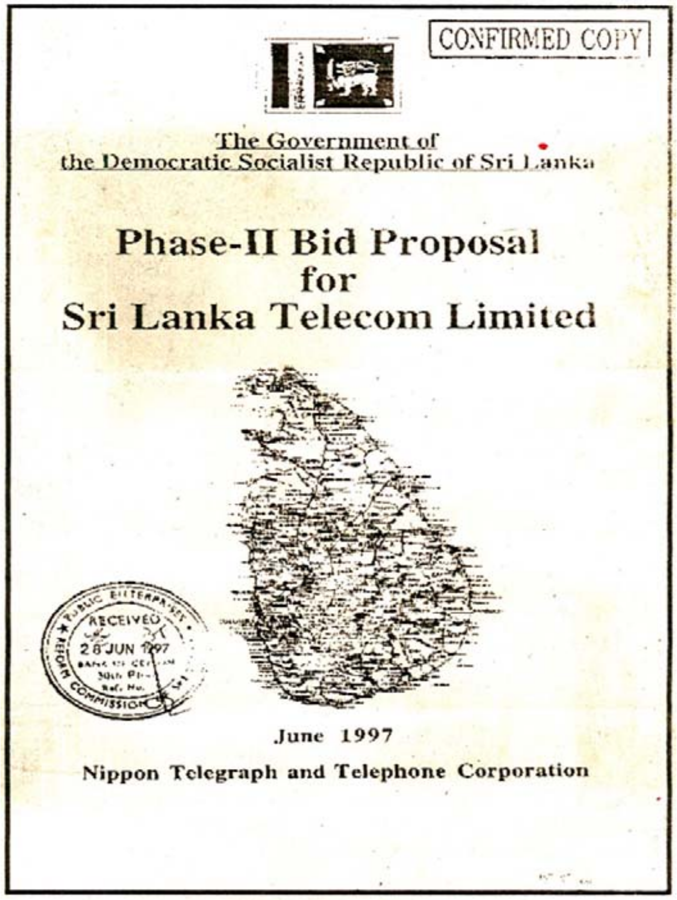
Yours faithfully,

R C R Dissanayake
for Director General of Telecommunications

c.c. Mr. K C Logeswaran
Chairman/TRCSL

The Shareholders' Agreement at Clause 18.6 had stated – "The provisions of this Clause 18 shall have the same effectiveness as if they were fully set out in the Licence". What is the purpose of having a Telecommunications Regulatory Commission of Sri Lanka, vested with the licensing and regulation of telecommunication services, if the government was to enter into commercial agreements, including Clauses stipulating that the conditions in such Clauses would have the same effectiveness, as if they were fully set out in the Licence?

AMAZINGLY PACKAGED IN A MONTH !!



CONFIRMED COPY

The Government of
the Democratic Socialist Republic of Sri Lanka

Phase-II Bid Proposal
for
Sri Lanka Telecom Limited

RECEIVED
28 JUN 1997

June 1997

Nippon Telegraph and Telephone Corporation

It is abundantly clear, that the relevant documentations pertaining to the privatisation of Sri Lanka Telecom Ltd., had been concluded on August 5, 1997. Accordingly, it has be presumed that the negotiations of the commercial and all other terms, including the agreement on the sale price for the 631,701,000 ordinary shares of Sri Lanka Telecom Ltd., forming 35% of the share capital thereof had been finalised between June 28, 1997 and August 5, 1997 – i.e. approximately within a period of one month, since the final offers for the privatisation of Sri Lanka Telecom Ltd., had been received by PERC on June 28, 1997 at the bid opening time of 2.30 p.m. Therefore, the evaluation of the offers and the finalisation of all the commercial and other terms had essentially been concluded by PERC in the month of July 1997.

On such a major and complex privatisation of a public utility, such as Sri Lanka Telecom Ltd., the question is posed, as to how such examination, evaluation, negotiation and the finalisation of all commercial and other terms had been concluded in such a short period of time of about one month? Amazingly, incredible is it not? Accordingly, had the commitment to guarantee minimum annual tariff increases on local telecommunication services, without a cap based on a formula, been agreed upon, without due consideration and in undue haste, not heeding the consequences thereof?

In July 1997, to consider the valuation of the 35% shareholding of Sri Lanka Telecom Ltd., PERC ought to have considered the valuation given by the Government Chief Valuer in November 29, 1996. The relevance of the net present value of the projected cash-flow projections of Sri Lanka Telecom Ltd., that had been reckoned by the Government Chief Valuer, as the appropriate basis for the reckoning of the value to be placed on the sale of 35% shareholding of Sri Lanka Telecom Ltd. had been under-pinned. The Government Chief Valuer's valuation having been made in November 1996 could not and would not have taken into reckoning the enhancement of guaranteed future profits by the guaranteed minimum annual tariff increases agreed with NTT by PERC in July 1997, affording also a monopoly status to Sri Lanka Telecom Ltd.

VALUATION RECKONED?

An endeavour had been made to adjust the discounted cash-flow valuation of Sri Lanka Telecom Ltd., that had been reckoned by the Government Chief Valuer in November 1996, with the impact thereon by the guaranteed minimum annual tariff increases agreed to by PERC. However, such adjusted valuation of Rs. 60,035 Mn. for 100% value of Sri Lanka Telecom Ltd., imputed earlier had been based on turnover levels reckoned for the year 1997 by the Government Chief Valuer in his Valuation Report, and had not taken into reckoning the annual growth in levels of volume. The guaranteed minimum annual tariff increases have been agreed to, on a year on year basis, guaranteeing minimum increases in relation to the preceding year's levels of turnover, which would also include the growth in levels of volume.

It is now endeavoured to impute the value of 100% of Sri Lanka Telecom Ltd., on the basis of the favourable discounted cash-flow model reckoned by the Government Chief Valuer in November 1996, taking into account the growth of volume reflected in such favourable cash-flow model. Such growth of volume reflected in a favourable cash-flow model reckoned in November 1996 is considered, since with expertised foreign management, the growth in volume ought to be considerably more than what had been envisaged by the Government Chief Valuer in November 1996 in the absence of such expertised foreign management. PERC having reckoned the valuation of Sri Lanka Telecom Ltd., in July 1997, would have had to reckon the Government Chief Valuer's valuation of November 1996 that was then before PERC. Ought not PERC have endeavoured to adjust such valuation, with the impact thereon by the guaranteed minimum annual tariff increases agreed to by PERC with NTT, giving also monopoly status to Sri Lanka Telecom Ltd.?

ADJUSTED DISCOUNTED CASHFLOW ANALYSIS *Favourable Scenario*

[Rs. Millions]

	1997	1998	1999	2000	2001	2002
Local Services Revenue	12,912	14,461	16,166	18,120	20,373	22,994
Adjusted for 6% p.a. Inflation	12,912	13,643	15,252	17,094	19,220	21,692
Adjusted for Guaranteed Minimum Annual Tariff Increases- 25%, 25% 20%.15%, 15%	12,912	17,054	23,831	32,051	41,443	53,789
Revenue						
(1) Local Services (Net) - [ADJUSTED]	12,912	17,054	23,831	32,051	41,443	53,789
(ii) International Services	5,805	5,885	6,180	6,488	6,813	7,154
Expenditure						
On International Services	2,330	2,853	3,510	4,332	5,356	6,629
Personnel	1,300	1,429	1,572	1,730	1,903	2,093
Other Operating	1,689	2,037	2,339	2,765	3,245	3,767
Operating Profit	13,198	16,620	22,590	29,712	37,752	48,454
Depreciation	6,640	9,436	9,894	4,738	2,688	2,125
Tax @ 35%	2,295	2,514	4,444	8,741	12,272	16,215
Net Profit	4,263	4,669	8,253	16,233	22,792	30,114
Depreciation	6,640	9,436	9,894	4,738	2,688	2,125
Net Cash-Flow - [REVENUE]	10,903	14,105	18,147	20,971	25,480	32,239
PV @ 18%	1.00	0.85	0.72	0.61	0.52	0.44
Net Present Values	10,903	11,990	13,066	12,792	13,249	14,185
Net Present Value Total	76,185					

Ought not PERC have caused the preparation of a realistic discounted cash-flow valuation, based on the parameters of the agreement that had been made with NTT, to reckon the valuation of the 35% shareholding of Sri Lanka Telecom Ltd., the sale of which shareholding PERC had handled, including the agreement of all terms and conditions pertaining to the privatisation of Sri Lanka Telecom Ltd. ? Even the corporate tax regime has been proposed to be brought down by the government. In the public interest it is set out as a model in the given chart, the adjusted discounted cash-flow valuation of Sri Lanka Telecom Ltd., based on the favourable model of the Government Chief Valuer. The net present value of 100% of Sri Lanka Telecom Ltd., discounted in terms of a 18% interest rate indicated is Rs. 76,185 Mn., thereby giving a value of Rs. 26,665 Mn. for the 35% shareholding of Sri Lanka Telecom Ltd., which shareholding had been sold by PERC agreeing to the aforesaid conditions for Rs. 13,200 Mn. PERC's self glorifying media blitz, however, claimed at that time that this was one of the best deals !!!

- ***Published in The Sunday Leader on 12.7.1998 by Nihal Sri Ameresekere under the pseudonym 'Bismark'***