

Message Text

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SUBJECT: INVESTMENT DISPUTE - PROPOSED GOB TAKEOVER OF US COMPANY

1. SUMMARY: THE BOLIVIAN CONGRESS RECENTLY PASSED A RESOLUTION SEEKING CONFISCATION OR NATIONALIZATION OF THE BOLIVIAN POWER COMPANY, A CANADIAN (NOVA SCOTIA) REGISTERED COMPANY WHOSE MAJOR SHAREHOLDERS ARE US CITIZENS OR CORPORATIONS, INCLUDING BALDWIN UNITED OF CINCINNATI, OHIO WHICH OWNS 49 PERCENT OF BOLIVIAN POWER'S COMMON STOCK. THE RESOLUTION RESULTED IN THE APPOINTMENT OF A SPECIAL TECHNICAL COMMITTEE OF THE LOWER HOUSE, CONSISTING OF LAWYERS, ENGINEERS AND OTHER EXPERTS TO STUDY THE ISSUE AND MAKE RECOMMENDATIONS. BOLIVIAN POWER RESPONDED WITH ITS OWN INITIATIVE, I.E., A LEASE-SALE ARRANGEMENT WITH FEES TO BE PAID OVER TWENTY YEARS AFTER WHICH THE BOLIVIAN GOVERNMENT WOULD RECEIVE TITLE TO THE COMPANY'S ASSETS FOR NO ADDITIONAL COSTS AND WITH NO INTEREST PAYMENTS. IN A CONVERSATION WITH THE AMBASSADOR ON OCTOBER 16, ENERGY MINISTER O'CONNOR STATED THAT BOLIVIAN POWER'S PROPOSAL WAS AN ACCEPTABLE BASIS FOR NEGOTIATION, BUT THAT A NUMBER OF SPECIFIC ELEMENTS OF THE PROPOSAL WERE UNACCEPTABLE TO THE GOB. END SUMMARY.

2. THE COMPANY.

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(A) COMPAÑIA BOLIVIANA DE ENERGIA ELECTRICA, S.A.--BOLIVIAN POWER COMPANY LIMITED, PRODUCES AND SUPPLIES HYDRO-ELECTRIC ENERGY TO THE CITIES OF LA PAZ AND ORURO, BOLIVIA, THE ADJOINING AREAS, AND NEARBY TIN MINES. BOLIVIAN OFFICES ARE LOCATED IN LA PAZ AND THE COMPANY'S HEAD OFFICE IS IN ST. JOHN'S, ANTIGUA, WEST INDIES. IN 1978, THE COMPANY SOLD 415.3 MILLION

KILOWATT HOURS GENERATING GROSS REVENUE OF \$US 11.3 MILLION
WITH NET INCOME OF \$US 3.4 MILLION.

(B) BOLIVIAN POWER IS INCORPORATED IN NOVA SCOTIA, CANADA, AND UNTIL OCTOBER 1977 WAS OWNED BY CANADIAN INTERNATIONAL POWER COMPANY, LTD. ON JUNE 30, 1978 BOLIVIAN POWER FORMED A PARTNERSHIP, HEMISPHERE LEASING ASSOCIATES, WITH BALDWIN UNITED CORPORATION OF CINCINNATI, OHIO, WHICH HOLDS 49.8 PERCENT OF BOLIVIAN POWER'S COMMON STOCK. IN SEPTEMBER 1978 DAYTON HYDRAULICS COMPANY BECAME A GENERAL PARTNER AND OCTOBER 1978 THE PARTNERSHIP WAS REORGANIZED AS AN ANTIGUAN PARTNERSHIP.

(C) IN JANUARY 1979 THE SHAREHOLDERS APPROVED THE CONTRIBUTION OF BOLIVIAN POWER'S BENEFICIAL INTEREST IN SUBSTANTIALLY ALL OF ITS ELECTRIC UTILITY PROPERTY, PLANT AND EQUIPMENT WHICH HAD A RECORDED BOOK VALUE OF ABOUT \$US 40 MILLION TO ITS PARTNERSHIP, HEMISPHERE LEASING, IN EXCHANGE FOR 50 PERCENT PARTNERSHIP INTEREST. BOLIVIAN POWER RETAINS LEGAL TITLE TO THE ASSETS. THE OTHER PARTNERS CONTRIBUTED \$US 10 MILLION TO BE USED FOR PURCHASING PROPERTY OR EQUIPMENT TO BE LEASED TO OR FINANCED FOR THIRD PARTIES PRIMARILY IN THE US. BOLIVIAN POWER THEN ENTERED INTO A TEN-YEAR LEASE WITH HEMISPHERE ASSOCIATES FOR RENTAL OF ALL ASSETS; THE LEASE CAN BE RENEWED THROUGH SEPTEMBER 30, 1999 WHEN BOLIVIAN POWER'S FRANCHISE TO OPERATE IN BOLIVIAN EXPIRES.

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3. BACKGROUND.

(A) ACCORDING TO A JULY 24, 1964 AGREEMENT WITH THE GOB, BOLIVIAN POWER IS ENTITLED TO EARN AN ANNUAL RETURN OF NINE PERCENT ON ITS ASSET BASE AND IN ANY PERIOD THAT IT DOES NOT EARN NINE PERCENT, IT IS ENTITLED TO RECOUP THE DEFICIENCIES. IN 1977 AND 1978 BOLIVIAN POWER'S RATE OF RETURN WAS 7.7 AND 6.5 PERCENT RESPECTIVELY. AS OF DECEMBER 21, 1978 THE ACCUMULATED DEFICIT TOTaled \$US 18.3 MILLION. TO INCREASE THE RATE OF RETURN, TO COVER PAST DEFICITS, AND TO COVER INCREASING COSTS, BOLIVIAN POWER ASKED FOR RATE INCRASES OF 27.32 PERCENT ON DECEMBER 13, 1977, 72.51 PERCENT ON DECEMBER 12, 1978, AND MOST RECENTLY A MODIFIED REQUEST OF 64.03 PERCENT IN JANUARY 1979. THESE RATE INCREASES WERE NOT GRANTED. THE LATEST ONE IS BEING STUDIED BY THE GOB AND HAS GENERATED A GREAT DEAL OF PUBLICITY.

(B) SPARKED BY THE PUBLICITY FROM THE RATE INCREASE REQUEST, A RESOLUTION SEEKING CONFISCATION OR NATIONALIZATION OF BOLIVIAN POWER WAS SUBMITTED IN THE NEW CONGRESS. THE RESOLUTION WAS MODIFIED CREATING A SPECIAL TECHNICAL COMMISSION OF THE CHAMBER OF DEPUTIES TO PREPARE RECOMMENDATIONS AND REPORT

BACK TO THE CONGRESS. THE COMMISSION IS COMPOSED OF THE FOLLOWING MEMBERS: JORGE O'CONNOR, MINISTRY OF ENERGY; ENGINEER OSCAR MORALES; DR. HUGO URQUIETA (LAWYER); AND JOSE RAUL GARZON.

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(C) JORGE O'CONNOR, FORMER GENERAL MANAGER OF ENDE, THE LARGE GOB POWER COMPANY WITH HEADQUARTERS IN COCHABAMBA, IS CONSIDERED ONE OF THE MORE MODERATE COMMISSION MEMBERS EVEN THOUGH ENDE, WHICH HAS MORE SOCIAL THAN PROFIT OBJECTIVES, HAD FREQUENT DISAGREEMENTS WITH BOLIVIAN POWER. FOR EXAMPLE, ENDE IS FAR MORE ACTIVE IN PROVIDING POWER TO THE REMOTE AREAS OF THE ALTIPLANO THAN BOLIVIAN POWER WHICH CONCENTRATES ON THE MORE DENSELY POPULATED OR INDUSTRIAL AREAS WHERE SERVICE CAN BE INCREASED AT A LOWER MARGINAL COST. (ENDE'S RATES ARE ALSO MUCH HIGHER.) O'CONNOR WANTS TO HAVE A NEGOTIATED SETTLEMENT WITH BOLIVIAN POWER AND REALIZES THAT OUTRIGHT NATIONALIZATION MIGHT HAVE A DELETERIOUS EFFECT ON BOLIVIA'S CREDIT RATING AND THE CLIMATE FOR FOREIGN INVESTMENT.

(D) UNDERSTANDING THAT THE FUTURE OF FOREIGN PRIVATELY-OWNED ELECTRIC POWER COMPANIES IS NOT VERY BRIGHT IN THE LONG-RUN IN LATIN AMERICA, THE SHAREHOLDERS OF BOLIVIAN POWER ARE WILLING TO SELL THEIR COMPANY TO THE GOB AT WHAT THEY CONSIDER A FAIR PRICE. MR. DAVID MITCHELL, PRESIDENT OF BOLIVIAN POWER, HAS DISCUSSED THE SALE DIRECTLY WITH MR. O'CONNOR AND HAS GIVEN HIM A WRITTEN PROPOSAL.

4. THE OFFER.

(A) BOLIVIAN POWER'S OFFER IS A LEASE-LEASE ARRANGEMENT WITH
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FEES TO BE PAID FOR TWENTY YEARS; AT THE END OF THE LEASE THE GOB GETS TITLE TO THE ASSETS FOR NO ADDITIONAL COST AND WITH NO INTEREST PAYMENTS. THIS SALES ARRANGEMENT IS TO BE FREE OF BOLIVIAN TAXES. THE GOB WILL PAY A MONTH FEE OF 0.41667 PERCENT OF THE VALUE OF NET FIXED ASSETS AT THE TIME OF SIGNING AND TOTALLING \$55 MILLION OVER TWENTY YEARS, PLUS AN INFLATION ADJUSTMENT (SEE BELOW). ALL ASSETS WILL BE SOLD EXCEPT THE COMPANY'S OFFICE BUILDING AND A PIECE OF LAND IN ORURO. CONTROL AND MANAGEMENT OF THE COMPANY WILL PASS TO THE GOB AT THE TIME OF SIGNING.

(B) THE GOB MUST PURCHASE NET CURRENT ASSETS AT THE SIGNING OF THE AGREEMENT; THESE TOTAL ABOUT \$US 1.5 MILLION. BOLIVIAN POWER ESTIMATES ITS NET FIXED ASSETS AT \$US 54.3 MILLION BY THE END OF THE YEAR AND THOSE OF EMPRESA DE LUZ Y FUERZA ELECTRICA DE ORURO, S.A., \$US 978,000. THE MONTHLY LEASE FEE FOR THESE ASSETS WOULD BE \$US 230,400.

(C) TO COMPENSATE FOR THE EFFECTS OF INFLATION, MONTHLY LEASE PAYMENTS WILL BE LINKED TO THE PRICE PER POUND OF TIN. AT THE SIGNING, THE MONTHLY LEASE FEE WILL BE DIVIDED BY THE CURRENT PRICE PER POUND OF TIN TO DETERMINE ITS EQUIVALENT IN POUNDS OF TIN. WHENEVER THE PRICE OF TIN FLUCTUATES, THE LEASE PAYMENT WILL BE ADJUSTED BY MULTIPLYING THE POUNDS OF TIN BY THE NEW PRICE OF TIN.

5. IN CONVERSATION WITH AMBASSADOR OCTOBER 16, ENERGY MINISTER O'CONNOR SAID THAT BOLIVIAN POWER'S WRITTEN PROPOSAL CONSTITUTED AN ACCEPTABLE BASIS FOR DISCUSSION AND OPINED THAT PROSPECTS FOR A MUTUALLY AGREED SALE WERE FAIR TO GOOD. O'CONNOR FURTHER NOTED THAT THE COMMISSION WOULD PROPOSE THE FOLLOWING CHANGES TO THE COMPANY'S PROPOSAL:

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(A) GOODWILL (\$2 MILLION) SHOULD NOT BE INCLUDED IN BOOK VALUE;

(B) BOLIVIAN POWER SHOULD SETTLE FOR LESS THAN BOOK VALUE;

(C) THE GOB WOULD NOT AGREE TO COMPENSATE THE COMPANY FOR PAST SHORTFALLS IN ITS NET RETURN ON CAPITAL BELOW THE NINE PERCENT ORIGINALLY GUARANTEED BY THE GOB;

(D) MAINTENANCE OF VALUE OF DEFERRED PAYMENTS BY MEANS OF A

TIN CLAUSE WAS NOT ACCEPTABLE TO THE GOB.

6. O'CONNOR FURTHER NOTED THAT FIVE YEARS AGO BOLIVIAN POWER HAD OFFERED TO SELL FOR \$30 MILLION, PAYABLE OVER TWENTY YEARS AT SIX PERCENT INTEREST. HE SAID THE GOB WOULD PREFER SUCH A FORMULA THAN THE ONE NOW BEING PROPOSED. AMBASSADOR NOTED THAT SIX PERCENT WAS HARDLY A REASONABLE FIGURE TODAY IN MEETING THE LEGITIMATE BOLIVIAN POWER OBJECTIVE OF MAINTAINING THE VALUE OF DEFERRED PAYMENTS.

7. BOLIVIAN POWER'S PROPOSED SETTLEMENTS BEING POUCHEDE SEPRATELY.

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