__Final Report__

Technical Assistance to the DOF Privatization Office on Specific Privatization Transactions:

Report of Accomplishments after 18 Months through June 30, 2007

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Preface

This report is the result of technical assistance provided by the Economic Modernization through Efficient Reforms and Governance Enhancement (EMERGE) Activity, under contract with the CARANA Corporation, Nathan Associates Inc. and The Peoples Group (TRG) to the United States Agency for International Development, Manila, Philippines (USAID/Philippines) (Contract No. AFP-I-00-03-00020-00, Delivery Order 800). The EMERGE Activity is intended to contribute towards the Government of the Republic of the Philippines (GRP) Medium Term Philippine Development Plan (MTPDP) and USAID/Philippines' Strategic Objective 2, "Investment Climate Less Constrained by Corruption and Poor Governance." The purpose of the activity is to provide technical assistance to support economic policy reforms that will cause sustainable economic growth and enhance the competitiveness of the Philippine economy by augmenting the efforts of Philippine pro-reform partners and stakeholders.

Undersecretary Gabriel "Jay" Singson, Jr., of the Department of Finance (DOF) requested, by letter dated August 24, 2005, EMERGE technical assistance to provide support to the Privatization Office in the disposition of highly complicated and big-ticket assets and those assets requiring restructuring prior sale. USAID approved the initial TA request on January 9, 2006, and two subsequent requests for 6-month extensions for a total of 18 months. Usec Singson gave specific assignments to each of the consultants. Sunny Sevilla's main tasks concerned the financial aspects of privatization affecting PNCC, the IPO of EDC, Al Amanah Islamic Bank, Iloilo Airport, IBC-13, Philippine Postal Corporation, and RPN-9. Job Ambrosio handled legal aspects of privatization. Ray Davis initially assisted in the privatization of the MWSS interest in Maynilad and of Nonoc Mines. After the initial 6 months Sunny Sevilla replaced Jay Singson as DOF undersecretary for privatization, and the EMERGE team was reduced to two.

The consultants assisted the DOF/PO by reviewing various legal and financial documents, attending meetings with government agencies and financial advisors on the privatization efforts of the government, reviewing the financial position of government corporations and assets to be privatized and providing general advice on various issues.

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Overview

EMERGE provided technical assistance to the Department of Finance (DOF) Privatization Office from January 2006 to June 2007. The assistance provided was initially three part-time consultants on the EMERGE Advisory Team reducing to two after 6 months, when one of the consultants became the Undersecretary for Privatization. During this time the Philippines Government made significant advances in several privatization cases. Two of the most important assets were sold supported by efforts from EMERGE Consultants. A number of terms of reference (TOR's) prepared by, or with the assistance of, these consultants were issued by the Privatization Office either for selection of a financial advisor or, in more advanced cases, for the sale process. A few cases, notably the successful sale of the International School Property, did not involve the EMERGE Team, but members of the team have worked on all of the larger, more complex cases involving corporate assets.

Notable accomplishments for the Privatization Office during the 18 month period were the sale of the International School Property, the first asset sale in over 18 months, followed by the sale of the controlling stake in Maynilad Corporation, the PhP19.2 billion IPO of EDC and the sale of shares of PTIC which in turn held a significant stake in PLDT, the largest telecom company in the Philippines. The Privatization Office at the termination of the EMERGE Project is actively working on the sale of a significant stake in San Miguel Corporation and the refinancing of the MRT-3 Lease rental payments.

The period also saw the failed bidding for two major assets, Al Amanah Islamic and Investment Bank and the real estate comprising the old Iloilo Airport.

Other major assets which remain to be addressed in the future are the broadcast stations RPN-9/IBC-13, the Philippines Postal System and Postal Bank the Government-owned shares of Meralco.

In addition to selling assets the Privatization Office, with the assistance of the EMERGE Team, worked on large, complex, troubled assets to reduce their cost to the Philippines Government or to restructure the assets to prepare them for new ownership by private third parties. In the case of MRT-3, the Privatization Office has worked intensively to reduce the cost to the Government of the ongoing payrnents to equity owners of that Project. The Government made significant progress on restructuring the MRT-3 obligations, obtaining an opinion from the Department of Justice that the MRT-3 obligations could be refinanced with sovereign debt without an act of congress.

Maynilad, the Manila West Zone water system operator, was in rehabilitation, and to avoid the Government, through MWSS, from reassuming ownership of that asset, the EMERGE Team was active in advising MWSS to the point of successfully structuring and executing the sale to a new private controlling owner for Maynilad. Additionally the team advised DOF, together with NRMDC, to the point of executing a MOU between the Government of the Philippines, Philnico and Jinchuan Group to restructure the $300 million of Philnico Debt and allow Jinchuan Group to invest $1 billion to rehabilitate the Nonoc Mine. Philnico subsequently increased it demands, aborting the sale. The failure of the Government to reach a conclusive settlement of the $300 million of debt owed by Philnico to the Government carries a lesson as outlined further in this report.

Issues Raised and Lessons Learned

Iloilo Airport

A feature of the auction process used by the Privatization Office is the reserve price on bids. By law, assets must be sold through public bidding, and a reserve price must be set by the disposition entity selling the asset. Whether or not the reserve price is disclosed is the subject of a case-to-case policy decision, but regardless of public bidding results, assets may not be sold below their reserve price. The reasoning behind the reserve bid is to prevent the Government from getting cheated by collusive bidders or simply selling something of value for too low a price. The market and not appraisals or judgments should determine the value of property sold. An open auction should set the price. Bidders want the benefit of a bargain. If the reserve price is set too high (above the market clearing price) you will have a failed bid. This was demonstrated in the case of the Iloilo Airport where the Privatization Office recommended that the reserve price be set at 1 billion pesos, a number chosen between two available appraisals. The Privatization Council, based purely on the judgment of individual members, set a higher price of 1.2 Billion. The highest bid received in the sealed bid auction was 1.08 Billion, resulting in a failed bid. The competing bids were much lower, resulting in the potential that a future round of bidding will result in lower bids and lower proceeds for the Government.

Al Amanah Islamic and Investment Bank

This is a case where the management of the asset seemingly pursued a different objective than the Government, throughout the sales process. The auction for the sale of this bank resulted in a failed bid with no bidders submitting offers. The stated reason was the failure of the bidders to fully understand the liabilities of the bank. Through this process the management and board of directors of the bank were at odds with the government officials attempting to conduct the sale, succeeding in retaining their positions as the bank failed to change hands. The privatization plan included a take out of the ROPOAs from the bank and the transfer of the same to the Philippine Government with a set-off on the deposits made by the Bureau of the Treasury and a restructuring of the balance at below market terms. This was done to entice foreign bidders. Nevertheless, the bidders were hesitant due to its inability to make a final determination of the risks involved due to the incomplete disclosure of liabilities. A legal issue was also raised with respect to the incorporation of a new entity to take over the Islamic banking license of Amanah.

<u>Nonoc Mines</u>

Nonoc Mines is an example of the inefficiency of the legal structure of the Philippines. The Nonoc Mine, where the Philippines Government has a significant economic interest, is an unproductive asset of the Government. The redevelopment of the mine would make a critical contribution to the economy of Northern Mindanao. The mine was sold by the Philippines Government to Philnico in 1996. No cash was paid. Consideration was an obligation for Philnico to pay the Philippines National Government (NG) US$300 million in 2 tranches of scheduled payments with duration of 10 and 15 years. These payments were without interest and had a then present value of approximately US$170 million.

The sales agreement provided that Philnico would invest US$67.5 million. Philnico's plan was to restart the mine and processing plant with then existing technology. The plan failed and the project never restarted. From 1996 to the present, a total US $1.254 million in scheduled payments were made by Philnico to NG against the $300 million obligation. In 2004, the NG declared a default and demanded rescission of the contract. The sales agreement provided that the NG would reimburse Philnico a maximum of US$67.5 million for funds invested in the project if the NG sought to rescind the sales contract Philnico sought protection of the Makati Regional Trial Court and obtained a restraining order requiring that the NG pay US$60 million to Philnico prior to rescission. No physical improvements were made in the mine. The claimed investment was for fees paid to the principals, feasibility studies and consultants hired in the failed attempt to restart the mine.

Jinchuan Group, a Chinese state owned company, sought, first through discussions with Philnico and then with the Philippines Government, to acquire the mine. Despite a claim of only $60 million in the court filing, Philnico demanded $125 million in cash consideration for the mine. The Philippines Government acquiesced to Philnico's demands and agreed to accept cash consideration of $45 million, despite concerns raised at the staff level at DOF that the Government was not being treated fairly. Jinchuan refused the $170 million combined offer. In the last round of negotiations Jinchuan offered consideration within the range of the DOF valuation, with Philnico receiving more than the $60 million asserted in their court filing. Philnico refused. The Government was seemingly powerless to overrule Philnico.

The ability of the Regional Trial Court to restrain the rescission of the sales contract is a bad economic circumstance. An operating productive mine would contribute revenues to the National Government and economic development to Mindanao. If Philnico is owed any compensation under the sales agreement, those funds could be paid subsequently. Proceeds of the sale to Jinchuan or any party could be escrowed by the court until the court determines what compensation Philnico might be entitled to, if any. The Government is clearly the most significant economic stakeholder in the Nonoc mine but its ability to drive the process of recovery and development of the mine has been thwarted by the restraining order of the trial court which gives all of the leverage in negotiations to Philnico. The result is that the National Government will lose the opportunity to maximize the value of recovery during the time when nickel prices and interest in nickel mining assets is at its peak.

Individual accomplishments

By Sunny Sevilla

Philpost
This project is to privatize the Philippines Postal System and the Postal Savings Bank.

Accomplishments
Sunny provided extensive input to the privatization committee for the terms of reference and scope of work for the financial advisory mandate for this asset. Since the failed bid for this mandate, Sunny spoke with most of the institutions which had earlier expressed interest to identify reasons for their decision not to bid. Since then, using their feedback, he helped put together new terms of reference to ensure a successful bid. Sunny has also provided the DOF-PO and other government agencies with input on proposals to develop the Postal Savings Bank into an OFW bank, particularly with regard to the impact this would have on the privatization of Philpost.

Background and Next Steps
After the hiring of a financial adviser, Sunny will likely help review the advisor's work. This is likely to be significantly more complicated than previously envisioned, given the approval of a BOT arrangement which will significantly affect Philpost's profitability and the new investor's flexibility to manage Philpost, and the emergence of the OFW Bank proposal, and Sunny will continue to provide guidance to the privatization committee and other government offices and how these issues will affect the privatization process.

RPN-9/IBC-13
This project is to sell the Governments interest in these two broadcasting stations. Since January, Sunny has provided significant support to the DOF-PO and the Privatization Committee for these two assets.

Accomplishments
Specific accomplishments include:

- Validation of the approach proposed by the financial advisors for these assets, namely, to perform a "quasi-liquidation" in lieu of a sale of the government's stake in these companies
- Validation of the valuation proposed by the financial advisors, and reconciliation between this valuation and other valuations based on methodologies proposed by members of the Privatization Council
- Detailed financial analysis of the balance sheet of RPN-9, leading to recommendations on how the proceeds of the privatization should be distributed among the different claimants. These recommendations have been used as the basis for negotiations between the privatization committee and representatives of RPN-9's labor unions.

- Serving as a neutral middleman to transmit informal proposals between the privatization committee and FEMII Inc., which disputes the government's ownership of 41% of RPN-9, with the objective of coming up with a suitable compromise to allow privatization to proceed without prejudicing each party's legal rights.
- Assistance to IBC-13 and RPN-9 in resolving issues which continue to arise and have an impact on the privatization process, such as the potential eviction of IBC-13 from land on which its transmission tower stands, RPN-9's liquidity problems and its block-time arrangement with a private television operator, and others. Sunny extended assistance by clarifying the reasons behind these issues, identifying and analyzing potential solutions, drafting communication between IBC-13 and RPN-9 and various parties, and facilitating meetings between the concerned parties.

Background and Next Steps

The sheer number of parties who need to come to agreement on what are effective haircuts on their claims on RPN-9, and the magnitude of these haircuts, make it difficult to predict the pace at which RPN-9's privatization will proceed. Sunny continues to assist the privatization committee in assessing the various proposals and counterproposals being made by the different parties. In the case of IBC-13, only one issue remains to be resolved before the privatization can proceed. Sunny will likely be involved in reviewing the draft terms of reference for any bid and making recommendations to the privatization committee on the conduct of the bid itself. Sunny also continues to participate in meetings with potential investors in order to provide feedback to the committee on their concerns.

MRT-3

This project has been to seek to minimize the cost to the Government arising from its support to this Build Operate Transfer Project (BOT).

Accomplishments

The specific accomplishments for this project included the preparation of a report prepared by an inter-agency committee tasked to review the project.

To complete the report, Sunny performed extensive analysis on this project, focusing on the following areas:

- its expected losses over the life of the project on an "as is" basis
- Comparisons between its fares and those of other modes of transport on EDSA, as well as other comparable mass transit systems in the region.
- Ways by which its largest financial obligations can be refinanced to reduce their cost to the government.
- Ways by which the project's arrears to its creditors can be minimized
- Legal basis for a refinancing of the project's financial obligations
- Ways by which the impact of such a refinancing on the government's fiscal deficit can be mitigated.

This analysis has been used as an important input for the report which recommends measures to improve MRT 3's financial performance. Sunny has also met very frequently with project stakeholders to get their inputs, explain the Government's concerns, and generally serve as a go-between between the project's stakeholders, who are now largely hedge funds and distressed investors, and the Government.

Subsequently Sunny Sevilla led the effort at DOE to obtain a legal opinion from the DOJ that the lease rental equity owners' lease rental equity payments could be redeemed with an act of Congress.

Background and Next Steps
Discussions and negotiations with the equity holders are currently underway.

Iloilo Airport

Accomplishments
The specific accomplishment on this project was to obtain a financial advisor and subsequent to becoming Undersecretary lead the effort to organize the sales process and review the bids for the property. Sunny coordinated with the DOF-PO and the World Bank Manila office to secure grant funding for a financial advisor to recommend the disposal method for the 55 ha. Iloilo airport property. He contacted five potential advisors who subsequently submitted proposals, one of whom, CB Richard Ellis, was ultimately selected by the DOF-PO for the assignment. He helped define the scope of work and terms of reference for the assignment, arranged presentations by CB Richard Ellis to the government-appointed Asset Disposition Program committee to discuss them, coordinated access by CB Richard Ellis to the various government offices they needed to meet with, and helped validate the consultant's interim report and valuation.

Background and Next Steps
Iloilo Airport is the real estate of the old airport which became available for sale when the new airport commenced operations. Bidding for the project failed when no bidder met the PhP 1.2 billion reserved price determined by the Privatization Council which was not announced to the bidders.

Next step is to re-bid the asset.

San Miguel

Accomplishments
Sunny identified the key legal impediments to a sale by the government of its stake in San Miguel Corporation, and researched ways to overcome them. He held discussions with the PCGG and the Office of the Solicitor-General to examine legal options, recommend legal strategies, and discuss the commercial rationale for selling the San Miguel stake in early 2006.

Background and Next Steps
In previous meetings with representatives of San Miguel, they expressed interest in a transaction under which the government and Mr. Danding Cojuangco would agree to a

sale of the shares claimed by the government, with the proceeds of the sale being put in escrow pending final resolution of the Sandiganbayan case on these shares. This has since been superseded by discussions involving the DOF, PCGG, and the Office of the Solicitor-General on one hand, and various farmers' organizations which are litigants in the case over the ownership of the disputed San Miguel shares, on an amicable settlement of the case to allow the sale of the shares.

Philippine National Oil Company-Energy Development Corporation (PNOC-EDC)

Accomplishments
The main accomplishment for this task was to be the sale, via a public offering of shares, of the alternative energy assets of PNOC.

Specific accomplishments were:

- Identified which assets of PNOC were to be included in the IPO
- Determined the percentage of proceeds to be retained for investment, with the balance remitted to the Government
- Selected a financial advisor/underwriter
- Met with the underwriter to consider pricing of the IPO
- Obtained Privatization Council approval of an underwriting range
- Priced the issue
- Exercised the over allotment option
- Met to discuss possible future sale of the remaining government stake

Background
PNOC-EDC is the Philippines' largest producer of geothermal energy. The company owns and operates steam fields in four areas: Bacman in southern Luzon, Leyte A and B in Leyte, Palinpinon in Negros and Mount Apo in Mindanao. It sells steam to power plants with a total installed capacity of 1,149.4-megawatts, accounting for nearly 60 percent of the country's installed geothermal capacity and 7 percent of the country's total power generation capacity. PNOC-EDC is currently raising its geothermal capacity by 265 MW and is looking at other renewable energy sources. It is building a 30 MW wind power plant in northern Luzon and evaluating other wind and hydro investment opportunities in the Philippines.

PNOC-EDC privatization was required under the Electric Power Industry Reform Act of 2001, which aimed to raise revenues for the government and continue the exploration and development of new and additional sources of geothermal energy. Under the PNOC-EDC privatization plan, PNOC retained 40 percent of the subsidiary's shareholdings and sold 60 percent via an IPO issue.

By Job Ambrosio

<u>Al Amanah Islamic and Investment Bank</u>
This project is to sell the Governments interest in Al Amanah Islamic and Investment Bank.

<u>Accomplishments</u>
Job advised the DOF-PO and the PMO on the terms of reference for the prequalification, bidding and selection of the financial adviser for Al-Amanah's privatization. We also reviewed the contract to be signed by the winning financial adviser to ensure consistency with the TOR. PWC was eventually chosen as the Financial Advisor for the privatization of Al Amanah.

The Technical Working Group composed of representatives from the BSP, PDIC, DOF and Al Amanah continues to meet regularly to discuss issues related to the financial assistance to be provided by PDIC to Al Amanah for the purchase of the ROPOAs. We advised the TWG on several legal issues including the procedure for taking out the ROPOAs, including the requirement of declaring property dividends.

<u>Background and Next Steps</u>
Legal Issues: There are certain regulatory issues that have to be clarified with regard to the charter of Al Amanah once it is privatized. The issues identified by PWC include the following:

- Whether or not Al Amanah can perform conventional banking transactions (in addition to Islamic banking transactions) despite its privatization.
- Whether or not Al Amanah can still be considered a government depository once privatized.
- What banking regulations will govern Al Amanah's conventional and Islamic banking transactions?

With regard to the purchase of Al Amanah's ROPOAS by PDIC using a loan from the BSP, the following legal issues will have to be threshed out:

- Whether or not the Al Amanah's ROPOAs will be part of the privatization process or will they be taken out;
- If the ROPOAs will be taken out, whether the PDIC, BSP and DOF agree to the scheme of using the ROPOAs as property dividends to be declared by the BSP to the National Government;

Next Steps: PWC, DOF, Al-Amanah will have to discuss and resolve regulatory issues affecting the privatization of Al-Amanah. Aside from the legal issues being flagged by PWC, it will have to determine what rights and privileges in its charter will remain with a privatized Al-Amanah. For example, will Al-Amanah be subject to the General Banking Laws on the capital requirement for a universal bank? There must be guidelines developed by DOF and BSP with respect to the regulatory requirements that will govern a privatized Al Amanah, especially on Islamic banking.

On the issue of property dividends, the DOF and BSP must also ensure that all the legal requirements of the Dividends Law and its implementing rules and regulations be satisfied prior to the implementation of the take out of the ROPOAs. Prior clearances from the Commission on Audit and Bureau of Treasury must also be secured as required by regulations.

After the failed bidding, there were discussions for a negotiated sale with interested buyers as the next step.

Philnico-Nonoc Restructuring

Accomplishments

The DOF met regularly with the representatives of the Philnico Group to discuss the restructuring of the Amended and Restarted Definitive Agreement (ARDA) between the National Government and Philnico. We advised DOF on the legal road map to be taken for the restructuring as well as providing several legal options. Job also advised DOF in evaluating the legality of the proposed restructuring plan of Philnico's lawyers. We outlined some scenarios on how to address the current court cases between PMO and Philnico.

The DOF also met with representatives of Jinchuan to discuss the latter's investment in Philnico/Nonoc. We advised DOF on several legal options with respect to the proposed investment of Jinchuan.

Background and Next Steps

Legal Issues: The proposed structure of Philnico for the Jinchuan investment and restructuring of Philnico's receivables initially would involved the following:

- PIC will continue to be PMO's counterparty
- Jinchuan and PIC to form a JV Company
- Jinchuan will contribute cash to JV Company while PIC will contribute all of its shareholdings in PPC
- JV Company will own 90% of PPC shares and majority of PNPI shares
- Portion of the cash contributed by Jinchuan will be used to purchase bonds which will be placed in a Special Purpose Trust with PMO as the Beneficiary

There are also issues on the payment mechanism for the National Government's incremental revenue/profit share in the event that the price of nickel reaches a certain level.

Philpost Privatization/Build Lease Transfer (BLT) Contract

Accomplishments

Job advised the DOF and Philpost on the legality of entering into a BLT agreement rather than a BOT. We also conducted a research and submitted a memo opining that Philpost is a public utility subject to the foreign equity limit of 40% of outstanding capital. Such opinion was confirmed by the Office of the Government Corporate Counsel.

Job also reviewed the unsolicited BLT Contract (and its annexes) proposed by ROA Systems of Japan to ensure that the interest of Philpost and the Government is adequately protected. We also accompanied DOF representatives on TWG meetings for the drafting of the BLT Contract and provided some advice on the terms of the contract.

Background and Next Steps
Privatization of Philpost will already include the implementation of the BLT Project with ROA Systems. The BLT Contract was awarded to the ROA and is currently being implemented. The Financial Advisory services for the privatization of Philpost was awarded to PWC and is currently being studied

RPN 9/IBC 13

Accomplishments
Job did some preliminary research on the issue of whether the National Telecommunications Commission could bid-out television frequencies and submitted a short memo on this issue.

Background and Next Steps
A meeting will be held between DOF officials and NTC officials to discuss this issue further. There is a need to outline the procedure in the event that the government decides to bid out the frequencies.

PNCC

Accomplishments
We reviewed the different toll operating agreements entered into by PNCC and the National Government with respect to the rehabilitation of the toll roads under the PNCC franchise and the potential legal consequences of the non-renewal of PNCC's franchise on them. We also did some research on the various DOJ opinions on the matter and submitted a memo on the jurisdiction and power of the Toll Regulatory Board with respect to awarding franchises for the operation of a toll road.

Background and Next Steps
Next steps-There would be a need to analyze and review the draft legislation for the renewal of PNCC's franchise.

PTIC

Job assisted Undersecretary Sunny Sevilla and the DOF in reviewing the TOR and the transaction documents for the sale by the National Government of its stake in PTIC. This resulted in the successful bidding and the exercise by the First Pacific Group of its right to match under PTIC's Articles of Incorporation.

By Ray Davis

Maynilad

The major accomplishment for this project was to structure and accomplish a highly successful competitive auction for this asset. Ray Davis has been involved with this project from the moment the Government made a determination that it would seek private sector ownership of this asset.

Accomplishments

Specific Milestones accomplished were:

- Selected a financial advisor
- Convinced the lenders that their right to exercise veto over the new owner should only be applied at the prequalification stage of bidding
- Resolved major issues to be addressed in TOR
    - Use of Proceeds
        - winning bidder will be allowed to invest any bid premium in Maynilad for capital expenditure or debt repayment
        - If Ondeo agrees to sell, use of 16% of debt premium can be applied for early retirement of Ondeo Debt
    - Measuring the winning bid
        - Winning bid is the party with the most committed capital to be injected into Maynilad
        - Other methodologies including a point system for non-revenue water targets were rejected
    - Performance Bond
        - MWSS agreed to reduce the requirements for a performance bond from the original $120 million to $30 million(with credit for additional capex)

- Publish the TOR to identify a new private owner for Maynilad.
- Four bidders actively participated in the process with two bidders submitting final bids of effectively $400 million and $449 million of committed capital.
- The process was completed early January 2007.

Background

The Maynilad project consisted of selling the Government's interest in Maynilad which arose from the court sanctioned Rehabilitation Plan governing the debts of Maynilad. Under that plan MWSS agreed to defer $22.7 Million of concession fees and provide an additional $31 million of Financial Assistance. Under the plan MWSS would either take 84% of the shares of the reorganized company or alternately find a third party to step into the MWSS's position as controlling shareholder. The Government determined that it will not subscribe to the shares and sought a private owner.

The process consisted of identifying a financial advisor and preparing a TOR and instruction to bidders which together describe the process and minimum requirements for bidding. This was a more complex process than the typical TOR in that the Rehabilitation

Plan gave Maynilad's bank lenders effective veto power over the selection of a new owner. To avoid giving individual banks power to control or influence the process, to their private advantage, DOF convinced most of the lenders to give their approval at the pre-qualification stage. With this accomplished, the remaining major issue was to seek a shareholder's agreement which would govern Suez's rights as the remaining 16% shareholder. DOF and MWSS worked to convince Suez to sell their shares together with DOF.

MWSS, led by OGCC, with the support of DOF, never complete negotiations with Suez on the shareholders' agreement. OGCC subsequently issued a legal opinion that the rights of Suez were reduced, by the court sanctioned rehabilitation plan, commensurate with their role as a 16% shareholder. On the basis of this opinion and other assurances related to the capital investment of the new shareholder, two of the bidders determined that they could submit binding bids. The bids were submitted and the sale was subsequently awarded and closed.

Philnico/Nonoc Mine

The major accomplishment for this project was to have developed and agreed, with both Philnico and the potential Chinese investors, on the framework for settlement of the $300 million of debt Philnico owes to the government. Ray Davis has been involved with this project from the initial proposal made by Philnico to settle the debt.

Accomplishments

The major accomplishment was an MOU with the Chinese Investors and Philnico setting forth the framework for settling the debt and future participation in the Nonoc Mine Nickel Project. This MOU was agreed on June 6, 2006, following the Philippines Chinese Business Forum and was signed by the parties on the visit by the CEO of Jinchuan Group on his trip to Manila on June 28, 2006.

A further step was accomplished with the signing in China of an additional document in October 2006 during a trip there by the President of the Philippines.

Interim steps to achieve these milestones were to:

- Design the framework for settling the debt using a Brady Bond type structure to defease the debt;
- Enlist the assistance of NRMDC to evaluate the cash flows and potential settlement value of the debt;
- Develop a proposal to satisfy the Philnico debt with zero coupon bonds and additional participation in cash flows at higher nickel prices; and
- Agree that instead of the price participation that the Government will form a Financial or Technical Assistance Agreement (FTAA) partnership that will give the government an additional share of cash flow or revenues above basic taxes after a period of cost recovery.

Background
This project is to settle debt owed by Philnico to PMO in a way which reflects the value of the underlying asset and will allow for the rehabilitation and restarting of the Nonoc mine. Philnico acquired the Nonoc mine under an agreement to purchase with consideration in the form of $300 million of debt owed to PMO. Following the failure of Philnico to repay the debt, the Government sought to rescind the purchase agreement. The project is now under a restraining order by a local court preventing the Government from reassuming ownership unless the claim of Philnico for $65 million of advances is settled. (These funds were principally spent on a failed attempt to restart the old processing plant.) Jinchuan Group, the largest nickel producer in China, initially entered an agreement with Philnico to consider investing US$1 billion to restart the plant.

DOF worked jointly with NRMDC to assess the economic value of the mine and to develop an appropriate restructuring plan for the debt. These studies indicate that the mine is worth less than the debt at typically assumed long-term prices for nickel.

DOF developed a restructuring plan that would have Jinchuan purchase a zero coupon sovereign bond to defease the debt. The DOF plan would have the Government own equity in the mine in addition to the funds needed to defease the existing debt. The plan was developed on the basis of an MPSA Tax regime together with an application by Philnico to be considered for Peza status that would provide for 5% income taxes for an extended period of time. This plan was presented the first week of May to Jinchuan Group which responded with an alternative proposal that the Government should instead consider a partnership with Jinchuan under a Financial or Technical Assistance Agreement (FTAA) regime that provides for significant Government sharing under a tax regime that provides for a 50% share after a specific recovery period. During the recovery period only royalty and excise taxes are paid. After the recovery period a calculation provides for an additional sharing of project cash flow with the Government over and above taxes and royalties. FTAA tax regimes are specifically negotiated under specific parameters set by enabling legislation.

The DOF Privatization Office worked together with BOI and BIR Tax Policy and Planning personnel to specifically design an individually tailored tax regime for the project and a transaction structure. Tax costs to the project and income for the Government were analyzed under alternative Mineral Production Sharing Agreement (MPSA) and FTAA tax regimes. A revised valuation and cash flow projections were developed based on NRMDC and Jinchuan's technical assumptions, valuing the Mine in a range of $140 to $180 million dollars; a proposed tax framework and regime for additional revenue sharing was prepared by the Government to be negotiated with Jinchuan

Jinchuan insisted that the NG lead the negotiations as the largest stakeholder in the project. The negotiations were subsequently led, not by DOF or PMO, but by other members of the cabinet through year end 2006 and early 2007.

Although the discussions in China centered around Philnico receiving shares in the joint venture and cash to settle approximately $10 million in third party claims and the NG receiving $45 million in cash to defease the debt plus shares, Philnico changed its demands following the signing of the MOU in China in October of 2006, insisting that it be paid $125 million in cash and the NG receive only $45 million to defease the debt.

Subsequently, in early 2007 Jinchuan offered $75 million to Philnico, including monies to pay the third party claims, $45 million to NG and 5% shares in the mine to the NG, which Jinchuan valued at $20 million. This offer was rejected by Philnico. Subsequently Philnico reportedly sought other potential investors. As of June 30, 2007 we are aware of no further progress relative to settlement of the $300 million in debt.

MRT-3

Ray supported Sunny Sevillia in meetings with DOTC MRT-3 officials to discuss strategy and tactics relative to negotiating with the MRT-3 equity rental holders and attended meetings with the MRT-3 holders and their advisors. Specific accomplishments were:

Accomplishments

- Developed a position of the Privatization Office to assert to the MRT-3 holders,
- Presented the position to the MRT-3 holders and their advisors

Background

MRT-3 is a build-operate-lease contract between a private party and the NG. The MRT-3 light rail line was built by the private sector and leased to the DOTC. The project was financed with debt and equity with the lease agreement promising a 15% annual return to the equity holders. These equity rental payments are required to be appropriated annually by congress (due to a shortfall in fare collections meeting operating and financial costs) and differ from the debt payments to the project, which carry a sovereign guarantee and are automatically appropriated in the budget process.
There are no effective typical voluntary termination clauses in the lease. In default the equity holders are paid the 15% return on their investment as a default claim.

The situation is further complicated in that a substantial amount of the lease equity rental payment obligations were sold through a securitization to third part financial investors. The NG established a task force in 2006 to analyze the overall MRT-3 situation. This Task Force recommended that the NG seek to repurchase the MRT-3 equity as part of a comprehensive solution that would give the NG complete control of MRT-3. The NG would achieve substantial savings by refinancing the 15% obligations with sovereign debt of equivalent remaining maturity that would bear an interest rate of perhaps 6.75%. Certain significant holders initially indicated a willingness to sell if the NG paid the 15% return to the present date.

Subsequently the DOF received an opinion of the DOJ that the rental payments could be refinanced with sovereign debt without an act of congress. The lease rental equity holders then sought a higher price for their debt seeking returns in excess of 15% arguing that they should share in the savings available to the NG over the remaining 15 years if the rental payments were refinanced at a much lower cost.

There are ongoing discussions with the holders at the time of the termination of the EMERGE advisory task.