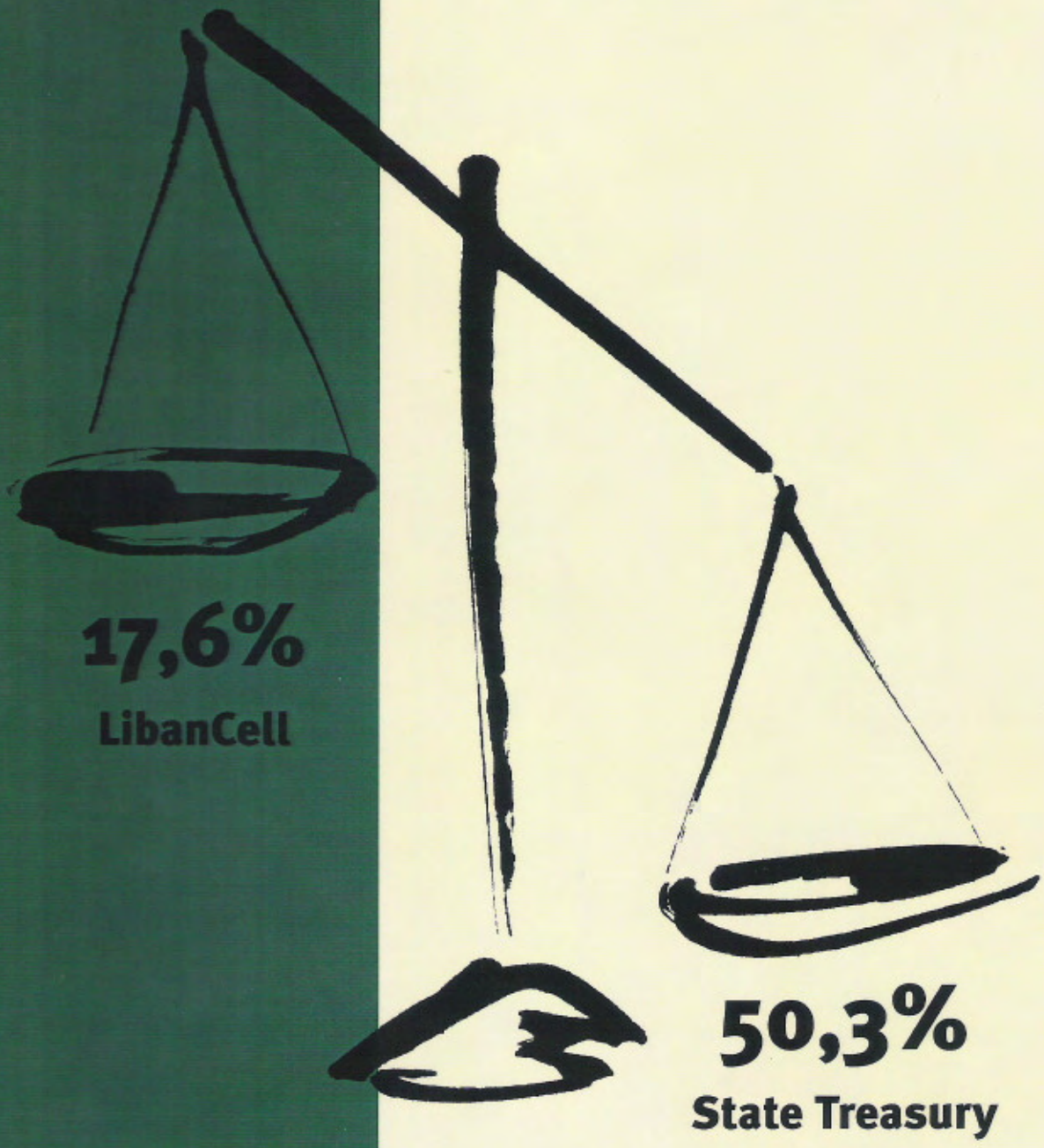
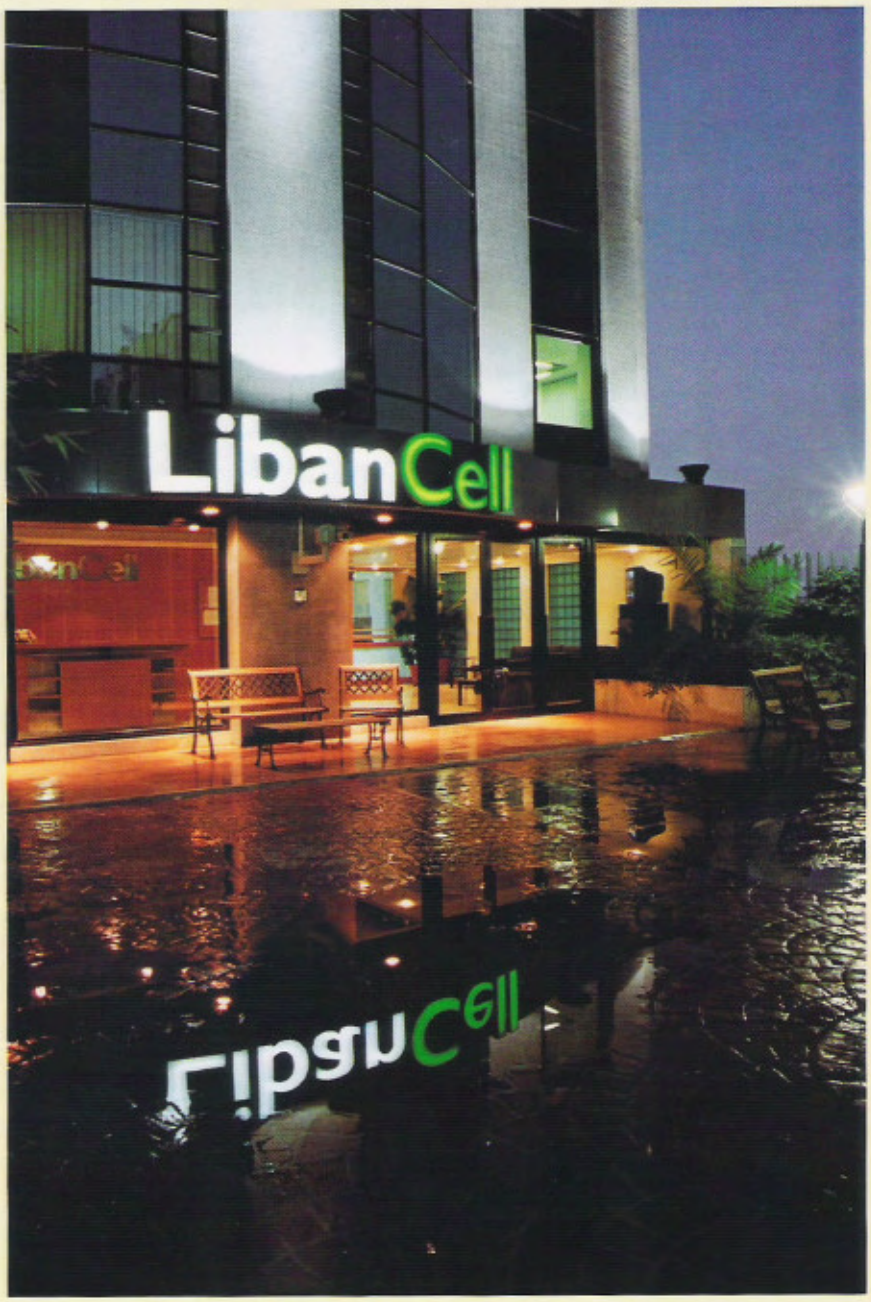
GSM in Lebanon

The Truth



LibanCell


LibanCell

LibanCell

Key Figures

Human Resources

> LibanCell number of employees end of 1999: **354**

> Number of employees projected end 2000: **402**

> Average age bracket: **30 years**

> Average salary including benefits: **$1450**

> LibanCell 2000 projected salaries and benefits: **$9.25 million**

Financial Data

> LibanCell total investments 1995-1999: **$277.5 million**
Out of which local investments: **$42 million**

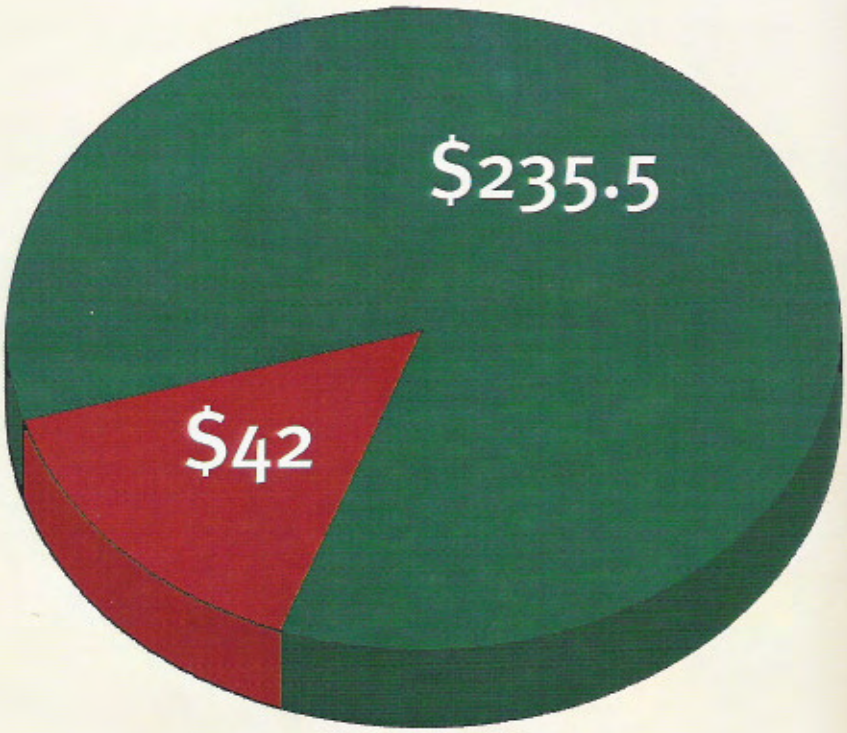
> LibanCell total revenues 1995-1999: **$802 million**

> LibanCell profits 1995-1999: **$140.8 million**

> Contribution to the Ministry of Post and Telecommunications (MPT) 1995-1999: **$403.4 million**

LibanCell 95-99 Investments in Million US$

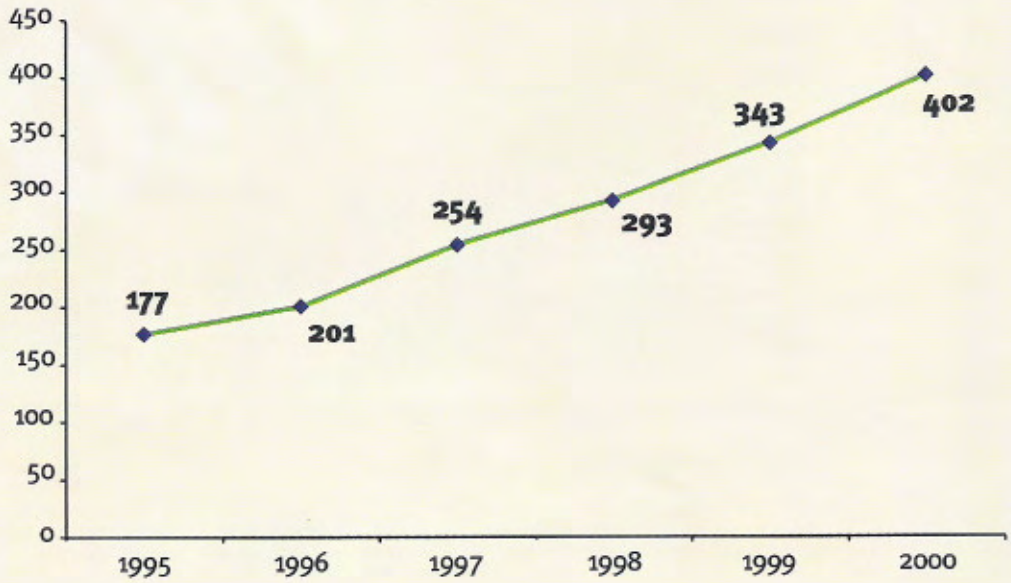
Total $277.5 M



Local Investment

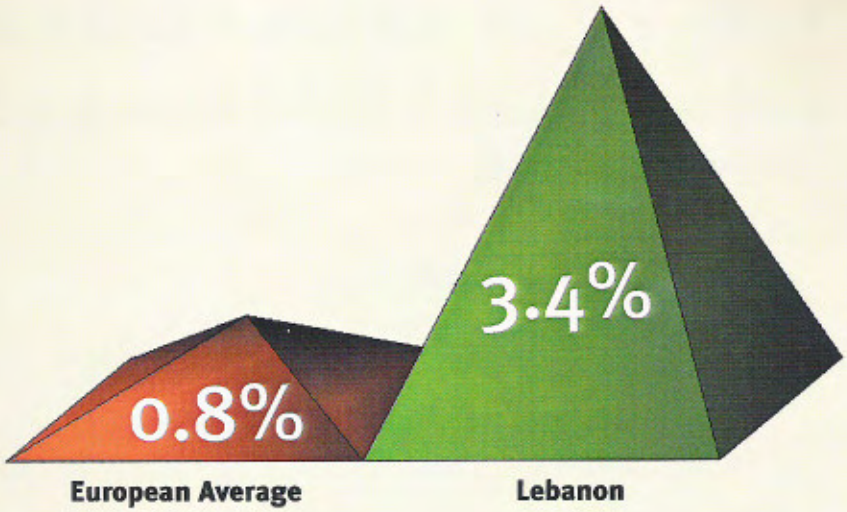
Foreign Investment

LibanCell Employees Growth

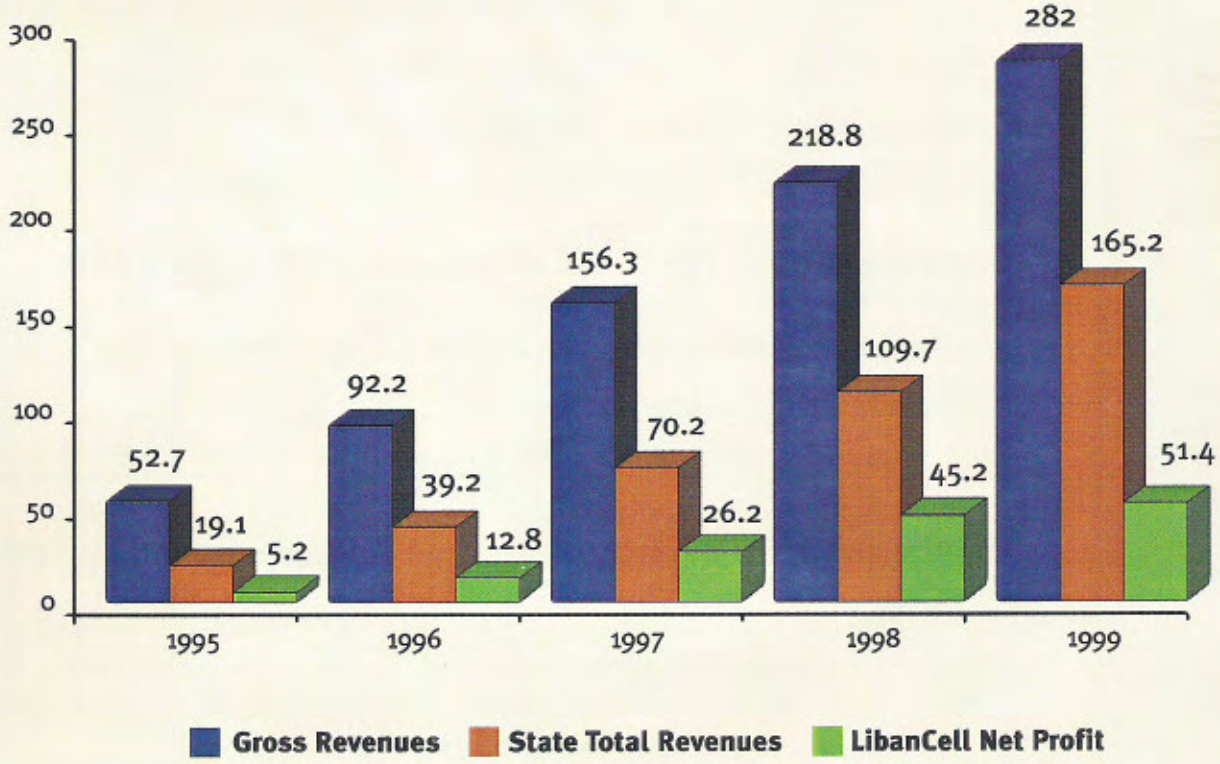


LibanCell

Mobile Contribution to GDP



LibanCell Revenues Evolution 1995-1999, in Million US$



LibanCell

Table of Contents

Repeated Accusations against Cellular Operators

1 Falsifying Revenue Share from 30% to 20% 12
2 The 250K Subscribers Ceiling 12
3 Cellular Operators' Profits and Contribution to the State Treasury 14
4 Fees on Microwave Frequencies 17
5 Non Payment of Revenue on Extra Lines and Late Payments 17
6 Rounding the Airtime Charges 18
7 Prepaid Cards 19
8 Providing Adequate Coverage and Capacity 19
9 KPMG Report 21
10 The "Cour des Comptes" Report 23

Major Griefs Voiced by the Cellular Operators

1 External Interference 26
2 Application of the July 1997 Agreements 27
3 The 6-cent Airtime Fee Increase 28
4 Exclusivity of Cellular Operations 30
5 Fulfillment of the Contractual GSM Coordination Obligation 30
6 Interconnection Capacity 30

Conversion of the BOT Contract into a License

1 The Case for a License 31
2 Valuation Methods of the License 32
3 Lebanon's Case 32

Relations with the Ministry of Post and Telecommunications (MPT)

1 The March-April 1999 Discussions 35
2 The October-December 1999 Negotiations 36
3 The Booz, Allen & Hamilton (BAH) Mission 38

GSM in Lebanon Operational and Contractual Clarifications

The objective of this paper is to give a complete visibility on the cellular operational and contractual struggle in Lebanon.

Cellular has received, since its inception, a lot of attention from both politicians and media. Operators' success in building **a state of the art** telecommunications network, in spite of extremely harsh and adverse conditions, in boosting the telecom sector and generating **substantial revenues** to the Government were unfortunately played down. Rather, the operators' **so-called** contract violations and their **supposed enormous profits** were indicted.

We will develop hereafter the counter-arguments to the charges commonly repeated, nurturing a negative common perception at the level of the Lebanese public. We will draw on a scientific approach, **avoiding emotional debates** and making use of supporting evidence and documentation.

We will also highlight the operators' claims pertaining to **unfulfilled obligations by the Ministry of Post and Telecommunications (MPT).** We will present a vision of the way forward, centered on the conversion of the **BOT Contract into a license.**

We will conclude with a chronicle of the relations with the MPT since December 1998 and report **the true story** of the negotiations that started early March 2000 and ended **abruptly** on April 17, 2000 by the Minister's unilateral decision.

Repeated Accusations against Cellular Operators

1 The Operators are accused of falsifying the Contract by altering revenue sharing from 30% to 20% for years 6-8.

2 The Operators are accused of exceeding the BOT set ceiling of 250,000 subscribers.

3 The Operators are accused of generating huge profits at the expense of the Government, which received a small share of revenues.

4 The Operators are accused of not paying the dues on extra lines and taxes, or of paying with 6 to 8 months delay.

5 The Operators are accused of not paying the Government fees on the use of microwave frequencies.

6 The Operators are accused of cheating subscribers by charging 6.1 cents per minute rather than 6.08 cents, achieving profits in millions of dollars.

7 The Operators are accused of not having the right to launch prepaid cards, and in all cases the revenue sharing agreement must be modified for prepaid cards.

8 The Operators are accused of not providing the geographical coverage and the network capacity as stipulated by the BOT Contract.

9 The Operators are accused of several contract violations reported by KPMG audit report and did not accept to pay the Government compensation for those violations.

10 The Operators are accused of several contract violations listed in the "Cour des Comptes" Report.

Major Griefs Voiced by the Cellular Operators

1 The Ministry failed to deliver the GSM frequencies clear of interference.

2 The Ministry did not fulfill its commitments dated July 1997 in compensation to surcharging by 2 cents per minute, to the benefit of the State Treasury, i.e.:
* Providing the Operators with GSM 1800 MHz frequencies.
* Providing a letter of comfort in regard to the arbitrary cancellation of the Contract.
* Approving the installation of PABX connections.

3 The Ministry unilaterally raised an additional fee of 4 cents per minute **in spite of Operators' objections and without the Parliament approval.**

4 The Ministry failed to guarantee the exclusivity of cellular operations until March 97 or 27 months after the start of the BOT Contract.

5 The Ministry is not fulfilling the contractual obligation of coordination with the Operators.

6 The Ministry is not providing the necessary interconnection capacity to remedy the congestion and poor reliability of the links between the Operators' networks and the fixed lines' network.

Conversion of the BOT Contract into a License

Privatization of the telecom sector has proven to be a main economic driver worldwide. At a point where the Lebanese Telecom Law has been announced, both the Government and the Operators agreed that **the conversion of the BOT Contract into a License** is the optimal way to go forward. We seize the opportunity of this report to detail:

- The case for a license.
- The valuation approach in general and for Lebanon in particular.
- Lebanon's case.

Lebanese Telecom Law

LibanCell

Relations with the Ministry of Post & Telecommunications (MPT)

The relations with the Ministry of Post and Telecommunications (MPT) are inconsistent since December 1998. **Not a single Coordination Meeting was held in spite of LibanCell's periodic requests.** Three phases of intense negotiations with the MPT can be identified:

March - April 99:

The discussions led to the Government's decree 502 surcharging the airtime by 4 additional cents, which is a **contractual violation by the Ministry.** LibanCell filed a lawsuit to "Al Shura Council" to overturn the decree.

October - December 99:

Mutual accusations of violations were exchanged during several rounds, without any result. Later on, negotiations with H.E. Minister Michel Eddé were conducted and were equally fruitless.

March - April 2000:

Booz, Allen and Hamilton was appointed as a moderator with **the mission of reaching an agreement on the value of a license to be granted**. Major progress was accomplished in spite of the Ministry's refusal to assign a negotiating team and validate gradually results, in conformity with the initial agreement.

On April 15, 2000, "The key terms of the license" were signed defining the scenario to be considered in order to provide a value for the license, within two weeks.

On April 17, 2000, the Minister aborted the process unilaterally.

Repeated Accusations against Cellular Operators

1. Falsifying Revenue Share from 30% to 20%

The Operators were accused of falsifying the BOT Contract, by altering the revenue sharing scheme approved by the Council of Ministers on February 2, 1994. This accusation is totally false.

The figure of 20% for years 6-8 is part of the BOT Contract and is also part of the minutes of the Council of Ministers dated May 26, 1994.

Years	Council of Ministers 2-Feb-94	Council of Ministers 26-May-94	BOT Terms
Years 1-5	20%	20%	20%
Years 6-8	**30%**	**20%**	**20%**
Years 9-10	40%	40%	40%
Years 11-12	50%	50%	50%

Why do officials ignore that the revenue sharing principle was proposed by the Minister and officially approved by the Council of Ministers on May 26, 1994 ?

2. The 250K Subscribers Ceiling

2.1.The Official Authorities' Positions

The positions of the various official authorities are, to say the least, not homogeneous:

- The previous Ministry acknowledged a ceiling of 250,000 subscribers per Operator.
- The "Cour des Comptes" Report confirms a ceiling of 250,000 subscribers per Operator.
- The current Ministry states a ceiling of 250,000 subscribers for both Operators.
- According to the Ministry's verbal statements, the opinion of Booz, Allen and Hamilton, the Ministry's consultants, indicates that **this issue is subject to "interpretation".**

The Ministry's position rests on one sentence in clause 1.2.1.1 of Attachment 4 of the BOT Contract stating:

> ***"This project has been planned to extend the existing telephone network in the Republic of Lebanon with 250,000 subscribers with 2 different GSM networks."***

2.2. The Cellular Operators' Position

The contract stipulates clearly in several clauses the obligation of the Operators **to build the network according to market demand:**

* In 1.2.3.2 of Attachment 4:
"The program will contain a mandatory Initial Phase with a capacity for at least 30,000 subscribers. Further expansion of capacity will be performed according to actual demand."

* In 1.2.4.5 of Attachment 4:
"Except for the Initial Phase, the increase in capacity of further phases shall be based on the number of requests for subscription presented by potential subscribers."

* In 3.1.2 of Attachment 4 :
"The program will contain an Initial Phase for 30,000 subscribers. Further implementation will be performed according to actual demand."

* In attachment 10, under the title "Further Phases":

"Capacity of NSS (Network Sub-Systems) and BSS (Base Station Controller) will be expanded according to the actual demand as assessed through customers' requests."

- The Contract further stipulates in clause 1.6.c. of the contract Part II that :

"MPT will consider the allocation of additional blocks of numbers to the Operator to the extent appropriate for the Operator to meet its justifiable business needs."

Therefore, the MPT already accepts the fact that networks may reach more than 400,000 subscribers.

- H.E. Minister Fadl Chalak raised the "market demand" obligation in August 1995 when he accused the Operators of breaching the Contract as a result of their failure to abide by this obligation.

- The "market demand" obligation was reconfirmed in the agreement dated July 18, 1997:
"The MPT reminds both GSM Operators of their obligation to fulfill the market demand and as such,..."

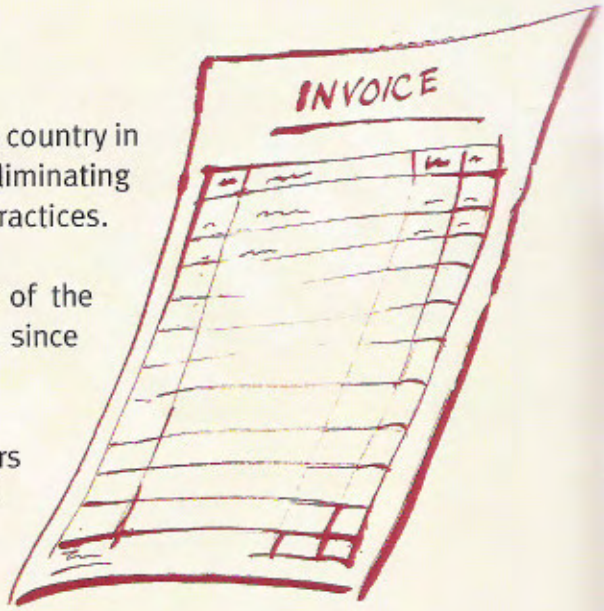
Furthermore, the contract does not mention at all the terms subscribers' ceiling, or subscribers' cap. How come the BOT Contract does not make a clear reference to such a limit, and does not describe related procedures and eventual infringement corrective actions ?

We are confident that if the Operators stopped investments and observed a limit of subscribers, the Ministry would have accused Operators of violating the Contract and not fulfilling the obligation of market demand.

2.3. Implications

The implications of a 250,000 subscribers' limit translated into:

- A **black market of GSM (Global System for Mobile) lines** creating mistrust in both Operators and the Ministry.
- Less revenue to the Operators and Ministry.
- A bad image to Lebanon since it is the unique country in the world imposing a cap on subscribers, eliminating competition and encouraging black market practices.
- An unfair social practice allowing only part of the Lebanese people to develop their life styles, since only 250,000 can profit from a GSM line.
- A 250,000 subscribers' limit for both Operators is setting absurd implications: How could one regulate the flow of subscribers? How to ensure that the 250K limit is respected at all times?



3. Cellular Operators' Profits and Contribution to the State Treasury

Countless figures were circulated regarding:

- Huge profits made by the Cellular Operators.
- Limited contribution to the Government's finances.

Those figures were meant to fuel the perception of a Contract unfair to the State Treasury and to emphasize the need to renegotiate the BOT Contract terms.

The table below summarizes LibanCell's yearly figures
(all figures in millions US$):

Description	1995	1996	1997	1998	1999	95-99
Gross Revenues, including Transitory	52.7	92.2	156.3	218.8	282.0	802.0
State Revenues						
International	7.6	17.3	20.7	20.8	18.7	85.1
2 Cents/ 6 Cents	0.0	0.0	5.7	13.0	35.6	54.3
Municipality Taxes	2.1	6.2	10.8	15.9	20.9	55.9
Revenue Share	8.6	14.3	22.8	31.9	38.4	116.0
Subtotal State from Invoices	18.3	37.8	60.0	81.6	113.6	311.3
Revenues from Fixed to LibanCell	0.8	1.4	10.2	28.1	51.6	92.1
State Total Revenues from LibanCell	19.1	39.2	70.2	109.7	165.2	403.4
State Revenues % Gross Revenues	36.2%	42.5%	44.9%	50.1%	58.6%	50.3%
LibanCell Net Profit	5.2	12.8	26.2	45.2	51.4	140.8
LibanCell Profit % Gross Revenues	9.9%	13.9%	16.8%	20.7%	18.2%	17.6%
Dividends Distributed	0.0	0.0	15.6	22.2	38.3	76.1
Total Investments	83.6	39.3	67.3	49.5	37.8	277.5

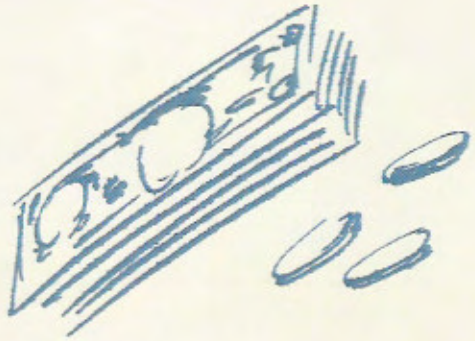
Above revenues to the State do not include other revenues to the Treasury generated from income tax, customs duties, usage of public utilities, ...

The analysis of the figures leads to the following facts:

- LibanCell's profits total $140.8 million over the last five years being 17.6% of the gross revenues.
- LibanCell's contribution to the State Treasury amounts to **$403.4 million** over the last five years and represents **50.3% of its gross revenues.**
- **LibanCell's profits are still quite below the level of investments** made: $140.8 million compared to $277.5 million.
- LibanCell's contribution to the Treasury has been steadily increasing from 36% in 95 to 58% in 99.
- **In 2000, the State revenues are reaching 63%** of LibanCell's gross revenues due to the impact of the 6 cents increase.

> One can conclude:

LibanCell's contribution to the Government is by far in excess of its profitability: almost 3 times as much, noting that the State did not spend any single penny on investments and operating expenses!



Comparing Cellular Operator's profits to international benchmarks and to profits achieved by international operators,

GSM Operators NOPAT (Net Operating Profit After Tax) 97 - 99

Operator	Country	NOPAT		
		97	98	99
Dete-Mobil	Germany	17%	20%	20%
Vodafone	U.K.	23%	25%	24%
TIM	Italy	17%	20%	20%
Swisscom	Switzerland	34%	33%	26%
Sonera	Finland	24%	4%	25%
Telnor	Norway	10%	21%	24%
TeleDenmark	Denmark	22%	16%	16%
Europolitan	Sweden	--	26%	27%
LibanCell	Lebanon	16.6%	20%	18%

> One can conclude:

LibanCell's profitability is well within the normal profit level for cellular operators, yet at the bottom of the scale.

4. Fees on Microwave Frequencies

The Ministry has recently claimed that the Operators should be paying fees for the use of Microwave Frequencies.

The Operators reject such claim since it is absolutely unfounded and exluded by the BOT Contract which clearly specifies all the sums to be paid to the MPT. As per paragraph 1, Attachment 1, Gross Revenue Sharing:

> ***"In consideration for the various obligations undertaken by the MPT under this Contract (including but not limited to Interconnection with PSTN, availability of frequencies, exclusivity), the Operator agrees to pay the following to the MPT:***
>
> - ***Sums specified in Attachment 3 to the Contract, and***
> - ***A Gross Revenue Sharing determined and paid in accordance with the provisions of this Attachment.***
> - ***Other call charges or part thereof to be collected by the Operator and repaid to MPT in respect of national and international calls routed through the PSTN (Public Sector Telephone Network), as indicated in Attachment 2 "Schedule of Tariffs".***
>
> ***These sums constitute the sums to be paid by the Operator to MPT under this Contract."***

As such, any fees not mentioned in Attachments 2 and 3, and especially fees related to microwave frequencies, are not part of the Operators' obligations.

5. Non Payment of Revenue on Extra Lines and Late Payments

This accusation is groundless. LibanCell is paying all dues on time, namely:

- Ministry's share including revenue share, international calls, airtime fees and municipality taxes.
- Income taxes to the Ministry of Finance.

Furthermore, in March of every year, LibanCell is providing as per the BOT Contract stipulations in clause 4.2 of Attachment 1, the "Gross Revenue Sharing" auditor's report stating all LibanCell's revenues for the preceding year and confirming that LibanCell has paid all its dues.

The MPT has never questioned any of the figures provided by LibanCell and did not appoint an independent auditor since the KPMG mission in July 1997.

As for the income taxes, LibanCell is paying all its dues as well as all income tax claims on time. Furthermore, the Ministry of Finance auditors have completed their review of the year up to 1997 and issued their final report. The Ministry's auditors have also completed their audit for 1998 accounts and LibanCell is expecting their final report.

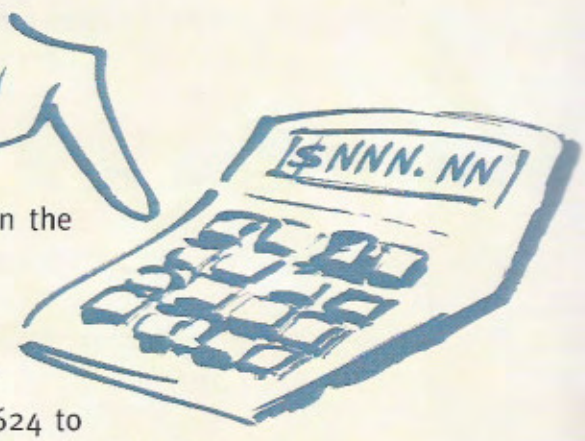
6. Rounding the Airtime Charges

A member of the Parliament accused the Operators of "abusing subscribers by rounding the airtime charge per minute from $0.1208 to $0.121 and achieving huge profits at the expense of the subscribers".

Such claims are "ridiculous" and reveal the non-scientific approach used in handling the cellular issues:

- Any company or institution applies rounding when billing its customers. Invoices are usually issued with two decimals, i.e. "$nnn.nn". Such practice is common in and outside Lebanon.

- Since our unit rates are in cents, we have elected to apply rounding based on 3 decimals on a call by call basis: "nn.nnn". The rounding to 2 decimals is only done on the total aggregate of all calls.



- The so-called profits achieved by rounding to $0.120 from $0.1208 are offset in case of a 3 minute call (rounding down from $0.3624 to $0.362) or a 4-minute call (rounding down from $0.4832 to $0.483). Accordingly, the subscriber benefits from the rounding in certain instances.

- The average regular subscriber in LibanCell generates around 420 minutes of outgoing calls, which would translate in the worst case and assuming a variance of $0.0002 cents for every minute called, into a surcharge of $0.084 per month. Even such figure is unrealistic since the difference might be to the advantage of the subscriber depending on the call duration as detailed earlier, and the effect on the invoice is negligible.

- **The same rounding principle is applied today, by the MPT, when billing its subscribers!**

LibanCell could have generated additional profits "legally" by applying the 5% contractual annual increase on all tariffs defined in the BOT Contract. We decided not to use this right, except on airtime, in consideration of the prevailing economic situation. And **we strongly reject the claims** referring to the application of rounding principles aiming at inflating profits.

7. Prepaid Cards

The Ministry claims that **the Operators are not allowed to launch prepaid cards without the Ministry's approval** and that the revenue sharing principles for prepaid cards must be reviewed. The Operators' position is based on the BOT Contract stipulations, namely article 2.5 of Attachment 2:

> ***"Notwithstanding the above provisions, Operator shall be free (1) to set up tariff structures combining the Connection Fee and/or a Monthly Subscription Fee with a number of prepaid telecommunication units fixed by the Operator and (2) to fix its tariffs at a level lower than the Ceiling Tariffs specified above".***

Such article clearly allows the launch of prepaid cards, as long as the bundled per minute tariff falls below the Ceiling Tariffs, which is currently the case.

The Operators have always advised the MPT of any changes in prepaid tariffs, the introduction of new packages and the revenue sharing principles applied which are based on:

- 10% municipality tax.
- 20% revenue sharing for years 1-8.

Prepaid has given the Lebanese people a wider choice in terms of offers, and has given them control over their telephone expenses. **It has given Lebanon the lead** in mobile communication allowing the country to reach a penetration of 17% after 5 years of operations well ahead of most of the Arab Countries.

The introduction of prepaid cards is **absolutely legitimate,** was welcomed by the Lebanese public and has boosted the cellular market and the telecom market overall, as well as the revenues of the State.

8. Providing Adequate Coverage and Capacity

8.1. The Official Authorities' Claims

The Ministry as well as various official authorities are claiming that:

- The Operators are not providing the required coverage, as per the BOT Contract.
- The Operators are constantly adding more subscribers than their networks' capacities allow.
- The network quality is below the contractual specifications.

8.2. The Cellular Operators' Position

- LibanCell has exceeded by far the contractual requirements whether in terms of coverage, capacity or quality. Any LibanCell roamer is able to compare the quality of LibanCell's network to foreign networks and evaluate the advanced stage of the services available in Lebanon.

- The contractual specifications for coverage are as follows:

  * Attachment 10 clearly details the technical specifications for the geographical coverage: ***"The coverage shall be 90/90 (time/location, refer CCITT) Recommendations 370.2".***

  * Compliance with the 90/90 geographical coverage of Lebanon was achieved in year 1 as per the BOT Contract requirements and the international standards.

  * This point was further clarified in the minutes of meeting dated October 22, 1995 and signed by H.E. Minister Fadl Chalak whereby it was specified : ***"The mentioned coverage of the Geographical territory of Lebanon in the BOT Contract does not include the unpopulated areas."***

- In terms of the relationship with the MPT:

  * LibanCell provides on a monthly basis to the GSM office of the Ministry a copy of its coverage maps computerized by means of its radio planning tool and has not received any comments or complaints on any lack of coverage.

  * We have on multiple occasions invited the GSM office to join us in our drive tests to confirm the quality of LibanCell's network coverage. For the last two years, **the GSM office refrained from participating in those drive tests**, whose results are included in the monthly GSM report.

  * Following claims on poor coverage, we have on October 22, 1998, July 20, 1998, December 11, 1997 and November 18, 1997 conducted with the GSM Office common drive tests to ascertain the quality of the coverage. The tests have been successful and the Ministry's representative has formally signed those sheets.

  * The last formal coverage or capacity claim was received on March 17, 1998 reference MPT letter 1644/O.M., to which we have responded, clarifying the issue. We did not receive since then any claims.

- As far as network capacity, it exceeds by far the number of subscribers. On a monthly basis, we provide the Ministry with our total capacity both in the switching and radio networks. As a reminder, we would like to indicate that as of March 31, 2000:

  * Total number of subscribers: **322,000 (HLR - *Home Location Register*).**
  * Total switching capacity: in excess of 400,000 subscribers.
  * Total radio capacity: in excess of 450,000 subscribers.

LibanCell has exceeded the BOT contractual terms for coverage and capacity. **We have decided to sustain investments in the network, despite the tension and uncertainty prevailing with the MPT**. LibanCell's network can host today over 400,000 subscribers.

9. KPMG Report

KPMG performed in July-September 1997, a due diligence exercise to ascertain that the MPT received its dues from the Operators for the years 1995-1996.

KPMG's Report quoted two main issues with respect to LibanCell:

- Delays in paying the monthly revenue share, and accordingly interest on the delays should be paid to the MPT.
- Errors in the system, which resulted in a loss of revenues to the MPT: KPMG estimated that the revenue share on those amounts should be paid, although LibanCell did not collect the amounts.

Other points raised include:

- The right of the Operators to set a variable connection fee and pay revenue share accordingly.
- The right of the Operators to issue service phones with preferred tariffs.

LibanCell answered all claims raised by KPMG on December 22, 1997 and did not receive since then any comments from the Ministry aside from a recent letter dated March 27, 2000 referring to interest on late payments.

Hereafter a summary of LibanCell's reply:

9.1. Claim for Interests on Late Payments

- The Operators are bound contractually to pay revenue sharing on **amounts collected**, as per clause 4.1 of Attachment 1 of the BOT Contract (attached as Annex 1) and stipulating:

  "On or before the 25th of each month, the Operator shall pay to the MPT the Gross Revenue Sharing calculated on the Service Charges received by the Operator during the preceding month".

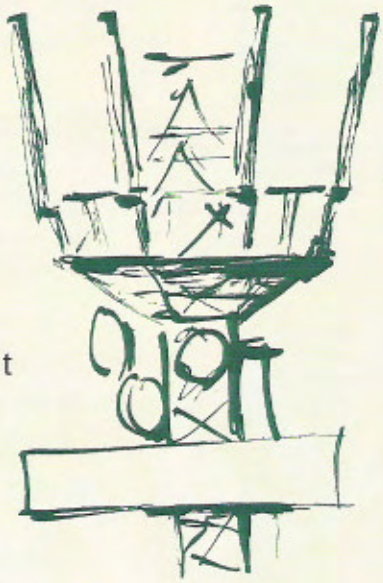
- The Operator believes that the BOT Contract's text is clear and leaves no room for any interpretation: **"received by"** cannot be assimilated in any form whatsoever to **"invoiced"**. As such, the above claim is fully rejected.

- The Operator confirms the payment of revenue sharing following partial collection of the Service Charges invoiced. Therefore, the statement related to "delays in payment" is not applicable.

9.2. Claim for Collecting Amounts Resulting from Lost Unbilled Revenues

- According to the BOT Contract, clause 3.1 of Attachment 2, the Operator is requested to install metering equipment and to record all chargeable PSTN Originating calls. LibanCell provided the MPT with all records available.

  "In order to record the number of telecommunication units for PSTN Originating Calls, Operator will install metering equipment at each interconnection point between the PSTN and the GSM System. All chargeable PSTN Originating Calls (real time) will be recorded by the Operator, free of charge to the MPT."



- According to the BOT Contract, clause 13 of Attachment 6, the MPT is requested to meter the traffic between LibanCell and PSTN at the level of the MPT exchanges, especially that:

  "The charging records for outgoing traffic in each System shall be the reference for monthly invoice"

This obligation was not fulfilled leading to the lack of a reference point that should have been provided by the MPT.

- In all cases, the Operator cannot be requested to pay revenue share on amounts not collected.

Audits by the MPT are necessary for both the Ministry and the Operators since they remove any doubts over the Operators' application of the BOT Contract and their fulfillment of all their obligations. LibanCell welcomes and cooperates with any firm appointed by the MPT.

9.3. Connection Fees

- KPMG claimed that the Operators should pay revenue sharing based on a connection fee of $500, irrespective of the actual selling price.

- LibanCell is bound contractually to pay revenue sharing on **the Gross Revenues**. The fees paid by users range between $0 and $500, in accordance with **the Operators' right to reduce the base connection fee.**

- The Operators have signed an Agreement with the MPT on October 22, 1995 whereby the Operator's settlements are based on actual collected connection fees from subscribers.

LibanCell has never received any correspondence questioning the application or the interpretation of the agreed upon principles. Furthermore, during a Financial Work Group Coordination meeting dated January 11, 1996, the MPT agreed that it shall:

"Present its remarks/comments within one month from the date of receipt of the revenue sharing statement.
The revenue sharing statement is considered as final and officially approved by the MPT in case no comments are presented."

9.4. Service Phones

- We would like to clarify the international concept of service phones: these are "lines" used by the Operator, that are totally free, whether for local or international calls. Such free lines are standard for any Operator. Moreover, the MPT is currently applying this principle with respect to its own employees.

- Based on the MPT's objection to grant LibanCell "service phones", LibanCell chose to set a specific price plan within the contractual flexibility granted. Lines provided to the MPT are included in this tariff plan, as an example.

As such, **LibanCell does not have "free lines"** and all dues to the Ministry (international calls, 6 cents airtime fee, interconnect fees (10L.L.) and municipality tax) are paid in full.

10. The "Cour des Comptes" Report

The "Cour des Comptes" report is an extensive detailed report, split in:

- Criticism of the terms of the Contract

- Criticism of the MPT

- Contractual violations by the Operators

The issues related to the first two points do not fall within the scope of this report, and shall not be developed. We would like to underline however that **the BOT contract was approved by the "Cour des Comptes" itself, without any reserves, on July 26, 1994, and prior to its signature by the MPT.** The violations by the Operators are classified under two chapters: financial and administrative.

10.1. Financial Violations

The financial violations listed include:

- Issues raised by KPMG.

- The 250 K ceiling per Operator.

- The non payment of fees for the additional GSM frequencies.

- The non payment of revenue share on Value-Added Services.

The first two points were addressed earlier. The last two issues cannot be considered as violations since they are in full conformity with the BOT Contract. Specifically, in relation to Value-Added Services, the BOT Contract clearly stipulates in article 3.1 of Attachment 1:

"The Revenue Sharing due to MPT in respect of Special Services shall be applied only to airtime charge of such services".

The Operators have applied the stipulations of the BOT Contract **formally approved by the "Cour des Comptes" on July 26, 1994.**

10.2. Administrative Violations

The administrative violations listed include, among others:

- Delays in submitting documents: articles of incorporation, names of shareholders, technical plans,...
- The non-payment of the full capital.
- Delays in coverage and capacity implementation in the first year.
- The absence of a training program for MPT staff.
- Unclear principles for revenue sharing on prepaid cards.
- Irregularities in the companies' books.

The Operators respond to the above claims, as follows:

- All the documents requested were submitted. The delays on submitting some documents do not have any impact on the performance of the BOT Contract. In addition, the MPT did not raise any claim in that respect, without being answered immediately and all requested documents were delivered to the MPT.
- The initial payment of 25% of the capital was formally approved by H.E. Minister Mohammad Ghaziri, who requested a bank guarantee to cover the remainder of the capital, until such time the Operators submit proofs of investments beyond the Capital's value. One of the Operators' claims is specifically related to the delays caused by the Minister in releasing this guarantee causing substantial losses to the Operators.
- In August 1995, H.E. Minister Fadl Chalak, accused the Operators of delays in the implementation and of failures to abide by their contractual obligations. Following multiple meetings, as well as various technical tests performed by the Ministry, the Operators and the Ministry signed an Agreement on October 22, 1995 clarifying all the points of contention and confirming that the Operators did not fail in meeting their contractual commitments.

- It should be noted that problems of quality can be met in general in the first year of operations as a result of the ongoing implementation works and of the high expectations of the users, familiar only with fixed line telephony.

- One should also not forget the major problems faced as a result of the interference from external sources, which impacted and is still impacting the quality of the network.

- The absence of a training program to the MPT staff is definitely not a violation since such training relates to the hand over of the system in the last years of the BOT Contract.

- Irregularities in the companies' books: this refers to tax issues that have been reviewed by the Ministry of Finance, which completed its audit for the years 1995, 1996 and 1997.

LibanCell has paid all amounts requested, in spite of its objection to most of the issues raised by the Ministry of Finance.

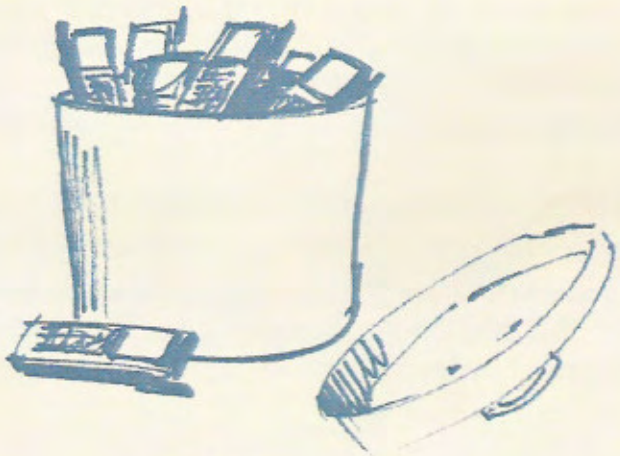
We have officially presented our objections and are expecting the Committee of Objections' response. Furthermore, the Ministry of Finance completed its 1998 audit and we are expecting its report soon.

> One can conclude:

The recommendation of the report to either amend the Contract terms or to terminate it, is not in line with the findings. One has to note that the "Cour des Comptes" recommendations referred to the clause of arbitrary cancellation 22.1.e:

"If MPT, in its sole discretion and for any reason whatsoever, decides to terminate this contract with a prior notice of 180 days".

This leads to the conclusion that the "Cour des Comptes" did not find the above reported violations as sufficient to recommend the termination of the contract for faults. In all cases, LibanCell has answered with facts and figures all allegations providing supporting documents. LibanCell confirms its abiding by the terms of the BOT Contract.



Major Griefs Voiced by the Cellular Operators

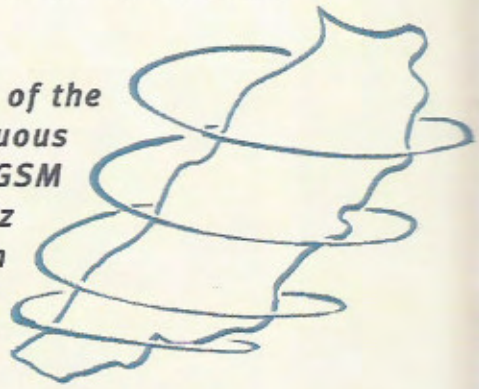
1. External Interference

This problem was faced by the Operators since the first day of operations and is still being faced although its impact is not today as major as it used to be, as a result of LibanCell's financial and technical undertakings and its densification of the cellular networks and the multiplicity of base stations.

1.1. Contractual Obligations of the Ministry

The obligations of the Ministry in that respect are clearly stated in clause 33.2.1. of the BOT Contract:

> ***"MPT agrees to ensure that each of the following conditions are satisfied as soon as practicable after the date hereof. Any delays in the fulfillment of these conditions beyond a period of 4 months after the entry into force of this Contract shall result in an extension of the period of the Initial Phase and/or Contract Period by a Period equal to such delay."***
>
> ***"The delivery by the MPT, for exclusive use of the Operator, clear of interference of the continuous frequency band of 2 x 9.6 MHz duplex in the GSM operating frequency band (i.e. 890-915 MHz and 935-960 MHz) as described in Attachment No.7, with the exception of foreign sources of interference which affect no more than ten percent (10%) of the frequency band so delivered."***



Attachment 7 describes the conditions pertaining to the measurement of the interference sources, namely:

> ***"A GSM channel will be considered as free and clear from any disturbance when the disturbing signal, other than an Operator GSM emission, is less than –110 dBm (minus One Hundred and Ten dBm) over a time span of two hours (measured with an omni-directional antenna 1.5m above ground level at the point of measurement)".***

1.2. What was done?

In light of the earlier complaints to the MPT in that respect, the Ministry requested in 1995 the cooperation of the Cellular Operators, who agreed to finance an independent company (LCC) to perform a survey of the Lebanese territories and identify all local interference sources. This mission was completed but **the Ministry was not able to implement the recommended actions** and some of the sources that were stopped were reactivated.

In spite of our repeated complaints, **the Ministry was not able to propose any action plan.** It announced at one time that a frequency management team will be created and that equipment will be purchased to enable identification of the interference sources. So far, we are not aware of any progress in that respect.

We are continuously pointing out in each monthly progress report to the Ministry the problems arising from the external interference but we are not receiving any response.

2. Application of the July 1997 Agreements

2.1. Background

In order to increase the revenues to the State, and following lengthy negotiations, an agreement was signed by the Prime Minister in his capacity of Minister of Post and Telecommunications and by the Cellular Operators, based on the following balance:

State:

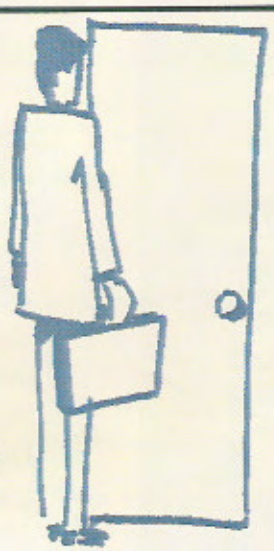
- 2 cents increase (translating into additional yearly revenue of $25m from both Operators and $25m from the PSTN subscribers).

Operators:

- More frequencies in 1800 MHz to cater for more capacity and offer better network quality.
- New services of PABX connections.
- Comfort letter over arbitrary termination of the Contract.

The Operators complied with the agreement, but the Government refrained from applying its commitments.

2.2 Implications



The confidence of the Cellular Operators in the willingness and in the ability of the Ministry to deliver the agreed upon commitments was shattered.

Since the cellular operations started, the Ministry has sought to review the Contract, to amend its terms and to increase revenues from the Cellular Operators by any means.

Even when agreements were reached and concluded, the Ministry stopped short of delivering what was decided.

Furthermore, the points that were blocked in the Agreement impact both Subscribers and Government:

- Granting the Operators GSM 1800 MHz frequencies will lead to the increase of the capacity and availability of the network, benefiting the Subscribers.

- Allowing the Operators to implement PABX connections satisfies a need the Ministry is currently not able to fulfill, and that will generate more revenues to the Ministry.

3. The 6-Cent Airtime Fee Increase

3.1 Background

During early 1999, the Minister sought to negotiate with the Cellular Operators ways to increase State revenues through increasing the airtime by another two cents.

The Operators proposed to study alternative ways to increase the Treasury revenues, without putting aditional burden on the subscribers.

The Operators repeatedly warned the Minister against any **unilateral action contesting its legality** and repeatedly indicated to him that an additional increase might not achieve the expected returns to the Treasury.

Despite the Operators' objections, the Council of Ministers issued decree 502 increasing by 6 cents the airtime including the previous 2 cents agreed upon, violating thus the law and the BOT terms.

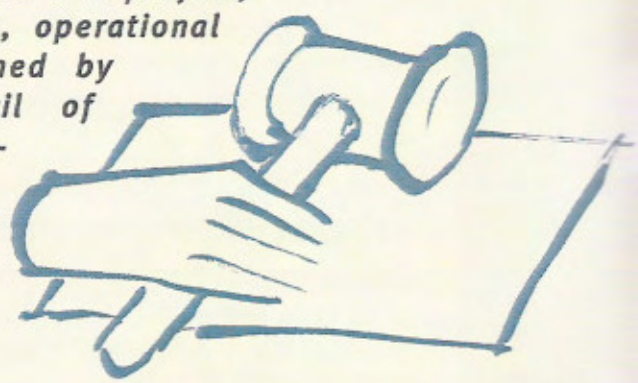
3.2 The Cellular Operators' Position

Two issues should be addressed: the **legality** and the **economical impacts.**

- **Legality:**

  * If the increase is considered as a tax, raising unilaterally additional taxes to the treasury is the prerogative of the Parliament. If the increase is an increase of airtime charges, it does not fall within the competence of the Council of Ministers, since the decree refers to clause 3 of law 218/99, which stipulates:

" If needed, the details related to the project, whether technical, administrative, operational and financial shall be determined by decrees issued by the Council of Ministers based on recommendations from the Minister of Post and Telecommunications and from the Minister of Finance".



As such, LibanCell's position is that the above clause does not give to the council of Ministers, the rights to increase unilaterally the airtime fees but to clarify details related to the project and to the contract.

* Imposing on the Operators the responsibility of collecting an additional 4 cents per minute to the treasury, without any legal basis and without any compensation is illegal and does not comply with the BOT Contract stipulations.

* The BOT Contract clearly stipulates in clause 2.4 of Attachment 2 of the BOT Contract that any changes in the Ceiling Tariffs have to be **approved by both Parties.**

* **Based on the findings of our legal counsel, Me. Hassane Rifaat, as well as external eminent lawyers, Me. Hassan Rifaï and Me. Fouad Boutros, the decree should be overturned.**

Accordingly, LibanCell has filed a lawsuit on June 16, 1999 to the "Conseil d'Etat (Al Shura Council)" to overturn the Council of Ministers' decision.

- **Economical impacts :**

* The 4-cent increase implies to a **50% increase on airtime** and did have a dramatic impact on the talk time from and to mobile phones. A 10% decrease has been recorded so far.

* The State's revenues from both the previous 2 cents and the 20% revenue share did decrease considerably.

* **The bad debts increased by 50%** as a result of the 6-cent introduction.

* We witnessed a migration from regular subscriptions to prepaid as a result, noting that a prepaid user generates revenues lower by 75% to both Operators and Ministry. Moreover, **we have lost over 10,000 regular subscribers.**

* Counting on an increase of fixed wireless minutes is not rational since the returns to the State per minute of GSM was at 3.2 cents (before the 4-cent increase) or 48 LBP, almost twice the local rates.

4. The Ministry failed to guarantee the exclusivity of cellular operations and did not stop the illegal Operator until March 1997 or 27 months after the start of the BOT Contract.

5. The Ministry is not fulfilling the contractual obligation of coordination with the Operators, to address the day-to-day operational requirements that are constantly delayed, impacting negatively the Operators, the Ministry and the Subscribers.

6. Interconnection capacity

The Ministry is not providing the necessary interconnection capacity to remedy the congestion of the links interconnecting the Operators' networks and the fixed lines network.

> One can conclude:

The Ministry has repeatedly violated the BOT contractual terms, failing to deliver and meet with basic and vital obligations, despite reccurring requests and reminders from the Operators.

Conversion of the BOT Contract into a License

Faced with the needs of the Government to:

- Increase revenues from the Cellular Operators.
- Get quickly substantial amounts of fresh money to help the State's finances.

And faced as well with the operational limitations of the BOT Contract:

- Restricted frequencies.
- Limitations in provision of value-added services.

The optimal approach for both Government and Operators is to convert the BOT Contract into a License, succeeding in resolving the above issues as well as ensuring the best services to the Subscribers.

1. The Case for a License

The majority of currently operating cellular networks falls under a "license", that spans in duration from fifteen to fifty years. Lebanon is now the single exception with a "BOT" type arrangement, following the conversion of the BOT Contract in Turkey into a license, recently.

A license is awarded against a financial package that usually includes:

- An upfront license fee.
- Revenue share or interconnect/frequency fees.
- Clear terms in relation to value-added services.
- Access to international gateway (Morocco's case).
- Exclusivity terms for a period of time.

An Operator with a license is able to:

- Address the international financial debt markets initially to finance its investments in building out the network.

- Go public and issue shares to various institutional and small investors, with a listing on both the local Exchange and some selected international Exchanges.

Going public translates in quoting the Cellular Operators on the local Exchange and as such quoted cellular companies would enhance Beirut Stock Exchange's activity and accordingly the Country's economy.

2. Valuation Methods of the License

A license is valued according to various methods. The two main methods used for non quoted cellular operators are:

2.1. DCF or Discounted Cash Flow Method

Such approach involves building a business plan, integrating all operational, technical, commercial and financial aspects, projecting the net cash flow that would be derived from the operation and discounting such cash flow to a present value, using a percentage value incorporating the interest, as well as the risks associated with the venture.

2.2. Per PoP Method

Such approach validates any other valuation approach used, as a sanity check. It gives a $ value per head of population. The value clearly differs from country to country, based on the country's economic conditions as well as on the license conditions.

3. Lebanon's Case

It is unfortunate that the "cellular case" in Lebanon is being publicly discussed and debated based on subjectivity and perceptions rather than on scientific facts and figures:

- The public's perception is that the Cellular Operators make too much money which should go rather to the Treasury's coffers. Accordingly, the public's tendency is requesting the authorities to act to limit the perceived "loss of revenue".

- The Members of Parliament and the Government's officials reinforce such perceptions through their statements, mostly politically motivated and without any hard facts or foundations. **All seem to forget that GSM is a success story because it is operated by the private sector**.

- The official authorities resort to announcing potential license fees in the hundreds of millions of dollars, portraying such issue as the solution for the budget deficits and blocking effectively any possibility for reaching a middle ground in the negotiations with the Cellular Operators.

One has to instigate a scientific approach to build up the basis of a valuation of the license.

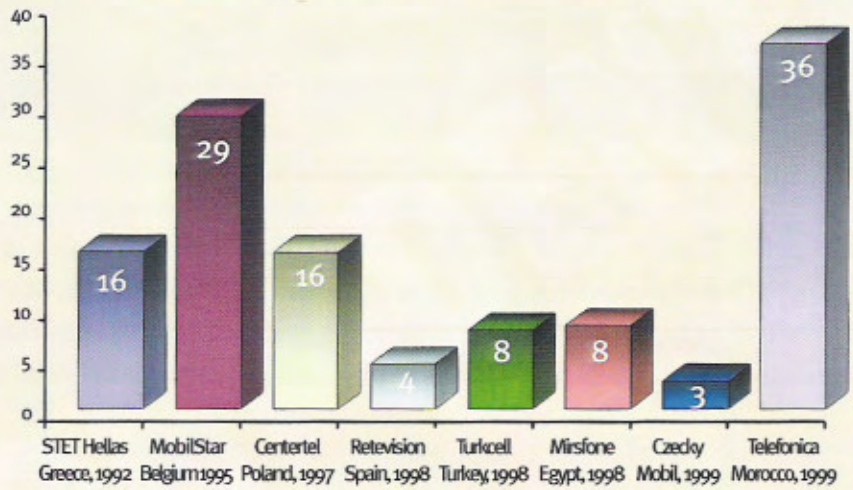
3.1. The Per PoP Approach

One can refer to cases that occurred recently in countries, geographically and culturally close to Lebanon:

Country	Remarks	Population	License fee	Per PoP value
Morocco	2nd Operator	30 million	$ 1.080 million	$ 36
Egypt	2 Operators	62 million	$ 516 million*2	$ 8.3
Turkey	2 Operators	64 million	$ 500 million*2	$ 7.8
Lebanon	**Simulation**	**4 million**	**$ 200 million*2**	**$ 50**

If we apply the same principles of calculation, with a 4 million population and a $50 value per PoP, the Lebanese market would justify a license fee in the range of **$200 million per Operator** (in case of 2 Operators).

License Fee per PoP in US$



3.2. The Discounted Cash Flow Approach

LibanCell has implemented a scientific method in building a business plan allowing running simulations of various scenarios for both license fee and revenue sharing arrangements. Booz, Allen and Hamilton used the same approach in its mission to reach an agreement on the license value. This involves the definition of the following parameters:

- The total penetration and market share of each Operator as projected over the coming 20 years.
- The ARPU line or Average Revenue Per User
- The share of the Government in taxes (municipality, VAT), interconnect fees and if applicable, revenue share.
- The projections of operating expenses.
- The capital expenditures or investments and the associated depreciation.
- The discount rate to be applied to derive a Net Present Value (NPV) for the future cash flows generated.

The parameters are fed into a business model allowing the definition of a value or range of values in case of divergence of opinions concerning the measurement of certain parameters.

> One can conclude:

Converting the BOT Contract of the Cellular Operators into a license has numerous benefits:

- Increased direct and indirect revenues.
- Increased benefits to the subscribers and development of the telecom sector.
- Introduction of competition at an early stage through a third license.
- Revitalization of the Beirut Stock Exchange through a public listing of the Cellular Operators.
- Additional proofs to the international community of the well-being of the Lebanese economy and the soundness of the fiscal policies.
- Increased level of investment by the Cellular Operators resulting in a further improvement of the telecommunications infrastructure of Lebanon.

The BOT Contracts for the cellular systems in Lebanon proved to be one of the landmark successes of the Government in terms of privatization, deregulation and infrastructure rebuilding. The conversion into a license would definitely be another landmark success along the road of economical recovery of Lebanon.

Relations with the Ministry of Post and Telecommunications

The last sixteen months since H.E. Minister Issam Naaman took over the reins of the MPT can be described as periods of **complete inactivity** interrupted by intervals of intense discussions or negotiations.

The relations lacked the consistent and continuous follow-up needed:
One major indicator is the failure to hold any GSM Coordination Meeting for over 16 months, in spite of recurring requests by the Operators.

Another indicator is the Minister's correspondence over the period that was limited to:

- 3 warning letters to which responses were forwarded.
- 48 letters covering administrative issues such as requests for phones, for lines, for documents!

Furthermore, the relations with the Minister started in an unfriendly manner as a result of his pre-conceived position with regard to the BOT Contract.

The periods of "activity" are split in three phases:

1. The March-April 1999 Discussions

The Minister initiated early March 99 discussions centering on the need to increase the Government's revenues and has specifically requested the unconditional approval of an increase of 2 additional cents on the airtime.

The Operators indicated their willingness to cooperate with the Minister. **However, they insisted on the detrimental impact** that the increase in airtime would have **on the Lebanese subscribers,** who will suffer from high invoices **at times of economic hardship.**

The Operators requested from the Minister that they study together alternative ways that could increase the MPT revenues without impacting the subscribers.

The Minister abruptly stopped the "discussions" and recommended to the Council of Ministers a "4-cent" increase rather than the "2-cent" discussed with the Operators. His recommendation was unfortunately unilaterally adopted.
LibanCell filed a lawsuit to "Al Shura Council" requesting to overturn the Council of Ministers' decision.

2. The October- December 1999 Negotiations

The Minister called the Operators to start negotiations following the completion of the Report prepared by Booz, Allen and Hamilton (BAH) appointed by the Ministry to study the cellular market in Lebanon and to examine the BOT Contract.

The Operators asked the Ministry to communicate to them a copy of BAH's report in order to use it as a starting point in the negotiations. The Minister refused to deliver the report.

The discussions started with each Party's claims of contractual violations, but soon led to a dead end due to the divergence of positions and the Ministry's unwillingness to substantiate its claims with evidence.

By mid November 1999, negotiations with Minister Michel Eddé started but were equally fruitless and were suspended by year-end.

During the whole process, the Operators insisted to conduct scientific negotiations and invited the Ministry repeatedly to involve international consulting firms. They persistently expressed their lack of understanding at the MPT's refusal to involve its own consultant BAH in the negotiations.

3. The Booz, Allen and Hamilton (BAH) Mission

By early March 2000, the Operators and the Ministry finally agreed on implementing a professional way forward and selected the Ministry's Consultant Booz, Allen and Hamilton as a mediator for agreeing on the future of the mobile communication sector.

3.1. Terms of the BAH Contract

The objectives were set as follows:

" The objective of this engagement is to assist the three parties – MPT, Cellis and LibanCell- in reaching terms of agreement on the future structure and relationships of the Lebanese mobile communications market during the first half of April 2000, taking into account:

- ***The current situation of the mobile communications market in Lebanon.***
- ***The optimal future development for this market.***
- ***The opportunities and constraints facing the current operators.***
- ***Acceptable general principles for license valuation.***
- ***Implementation constraints resulting from the current Lebanese legal and regulatory environment."***

The process was determined as follows:

> ***"The moderation process will involve a number of stages which will result in a set of conclusions. Once the conclusions related to each stage have been agreed by the three parties (through working sessions), the conclusions are "frozen" to allow the process to proceed to the next steps."***

The target was set to the middle of April 2000 with a possible extension to the end of April 2000:

> ***"If no agreement is reached on the principles of the future relationship by the middle of April 2000, the three parties and Booz, Allen and Hamilton will determine whether to proceed with the effort for another two-week period, or to stop it. The end date for this engagement cannot be later than April 30, 2000."***

Basically, all Parties agreed to concentrate the dicussions on the terms and the valuation of a license in a phased approach spanning until the end of April 2000.

3.2. Development of the Negotiations

From the start, the MPT did not follow the procedures set in the BAH Contract:

- **It did not nominate technical representatives to discuss the parameters of the valuation with BAH.**
- **It refused to sign the interim agreements.**

One has to highlight that the Minister refused during the whole process of the discussions to have minutes of meeting signed by all Parties to keep a trace of what was discussed and of the position of each Party.

In spite of the Ministry's lack of responsiveness, the Operators continued the negotiations with BAH that culminated in a meeting on April 13th, 2000, regrouping all Parties, where:

- The Minister requested **$1.25 bn** stating, it is the only figure that the Parliament can accept.
- Following consultation with Credit Suisse First Boston, appointed by LibanCell to assist in raising the funds needed once the agreement matures, the Operators accepted the Ministry's figure based on a license including **UMTS (Universal Mobile Telecommunications Systems), an international gateway and an extension of the duopoly,** which terms will secure a "marketable" license and allow to raise the required financing.

The Minister rejected this offer.

- The Operators offered **$530 million** for the license under the current terms outlined by the Ministry, and in line with the scientific Business Models developed.

The Minister rejected this offer.

As quoted by BAH in its final report:

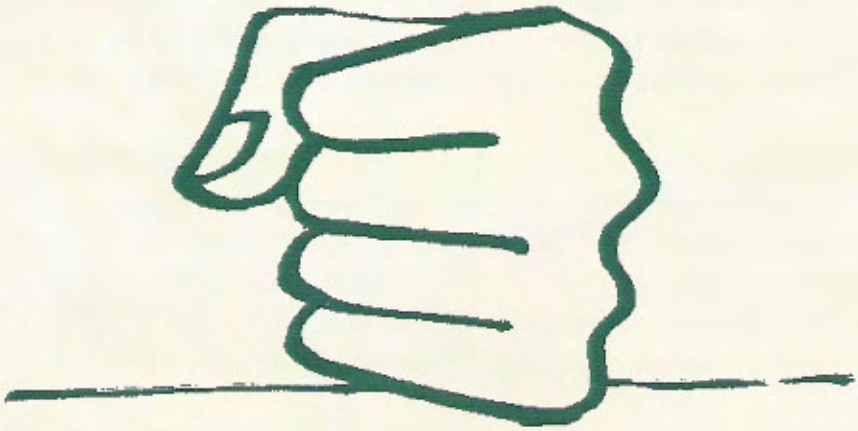
> ***"All parties agreed that a "scenario", illustrating key terms of agreement to be considered as a framework to continue negotiations in good faith, would be distributed to all Parties as a basis for substantiated pricing offers."***

The scenario was prepared by BAH and was signed by the Minister and by the Operators on April 15, 2000, as stated by BAH in its final report:

> ***"All parties signed the scenario terms, with some provisos to -and clarifications on- some of the terms."***

The terms of the license were signed with the understanding that the Operators will, jointly with BAH, and over the next two weeks, conduct intense negotiations to come up with a value for the license.

This process was aborted unilaterally by the Minister on April 17, 2000, two days after he signed the terms of the license and without any prior warning.



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