

ENRON
Power Corp.

**Interoffice
Memorandum**

To: David Odorizzi
From: Carl Waldo *[Signature]*
Subject: Payment and Tax Problems Re 6% Sun King
Obligation - Guatemala Operations

Department: Operations
Date: May 26, 1993

This is in response to your request for details on the subject made at Monday's staff meeting.

BACKGROUND

Enron Development Corp. entered into an agreement with Texas-Ohio Power, Inc. (the "TOP agreement") on March 12, 1992 whereby in consideration for TOP transferring the Power Contract with Empresa to EDC, EDC agreed to pay (among other sums) "an amount each month equal to 6% of the gross revenues generated by the sales of electricity and payment for contract capacity under the Power Contract."

*EPC
pays 6%
of Gross Rev
to
TOP
Texas Ohio Power
&
assigned to
SUN KING
TRADING CO.*

In a letter dated March 12, 1992, TOP notified EDC that the "right of a monthly payment of a 6.0% of the gross revenues...has been legally and effectively assigned in favor of SUN KING TRADING COMPANY, INC." The letter further stated that "any monthly payment...must be paid directly to the assignee, SUN KING TRADING COMPANY, INC., 6a. Avenida 20-25 zona 10, 8th floor, Guatemala City, Guatemala," and further requested that EDC notify Sun King of the receipt of this letter.

David Hang, by letters dated March 13, 1992 acknowledged receipt of the letter to TOP and informed Sun King of receipt of the TOP letter and acknowledged that EDC would make the required monthly payments directly to Sun King per that letter.

Thus, it was established that the Sun King group would receive a monthly payment equal to 6% of the gross revenues of Puerto Quetzal. This has been shown in various projections and budgets as "Guatemalan share of revenue."

You will note that the TOP agreement (as quoted above) gave a local address for the payment and was silent as to the denomination of the currency of payment.

Since Empresa Electrica pays us in Quetzals for the Capacity and Energy - although the rates are quoted in U.S. dollars in the Power Purchase Agreement - PQ must go through the auction process to acquire the dollars it needs to operate - the initial assumptions were that this Sun King payment would be a) made locally and b) in Quetzales. Under such circumstances the payment would be subject to VAT of 7% and a Withholding Tax of 4%.

*4%
WITHHOLDING TAX
7%
VAT TAX*

Sun King then announced through Oswal Herbruger, a member of the Group, that Sun King is entitled to receive payment in either Quetzales or dollars and disputes the withholding or deduction of any tax.

→ note in writing

EC2 000036574

EDC agreed to the option of dollars or Quetzales which was tied to which bank account Sun King instructed us to pay into.

On March 1, 1993 David Haug received a letter requesting that the monies be paid into either one of two named bank accounts in Miami for credit to Deutsch - Suedamerikanische Bank A.G., Miami Agency. This meant that they had opted to receive the payment in dollars.

Handwritten notes:
→ ...
May 1993
Lanille Tot

It was also revealed that Sun King Trading Company, Inc. was a Panamanian Corporation not registered in Guatemala.

Payments of this nature by a Guatemalan entity to a person or company abroad is subject to a 25% Withholding Tax and a 3% Stamp Tax.

Procedures had been written by Eric Wycoff outlining the treatment, including withholdings, to be applied to both Quetzal and USD payments to Sun King. This further provided for deducting any costs of conversion to dollars from the payment as well as providing that we could pay in Quetzales in such case as the currency exchange market could not provide adequate dollars or if government restrictions prevented PQPC from obtaining dollars.

These procedures were under discussion when we discovered that the tax law contained the following limitations on such payments.

ROYALTIES

Handwritten notes:
* Where are we sending payments?
Guatemala or Miami?

Payments made for the use of trade marks and patents registered in the Industrial Property Register, formulas, manufacturing rights. However, these payments may in no case exceed 5% of gross income. (If paid abroad will require 25% withholding tax and 3% stamp tax)

Handwritten notes:
5% of GI

Handwritten note:
→ further qualifies local payment to a local company.

COMMISSIONS

Payments representing commissions on sales or fees for technical, financial, scientific services are limited to 1% of gross income or 15% of Guatemalan worker payroll, whichever is greater. (If paid abroad will require 12 1/2% withholding tax and 3% stamp tax)

These restrictions "threw a spanner" into the entire matter:

Handwritten notes:
Why not?

- A. The payment to Sun King could not qualify as a "royalty" as defined in the law and, of course, exceeds the 5% limitation.
- B. The payment also did not fit the definition of commission or fee - the 1% limit notwithstanding.

In addition, Sun King continued objecting to the withholding of any taxes whatsoever.

In an attempt to overcome these problems the Fuel Supply and Management Agreement was drawn up between EPOS and Electricidad Enron ("EE") which provided that EPOS would sell the fuel oil to EE acquired under the current contract with Texaco and such other additional fuel that may be required. EE would pay EPOS an amount each month equal to 6% of Puerto Quetzal's gross revenue in exchange for "fuel supply and management services." In addition, EPOS could opt to have EE pay the fuel supplier direct rather than through EPOS. (In the case of the first Texaco invoice to come through EPOS, the payment was made to Texaco out of EPOC. I prepared an EPOS invoice to EE, which PQPC paid out of the USD account at NationsBank.)

The problem with this new procedure is that this 6% amount is still a separate item of payment and, as described in the contract, is subject to a 1% limitation (as well as a 25% withholding tax and the 3% stamp tax)

Based on the current estimate for the period April 1 through December 31, 1993, the 6% payments to EPOS would aggregate \$2,217,000 of which only \$28,800 would be deductible in EE. (EE's estimated gross rev. April - Dec. being \$2,876,590 X 1%)

Roberto Garcia, whom everyone claims opined that this arrangement avoided any tax problems, maintains that his understanding was that the 6% was to be billed as part of the fuel price and not as a separate "fee." This too should have been recognized as a nonstarter, however, since a markup of that magnitude cannot possibly be acceptable since it results in an entry price for above "going market price."

I made a study of the markup necessary to the fuel price in order to include the 6% factor (ignoring the timing problem arising out of a monthly payment obligation to Sun King vs. an estimated total of 7 - 8 cargoes of fuel per year!). Based on barrels projected to be consumed over the nine months to December 31st and the 6% payments projected over that period, the fuel would have to be marked up by \$2.36 per barrel. The May 1st cargo of fuel cost \$14.825 per barrel including transportation and insurance etc., the markup would raise this to \$17.185. This is grossly above market and it is all but assured that the authorities would not allow it as a tax cost in Guatemala. (Roberto Garcia is preparing an opinion on this point.)

Solution

The most obvious solution would be for PQPC to assume the obligation, splitting the payment between a royalty agreement with Enron for the use of Enron's trademark/logo in Guatemala providing for a 5% royalty (nebulous since PQPC does not use the logo) and a 1% fee for services to be supported by a credible contract with (EPOC?). These payments would be subject to the withholding tax of 25% and 12.5% respectively, plus stamp tax of 3%. Enron would then pay the net amount to Sun King via the Miami bank.

This, however, is NOT ALLOWED under our agreement with IFC!

*Topic - Sun King
15. OK for IFC*

Although Roberto suggested the same scenario through EE, it can't work since EE's gross revenues are only \$2.9 MM/year and the 5% and 1% limitations would result in most of the payments becoming nondeductible

Turnover? Pump this up by including fuel, O&M etc? + fuel etc

Eric Wycoff had a scheme several months ago which involved buying the Sun King "royalty" out on a NPV basis and then setting up a Royalty Trust in Guatemala, selling this publicly and recouping our buy out. The payments would then be local, in Quetzales, subject to local taxes without argument, and possibly gain some valuable goodwill and recognition for Enron/PQPC.

Although this idea generated some enthusiasm at one point, it apparently never progressed beyond the concept stage.

This problem, therefore, remains with us and I do not see a workable solution.

Part of the problem are the tax law limitations. Another facet is Sun King's insistence on receiving dollars, outside of Guatemala, not subject to withholdings of any kind.

Since our formal agreement with TOP did not specify any of the conditions later imposed by Sun King and since the letter of assignment by TOP to Sun King specified payment to a local Guatemala City address thus implying payment in Quetzales, and since Guatemalan tax laws require withholdings on such payments, I suggest we ignore these after-the-fact demands by Sun King. We should pay locally, in Quetzales, net of taxes. This removes one segment of influence on our solution attempts, i.e. the desire to accommodate Sun King beyond the scope of the signed agreements.

The only problem then remaining is for some structure that would fit the percentage limitations in the tax law. The solution to this latter point escapes me at the moment!!

An outstanding issue remains concerning 6% payments already made to Sun King!

-April 12th \$219,330.27 wire transferred from EPOC to Miami bank per R. Lammers.

-May 13th \$256,696.09 wire transferred from EPOC to Miami bank per R. Lammers.

These payments were made covering the gross 6% without any withholdings for taxes. When PQPC repays EPOC/EPOS we will have to pay the withholding and stamp tax. Either PQPC will have to "eat" this or Sun King will have to bear an adjustment on subsequent payments. The decision has to be made! (Jim Steele and/or David Haug are the original deal-makers on this.)

There are other problems outstanding in our Guatemalan business which should be focussed upon.