

**COMPREHENSIVE FORENSIC REPORT
ON THE STATE OF BAHAMAS ELECTRICITY CORPORATION
(BEC) – 2002 TO 2006
BY AL JARRETT, FORMER EXECUTIVE CHAIRMAN**

During the past twelve months many reports have been provided to the local media coming from the current administration at the highest official levels – Cabinet Ministers – Board Chairman and the GM. Most of these reports have been negative, coming mainly from professional politicians – the uninformed, but none from financial experts, such as the Corporation’s CFO or Auditors or external analysts. In other words, these reports lacked empirical data consequently they were reported as facts to the media.

In order to set the record straight on my tenure in BEC as Executive Chairman (2002 – 2005) I present this report analyzing from BEC’s internal records, annual audits and consultants reports, the true story as follows:-

**THE SCOTT, MADDEN ASSOCIATES’S
REPORT DATED JUNE 14, 2002**

In early 2002, BEC’s outgoing Chairman, Barry Farrington and the Board of Directors requested a “confidential “study of BEC’s generation assets and operations. This report was completed and received by them dated June 14, 2002. Upon my arrival in BEC as the new Executive Chairman during late July 2002, I was handed this report by the outgoing Chairman in a “professional hand over meeting” to appraise me on the challenges facing BEC in the areas of management, plant maintenance and financial concerns. Please refer to the attached exhibits.

Following therefore is a summary of highlights from this report:-

1) **THE “WILL TO MANAGE” IS WEAK**

“BEC’S management needs to be much more forceful in addressing shortcomings with employees, equipment, processes and vendors. The presence of the following problems is indicative of this syndrome:”

- Employees not held accountable for implementing a well-developed and clearly communicated a business plan.
- Unclear standards for employees’ performance and weak ethics.
- Generation equipment failures (constant)
- Vendor accountability issues

- Implementation delays of known improvement methodologies.
- Process compliance and enforcement problems
- A pattern of not diagnosing and not addressing BEC's problems leads to malaise and a growing acceptance of mediocre performance and impact.
- Performance delivery (unsatisfactory)
- Low employee morale

2) MAINTENANCE MANAGEMENT INTERVENTIONS ARE NEEDED

“Generating unit and availability is much lower than it should be”

- Average systems availability has fallen from around 80% in 1997 to only 75% in 2001
- Many major overhauls and periodic inspections have not been performed
- Maintenance records are kept manually although a computerized maintenance management system is being implemented
- Chronic defects are often accepted instead of solved. A case in point, a casual approach was taken on the high level of technical and non-technical losses, which were having a staggering impact on BEC's profitability including this degradation of equipment maintenance.

3) CAPACITY MAY BE INSUFFICIENT TO COPE WITH 2002 SUMMER PEAK

“BEC expects a peak load in New Providence of 212 megawatts in 2002, up almost 10% above 2001 which peaked at 193 megawatts.”

- Projected 2002 summer load growth may not materialize due to the general economic slow down in the Bahamas.
- If load growth is strong, however, capacity will be tight because new equipment will not be on-line until after the 2002 summer peak.
- Unit failures could happen because preventive maintenance scheduled to take place on some visits in 2001 was not carried out. It is unclear if these repairs have happened or will be carried out prior to summer loan peaks.

4) DEVELOP A CULTURE OF ACCOUNTABILITY

Many of the issues that are described in this report are related to reluctance or inability of Management to hold individuals and organizations accountable for their performance. There appears to be several contributing factors to this behavior:-

- The standard for performance may not be clear. If it is not clear to management, it certainly will not be clear to the organization or to the individual contributors maintenance management can be improved, especially in Blue Hills.
- BEC has been plagued by a series of equipment failures and fires which have resulted in protracted outages of a year or more. These types of setbacks erode overall system reliability considerably.
- A track record exists of not being able to diagnose certain defects quickly or effectively. In the meantime, the generating unit lies idle for weeks or months while Management decides what to do.

5) BEC'S MAINTENANCE MANAGEMENT PHILOSOPHY (please refer to attached exhibit)

As a result of poor maintenance practices, 'Break-down maintenance Standard' became the modus operandi "in BEC. Following are the three levels of maintenance management standards of a typical electrical company:-

- 1) Predictive Maintenance – this represents the gold standard where sophisticated practices, such as trend analysis, technically-trained staff, proactive management, superb knowledge of equipment operating behavior exist. This type of operation tends to be world class.
- 2) Preventative Maintenance is the next standard on the ladder. The culture in this environment is typically proactive in carrying out its maintenance procedures in order to avoid a catastrophic failure on the plant. This stage is a critical one.
- 3) Breakdown Maintenance is a system where due to maintenance neglect, the culture is one of "keeping the power on."
The state of BEC fell into this category. This represents the final step, which results in "Load shifted to Available Units", thus resulting in load shedding on a constant basis in the main units. This was in fact happening with regularity in BEC

6) SUMMARY OF ALL RECOMMENDATIONS TO BEC'S BOARD

- 1) Management and Leadership
 - Develop culture of accountability
 - Develop existing management skills and technical talent with "outside" power plant experts.
 - Ensure all staff can and do perform at their level of responsibility
 - Hold all staff accountable for meeting specific business objectives and ensure that their work is done correctly.

- Hold vendors accountable for any services or equipment provided.
- Implement improvements as soon as technically possible.
- Address any and all problems as they arise.

2) Maintenance/Availability

- Establish a maintenance contract for units at Blue Hills to oversee maintenance and technical support.
- Ensure preventive maintenance on units is being carried out consistently.
- Develop existing technical talent with several “outside” power plant experts.
- Accelerate implementation of maintenance management software currently under way.
- Optimize unit dispatch order to reduce fuel expenditure.

3) Capacity Expansion

- Reduce unit complexity by standardizing units through a preferred vendor relationship.
- Develop and maintain several “ready to run” portable units that could be deployed to any station during emergency including the Family Islands.
- Sell or scrap less efficient units at Blue Hills.

4) Demand Side Management

- Provide incentives for large customers to run standby generators during system load peaks load shedding on main unit.
- Introduce summer/winter price differentials, an attractive proposition that BEC can use moving forward.
- Perform “free energy audits” for customers.
- Develop conservation program and financing that offer high pay- back.
- Other major problems were in the management of its cash resources, collecting of receivables, which stand at \$104 million at September 30, 2002, and too many scattered and expensive debts. High risky technical losses on both Family Islands and New Providence were costing BEC \$20,000 - \$25,000 per annum.

The above represents the sad state in which I found BEC in 2002. BEC was on "life support" in terms of maintenance; aging plants; unsatisfactory management; unacceptable financial performance and technical losses evidenced by the delinquent receivables of \$104 mil with Government being the biggest culprit, owing \$65 mil.

Following, therefore, is a complete analysis of some of the key financial areas I met in BEC:

1) Financial Division

(A) Synopsis of Key Financial Results for years ended Sept 30, 2002 – 2006

| | <u>2002</u> | <u>Audited</u> <u>2003</u> | <u>2004</u> | <u>Draft Audit</u> <u>2005</u> | <u>2006</u> |
|------------------------------|--------------------------|-------------------------------|-------------|-----------------------------------|-------------|
| | (In Millions of Dollars) | | | | |
| Revenues | \$224.8 | \$257.4 | \$258.4 | \$312.6 | \$382 |
| % Change | | 36.2% | *1% | 20.97% | 22% |
| Fuel costs | 82.5 | 116.6 | 117.9 | 164.4 | N/A |
| % Change | | 41.58% | 1% | 39.44% | N/A |
| Oper. Maint. & Adm. Exps. | \$ 95.1 | \$ 97.7 | \$ 88.8 | \$107.1 | \$115 |
| % Change | | 2.73% | (9.11%) | 20.61% | 7.38% |
| Foreign Exch. Losses/IDB | (\$2.0) | (\$4.5) | (\$.088) | (\$.085) | N/A |
| Net Income/ Loss | \$10.1 | \$11.1 | \$14.1 | \$15.3 | (\$2.97) |
| % Change | | 10% | 27.03% | 8.51% | (19.41%) |
| Ret. Earnings/ Equity | \$265.1 | \$273.8 | \$289.1 | N/A | N/A |
| Total Assets | \$605.9 | \$628.0 | \$669.9 | N/A | N/A |

The above net income for 2005 was the highest recorded in 5 years.

* Tariff rate reduction of \$16.2 mil plus \$800,000 in interest on deposit held for customers would have made this figure \$275.4 mil or 6.5% of revenue.

While 2005 revenue increased by 20.97% (or \$54.2 mil) over 2004, revenues for 2006 increased even higher by 22.1% (or \$69.4 mil). This is a clear indication that BEC did not have a revenue problem.

(B) Debts Outstanding

| | <u>Audited Results</u> (In millions) | | |
|--------------------|---|----------------|----------------|
| | <u>2002</u> | <u>2003</u> | <u>2004</u> |
| Short Term Debts | \$55.6 | \$70.9 | \$84.8 |
| Long Term Debts | <u>\$173.6</u> | <u>\$185.5</u> | <u>\$167.1</u> |
| <u>Total Debts</u> | <u>\$229.2</u> | <u>\$256.4</u> | <u>\$251.9</u> |
| % Change | | 11.9% | (1.8%) |

(C) Outstanding Receivables

| | <u>(Audited)</u> <u>In Millions - Net</u> | | |
|-----------------------------|---|---------------|---------------|
| | <u>2002</u> | <u>2003</u> | <u>2004</u> |
| Government & Agencies - Net | \$56.9 | \$33.6 | \$17.0 |
| Private Sector | <u>\$38.7</u> | <u>\$32.1</u> | <u>\$34.4</u> |
| Total O/S | <u>\$98.6</u> | <u>\$65.7</u> | <u>\$51.4</u> |
| % Change | | (32.3%) | (21.7%) |

This amount represents the net balance due after deduction of Government stamp tax (7%) and customs duty of (10%) totaling 17%.

At fiscal 2002 BEC held a Gross Delinquent Receivables outstanding balance of over \$104.0 mil representing an astounding 46.43% of total revenues for the year. Government's portion represented \$65.3 mil or 25% of total revenue recorded at \$224.8 mil. No wonder they had cash flow concerns.

What is most disturbing about this picture was that Government also had been benefitting from BEC resources in a kind of "double dipping" way, as follows:-

- They benefitted from the Stamp Tax rate of 7%
- They benefitted from the 10% customs duty rate introduced by them in 1994 without consultation and without allowing BEC to recover this cost. Perhaps they did this to find a way to reduce their delinquent receivables position, but at BEC's expense.
- They benefitted from the extraordinary amount of net receivables owed BEC, without paying interest. We estimate that this delinquent debt caused BEC \$ 7 to \$8 mil p.a. in lost revenue.
- Government also benefitted from the famous tariff rate reduction of 2003 by 10%, which had a major positive micro and macro impact on the Country.

These practices have had the greatest negative impact on BEC's resources over the years, creating cash flow and working capital pressures for the Corporation and hampering its ability to fund new plants. It was only because of BEC's senior management's aggressive efforts mandated by the Board in 2003 and 2004.

(D) Cash Flow Analysis

| | <u>(Audited)</u> (In Millions) | | |
|--|-----------------------------------|-------------|-------------|
| | <u>2002</u> | <u>2003</u> | <u>2004</u> |
| Net Cash Flow from Operations | \$33.7 | \$34.9 | \$52.6 * |
| % Change | | 1.2% | 17.7% |
| Net Cash Flow from Financing Activities - Bank Loans | \$12.7 | \$53.1 | \$16.1 |
| Operating Revenue | \$24.5 | \$20.7 | \$25.3 |

* What are the implications from the above? It says that BEC amassed a historic \$52.6 mil in net cash flow to cover its cash flow and working capital needs in 2004. Consequently, BEC only had to borrow a net of \$16 mil during the year, compared to \$53.1 mil in 2003. This remarkable achievement was accomplished despite a Foreign Exchange loss of \$4.6 mil on IDB loans.

BEC has adequate resources in 2004 to support its ongoing needs going into 2005. When I left BEC net profits were projected to be over \$20 mil for 2005.

What it also says was that BEC benefitted significantly from management's cost effective and cost containment strategy implemented in 2003.

(E) Total Cash Flow & Source

| | (In Millions) | | |
|---|---------------|---------------|---------------|
| | <u>2002</u> | <u>2003</u> | <u>2004</u> |
| Internally generated from Operations - | \$33.7 | \$34.9 | \$52.6* |
| Externally generated funds/Bank loans - | <u>12.7</u> | <u>53.1</u> | <u>16.1</u> |
| Total cash flow | <u>\$46.4</u> | <u>\$88.0</u> | <u>\$68.7</u> |

*These comparisons are important because they clearly generated a healthy amount of internally generated funds from operations to the Corporation during 2003 and 2004, which was a historic amount.

A review of this area will show in stark reality that while at fiscal 2003, BEC generated \$257.4 mil in revenue, but net profits increased \$11.1 mil. More significant was the performance of 2004 when revenues only increased by \$258.4 mil but generated profits of \$14.1 mil, despite experiencing a foreign exchange loss of \$4.5 mil on the IDB multi-currency loans.

Another noteworthy achievement was made in the area of operations, administration and maintenance expenses, where we brought this figure down from the escalating trends in 2002 and 2003 to the lowest level since fiscal 2001

(F) Major Contributors to Cash Resources

BEC's performance as per the above also proves that the following contributors to its resources in 2004 indicate in clear terms why the refinancing of the "onerous" IDB loans was a "no-brainer" and financially doable.

Following is a break down of the major contributors to the significantly improved cash flow in 2004:-

| | <u>Per Annum</u> |
|--|--------------------------|
| ▪ Introduction of Itron's AMR meter reading project Saving – (over 200 new and purified meters were added). | \$15.0 mil |
| ▪ Refinancing of \$128 mil IDB loan amortized over 10 years savings on exchange rates, interest rate and cap rate of 4.5% - bought from Scotiabank Capital Markets, N.Y. in two tranches | \$15.0 mil |
| ▪ Installation of new fuel efficient plant - 23mw at Blue Hills savings - | \$18.0 mil |
| ▪ Savings from the signing of new 5 year oil Contracts with Shell signed Aug. 2003 - | \$4.08 mil |
| ▪ Increase in new lease of BEC's fuel tanker for over 5 years with suppliers saving - | \$1.24 mil |
| TOTAL CONTRIBUTION TO CASH RESOURCES | <u>\$53.2 mil</u> |

In his recent remarks to the Tribune, the Chairman of BEC refers to these items as “one-offs” contributors.

I trust this matter will finally be put to rest. Out of these funds BEC also financed four to five new fuel efficient plants with two being done via turn-key arrangements with the manufacturers, also adding to the cost efficiencies on oil during the period.

Arguably, 2004 in terms of cash flow, profitability and cost effectiveness was the best year in the 70-year history of BEC. If one were to eliminate the tariff reduction, BEC's net profit would have recorded a historic \$31 mil, evidencing this fact.

No, Mr. Gottlieb, this tariff rate reduction was not “ill-conceived”. It was done after careful deliberation by the technical professionals at BEC, in conjunction with the Marginal Cost Electricity Tariff Report dated April 1994 done by RCG/ Hagler, Bailly, Inc. This decision was made with macro-economic considerations of the economy being in recession and needing a major stimulus. This was a period when hotels and other corporations in the Bahamas were complaining about the Bahamas being too expensive a touristic destination because of the high cost of utilities. This reduction was enjoyed by 100% of BEC's customers, including the Bahamas Government and was the first stimulus toward our economic rebound, prior to the discount rate reduction of ½%, which also

positively influenced the Mortgage Sector. I know the Hotel Association was pleased. I also know that the late Butch Kerzner was ecstatic and so was the public at large.

The tariff reduction had the approval and support of 100% of the Parliament of the Bahamas and the Bahamian people.

(G) POSITION ON GOVERNMENT GUARANTEES

It was a newly established policy by the Board of Directors and Management of BEC to eliminate the Corporation's reliance on Government's direct and indirect support by producing a strong balance sheet. During the period 2002 through 2007 BEC had not required any fresh guaranty from Government, including on the \$100 mil unsecured (10, 15 and 20 years) bond issue, underwritten in 2006 in keeping with our 5 year capital budget from 2004 to 2009 which totaled \$131 mil. The balance of \$31 mil was to be funded from internally generated funds, including the sale of Cable Bahamas' shares for \$14 mil. These funds were raised in 2006 on the strength of BEC's balance sheet performance.

(I) BEC's EXCHANGE LOSSES – 2001 – 2004

| | | (millions) | |
|-------------|-------------|-------------|-------------|
| <u>2001</u> | <u>2002</u> | <u>2003</u> | <u>2004</u> |
| \$1.2 | \$2.0 | \$4.5 | \$.08 |

Total losses in this area amounted to \$7.6 mil (2001 – 2004)

Movement of Average Annual Exchange Rates Euro rates vs US\$

| <u>2002</u> | <u>2003</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> |
|-------------|-------------|-------------|-------------|-------------|-------------|
| US\$.98 | US\$ 1.20 | US\$1.35 | US\$1.38 | US\$ 1.40 | US\$ 1.55 |
| = Euro1.00 | Euro1.00 | Euro1.00 | Euro1.00 | Euro1.00 | Euro1.00 |

2000

US\$1.60
Euro 1.00

(II) SPOT MOVEMENT OF EURO DOLLAR RATES (2003 - 2009)
Three Month Libor Rates

| <u>2003</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> |
|-------------|-------------|-------------|-------------|-------------|-------------|
| 1.125% | 1.250% | 1.275% | 1.275% | 3.00% | 1.125% |
| To | To | To | To | To | To |
| 1.50% | 1.275 | 1.375% | 4.50% | 5.50% | 3.50% |
| <u>2009</u> | | | | | |
| 1.100% | | | | | |
| To | | | | | |
| 1.425% | | | | | |

Just imagine if BEC had stayed in these risky multi-currencies what would have been the cost of paying off the loan in these currencies from then to 2009.

Please note that because of BEC's ten year interest rate cap of 4.5%, any rate fixing above the 4.5% accrues the net increase in interest to BEC from its Banker to profit. For example, on a rate fixing of 5.5% plus a spread of 1.125% which would total 6.625% BEC would earn the difference of 2.125% on the outstanding balance of the refinanced loan, which would accrue directly to net profits, hundreds of thousands of dollars on a per annum basis. In short, BEC is in a "win/win" situation, because the higher the interest rate, the more profits they earned and any rate below 4.5% cap earns them additional profits. The interest rate cap was bought from Scotiabank's Capital Markets, N.Y. in two 5 year tranches tied to the final maturity of the loan in 2013.

These facts are incontrovertible and conflict with Mr. Gottlieb's statements that the rates on BEC's loans were becoming more costly due to rising interest rates. The current balance of BEC's loan should be, if original terms are being met, approximately \$65 to \$70 mil on which they are paying interest of 2-1/4 or 2-1/2%. The new rate fixing will be on March 31, 2009, which should show no material changes in these rates for the ensuing three months.

These are the facts according to BEC's annual reports and internal records.

(H) INTRODUCTION OF ITRON'S METER READING (AMR)
INITIATIVE - 2004
(Please refer to attached Exhibit)

During 2003/2004 period BEC invested approximately \$10 mil from its cash flow in a Consultancy Contract Agreement with ITRON, a Seattle based group to

purchase 100,000 meters, which they would install on all private customer accounts, based in New Providence and the Family Islands. This was designed to create improved customer service with more accurate billings and purify existing meters for the most part, which had been tampered with over the years, thereby adding hundreds of new and improved accounts to BEC's network, generating significant improvements in annual revenues in the tens of millions of dollars annually. This project was approximately 75 – 80% completed by the time I left BEC in 2005.

In addition to this, an exercise was carried out headed by Senior Management to review the meters on all commercial accounts on New Providence and the Family Islands. This was 80% completed by the time I left BEC and already accrued to BEC in excess of \$6 mil from tampered meters or wrong numbers discovered, some of the major accounts ranged from \$10,000 to \$3 mil. Several of them which were in the \$100,000 to \$250,000 category were not included in BEC's data base, resulting in loss of revenues. This exercise was estimated to add a minimum of \$15 mil per annum to BEC's revenues once all of the accounts were "purified".

No, Mr. Gottlieb, this was not a "one-off" exercise.

(I) BLUE RIBBON COMMISSION APPOINTED BY FNM
GOVERNMENT IN LATE 1990'S TO 2000

As a result of findings of BEC's Board of Directors in the late 1990's that the IDB loans were becoming too risky to remain in its multi-currency status, as well as the high cost of interest being charged, as high as 385% above the Euro-dollar market rates of 2.2% in 2003, a Blue Ribbon commission was established. Undoubtedly the FNM's Board agreed with our decision when they requested the Minister of Finance to review consideration for refinancing these loans in US dollars. To this end, Mr. William Allen, the Minister of Finance at that time appointed the Blue Ribbon Commission to explore the matter. The Commission was headed by Julian Francis, Governor of the Central Bank and Board members including Sharon Brown, Wendy Warren, BEC's General Manager and a representative from the Ministry of Finance, Mr. K. Bhogra, BEC's CFO and others.

After approximately 18 months deliberation, BEC's minutes recorded that they made a recommendation to the Minister that these loans should be refinanced in US dollars. The response from the Ministry was mixed and the Commission's recommendations died with the Commission. The inside intelligence was that it was blocked by the beaucrats at the Ministry of Finance. It was not until I arrived in BEC that I had this particular refinancing done within my first 18 months of being in office.

The idea was right then and history has shown is still right, given the losses absorbed since then on both the exchange and the interest rate sides of the IDB loans.

This is a matter of empirical record and not spin!

Conclusion

On March 30, 2005 I tendered my resignation from the Board of Directors of BEC. My total tenure amounted to 33 months. The FNM Government has been in control of BEC since May 2, 2007 to date (21 months).

I leave the current Board to report on what they achieved during that period and I leave the professional Analysts to report on whether Al Jarrett was a bad steward in BEC during his tenure as Executive Chairman.

Just as history cannot be revised, so too cannot official statements produced by respected Auditors, Deloitte & Touche be revised merely on the basis of innuendos and visceral information.

Those persons who know me, know my modus operandi and they would confirm that I do not make decisions without proper research and facts. No sir, the rate reduction was not done randomly, nor out of self interest! It was done for macro reasons and based on BEC's strong financial performance and projected to continue based upon BEC's capital budget for 2004 – 2009. I left BEC in a better state in 2005.

I now rest my case!

(Please refer to the attached exhibits for supporting documents.)