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**THE ONLY SUCCESSFUL EXPERIENCE IN VENEZUELA OF A DEFENSE
AGAINST A HOSTILE TAKEOVER**

Luis Esteban Palacios, José Manuel Ortega Pérez y Arturo H. Banegas Masía[†]

Extract

As we have analyzed throughout these notes, different economic, social and legal aspects, resulted in the frustration of the takeover launched by AES against CANTV.

Among the most important economic aspects, we must point out the one resulting from the September 11, 2001 events, which caused American companies to center their efforts on investments of their own country.

[†] Partners of PALACIOS, ORTEGA Y ASOCIADOS, attorneys of Verizon Communications Inc., owner of the entire capital stock of GTE Venholdings B.V., principal shareholder of C.A. Nacional Teléfonos de Venezuela (CANTV) since 1991, year of its privatization.

Additionally, while the takeover was in force, AES' shares dropped from around US\$ 56 to US\$ 11, which, according to the investors, this was due to the high level of leverage and the low yield of its shares.

Regarding the social aspect, the employees' rejection of AES policies implemented in Electricidad de Caracas was important, according to which a high number of lay offs occurred. The cost reduction relating to the compliance with the hygiene and security regulations that originated the death of at least three (3) people for such causes, and in particular, the policies developed against the unions' directors, the majority of which, were laid off.

Consequently this generated a rejection from the organized work union of Cantv, which were concerned about the fact that AES directed their efforts to acquire the class "C" shares of CANTV, trying to diminish the share interest of the CANTV employees below the 10% of the outstanding shares, and consequently they would loose one of the two (2) principal representatives they had in the Board of Directors of the company according to the bylaws.

AES thought that again it could successfully achieve a new tender offer. However it did not take into account that CANTV had:

➤ *An absolutely united Board of Directors. Note that their decisions relating to the rejection of the tender offer; the creation of the Value Fund and the support to the Excellence Fund, among others, were approved with the favorable vote of its members (class A shareholders; class B –the Government; class C –Employees, and class D, except for the vote of the representative elected by AES).*

➤ *A Management absolutely committed to the shareholders.*

➤ *Shareholders totally clear regarding their targets within the company and its defense.*

➤ *A working force closely united to their representatives in the Board and to their unions' directors and with a clear position of the defense of the company, their presence in the Board of Directors and the stability of their jobs.*

Regarding the legal aspect, we must point out those relating to:

1) The reinforcement of the Excellence Fund benefiting the employees provided for in Section 4.8 of the purchase agreement executed on December 3, 2001, which authorized the purchase by the Trust of an additional 2% of

the outstanding shares to increase it to a 3% and providing it with the necessary funds.

2) The creation of the Value Fund, benefiting the current employees of the company and its subsidiaries and affiliates. Such fund would benefit, among others, employees of the company that were not shareholders of the company since they were not working for the company in 1991. This fund would be equivalent to a 5.5% of the outstanding shares. The Board also approved the necessary funding for its purchase and further sale to the employees in better conditions than the market.

3) The approval by the Shareholders Meeting held on October 24, 2001, of a dividend to be paid in two installments: One in December of that same year and the other in March 2002. This constituted an incentive for the shareholders not to sell to the "Initiator" of the tender offer. The shareholders decided to maintain their shares in order to receive the payment of the dividend.

4) The approval by the Shareholders Meeting held on October 24, 2002 of the Third Repurchase Program of the company's shares for an amount of shares equivalent to a 15% of the outstanding shares. This buyback program offered the shareholders a more attractive alternative to sell their shares since it offered a higher price with no need of giving away the control of the company.

For all the reasons above, on November 7, 2001, AES informed the CNV their intention of retiring the tender offer over CANTV.

I. PRECEDENTS

These notes refer to the process of the hostile takeover launched by AES Corporation over C.A. Nacional Teléfonos de Venezuela (CANTV). The former is a company dedicated to the generation and distribution of energy all around the world. Its headquarters are located in the United States of America and is the owner of more than 80% of the capital stock of La Electricidad de Caracas and Corporación EDC, which shares were acquired through a similar process in 1999.

To locate us in the situation that gave place to the above-referred tender offer, it is necessary to make some comments about CANTV and its shareholding structure.

CANTV was a company owned by the Venezuelan State, privatized in 1991. At that time a group was formed by GTE; Telefónica de España; AT&T, as foreign investors and as local investors: Banco Mercantil and La Electricidad de Caracas (or Corporación EDC), which won the privatization process and created a Venezuelan corporation named VenWorld Telecom, C.A. After a few changes in the shareholding structure of VenWorld, its capital stock as of year 2000 was as follows: Verizon Communications Inc. (resulting company from the merger of Bell Atlantic y GTE), through GTE Venholdings B.V.: 57.8 %; Telefónica de España, through Telefónica Venezuelan Holding B.V.: 16 %; La Electricidad de Caracas (or Corporación EDC), through Inversiones Inxtel, C.A. 16%; AT&T, through AT&T Communications Services Inc.: 5% and Banco Mercantil C.A.: 5.2%.

After the privatization, VenWorld became owner of 40% of the capital stock of CANTV. This interest represented 100% of the class “A” shares of CANTV, and VenWorld or its shareholders could only hold said ownership.

Afterwards and complying with the privatization agreements and the legislation in force in Venezuela, 60% of the remaining capital stock of CANTV was distributed, including through Public Offerings in the Venezuelan stock market and in the New York Stock Exchange. Additionally, the shareholders of CANTV agreed upon two repurchase of shares plans. Therefore the shareholding structure of CANTV for year 2000 was the following: VenWorld held 43.19% of the capital stock, that is, 100% of class “A” shares of CANTV; the Republic of Venezuela held all class “B” shares of CANTV, which represented 5.6 % of the capital stock; class “C” shares of CANTV, belonged to the employees and represented 11.01% of the capital stock and class “D” shares, held by the investors, which are the only shares freely traded in the stock market, represented 40.19% of the capital stock of CANTV.

VenWorld bylaws indicated that until January 1st, 2001 the shareholders were bound to remain in the company and as of that date they could request the “redemption” of their VenWorld shares. This procedure implied that VenWorld received its own shares and in exchange it gave to the shareholder that requested the redemption, a portion of the

corporate assets (basically, class “A” shares of CANTV) equivalent to its interest. However, the class “A” shares of CANTV corresponding to the shareholder that requested the redemption, had to be offered to the other shareholders of VenWorld who had a right of first refusal to acquire them with a 5% discount of its value, before these were handed.

The shareholders of VenWorld agreed on the applicable procedure for the redemption of their shares even before the privatization of CANTV in 1991 took place, and among other issues they had agreed on the way to determine the price of the shares, the pro rata division in case several shareholders were interested and the method of payment of the price. These agreements clearly evidenced their intention to prevent that the group of shareholders that created VenWorld was diluted among the rest of the shareholders of CANTV due to the redemption of the shares held by VenWorld.

Once the process began on May 23, 2001, four (4) citizens, shareholders of CANTV that represented together less than 0.0001% of the capital stock of CANTV appeared before the Venezuelan securities commission (*Comisión Nacional de Valores – “CNV”*), Venezuela’s Capital Markets regulator. These shareholders of CANTV requested the CNV to order the following within the redemption process of VenWorld:

- 1) GTE VENHOLDINGS B.V. and any of its related persons (Verizon) to abstain from acquiring any additional shares of CANTV either directly or indirectly, unless they did it through a tender offer for at least 75% of the shares of CANTV;
- 2) Any of VenWorld shareholders to abstain from increasing directly or indirectly, its interest in the capital of CANTV in more than a 10% or completing or acquiring a Substantially Reputed Interest (as defined in the Venezuelan regulations regarding tender offers) or a Controlling Political Majority, unless it is made through a Tender Offer.

On May 24th, the CNV summoned VenWorld and the representatives of its shareholders, to appear the following day beginning at 9:00 a.m. in the Presidential office of the entity for an Oral Hearing, which would last not more than 30 minutes.

The following day, May 25th, GTE Venholdings presented a writ containing the different arguments explained during the brief lapse of the oral hearing, among which we point out the following:

- A) That the “redemption” of VenWorld shares is and it has always been a fundamental condition under which and for which VenWorld’s shareholders decided to subscribe the articles of incorporation of said corporation at the privatization of CANTV. Pretending to apply to this case the Tender Offer Regulations, in force since September 2000, *would be a violation of the*

constitutional guarantee that bans the retroactive application of “all” the laws and other state regulations.

- B) That the *redemption process rather than constituting a tender offer, includes in its stages, the obligation from the entity requesting the redemption to offer to the other shareholders of VenWorld the corresponding class “A” shares of CANTV for them to exercise a right of first refusal established in the bylaws of the Company.* That said procedure does not contemplate, as in the case of tender offers, an offer to “acquire” shares.
- C) That the *“redemption of shares” occurs within the scope of the articles of incorporation of a private corporation, and creates a right of first refusal in which none of the shareholders offers to publicly acquire shares.*
- D) That article 3, paragraph 3, number 3 of the Tender Offer Regulations, which establishes that it is mandatory for those shareholders who currently hold a controlling political majority, to offer for at least 75% of the capital stock of the corporation subject to the tender offer, was not applicable since GTE did not hold such controlling political majority.
- E) That through the compliance of the redemption procedure, GTE, nor any other shareholder could increase the “control” or the interest that VenWorld had in CANTV. *As it was pointed out, the redemption process was over the class “A” shares of CANTV held by VenWorld (that could only be held by VenWorld shareholders), therefore the only result of such “redemption” process would be a redistribution of the ownership over said class “A” shares of CANTV, but never an increase of said interest.*
- F) That the redemption process was referred to shares of a private corporation (VenWorld) that was not listed in the Venezuelan stock exchange and since it was not registered before the registry carried on by the CNV, it was not subject to the Capital Markets Law or to the Tender Offers Regulations.

On May 28, 2001—unusually prompt, the Venezuelan securities commission issued Resolution No. 104-2001 through which it admitted all the requests of the complainants. The CNV established that the Tender Offer Regulations should apply to the redemption process, although the shares that were subject to the redemption were of a private corporation, that does not trade its securities in a stock exchange nor was registered before the Venezuelan securities registry (*Registro Nacional de Valores*) and that the shares that the shareholders that requested the redemption would eventually receive, were class “A” shares of CANTV that are not traded either in any stock exchange. Consequently, in case GTE Venholdings B.V. or its related persons exercised their right of first refusal to acquire the class “A” shares of CANTV from other redeeming shareholders, within the redemption process of VenWorld, they should do so only by launching a tender offer for an amount that represented at least 75% of the capital stock of CANTV.

This way, the right of GTE to participate in VenWorld's internal "redemption" process was impaired.

An appeal was filed against such decision before the administrative lower court (*Corte Primera de lo Contencioso Administrativo*). Such appeal included a constitutional injunction (*Amparo*) petition pursuing the suspension of effects of said resolution. The appeal is still under way nowadays, but the requested constitutional injunction was rejected.

Accordingly, the "redemption" process of VenWorld went on without GTE being able to participate on it. However, we should ask now: Who benefited from this situation? The rest of VenWorld shareholders, particularly those with an important interest, that in this way would receive class "A" shares of CANTV without fearing that their corresponding CANTV class A shares would be acquired by any of the other shareholders of VenWorld pursuant to the commitment assumed ten years ago. This way, AT&T and Inversiones Inxtel achieved the redemption of their VenWorld shares while the rest of the shareholders could not exercise their corresponding right of first refusal to acquire their corresponding CANTV class A shares. Consequently, AT&T and Inversiones Inxtel, received in exchange for their VenWorld shares, a direct interest in the capital stock of CANTV equivalent to 2.16% and 6.91% respectively, represented in class "A" shares.

When Inversiones Inxtel received the class "A" shares of CANTV, it had free disposition of its shares in the company, which was with no doubt, the purpose of the complaint presented by the above mentioned citizens and bring it to the position of beginning the takeover to which we will refer to in this paper.

These precedents are important since the facts that occurred afterwards related to the takeover launched against CANTV allows us to conclude that these events could correspond to an organized plan in which several actors participated benefiting Inversiones Inxtel S.A., subsidiary of Corporación EDC, which principal shareholder is AES, the company that launched and successfully achieved the takeover against C.A. La Electricidad de Caracas.

II. STRANGE ANNOUNCEMENT PRECEDING THE TAKEOVER

On August 29, 2001, violating all the legal dispositions on the matter and without the required authorization of the CNV, directors of AES publicly announced in a press conference their intention to launch a takeover against CANTV. At this time, no details were given regarding the offer they would present, although the value that they assigned to CANTV was announced and that they could sell the wireless telephony business of the phone company. That same day, the CNV ordered the suspension of the transactions over the CANTV shares in the Caracas Stock Exchange. However, the ADRs registered

in the New York Stock Exchange kept on trading, and in short days they reached a price near to four dollars per share.

One week later, after great discomfort among the local investors and after threats of legal actions by the directors of the Caracas Stock Exchange, the CNV allowed resuming the trading of CANTV shares in the Caracas Stock Exchange. Amazingly, the CNV, alleging a supposed defense of the rights of the minority shareholders of CANTV, decided to fix the opening price of the share on September 7, 2002 and it also established, without apparent justification, that its price should not increase or decrease more than 5%, otherwise, the trading would be suspended again.

On the date on which the trading resumed, AES had not presented the report of the tender offer to which it was obliged before making any announcement. Accordingly, not even the offered price was known. Additionally, the CNV never considered the unlawful disclosure of AES' intentions to launch a takeover against CANTV.

III. COMMENCEMENT OF THE CONTROL TENDER OFFER OVER CANTV

On September 21, 2001, the securities commission finally approved the publication of the report for the tender offer launched by AES over CANTV. It began on September 25.

The "Initiator" of the offer was AES Comunicaciones de Venezuela C.A., a company constituted and domiciled in Caracas. Its shareholders were AES Corp, a company constituted pursuant to the laws of the State of Delaware, United States of America, holding a 66% interest in it, and Corporación EDC C.A. with a 34% interest.

The offer was simultaneously presented in the United States of America and in Venezuela.

At the beginning of the tender offer, AES was the indirect owner (through affiliates including Inversiones Inxtel, C. A., totally owned by Corporación EDC) of 64,000,524 shares and 1,000 ADS, which represented approximately 6.9% of the outstanding capital stock of CANTV.

The outstanding capital stock was represented in 926,037,385 shares divided in four classes of shares –A, B, C and D.

CONTENTS OF THE OFFER

The purpose of the offer in the United States was to acquire 28,566,944 American Depositary Shares ("ADS"), representing 199,968,608 outstanding class "D" shares at a price to be paid in cash of US\$ 24 per ADS.

The offer in Venezuela was of US\$ 3.4285714 per share (the same price offered pursuant to the offer in the USA, taking into account the number of class “D” shares represented by each ADS, e.g. 7).

The purpose of the offer in Venezuela was to acquire an amount of outstanding shares (free of lien, guarantee assignments, privileges, preemptive rights or other encumbrances or rights that could affect its complete possession, use and benefit) that together with class “D” shares represented by ADS to be acquired pursuant to the offer in the United States, represented 43.19% of the outstanding capital stock of CANTV.

Additionally, AES proposed a total reorganization of CANTV. Accordingly, it established in its offer that the wireless telephony business, Telecomunicaciones Movilnet, C.A., a wholly owned subsidiary of CANTV, would be sold. Furthermore, it announced that CANTV would be merged with the “Initiator” to create a new company and that the shares of this new company would be given to the remaining shareholders of CANTV.

In the offer, AES also reserved for itself an absolute discretionary power to consider the offer “frustrated” and to withdraw it. Among those, we can point out the following:

- The failure to obtain the approvals, authorizations or dispenses necessary to acquire the shares and the ADS according to the offers.
- If an action, process, request or claim, or threat of any action, process, request or claim before any governmental authority is initiated by any authority or third party, that:
 - a) Challenges, or intends to challenge, restrict, delay or prohibit the acquisition of shares or ADS by the “Initiator”.
 - b) Obtains or intends to obtain compensation for the substantial damages, or adversely affects the negotiations contemplated in any of the Offers.
 - c) Obtains or intends to obtain an order through which the total or partial illegality or inefficiency of any of the offers or of one of the transactions prior to each offer is declared.
 - d) Imposes or attempts to impose a condition causing any of the offers to be substantially more onerous or disadvantageous to the “Initiator”.

And thereon, it keeps breaking down up to *10 more hypothesis*.

Additionally, AES reserved the power withdraw the offers in the following situations:

- If the Venezuelan competition agency (*Superintendencia para la Promoción y Protección de la Libre Competencia* – “PROCOMPETENCIA”) had an objection to the purchase of the shares and ADS by the “Initiator”.
- If a change in laws occurred as a consequence of the issuance, amendment, suspension or annulment of any juridical ruling or act from a government or a threat that this could occur.
- If the offer were withdrawn in the United States.

Additionally, it also reserved for itself the right to withdraw the offer *in case that adverse changes occurred in CANTV* or a threat of any change, decision, condition, event or happening that would affect the business, properties, assets, liabilities, capitalization, estate, financial situation, operations, authorizations, licenses, franchises, permits, permits requests, fees or fees structure, results in the operations or expectations of CANTV or of any of its Related Persons that has or may have a substantial adverse effect to CANTV or of any of its Related Persons.

Accordingly, it could withdraw the offer, particularly, if:

- Any substantial right deriving from agreements executed by CANTV or by any of its Related Persons has been impaired or in any other manner adversely affected.
- Any obligation, condition or term established in any instrument or agreement of CANTV affected or may substantially affect and in an adverse manner, the value of the shares or ADS for the “Initiator”.

Likewise, it reserved the power to withdraw the offers if *adverse changes occurred in the National or International Markets*, such as, among other:

- Any general trading suspension, or any limitation in the prices of the securities listed in any stock exchange in Venezuela or in the United States.
- Any banking moratorium situation or suspension of general payments to banks in Venezuela or in the United States.
- A war, armed hostility or any other national or international crisis related to Venezuela or the United States.
- A change or an event that could lead to a change in the prospective value of the Bolivar with respect to the Dollar of the United States of America.

- Any dramatic change materially adverse in the financial markets or in the principal stock index of Venezuela or the United States.
- Any materially adverse change in the economic or politic situation or in other national or international circumstances existing in the United States of America or in Venezuela at the moment of the announcement of the offers.

It could also withdraw the offer if *any other persons or Group different from the "Initiator" presented Competing Offers*. Likewise, if the acquisition or holding of more than 50% of the outstanding capital stock of CANTV *did not grant the "Initiator" the capacity to designate the majority of the members of the Board of Directors of CANTV*. Also, a cause for withdrawal could be if after August 29, 2001, date of the presentation of the request before the CNV, *hindering measures* occurred. From the 20 stated hypothesis, we point out the following:

- a. If CANTV decrees, pays or proposes to decree or pay any dividend or other distribution to the holders of the shares or of any other security of CANTV.
- b. If CANTV buys, acquires or in any other manner, reduces the number of shares, ADS or other of its outstanding securities.
- c. If CANTV sells its assets or securities.
- d. If CANTV amends its bylaws or executes a shareholders agreement or a similar company agreement.
- e. If CANTV performs or holds a shareholders meeting to consider the implementation of any of the above-mentioned situations or businesses.
- f. If CANTV performs any other act or business that can be qualified as a hindering activity by the CNV pursuant to the Tender Offer Regulations.

Regarding *CANTV's capital structure*, other hypotheses were provisioned regarding the withdrawal of the offer. Among others:

- If CANTV acquires currently outstanding shares.
- If CANTV declares or pays any dividend in cash or in kind or performs any other type of distribution, including distributing shares.

CANTV BOARD OF DIRECTOR'S POSITION

CANTV's Board of Directors, following the Tender Offer Norms, determined its position in the meeting held on October 1, 2001 and made it known to the public on the following day. At this meeting the offer announced by AES was rejected based on the following reasons:

1. Inadequate price offered for the shares and ADS:
 - a- The price of the ADS of CANTV, prior to the announcement of the offers on August 29, was US\$ 21.98.
 - b- On 1999 and 2000 CANTV had put in practice two Repurchase Programs of its shares at an average price of US\$ 29 and US\$ 27 per ADS, respectively.
 - c- The price offered by the "Initiator" represented only a premium of 4.4% compared to the closing price of ADS during the thirty previous days to the announcement by the "Initiator".
2. The adverse tax consequences that the transactions proposed by the "Initiator" would have for the remaining shareholders and holders of CANTV ADS.
3. The purchase of CANTV shares and ADS by the "Initiator", through the offers would adversely affect the liquidity of the remaining shares and ADS of the company.
4. The offers were highly conditional. Due to the number of conditions established by AES to withdraw the offer, CANTV shareholders had to determine whether they tendered in advance, prior to the termination date of the offers, with no knowledge if the "Initiator" actually intended to complete them.
5. The offers were coercive because they were partial and there was no certainty of the value of the remaining shares.
6. The plans that the "Initiator" had in case of completing the acquisitions established in the offers and the completion of the transactions established in the offers, would debilitate the financial and operational situation of CANTV and would create uncertainty with respect to the amount and opportunity of the payment of dividends.
7. The "Initiator" had indicated in its offers that it was negotiating with a third party, the possible sale of Movilnet (wireless telephony). This could jeopardize CANTV since the sale negotiations were limited to only one interested party. They had not considered either the current adverse

market conditions, which caused the Board consider that there was no certainty that those negotiations would result in the best price for its sell.

8. The “Initiator” had no experience in the operation of national telecommunications networks and there are no significant synergies between CANTV and AES (“Initiator”). CANTV is the principal provider of fixed phone services and an important provider of wireless phone services in Venezuela. AES is a company dedicated to the generation and distribution of energy and does not have experience in running or operating a phone company as CANTV.
9. The tender offer of CANTV launched by AES probably would cause CANTV to loose the technical and administrative support that it has received from its shareholders like VERIZON Communications Inc.

CANTV EMPLOYEES’ POSITION TOWARDS THE OFFER. C.A. LA ELECTRICIDAD DE CARACAS EMPLOYEES’ POSITION.

From the beginning, the employees—owners of approximately 10.51% of the outstanding capital stock of CANTV—maintained a firm rejection to the offer presented by AES.

The reasons for such rejection are found in three fundamental facts:

- a. The attitude assumed by AES in connection with the employees and unions’ representatives of C.A. La Electricidad de Caracas.
- b. The employees feared to loose the representation in the Board of Directors that would be very limited if class “C” shares (only owned by the employees) went below a 10% of the outstanding capital stock.
- c. The announcement by the “Initiator” of its intention to sell certain assets of CANTV, among them, Movilnet (second wireless telephony in the country).

They still remembered the lay offs of approximately 70% of the employees of La Electricidad de Caracas and its unions’ directors. The costs’ reductions implemented by AES impaired the workplace security for the workers and other employees of the company.

In fact, at that time, La Electricidad de Caracas’ union (*Sindicato de Trabajadores Electricistas Similares y Conexos del Distrito Federal y el Estado Miranda*) asked the Venezuelan congress (*Asamblea Nacional*) to beseech the President of La Electricidad de Caracas in connection with the decease of three

employees in less than one year, due to the failure to comply with the hygiene and industrial security norms.

CANTV employees, as shareholders, had in mind the damage that would be caused to the company by selling the wireless telephony business (Movilnet) in the most inconvenient economic moment, with a purchaser already contacted without knowing the real market value of said company and the reduction of workforce that it would cause.

The employees also showed a great degree of dissatisfaction with the purchase price offered by AES, most of all considering the amount of retained earnings, to which they would not have any right in case they sold their shares to the “Initiator”. In that hypothesis, the dividend would correspond to the purchaser, to AES, recovering almost immediately the price paid for CANTV’s control. Selling Movilnet and other assets would recover the rest of the price.

The employees that were members of the Board of Directors as representatives of class “C” shares, maintained an active attitude against the tender offer. As members of the Board of Directors they supported the Board of Director’s position against it. They requested their represented parties “NO TO SELL”. The reasons are the same mentioned above, but maybe the most important ones were the inadequacy of the offered price and maintaining the presence of two (2) members of the Board of Directors, which would be reduced to one representative in case class “C” shares decreased from a 10% of the outstanding capital stock of CANTV.

The employees were aware that if class “A” shares held by VenWorld represented 32.99% of the outstanding capital stock, while the “Initiator” owned 6.91%, represented in class “A” shares as a shareholder of VenWorld; the class “B” shares of the Venezuelan government, through BANDES represented a 5.6% and class “D” shares owned by the public investors represented a 40.43% and Verizon held a 3.56%, the mayor effort of the “Initiator” would be directed to the purchase of shares held by the employees, that is, class “C” shares, to reach the target of taking the control of CANTV. The purchase of the class “C” shares from the employees would also allow the “Initiator” to reduce the representatives of said type of shares in the Board of Director to one, leaving the other seat free for the designation by the class “D” majority shareholder. *That was the reason for the direct rejection from the employees that only tendered about 35,000 shares in the tender offer process, that is to say, less than a 0.004% of the capital stock of CANTV.*

Similar opinion had the telecommunications union (*Unión de Obreros y Empleados de la Industria de Telecomunicaciones del Distrito Federal y Estado Miranda*), a group self-named *Frente Revolucionario por la Dignidad*

(Revolutionary Front for the Dignity) and the federation of telecommunications unions (*Federación de Telecomunicaciones de Venezuela –FETRATEL*).

SOCIAL CONTEXT. POSITION OF THE DOMESTIC CLASS “D” SHAREHOLDERS

The investors expressed a nuisance reaction against the Tender Offer, given the facts that occurred after the hostile tender offer against La Electricidad de Caracas. AES had sold La Electricidad de Caracas’ foreign investments, such as Colombia, among others, negotiated with a Spanish investor prior to the tender offer. The same happened with other domestic assets. This way, AES, rapidly recovered its investments in the purchase of said company. Logically, the benefit of said sales went to the pockets of the new owner of the shares and not to the pockets of those who tendered their shares.

Additionally, the society, very sensible to the abusive practices, rejected the actions taken by AES against the personnel of La Electricidad de Caracas, some of them veterans of more than 20 years of service in the company, which were separated from their jobs with no consideration. The same situation occurred with the unions’ representatives.

Class “D” shareholders that were not far from said reality, in an almost unanimous way, rejected the offer to tender their shares, mainly due to the low price offered and because they agreed with the position expressed by the Board of Directors on October 1, 2001.

DEFENSIVE MEASURES TAKEN BY CANTV

The Board of Directors in their meetings held on October 4, and October 7, 2001, resolved:

- a. *Authorizing the Trust created for the management of the Excellence Prize Program, to buy in the Internal Market of Class “C” Shares of the company, an additional amount of shares of up to 2% of the capital stock of the company as of December 2, 1991 in order to complete a 3% of the capital stock of the company as of that date, pursuant to section 4.8 of the Share Purchase Agreement dated December 3, 1991 (privatization agreement) and the Trust Agreement with Banco Mercantil executed on June 16, 1993.*
- b. Authorizing the company to make contributions to the Trust created for the management of the Excellence Prize Program for the necessary amount in order to allow such Trust the acquisition of additional class “C” shares up to a 2% of the capital stock of the company as of December 2, 1991.

- c. Authorizing the company *establishing a new Plan named "Value Fund" directed to acquire class "C" shares up to 5.5% of the total capital stock of the company* for the purpose of:
 1. Granting options to the employees over the shares acquired by the Value Fund.
 2. Allowing the sale of shares held by the company's and its subsidiaries' employees' under terms and conditions more favorable than those currently existing in the market, in order to consolidate the workers' participation plan in the stock capital of CANTV, as it is established in section 4.5 of the Purchase Agreement dated December 2, 1991.
 3. Funding the Trust to be created for the management of the Value Fund through contributions and loans that would allow the acquisition of class "C" shares up to 5.5% of the capital stock of the company.
- d. Calling a Special Shareholders Meeting of the company to be held on October 24, 2001 to consider the following issues:
 1. Declaration and payment of an extraordinary dividend.
 2. Third Repurchase Program that the Board of Directors will submit to the Shareholders Meeting. The proposal that the Board of Directors would submit to the shareholders regarding the third phase of the repurchase program, which would be handed on the date and time prior to the Shareholders Meeting called, that the Board of Directors would announce later.

The Shareholders Meeting of CANTV call was published in the expressed terms on October 8, 2001. The following day, October 9, 2001, the Venezuelan securities commission issued Resolution No. 217-2001. This resolution ordered the Board of Directors to present to the shareholders of CANTV, within the 48 hours following said resolution, the extraordinary dividends proposal announced, as well as the Third Repurchase Program proposal that would be submitted to the Shareholders Meeting to be held on October 24, 2001.

This Resolution No. 217-2001 was addressed to CANTV. However, the CNV grounded its ruling, among others, in Resolution No. 104-2001.¹ Based on this resolution and in an absurd manner and in violation of the fundamental right to

¹ See *supra*. This resolution was issued on May 28, 2001, in which the CNV, interfering with statutory norms agreed upon ten years ago by the shareholders of VenWorld, established that no shareholders could use its right of first refusal to acquire class "A" shares of CANTV that were subject to the redemption process, disregarding that the Tender Offer Norms were not applicable at all.

private property, it ordered VenWorld “...to offer and sell an interest equivalent to its share’s quota in the total offered and accepted in the corresponding repurchase plan...”² because if VenWorld did not sell its shares in the proposed repurchase program, its interest, as the interest of any other shareholder that did not sale its shares, would increase once the outstanding capital stock decreased.

The CNV issued the following ruling in the above-mentioned resolution: “...in order to avoid an increase in the control or interest quota in the capital stock of the company [CANTV], obviating the procedures established in the Acquisition, Exchange or Control Tender Offers pursuant to the Regulations that are in force regarding this matter.”

On October 15, 2001 the Board of Directors of CANTV met again to consider among other issues, the Internal Market procedure for the sale of the class “C” shares of the company on behalf of its employees; the extraordinary dividends decree and the third repurchase program to be proposed to the Shareholders meeting to be held on October 24. In this opportunity, the Board of Directors agreed to submit to the Shareholders Meeting the funding the Excellence Prize Trust and the Value Fund to purchase from class “C” shareholder offering their shares within the Internal Market in the same percentage and price conditions as established for the Third Repurchase Program. Likewise, it agreed to propose to the Shareholders Meeting, an extraordinary dividend of Bs. 520 per share³ to be paid in two installments. The first payment would be made in December, for the amount of Bs. 284 per share⁴ and the second in March 2002, for the balance.⁵ Also the proposal for the Third Repurchase Program was agreed upon, with the purpose to acquire up to 15% of the outstanding shares of the Company at a maximum price of US\$ 4.29 per share.

REACTION TO RESOLUTION NO. 217-2001. RESOLUTION NO. 228-2001.

Notwithstanding the violation of the fundamental right of private property, VenWorld agreed to comply with the principles that motivated the order issued by the CNV to *offer and sell an interest equivalent to its share quota in the total amount offered and accepted in the corresponding repurchase plan*. Accordingly, the reconsideration writ presented before the CNV on October 15, 2001, proposed that such quota would be transferred to a trust that could have especial voting instructions or instructions to abstain from voting in the shareholders meeting.

² See Resolution No. 217-2001 issued by the CNV, date October 9, 2001.

³ Equivalent on that date to US\$ 0.70.

⁴ Equivalent on that date to US\$ 0.38.

⁵ That is, Bs. 236 per share, equivalent on that date to US\$ 0.32.

Therefore, the private property right of VenWorld over the shares would only be affected regarding the use and benefit of such shares, since the voting right over those shares transferred to the proposed trust, would not necessarily vote as the shares remaining in VenWorld. But VenWorld would maintain its domain over them in benefit of the shareholders.

Furthermore, the request of VenWorld was based on its substantial interest in the capital stock of CANTV. If VenWorld tendered its shares within the Repurchase Program, given the way it would be instrumented, then the prorating formula would be affected. Accordingly, the other CANTV shareholders would be affected because CANTV could only buyback up to a 15% of its capital stock.

However, the CNV, through Resolution No. 228-2001, dated October 19 2001, addressed again to CANTV, ratified the contents of Resolution No. 217-2001, reaffirming that VenWorld was obliged to *offer and sell an interest equivalent to its share quota in the total amount offered and accepted in the corresponding repurchase plan*.

Additionally, in this resolution, the CNV ordered CANTV the following:

- To abstain from implementing the Value Plan and Excellence Prize during the ordinary terms and extensions of the tender offer launched by AES Comunicaciones de Venezuela C.A., the Third Repurchase Program of CANTV shares or any other competing offer.
- That the shares contained in the Trusts of the Excellence Prize and Value Fund Plans, abstained from voting until they are not distributed to the beneficiaries of such plans (although afterward it was cleared up that the 1% of the Excellence Prize could vote through the Trustee).

Accordingly, the Value Plan and the Trust of the Excellence Prize could not be implemented during the Tender Offer launched by AES, which was a disadvantage to the employees of CANTV that are at the same time shareholders of it. It was only pending to favor the remaining shareholders of CANTV, that is, the holders of the class “D” shares.

IMPLEMENTATION OF THE REPURCHASE PLAN

Given the authorization issued by the Board of Directors of CANTV, the Board decided to implement the Third Repurchase Program through what it is commonly known in the American capital markets jargon as a *self-tender*. Therefore, in October 2001, CANTV filed before the CNV, a report to be disclosed once authorized.

The CNV through Resolution No. 227-2001, dated October 19 2001, decided to:

- Authorize the disclosure of the Report on the Third Repurchase Program of CANTV shares, provided that the Shareholders Meeting of CANTV approved such proposal.
- In case the Shareholders Meeting of CANTV approved the Third Repurchase Program, the CNV ordered AES Comunicaciones de Venezuela C.A., to extend the term of its tender offer until the date on which the Shareholders Meeting of CANTV agreed on the termination of the Third Repurchase Program of CANTV.

The report basically contained a repurchase offer that CANTV made to its shareholders, subject to a prorating formula. Such formula established that although all shareholders and holders of ADS were called to accept the offer presented by CANTV, CANTV would only acquire up to 15% of the shares of the outstanding capital stock as of the date of the offer.

Additionally, the report included an offer addressed to all the shareholders, including those owners of shares class A, B and C.

This way CANTV would be subject to the terms agreed by the Board of Directors for the Third Repurchase Program that furthermore, were subject to the legal limitations for the implementation of the repurchase programs in force at such time. But the authorization for the disclosure of the offer to repurchase, as well as the repurchase itself was subject to the approval by the Shareholders Meeting to be held on October 24, 2001.

APPROVAL BY THE SHAREHOLDERS MEETING HELD ON OCTOBER 24, 2001

At the Shareholders Meeting, on October 24, 2001, the majority of shareholders agreed to approve the dividends proposed by the Board of Directors, as well as the Third Repurchase Program in the terms explained above.

Accordingly, an extraordinary dividend was ordered which first installment would be paid in December 2001. Additionally, a more appealing price for their shares was offered to the shareholders without running the risk of giving the control of the company to investors whose experience in the telecommunications market is very little or nonexistent, and that had plans that were not according to the best interests of the company.

IV. LEGAL BASE OF THE DEFENSES

The defenses proposed by the Board of Directors of CANTV against the tender offer launched by AES were designed on the benefit of all its shareholders, for them to obtain a higher value of their shares. These were measures with no precedents in the

Venezuelan law. Therefore we would like to present you some notes regarding their legal base.

SHARES' FUNDS

The Excellence Prize Trust has its legal base on section 4.8 of the Share Purchase Agreement executed on December 3, 1991 (privatization agreement) between Fondo de Inversiones de Venezuela (FIV) and the winning Consortium of the Privatization (VenWorld).

According to the above mentioned section 4.8, CANTV was obliged to establish an irrevocable trust for a share distribution program for the employees of CANTV and was obliged to grant enough funds to the trust to purchase the class "C" shares. Complying with its obligations, CANTV made a contribution of the necessary amounts to acquire 1% of the class "C" shares to the trust created with the Banco Mercantil as trustee.

On October 2001, this Fund had 1% of the capital stock of the company and the maximum amount established in the Agreement that originated it is a 3%, therefore on the Board of Directors meeting of October 7, 2001 an increase up to said amount pursuant to the provisions of the purchase agreement above mentioned was approved.

The *Value Fund* has its base on the bylaws of the Company approved within the privatization agreements of CANTV and obeys to a request presented by the labor representation, that is, the members of the Board of Directors of CANTV designated by the class "C" shares.

This Trust, created by the Board of Directors in its meeting of October 7 2001, represents one of such plans and is addressed to acquire class "C" shares of the company for its further sale to the current and retired employees of CANTV and its affiliates and subsidiaries in terms and conditions more favorable than the existing market conditions.

Furthermore, this Fund allows those employees of CANTV that were not at the moment of the privatization and that could not acquire shares of the company during said process, enter as new shareholders.

This is a new Fund of a 5.5% of the capital stock of CANTV threshold.

The creation and implementation of these plans is an exclusive power of the Board of Directors pursuant to article 20 of the bylaws of CANTV, stating the following:

“ARTICLE 20: THE BOARD OF DIRECTORS HAS THE POWER TO DIRECT, DISPOSE AND ADMINISTRATE THE COMPANY WITHIN THE LIMITS OF THESE BYLAWS AND ESPECIALLY THE FOLLOWING POWERS:

“A) ESTABLISHING THE POLICIES REGARDING THE PREPARATION OF THE PLANS, PROGRAMS AND BUDGETS OF THE COMPANY, THE COMPENSATION OF EMPLOYEES’ POLICIES, APPROVE SUCH POLICIES AND PERIODICALLY SUPERVISE ITS PROGRESS.”

Additionally, article 11 restrictively states⁶ the powers of the shareholders meeting of the company but among them it does not include the authorization to establish the Benefit Programs for the employees, nor the obligation to be submitted to its approval in case they are established by the Board of Directors. Therefore and by virtue of the so-called residual powers that in this case are attributed by the bylaws to the Board of Directors, there is no doubt that it is the Board that has the power to create such program.

THE DISTRIBUTION OF THE DIVIDENDS

The Shareholders Meeting of the company has the jurisdiction according to letter h) of article 11 of its bylaws, to decide on the amount, frequency and form of payment of the dividends pursuant to article 28 of the same bylaws.

“ARTICLE 11: THE SOLE POWERS OF THE SHAREHOLDERS MEETING ARE THE FOLLOWING:

“ ...

“G) DECIDING ON THE AMOUNT, FREQUENCY AND FORM OF PAYMENT OF THE DIVIDENDS PURSUANT TO THE PROVISIONS OF ARTICLE 28 OF THESE BYLAWS.”

“ARTICLE 28: ...

“THE BOARD OF DIRECTORS WILL SUBMIT TO THE SHAREHOLDERS MEETING THE AMOUNT, FREQUENCY AND FORM OF PAYMENT OF THE ORDINARY AND EXTRAORDINARY DIVIDENDS. IT WILL CORRESPOND TO THE SHAREHOLDERS MEETING TO DECIDE ON THE ABOVE MENTIONED MATTERS, REQUIRING FOR SUCH PURPOSES THE FOLLOWING SPECIAL MAJORITIES: (I) WHEN THE SHAREHOLDERS MEETING DECIDES TO COMPLETELY APPROVE THE PROPOSAL MADE BY THE BOARD OF DIRECTORS, A FAVORABLE VOTE OF A SIMPLE MAJORITY OF THE VOTES REPRESENTED ON THE CORRESPONDING MEETING WILL BE REQUIRED; (II) WHEN THE SHAREHOLDERS MEETING DECIDES TO AMEND IN ANY MANNER THE PROPOSAL EFFECTED BY THE BOARD OF DIRECTOR, A FAVORABLE VOTE OF SIXTY SIX COMA SIXTY SIX PERCENT (66.66%) OF THE VOTES REPRESENTED IN THE CORRESPONDING MEETING WILL BE REQUIRED. EXERCISING THE ABOVE MENTIONED POWERS, THE SHAREHOLDERS MEETING MAY ORDER THE BOARD OF DIRECTORS TO MAKE THE DECISIONS THAT IT DEEMS CONVENIENT REGARDING ANY FISCAL YEAR, TAKING INTO ACCOUNT THE ECONOMIC AND TREASURY CONDITIONS OF THE COMPANY AND COUNTRY AND THE

⁶ Note the drafting of the heading of this article in the bylaws of CANTV: “Article 11; The sole powers of the Shareholders Meeting are the following:...” Among them the establishment of Benefit Programs in favor of the Employees is not included.

INVESTMENT PLANS THAT THE COMPANY EXPECTS FOR THE FOLLOWING YEARS. IN THE LATTER CASE, THE SHAREHOLDERS MEETING MAY FORMULATE RECOMMENDATIONS TO THE BOARD OF DIRECTORS REGARDING THE MATTERS ABOVE REFERRED. IT WILL CORRESPOND TO THE BOARD OF DIRECTORS TO DETERMINE THE OPPORTUNITY TO PAY THE DIVIDENDS THAT ARE AGREED UPON PURSUANT TO THE PROVISIONS OF THIS ARTICLE.”

THE REPURCHASE PLAN

The Shareholders Meeting held on October 24, 2001 approved the Third Repurchase Plan proposed by the Board of Directors.

As established on article 263 of the Commercial Code, the power regarding the approval of the repurchase of the shares of the company plans corresponds to the Shareholders Meeting. Pursuant to such provision, this purchase can only be made with amounts coming from profits regularly obtained.

“ARTICLE 263: THE ADMINISTRATORS CAN NOT ACQUIRE THE SHARES OF THE COMPANY ON ITS BEHALF, EXCEPT IN THE CASE THAT THE ACQUISITION IS AUHTORIZED BY THE SHAREHOLDERS MEETING AND IT IS MADE WITH AMOUNTS COMING FROM PROFITS REGULARLY OBTAINED, ACCORDING TO THE BALANCE SHEETS OF THE COMPANY. IN NO CASE IT IS ALLOWED TO THE COMPANY TO MAKE LOANS OR ADVANCE PAYMENTS GUARANTEED WITH THEIR OWN SHARES.”

Likewise, the Capital Markets Law establishes rules for the repurchase programs. Therefore, the most relevant provisions are in those stated in articles 55, 56, 58 and 63 of this law, that state the following:

“ARTICLE 55.- THE COMPANIES WHICH SECURITIES ARE REGISTERED BEFORE THE NATIONAL SECURITIES REGISTRY, MAY ONLY ACQUIRE ON A ONEROUS TITLE ITS OWN SHARES OR THE SHARES ISSUED BY ITS CONTROLLING COMPANY OR OTHER SECURITIES THAT GRANT RIGHTS OVER THEM WHEN THE FOLLOWING CONDITIONS ARE FULFILLED:

“1. THAT THE ACQUISITION IS PREVIOUSLY AUTHORIZED BY THE SHAREHOLDERS MEETING OF THE ACQUIRING COMPANY;

“2. THAT THE SHARES HAVE BEEN TOTALLY PAID;

“3. THAT THE ACQUISITION AMOUNT DOES NOT EXCEED THE AMOUNT OF THE BALANCE PROFIT ACCOUNTS NOT COMMITTED BY LAW OR BY THE BYLAWS OF THE ACQUIRING COMPANY, PURSUANT TO THE CONSOLIDATED FINANCIAL STATEMENTS OF THE CONTROLLING COMPANY.

“4. THAT THE FACE VALUE OF THE ACQUIRED SHARES, ADDED TO THE VALUE OF THE SHARES ALREADY OWNED BY THE CONTROLLING COMPANY AND ITS CONTROLLED COMPANIES, DOES NOT EXCEED FIFTEEN PERCENT (15%) OF THE PAID IN CAPITAL, REPRESENTED IN COMMON SHARES ISSUED BY THE CONTROLLING COMPANY.

“5. THAT THE ACQUISITION IS MADE THROUGH A STOCK EXCHANGE.

“THE ABOVE LIMITATIONS ARE APPLICABLE ALTHOUGH THE ACQUISITION IS MADE THROUGH INTERMEDIARY PERSONS OR TRUST COMPANIES.

“SOLE PARAGRAPH.- THE NATIONAL SECURITIES COMMISSION MAY ESTABLISH THROUGH GENERAL REGULATIONS, RESTRICTIONS OR LIMITATIONS FOR THE ACQUISITION OF SHARES ISSUED BY COMPANIES WHICH SECURITIES ARE REGISTERED

BEFORE THE NATIONAL SECURITIES REGISTRY, ON BEHALF OF AFFILIATE COMPANIES OR RELATED TO THEM.”

“ ARTICLE 56.- CONDITIONS ESTABLISHED ON NUMERAL 3 OF THE PREVIOUS ARTICLE WILL NOT BE APPLICABLE WHEN THE ACQUISITION OF SHARES IS MADE BY VIRTUE OF THE DECISION OF THE SHAREHOLDERS MEETING TO REDUCE THE CAPITAL THROUGH THE REDEMPTION AND FURTHER ANNULMENT OF THE SHARES PROVIDED THAT THE FOLLOWING CONDITIONS ARE COMPLIED WITH:

“ 1. THAT THE CAPITAL STOCK REDUCTION IS NOT MADE IN COMPLIANCE TO ARTICLE 264 OF THE COMMERCE CODE; AND

“ 2. THAT THE RESCUE AND FURTHER ANNULMENT OF THE ACQUIRED SHARES IS MADE WITHIN A TERM OF SIX (6) MONTHS, FROM THE DATE OF THE DECISION OF THE SHAREHOLDERS MEETING. ONCE THIS TERM HAS ELAPSED, THE CAPITAL REDUCTION WILL BE LIMITED TO THE AMOUNT OF THE SHARES EFFECTIVELY RESCUED.

“ ARTICLE 58.- THE AGREEMENT OF THE SHAREHOLDERS MEETING THAT AUTHORIZES THE ACQUISITION OF THE SHARES ISSUED BY THE SAME COMPANY OR BY ITS CONTROLLING COMPANY MUST STATE:

“ 1. THE MAXIMUM AMOUNT OF SHARES TO BE ACQUIRED;

“ 2. THE MAXIMUM PRICE OF THE ACQUISITION AND THE CONDITIONS FOR ITS PAYMENT;

“ 3. THE TERM DURING WHICH THE ACQUISITION CAN BE MADE, THAT IN NO CASE SHALL EXCEED FROM SIX (6) MONTHS; AND

“ 4. THE OTHER ITEMS THAT THE NATIONAL SECURITIES COMMISSION DETERMINES IN THE NORMS ISSUED FOR SUCH PURPOSES.”

“ ARTICLE 63.- THE ADMINISTRATORS SHALL OFFER THE SHAREHOLDERS OF THE RESPECTIVE ISSUING COMPANY, THE TREASURY SHARES THAT IT KEEPS, AS DETERMINED BY THE NATIONAL SECURITIES COMMISSION IN THE NORMS ISSUED FOR SUCH PURPOSES. THE SHARES THAT ARE NOT ACQUIRED BY THE SHAREHOLDERS OF THE RESPECTIVE ISSUING COMPANY SHALL BE SOLD BY THE ADMINISTRATORS THROUGH A STOCK EXCHANGE, WITHIN THE TWO (2) YEARS FOLLOWING THE DATE OF THE CORRESPONDING ACQUISITION, UNLESS THE SHAREHOLDERS MEETING AGREES THE CAPITAL STOCK REDUCTION THROUGH THE REDEMPTION OF THE TREASURY SHARES KEPT BY THE COMPANY.”

The Shareholders Meeting agreed on the implementation of the Third Repurchase Program of shares, which would become Treasury shares that shall be offered for sale within the two (2) years following the acquisition by CANTV, in first place to the shareholders of CANTV and if they do not buy them, to the public, through a stock exchange, unless the Shareholders Meeting of CANTV decides on a reduction of its capital stock through the redemption of said shares as established in the Capital Markets Law.

The acquisition price of these shares, which purchase value had been estimated on the amount of US \$ 596,000,000.00, was covered pursuant to article 263 of the Commercial Code and article 55 of the Capital Markets Law, with retained earnings of CANTV, which at the moment of the Shareholders Meeting had an amount for this purpose equivalent to one billion dollars of the United States of America (US\$ 1,000,000,000.00).

V. CONCLUSIONS

As we have analyzed through these notes, several aspects of economic, social and legal nature resulted on the frustration of the tender offer launched by AES against CANTV.

However, we must point out that the measures adopted by the Board of Directors of CANTV for the defense of the shareholders of the company, could be summarized in the strengthening of the price of their share and the presentation to the shareholders of a better alternative that increased their value.

If you wish to know further details on the facts described in these notes, do not hesitate to contact us:

Calle Guaicaipuro con Av. Ppal. Las Mercedes, Torre Forum, Piso 6, Ofic. A,
Urb. El Rosal.

Master: +58 212 951 3333 Fax: +58 212 951 2851
Apartado Postal 1423 – 1010-A. Caracas – Venezuela.
E-mail: general@palaciosortega.com

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