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Report No. P-193

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PRELIMINARY REPORT OF THE PRESIDENT

TO THE EXECUTIVE DIRECTORS

ON A PROPOSED LOAN TO THE SOCIETE ELECTRIQUE DE L'OUR

April 24, 1959

PRELIMINARY REPORT OF THE PRESIDENT
TO THE EXECUTIVE DIRECTORS ON A
PROPOSED LOAN TO THE SOCIÉTÉ ELECTRIQUE DE L'OUR

1. I submit the following preliminary report on a proposed loan equivalent to \$6.5 million to the Société Electrique de l'Our for the Vianden project in Luxembourg. The outline of the joint operation of which the proposed loan would be a part was given in my memorandum circulated to the Executive Directors on November 6, 1958 (R58-114).

PART I - HISTORICAL

2. The proposal for a hydroelectric development at Vianden on the river Our, which forms the border between Luxembourg and Germany, was informally brought to the attention of the Bank as far back as 1949. The project was conceived as part of the electricity generating and distributing system of the Rheinisch-West-faelisches Elektrizitaetswerk, A.G. (RWE), the largest German utility company. In view of its location in Luxembourg territory, however, a separate company, the Société Electrique de l'Our (SEO), was formed in Luxembourg in 1951 to study, build and operate it.

3. At the 1953 annual meeting of the Bank the project was raised officially by the Luxembourg Government and the management indicated that, in principle, it was prepared to consider it. Since then, the Government has maintained contact with the Bank, while SEO proceeded with the preparatory work on the project. The engineering advisor of the Bank visited the site in 1955 and subsequently extensive documentation was examined in Washington.

4. In the spring of 1956, I informed the Minister of Finance that the Vianden project could become a basis for a loan and asked for additional information on costs and financing. A mission went to Luxembourg in the summer of 1957 to look into various aspects of the project and one of its members subsequently visited RWE in Germany. Several financial and legal matters remaining to be settled were discussed in Washington in April 1958 with the representatives of the Luxembourg Government, SEO, RWE and Société Générale pour l'Industrie of Geneva, the consultants to SEO.

5. Soon after these discussions, The First Boston Corporation and the newly established European Investment Bank (EIB) made arrangements to participate in the financing of the project. A financing plan was worked out in September 1958 by the interested parties in Luxembourg and Brussels. It provided for an increase in the capital of SEO, for public issues of SEO bonds in New York, Luxembourg and Germany, and for loans by the EIB and the Bank.

6. The Loan and Guarantee Agreements were negotiated in Luxembourg at the end of October 1958 with a view to signing them in early December together with the underwriting agreement with First Boston and the EIB agreements. However, because of the delay in passing the necessary legislation, due mainly to the dissolution of the Luxembourg Chamber of Deputies, the New York bond issue had to be postponed and with it the signing of the Bank and EIB loans.

7. The Dresdner Bank, which heads the German underwriting syndicate, had intended to have SEO's German bond issue secured by an assignment of revenues,

but it has now decided to give this up. As a result, the other lenders, including the Bank, are not taking security.

8. The Bank has already made one loan in Luxembourg in 1947:

<u>No.</u>	<u>Borrower</u>	<u>Purpose</u>	<u>Amount</u> (equivalent, in \$ million)
4 Lu	Grand-Duchy of Luxembourg	Steel mill and rail- road equipment	11.76 ^{1/}
	Of which has been repaid (including \$1 million prepaid)		<u>4.50</u>
	Total now outstanding		7.26
	Amount sold	4.30	
	of which has been repaid	<u>2.89</u>	<u>1.41</u>
	Net amount now held by Bank		5.85

^{1/} Net of \$0.24 million cancelled.

PART II - DESCRIPTION OF THE PROPOSED FINANCING

9. The cost of the Vianden project is estimated at about \$40 million equivalent. This amount is to be provided in accordance with the following financing plan:

<u>Share Capital</u>	(equivalent, in \$ million)	
Luxembourg Government	4	
RWE	4	
Other (foreign and Luxembourg companies and Luxembourg public)	<u>2</u>	10
 <u>Loan Capital</u>		
New York bond issue	10	
Luxembourg bond issue	5	
German bond issue	5	
EIB loan	4	
IBRD loan	<u>6.5</u>	<u>30.5</u>
		<u>40.5</u>

Share Capital

10. The present share capital of SEO will be increased in May by \$9.4 million to \$10 million equivalent. Twenty per cent of the increase, or about \$1.9 million equivalent, will be paid in on subscription. The remainder will be paid in five semi-annual instalments, each of about \$1.5 million equivalent, commencing

in November 1959 and ending in November 1961. The major shareholders, i.e. the Luxembourg Government and RWE, will commit themselves in writing before the loan is signed, to subscribe on a fifty-fifty basis to any further increase in the share capital which may prove necessary in the course of construction.

Bond Issues

11. A New York issue of \$10 million SEO bonds guaranteed by the Luxembourg Government is being arranged by an underwriting syndicate headed by The First Boston Corporation and Kuhn, Loeb and Co. As of now, the issue is expected to be made on or about June 3 for a term of twenty years. Constant sinking fund payments, calculated to retire the issue by maturity, will start on December 1, 1962. The bonds will not be subject to call for ten years but can be called thereafter at a premium.
12. An issue of SEO bonds in Luxembourg francs, guaranteed by the Luxembourg Government, will be made in Luxembourg, presumably in 1961. Its amount will be equivalent to \$5 million (Lux.frs. 250 million at the present rate of exchange). The issue will be for a term of twenty-five years with amortization commencing probably in the fourth year by means of constant annuities of interest and principal. The other terms of the issue cannot be determined at present. Before the Bank's loan is made, the Luxembourg Government will give a written undertaking that it will ensure the placement of the entire issue.
13. An issue of SEO German mark bonds will be arranged in Germany, presumably late in 1961, by a banking syndicate headed by the Dresdner Bank. Its amount will be equivalent to \$5 million (DM 21 million at the present exchange rate). The issue will be for at least twenty years with amortization commencing not earlier than in the sixth year. The interest rate and price will, of course, be determined at the time of issue. Before the Bank's loan is made, the Dresdner Bank will give a written undertaking to provide SEO with an amount in German marks equivalent, at the time of the issue, to \$5 million and to increase this amount to the extent that actual construction costs would exceed the present estimate. However, should the over-run be higher than the equivalent of \$2 million, it would be divided between the Dresdner Bank on the one hand and the two major shareholders of SEO (i.e. the Luxembourg Government and RWE) on the other, in the proportion of 3:1.

Loans

14. The EIB will make a loan equivalent to \$4 million in various currencies to SEO simultaneously with the Bank's loan. The loan will be guaranteed by the Luxembourg Government. It will have a life of twenty years with amortization commencing on December 1, 1962 and with constant annuity of interest and principal.
15. The main characteristics of the proposed Bank loan will be as follows:

<u>Borrower:</u>	Société Electrique de l'Our.
<u>Guarantor:</u>	Grand-Duchy of Luxembourg.
<u>Amount:</u>	The equivalent in various currencies of \$6.5 million.
<u>Amortization:</u>	In forty-four increasing semi-annual instalments commencing December 1, 1962 and ending June 1, 1984.
<u>Interest Rate:</u>	_____% , including 1% commission.
<u>Commitment Charge:</u>	3/4 of 1% per annum.

Disbursement of the EIB and IERD Loans

16. It has been agreed between the EIB and the Bank to disburse the two loans in step one with the other and in proportion to their respective amounts. Since initially SEO will have ample funds derived from the New York issue and from payments on account of the authorized capital, both banks have agreed that SEO would start drawing on their loan accounts only after these funds have been applied to the project. Consequently, disbursement of the two loans would take place between the autumn of 1960 and the spring of 1962, and withdrawals would be so spaced that the two loans would not be fully drawn down until after the last payment on account of the authorized capital had been made.

PART III - APPRAISAL OF THE PROPOSED LOAN

17. The technical report on the Vianden project was circulated to the Executive Directors as an attachment to my memorandum (R58-114). Except for the change in timing and the exclusion of the assignment, the presentation given in the report is up to date. No separate economic report on Luxembourg has been prepared because of the specific features of the operation. As explained below, responsibility for the service of the Bank's loan in Luxembourg francs rests on the German economy and responsibility for the transfer of service payments into dollars or other currencies due to the Bank on the Belgo-Luxembourg Economic Union.

The Project

18. The project would be a pumped storage installation with a generating capacity of 320,000 kw. which could in future be expanded to 640,000 kw. Off-peak energy would be used to pump water from a lower reservoir, formed by a dam across the river, into an upper reservoir built on a hill, and power would be generated in the hours of peak demand by releasing the stored water through the turbines into the lower reservoir. The main function of the project would be to help meet the need for peak power in the RWE system. RWE would supply pumping power and would take all power generated by the project into its grid through transmission lines built by it for this purpose in German territory.

19. While absorbing into its grid all peak power produced by the project, RWE would make available certain quantities of base power for consumption in Luxembourg and other countries with which its system is inter-connected. In fact, since 1956 RWE has been delivering to Electricité de France for account of SEO small amounts of energy at times of high seasonal demand. After the expansion in capacity to 640,000 kw., larger quantities of power from the RWE grid, and possibly even from the Vianden plant directly, would be made available to Luxembourg, Belgium, France or the Netherlands.

20. The right to use the waters of the Our for the project is among the provisions of a Treaty concluded on July 10, 1958 for ninety-nine years by Luxembourg and the German Land of Rhineland-Palatinate, the latter acting with the approval of the Federal Republic of Germany. The Belgian Minister of Foreign Affairs has stated that Belgium, the up-stream riparian country, has no objection to the project.

21. The project has been worked out with great care over a long period of time. It is well thought out and well engineered. Construction will start as

soon as the required \$40.5 million equivalent is secured and is expected to last about three years. Future expansion would cost about \$25 million equivalent and should start within the next ten years.

The Société Electrique de l'Our

22. SEO is an internationally owned company incorporated in Luxembourg. It has an authorized capital of Lux.frs. 30 million (\$0.6 million) which will be increased to Lux.frs. 500 million (\$10 million) before the loan is signed. The Luxembourg Government and RWE will subscribe an amount required to give each of them 40% of the authorized capital. The remainder will be partly subscribed by some of the existing shareholders, i.e. Belgian, Swiss, French, Dutch and Luxembourg electric holding and utility companies, and partly taken firm by the "Banque Internationale a Luxembourg" and offered to the Luxembourg public.

23. The Luxembourg and German members together must have the majority of votes in the Board of SEO. An annex to the Treaty gives the Luxembourg Government and the Government of Rhineland-Palatinate the right to suspend Board resolutions and put them up for renewed consideration, should this be necessary to safeguard the interests of their respective countries.

24. Financially, SEO will depend entirely on RWE. A contract between the two companies commits RWE to pay regularly the operating and administrative expenses of SEO, taxes, amortization and interest on loans, amounts necessary to form certain reserves and a dividend on the share capital. These payments are estimated at the equivalent of \$4 million per annum and, unless the corresponding expenditures are to be made in Germany, will be made in Luxembourg francs. RWE should easily be able to meet them. It is in a strong financial position, has assets equivalent to about \$500 million and annual gross operating revenues equivalent to over \$350 million. In the course of its 60-year long existence, it has acquired an excellent standing in Germany and abroad.

Justification for the Loan

25. Once the project is built, its capacity will be fully used to meet the increasing demand for peak power in the RWE system, which supplies a large part of Western Germany's power requirements and is interconnected with other Western and Central European countries. As RWE is a major participant in the European power clearing, France, Belgium, the Netherlands and possibly other countries would derive benefits from the operation of the project.

26. Most of the industrial and household power needs of Luxembourg are at present being supplied by thermal plants owned by the Luxembourg steel mills. However, by 1966, the capacity of these plants is expected to be fully absorbed by the steel industry itself. The amount of power available to Luxembourg from the RWE system after the completion of the project would thus make it possible to meet future demands of the other industries and the general public.

27. The estimated cost of peak power produced by the Vianden project compares favorably with the cost of power which could be produced by an alternative thermal plant of equal capacity.

28. Although the project is located in Luxembourg it benefits primarily Germany. Luxembourg is a small country and could hardly provide from its own savings the capital needed both for its own basic services and for the comparatively large and costly Vianden project. Consistent with its interest in Vianden, Germany is furnishing a substantial part of the capital and in addition the entire cost of the appurtenant transmission lines. The major shareholders have, however, always been reluctant to go ahead with the venture without also obtaining the participation of interests outside Germany and Luxembourg and thus putting the project on a broader international basis.

Prospects for Fulfillment of Obligations

29. In the last analysis, repayment of the proposed loan depends upon RWE. The transfer of amortization, interest and other charges on the loan into Luxembourg francs should cause no problem; the German Federal Minister of Economics, after consultation with the German Federal Bank, has given RWE specific written assurances in this respect. A copy of these assurances has been officially transmitted to the Bank.

30. Once the requisite amounts in Luxembourg (Belgian) currency have been received, they will have to be converted into dollars or such other currencies as are needed for loan service. Since Luxembourg has no central bank and shares in the monetary reserves of the Belgo-Luxembourg Economic Union, SEO has obtained written assurances from the Belgo-Luxembourg Foreign Exchange Institute to the effect that the necessary foreign exchange would be made available for the service of the loan. Similar assurances were given to the Bank in the case of the 1947 Luxembourg loan.

31. The Grand-Duchy of Luxembourg, which would guarantee the proposed loan, has a good debt record. Incomes in Luxembourg are among the highest in Europe and thrift is a national characteristic. For almost a decade, the ordinary budget has shown large surpluses and these financed the greater part of government investment, the rest being covered by domestic savings. The recent decline in the price of steel, resulting in a reduction in corporate income tax proceeds, has caused ordinary revenue in 1958 to fall below estimates so that the surplus, if any, will be small. Nevertheless, the financial position of the Government remains strong. For a number of years, annual service on the public debt has not exceeded 12% of ordinary budget revenue, far below the 25% ratio written into the debt limitation clause of the 1947 loan agreement with the Bank. Politically and socially, the country is very stable and the recent government crisis has had no effect on economic life. The Luxembourg Government is well able to meet the obligations which the proposed operation would place upon it.

32. The transfer of Luxembourg (Belgian) francs into the currencies needed to service the proposed loan should not raise any problem. Luxembourg's export earnings accrue to the gold and foreign exchange reserves of the Belgo-Luxembourg Economic Union and Luxembourg draws on these reserves to pay for imports and to service external debt. Including the proposed government-guaranteed borrowing for the Vianden project, the long-term public external debt of Belgium and Luxembourg, and the dollar and Swiss franc debt of the Belgian Congo and Ruanda-Urundi, amount to about \$700 million. Service payments on this debt represent about 1.5% of the Belgo-Luxembourg Economic Union's current external receipts of about \$4 billion per annum, while the gold and foreign exchange

reserves of the National Bank of Belgium, now about \$1.4 billion, correspond to about six months' merchandise imports.

PART IV - LEGAL INSTRUMENTS AND AUTHORITY

33. To fit the special circumstances of the operation, the Loan Agreement with SEO will depart from the general pattern of the Bank's loan agreements in the following principal respects:

- a) It will provide that SEO would draw on the loan account only after it has applied to the project the proceeds of the New York issue and at least 50% of its authorized capital, and that withdrawals must not exceed 80% of the amount of the loan until the authorized capital has been fully paid in. Withdrawals from the loan account will be simultaneous and in the proportion of 6.5:4.0 to withdrawals made by SEO under the EIB loan.
- b) It will provide that SEO: (i) will duly perform its obligations under its contract with RWE and will not agree to any assignment, waiver, modification or change of this contract which could result in SEO's inability to service the loan and finance the project; (ii) will duly comply with the terms of the Treaty between Luxembourg and Rhineland-Palatinate and the concession which forms part of the Treaty;
- c) It will specify as additional conditions of effectiveness that the Treaty shall have entered into force, the EIB loan agreement shall have become effective and SEO shall have delivered, and received payment for, the bonds issued in New York;
- d) It will add to the events permitting the Bank to suspend withdrawals or to premature the loan (i) default on other debt incurred to finance the project and (ii) any action to amend, suspend or terminate the Treaty.

34. The Guarantee Agreement with the Grand-Duchy of Luxembourg will provide for a guarantee of performance of all the obligations of the borrower under the Loan Agreement.

PART V - TIMING

35. The underwriters plan to make the public offering on or about June 3 and for that purpose to file early in May a registration statement which will mention the prospective Bank lending. Since the Bank's loan, the public bond issue and the EIB loan are each conditioned upon the others, the underwriters wish to be assured before the registration statement is filed that in the absence of some major adverse development there is no reason to believe that the Bank loan would not be approved by the Executive Directors in time for the public issue. If you concur, I will give them this assurance.

36. Given your concurrence, I propose to submit to you at a meeting preceding the public offering a supplement to this report attaching the Loan and Guarantee Agreements and containing my recommendation regarding the Bank loan.

Washington, D.C.
April 24, 1959

Eugene R. Black