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14th April, 1994

By Fax: (i) 0101 202 728 0546
(ii) c/o Marina Yablonskaya, Tashkent
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Dear Joe,

BAT Industries plc ("BAT")'s proposed Joint Venture investment ("UZBAT") in the Republic of Uzbekistan.

Thank you for your letter of 12th April written on behalf of all the Uzbek Parties to these negotiations. I am replying on behalf of BAT to the matters you raised and issues discussed with Alexis Bedos over the telephone earlier today. For the purposes of this response, the Uzbek Parties are deemed to include but not be limited to, in alphabetical order, the Cabinet of Ministers, the Ministry of Finance, the Ministry of Foreign Economic Relations, the State Committee on State Property and the State Joint Stock Concern Uzpischeprom. Although this letter is addressed to you in Washington it is also being sent to you through BAT's secure fax facilities in Tashkent. As agreed with Alexis Bedos, in the interest of speed this English language letter is being sent to you in advance of a Russian translation.

1. **Proposed Schedule**

May I repeat BAT's commitment to the timetable specified in the 11th February, 1994 Decision of the Cabinet of Ministers and its endorsement by First Deputy Prime Minister Jurabekov at the meeting with BAT on 7th April, 1994. To this end, BAT has arranged the following:

- Thursday 14th April: a meeting between McKenna & Co and Meyer Brown Platt in London to address issues arising out of your expected legal letter, to agree a list of documents necessary for Completion and the Completion process.

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- w/c Monday 18th April:
  - (i) the relevant personnel in Tashkent to discuss agreed agendas for Valuation, Leaf, Fiscal and Legal working groups; and
  - (ii) Completion planning team in Tashkent and Samarkand to begin preparation of Completion accounts and the asset and liabilities verification process.
- *so that by* Friday 22nd April:
  - (i) working group discussions concluded; and
  - (ii) agenda for final discussions agreed.
- w/c Monday 25th April:
  - (i) lead negotiating team available for as long as necessary in Uzbekistan; and
  - (ii) Completion procedures (legal and financial) continuing.

It would be helpful to define precisely what the Uzbek Parties expect to sign on or before 1st May. It is assumed by BAT that the documentation for signing at that point will be the Joint Venture Agreement with its supplementary documentation so as to permit registration during the period 2nd to 11th May. It will be important for the legal advisers to both sides to identify the documents required for registration and to clarify precisely the procedures required so as to minimise the risk of impediments to a swift registration process.

As discussed with Alexis Bedos, BAT will endeavour to provide a draft of a decree for the Cabinet of Ministers within the next few days.

Mindful of the timetable, BAT are now taking steps to arrange for Sir Patrick Sheehy to visit Uzbekistan on Wednesday 11th May to meet President Karimov to publicize the establishment of UZBAT.

2. Working Groups

(a) Membership

BAT believe it appropriate that the Ministry of Finance are represented in the lead negotiation team as an important part of BAT's conditions for investment relate to fiscal and excise matters. I hope that this will be possible as it was understood at the meeting with Mr. Jurabekov that the Ministry of Finance would be present.

(b) Working Group agendas

It may be appropriate to avoid wasting time discussing agendas for each working group on Monday 18th April by agreeing in advance the agendas. Therefore, the following agendas are proposed and I would be grateful if I could receive your comments on these as soon as possible so that the agendas can be finalised:

- Valuation Working Group:
  - (i) agreement on the method of valuing the Uzbek asset contribution proposed by BAT;
  - (ii) agreement as to any alterations to the list of assets valued by BAT;
  - (iii) agreement on the approach to valuing of land;
  - (iv) agreement on the exclusion of assets from UZBAT; and
  - (v) agreement as to the allocation of equity in UZBAT arising from the valuation of assets.

It is understood that Uzpischeprom have been reviewing the preliminary valuation information provided by BAT over the last fortnight and should, therefore, be in a position to comment in detail. Fixed asset valuation was agreed as the most appropriate method of allocating equity within UZBAT so that such allocation was achieved by reference to items comparable to BAT's proposed capital investment. The exclusion of non-fixed asset and intangible items has been deliberate, although the Feasibility Study clearly states that the US$225 million capital investment and US$7 million immediate working capital investment significantly understates the overall economic value to Uzbekistan of UZBAT.

You may also be aware that Mr. Jurabekov undertook to provide BAT with details of the established procedures for the valuation of land in Uzbekistan; I would be grateful if these could be made available as soon as possible.

- Tobacco Leaf Working Group:
  - (i) confirmation, or otherwise, that Uzpischeprom is the only organisation directly involved with leaf barter;
  - (ii) confirmation of future leaf barter commitments by Uzpischeprom (or any other agency) in terms of volumes and duration of commitment;
  - (iii) explanation of Uzpischeprom's estimates of "value" received from leaf barter (stated as between US$7 million and US$10 million *per annum*);
  - (iv) explanation of the barter cash flow procedures;
  - (v) explanation of forecast future requirements in terms of Green and Dry weight volumes/ unprocessed or processed oriental leaf;
  - (vi) confirmation that BAT has freedom to contract with leaf farmers;

(vii) confirmation of BAT's forecast requirements (for manufacture and export);

(viii) confirmation of priority access to leaf for domestic cigarette manufacture (which point BAT have agreed with Uzpischeprom); and

(ix) confirmation of freedom to price leaf.

It is recommended that a representative of the State Committee on State Property attend these discussions as tobacco leaf will be an integral part of the overall valuation of any joint venture investment and BAT would expect this working group to be subsumed rapidly into the Valuation Working Group. The proposed involvement of the Ministry of Agriculture is welcomed; it would be helpful to receive an advance indication of their particular areas of interest.

In your letter, you refer to the determination of the "ownership rights and payment for tobacco leaf". The reference to ownership rights is not understood; BAT is not proposing to acquire leaf farms but rather to contract freely with leaf farmers. It is expected that inasmuch as UZBAT purchases leaf from farmers for processing, it will hold title to the leaf. However, leaf could also be processed on an agency basis.

- Fiscal Working Group:
  (i) confirmation and clarification of tax incentives available to foreign investors;

  (ii) confirmation of discretionary tax incentives available to UZBAT and the methods of securing such incentives; and

  (iii) BAT's excise requirements.

Appended to this letter is a list of tax incentives to be discussed by the fiscal experts. BAT are aware that the Ministry of Finance are receiving advice on excise and fiscal reform from a number of domestic and international sources, so it will be important to consider the need for reform in the light of this advice.

- Legal Working Group:
  (i) confirmation of title to the Uzbek assets to be contributed to UZBAT;

  (ii) confirmation of land use rights to be contributed to UZBAT;

  (iii) agreement on documentation for Completion;

  (iv) agreement on Completion procedures; and

  (v) form and content of Cabinet of Ministers Decree

As indicated previously, this work should commence on Thursday afternoon in London with Meyer Brown Platt.

The proposed agendas for the working groups and the timetable are predicated on a Joint Venture investment structure formed by way of asset contributions to a newly established closed joint stock company. Your letter appears to envisage a privatisation structure - namely the corporatisation of the relevant operating entities and the acquisition of equity. This is not the structure set out in the Decision of the Cabinet of Ministers, dated 11th February. Moreover, this approach seems to raise a number of substantial issues (*eg.* title to assets; operating contracts) and matters of timing which, in our view, will not permit investment within the Presidential timetable. As explained during the telephone conversation with Alexis Bedos, BAT will need to be convinced of the unanimous support of the Uzbek Parties for this approach as well as the feasibility of achieving it within the specified timetable. This matter should be addressed as a matter of urgency either before the end of this week by telephone or immediately on Monday 18th April.

3. Preliminary Clarification

3.1 Ownership of UZBAT

It will be important for the legal advisers to the parties to agree which Uzbek entity or entities have title to the assets to be contributed to UZBAT. BAT is satisfied that Uzpischeprom and the factories have such title; if this situation has changed, BAT will need to be satisfied of such change and will require appropriate confirmation of the position so that there can be no possibility of challenge to title either at or after the formation of UZBAT. This should be discussed in detail by the legal advisers to both sides on Thursday. The amendment of documentation should merely be a formality, should it prove appropriate.

3.2 Ownership structure

As explained in the Investment Proposal and in discussions to date, the allocation of equity is a function of the values attributable to the BAT and Uzbek contributions to UZBAT. Indeed, BAT are clear that the value imputed to the Uzbek fixed assets is generous given that it is highly questionable what the second hand and/or alternative use value of the existing Uzbek assets would be in hard currency terms. As you will be aware, it is BAT's view that the preliminary valuation indicates a premium of in excess of 200 per cent. over the inflation adjusted value commonly used in Uzbekistan.

Your letter indicates that the Uzbek Parties accept that in order to ensure successful investment, BAT should hold *at least* 75.1 per cent. of the issued ordinary equity of UZBAT. Given that BAT believes there is already a premium in the valuation of the Uzbek assets, it is deemed that 75.1 per cent. should be available to BAT immediately upon the formation and registration of UZBAT.

You will also be aware that BAT strongly welcomes the participation of the Uzbek Parties in UZBAT as BAT believes that such participation will be an important component of success. In particular, BAT is receptive to each of the Labour Collectives at the existing factories having an equity interest in UZBAT.

It would be helpful to have explained in more detail your proposal that the Uzbek Parties, through the State Committee on State Property, would have the right to acquire shares in the joint venture company in the future, to a limit of 24.9 per cent. of the issued ordinary equity. Do the Uzbek Parties have in mind a sustained level of ordinary equity so as to avoid dilution during BAT's capital investment programme?

In conformity with the statement by Mr. Jurabekov, it is assumed that there is now no uncertainty about BAT having both equity and management control.

3.3 Tax Holidays

Please see Appendix A

3.4 Investment Programme

Please see Appendix B. In addition, you may find the following comments helpful.

- technical assistance and ex-patriate salary reimbursement. These figures have been excluded from the calculation of the BAT contribution to UZBAT in order to simplify the process. At this stage, BAT would not propose to change this approach. You should be aware that Uzpischeprom have advised BAT that ex-patriate salaries should be charged directly to UZBAT;

- the US$38 million forecast capital expenditure to sustain production over the five years after the capital investment cycle is expected to be self-financed;

- TTF: the discrepancy (actually only US$1.25 million because of rounding) is in the form of vehicles, computers and miscellaneous smaller capital items;

- the Preliminary BAT Equipment Agreement, now with an increased value of US$608,595.29 because of the addition of leaf, is included in the first year contribution to working capital;

- social investments are indicated as US$1 million for each existing factory (in aggregate US$3 million), subject to discussions with the relevant factory management;

- UFP: the figure of US$35 million stated in section 4.5 excludes the US$2.0 million referred to in paragraph 4.5.1 as additional expenditure for health and safety. Apologies for any misunderstanding; and

- the Leaf Development Programme is included in the investment in UFP at an overall capital value of US$3.1 million (comprising US$1.4 million on dedicated equipment and the balance in building, health and safety). This has been disclosed to both Uzpischeprom and the factory director of UFP, Mr Echankulov. It should be stressed that the Leaf Extension Programme is not limited to the capital expenditure.

4. Other Issues

In the course of the review of your letter, a number of issues arose which you might find it helpful to have set out in this letter.

4.1 Investment Assumptions

Section 8 of the Feasibility Study sets out in some detail the conditions underlying BAT's proposals for UZBAT. Whilst a number of these items will be addressed in the Leaf and Fiscal Working Groups, it would be helpful to have confirmed that the other conditions are available to BAT. It is proposed that this is addressed by the Valuation Working Group on Monday afternoon.

4.2 Employment, Training and Social Issues

BAT is clear that employment issues should be addressed - in consultation also with the individual factory directors - so as to minimise uncertainty. Indeed, in conjunction with the relevant factory management, BAT is eager to brief the individual Labour Collectives on UZBAT and what it means for them as prospective employees.

4.3 Authority to agree

Clearly, an important aspect of meeting the timetable will be the level of authorisation which the negotiators and experts on each side have to agree the investment. It would be helpful to be advised how the Uzbek Parties see this happening in terms of the time required to brief senior officials at their individual ministries or agencies. I am conscious that the decision of 11th February indicated that Mr. Jurabekov was responsible for negotiations and that, more specifically, Mr. Sultanov accepted a similar responsibility at the meeting last week.

BAT's representatives in Tashkent will be fully authorised to negotiate an investment.

Please do not hesitate to contact either me or my colleagues Guy Harington and Claire Pearce on any issues arising from this letter. In particular, I hope that in advance of Monday 18th April we can agree the Working Group agendas, have clarified the nature of the investment to the satisfaction of all parties and received details of the leaf barter requirements and calculations.

I would be grateful if you could inform the members of the Uzbek side of the contents of this letter; a Russian language version will follow shortly.

Finally, you should be aware that Jim Rowlands-Rees of BAT is currently in Uzbekistan and will be available to bring information to the UK on Friday should it be appropriate. He can be contacted on 31-30-03.

Yours sincerely,

William

William Wells

cc: Nick Brookes Esq., Director New Business Development, BAT
Neil Bruce-Miller Esq., BAT Project Leader for Uzbekistan
Jeffrey Gordon, Meyer Brown Platt

APPENDIX A

UZBAT

FISCAL REQUIREMENTS

1. General and Specific Exemptions Available to Enterprises with Foreign Investor Ownership for Explicit Confirmation

(i) Exemption until 1st July, 1995 from import duty on the import of all goods into the Republic of Uzbekistan.

(Presidential decrees "On measures to further deepen economic reform. Guarantee the defence of private property and the development of enterprise" issued 22nd January, 1994).

(ii) That part of the income of enterprises with foreign investment reinvested in the expansion of production, technological modernisation and for fulfilment of social programmes is income tax deductible.

("On measures to stimulate foreign economic activity and to protect foreign investment in the Republic of Uzbekistan" issued 24th July, 1992)

(iii) No income tax is payable during the first five years from date of registration where a company is included in the Republic of Uzbekistan Investment Programme.

("On measures to stimulate foreign economic activity and to protect foreign investment in the Republic of Uzbekistan" issued 24th July, 1992)

(iv) Enterprises where a foreign investor has invested at least 30 per cent. of the capital of the enterprise, are not subject to tax on income including foreign currency income for a period of two years from the date of registration of the enterprise with the Ministry of Finance.

("On measures to stimulate foreign economic activity and to protect foreign investment in the Republic of Uzbekistan" issued 24th July, 1992)

(v) Joint ventures with a foreign holding of over 50 per cent. are freed from the tax on foreign currency earnings and obligatory sale of foreign currency to the State for five years from their date of registration.

(Presidential decree "On measures to further deepen economic reform, guarantee the defence of private property and the development of enterprise". 22nd January, 1994).

(vi) Enterprises with more than 30 per cent. foreign ownership are exempt from depreciation taxes.

(Instruction N 8/15 of 15th January, 1993)

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(vii) For enterprises with more than 30 per cent. foreign investment, a reduced rate of income tax of 10 per cent. is applicable following the expiry of income tax holidays.

(Instruction N 8/15 of 15th January, 1993)

(viii) For enterprises with foreign investment, contributions by the foreign investor to the Charter Capital of the enterprise are exempt from customs duties and import taxes.

(Article 21 Law on Foreign Investment and Decree 290, 12th November, 1991)

(ix) The taxable base for income tax of an enterprise with foreign investment is calculated as the gross income (amounts received from gross sales of goods produced and non-production operations including VAT and excise) less the following deductible items:

- obligatory payments including VAT, excise, social security and pension funds contributions, COT and land tax;
- payments for bank loans;
- rent payments;
- depreciation;
- leasing payments;
- expenditure incurred on intangible assets (know-how, patents, royalties, licences, software, right for trademark) - at the discretion of the enterprise this cost may be amortised over up to five years;
- payments for receiving a certificate of quality of goods produced;
- consultancy and auditing costs;
- payments for fire and security services;
- communication and computer centre costs;
- travelling expenses;
- advertising and exhibition expenses;
- costs of production, including raw materials, depreciation of instruments not considered to be fixed assets, spare parts, fuel and energy, reconstruction and refurbishment of fixed assets, packaging materials not included in purchasing price, transportation, storage, natural losses;
- payments for customs procedures and commission fees on importation and exportation of goods;

- expenses on supporting kindergartens and other social profile entities which are included in the balance sheet of the enterprise;
- repayments of loans received for investments into production of consumer goods and 30% of investments made to produce consumer goods, including cigarettes;
- training expenses;
- 15% of the income received from sites constructed for social purposes; and
- 20% of the income for the year available to be transferred to the Reserve Fund (retained profits). The reserve fund shall not exceed 25% of the Charter Fund. Ince (profit can be transferred to other reserves but only after deduction of tax.

(x) Income tax holidays are granted from the date of registration of an enterprise with foreign investment.

(Instruction of Income Tax of Enterprises with Foreign Investment N 1/9 of 7th January, 1993).

(xi) Income tax holidays are granted from the date of operation of an enterprise with foreign investment.

(Decree of 24th July, 1992).

(xii) In the event of subsequent Uzbek legislation specifically affecting foreign investment being passed which adversely affects an investment, foreign investors are permitted to operate under legislation current at the time the investment is made for 10 years after the enactment of new legislation. This provision applies to tax legislation.

("On foreign economic activity in the Republic of Uzbekistan" of 7th June, 1991; and "Law in foreign investment in Uzbekistan" which has passed on 14th June, 1991 and amended 2nd July, 1992").

2. **Further Clarification and Confirmations Required**

(i) With respect to exemption 1(ii) listed above, such expenditures will be deductible in amounts and over a period, as deemed appropriate by the Supervisory Board of UzBAT.

(ii) UZBAT will be included in the Republic of Uzbekistan Investment Programme and will qualify for a five year exemption from income taxes as described in 1(iii) above.

(iii) Depreciation expenses, as determined with reference to depreciation policies established by the Supervisory Board of UZBAT, will be fully deductible.

(iv) With respect to 1. (xii) above, this clause would apply to any fiscal and excise legislation which adversely affects UzBAT.

(v) No excise duties or VAT will be levied against imports which form part of BAT's initial and subsequent capital contributions to UzBAT.

(vi) Confirmation that in the event that the Republic of Uzbekistan introduces profits taxes, profits taxes and income taxes will be mutually exclusive. ie, UZBAT will not be subject to both income and profits taxes.

(vii) Clarification that income tax holidays are granted from the date of operation of an enterprise with foreign investment, as described in (xi) above and not from the date of registration of the enterprise.

3. Specific Exemptions Requested

(i) An additional five year exemption from income taxes commencing from the date on which the new factory becomes fully operational. This exemption would only be applied to the income generated by the new factory.

(ii) Protection from future exclusions from deductibility of costs currently deductible, as described in 1. (ix) above, when establishing the taxable base of an enterprise with foreign investment for a period of 10 years.

(iii) No import taxes, customs duties, excise duties or VAT will be payable on the import of materials by UzBAT for further processing in Uzbekistan for a period of 10 years.

(iv) A further 5 year exemption from taxes on foreign currency income and obligatory surrender of foreign currency to the Central Bank of Uzbekistan or to any other Uzbek State organisation.

4. Reform of the Tobacco Fiscal and Excise Regime

Reform of the current fiscal and excise regime as it applies to the import of tobacco products to ensure that a fair system of taxation is applied to domestically produced cigarettes. In particular, the application and enforcement of import duties on imported cigarettes so as to ensure a "level playing field" for domestically manufactured cigarettes. Further proposals for excise reform will be supplied shortly.

Appendix B
UZBAT REQUIRED CAPITAL EXPENDITURE
Tashkent Tobacco Factory
(US $ 000's)

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	5 Year Total
Building Upgrades:						
Construction	240	3,000	0	0	0	*3,240*
Fire, Safety and Environment	270	950	0	0	0	*1,220*
Mechanical	140	1,500	0	0	0	*1,640*
Electrical	260	2,000	0	0	0	*2,260*
Professional Fees	180	1,200	0	0	0	*1,380*
Sub – Total Building	1,090	8,650	0	0	0	*9,740*
Plant & Equipment : Secondary Manufacturing Department ("SMD")						
MK9 Maker/Sasib Packer x 2	2,900	0	0	0	1,150	*4,050*
MK9 Maker/HLP Packer x 2	3,200	0	0	0	0	*3,200*
AF2/KD2 Filter Maker	650	0	0	0	0	*650*
COP5 Cigarette Ripper	220	0	0	0	0	*220*
Quality Control Equipment	240	0	0	0	0	*240*
Pneumatic Tobacco Feeders	50	0	0	0	0	*50*
Protos 70/GDX1 x 3	0	3,860	7,710	0	0	*11,570*
MK9R/Sasib Packer x 6	0	2,060	2,060	2,060	0	*6,180*
AF2/KDF2/HCF80	0	0	960	0	0	*960*
Spare Parts	600	0	0	0	0	*600*
Contingency	830	200	200	200	0	*1,430*
Sub – Total SMD	8,690	6,120	10,930	2,260	1,150	*29,150*
Plant & Equipment : Primary Manufacturing Department ("PMD")						
Bale Slicer	0	120	0	0	0	*120*
Direct Cylinder Conditioner	0	300	0	0	0	*300*
Hauni Cutter	380	0	0	0	0	*380*
KTC (45) Cutter	0	220	0	0	0	*220*
Drier	0	450	0	0	0	*450*
Add Back System	0	300	0	0	0	*300*
Legg Classifier	0	120	0	0	0	*120*
Sand Sieve	0	60	0	0	0	*60*
Freight & Installation	100	380	0	0	0	*480*
Contingency & Spares	50	400	0	0	0	*450*
Sub – Total PMD	530	2,350	0	0	0	*2,880*
Health and Safety	500	500	500	500	0	*2,000*
Miscellaneous and Vehicles *(office equipment, plant vehicles, trucks for distribution etc.)*	293	1,105	39	39	0	*1,476*
TTF Capital Expenditure Requirement	11,103	18,725	11,469	2,799	1,150	*45,246*

It should be noted that the timing of the expenditures set out in the table above is subject to the timing of the commencement of UZBAT.

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Appendix B
UZBAT REQUIRED CAPITAL EXPENDITURE
New Cigarette Factory at Samarkand *
(US $ 000's)

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	5 Year Total
Building	7,850	15,680	7,850	0	0	*31,380*
Plant & Equipment						
Primary Manufacturing Department	0	3,990	8,000	3,990	0	*15,980*
Secondary Manufacturing Department	0	0	28,770	13,280	0	*42,050*
Ancillary	0	0	680	680	0	*1,360*
Quality Control	0	0	590	590	0	*1,180*
Material Handling	0	0	540	540	0	*1,080*
Management Services Department	0	0	420	420	0	*840*
Factory Infrastructure and Other Equipment	0	6,570	13,140	6,570	0	*26,280*
Sub-Total Plant & Equipment	0	10,560	52,140	26,070	0	*88,770*
Warehousing	0	0	5,630	5,630	1,120	*12,380*
Miscellaneous	290	0	560	840	0	*1,690*
Contingency	210	710	2,740	2,050	0	*5,710*
New Factory Required Capital Expenditure	8,350	26,950	68,920	34,590	1,120	*139,930*

* *This schedule assumes that the New Cigarette Factory at Samarkand will be built to a potential 25 – 30 billion cigarette annual capacity and will initially be equipped to produce 15 billion cigarettes per annum.*

It should also be noted that the timing of the expenditures set out out in the table above is subject to the timing of the commencement of UZBAT.

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Appendix B
UZBAT REQUIRED CAPITAL EXPENDITURE
Urgut Fermentation Plant
(US $ 000's)

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	5 Year Total
Building Upgrades:						
Construction	13,200	0	0	0	0	*13,200*
Fire, Safety and Environment	2,000	0	0	0	0	*2,000*
Sub – Total Building	15,200	0	0	0	0	*15,200*
Plant & Equipment :						
Manipulation Line	1,000	0	1,000	0	1,000	*3,000*
Quality Control	0	0	0	0	0	*0*
Green Leaf Threshing Plant	8,300	0	0	0	3,300	*11,600*
Plant & Equipment	2,000	2,000	0	0	0	*4,000*
Leaf Extension	600	500	100	100	100	*1,400*
	11,900	2,500	1,100	100	4,400	*20,000*
Contingency	2,000	0	0	0	0	*2,000*
UFP Capital Expenditure Requirement	29,100	2,500	1,100	100	4,400	*37,200*

It should be noted that the timing of the expenditures set out in the table above is subject to the timing of the commencement of UZBAT.