

THE BAKU-TBILISI-CEYHAN PIPELINE PROJECT**UNDERWRITING COMMITTEE****BASIC CASE DETAILS**

1 **Case Name:** Baku-Tbilisi-Ceyhan Pipeline

s40 2 **Division & Case Manager** [REDACTED] (BD2)

s40 **Case Team:** [REDACTED]

3 **Case Details:**

3.1 **Markets of Risk** – Azerbaijan (ECGD Rating BB-), Georgia (B) and Turkey (BB)

3.2 **Product** – Project Finance/Project Line of Credit and Oil

3.3 **Exporter's Name** – Bechtel, John Brown and various sub-contractors

3.4 **Borrower** – The Baku Tbilisi Ceyhan Pipeline Finance B.V. (BTC Finance B.V.)

3.5 **Buyer/Guarantor** – The Baku Tbilisi Ceyhan Pipeline Company (BTC Co.)

3.6 **Maximum Liability** – £161m

3.7 **Current Exposure to same risk parties** – Nil

3.8 **Risk Details**

3.8.1 **Limited Recourse Project Finance Risk**

3.8.2 **Risk Type:** Project Finance Special Purpose Company (Corporate)

3.8.3 **Risk Quality:** Acceptable

3.8.4 **Recourse Party/ies:** None (see paragraph 8.2)

3.8.5 **Horizon of Risk:**

Pre Credit 36 months

Credit 108 months

Total 144 months

s43 3.8.6 **Premium Rate:** [REDACTED] (see clause 9 for more information)

3.9 **Summary of Main Parties:**

3.9.1 **"Senior Lenders"**

- ECAs – ECGD, COFACE, Hermes, SACE, US ExIm, NEXI, JBIC.
- Counsel for ECAs – Freshfields Bruckhaus Deringer
- Co-ordinating Bank for ECAs and Commercial Senior Lenders, and Modelling Bank – ABN Amro

- ECA Financial Advisor – Taylor DeJongh
- Other Non-Commercial Lenders – IFC, EBRD (the IFIs)
- Commercial Lenders – ABN Amro, Société Générale, Citigroup, Mizuho Corporate Bank and syndicates.
- Counsel to IFIs and Commercial Lenders – Allen & Overy
- Sponsor Senior Loans – BP, Statoil and TotalFinaElf

3.9.2 “The Sponsors”

- Project Sponsors – BP, SOCAR, Unocal, Statoil, TPAO, Eni, TotalFinaElf, Amerada Hess, Itochu, INPEX, and ConocoPhillips.
- Advisors to the Sponsors – Sullivan & Cromwell, Baker & Botts
- Financial Advisors to the Sponsors – Lazard

3.9.3 “The UK Exporters”

- Bechtel
- John Brown
- and various sub-contractors

4 Reason for Submission

4.1 Following a case conference to discuss a draft of the UC paper held between members of the Business Divisions, CPD and ORPRA in October, to seek UC's advice on the following outstanding issues:

- Environmental/Social Issues (see BPU's review)
- [REDACTED] – whether we can accept the Sponsors' proposal (see paragraph 10.20)

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4.2 For UC to recommend to the underwriting authority whether ECGD should provide support for the project and, if so, subject to what conditions.

5 Underwriting Authority

5.1 Underwriting authority lies with the Chief Executive after consent from the Treasury. ECGD has no authority to underwrite any business in Georgia, and as Georgia is an IDA only country DFID must notify the Treasury whether it approves the project in so far as it extends to Georgia on Productive Expenditure grounds.

5.2 The Minister for Trade and Investment's confirmation will be sought before a decision is conveyed to the sponsors; he may want to write to other Government Departments/Ministers to get their views on the project.

6 Timing

Urgent – We are aiming to get a paper to Treasury in early December, with a view to obtaining their approval by mid December.

7 Project Background

- 7.1 This project involves the development and construction of a 1 million barrels per day (bpd) pipeline, capable of transporting crude oil and other liquid hydrocarbons over a distance of approximately 1750 kilometres from Baku, Azerbaijan, through Georgia to Ceyhan, Turkey. The total cost of the pipeline will be in the region of US\$3.4 billion.
- 7.2 The crude oil will be produced from the Azeri, Chirag and Gunashli (ACG) oilfield in the Caspian Sea. The development of this field is already underway, with oil being produced from the initial phase – Early Oil. The operation of the BTC pipeline will rely on the success of upstream developments of the Azeri-Chirag-Gunashli (ACG) oilfield. The ACG oilfield, in turn, will rely on the BTC pipeline for transportation of the oil produced, as existing pipelines do not have anything like the capacity required.
- 7.3 The owning consortium of the pipeline, BTC Co., is made up of 11 Sponsors. They are BP Plc (30.1%); the State Oil Company of the Azerbaijan Republic (SOCAR) (25%); Unocal Corporation (8.9%); Statoil ASA (8.71%); Türkiye Petrolleri A.O. (TPAO) (6.53%); ENI SpA (5%); TotalFinaElf (TFE) (5%); Itochu Corporation (3.4%), Inpex (2.5%), ConocoPhillips (2.5%) and Amerada Hess Corporation (2.36%). The major participants in the BTC pipeline are also participants in ACG (Investor ACG Shippers), and are required to ship their oil through BTC under a Transportation Agreement.
- 7.4 Construction of the pipeline is now underway, and it is scheduled to be physically complete by the middle of 2005 and its operation to start at the end of 2005. Commissioning will be completed by mid 2006. For a more detailed project summary see Annex A.
- 7.5 The IFC and EBRD boards have now both approved funding for the project. Other ECAs have also gained provisional consent to provide support.

8 ECGD Involvement

- 8.1 Although we have not yet received a formal application for a Line of Credit from the financing bank, preliminary applications (on the lines of the Application for Approval that will eventually be required under any LOC) have been received from ABN Amro for many of the UK contracts (including Bechtel, John Brown and BP (for start-up costs)). An issue has arisen, however, concerning the declaration and undertaking that the

§43 exporters are required to sign before ECGD support is given. [REDACTED]

- 8.1 Following discussion at UC it has been agreed by Mr Weiss that recourse will not be sought for any of the contracts benefiting from ECGD support. This decision has been made because, although most of the contracts are service contracts, the payment terms are on a reimbursement basis. The contracts are also mostly around £20m or below, and it has previously been agreed that for service contracts of this size recourse will not be sought. There are also mechanisms within the project, such as the completion guarantees and direct agreements for the EPC contracts that already provide the Senior Lenders with recourse.
- 8.2 Oll received a Preliminary Proposal from BP plc. in their capacity as operator of and shareholder in the BTC pipeline, and not as an investor, in July 2003. Political risk insurance (PRI) was being sought for a total amount of US\$500m plus interest. ECGD were being asked to consider an amount up to US\$250m for a period of 12 years (as opposed to our standard 15 year policy length). It has now become apparent, from an updated finance plan (see Annex A), that Oll support, along the lines of the above, will no longer be sought.

9 Premium

§43 9.1 In July CPD, in consultation with ORPRA and CRED, calculated a premium rate on this project of [REDACTED]. This was based on the category 6 OECD benchmark rate for two of the markets (Turkey and Azerbaijan) and gave a premium coverage of [REDACTED]. We received Treasury consent to indicate this rate and informed the project Sponsors. [REDACTED]

§43 9.2 [REDACTED]

§43 [REDACTED] This rate would enable us to compete with those ECAs offering premium discounts under the Permitted Exceptions, whilst maintaining and improving [REDACTED] the previous premium coverage. We would of course have to notify internationally

about charging lower than the category 6 benchmark and would do this by reference to the Permitted Exceptions.

9.3 CPD wrote to Treasury outlining the above at the beginning of September, requesting consent to indicate (without commitment) the recalculated premium rate. Treasury approval was given on 7 October 2003.

§43 9.4 Although we are technically able to offer a rate of [REDACTED] this is considerably lower than what other ECAs will be charging, therefore we will want to implement a higher rate. We have previously indicated a rate of [REDACTED] to the Sponsors, and propose that we continue to indicate this rate. In any event we should not charge less than [REDACTED]

10 Project Issues

Political

10.1 Host Country Risks

The three pipeline Host Governments have entered into Host Government Agreements (HGAs) with BTC Co. and an Intergovernmental Agreement (IGA) with each other (see Annex A for more information) [REDACTED]

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[REDACTED]

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[REDACTED]

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[REDACTED]

10.2 Current Political Situation in Azerbaijan and Georgia

The pipeline passes through a region where there are a number of potential political risks. These were initially considered in UC (02) 84. There have been a number of recent developments:

Azerbaijan

In November, Ilham Aliiev was elected as President of Azerbaijan in succession to his father. The election was marred by allegations of vote rigging [REDACTED]. Election observers believe that, although the number of votes may have been inflated, the ranking of the candidates was not materially affected [REDACTED]

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Georgia

President Shevardnadze has been forced to resign following massive protests over disputed elections results. Market Committee considered an Information Note produced by CRED on the situation on 26 November. ECGD's position on the market has not changed as a result.

BD2 have consulted the FCO, both in London and Tbilisi, and they advised that:

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Conflict Issues:

Caspian

Within the last month, Turkmenistan has renewed its protest against the Azeri development of the ACG oil field, which they claim should be theirs. There are on-going disputes between the Caspian littoral states regarding allocation of the undersea resources. [REDACTED]

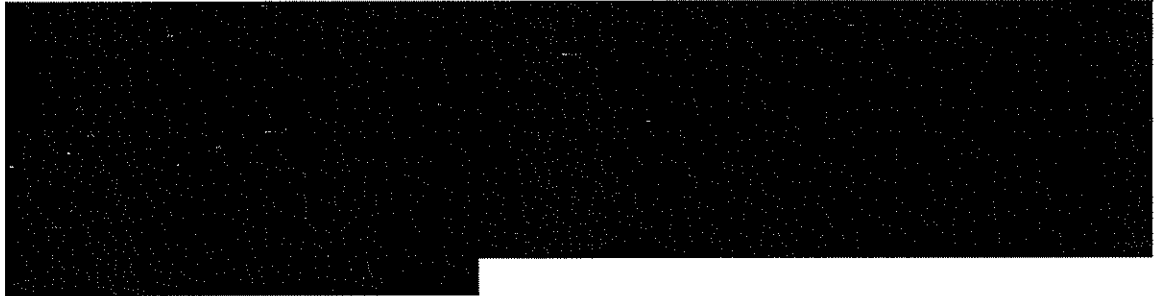
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PKK

With the PKK's recent threat to renew hostilities with the Turkish authorities, the pipeline could become a target. PKK has in the past carried out several attacks on pipelines in Iraq.

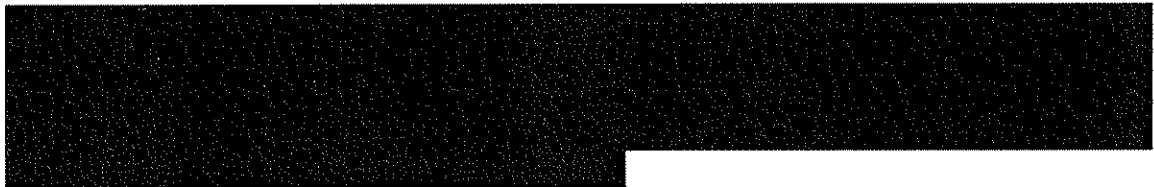
Nagorno Karabakh

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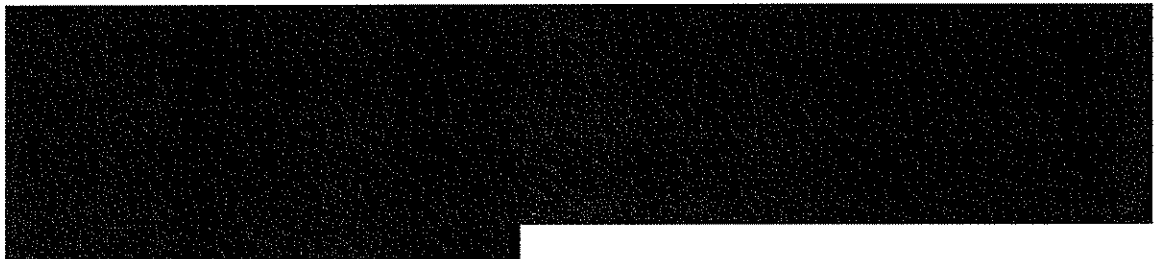
Mitigation

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10.3 Political Risk

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10.4 Political Violence

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¹ Special conditions apply for political violence/terrorism (see paragraph 10.4).

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The Stage 1 Completion proposal has now been agreed and a brief outline of it is attached at Annex B.

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[Redacted]

Commercial

10.5 Source of Revenue for the Cashflow

With pipeline revenue being based on a service charge for use of the pipeline, oil prices will not have any direct impact on the cashflow to BTC. Shippers are charged under a "Ship and Pay" contract with a commitment to ship any crude produced in the ACG field through BTC pipeline (with limited exceptions to transport through the existing Western Route Export Pipeline). The service charge will be set when the pipeline starts operation and the full costs are certain. The Transportation Agreement, under which the tariff is set, will give the project Sponsors a [Redacted] real rate of return on their investment. Cashflow from the service charge will track the expected oil production from the ACG shipper-investors so that a level tariff can be charged over the life of the concession.

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[Redacted]

10.6 Repayment Profile

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The repayment profile has been designed to mirror cashflow to the project, which is directly related to the expected flow of oil from the ACG field. The Debt Service Coverage Ratio (DSCR) over the life of the loan ranges from [REDACTED] with a Loan Life Coverage Ratio of [REDACTED]. [REDACTED] Also, the cash available for loan repayment will only vary if oil is not available to pump through the pipeline or if there is a stoppage in the operation of the pipeline due to political or mechanical problems.

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An excess of equipment in the operating systems – for example there are more pumps than required to operate the pipeline – reduces the likelihood of a complete stoppage of the pipeline. [REDACTED]

10.7 Pipeline Completion / ACG Performance

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[REDACTED]

A set-back recently occurred in the development of the ACG field when certain pre-drills in the West Azeri section failed. However, the Sponsors have advised that this set-back will not affect the expected oil recovery from the ACG field (this has been confirmed by the Senior Lenders' independent advisor). This will most likely affect the completion tests [REDACTED]

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[REDACTED] In any event it is likely that the Final Stage 2 Completion Date⁵ (31 March 2008) may be pushed out by 4 months (this has not yet been agreed by all Senior

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[REDACTED]

Lenders

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10.8 Sponsor Support

The Sponsors are providing the following indemnities on the borrowing structure:

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[Redacted]

The borrowing structure has been set up to minimise tax obligations of the Sponsors (for further information see Annex A [Redacted])

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[Redacted]

For more information on Sponsor support, please see Annex A for a brief outline of the Sponsor Support Agreement.

10.9 Share Transfers

The Sponsors to the project bring both commercial and political benefits. The major oil companies including BP bring knowledge of the oil market and pipeline operation. They also have a financial strength that is important should cash calls or other financial remedies be required. The national oil companies SOCAR and TPAO are important for the political connections they have with their governments [Redacted]

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[REDACTED] A brief summary of the Transfer Restriction Agreement is included in Annex A.

10.10 Dividend Distributions

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[REDACTED]

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All parties have now agreed a mechanism to allow dividends [REDACTED], and is outlined below:

[REDACTED]

10.11 Shipper Support

The shippers that are party to the ACG Transportation Agreement have certain payment obligations, which will be guaranteed by their respective guarantors. These guaranteed obligations are as follows –

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[REDACTED]

10.12 Construction

The pipeline is being constructed in three sections. The Turkish section is being managed by BOTAS under a Lump Sum Turn Key (LSTK) EPC contract. Bechtel is managing the Azerbaijan and Georgian sections under a LSTK EPC contract. Bechtel also have an oversight contract for the Turkish section of the pipeline. The mid-stream consultant (Parsons) has reviewed the costs of the EPC contracts. There is little risk of a significant cost over-run on the construction costs, however Parsons will be able to advise in advance if cost overruns or delays are likely to occur.

A UT (Turkish Government) guarantee is being provided for up to US\$300m of cost over-runs by BOTAS.

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[REDACTED]

10.13 Shut-in

The ACG field is a giant oilfield with proven reserves of 4.3 billion barrels (cf. UK proven oil reserves of 4.7 bn bbls at 2002). The size and quality of the resource has been confirmed by NSAI acting as independent reserve engineers to the Senior Lenders. They have confirmed that average production costs over the life of the field are [REDACTED] with variable operating costs as low as [REDACTED] and always less than [REDACTED]. Shut-in risk of the oil field, other than because of a political event, is low, and the independent upstream consultant (Paragon) has advised that any system failure would last no longer than 9 months. Following a prolonged upstream shut-in, after DSU release, a mechanism for injecting liquidity into BTC has been agreed. This mechanism is outlined below:

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[REDACTED]

10.14 Permitted Expansions

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[REDACTED]

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[Redacted]

The current proposal for permitted expansions is attached at Annex C. We recommend that UC approve this proposal.

10.15 Shared Facilities

The Sangachal Terminal in Baku, Azerbaijan, where the oil from the ACG field comes ashore and is stored, is shared with the ACG project, the Shah Deniz gas field, the Western Route Export Pipeline (WREP) and the Southern Caucasus Gas Pipeline (SCP). It is unclear where responsibilities over this facility will lie, and the Senior Lenders require assurance that the BTC pipeline will not suffer loss or damage because of other parties usage of the facility. See Annex A for further information on the Sangachal shared facilities.

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[Redacted]

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[Redacted]

10.16 Insurance

Insurance during the **construction phase** has now been placed and the following has been purchased:

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- Marine Cargo/Transit [REDACTED];
- Construction All Risks – **Phase I** = estimated final insurable value, being [REDACTED]. **Phase II** = estimated final insurable value, being [REDACTED] arising out of any one occurrence. An overall policy sub-limit of [REDACTED]
- Sabotage and Terrorism (S&T) – up to [REDACTED]
- Third Party Liabilities⁸ – minimum of [REDACTED] any one occurrence.

The Lenders are requesting the following insurance be purchased for the **operational phase**:

- All Risks (fixed assets) – [REDACTED];
- Business Interruption following All Risks – first loss limit of [REDACTED] any one occurrence;
- Terrorism – up to [REDACTED] any one occurrence;
- Third Party Liabilities – up to [REDACTED] any one occurrence;
- Environmental Impairment Liability (EIL) Insurance – [REDACTED]

Outstanding insurance issues are outlined below:

- A PML study has been carried out by WS Atkins on the above ground installations. This study not only included the pipeline installations but also the Sangachal Terminal. The initial conclusions of the study suggest that the PML of these installations is [REDACTED].

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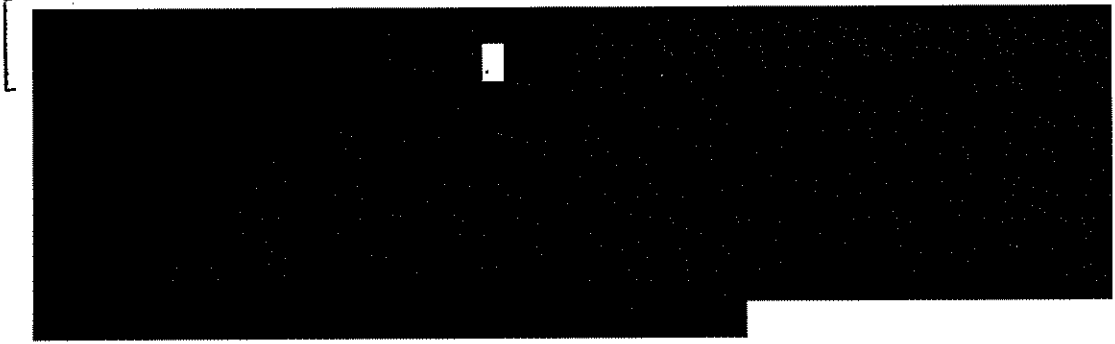
[REDACTED]

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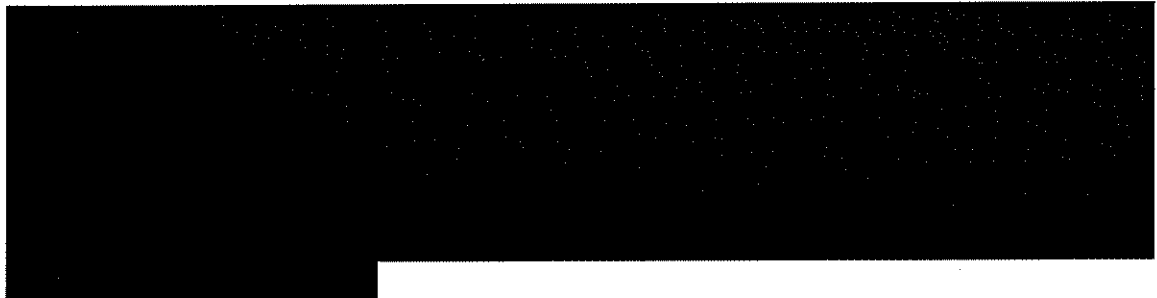
The definition of **Commercially Reasonable Terms (CRT)** has not yet been finalised, but the Senior Lenders are proposing that it be along the following lines:

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10.17 Intercreditor Issues / Preferred Creditor Status

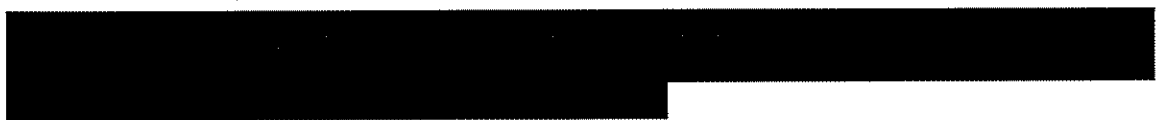
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10.18 Security

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The senior debt will be secured by the following:

[REDACTED]

10.19 Events of Default

There are two types of events of default –

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[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

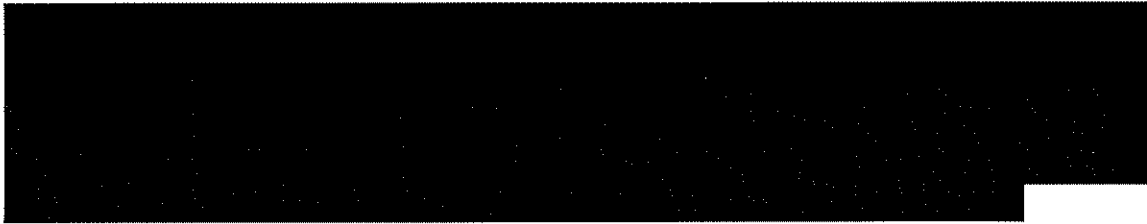
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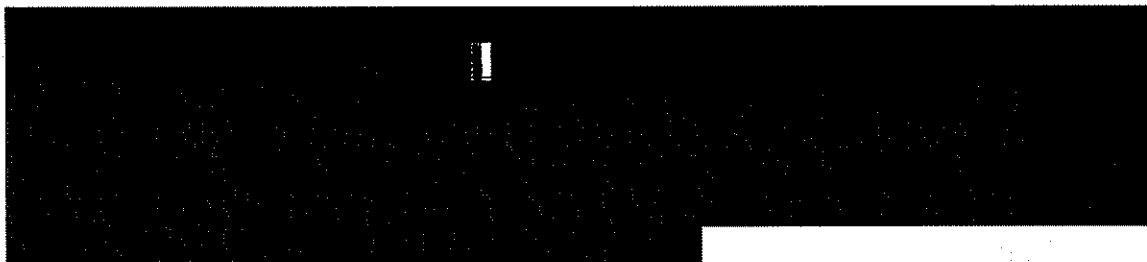


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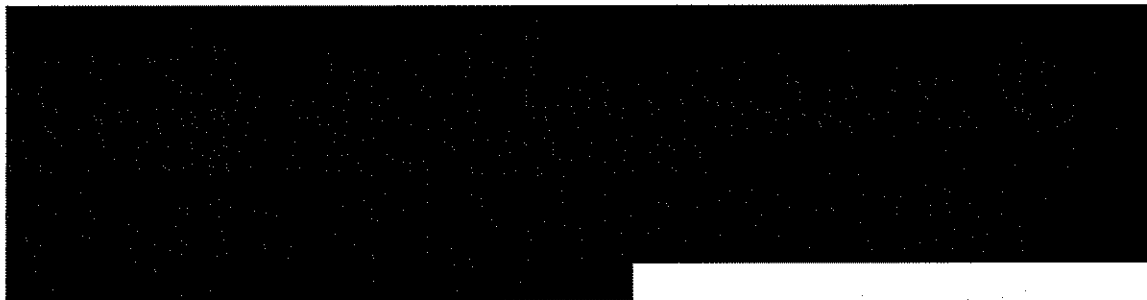
A claim was filed by Green Alternative, a Georgian Civil Society Association, against BTC Co. and four Georgian Government co-defendants seeking to void an environmental permit relating to the transportation of oil. This claim and the legal implications of it are described in more detail in paragraph 11.2.

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Three issues that require consideration in relation to this proposal have been identified:

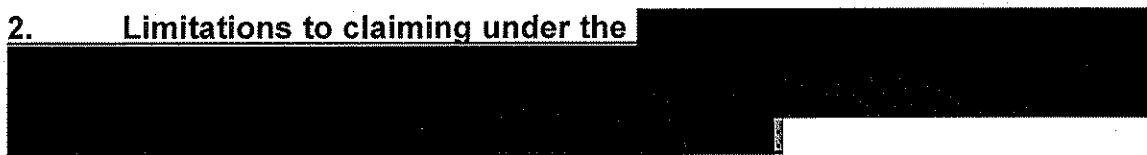
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2. Limitations to claiming under the

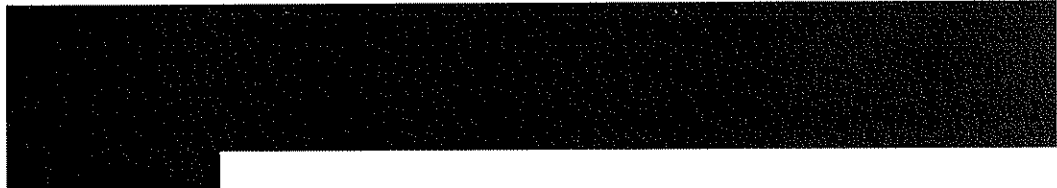
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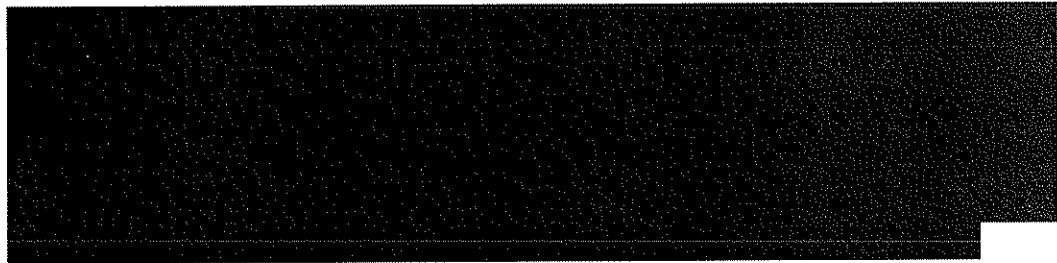
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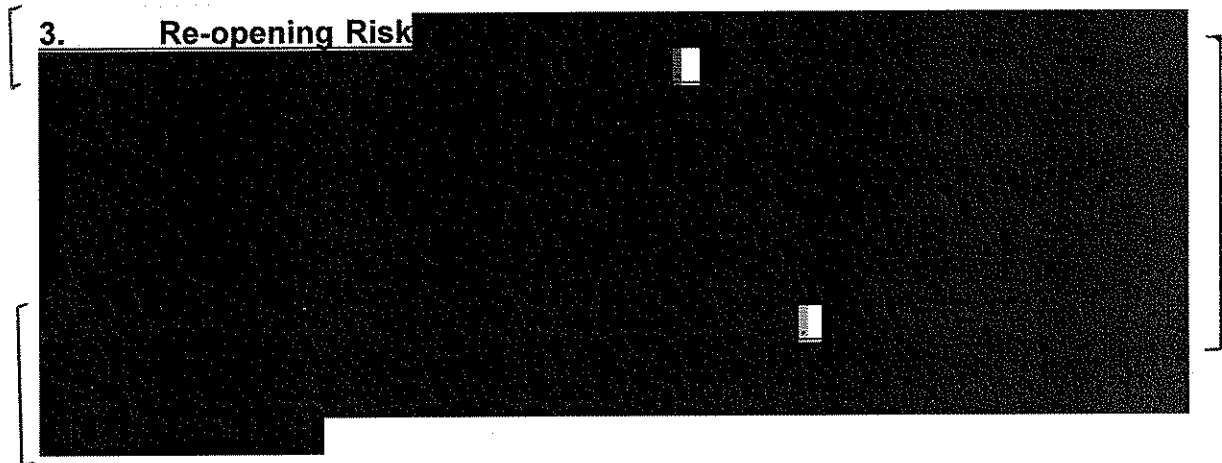
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11 Legal Due Diligence

Much of the work product of the legal due diligence on the project has informed negotiations with BTC Co. and the Sponsors, as well as assessments reached in relation to particular matters arising out of the project. This heading therefore is limited to discrete topics not covered elsewhere in this Underwriting Committee Paper.

11.1 Host Country legal requirements

For some eighteen months Freshfields Bruckhaus Deringer, as counsel to the Export Credit Agencies, and Allen & Overy, as counsel to the Commercial Banks and Multilaterals, have pursued a process of identifying local law issues relevant to the project. This has involved detailed questioning of local counsel, an analysis of their replies and preparation of detailed due diligence reports in relation to each of the countries. The local law firms involved were:

- Ledingham & Chalmers as local counsel in Azerbaijan;
- Mgalobishi, Kipiani & Aziiziguri as local counsel in Georgia; and
- Birsel Hukuk Burosu & Co. as local counsel in Turkey.

In carrying out the local law due diligence, an investigation was carried out to ascertain what were the relevant laws in each jurisdiction. This resulted in the production of local law due diligence reports in aspect of each jurisdiction. The local law due diligence reports for Azerbaijan, Georgia and Turkey are available for inspection and will be tabled at the Underwriting Committee Meeting.

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It was because of these [redacted] laws and the fact that the legal system in these countries were not well adapted to providing the legal protections appropriate for a project of this nature that the HGA's contained such extensive requirements relating to land acquisition and environmental compliance. The due diligence process was further complicated by the fact that the local law of each jurisdiction had to be read in the light of the Intergovernmental Agreement and the corresponding HGA, which in each country enjoys the status of law.

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Each of the local law firms has been asked to produce a form of legal opinion for the Project for the purpose of seeking confirmation that the Project documentation is legally valid, binding, and enforceable in accordance with its terms and that the execution and performance by the relevant parties of their respective obligations under the Project documentation to which they are a party do not and will not violate or conflict with any applicable law of Azerbaijan, Georgia or Turkey. Draft legal opinions have been sent to our local lawyers for review. The present draft is attached as Annex F.

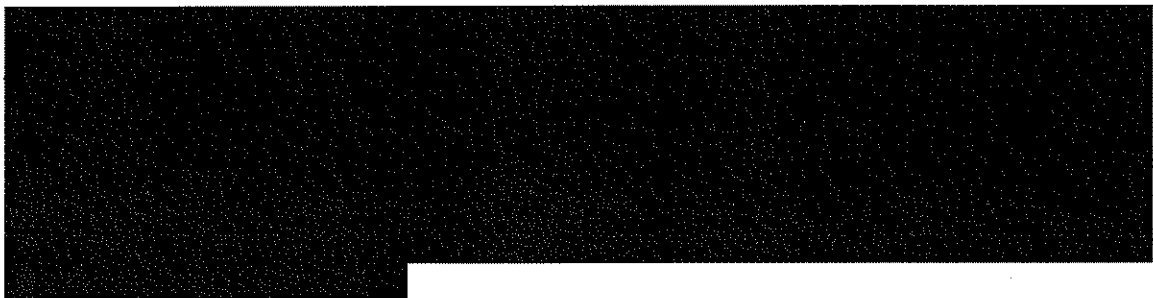
11.2 Green Alternative litigation in Georgia

A claim has been filed by Green Alternative, a Georgian Civil Society Association, against BTC Co. and four Georgian Government co-defendants seeking to void Environmental Permit No. 0011 relating to the transportation of oil issued by the Georgian Ministry for the Protection of the Environment and Natural Resources. Green Alternative claims that:

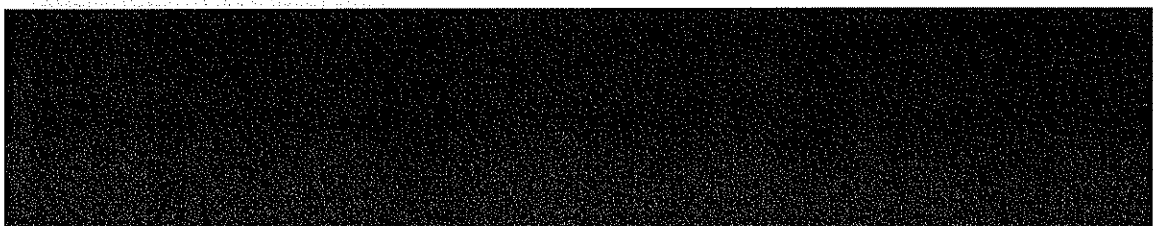
- a) when applying for the environmental permit, BTC Co. failed to file with the Georgian Government the documentation prescribed by Georgian law (including the Georgian HGA);
- b) the Ministry of the Environment, prior to issuing the environmental permit, failed to ensure transparency and public participation in accordance with the requirements of Georgian law (including the HGA);
- c) the Ministry for Foreign Affairs, the Georgian Parliament and the Georgian International Oil Company (GIOC) failed to ensure that the Intergovernmental Agreement (the IGA) was officially published in accordance with Georgian law.

In June 2003, the Tbilisi Regional Court accepted jurisdiction to hear that part of the claim requesting the declaration of invalidity of the Permit and referred the remainder of the claim to the District Court.

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To date there is no information on the likely timing of the hearings nor any indication whether, if a decision were to be made in favour of BTC Co., Green Alternative would seek to take the matter to the Georgian Court of Appeal.

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[REDACTED]

11.3 The HGA “economic equilibrium” clause

Each HGA contains an “economic equilibrium” provision. Often referred to as a “stabilisation clause”, the provision is commonly found in agreements relating to major investments and constitutes a device for allocating risk as between sponsors and the host government. Investors would not be willing to risk major investments without having considered and allocated the risk of changes to the legal environment in which the investment is to be made. Governments are, as a matter of principle, in a better position to assess and manage change of law risk than investors and each of the Host Governments has accepted this position.

The HGA does not attempt to limit the government’s ability to pass whatever law it wishes. Any such attempt would almost certainly be unconstitutional and unenforceable. The “economic equilibrium” provision does however seek to allocate to the government the risk and cost consequences of new legislation which has the effect of undermining the Project economics.

Similarly, nothing in the HGA prevents Host Government courts from taking whatever decisions they consider appropriate. Such decisions are in fact anticipated and their consequences provided for in each HGA.

The HGAs contain specific obligations on BTC Co to act in accordance with defined health, safety and environmental standards and those obligations are enforceable by the government against BTC Co in the event of breach. Thus, under the HGA, BTC Co is liable to the State Authorities for any breach of applicable law and to third parties for any breach of the standards of conduct set out in the IGA, HGA or other Project Agreements.

Moreover, under the BTC Human Rights Undertaking entered into by BTC Co in September 2003, BTC Co undertakes as between itself and the three Host Governments

- not to seek compensation under the “economic equilibrium” clause of the HGAs solely in connection with any action of a Host Government that is reasonably required under any international treaty on human rights, labour, health, safety or the environment binding on that Host Government; and
- not to assert any interpretation of certain sections of the HGAs that would preclude any action of a Host Government that is reasonably required under any such binding international treaty.

The effect of the Undertaking is thus to limit the circumstances in which BTC Co can claim compensation under the “economic equilibrium” clause and, to that extent, it does result in a partial reallocation of the change in law risk under the HGAs.

11.4 Complaint under the OECD Guidelines for Multinational Enterprises

The Guidelines are recommendations addressed by adhering countries to MNEs. They represent a voluntary framework of principles of “good conduct” for international companies in their business activities, designed to help ensure that MNEs act in harmony with the policies of the countries in which they operate and with societal expectations. As such the Guidelines form an integral part of the UK Government’s policy towards corporate social responsibility. Amongst the three host countries of the Project only Turkey (as an OECD member) is an adhering country, although the Guidelines cover activities by MNEs operating in and from adhering countries.

A formal complaint led by Friends of the Earth was made in April 2003 to the UK National Contact Point at the Department of Trade and Industry. The complaint submitted that the BTC Consortium:

- exerted undue influence on the regulatory framework;

- sought or accepted exemptions related to social, labour, tax and environmental laws;
- failed to operate in a manner contributing to the wider goals of sustainable development;
- failed to adequately consult with project affected communities on pertinent matters; and
- undermined the host governments' ability to mitigate serious threats to the environment, human health and safety.

The role of the UK NCP includes that of ensuring the effective implementation and development of the Guidelines. To this end the UK NCP is required to contribute to the resolution of issues related to the Guidelines, for example by offering a forum for discussion between interested parties. The aim of these discussions is to reach agreement with all parties on the issue raised and for the company to take any appropriate action to resolve it. If no agreement can be reached, the UK NCP will issue a statement and, if appropriate, make recommendations on the implementation of the Guidelines.

Although ECGD is not directly involved in the complaint, in providing initial feedback to the UK NCP ECGD questioned the validity of the NGO submissions, although the absence of any requirement in the HGAs for BTC Co to implement improvements in international best practice that occur during the project lifetime was commented upon.

The concerns expressed by the various NGOs about the Project prompted the three Host Governments and BTC Co to issue a Joint Statement in May 2003 in which:

- the three Governments refuted assertions that the IGA and HGAs do not take account of their respective national interests;
- the signatories confirmed that all activities undertaken and contemplated to be undertaken with regard to the IGA, the HGAs and the other BTC Project Agreements have been and shall be consistent with the Guidelines in all material respects;
- confirmed that the IGA commits each State to the application of environmental standards and practices that are "no less stringent" than those generally applied within member states of the European Union from time to time, and that the HGAs and other BTC Project Agreements give effect to this commitment, and provide a dynamic benchmark that will evolve as EU standards evolve, and as international standards and practices within the petroleum pipeline industry also evolve.

11.5 Public international law aspects of the Project

Certain allegations of unlawful conduct were summarised in the letter from the NGOs to the IFC dated 28 October 2003. ECGD has sought advice on the allegations from [REDACTED]

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Annex G summarises the advice received [REDACTED] on these public international law aspects of the Project.

12 Other Issues

12.1 Business Principles Unit Appraisal

The Business Principles Unit review is attached at Annex G.

12.2 Productive Expenditure

DFID, and Treasury, must be assured that any expenditure incurred by Georgia in relation to the project will meet productive expenditure rules. The only

expenditure that has been identified will be costs for the provision of security along the pipeline route, for which requirement is set out in the HGA. Although it was difficult to get an estimate of these costs from the Sponsors, we have now been informed that costs will be in the region of US\$100,000 per year, which is considerably lower than the revenue that will be received from transit taxes¹⁰. We are, however, still awaiting DFID and HMT's approval.

12.3 Sensitive Case Procedure

Other government departments have been notified about this project, initially through a sensitive case notification, and an inter-department working group has been set-up to coordinate HMG issues.

12.4 NGO Interest

ECGD has received a fair amount of correspondence concerning this project (letters from the public and Minister's Cases), although DFID has been more of a target because of its involvement with the IFC and EBRD.

This project has raised many concerns within the NGO community; Friends of the Earth (FOE) in particular have taken an active role in campaigning against the pipeline and Amnesty International have produced a report on perceived human rights abuses. A campaign affiliated to the Ilisu Dam campaign – the Baku-Ceyhan Campaign – has been started to protest against the pipeline, and NGOs such as FOE, Cornerhouse and the Kurdish Human Rights Project are involved. Many NGOs, such as Amnesty International, are working with BP and BTC Co., but some like FOE, are uncooperative.

The main concern surrounding NGO interest is the threat of a judicial review by Friends of the Earth or other NGOs, if either ourselves or DFID approve support.

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[REDACTED]

s41

[REDACTED]

More recently ECGD received an accusation from an NGO (Cornerhouse) that much of the welding that had taken place in Turkey did not meet the standard and that the weld reporting was of such a bad quality that it would be hard to tell where the welding was not up to standard. To back up this claim anonymous

¹⁰ The Georgian tax starts at \$0.12/bbl, increases to \$0.14/bbl in 2010 and increases to \$0.17/bbl in 2021. This equates to approximately US\$12m in tax revenues for Georgia per quarter.

witness statements were provided. In reaction to these accusations we informed the Sponsors and requested their response; they replied along the following lines:

reg 12(5)(e)

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

In addition to the above information provided by the Sponsors, we have asked the independent pipeline engineer (Parsons) to look into the allegations and take them into account during their next site visit.

13 Post-Issue Management

13.1 There are a number of issues that will need to be taken into account for post-issue management. These include:

- Completion Guarantees – tests need to be satisfied before the Completion Guarantees are released;
- DSU release – tests need to be satisfied before the DSU is released;

- Pipeline expansions – those that are not Permitted Expansions will require lender consent;
- Financial ratios and level of Tariff – need to be monitored;
- Intercreditor – voting thresholds;
- Conditions Precedent to Subsequent Disbursements – need to be aware of the conditions to disbursements after the first disbursement (for example the debt to equity ratio, consultant's reports and pro rata drawdown).

14 Recommendations and Signature

In my view the commitment proposed on the terms outlined above is of minimum investment grade equivalent. I recommend to ECGD.

1 Underwriting Case Manager

Signature:

Date:

2 ORPRA

Signature:

Date:

3 FAU

Signature:

Date:

3 CRED

Signature:

Date:

4 CPD

Signature:

Date:

5 BPU

Signature:

Date:

LIST OF ANNEXES

| | |
|---|----|
| ANNEX A – PROJECT SUMMARY | 32 |
| PROJECT DESCRIPTION..... | 32 |
| PROJECT CONSTRUCTION AND OPERATION | 32 |
| POLITICAL SUPPORT FOR THE PROJECT | 33 |
| SPONSOR SUPPORT..... | 34 |
| PROJECT COMPANY | 34 |
| FINANCING..... | 35 |
| BORROWING STRUCTURE..... | 37 |
| CONDITIONS PRECEDENT | 37 |
| FINANCE DOCUMENTS | 38 |
| ACG TRANSPORTATION AGREEMENT..... | 38 |
| COMPLETION AGREEMENT | 40 |
| TRANSFER RESTRICTION AGREEMENT | 42 |
| SPONSOR SUPPORT AGREEMENT | 45 |
| SANGACHAL TERMINAL EXPANSION PROGRAMME: DRAFT GENERAL PRINCIPLES AGREEMENT | 46 |
| ANNEX B – POLITICAL VIOLENCE STAGE 1 COMPLETION..... | 48 |
| ANNEX C – PERMITTED EXPANSIONS | 50 |
| ANNEX D – PREFERRED PAYMENTS | 59 |
| ANNEX E – FUNDAMENTAL EVENTS OF DEFAULT | 62 |
| ANNEX F – DRAFT LEGAL OPINION..... | 64 |
| SCHEDULE 1 | 71 |
| ANNEX G – PUBLIC INTERNATIONAL LAW..... | 74 |
| ANNEX H – BPU REVIEW OF BAKU-TBILISI CEYHAN PIPELINE..... | 78 |

ANNEX A – PROJECT SUMMARY

PROJECT DESCRIPTION

The Project entails the construction of a 1,760km, 42-inch diameter, dedicated crude oil pipeline (the *Pipeline*) from an existing terminal at Sangachal near the Azeri capital, Baku, through the State of Tbilisi in Georgia to Yumurtalik near the port of Ceyhan on the Mediterranean coast of Turkey. The projected annual capacity of the Pipeline is 50 million tonnes of oil. First stage capacity is expected to be approximately 400,000 barrels per day (*bpd*), which is to increase to 800,000 bpd (according to Paragon) on completion of the planned Phase 1 and Phase 2 development of the Azeri section of the ACG Field in 2008. Construction is underway, with first oil flows expected in February 2005.

The Pipeline is being developed to accommodate new production from the Azeri, Chirag and deep-water portion of the Gunashli fields (together, the *ACG Field*) in the Azerbaijan section of the Caspian Sea. Existing pipeline and other transportation capacity in the region is insufficient for the export of this new production. According to the reserves report produced by Netherland, Sewell & Associates, Inc. dated September 2002, the estimated amount of original oil in place for the ACG Field Complex at a 3P level of certainty (the least conservative estimate) is 14.6 billion barrels of crude oil, 5.3 billion of which will be recoverable during the term of the ACG Production Sharing Agreement (the *ACG PSA*). The ACG Field will be developed in phases.

The first stage of development of the ACG Field, known as the Early Oil Project began production in 1997 and had produced an estimated 150 million barrels of oil by February 2003. The parties to the ACG PSA agreed to Phase 1 of development of the ACG Field in August 2001 and Phase 2 in September 2002. Actual funding commitments by the parties to the ACG PSA are made on an annual, year to year basis depending upon the then current ACG Field development plan.

Capital expenditure of approximately US\$1.15 billion (according to Paragon) has been incurred under the ACG PSA to date. Total future capital expenditure for the development of the ACG Field is expected to be approximately US\$12 billion.

PROJECT CONSTRUCTION AND OPERATION

Construction

The Pipeline is currently expected to be completed (apart from certain deferred facilities comprising certain pump stations in the Georgian and Azeri sections of the Pipeline) in February 2005. The deferred facilities are scheduled to be fully installed by mid-2006.

For the Turkish section of the Pipeline, all supplier contracts fall within the scope of the \$1.3 billion lump sum fixed price construction contract with BOTAŞ. The Republic of Turkey has provided a guarantee in respect of BOTAŞ' financial obligations under the

contract. BOTAŞ has subsequently subcontracted with eight main subcontractors to build the Pipeline, pump stations, terminals and related infrastructure. In addition, BOTAŞ has also purchased directly several long lead items to be utilized by the Project. The pipeline contracts involve primarily local Turkish workforce. The most significant Turkish subcontracts that include items eligible for export credit agency support include: Salzgitter Handel (Germany, and further sub-contracted through Europipe France) for linepipe, and Mitsui (Japan), for primarily linepipe. Other Turkish contracts that have ECA eligible procurement include ILF (Germany), Universal (US), ABB (UK), and Ringmill S.p.A (Italy).

In addition to the construction cost for the Turkish section of the Pipeline, US\$99 million is required for land acquisition in Turkey.

With respect to Azerbaijan and Georgia, Spie-Petrofac (a Spie Capag led joint venture with Petrofac) is the main contractor, although many long lead items have also been purchased directly by BTC Co. The most significant contracts involving export credit agency eligible content include the Spie Petrofac contract (primarily from France, but also Italy and the UK), CCIC (content from Germany and the UK), Bechtel (UK), John Brown (UK), Solar (US), Petrofac (US), Northern Power (US), Marubeni-Itochu (Japan), Sumitomo (Japan), and Petrovalves (Italy).

Operation

An affiliate of BP, BP Exploration (Caspian Sea) Limited (**BP Caspian**) is to enter into a management services agreement pursuant to a term sheet signed on 1 August 2002 under which it will be responsible for the construction and physical and commercial operation of the Pipeline in Georgia and Azerbaijan. BOTAŞ International Limited will have this responsibility in Turkey (under the overall supervision of BP Caspian) under the terms of the Turkish Operating Agreement executed on 25 October 2002.

POLITICAL SUPPORT FOR THE PROJECT

An Intergovernmental Agreement (the **IGA**) between the Azerbaijan Republic, Georgia and the Republic of Turkey (the **Project States**), entered into on November 18, 1999 is a treaty documenting each Project State's support for the development, construction and operation of the Pipeline. The IGA became effective on June 21, 2000 after ratification by the parliaments of each state.

Host Government Agreements (**HGAs**) between each of the Project States and affiliates of the Sponsors, setting out the legal and fiscal regime for the Project and the rights and obligations of the parties, were concluded in October 2000. BTC Co. succeeded to the rights of such affiliates under the HGAs on August 1, 2002.

SPONSOR SUPPORT

The Pipeline will be developed by the following affiliates of the Sponsors (the *Participants*):

| Participant | Percentage Ownership in BTC Co. |
|---|--|
| Azerbaijan (BTC) Limited (affiliated with SOCAR) | 25.0 |
| Eni (BTC) Limited | 5.00 |
| BP Pipelines (BTC) Limited | 30.10 |
| ConocoPhillips BTC Ltd | 2.50 |
| Amerada Hess (BTC) Limited | 2.36 |
| INPEX BTC Pipeline, Ltd ¹¹ | 2.50 |
| ITOCHU Oil Exploration (BTC) Inc. ¹² | 3.40 |
| Statoil BTC Caspian A.S. | 8.71 |
| TotalFinaElf (BTC) Limited | 5.00 |
| Turkish Petroleum BTC Ltd. (affiliated with TPAO) | 6.53 |
| Unocal BTC Pipeline, Ltd. | 8.90 |
| Total | 100 |

PROJECT COMPANY

BTC Co., an exempt company organised with limited liability under the laws of the Cayman Islands will own all the assets and be a party to all commercial agreements relating to the Project. BTC Co. will be owned by the Participants, in the proportions set out above.

The Participants will establish BTC Finance B.V. to borrow the Senior Debt (described in more detail under “Borrowing Structure” in paragraph 8 below).

¹¹ Subject to the completion of negotiations, Inpex BTC Pipeline, Ltd will be majority-owned by Inpex, with the remaining minority interest held by the Japan National Oil Corporation (*JNOC*).

¹² ITOCHU Oil Exploration (BTC) Inc. is owned 51% by ITOCHU and 49% by JNOC.

FINANCING

The estimated cost of the Project is approximately US\$3.4 billion, including contingencies, working capital, interest during construction, financing expenses and other fees.

It is intended that the Project will be financed during the construction period with a 70:30 Senior Debt: Equity ratio.

Indicative Finance Plan

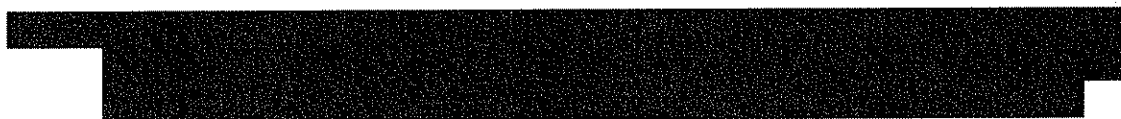
The exact amounts of finance from each source will depend on negotiations with Senior Lenders and the availability of ECA loans based on the procurement contracts to be entered into. The Indicative Finance Plan is set out below:

| Total capital | US\$ millions |
|------------------------------------|---------------------------|
| Senior Debt | 2,400 |
| Participants' equity | 1,000 |
| Total | <u>3,400</u> |
| Sources of Senior Debt | |
| IFC/EBRD A/B Loans | 350 - 500 |
| ECA and other agency covered loans | 700 - 850 |
| PRI covered loans | 75 - 125 |
| Sponsor Senior Loans | 800 - 850 |
| JBIC Un-tied Lending | 300 |
| Total | <u>Up to 2,625</u> |

Sponsor Senior Loans

Once financing commitments from third party Senior Lenders have been finalised, certain of the Sponsors will provide senior loans to the Project (**Sponsor Senior Loans**). It is currently envisaged that the Sponsor Senior Loans (of between US\$800 and US\$850 million) will be made by BP International Limited, Conoco Phillips Company, Statoil Coordination Center N.V. and Total Finance S.A. The Sponsor Senior Loans will be on similar terms to the Senior External Debt, subject to certain requirements and restrictions, including:

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[REDACTED]

Repayment

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[REDACTED]

BORROWING STRUCTURE

[REDACTED]

CONDITIONS PRECEDENT

[REDACTED]

s27
and
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[REDACTED]

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and
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[REDACTED]

FINANCE DOCUMENTS

ACG TRANSPORTATION AGREEMENT

1. Background

[REDACTED]

2. BTC Co.'s Obligations under the ACG TA

[REDACTED]

3. Shipper Group Members' Obligations under the ACG TA

Dedication Obligations

[REDACTED]

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and
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[Redacted text block]

Stapling Obligations

[Redacted text block]

4. ACG Tariff

[Redacted text block]

5. Payment-in-kind

[Redacted text block]

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and
843

[REDACTED]

6. Force Majeure / Events of Default

[REDACTED]

[REDACTED]

[REDACTED]

7. Capacity Rights Rules

[REDACTED]

COMPLETION AGREEMENT

1. Background

[REDACTED]

2. Completion

[REDACTED]

[REDACTED]

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[Redacted text block]

3. DSU Release

[Redacted text block]

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and
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[Redacted text block]

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[REDACTED]

TRANSFER RESTRICTION AGREEMENT

1. Background

[REDACTED]

2. Permitted Midstream Transfers¹⁵

Pre-Completion

[REDACTED]

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and
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[REDACTED]

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and
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[Redacted text block]

Post-Completion

[Redacted text block]

3. Continuing liability of transferor; transferee assumption of obligations

[Redacted text block]

4. Permitted Upstream Transfers¹⁶

Exceptions to transfer restrictions

[Redacted text block]

¹⁶ Certain Sponsor minimum hold levels apply, see 5 below.

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[Redacted]

| | Midstream - BTC Co. Minimum Equity and Economic Interests | | | | Upstream - ACG PSA Minimum Equity and Economic Interests | |
|------------|--|------------|------------|------------|--|------------|
| [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] |
| [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] |
| [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] |
| [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] |
| [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] |
| [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] | [Redacted] |

[Redacted]

SPONSOR SUPPORT AGREEMENT

1. Background

[Redacted]

2. Shipper Payment Guarantees

[Redacted]

[Redacted]

3. Shipper Tariff Indemnities

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

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s27
and
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[REDACTED]

SANGACHAL TERMINAL EXPANSION PROGRAMME: DRAFT GENERAL PRINCIPLES AGREEMENT

1. Background

[REDACTED]

[REDACTED]

2. Structure

Direct Facilities and Shared Facilities

[REDACTED]

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and
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[Redacted text block]

3. Risk Allocation

[Redacted text block]

[Redacted text block]

4. Insurance

[Redacted text block]

5. Termination

[Redacted text block]

ANNEX B – POLITICAL VIOLENCE STAGE 1 COMPLETION

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[REDACTED]

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ANNEX C – PERMITTED EXPANSIONS

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[Redacted]

4 RESTRICTIONS ON EXPANSIONS

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

5 PERMITTED EXPANSIONS

5.1 General

[Redacted]

5.2 Technical approval

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

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5.3 Insurance approval

[Redacted text block for section 5.3]

5.4 Environmental approval

[Redacted text block for section 5.4]

5.5 Available funding

[Redacted text block for section 5.5]

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and
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5.6 Consultants' approval

[Redacted text block]

6 ALLOWABLE COSTS

6.1 Restrictions on Allowable Costs

[Redacted text block]

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and
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[Redacted text block]

6.2 Expansion Tariff test

[Redacted text block]

7 CONDITIONS

7.1 General

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and
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[Redacted]

7.2 General criteria

[Redacted]

7.3 Specific conditions





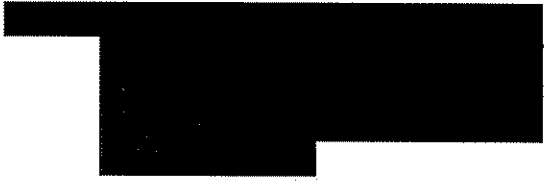
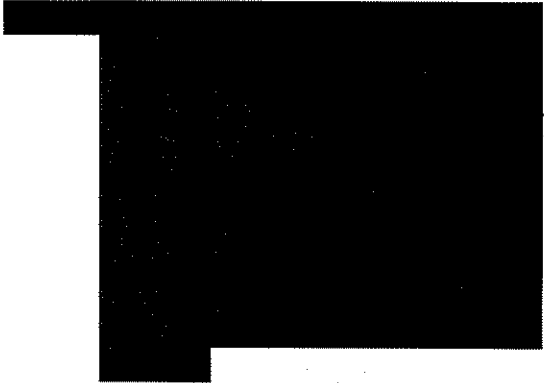

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| [Redacted] | [Redacted] |
| [Redacted] | [Redacted] |






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|------------|------------|
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |

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7.4 Credit requirements

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[Redacted text block]

7.5 Satisfactory commercial terms

[Redacted text block]

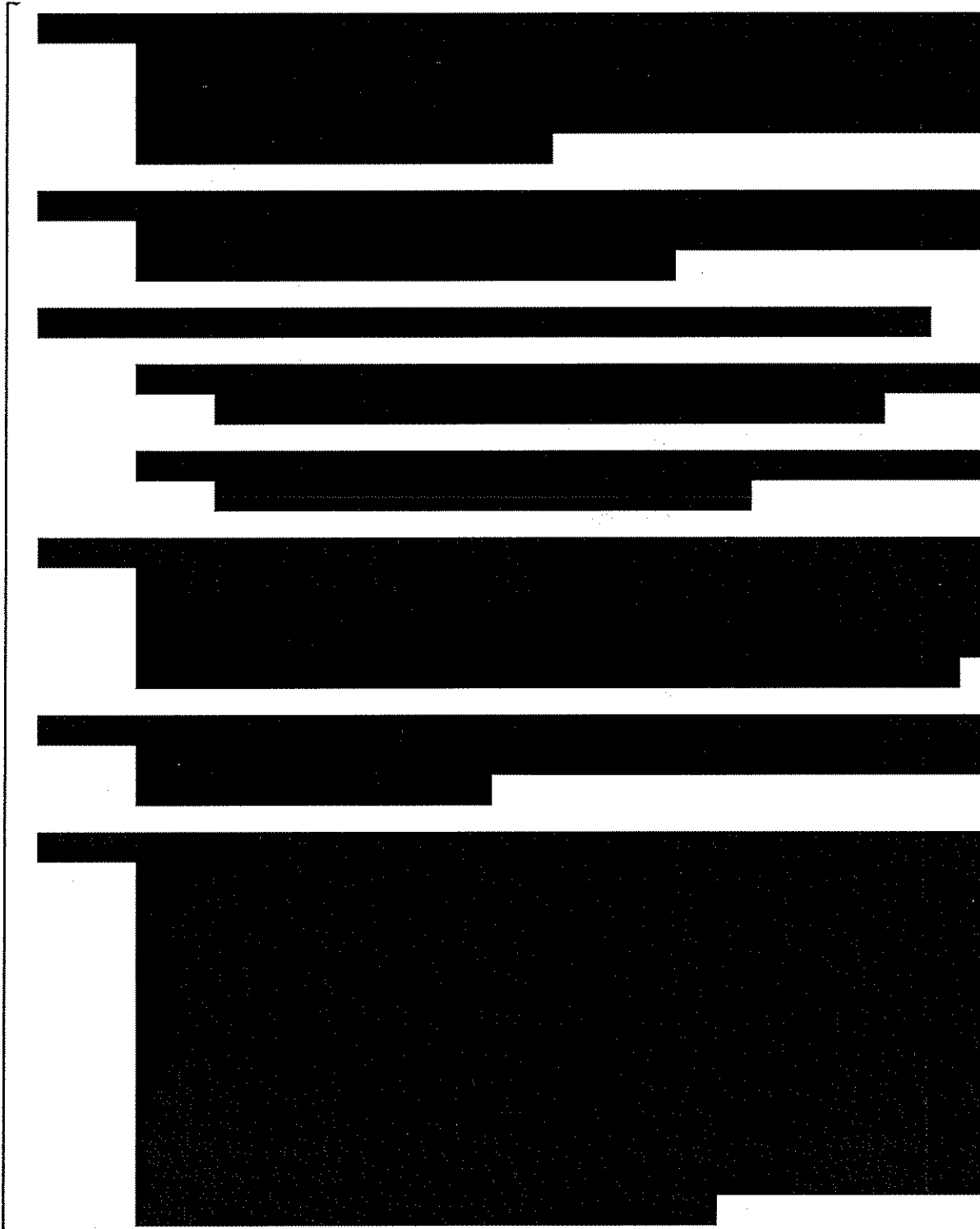
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[REDACTED]

ANNEX D – PREFERRED PAYMENTS

Preferred Payments

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[Redacted text block]

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ANNEX E – FUNDAMENTAL EVENTS OF DEFAULT

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[REDACTED]

[REDACTED]

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[REDACTED]

ANNEX F – DRAFT LEGAL OPINION

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[Redacted]

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ANNEX H – BPU REVIEW OF BAKU-TBILISI CEYHAN PIPELINE

The BPU Review will be circulated as a separate document.