



August 1, 2003

Ms. Karen Decker  
Bank Information Center  
733 15<sup>th</sup> Street, NW # 1126  
Washington, D.C. 20005

*Baku-Tbilisi-Ceyhan Oil Pipeline Project - Release of Information*

Dear Ms. Decker:

Thank you for your letter dated July 11, 2003 addressed to Messrs. Wolfensohn and Woicke regarding the Baku-Tbilisi-Ceyhan (BTC) pipeline project. We appreciate your interest in the project, and offer the following summary of our economic and legal analysis, including the development impact in response to your concerns.

**Development Impact**

We strongly believe IFC's potential participation in this project will have significant developmental impact, both financial and non-financial, and we would not participate in any project if our due diligence did not convince us of the development impact, or if our Board of Directors, which represents the client countries we serve, were not convinced.

In the widest geopolitical context, the projects will provide global markets with a new, important source of crude oil by creating an east-west energy corridor. The BTC pipeline will provide the first direct transportation link between the hydrocarbon-rich, land-locked Caspian Sea and the Mediterranean. It has already strengthened relations between Azerbaijan, Georgia, and Turkey through increased cooperation on a variety of issues, and through the co-dependence required to realize the project's benefits. We see the development of economic relations, trade, and transport as a major impact in the region.

The BTC project also reflects the development of new economic and political links between the three host countries and Western Europe, e.g., Turkey's significance as the western outlet of the future east-west energy corridor and as a hub for energy distribution through the Mediterranean, to European and other international markets. From an environmental perspective, avoiding the shipment of large volumes of crude through the Turkish Straits is viewed as a significant advantage of the project.

With prudent management, hydrocarbon revenues have the potential to improve economic conditions in Azerbaijan, assisting it in the transition from a centralized command economy to a market driven one. Through IFC's insistence, the project has also raised the bar in terms of transparency, including public disclosure. You are well aware of the agreements that have been made accessible to the public, such as the Production Sharing Agreement (PSA), the three Host Government Agreements (HGAs) and the Intergovernmental Agreement (IGA).

### **Economic & Financial Due Diligence**

Your letter refers, presumably, to the controversies raised in the Claros Consulting Financial Analysis about the economic and financial viability of the project. This is an argument that we have found difficult to understand, as it would be very odd for commercial lenders or the private sponsors to have any interest in investing large sums in a project that is not financially viable. The pipeline sponsors require a reasonable return on their investment and transit countries require reasonable compensation. We carry out our own lending due diligence based on proprietary commercial information (supplied by sponsors under confidentiality agreements), as well as publicly available information. As indicated before, IFC is lending on a commercial basis and would not finance the project if our final due diligence indicated that the project was not commercially viable.

The summary of economic due diligence for Bujagali was made public because the project cost had a direct impact on electricity tariffs to the local consumers. In that type of project there is some element of regulation and the investor rate of return/economic analysis is therefore, of critical public importance. In the BTC project, where the crude oil is fully intended for export, the key area of public interest is the use of the revenues generated from the oil development. The detailed economic analysis of the pipeline is a matter for the private sector to assess and the rate of return and cost analysis are proprietary information - vital in a competitive environment. In the case of BTC, the overall share of the project revenues that will accrue to the sponsors and the host governments has already been fully disclosed by BTC Co., and these analyses are based on precisely the same information that is provided to IFC as part of our due diligence.

In addition, IFC has released an extended Summary of Project Information (SPI) for the BTC and ACG Phase 1 projects (available on the web at <http://www.ifc.org/btc>), which describes in detail the development impact and principal economic benefits of both projects including expected revenues to the three host countries.

### **Legal Due Diligence**

It is not IFC's practice to make public its legal analysis of the structure of projects in which it participates, in light of your concerns we would like to convey the following summary of our conclusions.

After reviewing the Inter Government Agreement (“IGA”) and the three Host Government Agreements (“HGAs”), we find that these documents constitute a supervening legal framework for the BTC project across all three host countries and that there is good reason for the adoption of this structure based on:

- (i) the need to have a consistent framework across all three host countries to reflect the project’s unitary nature and to avoid the difficulties that would arise from requiring one integrated operation to comply with three potentially conflicting sets of regulations;
- (ii) the fact that the relevant local legal regimes, are not adequate to deal with a project of this scale and complexity; and
- (iii) the importance of providing a predictable, stable and modern legal framework in ensuring that such a large investment will proceed.

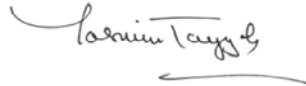
We would like to point out that our legal due diligence is an ongoing process. So far, we have not found any reason to be concerned about the possibility that the three host governments may have relinquished their legislative and administrative powers to supervise the implementation of the project. The HGAs only exempt the project from local laws where these laws conflict with the requirements of the framework set out in the HGAs. The HGAs require stringent technical, environmental, health and safety standards to be followed by BTC Co. According to the IGA, these standards cannot be any less stringent than those applied in the member states of the European Union, and in the case of Georgia less stringent than the environmental standards of the Netherlands and Austria. In this regard our observation is that specific arrangements for projects of this nature are needed in order to provide a reasonable framework for their implementation, where none existed before.

In addition to IGA and HGAs, on May 16th 2003, Azerbaijan, Georgia and Turkey together with BTC Co. signed a joint statement including the following four key commitments:

- (a) Paragraph 5 (OECD Guidelines on Multinational Enterprises) – a commitment to implement the project consistently with the OECD Guidelines on Multinational Enterprises;
- (b) Paragraph 6 (Project Security and Human Rights) – a commitment to the goal of promoting respect for and compliance with human rights principles and conclude a protocol between the host governments and BTC Co. setting out how security operations will be conducted in accordance with specified human rights conventions;
- (c) Paragraph 7 (Environment) – confirmation that references in the project documents to EU standards are references to those standards as in force from time to time, which means that the HGA standards will evolve rather than being “frozen in time”;
- (d) Paragraph 8 (Labor) – a commitment to specified labor standards and to any other international labor standards, which may be in force in the project State from time to time.

We look forward to your continued interest in this project and welcome your engagement in the coming months.

Sincerely,

A handwritten signature in cursive script, appearing to read "Yasmin Tayyab", with a horizontal line underneath.

Yasmin Tayyab

C.c.: Mr. James D. Wolfensohn, President, The World Bank Group  
Mr. Peter Woicke, Executive Vice President, International Finance Corporation