

## Legal Meeting with BP, 8/11/02

Present: Barry Halton, Tom Dimitroff (BP), Nick Hildyard (Corner House), Phil Michaels (FoE), Jane Gordon and Anders Lustgarten (KHRP).

Phil: Was anyone in the public sphere consulted on the terms of the agreement prior to ratification?

Tom: There is a precedent for IGA/HGA in the Western Route Export Pipeline (Baku-Supsa) for early oil, which has a similar agreement structure. The publics of the host countries "understood the agreements"- it was debated in Parliament in Georgia and Azerbaijan, and unanimously adopted in Georgia. This is a project which is recognised by local populations as important, and has lots of non-partisan support.

Jane: Can you tell us some of the history of the project?

Tom: We put the agreements together from late 1997 through 1998; it was an internal process as we got comfortable with the documents. It was launched through a governmental not an investor process—we made a recommendation to the governments, and the Azeri govt received a formal notice of invitation.

There were three projects: Baku-Novorossiysk, Baku-Supsa and BTC. The first two flowed from the PSA, but BTC was entirely outside the PSA. Preliminary discussions were held with the Ukraine and other Black Sea countries in 1998 to explore the possibilities of pipelines. The Azeri government tabled invitations to the other countries en route, and BP then initiated discussion with Turkey from October 98-Oct/Nov 99, the agreement packages from which became the IGA. The project was driven by inter-governmental relations; BP was happy to participate, and we signed up when we were happy with the state of agreements. BP was part of the working group that negotiated the agreements, invited in by Azerbaijan; we had "some influence" in the decision-making process.

The govt part was not concluded until the agreements were ratified; investors were only invited to sign on to the HGA in October 2000. We then undertook a detailed 12 month engineering phase, including routing and commercial aspects. We then concluded from this that BTC is the premium commercial and environmental route; one must remember that infrastructural difficulties and the Bosphorus problem make other routes financially problematic. 4 companies with interests in Kazakhstan—Agip, TFE, Impex and ConocoPhillips—have recently joined BTC, indicating that they see it as financially attractive.

### Tom's presentation:

- There are 11 sponsors in BTC Group, led by BP.
- Nameplate capacity of BTC will be 1 million barrels per day. When changes are made to the chemical viscosity of the oil, that will rise to 1.2 to 1.4 mbd; other technical changes will allow for up to 1.7 to 2 mbd.
- The reserves in the Azeri fields have not developed as planned, so we now plan to take oil from the Kazakh fields. The recent addition to BTC of four Western investors with Kazakh interests proves that BTC will take Kazakh oil. The higher sulphur content that be processed out through decapterinisation (???)
- The Bosphorus is too narrow; we took a firm position against putting additional volume through it.

- We have not planned for alternatives to BTC: originally we considered them, but the investors have now pulled the trigger on financing BTC: there's no stopping this commercially. The govts have clauses not to do anything that devalues BTC, so this is the route.
- The standards used are benchmarked up to the highest international standards, higher than local standards—Article 4 of the IGA says they will be no lower than those prevailing among member states of the EU.
- BTC will be locked in to applied HSE standards, which will be BP standards—“we have stepped out in front on this”.
- None of the three host countries have fully developed market economies. The host country agreements gives strong imprimatur of govt and popular support to the project in return for local regional benefits.
- The IGA/HGA arrangement is “a highly unusual deal” but increasingly prevalent form of agreement in energy transit across international boundaries. It harmonises environmental and technical standards across international borders. It also benchmarks the extensiveness and effectiveness of legal and economic systems: most of the former Soviet Union countries have laws on the books, but in practice don't apply them. In 1998-99 Georgia, in terms of taxes as % of GDP, was among the least developed states in the WTO. Also, the old admin and legal codes had different intentions—they were intended to bring offending officials to book rather than to ensure the enforcement of environmental, legal and population rules.
- The HGA is a 60 year agreement. It creates enough space for us to do the right thing legally, but also create a set of standards which we can live with reputationally. We are very vigilant in maintaining our reputation. The IGA/HGA are not a blueprint for the BTC project, nor are they the thing to look at in the first instance. They are not designed for us to jump into arbitration, but to create a dialogue with govts within an acceptable legal framework. We need a tremendous amount of security to make this happen. It is not a simple project taking place within one jurisdiction; the 11 sponsors come from 8 countries, complex tax rules, 14 multi-lateral ECAs and project providers.
- Legal hierarchy: the HGA applies, but existing inter-governmental treaties like the Energy Charter Treaty 1994 and bilateral agreements still apply. The HGA primarily refers back to local law. The governing law provision does not mean that English law replaces local law: English law will only be used in deciding interpretation of specific legal phrases e.g., ‘material adverse impacts’. We don't want to get mixed up in terms of legal culture: we need a baseline to be co-ordained. We create enough space in terms of optionality, but with the HGA as the main area.

Anders: What international standards are there for pipelines, in environmental, human rights and social terms? The Dutch and Austrian standards are technical, but there are no pipelines there and the landscape is entirely different ( The Netherlands is flat, Austria is mountainous).

Barry: There are few relevant standards—Concawe for environmental, but little for human rights and society.

Nick: But Concawe is entirely technical, to do with pipesize and the like. You refer to prevailing social and environmental standards in the contract. So you must have some

in mind. So what are they? Can you be specific? Which standards did you have in mind when drawing up the agreements?

Tom: We tried to embed legal benchmarks against which, after the EIA, environmental standards could be enshrined before engineering work. We use BP's own HSE policies. It is not a blueprint, but it does mean something. And Article 4 stipulates that the standards should be no less than those applied in the EU.

Phil: Article 4 does not require the use of EU standards. It merely states that they would be acceptable to the host governments.

Anders: Doing the contract first, then carrying out the EIA seems the wrong way round.

Phil: (a) The HGA seems to serve not as a benchmark but a cap; it sets a level above which states cannot go.

(b) It is nebulous—where is the hard stuff about Codes of Practice and impositions or penalties for the MEP Participants rather than the host countries?

Tom: The arrangement is backwards because the agreement and Lump Sum Turnkey Contract came first, then the contract was signed after construction was agreed.

Normally it would be the other way around, you would want to scope first and do the engineering after.

Jane: Does that mean you got a cheap deal?

Barry: When the deal was put in place, the situation was much more contingent, no commercial deal had been struck.

Nick: You must have known what environmental standards you had in mind from other pipeline experiences.

Tom: In any instance one can be challenged that it is not up to EU standards. You have a legitimate basis to do that. And we want the international community to look at this and make sure we come up to scratch. We don't want to subvert on a commercial basis what we are obliged to do legally.

Nick: So social and environmental standards are not specified because of the prospect of a legal challenge?

Tom: No, the opposite.

Nick, Jane, Anders, Phil: Can we be clear about this. When you drew up the agreement you had no environmental or social standards in mind? Do such standards actually exist? What are they? What are these international standards?

Barry: We can draw a list of environmental standards and send them to you. The social standards are more difficult. They are the vaguest. But we have our own HSE policies. Our environmental standards will satisfy you. Our concerns are land acquisition and compensation and military security. We would find it useful if you told us where your areas of concern lie and we will tell you.

Jane: Surely it's not up to us. What is your list of standards?

Barry: We don't have a list, it's a new science.

#### **Conversation returned again to Phil's two questions**

Tom: BTC Co. is not going to enforce any commercial right which will violate anyone's human rights, on a reputational basis. By making the Project Agreements and ESIA's available, by putting them on the Web, you can get comfortable with the results of what was done on the ground. That helps close the gap between the vague legal basis and what has actually happened.

As far as the limitation of liability of MEP Participants to the states and to third parties is concerned, don't forget Article 11: we are obliged to compensate for damages, and all local law applies. The IGA and HGA doesn't apply to human rights

per se, so local criminal and tort law will address that problem. We are not immunised against liability. There are sanctions under local law.

Phil: The implication is that Article 11 is about not breaching standards within the Project Agreements themselves, which seems like a tautology.

Tom: I want to address the point that the participants are exempted from liability; this is not the case.

Jane: But it is the countries that must pay compensation if the Economic Equilibrium is affected.

Tom: Since the rule of law is not respected in the host countries, we need mechanisms to create the space to get things done.

Jane: But if the host countries try to go above the benchmarks set out in the HGA, are you indemnified, yes or no?

Tom: BTC is the only FDI project in Georgia and one of the biggest in Turkey. The collective magnitude of the benefit is around \$1 billion over 40 years. Once we achieve stability, you folks would have a field day if BP tried to assert an Economic Equilibrium claim versus the Turkish govt. Reputationally we aren't going to go public with that. The IGA/HGA is a clumsy tool, but one which was necessary to make this project happen under the circumstances.

Anders: So you have designed a contract that you hope not to have to use?

Tom: What we are hoping to agree is not to use the contract.

Jane: But a contract is a contract.

Tom: The fundamental nexus is the trans-boundary nature of the contract, in this specific context. There are over 1600 bilateral treaties between govts and others. This is the first time in history that Azerbaijan, Georgia and Turkey have been linked together; this gives the region stability and the security of relations with the international business community.

Nick: In terms of the contract, if Turkey chooses to enact higher environmental standards which add to the cost or detract from the profitability of the project, who will pay, Turkey or BP?

Tom: The cost is on the state. The context of the contract means that we have to have a way to push back.

Nick: The article in American Lawyer on Baker Botts says that the HGA is drawn up in such a way as to avoid putting security costs onto BP, since the security forces used to police other pipelines have been costly and have provoked many lawsuits.

Tom: Would we really do that?

Phil: Well, it makes sense.

Barry: I have seen the American Lawyer. The interpretation is the authors, not Baker Botts'.

Nick: Would the HGA indemnify the MEPs against the actions of the security forces?

Phil: If a citizen of Turkey makes a claim against the MEPs for the actions of the pipeline security forces, are they liable?

Jane: The security forces are at the sole cost and responsibility of the state.

Tom: What is done by the security forces is done in consultation with the MEPs, so if we told them to kill anyone we'd be in trouble! But the govt must look after its own security forces.

Barry: We can arrange an meeting with out security people.

Nick: Could the security forces be taken to court in America a la Unocal?

Tom: The Alien Tort Claims Act provides for that in the US.

Jane: Because of specific indemnification, the MEPs can't be sued.

Barry: We don't pay for state security, arm them or control them. I accept that the record of the Gendarmerie in Turkey is not good. We have proposed a dedicated gendarme force whose sole role is pipeline protection, which gives us confidence that they won't exceed their responsibilities. This is an extension of the work we've done with the Iranian gas pipeline. We don't want to see people being attacked. Tell us if you think people will be disadvantaged.

Tom: The HGA is clumsy in many ways. We don't want to be insulated against legitimate claims, but to have the ability to go to areas where no-one else is willing to go.

Phil: Is the HGA agreement standard? Has BP entered into similar agreement elsewhere?

Tom: It is recognised: the EBRD 2001 Transition Report, chapter 3, suggests that PSAs enacted with the force of law are effective mechanisms for such projects. In transitional economies these HGAs are a necessary instrument, not an anomaly. There are PSAs for single countries, but not over three countries. In Georgia the IGA and HGA were published on a wide basis before they were debated in parliament.

Jane: What if a country decides to quit the agreement?

Tom: MIGA and other political risk insurance agencies will cover it if a govt does what it wants to do.

Barry: If you look at local areas, that is where other projects have suffered, so HGAs need insurance. Shareholders need it; the Energy Charter Treaty has investment protection.

Jane: What is the balance between covenants:

Tom: There are a huge number of covenants in place. Without the HGA the banks themselves would put these arrangements in place. The companies are seeking loans from multi-lateral agencies with development objectives, which will also put pressure on the states. It's a question of how we operate in risky areas; we shift govt risks onto the govts. The whole project is pledged as security to the World Bank. We have pledged to hand over all our shares as security for the loans and to subordinate all other claims to those of the senior lenders. The Bank would claim against the states and BP's rights would be subrogated.

Phil: How do you see the HGA impinge on Turkey's EU accession negotiations?

Tom: The negotiations are on a state to state basis. The US govt invited itself to become heavily involved. The IGA package is in public law, but the HGA is a private agreement between state and company consortium.

Anders: From your knowledge, was the issue of EU accession raised during negotiations?

Tom: We didn't raise the question, and I don't remember anyone mentioning EU accession. Maybe the Turkish government asked the EU about this. We don't want Turkey to have its accession ruined; we think it would help BTC.

Phil: Why did you include Article II (8) in the IGA, specifically stating that this agreement is not intended to help the public?

Tom: Many power contracts in Turkey are concession contracts; we didn't think arbitration would work in that context. We wanted to ensure that it wasn't a concession contract because the arbitration clauses would not apply..

Nick: But the wording of the IGA is such that it doesn't apply merely to Turkey but to all three countries.

Tom: The negotiations took place first with the Turkish party, then were introduced into Azerbaijan and Georgia. It wasn't intended to apply to them. The wording is clumsy.

Phil: Could we have a list of the PSAs between BP and other govts?

Barry: They are confidential between the company and the govt. Some of them might be available.

Tom: What is unique is that this one was published.

Phil: But certain clauses are not recognised, even if the model is.

Nick: Of the people we met in Turkey, most of them had never seen the HGA; it was hard to obtain. People had even less idea that BP was involved. And the HGAs were only put on the Web after NGOs wrote to the IFC and other institutions pointing out that, despite being public documents, they were not available. Is the document on the website the entire PSA?

Barry: Yes, except for some of the commercial elements.

Nick: Are those available to lending agencies?

Barry: Yes, along with a declaration of signature/bonus payments and Oil Fund contributions.

Nick: The PSA says that the whole agreement is invalidated without the main export pipeline. What is the contractual relation between the PSA and the HGA, and does the PSA undergird the HGA, for example for due diligence?

Tom: There is no contractual relation; the upstream relationship is the Transportation Agreement between the shippers and BTC. The Transportation Agreement links the two; it is a commercial agreement, not for us but for the banks. You would be a fool not to look at the PSA if you were conducting due diligence for the HGA. Exxon, Devon and Lukoil are all in the PSA but not the HGA. All the other small companies are in; McDermott is not.

Nick: But you would look at the two contract together for due diligence, for example if there were any suggestion that there was something not above board happening?

Tom: That would be the sine qua non of due diligence; it is the fundamental reason to build a pipeline.

What do you mean by “above board”? The World Bank would walk away from any suggestion of wrongdoing. This agreement has been rigorously scrubbed by the lenders and their consultants. They wouldn't touch it with a bargepole.

Nick: The IFC loan to BTC is made with a sovereign guarantee from the Turkish state. If the covenants incur costs, who pays?

Tom: BOTAS is in a contract with us. In the HGA the Turkish govt has pledged to deliver the land for construction for \$99 million, so they must pay for any overspill.

Nick: If the IFC puts conditions on the loan and they add to the costs, for example implementing WB OD 4.20, who pays for those increases? There are additional safeguard policies on all IFC loans, which will add extra costs not covered in the Lump Sum Turnkey Contract.

Tom: Under the LSTC, BOTAS must deliver the land. We wired it so the govt would deliver the land, and put the cost in to provide an arrangement that investors could step into.

Anders: How did you come up with the figure of \$99 million?

Tom: We would have benchmarked types of land, since you know where you are going, and ratcheted it up from there.

Jane: In terms of land acquisition techniques, is Azerbaijan like Georgia or like Turkey?

Tom: A fusion; there is a transparency process so that you can see the money is paid fairly. Eminent domain is a last resort; we want to negotiate a fair deal.

Jane: Who acquires the land? In Turkey it seems like BOTAS, in Georgia it is BTC, in Azerbaijan it is BTC and the state. So if there is an appeal in Georgia over land prices it goes to BTC?

Tom: In Turkey an appeal goes to court; the same is true in Georgia. But there is a difference between state land and non-state land.

Barry: In the greater scheme of things it's not expensive, so we won't penny pinch, but it must fit govt methods. This agreement create a structure that didn't exist; it is a contribution to Turkish law. We don't want to disadvantage anyone, so we will compensate all land users despite being prohibited from doing so by Turkish law. A simplified version of the RAP is going out to landowners.

Nick: But what about those who have no title to land. The land acquisition section in the draft EIA also promised that everyone would be compensated – but the Fact Finding Mission found out that this was not happening.

Barry: Yes this is a problem. That's why we need your help to let us know what is going on on the ground.