

March 1, 2006

Dr. Jean Aden
Director
Office of Accountability
U.S. Overseas Private Investment Corporation
1100 New York Ave., NW
Washington DC 20527
E-mail accountability@opic.gov

RE: Request for Compliance Review

Dr. Aden,

I, Manana Kochladze, lodge a complaint concerning the Baku-T'blisi-Ceyhan (BTC) pipeline project. This complaint is lodged on behalf of myself and the Central and Eastern European Bankwatch Network (CEE Bankwatch Network). In addition to this affiliation, I am also the founder of a local grassroots environmental group, Green Alternatives, and I am a 2004 recipient of the Goldman Prize, an award which is internationally recognized as the environmental equivalent of a "Nobel Prize." My recipient profile can be found at <http://www.goldmanprize.org/recipients/recipientProfile.cfm?recipientID=134>

I live in T'blisi, Georgia, which is the city whose name is part of the BTC pipeline project due to its geographic centrality of the project. I can be reached at the following address:

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380062
Tel: 99532 22 38 74
 99 04 72
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CEE Bankwatch Network and I do not seek anonymity with regards to this complaint. Also, we wish to designate Doug Norlen, Policy Director, Pacific Environment, as our US-based representative and we request that any communications to us be copied to Mr. Norlen. Mr. Norlen can be reached at the following address:

Doug Norlen
Pacific Environment
C/O CIEL
1367 Connecticut Avenue N.W. #300
Washington DC, 20036
Tel: +1 (202) 785-8700, #31

Cell: +1 (202) 465-1650.

Email: dnorlen@pacificenvironment.org

The BTC pipeline traverses 1,750 kilometers through Azerbaijan, Georgia and Turkey, beginning on the Black Sea (at Baku), through Georgia (T'blisi), to the Mediterranean Sea (at Ceyhan). The BTC pipeline will transport about one million barrels of oil per day. The BTC pipeline was financed with \$100 million USD in political risk insurance by OPIC in 2004.

I, along members and supporters of CEE Bankwatch Network residing in the three countries, and the communities along the BTC pipeline route are likely to be affected by the environmental, social, worker rights and/or human rights impacts of the project in a number of ways that are elaborated upon in documents that we hereby incorporate by reference, available at <http://www.bankwatch.org/issues/oilclima/baku-ceyhan/mbaku.html>.

This complaint concerns, *inter alia*, the lack of notification to OPIC of events surrounding the widespread failure of a pipeline coating needed to protect against potential oil leaks and spills over the lifetime of the BTC pipeline project. The complaint focuses on four areas of violations of OPIC's environmental policy [(231 (n), 231A, 237(m), 239(g) and 239(i) of the Foreign Assistance Act of 1961, as amended, and OPIC's Environmental Handbook - February 2004]:

1. Breach of OPIC environmental policy with regards to requirements to comply with all contractual conditions, including:
 - a. Environmental conditions found in the BTC-OPIC Direct Agreement;
 - b. Environmental conditions found in the BTC Common Terms Agreement.
2. Breach of OPIC environmental policy with regards to the lack of annual environmental and development impacts monitoring;
3. Failure of OPIC to act on the event of default;
4. Lack of adequate OPIC due diligence and compliance monitoring.

Breach of OPIC Environmental Policy, BTC-OPIC Direct Agreement, and Common Terms Agreement

According to OPIC's Environmental Handbook:

For investments in all projects in Category A activities, OPIC expects the project to comply with all contractual conditions and critical and material representations regardless of whether or not the OPIC-supported investor has a controlling interest in the foreign enterprise.

Following a Freedom Of Information Act (FOIA) request to OPIC by Pacific Environment,¹ which sought “[e]nvironmental and social covenants to OPIC’s finance agreement for the BTC pipeline,” the agency disclosed a responsive redacted record² entitled, “BTC-OPIC Direct Agreement,”³ which includes the following contractual conditions:

4.3 SPECIFIED CTA OBLIGATIONS

For the benefit of OPIC, BTC Co. shall comply with the following obligations under the Common Terms Agreement:

- (a) as provided in Clauses 19.10, 19.11, 19.30(e), 20.5(vi), 20.5(vii), 20.5(viii), and 20.11(iv) (environmental matters);
-

OPIC’s FOIA response also included a redacted version of document entitled “Common Terms Agreement,”⁴ which includes the following contractual conditions:

20.5 Notice of defaults and certain other events

- (a) BTC Co. must promptly notify the Intercreditor Agent upon its discovery of the occurrence of:
- (vi) any event which occurs during construction or operation of the Pipeline and is reasonably expected either to give rise to material environmental claims against BTC Co., or to constitute a material breach of the ESAP, the RAP or any OSRP by BTC Co.;
- (vii) any accident or incident that has a material adverse effect on the Environment (including social or community impact) or worker health and safety that occurs as a result of Project operations (and in any event no later than three days after becoming aware of such accident or incident), including an indication of when the incident investigation and report is expected to be finalised, and BTC Co. shall provide the Intercreditor Agent with a detailed written report of such incident promptly, in a manner consistent with the notice requirements under the Participants Agreement, after the incident report is finalised;

Meanwhile, Pacific Environment’s FOIA request also sought “[a]ll studies and reports concerning the risk of leaks from the BTC pipeline in OPIC’s possession other than the Oil Spill Response Plan and the Documents Generated by Parsons listed in Appendix A

¹ Request initially submitted by Pacific Environment August 4, 2005, and later narrowed to include the request for this record on September 6, 2005.

² Final FOIA response sent by OPIC November 21, 2005

³ BTC-OPIC Direct Agreement; Overseas Private Investment Corporation; The Baku-Tblisi Ceyhan Pipeline Company; and Baku-Tblisi Ceyhan Finance B.V, dated February 3, 2004, Re Contract No F320

⁴ Contract dated February 3, 2004

hereto.⁵ OPIC's partial response to this FOIA request indicates that the agency has no responsive records to this request.⁶

Based on this FOIA response by OPIC and additional information provided below we believe that a breach of contract has occurred with regard to notification requirements contained in the Common Terms Agreement 20.5 (a) (vi), (vii), incorporated by reference in the BTC-OPIC Direct Agreement.

The facts are as follows:

- i) The ESAP for the BTC Project states: "Corrosion protection measures shall be implemented including . . . pipeline protective coating;"⁷
- ii) The field joint coating is integral to the protective coating for the pipeline: a failure could result in a major pollution incident involving the leaking of oil;
- iii) BP, the lead company in BTC Co, was responsible for the selection and management of the coating process;
- iv) On 27th July 2002, Rod Hensman, senior project engineer in BP, wrote to Trevor Osborne of BP Projects, who was responsible for the coating selection process, expressing concerns about SPC 2888. Hensman argued: "We should not be a testing ground for new materials";⁸
- v) On 10 November 2002, BP was warned in an internal report by corrosion expert Derek Mortimore that its specification for SPC 2888 was "utterly inappropriate"⁹ to protect the pipeline (see Attached – Mortimore Report);
- vi) Mortimore deemed that the specification for the coating was "under developed and incomplete."¹⁰ His report went on: "As a field joint coating specification on a major pipeline, it is utterly inappropriate as it does not confirm a protective system that can be successfully applied in all the conditions under which this pipeline will be constructed, nor does it confirm the integrity of the protection for the design life of the pipeline;"¹¹

⁵ Op Cit #1 Appendix A contains records obtained by Pacific Environment resulting from a FOIA request to the US Export-Import Bank.

⁶ Partial FOIA response sent by OPIC November 8, 2005

⁷ Environmental and Social Action Plan , "Environmental and Social General Commitments Register BTC CO (Georgia), Commitment E5, [http://www.caspiandevlopmentandexport.com/Files/BTC/English/ESAP/Commitments%20Registers/Georgia/Content/Georgia%20Commitments%20Register/BTC%20Commitment%20Register%20\(En\).pdf](http://www.caspiandevlopmentandexport.com/Files/BTC/English/ESAP/Commitments%20Registers/Georgia/Content/Georgia%20Commitments%20Register/BTC%20Commitment%20Register%20(En).pdf) .

⁸ Memorandum from R. Hensman, BP's senior project engineer, to T. Osborne, BP materials consultant for BTC project, 27 July 2002, quoted in Trade and Industry Select Committee, Ninth Report, Session 2004-05, 4 April 2005, Implementation of ECGD's Business Principles, Written Evidence, Memorandum of Michael Gillard,

<http://www.publications.parliament.uk/pa/cm200405/cmselect/cmtrdind/374/374we07.htm>

⁹ "BP Caspian Developments, AGT Pipelines Project, Review of Field Joint Coating Specification No 410088/00/L/MW/SP/015 (issue 02.10.02)", unpaginated, Appended to Mortimore D., "Response from Derek Mortimore to ECGD submission" in Trade and Industry Select Committee, Ninth Report, Session 2004-05, 4 April 2005, *Implementation of ECGD's Business Principles*, Written Evidence, Appendix 4, <http://www.publications.parliament.uk/pa/cm200405/cmselect/cmtrdind/374/374we05.htm>. See also attached Mortimore report, at pg 24.

¹⁰ Ibid and attached Mortimore report, at pg. 24.

¹¹ Ibid and attached Mortimore report at pg. 24.

- vii) Mr Mortimore warned BP: "We are specifying material and application that is not 'best industry practice' or even 'normal industry practice' we are in fact completely out on a limb, we cannot identify any pipeline owner who uses the epoxy by this application on PE [polyethylene] field joints any where in the world;"¹²
- viii) Mr Mortimore also stated: "Clearly the use of [SPC] is going to lead to a serious problem."¹³ Mortimore warned in particular that the SPC coating would not stop the ingress of water over time and therefore not protect the field joint;
- ix) Mr Mortimore concluded that "the cost of repairs could prove astronomical"¹⁴ and "the potential for claims against [BP] is open-ended."¹⁵ The Sunday Times further quotes him as saying: "I have witnessed many failures in specifications . . . but the situation on the pipeline is unique in my 41 years experience. There is no question in my own and many other peoples' minds that the wrong system has been chosen through a seriously flawed selection programme;"¹⁶
- x) **The Lenders Group, which includes OPIC, was not informed of the findings of Mortimore's report;**¹⁷
- xi) In August 2003, the first pipe joints were coated with SPC 2888
- xii) In November 2003, cracks were discovered in the joint coatings on which SPC had been used, leading to a 8 week suspension in construction, (See Annex A of this claim), a failure predicted by Mr. Mortimore (see attached–Mortimore Report). This wide spread cracking and suspension in construction are clearly events or incidents required to have been reported to OPIC and other lenders under the Common Terms Agreement and the BTC-OPIC Direct Agreement;
- xiii) **The Lenders Group, which includes OPIC, was not informed on the discovery of cracking, much less of the consequent suspension of work.**¹⁸
- xiv) On 9th February 2004, BP/BTC Co issued new specifications for the coating process.¹⁹ This demonstrates that events or incidents—the cracking and suspension of work--were significant enough to require attempted remedial

¹² Ibid and attached Mortimore report at pg 23.

¹³ Ibid and attached Mortimore report at pg 23.

¹⁴ Ibid and attached Mortimore report at pg 24.

¹⁵ Ibid and attached Mortimore report at pg 24.

¹⁶ Gillard, M., "*BP accused of cover-up in pipeline deal*", The Sunday Times, February 15, 2004 (See Annex A of this complaint)

¹⁷ Baku-Tblisi-Ceyhan (BTC) Crude Oil Pipeline: EBRD Management's Response to NGOs Queries, February 23, 2004, which states, "BTC Co did not inform EBRD, or other lenders or relevant Ministries of the technical problems with the field joint coating material and its specific application." (See also quote from ECGD spokeswoman, Annex A of this complaint)

¹⁸ Baku-Tblisi-Ceyhan (BTC) Crude Oil Pipeline: EBRD Management's Response to NGOs Queries, February 23, 2004, which states, "BTC Co did not inform EBRD, or other lenders or relevant Ministries of the technical problems with the field joint coating material and its specific application." See also Annex A

¹⁹ Trade and Industry Select Committee, Ninth Report, Session 2004-05, 4 April 2005, Implementation of ECGD's Business Principles, Written Evidence, Second Memorandum of Michael Gillard, paragraph 98, <http://www.publications.parliament.uk/pa/cm200405/cmselect/cmtrdind/374/374we07.htm>

- action and therefore required to have been reported to OPIC under the Common Terms Agreement and the BTC-OPIC Direct Agreement;
- xv) The 15th February 2004 article in *The Sunday Times* (Annex A) reported the extent of cracking and of suspension of construction. NGOs, not OPIC clients, then brought this article to the attention of the agency;
 - xvi) A desk study by WorleyParsons Energy Services was commissioned by the Lenders' Group. The study confirmed that SPC 2888-coated sections of the pipeline have been subject to extensive cracking (26 per cent in Georgia alone);²⁰
 - xvii) An internal BP report of 18th June 2004 records that, despite the remedial measures adopted, the polyethylene coating on the pipeline in Georgia had peeled away from "a large proportion" of the steel pipe;²¹
 - xviii) The same report states that BP limited the extent of adhesion tests based in part on "the desire to reduce repair frequency." The acknowledgement that repairs are needed further demonstrates that events or incidents occurred that are required to have been reported to OPIC under the Common Terms Agreement and the BTC-OPIC Direct Agreement;
 - xix) We believe neither OPIC nor the Lenders Group were informed by BP of this internal BP report;**
 - xx) Two contractors - AMEC and the Consolidated Contractors International Company (CCIC) - have been in dispute with BP over who is responsible for the delays that have followed the predicted cracking of the coating. CCIC are threatening to take BP to the courts in London.²² This legal dispute is further demonstrates that events or incidents occurred that are required to have been reported to OPIC under the Common Terms Agreement and the BTC-OPIC Direct Agreement;
 - xxi) An independent expert assessment commissioned by the CCIC concluded that even after the remedial measures adopted by BP, the SPC field joint coating is still cracking. This suggests the pipeline will corrode, and is therefore, in effect, uninsurable.²³ This demonstrates that there are ongoing events or incidents that are required to have been reported to OPIC under the Common Terms Agreement and the BTC-OPIC Direct Agreement;
 - xxii) We believe neither OPIC nor the Lenders Group were informed of the dispute between the contractors and BP, nor of the independent expert assessment commissioned by CCIC;**

²⁰ WorleyParsons Energy Services, Desktop Study Final Report Field Joint Coating Review (Redacted Version) , Section 5: Field Joint Cracking, para 5.1, unpaginated, /in/ Trade and Industry Select Committee, Ninth Report, Session 2004-05, 4 April, 2005, / Implementation of ECGD's Business Principles/, Written Evidence, Appendix 2, <http://www.publications.parliament.uk/pa/cm200405/cmselect/cmtrdind/374/374we03.htm>

²¹ Trade and Industry Select Committee, Ninth Report, Session 2004-05, 4 April 2005, Implementation of ECGD's Business Principles, Written Evidence, Second Memorandum of Michael Gillard, paragraph 109, <http://www.publications.parliament.uk/pa/cm200405/cmselect/cmtrdind/374/374we07.htm>

²² Gillard, M. and Connett, D., "BP 'covered up' pipeline flaw", *The Sunday Times - Business*, April 17, 2005 (See Annex B of this complaint).

²³ Gillard, M. and Connett, D., "BP 'covered up' pipeline flaw", *The Sunday Times - Business*, April 17, 2005 (See Annex B of this complaint).

- xxiii) As reported by UPI, in September 2005, cracking of the pipeline coating continues in Georgia.²⁴ This also demonstrates that there are ongoing events or incidents that are required to have been reported to OPIC under the Common Terms Agreement and the BTC-OPIC Direct Agreement.
- xxiv) We believe neither OPIC nor the lenders group were informed of the UPI story or of the ongoing cracking.**

We contend that that the cracking of the field joint coating first discovered in November 2003, and events that subsequently occurred, including the suspension of work, attempted remedial action, ongoing cracking and a legal dispute between contractors and BP demonstrate that material events and incidents occurred that place BTC Co in breach of the Environmental and Social Action Plan (ESAP),²⁵ in that the cracking:

- (i) Is systemic, indicating a major problem that was not restricted to one area but potentially affected all coated field joints in Azerbaijan and Georgia;
- (ii) Is widespread, in that it affected 26 per cent of the field joints in Georgia alone;
- (iii) Is therefore a de facto evidence of a failure to “implement a . . . pipeline protective coating” as required under the ESAP.²⁶

We further contend that BTC Co and OPIC’s client was obliged under the ESAP to notify the Intercreditor Agent of the cracking incident “as soon as practicable and in any event no later than three days of becoming aware of the incident”²⁷, in that:

- (i) The cracking involved a systemic fault that could reasonably be expected to have “a material adverse effect on the environment”²⁸ and which thus

²⁴ Mihailescu, A., “Cracks revealed in BTC oil pipeline”, 21 September 2005 (See Annex C of this complaint).

²⁵ Environmental and Social Action Plan, as agreed at financial closure, February 2004

²⁶ Environmental and Social Action Plan, “Environmental and Social General Commitments Register BTC CO (Georgia), Commitment E5,

[http://www.caspiandevlopmentandexport.com/Files/BTC/English/ESAP/Commitments%20Registers/Georgia/Content/Georgia%20Commitments%20Register/BTC%20Commitment%20Register%20\(En\).pdf](http://www.caspiandevlopmentandexport.com/Files/BTC/English/ESAP/Commitments%20Registers/Georgia/Content/Georgia%20Commitments%20Register/BTC%20Commitment%20Register%20(En).pdf)

²⁷ Environmental and Social Action Plan, as agreed at financial closure, February 2004, para 6.7.1.6, “Lender Incident Reporting – Serious Incidents (including Level III non-compliance)”, p.70,

<http://www.caspiandevlopmentandexport.com/Files/BTC/English/ESAP/ESAP/Content/Main%20Document.pdf>. Also: Environmental and Social Action Plan Operations, para 6.8.9, “Lender Incident Reporting – Serious Incidents (including Level III non-compliance)”, April 2005, p.55,

http://www.caspiandevlopmentandexport.com/Files/BTC/English/Operation%20Plan%20ESAP/Content/FINAL_BTC_Operations_ESAP.pdf

²⁸ Environmental and Social Action Plan, as agreed at financial closure, February 2004, para 6.7.1.6, “Lender Incident Reporting – Serious Incidents (including Level III non-compliance)”, p.70,

<http://www.caspiandevlopmentandexport.com/Files/BTC/English/ESAP/ESAP/Content/Main%20Document.pdf>. Also: Environmental and Social Action Plan Operations, para 6.8.9, “Lender Incident Reporting – Serious Incidents (including Level III non-compliance)”, April 2005, p.55,

http://www.caspiandevlopmentandexport.com/Files/BTC/English/Operation%20Plan%20ESAP/Content/FINAL_BTC_Operations_ESAP.pdf

constituted a “serious incident” as defined in para 6.7.1.6 (Lender Incident Reporting) of the February 2004 ESAP (as agreed at financial closure)²⁹, later reiterated in para 6.8.9 (Lender Incident Reporting) of the Operations ESAP;³⁰

- (ii) The cracking involved “a reasonable expectation of impending material damage” to “a specifically protected sensitive resource”³¹, *inter alia* the Borjomi National Park, other protected areas, and watersheds through which the pipeline passes in Azerbaijan and Georgia, thus constituting a Level III non-compliance incident and thus a “series incident” within the terms of the ESAP³².

In the alternative, we contend that BTC CO and OPIC’s client should have “promptly notified” the Intercreditor Agent upon discovery of the cracking since:

- (i) The cracking involved a material breach of the ESAP, requiring prompt notification;³³

²⁹ Environmental and Social Action Plan, as agreed at financial closure, February 2004, para 6.7.1.6, “Lender Incident Reporting – Serious Incidents (including Level III non-compliance)”, p.70, <http://www.caspiandevlopmentandexport.com/Files/BTC/English/ESAP/ESAP/Content/Main%20Document.pdf>.

³⁰ Environmental and Social Action Plan Operations, para 6.8.9, “Lender Incident Reporting – Serious Incidents (including Level III non-compliance)”, April 2005, p.55, http://www.caspiandevlopmentandexport.com/Files/BTC/English/Operation%20Plan%20ESAP/Content/FINAL_BTC_Operations_ESAP.pdf

³¹ Environmental and Social Action Plan, as agreed at financial closure, February 2004, para 6.6.4, “Non-compliance”, p.62, <http://www.caspiandevlopmentandexport.com/Files/BTC/English/ESAP/ESAP/Content/Main%20Document.pdf>. Also: Environmental and Social Action Plan Operations, para 6.8.4, “Non-compliance”, April 2005, p.48, http://www.caspiandevlopmentandexport.com/Files/BTC/English/Operation%20Plan%20ESAP/Content/FINAL_BTC_Operations_ESAP.pdf

³² Environmental and Social Action Plan, as agreed at financial closure, February 2004, para 6.6.4, “Non-compliance”, p.62, <http://www.caspiandevlopmentandexport.com/Files/BTC/English/ESAP/ESAP/Content/Main%20Document.pdf> : “BTC Co will notify the Intercreditor Agent of all Level III non-compliances as Serious Incidents as required by Section 6.7.16 (Lender Incident Reporting).” Also: Environmental and Social Action Plan Operations, para 6.8.4, “Non-compliance”, April 2005, p.48, http://www.caspiandevlopmentandexport.com/Files/BTC/English/Operation%20Plan%20ESAP/Content/FINAL_BTC_Operations_ESAP.pdf

³³ Environmental and Social Action Plan, as agreed at financial closure, February 2004, para 6.7.1.6, “Lender Incident Reporting – Environmental Claims/ESAP breaches”, p.71, <http://www.caspiandevlopmentandexport.com/Files/BTC/English/ESAP/ESAP/Content/Main%20Document.pdf> : “BTC Co will promptly notify the Intercreditor Agent upon its discovery of the occurrence of any event which occurs during construction or operation of the BTC Pipeline and is reasonably expected either to give rise to material claims against BTC Co., or to constitute a material breach of this ESAP . . .” Also: Environmental and Social Action Plan Operations, para 6.8.9, “Lender Incident Reporting – Environmental Claims/ESAP breaches”, April 2005, p.48, http://www.caspiandevlopmentandexport.com/Files/BTC/English/Operation%20Plan%20ESAP/Content/FINAL_BTC_Operations_ESAP.pdf

- (ii) The cracking could “reasonably be expected to give rise to material environmental claims against BTC Co.”, similarly requiring prompt notification.³⁴

We note that this failure to abide by the Incident Reporting terms of the ESAP has not been restricted to the November 2003 cracking events. We reiterate, for example, that, to our knowledge, OPIC’s client failed to report:

- (i) The findings of the Mortimore report, even though the report warned BTC management against using SPC 2888, and could “reasonably be expected to give rise to material environmental claims against BTC Co” should the pipeline’s anti-corrosion coating fail;
- (ii) The changed specification adopted by BP/BTC on 9th February 2004 for applying SPC 2888, despite this change constituting an Unplanned Class III change³⁵ under the ESAP, thus requiring notification to the Intercreditor Agent “as promptly as practicable;”³⁶
- (iii) The above-listed internal 2004 BP report;³⁷
- (iv) The 2005 threat of legal action against BTC Co by pipeline contractors with respect to the use of SPC 2888 (see Annex B);
- (v) Cracking of the coating in Georgian sections of the pipeline as late as September, 2005.

³⁴ Ibid.

³⁵ Environmental and Social Action Plan, as agreed at financial closure, February 2004, para 6.7.1.2, “Notification of Change – Unplanned Class III Change”, p.66, <http://www.caspiandevlopmentandexport.com/Files/BTC/English/ESAP/ESAP/Content/Main%20Document.pdf> : “Any Class III Change that BTC Co reasonably considers necessary, following the occurrence of an unexpected event, to avoid or mitigate the anticipated impact of that unexpected event. Unexpected events include events, findings or other circumstances that were not foreseen by BTC Co and which, if not avoided or mitigated by prompt action, are reasonably likely to have an adverse impact on the environment, natural habitats . . . communities or landowners.” Also: Environmental and Social Action Plan Operations, para 6.8.7, “Notification of Change – Unplanned Class III Change”, April 2005, p.51, http://www.caspiandevlopmentandexport.com/Files/BTC/English/Operation%20Plan%20ESAP/Content/FINAL_BTC_Operations_ESAP.pdf.

³⁶ Environmental and Social Action Plan, as agreed at financial closure, February 2004, para 6.7.1.2, “Notification and Review of an Unplanned Class III Change”, p.67, <http://www.caspiandevlopmentandexport.com/Files/BTC/English/ESAP/ESAP/Content/Main%20Document.pdf> : “As promptly as practicable following the occurrence of an unexpected event which gives rise to or is reasonably expected to give rise to an Unplanned Class III Change, BTC Co will give the Environmental Consultant and the Intercreditor Agent notice of the unexpected event (the “Unexpected Event Notification”). The Unexpected Event Notification will include a description of the unexpected event. Also: Environmental and Social Action Plan Operations, para 6.8.7, “Notification and Review of an Unplanned Class III Change”, April 2005, p.52, http://www.caspiandevlopmentandexport.com/Files/BTC/English/Operation%20Plan%20ESAP/Content/FINAL_BTC_Operations_ESAP.pdf.

³⁷ Op. Cit. # 21

We contend that the cracking of coating on the pipeline in Georgia as late as September 2005 represents an “Event of Default” as defined in the ESAP and therefore also triggers reporting requirements because it demonstrates that the “BTC Co. fails in the development, construction, and operation of the Project to comply...in all material respects to the ESAP...and where such failure is capable of remedy, such failure is not remedied in 90 days (or a further 90 days if BTC Co. is diligently engaged in actions reasonably designed to remedy such non-compliance at the end of such first 90-day period after...BTC Co. having knowledge of such non-compliance....”³⁸

We note that, despite the obligation under the Common Terms Agreement to report all Events of Default, material breaches of the ESAP or event which could give rise to material claims against BTC Co, OPIC’s client failed to report the cracking incident either “as soon as practicable” or “within three days” or “promptly” or indeed at all. This includes events that occurred *before and after* the Common Terms Agreement were signed.

We contend that this failure to abide by the Incident Reporting terms of the ESAP represents a clear and flagrant breach of OPIC’s Common Terms Agreement and of the BTC-OPIC Direct Agreement, and of OPIC’s environmental policy requirement that the agency “expects the project to comply with all contractual conditions and critical and material representations”

We reject any suggestion that OPIC’s client was not obliged to report those events which took place *prior* to its signatory of the Common Terms Agreement. The terms of the Common Terms Agreement are clear: OPIC’s client is obliged to disclose information about “*any event*” which might give rise to a material environmental claim against BTC. This obligation is not limited by the Common Terms Agreement to events after signature of the contract but applies to events that occur throughout the construction and operation of the project. The cracking revealed in November 2003 is thus clearly covered by the terms of the Common Terms Agreement since it occurred during the physical construction of the project. We would also contend that the Mortimore report should similarly have been disclosed because it relates directly to construction of the pipeline and because of its nexus with any future environmental tort claims.

Meanwhile, OPIC’s Environmental Handbook states that the agency:

...will decline support for a project on environmental grounds [if] the applicant fails to provide OPIC with an EIA... to conduct a review sufficient to determine project eligibility on environmental grounds.

In many cases, determinations of eligibility rely on critical representations made by the client with respect to baseline environmental conditions, mitigative measures and net impacts of proposed projects.

³⁸ and Social Action Plan, as agreed at financial closure, February 2004, para 6.7.1.6, “Lender Incident Reporting – Serious Incidents (including Level III non-compliance)”, p.71,

The fact that BTC project sponsors knew of problems associated with the SPC 2888, but did not include this information in the EIA or otherwise inform OPIC while the agency was performing its environmental due diligence on the EIA, demonstrates that project sponsors failed to make critical representations, a breach of OPIC's environmental policy that if known by the agency should have compelled it to decline support.

Breach of OPIC Environmental Policy With Regards to Lack of Annual Environmental and Developmental Monitoring

OPIC also requires annual self monitoring of projects' US economic effects and development impacts:

*OPIC operates a "self-monitoring" system in which each investor/sponsor completes a Self-Monitoring Questionnaire (SMQ) on an annual basis....The SMQ identified information including:...[h]ost country development effects. The SMQ is contractually required for all OPIC projects...."*³⁹

Also, the requirement to monitor environment and development effects is also provided in OPIC's Environmental Handbook:

OPIC routinely conducts on-site monitoring of projects, using OPIC staff and/or consultants, for environmental, and environmentally based social impacts as well as U.S. economic and host country development effects.

The aforementioned FOIA request to OPIC from Pacific Environment sought:

OPIC's annual U.S. Economic Effects and Development Impacts "Self Monitoring Questionnaire" ("SMQ") and any related site monitoring records for the BTC pipeline from 2001 to present

[and]

*Environmental monitoring records including OPIC's required annual self monitoring...*⁴⁰

However, OPIC's response stated that the agency has no responsive records.⁴¹ Given that OPIC's contractual relationship with its client on the BTC project began February 3, 2004, OPIC's client is contractually required to have provided at least one SMQ by the time of Pacific Environment's FOIA request (and two by the time of filing of this

³⁹ Bullet point presentation provided by OPIC to Pacific Environment

⁴⁰ Op Cit #1

⁴¹ Op. Cit # 6, with regard to the SMQ. See also January 9, 2006 OPIC response to November 28, 2005 Pacific Environment FOIA appeal. With regard to annual environmental self monitoring, in this response OPIC states it has no responsive records generated after February 2004, when the annual environmental self-monitoring report should have been submitted to the agency.

complaint). OPIC's response to Pacific Environment's FOIA request indicates that the SMQ and annual environmental self monitoring record has not been provided, demonstrating a breach of contract and of OPIC's Environmental Handbook.

Failure of OPIC to Act on Event of Default

We note that under the terms of the ESAP, an Event of Default occurs if BTC Co has failed to remedy a material breach of the ESAP within 180 days from the date that the company first had knowledge of non-compliance.⁴²

More than twice that period has now passed since the problem of cracking first emerged in the pipeline coating. Despite remedial efforts by BP, however, the problem persists, as reported in the international press (Appendix C).

Moreover, the field joint coating is also subject to widespread disbondment – that is, it is peeling away from the pipe – as evidenced by a BP internal memorandum dated 18 June 2004.⁴³

We therefore contend that an Event of Default has occurred upon which OPIC has failed to act.

Lack of adequate OPIC due diligence & compliance monitoring

According to OPIC's Environmental Handbook:

OPIC conducts an internal assessment of the project based on the EIA and other available information, including any comments it receives from the public.

OPIC cannot provide a final commitment to a project (i.e., issue an insurance contract, disburse a loan, or approve a Category A transaction by a financial intermediary) until its environmental assessment is complete and a determination

⁴² Environmental and Social Action Plan, as agreed at financial closure, February 2004, para 6.7.1.6, "Lender Incident Reporting", p.71-72, <http://www.caspiandevlopmentandexport.com/Files/BTC/English/ESAP/ESAP/Content/Main%20Document.pdf> : "An event of default will occur . . . if BTC Co fails in the development, construction and operation of the project to comply . . . (2) with its covenant in the CTA to comply or cause compliance with the ESAP . . . and where such failure is capable of remedy , such failure is not remedied within 90 days (or a further 90 days if BTC Co is diligently engaged in actions reasonably designed to remedy such non-compliance at the end of such first 90-day period after the earlier of (1) BTC Co having knowledge of such non-compliance . . ." Also: Environmental and Social Action Plan Operations, para 6.8.9, "Lender Incident Reporting", April 2005, p.56, http://www.caspiandevlopmentandexport.com/Files/BTC/English/Operation%20Plan%20ESAP/Content/FINAL_BTC_Operations_ESAP.pdf.

⁴³ Op. Cit, # 21

is made by OPIC that the environmental, health and safety impacts of the project are acceptable.

“Other available information” that OPIC uses to conduct its internal assessment of the BTC project should include information shared between other public and private financiers and other agencies of the U.S. Government. OPIC’s Dr. President Peter Watson confirmed this when he wrote to Pacific Environment:

... With respect to the continuing and understandable concerns expressed by yourselves and other NGOs in the international community concerning construction standards and contractor compliance in the implementation of the Baku-to-Ceyhan (BTC) oil pipeline project, given press accounts and other statements, we view this as a serious matter and share the desire for a full review of the circumstances which we are doing as part of the lender group due diligence. We will continue to working toward that end with other senior lenders.⁴⁴

In the afore-mentioned FOIA request to OPIC, Pacific Environment requested:

“[a]ll studies and reports concerning the risk of leaks from the BTC pipeline in OPIC’s possession other than the Oil Spill Response Plan and the Documents Generated by Parsons listed in Appendix A hereto.⁴⁵”

“Appendix A” of this FOIA request includes volumes of reports concerning environmental impacts of the BTC projects that Pacific Environment obtained from the U.S. Export-Import Bank through a FOIA request. Since Pacific Environment’s FOIA request to OPIC asks the agency to disclose documents other than those provided in “Annex A” of the FOIA request, it is not clear whether OPIC also possesses these records. However, OPIC’s response to the FOIA request is troubling in that it states that the agency has no responsive records.⁴⁶ Meanwhile, Pacific Environment’s FOIA request also sought the following record:

7. A report prepared by the U.S. Agency for International Development (USAID) entitled “Multilateral Development Bank Assistance Proposals Likely to have Adverse Impacts on the Environment, Natural Resources, Public Health and Indigenous People, September 2002-October 2004, Section One, BTC Oil Pipeline”.
8. A trip report prepared by USAID in October of 2003, regarding environmental and social impacts related to the BTC pipeline.

Again, OPIC’s FOIA response stated that it has no such records.⁴⁷ This is significant because a) OPIC grew out of USAID and presumably should work in cooperation and, more importantly, b) USAID’s due diligence and monitoring work on the BTC project is

⁴⁴ Letter from Dr. Peter Watson, OPIC President, to Doug Norlen, Pacific Environment, August 6, 2004.

⁴⁵ Op. Cit. #1

⁴⁶ Op. Cit. #6

⁴⁷ Op. Cit. #6

conducted pursuant to the US Government's oversight of Multilateral Development Banks, including the International Finance Corporation and the European Bank for Reconstruction and Development. Both of these banks are amongst the lender group with which President Watson claimed the agency was working.

It seems likely that in its due diligence and monitoring OPIC worked very little if at all with other branches of the US Government and other lenders including US Export-Import Bank, International Finance Corporation, and International Finance Corporation. Informal conversations with those other lenders support this contention. This, together with the fact that BTC has not provided any annual SMQ to OPIC, strengthens the prevailing view that OPIC is not doing anything close to proper due diligence and monitoring, whether this means working with other lenders and agencies or ensuring compliance with its own policies and procedures.

Taken together, it appears OPIC is doing very little if anything internally to support what it is saying externally:

Routing of the pipeline was carefully planned, taking into account local and international security, human rights, environmental and social concerns. OPIC is working closely with the borrower, BTC Co. Ltd. and international lenders to ensure the application of best practices in all areas, including public consultation, monitoring and transparency.

"In an environmentally-sensitive way, it contributes importantly to the integration of the Caucasus into the global economy, and will thereby provide significant developmental benefits to the people of Azerbaijan, Georgia and Turkey...."
[OPIC President Peter Watson]⁴⁸

Requested Remedies:

We respectfully ask the Office of Accountability to recommend OPIC cancel its political risk insurance for the BTC project based on these serious findings:

- *Breach of the Common Terms Agreement related to failure to comply with the ESAP requirement to implement a pipeline protective coating;*
- *Breach of the Common Terms Agreement related to failure to comply with the ESAP notification requirements including obligations to report any:*
 - *Material breach of the ESAP;*
 - *Level II ESAP violation;*
 - *Serious incident;*
 - *Material adverse effect on the environment;*
 - *Expectation of material environmental claims;*
 - *Event of Default;*

⁴⁸ OPIC Press Release, February 4, 2004

- *Breaches of the Common Terms Agreement are by extension breaches of the BTC-OPIC Direct Agreement;*
- *Breaches of the BTC-OPIC Direct Agreement are by extension breaches of OPIC's environment policy;*
- *Breaches of the BTC-OPIC Direct Agreement and of OPIC environment policy stemming from the failure to submit annual environmental and development impacts monitoring reports.*

We also request the Office of Accountability issue a findings that OPIC violated the agency's environmental policy as demonstrated by its lack of adequate due diligence and compliance monitoring with respect to the policy and contract breaches demonstrated in this complaint.

Also, we request the Office of Accountability to assess whether the inadequate due diligence and monitoring is limited to the BTC project or is more widespread. We feel a more comprehensive review by the Office of Accountability of overall performance of environmental and developmental due diligence and monitoring is warranted. We also believe OPIC should use the Congressionally-required Transparency Initiative to strengthen its project environmental and developmental impacts monitoring and to publicly disclose all monitoring reports.⁴⁹

Sincerely,

A handwritten signature in blue ink, appearing to read 'Manana Kochladze', with a long horizontal flourish underneath.

Manana Kochladze
CEE Bankwatch Network

CC: Nicholas Hildyard, The Cornerhouse
Doug Norlen, Pacific Environment

⁴⁹ See NGO Evaluation of OPIC Transparency Initiative, January 11, 2006

Annex A

The Sunday Times - Britain

The Sunday Times

February 15, 2004

Insight

BP accused of cover-up in pipeline deal

[This article is subject to a legal complaint]

ONE of Britain's biggest companies has been accused of failing to disclose crucial information to the worth more than £1 billion to finance a key construction project.

BP, the petrochemical giant, is alleged to have been aware of safety design faults that could have jeopardised the funding.

The disclosure — revealed in leaked documents to The Sunday Times — will embarrass BP, which prides itself on its closeness to Tony Blair.

Allegations of suspected corruption, mismanagement and incompetence were all covered up as BP fought a propaganda war against environmental campaigners lobbying for public backing to be withdrawn.

At stake was one of the world's most ambitious pipelines, which is intended to reduce the West's dependence on oil from volatile regimes. BP leads the Baku-Tblisi-Ceyhan (BTC) consortium building the pipeline.

Environmental groups say the pipeline, which runs for 1,000 miles underground from the Azerbaijan capital Baku, through the Caucasus mountains to Ceyhan on Turkey's Mediterranean coast, will cause an ecological catastrophe if it leaks. But the British government has given assurances that the pipeline had undergone "rigorous assessment" and is safe.

It is understood, however, that ministers were unaware of a report by a leading expert hired by BP who discovered "serious flaws" in the pipeline's design, which would make it highly likely to leak.

Derek Mortimore, a world-renowned pipeline consultant, was called in by BP managers in Azerbaijan to assess a key material used to seal the pipe's estimated 50,000 joints: its paint coating.

The paint plays a vital role in protecting the joints from corrosion. Unusually, however, for such a large project, BP had opted for an untried coating from SPC, a Canadian company. Mortimore, a consultant to BP for more than 30 years, was shocked at what he found.

"We are completely out on a limb," his report to BP warned. "Clearly the use of (this paint) is going to lead to a serious problem. (In the event of cracks appearing) the cost for repairs could be astronomical. The potential for claims against (BP) is open-ended.

"I have witnessed many failures in specifications . . . but the situation on the pipeline is unique in my

41 years' experience. There is no question in my own and many other people's minds that the wrong system has been chosen through a seriously flawed selection programme."

His fears were realised in November last year when construction was halted after cracks were discovered in the joint coating before burial. An estimated 15,000 joints have already been buried in Azerbaijan and Georgia. Work was suspended on the pipeline until last week.

The findings had potentially catastrophic implications for the project. Consultants estimate that it could cost £500m to dig up the pipeline and recoat the joints with a new material. This has not been done.

Rival suppliers have also claimed there were irregularities in the way BP awarded the £5m contract to supply the paint. Two other companies that competed for the coating contract have claimed the selection contest was rigged.

The tender was controlled by Trevor Osborne, BP's materials consultant. The Sunday Times has learnt that Osborne's own consulting firm, Deepwater Corrosion Services (DCS), was the UK representative of SPC at the time of the selection process. One of Osborne's DCS directors has since joined the Canadian company. Osborne referred all questions to BP last week.

The oil giant carried out a confidential inquiry into procurement fraud allegations in November 2002, which apparently exonerated SPC and BP staff. The company refuses to publish its findings.

It appears, though, that such concerns failed to surface when BP was negotiating with the British government to secure a £56m export credit guarantee loan to underwrite the project. The credit guarantee was crucial — along with the backing of the World Bank and the European Bank for Reconstruction and Development — in persuading the commercial banks to lend £1.3 billion, the lion's share of the project's total cost.

Under the BP-led consortium's agreement with those putting up the money, it was obliged to disclose any event that could have a "material adverse effect" on the pipeline.

But a spokeswoman for the Export Credits Guarantee Department (ECGD) last night confirmed BP had not informed it of any significant problems. In fact, the ECGD had only been informed of minor welding problems in June 2003, she said.

On December 17 last year Mike O'Brien, the trade minister, told MPs his decision to pledge £56m to the project had been made after a "rigorous assessment of the risks and a thorough review of the environmental, social and human rights impacts".

Today's revelations raise serious questions about how rigorous the government's assessment of the project was. MPs on two Commons committees are now demanding to know whether ministers misled parliament and whether they, in turn, had been misled by BP.

The Conservative MP John Horam, a member of the house environmental audit committee, said the ECGD had failed to monitor the project properly and should consider withdrawing its loan.

"If this is a dangerous project because of the possibility of leakage, ECGD should exercise some leverage on the situation," he said.

Yesterday, BP denied the company had acted improperly. It said the pipeline was being produced to the "highest" industry standards.

“The BTC consortium is confident that its construction techniques and testing regimes ensure that the pipeline will be laid safely and that it will operate safely,” a spokesman said.

“BTC is aware that certain allegations have been made and these allegations have been thoroughly investigated. Full discussions on this have been held with the financial institutions and other interested parties, where appropriate.”

Annex B

The Sunday Times - Business

April 17, 2005

BP 'covered up' pipeline flaw
Michael Gillard and David Connett

BP FACES accusations in court from pipeline contractors that it covered up a safety flaw on a strategic energy project, which if uncorrected could cause an environmental disaster in the Caspian region.

BP is the leading shareholder and operator of the Baku-Tbilisi-Ceyhan (BTC) project .

The oil pipeline runs underground for 1,000 miles from Azerbaijan, through Georgia to the Turkish Mediterranean. It is due to start receiving oil next month from an offshore field, which BP operates in the Caspian Sea.

However, a recent scientific report could seriously delay the £1.8 billion project because it suggests the pipeline will corrode, and is therefore, in effect, uninsurable.

The report follows tests on the pipeline, which Consolidated Contractors International Company (CCIC) commissioned as part of the multi-million-pound claim it is bringing against BP. The British construction giant Amec is also suing the oil company.

The claim centres on who is responsible for delays following the cracking of a vital anti-corrosion coating used to protect 60,000 pipeline joints. The cracks occurred within months of construction starting in August 2003.

BP blames the contractors for poor application of the coating. CCIC and Amec claim BP forced them to use a coating with no track record, despite warnings from its own experts that the pipeline would rapidly corrode.

Unless the claim is settled soon, the case is heading for an international arbitration tribunal in London.

Lord Browne, BP's chief executive, has known about the coating failure since last year when Derek Mortimore, a pipeline consultant sacked from the BTC project for speaking out, alerted him to the financial risks.

"BP is burying thousands of environmental time- bombs," Mortimore told The

Sunday Times. “This is engineering of the madhouse.”

A BP spokesman said: “The pipeline construction, operation, inspection and testing procedures are carried out rigorously to the highest industry standards.

“We are happy with the pipeline coating and as far as we are concerned (its) integrity is not in question.”

<http://www.timesonline.co.uk/article/0,,2095-1572205,00.html>

Annex C

Cracks revealed in BTC oil pipeline

By Andrea R. Mihailescu

UPI Energy Correspondent

Published September 21, 2005

WASHINGTON -- One of the most expensive pipeline systems in the world, the \$3.6 billion Baku-Tbilisi-Ceyhan oil pipeline, will fill its first tanker in less than two months and the pipeline is already showing cracks, but Georgian officials assert they pose no ecological threat.

"BP does have the problem of coating the surface of the pipeline," said Zaal Lomsadze, Georgian deputy minister for natural resources and environmental protection. "Unfortunately, we found this out a little later, although not from BP."

Experts have been hired to assess the cracks.

"The Georgian authorities have employed international experts who are acting as environmental protection and technical advisors and who are monitoring the oil pipeline construction process," he added.

International experts hired by the Consolidated Contractors International Co., the contractor involved in the engineering and construction of the project, revealed the Baku-Tbilisi Ceyhan oil pipeline has cracks that have appeared on the welded edges of the pipes on the Georgian and Azeri sections of the pipeline, which might cause oil to leak from the pipes.

"We found out precisely from them that the company did make some mistakes in the process of welding the pipes together," Lomsadze added. "The existence of the problem is confirmed ... and it does not pose any threat."

BP, the lead project operator, maintains the highest quality products were used to construct the pipeline.

"We are not interested in any way in putting the pipeline under any threat," Rusudan Medzmariashvili, head of British Petroleum's Public Affairs Office in Tbilisi, was quoted by local media. "BP used only the highest-standard technologies."

The BP official said the cracks will not cause leaks.

"Our experts explained to us that the number and size of the cracks is such that it cannot cause leaks," Medzmariashvili added.

Other firms involved in the project would have known about the cracks.

"Besides, apart from the experts whom we hired, both domestic and foreign experts monitored the oil pipeline construction process," he said. "Countless groups are working, international financial institutions are also involved that invested quite significant sums in this project The oil pipeline has been built according to international standards and is absolutely safe."

The report produced showed cracks appearing in 26 percent of the sections of the Georgian section of the pipeline.

Rod Hensman, BP's senior project engineer, said in July 2002, territory in Georgia and Azerbaijan was being used as a "testing ground for new materials." He added: "We should not be a testing ground for new materials."

BP and its contractor are still assessing who should be held responsible for the delays in the construction process that were caused by the appearance of the cracks.

The Georgian government and BP plan to hold a ceremony on Oct. 12 to celebrate the completion of the Georgian section of the oil pipeline.

Construction for the remaining Georgian section of the pipeline is scheduled for Oct. 12 but BP may not be able to repair the mistakes by then, according to Azeri media reports.

On Nov. 15, the first tanker will receive its oil from the Azeri-Chirag-Guneshli deposits at the seaport town of Ceyhan in Turkey.

The contractor expressed an interest to initiate a legal action against BP.
<http://www.wpherald.com/storyview.php?StoryID=20050921-041047-5793r>