


OVERSEAS PRIVATE INVESTMENT CORPORATION
WASHINGTON, D.C. 20527, USA



OFFICE OF THE
PRESIDENT

Memorandum

To: Jean Aden, Ph.D.
Director, Office of Accountability

From: Robert Mosbacher, Jr.
President & CEO 

Date: September 19, 2007

Subject: Office of Accountability Compliance Review of OPIC's
Environmental Due Diligence and Monitoring of the Baku-Tiblisi-
Ceyhan Oil Pipeline Project (BTC Project) – Update on Agency
Response

This memorandum sets forth further action by OPIC Management with regard to specific recommendations made by the Office of Accountability (OA) in its Compliance Review of the BTC project issued in January 2007. This response follows additional careful review of the OA recommendations and supplements the previous Management reports, including the February 7, 2007 Interim Response of OPIC Management to the OA report (Attachment #1), and the March 23, 2007 OPIC Draft Response to OA Recommendations (Attachment #2).

OPIC Management remains committed to the safe and responsible operation of the BTC project and the OPIC response will include effective oversight and appropriate monitoring of the project throughout the life of the OPIC political risk insurance contract.

The following are updates to specific recommendation contained in the OA Review:

1. OA Recommendation: OPIC should give specific attention to implementation of additional monitoring for field joint coating cracks or leakage, as recommended by the Independent Engineer and required by the BTC Environmental and Social Action Plan (ESAP).

Additional OPIC Action:

Section 5.2 of the ESAP states “Article IV of the Inter-Governmental Agreement requires that the environmental and safety standards for the construction, operation, repair, replacement, capacity expansion, or extension and maintenance of the project facilities

will comply with (i) international standards and best practices within the petroleum pipeline industry, which shall in no event be less stringent than those generally applied to the member states of the European Union.”

In Section 6.4 of the Final BTC Independent Engineering Assignment Report (Report), Parsons E&C had expressed a concern regarding BTC Co.'s ability to effectively repair coating damage and field joints in a manner that would meet the project's 40-year design life requirement. Parsons had recommended in the Report that the coating conditions through, “high groundwater right-of-way areas be monitored and inspected at more frequent intervals than normal and budgets developed to reflect the need to repair/replace the pipeline coating in these sections in later years as indicated by the monitoring and inspection program.”

OPIC has reviewed material provided by BTC Co., which summarizes BTC pipeline operations, inspection and integrity activity plans. OPIC subsequently requested that Parsons E&C review the material and comment on the adequacy of the monitoring and inspection plans in light of their original recommendations and best practices within the petroleum pipeline industry.

Based on Parsons' analysis, OPIC has requested that BTC Co., amend its inspection and monitoring plan to include the following actions:

- 1) BTC should commit to monitoring cathodic protection (CP) posts at six month to one-year intervals.
- 2) A second Intelligent Pigging survey should be performed three years after the baseline survey to assess the extent of corrosion. If no significant corrosion associated with the metal loss is detected, the Intelligent Pigging frequency may be extended to five years.
- 3) Leak detection using acoustic pigs (to assure that the leak detection system is working) should be conducted every year instead of a “point-in-time” as indicated in the initial plan.

In addition, OPIC has notified BTC Co., requesting that the inspection and monitoring plan be amended to include these recommendations.

2. OA Recommendation: OPIC should give particular attention to ensuring that the required summary of environmental monitoring data and periodic validations of monitoring methodology are included in monitoring reports.

Additional OPIC Action:

Under Section 5.3 of the BTC Environmental and Social Action Plan (ESAP), BTC Co., agreed to comply with certain policies and guidelines set out in OPIC's Environmental Handbook (1999). In particular, BTC Co., agreed to conduct at least one independent audit within the first three years of operation, which will, among other things, validate the methodology used for the BTC projects' own environmental and social reporting.

In discussions with OPIC management, BTC Co., acknowledged that under the terms of the ESAP, one of the tasks that the Independent Environmental Consultant (IEC), D'Appolonia, should undertake during the final completion audit was a validation of BTC's reporting methodology. While BTC could not specifically instruct D'Appolonia in the exact manner D'Appolonia should carry out its audit, as it is the consultant of and reports to the BTC lenders, BTC Co., did convey to BNP Paribas and Societe General, in their capacity as Technical and Facility Agent for the project, that the issue was important. OPIC independently made the same point to the Technical and Facility Agent. D'Appolonia has since confirmed that they have reviewed monitoring data and assessed the data in accordance with commitments made in the ESAP and that their findings will be reported in their draft report upon completion of the audit.

Attachments - 2:

1. Interim Response of OPIC Management to the OA Report - February 7, 2007
2. OPIC Draft Response to OA Recommendations - March 23, 2007

Interim OPIC Management Response

February 7, 2007

Office of Accountability Compliance Review of OPIC's Environmental Due Diligence and Monitoring of the Baku-Tbilisi-Ceyhan Oil Pipeline Project

The Overseas Private Investment Corporation (OPIC) management welcomes the Office of Accountability Compliance Review Report (OA Report) of OPIC's environmental due diligence and monitoring of the Baku-Tbilisi-Ceyhan Oil Pipeline Project (BTC Project).

OPIC is encouraged that the findings of the OA Report found that OPIC followed its environmental due diligence process.

The following are general comments on the OA findings. OPIC will carefully review the recommendations in the OA Report, and will provide full consideration to the recommendations and other comments, reporting promptly on progress within 30 days.

Findings:

OA Finding: OPIC did comply with the seven steps in OPIC's due diligence process as stated in OPIC's environmental Handbook.

OPIC Management Response: OPIC concurs.

OA Finding: OPIC did collaborate with other lenders and insurers of the Project regarding assessment and mitigation of significant environmental issues.

OPIC Management Response: OPIC concurs.

OA Finding: As pipeline construction commenced during due diligence, OPIC did not access all material construction monitoring data.

OPIC Management Response: With the wide variety of sectors, countries and types of projects for which U.S. investors seek OPIC support, OPIC relies on specialized and industry recognized technical expertise and independent environmental consultants in the review of information on proposed projects to supplement the expertise of OPIC staff. To a reasonable and appropriate degree, OPIC defers to such experts as to the significance of construction issues, specifically as to when construction issues have a significant bearing on the outcome of OPIC's own environmental analysis.

OPIC works with other multilateral and bilateral organizations to achieve the highest level of environmental protection and necessary safeguards. In the context of BTC, the project has several different private and public sector sponsors, international lenders, investors and insurers whose interests in proper environmental monitoring are directly aligned with OPIC's interests. As a general matter, with regard to projects such as BTC, OPIC agrees that a review of all relevant construction reports by qualified experts is essential prior to the provision of financing or political risk insurance.

OA Finding: OPIC received two kinds of monitoring reports after close.

OPIC Management Response: OPIC concurs.

OA Finding: OPIC did not fully meet its requirements regarding third party monitoring in two instances.

OPIC did not enforce its requirements, as stated in the *Environmental Handbook* and *Environmental and Social Action Plan*, that the Project's annual *Environmental and Social Annual Report* must provide a summary of the environmental data; and

The Independent Environmental Consultant's reports to date have not included a section on the validation of self-monitoring methodology. The IEC should validate the methodology in at least one of its reports during the three-year period within which the *Environmental Handbook* calls for an independent third-party audit. OPIC has not enforced its requirement that these reports validate the clients self-monitoring methodology.

OPIC Management Response: OPIC disputes the finding that the agency did not enforce its requirements as stated in OPIC's *Environmental Handbook* and the Project's *Environmental and Social Action Plan (ESAP)*. OPIC notes that the ESAP for the BTC project specifies the content of environmental reports. During the construction phase, environmental reports are due quarterly subject to requirements in Annex B of the ESAP. Post-construction environmental reports are due annually, subject to the requirements of Annex C of the ESAP.

For the purposes of project compliance with OPIC requirements, OPIC treated the fourth quarter report from BTC in 2004 as an "annual" report. This document, referenced on page 13 of the OA report is subject to the requirements found in Annex B of the ESAP. Annex B does not require reporting on emissions and discharges.

Annex C to the ESAP *does* require a summary of air emissions and environmental discharges. Annual reports issued after 2004, post construction, did report on emissions and discharges.

OPIC thus maintains that it did meet its requirements.

With respect to reporting on the validation of self-monitoring methodology, the Independent Environmental Consultant was asked to pre-validate all monitoring methodology to be employed by the BTC Project. The Independent Environmental Consultant did so during pre-commitment reviews. Although this validation was conveyed to OPIC, OPIC acknowledges that the information was not explicitly reported in audit reports issued post-commitment.

OA Finding: To OA's knowledge OPIC has not defined when the three-year client audit requirement commences.

OPIC Management Response: Determining the precise timing of an audit requires some flexibility and tailoring to the project lifecycle. For its 1999 Environmental Handbook, OPIC chose the three-year milestone based on OPIC's operational experience in 1998 that revealed most construction was completed within three years following financial close. While OPIC does customize the most appropriate audit schedule for a particular project on a case by case basis, OPIC is aware of the necessity to revise the OPIC Environmental Handbook to reflect current, international best practice regarding audit requirements.

Memorandum

To: Robert Mosbacher, Jr. P&CEO

From: Christine Emery, VP-OIP

Subject: Draft OPIC Recommendations Concerning the Office of Accountability's (OA) Conclusions Set Forth in the OA Report on the BTC Pipeline Project, January 2007.

Date: March 23, 2007

At your direction I convened an inter-departmental working group to assess the recommendations contained in the January 2007 compliance review prepared by the OPIC Office of Accountability (OA). The report detailed OPIC compliance with its environmental procedures regarding the BTC pipeline project. The working group makes the following assessments for your consideration.

OA Recommendation: Where project construction commences during the due diligence process, OPIC should make a regular practice of requesting and reviewing all available construction monitoring data, not only data labeled "environmental".

OPIC Response: OPIC concurs.

As a practical matter, consistent with the agency's legal obligations, OPIC will continue to access reports, including environmental and construction reports, in order to provide comprehensive vetting for environmentally sensitive projects. This vetting may include review by qualified, independent engineers retained in the project.

OA Recommendation: OPIC renew its focus on environmental monitoring of the Project in the medium and long term.

OPIC Response: OPIC concurs.

Environmental monitoring is a vital component of the project lifecycle in OPIC-supported projects. OPIC will continue to fulfill its statutory and contractual obligations in the BTC project. As necessary, the agency will continue to evaluate process improvements in the environmental program to assure the quality and credibility of OPIC environmental monitoring.

OA Recommendation: OPIC give specific attention to implementation of the additional monitoring for field joint coating cracks or leakage, as recommended by Independent Engineer and required under the Operations ESAP.

OPIC Response: OPIC has determined that implementation of existing agreements with regard to environmental monitoring is necessary and constructive, both with regard to groundwater monitoring and intelligent pigging.

OPIC notes the language of the Independent Engineer's Final Report in September 2003, referenced in the OA Report:

"If the BTC project uses the 3 layer coating system, Parsons E&C would recommend that the coating conditions through 'high groundwater' right-of-way areas be monitored and inspected at more frequent intervals than normal and budgets developed to reflect the need to repair/replace the pipeline coating in these sections in later years as indicated in the monitoring and inspection program [emphasis added]."

The April 2005 ESAP Operations Report noted:

"BTC Co., has conducted, or caused to be conducted, ground water monitoring during the construction phase in order to establish the baseline contamination status of water in the aquifers. The monitoring was conducted at existing wells, and also at wells drilled specifically for the BTC Project's groundwater monitoring programme."

Beyond the activities undertaken by the BTC, Co., in fulfilling the recommendations of the Independent Engineer, the government of Georgia has mandated environmental conditions in excess of the Independent Engineer's report and the ESAP Operations report. This includes construction of associated facilities in the Kodiana Section of the pipeline and the provision of secondary containment at six locations in the Upper Borjomula catchment to arrest the (potential) flow of oil in watercourses in the event of a pipeline rupture. The oil spill response plan also requires an emergency drain down facility in the Kodiana section that could be used to receive pipeline inventory and maintain it in the (unlikely) event of a breach.

OPIC also supports the use of intelligent pigging to identify anomalies that may impact pipeline integrity.

OA Recommendation: OPIC give particular attention to ensuring that the required summary of environmental monitoring data and periodic validations of monitoring methodology are included in monitoring reports.

OPIC Response: OPIC seeks to provide a clarification on this recommendation.

OPIC reviews and validates all monitoring methodology for all its projects. OPIC will repeat review and validation of the methodology in the event that results fail to provide an accurate view of the project. Moreover, all monitoring reports contain a summary of environmental monitoring data.

OPIC has determined that previously validated environmental methodology need not be included in each monitoring report, provided that the methodology is free of error and is readily available to the analyst during the review.

OA Recommendation: OPIC clarify when the three-year independent third party audit period commences.

OPIC Response: OPIC seeks to provide a clarification.

The independent third party audit is an important component of OPIC's environmental monitoring program, but it represents only one facet of OPIC's monitoring activities. As illustrated in the OPIC Program Handbook, OPIC *endeavors* to audit projects within three years. The third party audit should be conducted when there is the greatest probability of obtaining information on how effective a project is in managing risks. Usually that occurs within the first 3 years. However, when OPIC is most concerned with management during operations, and operations are delayed due to a longer construction period, the audit may be conducted in the 4th or 5th year.

The third party audit is but one tool that OPIC utilizes in monitoring projects. OPIC staff determine when OPIC can acquire the greatest amount of information on a project, and can best determine the environmental impact of said project. OPIC staff or consultants also endeavor to visit each site – usually within the first 3 years, and will select the most appropriate season to visit the project.