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For background only

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June 13, 2000

VIA COURIER AND FACSIMILE

His Excellency Bulent Ecevit
Prime Minister
The Republic of Turkey
Ankara, Turkey

Dear Prime Minister Ecevit:

This letter is submitted on behalf of the American companies listed below, many of which have invested millions of dollars in the development of projects essential to meet Turkey's energy requirements. The purpose of this letter is to request that a reasonable transition be implemented by which the Turkish Undersecretariat of the Treasury makes financial guarantees available for eligible energy-related projects. Recent communications from the Turkish Government and World Bank indicate that such guarantees now may be withheld even though several energy projects, after years of preparation and negotiations, are in advanced stages of development.

In a March 10, 2000 letter to the World Bank, Minister of State for the Economy, Mr. Recep Onal, observed that reforms and the consequent introduction of competition in the Turkish energy sector "takes time and the transition period must be properly managed." Of course, in any shift from state controls to market driven policies, transition is an important topic, worthy of close attention. Unfortunately, it seems that proper management of the transition in the energy sector may have fallen prey to a formalistic effort by the Bank to eradicate immediately Treasury's contingent liabilities. The Government appears to have accepted this precipitous approach. As a result of a Bank-sponsored "Public Expenditure and Institutional Review," several reforms are expected to be incorporated in the 2001 Government budget. Minister Oral reported in his letter that, among other things, "limits on the issuance of new guarantees" would be part of the immediate budgetary reform package. After several consultations by representatives of our companies with officials at Treasury, the Ministry of Energy and Natural Resources and the Bank, it appears that for energy projects being developed under the Build-Operate-Transfer (BOT) or Transfer of Operating Rights (TOR) models, the Government may decide to withhold Treasury guarantees for such projects unless a project-specific agreement is in place that provides for such guarantee.

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The ramifications of such a policy, if it becomes effective immediately, would be disastrous for Turkey. Out of over 20 BOT and TOR energy projects currently under development, no more than one or two have signed a guarantee agreement. However, the vast majority of the companies developing these projects, our own included, were led to believe that the BOT and TOR projects would be eligible for such guarantees. The lack of a guarantee would require a substantial recalculation of financial models upon which responsible and established companies rely when determining the financeability and economic viability of a given project. In the context of BOT and TOR energy projects, which must be financed on the basis of the value of the project revenue and its assets ("project" financing), the lack of a government guarantee for one or more of the transactions that make up the project will render the project ineligible for financing from most western financial sources. This condition is not unique to Turkey. It is a traditional consideration in the qualification and quantification of risk that all established western financial institutions assess before agreeing to support a project in an emerging market. Thus, in the absence of full implementation of energy sector reforms, commercial financing will not be available without a Treasury guarantee.

The problem created by the proposed restraints on guarantees is the same fundamental problem we had hoped would be put to rest by the adoption of international arbitration for concession and privatization contracts in Turkey. There, we worked together to remove legal impediments to the availability of financing for Turkish energy projects. The irony is that only after the ink dried on the enactment of the constitutional amendments and Law Number 4501 did this new initiative to withhold Treasury guarantees surface under the mandate of the World Bank Economic Reform Loan. Now, the restricted guarantee policy, if implemented without a rational transition process, will make the international arbitration achievement a Pyrrhic victory. The international investors will be forced to withdraw for lack of financing and the critical promotion of investment and private sector participation in the Turkish energy sector will be stillborn. Energy shortages will be more than predicted. Millions of dollars of project development costs will be jeopardized and litigation by companies led to believe that guarantees would be available could embroil the Government and possibly the Bank in an embarrassing round of confrontations in the courts.

All of our companies endorse and support Turkish Government efforts to achieve budgetary reforms. We agree with the need for the Government to stabilize the public debt as a share of GNP. And our companies agree that guarantees should be phased out once the reform and demonopolization program for the energy sector is fully implemented. We do take issue, however, with the lack of a reasonable transition during the reform period. That transition should take into account the realities of financing the projects that must bridge the gap between

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current conditions and the demonopolized market that the architects of Turkey's energy future foresee.

History is a good teacher, and it is particularly relevant to our point. In virtually every country in which deregulation of the energy sector has been legislated (including the United States), it has taken far longer than expected for the process to move beyond the legislative act. Turkey is not likely to perform differently. A hiatus on privately developed power production, fuel supply or energy distribution projects until the new regulatory regime is operational would be fatal for Turkey's economy. And the lack of guarantees would cause such a hiatus because financing from private institutions would be sparse if not completely unavailable.

For the foregoing reasons, our companies believe that a transition formula for assessing the availability of Treasury guarantees for projects currently under development best serves existing realities and future objectives in the Turkish energy sector. It also minimizes the possibility of a real crisis in power production and delivery if the new regime falters or is delayed for any reason. The formula proposed below is based on four fundamental factors:

- (1) Treasury guarantees should continue to be offered for energy projects but with certain transitional qualifications;
- (2) financing for privately developed and operated energy projects in Turkey at this time needs Treasury guarantees;
- (3) the nature and extent of the guarantees can be negotiated to meet Turkish Treasury and commercial lenders' requirements;
- (4) Turkey's need for energy and private foreign investment and financing require that the Turkish Government demonstrates good faith and predictability in the implementation of its fiscal and privatization policies.

The formula that we propose for determining eligibility of a project for a Treasury guarantee would have Treasury consider the following as indicators of a well-developed and viable project (subject to whether the project is for power production or local distribution):

- A. a signed Implementation Contract or Concession Agreement;
- B. an Energy Sales Agreement under negotiation or signed;
- C. a Fuel Supply Agreement under negotiation or signed;
- D. a completed Environmental Impact Assessment Report;

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- E. a Public Benefit Interest Resolution from the Ministry of Energy and Natural Resources;
- F. a posted and current performance bond;
- G. a formal letter of interest from an internationally recognized financial institution.

If a project can substantially fulfill these criteria, we believe it is in the best position to help Turkey bridge the energy gap between today's problems and the promise of a new, market-oriented system for the future. The private sector is doing its best, and has devoted substantial resources, to participate in the privatization of the energy sector in Turkey. It is not only fair, but good policy for the Turkish Government to continue support of that transition if it hopes to avoid major energy shortages.

We have submitted the observations and proposals contained in this letter because our companies are friends of Turkey. When a bilateral issue arises in Washington, we are among the first to commit resources that will resolve the issue in a manner that promotes our bilateral relationship. We are also investors in energy sectors around the world. We hope that you and your government may find our experience and point of view useful as you finalize and implement the transition to a deregulated energy market.

We would welcome the opportunity to meet with you in person to discuss this matter more fully. If you or any official from your government would like to discuss the content of this letter with a representative of any of our companies, please advise our Ambassador, Mark Parris, and we will respond in a timely and forthright manner.

Respectfully submitted,

Charles R. Johnston, Jr. On behalf of
Forestar Wheeler Corp.
GE Power Systems
Howard Energy Company
North American Coal Company
PSEG Global Inc.

cc: The Honorable Mark Parris
Ambassador
U.S. Embassy-Ankara