committed to the project and would continue to be so. That is what I mean by the
criticality of political continuity and confidence.

The largest and most prominent components in Mr. Ozal's privatization strategy
are three base-load electric power plants to be located at coastal sites in Turkey and
fueled with imported coal. Each one will cost in excess of $1 million and each is being
developed by a multinational consortium of large contractors and equipment and coal
suppliers. The government is encouraging the development of all three projects ac­
tively because its electricity consumption has been growing at 13 percent per annum
for years, and it expects to run out of generating capacity in the early 1990s. Its state­
owned utility is inefficient and the financing demands on the government exceed its
ability to raise the money necessary to develop the necessary additional capacity itself.

The Government of Turkey's objectives for attracting private investment into the
public sector are threefold. First, in order to ensure that adequate power will be avail­
able to meet projected demand, it wants to create reliable generating capacity at the
lowest obtainable capital cost and in the shortest possible time at sites that are as near
as possible to the demand load centers. Second, it wants to leverage the scarce capital
resources that are available to it within the country and to minimize reliance upon
Turkey's sovereign borrowing capacity in the financing of the new power generating
units. Finally, it wants to realize high utilization of this new capacity at the lowest
sustainable operating costs.

The private sector participants are willing to take a chance with these projects be­
cause their traditional markets have been depressed, making it difficult for them to
remain in the power generation business. Many of the coal suppliers invested billions
of dollars to create new production capacity during the late 1970s and early 1980s
when their competition, oil, was selling for $50 per barrel. Privatization thus offers
both the buyers and the sellers a unique opportunity to marry their interests.

I should mention that, under Mr. Ozal's leadership, a law was passed in late 1984 to
provide a clear legal basis for encouraging private investment in the public sector.
That law gives the Turkish Cabinet authority to assign to private companies estab­
lished for these purposes, for periods of up to 99 years, the right to construct and
operate power-generating facilities for the purpose of selling electricity to the Turkish
electric authority. The law further provides that the private power company is to
propose a financing structure for approval by the government and based on the princi­
ple of full recovery of cost and reasonable dividend payment to the company's share­
holders. Thus, a clear legal basis fully consistent with the government’s objective for
the sector supports the establishment and structuring of privately funded and operated
companies in the Turkish power production sector.

REMARKS BY MS. FRANCIS

Mr. Stevenson's comments on the changes in the Turkish law governing foreign
investment provide a perfect example of how integrated and interdisciplinary this type
of project is. Because he and I have been working intensively for the last six months
on a project in Turkey, we are now at the point where he, a finance person, explains
the legal aspects of these projects and I, a lawyer, am here to tell you about their
commercial structuring.

I would like to emphasize some of the points Mr. Stevenson made as they particu­
larly impact the structure of these transactions. The cost and complexity of these
projects is enormous. As he mentioned, there is a tremendously long lead time, during
which millions of dollars of development costs must be paid, before agreements can be
formalized and construction commenced. We have found that the burdens these
projects entail, in terms of both time and money, are almost always significantly greater than the parties initially thought they would accept and, in fact, may prove to be unacceptable in the end. Although denationalization and contracting out are becoming more common and several Greenfields projects (projects built from the ground up by private investors) are in the development stage, international privatization of a major Greenfields project has yet to occur. Whether or not these projects are going to be feasible in current world financial markets is certainly a fascinating question.

The legal, financial and commercial relationships inherent in these projects are extraordinarily complex. Risk allocation has proved to be a particularly troublesome issue. Lawyers love complex structures, but these projects can become a lawyer's nightmare as the business people work out their relationships. If the business relationships are not thought out carefully during the structuring stage, which may last several years, all the agreements and documentation that follow only will leave the project further away from where it should have been, and it is very difficult to get back up that slippery slope.

Finally, as Mr. Stevenson mentioned, the importance of government support cannot be underestimated. This support can be difficult to maintain in that host governments often have unrealistic expectations of what can be accomplished by privatizing public development projects. Governments, including Turkey and even the United Kingdom, tend to view privatization as a way to reduce their burdens, to deliver difficult, risky and unprofitable businesses to the private sector and ignore them until they are running smoothly and profitably. It is not uncommon for the government to commence privatization negotiations with the expectation that all the cost and risk that could affect the project will rest entirely with the private sponsors until the date 10 to 20 years later when the government comes back to take over the facility.

Not surprisingly, the business and financial communities do not share that view as the proper characterization of their relationship with the host government. If a project is completed without extraordinary cost overruns and is operated efficiently, the project company will make a profit. These projects, however, generally are not big moneymakers; their public purposes, the economic health of the host nation and in some countries, Turkey for example, specific legal restrictions limit their rate of return. These relatively slim and limited profit margins would be unreasonable commercially if the project company faced responsibility for force majeure risk as well as the more predictable construction and operational risks. Consequently, equity investors and lenders have insisted that the host government bear the risk of force majeure losses.

There has been an evolutionary process during which participating governments have come to accept some of the private sector's argument that these are three-party ventures and that the government, as the ultimate beneficiary and frequently the ultimate owner of these projects, should bear a significant portion of the risk in their development.

Because of their public purposes and the financial and commercial participation of both private and government sectors, these projects are really quasi-governmental ventures and, consequently, do not fit neatly within the legal systems and commercial codes of their host countries. For many of the issues they present there simply are no precedents. In two projects in which Bechtel has been involved recently, we spent a lot of time talking about the nature of and legal basis for guarantees that the government already had agreed to give. It was as difficult to implement that agreement as it had been to reach it. The other day I attended a panel on arms control verification where Tom Gray, the General Counsel of the Arms Control Agency, admitted that
getting the INF Treaty signed had been the easy part of their work; the hard part was establishing the mechanisms to implement the treaty.

I’d like to turn now to the structuring of privatized projects. At the heart of the deal is what we call the project company, the developer of the project. The size of these projects makes it virtually impossible for them to be handled by a single investor. The project company typically is a joint venture among a mix of investors including contractors, engineers, equipment and material suppliers and, when possible, international equity investors like the International Finance Corporation (IFC) or the Overseas Private Investment Corporation (OPIC). In the case of energy projects, it is often useful for financial and operational reasons to have among the investors suppliers of the fuel to be used by the project. Unlike equipment and material suppliers, engineers and contractors generally are not capital rich. The concept of a service company taking an equity position is somewhat unusual; normally the profit margin on services is relatively low, and we are not profit suppliers. In addition, we have neither inventions nor large natural resources, which may fluctuate in value but often command very rich market prices. We can supply planning, operational and other managerial skills, however, which are critical to the success of privatization projects. It is generally desirable to have a broad-based group for the equity consortium.

Whether it was planned in the beginning or not, the project company inevitably will include a government participant. From the private investors' point of view having a government “partner” is very attractive because it pulls the government further into the project, adding another level of commitment to the success of the project. From the government’s point of view it may or may not be attractive to maintain an equity interest in the project as it is being developed. Participation in the equity group increases the government’s exposure to and involvement in a project it may have thought it was palming off to the private sector. On the other hand, it may feel that such participation will give it more control in the organization of the project. Majority ownership of the project company should always be private.

Establishment of this first link of commitment between private sponsors and the government, in our experience, has been interesting and very difficult. One thing to keep in mind is that whether or not the government participates in the project company, the project company must strike a deal with the government in its capacity as host and eventual purchaser of the project. The government equity participant plays two roles, complicating both the internal working of the project company and its relationship with the government as host.

With the formation of the project company and the introduction of lenders, the first major laying off of risk and sharing of risk occurs. Although these projects are not pure project financings in that most lenders require them to have some form of government guarantee of the project debt, the lead banks do look very carefully at a lot of traditional project financing factors in deciding whether or not a particular project is one they will be able to sell in syndication.

A second level of risk allocation occurs with the introduction of insurance. It should be kept in mind, however, that the availability of insurance for projects of this type is limited and the amount of insurance needed to offer any true security to projects of this magnitude is tremendous. A billion-dollar business interruption insurance policy, for example, would cover only a few days of operation at a major power plant.

Another key component of the project structure is the builder of the plant. The construction company may be the project company itself, one or a consortium of several of the project company investors or an outside company. Not all the investors...
within a project company may be interested in participating in the risks attendant to its construction. International institutions such as OPIC, for example, may insist that the investors in the project company with expertise in construction should undertake responsibility for completion of the project separately. In our project in Turkey a smaller group of those equity investors who are technical experts or suppliers of construction materials formed a separate joint venture to design and build the project.

The final structural component is the operator of the completed project. One of the reasons governments are interested in BOT projects is the commitment of the private developers to operate the facility for a certain period of time after its completion. This long-term commitment ensures that the project will be built to last and, because the developer's profit comes from the operating income produced by the project, that it will be in good working order and will be operating profitably and efficiently when it is turned over to the government. In the case of the power facilities planned for Turkey, for example, the combined benefits of new technology and the efficiency differential between publicly and privately operated facilities should result in energy production that is significantly more reliable and efficient than the Turkish Government could expect from any of its own plants. I think the availability factor for the Turkish national power plants is about 40 percent to 50 percent. By comparison, in the United States plant availability runs at 70 percent or above and in the Federal Republic of Germany it is at 80 percent or above.

Like construction, plant operation poses special risks, risks that portfolio investors rarely are interested in sharing. Consequently, you often will find that those project company participants with expertise in the operation of the type of facility being developed will form a separate company, joint venture or consortium of some sort, peeling off another layer of risk from the project company. In the case of our Turkish power project a major U.S. utility is both a project company partner and an operating company partner.

To summarize, the goal in structuring these projects is to provide a grid or spider pattern of expertise and risk allocation that can withstand challenges from all sides. You can rest assured that, even with the best planning in the world, you will be faced with unexpected delays, costs, losses and complications. The project structure should permit them to be distributed as widely as possible. If the private and public participants have not assessed and accepted realistically the burdens each of them must assume in order for the project to have this strength and resiliency, it is unlikely that the project will go to closing. The risks are simply too great without good partnering on all sides.

Remarks by R. Adams Perry III*

Earlier this week the Financial Times ran an article written by David Barchard directly relevant to the subject of privatization of public development projects. The title of Mr. Barchard's article was "When Boot Can Provide the Spur." This two-dimensional image does not necessarily elicit a humorous response, but it does accurately reflect the motivation for and objectives of those governments that are promoting the BOOT.

BOOT is an acronym standing for the "build, own, operate and transfer" financing scheme. For simplicity, BOOT is increasingly being shortened to BOT, but the latter acronym is referring to the same limited-recourse financing model for privatization. Under this model, foreign companies are allowed to finance, build and own a project,

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