Summary of the Operation Performance Evaluation Review

Review evaluation of modernisation and upgrading of product pipelines and supporting infrastructure.

January 2007

THE PROJECT

In July 2003, the Bank's Board approved a loan of up to US$ 75 million. The loan had an A/B loan structure and the B loan was for an amount of up to US$ 25 million. The loan was structured in two tranches. The first disbursement of US$ 21 million was made from the A-loan portion of the loan only. Following changes in the scope of a modernisation programme and the expiration of a commitment period, the company decided not to draw down additional funds and the Bank's exposure did not exceed the US$ 21 million already disbursed under the A-Loan. This loan is fully repaid based on a pre-payment by the company in 2005.

PROJECT RATIONALE

The main rationale was to obtain long-term financing for its modernisation and upgrading programme. The company pursues the following main objectives (a) to modernise the existing pipeline network in order to achieve a high level of operations in terms of safety, reliability and efficiency and (b) to remove bottlenecks for the transportation of oil products and increase utilisation of capacity.

ACHIEVEMENT OF OBJECTIVES

Modernisation of the oil product pipeline network: The proceeds of the loan were used to finance urgent parts of the modernisation programme (acquisition of pipes for replacements of river crossings and supporting infrastructure) and improvements in health, safety and environmental standards. This objective has been *Achieved in Part.*

Setting standards for corporate governance and business conduct: The company has hired an auditing firm to convert from RAS to IAS accounting and prepared the first two sets of IAS accounts. The time period of engagement by the Bank was fairly short and it is unlikely that the full intended transition impact could be achieved. This objective was *Achieved in Part.*

Market expansion: The Board Report proposed that improvements and de-bottlenecking of the company's operations would have a positive impact on the refining industry within the country by stimulating upgrades of refineries and allowing oil companies to increase exports of higher value-added products. The OPER Team is of the view that this objective was unrealistic considering the complexities of decision-making in the sector which is largely dominated by state-owned or controlled entities. The low rating of "satisfactory" transition impact potential also signal a similar view. This objective was *Not Achieved*.

Fair tariff-setting mechanism: The Bank had established direct dialogue with the pipeline tariff regulating body. A decree on best practice for setting tariffs was released to allow for repayment of the EBRD loan. However, this dialogue slowed down in 2004 due to the restructuring of the government and the creation of a new agency for tariffs. The OPER Team is of the view that this objective was *Achieved only in Part.*

Whilst most of the objectives were rated as achieved in part, the OPER Team is of the view that the total impact is limited and therefore the fulfilment of project objectives is rated as *Marginal.*

OVERALL ASSESSMENT

Based on a desk review of the operation's performance, EvD assign a performance rating of *Partly Successful*. The overall transition impact is rated *Satisfactory.* The project contributed to improvements of standards for corporate governance. The Bank was able to assist in developing from a loose group of domestic pipelines with accounting, to a consolidated, transparent company, with international accounting principles. The Bank knew from the outset that the company would not be privatised.

Considering that this was a significant first commercial and international financing for the company it is disappointing that both the Banking Team and EvD were not able to develop further follow-up projects. This could, however, also signal that the decision-makers at the company have defined different priorities regarding the most appropriate funding sources.

The operation has contributed to the upgrading of the network and the creation of a dedicated environmental department. Hence, the environmental performance of the project is rated *Good* and the extent of environmental change as *Some.* The Bank's additionality is *Verified in all respects.* It can be assumed that the restructuring of the pipeline companies and the introduction of IAS contributed to a somewhat better financial performance.

The objectives of the Bank in this transaction were very ambitious. Considering the only partial utilisation of the facility and the early prepayment, fulfilment of the project objectives is rated *Marginal.* The Bank's handling is rated *Good* and considers the efforts undertaken regarding environmental aspects and sector framework dialogue. The Bank achieved a *Satisfactory* investment performance.

TRANSITION IMPACT AND BANK'S ADDITIONALITY

Overall transition impact. The OPER Team rates the overall transition impact as *Satisfactory*. The well-known fact that the company would remain fully government owned potentially limited the transition impact from the outset. The *Satisfactory* transition impact potential rating with a *Medium* risk confirms this view. Full marks are given for the attempt to restructure the very important pipeline system within the country. Given the small size of the operation in view of the task at hand, the objectives were set very high and could not be achieved within the context of one single transaction. It appears that a follow up transaction will not materialise easily despite repeated efforts by the Banking Team. This could signal changing views at the government level as to how this sector should be modernised and financed in the future.

Additionality. The Banking Team indicates that at the time of Board Approval, Bank financing was highly additional since no commercial banks were willing to lend to the company even for considerably shorter periods than 5 years. Only subsequent to the Bank's involvement did more commercial banks showed interest in lending. Ultimately, they were able to raise more domestic financing including a rouble bond issue. Additionality is rated as *Verified in all respects.*

BANK HANDLING

The Banking Team's self assessment shows a *Good* rating for Bank handling based on working with a company that had no prior experience with commercial banks. The successful introduction of changes made the company more bankable. The expanded monitoring report (XMR) argues that the project involved a very considerable preparation and appraisal effort, partially due to a considerable lack of experience in dealing with banks and partially due to the high impact of the Bank's financing (conditionality). The Bank's main contact at the company left and it appears that whilst there was some interest in discussing a new transaction with the Bank, it became more difficult to agree on meetings with the Bank including with the OPER Team. This may also signal that other, less restrictive or less conditional funding can be obtained. The OPER Team rates Bank handling as *Good.*

MAIN OPER ISSUES AND LESSONS LEARNED

Structuring of conditionality in loans to a state-owned company may not only need actual management support but also higher government consensus. The structuring of conditionality in a highly visible government-owned company may need to consider the higher level government objectives. Supporting a reform-minded management is desirable but may also be risky in case of management changes, which may lead to a reduction of the effectiveness of the conditionality due to new company policies and objectives.

Consensus with senior government officials may be required for defining reasonable medium-term conditionality for state-owned monopoly companies. The Bank's interventions may require a higher level of support especially to mitigate the negative effect of periodic management changes at a state-owned monopoly company.

Early identification of potential security issues in state-owned companies. State-owned companies may be subject to specific negative pledge conditions imposed by the World Bank or IMF. This requires substantial due diligence and possibly obtaining written clarifications from the relevant IFI so that eventual bottlenecks can be avoided early on.