SUMMARY OF OPERATION EVALUATION

Power sector project

South-eastern Europe

February 2014

EVALUATION DEPARTMENT

European Bank
for Reconstruction and Development

The Evaluation Department (EvD) at the EBRD evaluates the performance of the Bank's completed projects and programmes relative to objectives in order to perform two critical functions: reinforcing institutional accountability for the achievement of results; and, providing objective analysis and relevant findings to inform operational choices and to improve performance over time. EvD reports directly to the Board of Directors, and is independent from the Bank's Management. Whilst EvD considers Management's views in preparing its evaluations, it makes the final decisions about the content of its reports.

This report has been prepared by EvD and is circulated under the authority of the Chief Evaluator. The views expressed herein do not necessarily reflect those of EBRD Management or its Board of Directors. Responsible members of the relevant Operations team were invited to comment on this report prior to internal publication. Any comments received will have been considered and incorporated at the discretion of EvD.

This report was prepared by Tomasz Bartos, Senior Evaluation Manager, of the EBRD Evaluation department.

One Exchange Square
London EC2A 2JN
United Kingdom
Web site: www.ebrd.com

Operation Evaluation Summary

The Board approved a loan to a vertically integrated wholly state-owned electricity utility in south-eastern Europe to finance the rehabilitation of thermal and hydro power plants and the electricity transmission network throughout the country (the "Investment Operation A"). It was designed to improve the reliability of the electricity supply, increase generation capacity, and catalyse sector reforms. Moreover, the loan was accompanied by an extensive technical assistance package designed to spearhead power sector reforms and financed from multiple sources including the EBRD. The EBRD provided technical assistance related to the project's technical appraisal, Project Implementation Unit (PIU) support, tender preparation and financial analysis of the borrower (the "Technical Cooperation Operations").

The objectives of Investment Operation A, both of which were achieved, were to:

– restructure the country's power sector by unbundling power transmission; and,

– create an independent energy regulatory agency.

The loan was novated to allocate the transmission-related component of the loan to a newly-created transmission company – "the Company" (the novation loan is the "Investment Operation B")

Together the Investment Operations A & B and associated Technical Cooperation Operations form "the Project", the subject of this Operation Evaluation.

About two thirds of the part of the Project related to upgrading of the transmission infrastructure was implemented, while the part related to increasing the power generation capacity at three plants went through several changes and ultimately the Bank primarily financed coal storage and ash disposal facilities at one plant and small rehabilitation works at another plant. A third of the loan was cancelled, as some components originally allocated to the Bank were financed by others.

Overall ratings

This Project is rated by the Operation team's self-assessment as *'Successful'* overall. EvD generally agrees with this rating because of the project's strong relevance (addressing high priority investments in a strategic sector), *fully verified* additionality (the EBRD was the only source of financing in the country at the time of approval due to high political risks), and the achievement of the project's broadly defined operational and transition objectives. The Project also brought about substantial positive environmental change at one of the power plants due to the implementation of a new component – an ash disposal system, which was selected for Bank financing after the scope of the project was adjusted. However EvD does have some reservations about the overall rating and notes the following:

– The Project did indeed achieve most of its operational objectives, but only after long delays (three years on average and seven years for the whole project), and mostly due to the financing ultimately provided by other financiers, rather than the Bank. The scope of the Project changed substantially over the period of slow implementation and the Bank had to drop some components and select other new ones to finance. However the EBRD should not be penalised for these adjustments (on the contrary, it helped the efficient utilisation of financing, which became available at a later stage of the Project). Nevertheless, the fact remains that the Bank's investments made a very modest contribution (if any) to the achievement of the Project's original key objective that is to increase capacity at the three power plants.

– Only about two thirds of the originally planned sub-project for upgrading the transmission infrastructure was implemented. Four out of eleven components of this sub-project were not implemented due to public protests and permitting problems. However, over the subsequent years, the Company has invested heavily in asset renewal, financed from its own funds and those provided by other IFIs, which by now in aggregate has substantially improved its operational performance (reducing electricity supply interruptions and technical losses– which were the objectives of the Bank's project).

- The key transition impact objectives of the Project have also been achieved (with the exception of a fully cost-reflective electricity tariff). However it took much longer than originally planned, while the Bank's role in ensuring their achievement was rather modest. The Bank has played a more active role in a policy dialogue in respect of the country's power sector for a number of years, when a dedicated sector specialist was assigned to Resident Office. However by that time most of the project had been implemented, while the Bank was working on several new projects in this sector.

Findings

Evolving nature of large-scale sector reform and reconstruction projects

High profile reconstruction projects in strategic sectors, particularly those designed to encompass major reforms and address damage sustained during conflicts[1], usually attract many bilateral and international financiers, willing to participate but not always ready to agree on the financing of specific components or confirm their participation at the same time. Therefore such projects are likely to evolve over a longer time as new players join the project after it has actually started and may offer more attractive financing conditions for some project components (such as through grants rather than loans).

The Bank needs to remain flexible and ready to adjust to the Company's priorities, while encouraging new project participants to join the others in pushing the sector reform agenda.

Negative long term impacts of signing financing too early.

The timing of Bank loan signings has been in some cases driven by the EBRD's interest in meeting its annual volume targets. In the case of complex public infrastructure projects, the protracted procurement process (often extended even further by complaints from losing bidders), creates huge delays in disbursements and requires the client to pay substantial commitment fees. The aggregation of delays affecting several large public projects in one country draws media attention and may result in very negative publicity and even hostility towards the IFIs which provided the financing. The media in the recipient countries may present lending conditions as exploitative, with commitment fees dubbed as "penalty charges", criticising IFIs for taking advantage of inexperienced public clients.

<u>*Recommendation:*</u> As an IFI with transition mandate, the Bank should pay more attention to the interests of its public clients when timing the signing of the loan agreements. Delaying the signing of such projects until the procurement process has been well prepared and is ready to start would improve public perception of the Bank and bring it long-term benefits, while minimising loan cancellations and disputes regarding commitment fee payments. It is noted, that the Bank has been making progress in addressing this matter since this operation was implemented.

Management comments on this recommendation are included at the end of this summary on page 5.

[1] Please note the potential applicability of this finding to some SEMED countries.

Attribution of transition impact related achievements

Projects supported by many agencies and IFIs present a problem of attribution of achievements stemming from the implementation of various technical assistance programs (discovered during such projects' evaluations). The best practice is that the achievements stemming from any particular TC are attributed to the agency/IFI which implemented it, rather than collectively to all other project participants (unless it can be demonstrated that the others made a substantial contribution to such an achievement). In case of this project, the Bank's prospective role in supporting structural, regulatory and tariff reforms in the sector were not very clearly defined in either the Board document or the Board memo, except for the Bank's participation in annual reviews of the Sector Action Plan. Policy dialogue and other key actions leading to reforms and transition impact were to be supported by TCs provided by other IFIs and donor agencies, rather than the Bank.

Need for claims resolution expertise within the project implementation units of Bank clients

The lack of an experienced claims engineer within the clients' Project Implementation Units has been one of the main reasons for substantial delays in implementing public infrastructure projects financed by the Bank. In the course of contract implementation, contractors tend to make all sorts of justified or unjustified claims to recover part of their costs or increase the contract price. The absence on the client's side of an expert who could judge the merit of such claims relatively quickly, often results in the contractor suspending project implementation and causes long delays.

Table 1: Ratings summary

	EvD ratings
Overall performance (Highly successful, successful, partly successful, unsuccessful)	Successful
Project relevance	
Additionality (Fully verified, largely verified, partly verified, not verified)	Fully verified
Project effectiveness	
Achievement of operation objectives (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	Satisfactory
Company/Project financial performance (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	Good
Project efficiency	
Bank handling (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	Good
Bank investment performance (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	N/A
Project impact and sustainability	
Transition impact (Excellent, good, satisfactory, marginal, unsatisfactory, negative)	Good
Environmental and social performance (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	Good
Extent of environmental and social change (Outstanding, substantial, some, none/negative)	Substantial

Management Comments on Recommendation

Management notes the Operation Evaluation (OE) recommendation, provided as part of the review of the Power Sector Project states:

> "As an IFI with transition mandate, the Bank should pay more attention to the interests of its public clients when timing the signing of the loan agreements. Delaying the signing of such projects until the procurement process has been well prepared and is ready to start would improve public perception of the Bank and bring it long-term benefits, while minimising loan cancellations and disputes regarding commitment fee payments. It is noted, that the Bank has been making progress in addressing this matter since this operation was implemented."

This recommendation raises issues relevant not only to this project in particular but would affect all public sector projects. The timing of signing of public sector projects is driven by the need for compliance with the Bank's sound banking principles in terms of quality of project due diligence (technical, environmental and social, procurement, and legal) and structuring, the EBRD Procurement Rules, as well as requirements for compliance with local rules, regulations and requirements for public sector entities in terms of project negotiations, approvals, and implementation.

EBRD Procurement Policies and Rules

1. It should also be noted that in order for clients to apply the Bank's Procurement Policies and Rules (PPR) on public sector operations the requirements of the national public procurement law must be met. These laws generally provide an exemption from use of national procedures where contracts are financed by an IFI. Obviously, until the loan is actually signed, no such financing is in existence. Therefore only in very rare circumstances it is actually legally possible for a client to sign a contract under EBRD financing prior to signature of the loan agreement. This is especially an issue in sovereign projects such as this which required ratification of the loan agreement by parliament.
2. As the PPRs takes precedence over national procurement rules in procurement and implementation, the EBRD public sector clients are in effect overruling local procurement procedures when they start the procurement process based on the EBRD rules. This means that should the Bank decide not to proceed with a particular project, public sector clients would be required to re-start the procurement process under national procurement rules thus incurring not only considerable time delays but incurring unnecessary costs on both the part of the client and for suppliers.
3. The PPRs, in fact, clearly assume that the signing of the loan agreement with the client should occur prior to completion of the procurement process; in this respect, Section 3.6 of the PPRs specifically states that "the particular procedures and the goods, works and services to which they apply are determined by agreement between the Bank and the client and are specified in the legal documentation".
4. The PPRs set forth a list of undertakings which the clients should comply with to be eligible for the Bank financing. Such undertakings are in turn incorporated in the loan agreement which is entered into by the Bank and the client and are subsequently monitored by the Bank during the entire life of the loan. In particular, Section 3 of Annex 3 clearly requires the Bank to review the procurement procedures, documents, tender evaluation reports, award recommendations and

final contracts to ensure that the tendering process is carried out in accordance with "agreed procedures" (i.e. procedures agreed in the loan agreement).

Project Implementation issues

1. It is a standard practice for the Bank to work with public sector clients well in advance of loan signing and progress, as far as feasible in any given set of circumstances. Where feasible, the procurement process is launched ahead of signing but this is not possible or advisable in every case: e.g. very often the proceeds of the EBRD loan are used to fund consultancy assistance in preparation of tender documentation – in such cases, the loan needs to be signed and effective otherwise the consultant cannot be paid for their services.

2. It is very difficult to have public sector clients commit project preparation, negotiation and procurement resources at a stage where there is no formal engagement and uncertainties in terms of the Bank's commitment to a project. Once a loan financed contract is signed, the supplier may submit its invoice for the advance payment. If the Loan Agreement has not been signed, it will result in a delay in paying this advance payment which will incur penalties to be paid by the client and in the event of severe delays result in a default of the part of the client leading to termination of contract with resultant costs.

3. In other cases, local clients may not be allowed under national law to start the procurement (even if they use our rules) unless they have the entire financing package confirmed (for instance, there may be complementary contracts which are financed solely from local budget which requires local budget approvals contingent upon the signing of the financing package), or the fact that very often the public sector clients have to arrange the loan signings to fit with the available fiscal space in the national budgets and may insist on earlier signing.

Relating specifically to this project

1. At the time of the power project implementation the Bank organised significant TC support to assist the client's Project Implementation Unit ("PIU") in preparation of tender documents and evaluation of bids – in line with the standard practice of assisting the public sector clients in advancing the procurement process prior to signing and providing significant support post signing to effect timely implementation.

2. Experienced consultants worked alongside the PIU to ensure the procurement strategy was appropriate and efficient. The first of the tender packages was advertised on time and the other tender documents were ready, but delays were caused by the need to coordinate and the investments financed by the Loan with investments being financed under EU grant funding.

Conclusion

Management therefore confirms its commitment to the existing practice of advance cooperation and assistance to public sector entities in compliance with the Bank's PP&R. However it cannot endorse the recommendation to delay the signing of public sector transactions until the procurement process is completed, for the reasons outlined above. The timing of the signing of each public sector transaction needs to be an outcome of required approvals (on both sides), project negotiations, technical requirements, and compliance with the EBRD PP&R, as expressed in the agreed project implementation schedule for each transaction. The Bank's systems both for analysing risk and for project implementation, monitoring and management have substantially improved in the years since the contracts under this Project were tendered. We believe that the existing processes and systems now in place ensure that procurement, and project implementation in general, is handled with due regard to economy and efficiency, as required by the articles of the Bank.