OPERATION EVALUATION SUMMARY

Electricity Transmission Company

November 2015

EBRD 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 publication. Any comments received will have been considered and incorporated at the discretion of EvD.

Nothing in this document shall be construed as a waiver, renunciation or modification by the EBRD of any immunities, privileges and exemptions of the EBRD accorded under the Agreement Establishing the European Bank for Reconstruction for Development, international convention or any applicable law.

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

Summary

This summary of an EvD Operation Evaluation includes a brief description of the project, overall ratings and findings.

Description

This Operation Evaluation reviews a loan to a monopoly electricity transmission company, wholly owned by the state in a country of operations. The project was designed to reduce energy losses, increase transmission capacity, improve supply reliability, and support new electricity tariff methodology.[1] It was the first of three Bank projects with the company, all intended to upgrade outdated electricity transmission infrastructure.

In respect of the project, the EBRD loan was to finance the construction of a new electricity transmission line to modernise existing substations and to install a control and protection system for the new line. The programme was accompanied by technical assistance for project preparation and environmental due diligence.

A broader objective was to help the country to integrate its system with ENTSO-E (the European Network of Transmission System Operators for Electricity) and to reduce the need to import electricity.

Results

Physical objectives were achieved, albeit with nearly two years delay and a large cost overrun. The main reasons for the delay were lengthy procurement and public protests about the routing of the new line, cost overruns were a result of the change of the design and re-routing of the line and were covered by the company. This first project contributed to the "learning process" of the company's employees.

However, results for ambitious institutional and transition objectives were mixed. The broader objective of contributing to the country's integration with ENTSO-E is still estimated to be ten years away. Electricity tariffs for corporate clients were gradually increased and are at cost recovery level (more or less where they were before the project due to fuel cost increases and currency devaluation) but those for residential clients were frozen for many years and were subject to a modest increase only more recently. In terms of specific transition benchmarks, their assessment is complicated due to discrepancies between the wording of some of them in the Board approval documents and the TIMS. However only two of five of them can be considered fully achieved (and one with only partial supporting evidence). More ambitious institutional objectives were not achieved: the E-TENS study was completed but its recommendations were not implemented; and new tariff methodology was developed but, again, not implemented.

Overall ratings

The self-assessment by the operations team (the Operation Performance Assessment or OPA) rates the project *Highly Successful*. EvD confirms some positive impact and the OPA's generally fair and restrained sub-category ratings; however they do not support a *highly successful* overall rating. Indeed, the OPA itself states that the "project has been only partially successful in achieving the institutional impact".

Following EvD's interviews with the company and a project site visit, EvD's view is that the project's overall performance is borderline *Partly Successful/Successful.*

[1] E-TENS - Electricity Trans-European Networks. An E-TENS study was financed and consultants managed by the European Commission.

It may be rated *Successful* taking into account its achievement of operational objectives (albeit with some delay), the company's good financial performance and substantial environmental change, as well as pioneering nature, which paved the way for subsequent projects, under which work continues on some of this project's ambitious transition objectives (some of which were unlikely from the start to have been achieved in course of a single project, even in better circumstances).

The Bank's three projects with the company may be seen as moving transition of the country's energy sector in the right direction. Moreover, in aggregate they enabled the Bank to achieve critical mass of financing in the power sector in the country, becoming one of the main financiers of this sector. This prompted the Bank to develop an Integrated Approach for the power sector, which was approved by the Board. At that time, the government's program envisaged a series of large investments and electricity market and tariff reforms in line with the EU's *acquis communautaire* for the energy sector. The Bank showed its commitment to support these reforms through a series of projects in power transmission and generation backed up by technical cooperation and continued policy dialogue. Gradually, the Bank has become a leading force among IFIs in pushing for power sector reforms in Ukraine. Its policy dialogue led to the preparation of a wholesale energy market reform concept, which later transformed into an approved energy market reform law. The Bank also led the preparation of the road map for the country's corporatisation and the preparation of green tariff support scheme for renewable energy. EvD also notes that the implementation of the new tariff methodology was covenanted, while the company's corporatisation law was registered in the parliament. Nevertheless, recent political developments in the country derailed these efforts. The approval of the corporatisation law and the government's compliance with the covenant are still pending.

Table: EvD performance ratings of the evaluated project

	Overall performance (Highly successful, successful, partly successful, unsuccessful)	Successful
Relevance	Additionality (Fully verified, largely verified, partly verified, not verified)	Largely verified
Effectiveness	Achievement of operation objectives*	Good
	Company/Project financial performance*	Good
Efficiency	Bank handling*	Good
	Bank investment performance*	Satisfactory
Impact and sustainability	Transition impact*	Satisfactory
	Environmental and social performance*	Good
	Extent of environmental and social change (Outstanding, substantial, some, none/negative)	Substantial

*Rating scale: excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory

Findings

Setting realistic transition objectives for sector reform projects

This relatively small project, the first with the client and in a politically-charged sector, made a set of claims that raised high expectations of big strides in power sector reforms in the country, which eluded other IFIs in the past. It very likely should have been clearer at the outset that it would take substantially greater engagement - multiple projects and effective policy dialogue - and a longer time frame to deliver on the stated objectives of the original project. Transition objectives of specific projects need to be realistic and their expected contribution to longer-term impact clearly defined[2].

Need of regular and systematic monitoring of the high-voltage transmission projects' implementation (finding proposed by the self-assessment, edited by EvD)

The high voltage line routing is an extremely sensitive issue due to real or perceived health risks stemming from magnetic fields produced by high voltage lines. The Bank agreed on financing the line routed outside of inhabited areas. However, the company changed the routing without informing the Bank. This created a conflict between the company and two villages, which threatened the success of the project. The Bank learned about the conflict and played active and constructive role in its resolution. However this conflict might have been avoided if this project was better monitored. However, due to the project's limited budget, the lender supervisor was expected to provide only periodic reports on the key aspects of the project's implementation. The change of routing was not disclosed by the company to the Bank until the conflict with the village population became publicly known, compromising the success of the project and the Bank's reputation.

Engagement of the lender's supervisor should be properly budgeted for and such a supervisor required to closely and continuously monitor the project, providing timely reporting to the Bank on all important developments related to its implementation.

Findings from past EvD's studies applicable to this project:

In the process of the preparation of this evaluation, EvD reviewed several other evaluation reports published in the past on electricity transmission projects, as well as special studies on the Power and Energy Sector (2011) and on Policy Dialogue in Ukraine (2014). Two findings from these reports, most applicable to this project, are presented below:

- Policy dialogue is resource intensive but essential for the Bank to have a wider impact. The Bank could consider developing a system of targets for bankers, which include policy dialogue activities, as well as incentives for achieving these targets. A dedicated Policy Dialogue Coordinator position in the power and energy team could assist execution. *(Source: Special Study Power & Energy Sector Review -October 2011).*
- The Bank should demonstrate a clearer linkage to sector policy dialogue in the design and structuring of a project operation. The project design may need to consider a better balance between providing budgetary financing for a government owned company in the electricity sector and the efforts towards transition progress, which may be linked through conditionality in

[2] EvD notes that a longer-term vision and a joined-up approach involving investment, policy dialogue and technical cooperation was provided for under the Bank's Integrated Approach for the Power Sector

disbursements or via conditionality in the design of a longer term TC operation which would complement the financing of infrastructure solutions. *(Source: Power company evaluation)*

- In case of a previous project evaluation, more ambitious transition objectives were not achieved: the E-TENS study was completed but its recommendations were not implemented; and new tariff methodology was developed but, again, not implemented. According to the project team, interviewed by EvD, covenanting of tariff methodology and other transition measures was attempted but firmly rejected by the client. The Bank took a decision that it was better to start engagement with the company (even without covenants in respect of tariffs), rather than doing nothing.