



Project
Complaint
Mechanism

EPS RESTRUCTURING

REQUEST NUMBER: 2018/05

COMPLIANCE REVIEW REPORT – APRIL 2019

The Project Complaint Mechanism (PCM) is the independent accountability mechanism of the EBRD. PCM provides an opportunity for an independent review of complaints from one or more individual(s) or organisation(s) concerning an EBRD Project, which allegedly has caused, or is likely to cause harm. PCM may address Complaints through two functions: Compliance Review, which seeks to determine whether or not the EBRD has complied with its Environmental and Social Policy and/or the Project-specific provisions of the Public Information Policy; and Problem-solving, which has the objective of restoring a dialogue between the Complainant and the Client to resolve the issue(s) underlying a Complaint without attributing blame or fault. Affected parties can request one or both of these functions.

For more information about PCM, contact us or visit www.ebrd.com.

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How to submit a complaint to the PCM

Complaints about the environmental and social performance of the EBRD can be submitted by email, telephone or in writing at the above address, or via the online form at:

<http://www.ebrd.com/work-with-us/Project-finance/Project-complaint-mechanism/submit-a-complaint.html>

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Executive Summary

A Complaint was sent to the Projects Complaints Mechanism (PCM) of the European Bank for Reconstruction and Development (EBRD) by Bankwatch Network and CEKOR (Complainants) on 25th April 2018 concerning the Elektroprivreda Srbije (EPS) Restructuring Loan in Serbia for the amount of 200 million Euros. The Eligibility Assessors concluded that the Complaint raises more than a minor technical violation of the Environmental and Social Policy (ESP), on which basis they have determined that the Complaint is eligible for a Compliance Review (CR).

The EPS Restructuring is a Corporate loan whose objective is to support EPS in restructuring its balance sheet especially after the 2014 floods, which had severely affected operation of the largest power plants as well as large parts of the distribution and transmission electricity grid.

The Complaint acknowledges that although the investment is at the corporate level and not directed at specific physical assets, the Project has caused harm and has the potential of causing further harm due to the freeing up (of) resources to allow the Company to focus on and boost the implementation of its long-term capital expenditure program. The Complaint also seeks clarity on the application of EBRD Environmental and Social Standards in corporate level finance Projects.

The Compliance Review finds that there are harms associated with EPS activities in Serbia, as witnessed both from previous complaints to PCM and from observations made during the field visit, however it is asserted that the relationship between those harms and the EPS Restructuring is indirect, and, therefore, the Bank is in compliance with the ESP as regards this specific operation. The Expert maintains that the nature of the stipulations in the Policy pertaining to Corporate loans, such as the present one, have allowed certain vagueness as to the extent and nature of their application. In this case, it is the Compliance Expert's view that the result was a weak ESDD, associated risk analysis and ESAP, which do not adequately mirror the magnitude of some of the environmental and social challenges faced by EPS, especially as they continue to be reflected in the series of PCM complaints against EBRD operations supporting EPS.

In the context of the PCM's ongoing policy review, the Bank should provide a clarification of the policy provisions pertaining to Corporate Loans, most notably those involving potentially significant environmental and social risks. Appropriate strategic guidance should also be developed regarding how to implement these provisions including, minimum standards for due diligence and subsequent environmental and social actions required. Furthermore, the Bank should ensure the application of such provisions and that, especially in the context of fast disbursing loans, that there is sufficient pressure on Clients to adhere to such reformulated provisions.

Acronym List

BREF - Best Available Techniques Reference

CR - Compliance Review

EBRD - European Bank for Reconstruction and Development

EPS - Elektroprivreda Srbije

ESAP - Environmental and Social Action Plan

ESDD - Environmental and Social Due Diligence

ESP - Environmental and Social Policy of EBRD

EU - European Union

GOS - Government of Serbia

IMF - International Monetary Fund

PCM - Project Complaint Mechanism

PCM RP - Project Complaint Mechanism Rules of Procedure

PR - Performance Requirement

QEHS - Quality Environmental, Health and Social Issues

SEP - Stakeholder Engagement Plan

TC - Technical Cooperation

TPP - Thermal Power Plant

WB - World Bank

I. Introduction

Background

1. The present document is a Compliance Review for the Complaint¹ sent to the Project Complaint Mechanism (PCM) of the European Bank for Reconstruction and Development (EBRD) by Bankwatch Network and CEKOR (Complainants) on 25th April 2018 concerning the Elektroprivreda Srbije (EPS) Restructuring Loan in Serbia for the amount of 200 million Euros. This is a sovereign guaranteed loan. PCM registered the Complaint on 10th May 2018 in accordance with paragraphs 11-13 of the PCM RP. The Complaint was subsequently posted on the PCM Register pursuant to the PCM Rules of Procedure (PCM RP). The Complainants have specifically requested a Compliance Review. As specific outcomes, the Complainants expect measures at both Project and policy levels as indicated below.
2. On 23rd May 2018 Mr. Luc Zandvliet was appointed as Eligibility Assessor with the objective of conducting the Eligibility Assessment jointly with the PCM Officer in accordance with paragraph 22 of the PCM RP. The Eligibility Assessors concluded that the Complaint raises more than a minor technical violation of the Environmental and Social Policy (ESP), on which basis they have determined that the Complaint is eligible for a Compliance Review in accordance with the set Terms of Reference.²
3. The EPS Restructuring is a Corporate loan. The International Monetary Fund (IMF) asked the Bank and World Bank (WB) to lead the restructuring process at EPS using both financing and guidance. The Project is intended to support EPS in restructuring its balance sheet especially after the 2014 floods, which had severely affected operation of the largest power plants as well as large parts of the distribution and transmission electricity grid. This led EPS to depend on expensive short- term financing from commercial banks to face this economic crisis. This refinancing is intended to free up resources to allow the Company to focus on the implementation of its long- term capital expenditure program which involves substantial modernization of Serbia's power sector infrastructure.³
4. The EBRD and WB agreed a reform plan with the Government of Serbia (GOS) to both define the EPS restructuring as well as setting reforms for the sector. The EPS Restructuring Project is proposed to support sector reforms by making them a condition to the Project as well as covenanting their main elements.⁴
5. The Project also provides for broader sector reform goals, including: a) progressing regional integration through a number of measures that will result in the Serbia Power Exchange coupling with other national and regional exchanges and b) improving corporate governance at EPS.⁵
6. The improving of corporate governance at EPS was to be achieved mainly through agreeing and adopting a comprehensive Corporate Governance Action Plan. The Bank required the Government to engage a consultant using TC funding to advise on gaps in EPS governance. This was to be followed by an agreed Corporate Governance Action Plan aiming at addressing these

¹ Complaint

² Eligibility Assessment

³ Board Memorandum EPS Restructuring Project, p.3

⁴ Ibid.p.7

⁵ Ibid

gaps. The Project was also intended to allow the proactive engagement with EPS on environmental and social issues. Following the Bank's due diligence, a new and updated company-wide ESAP was agreed, providing a response to environmental and social issues associated with EPS operations, in addition to addressing a number of recommendations of the PCM Compliance Review on the Kolubara Environmental Improvement Project.⁶

7. This Project has received a B categorisation. It is a corporate restructuring Project without a specified investment plan, meanwhile environmental and social due diligence has focused on identifying opportunities to improve environmental, safety, social and labour governance and capacity and on assisting EPS to develop a more strategic approach to managing these issues.⁷

Compliance Review Methodology

8. A combination of methods was adopted in undertaking the CR. In line with paragraph 7 of the PCM RP, the Expert has undertaken a thorough review of relevant documentation, in addition to a field visit.⁸ Documents reviewed include those relevant to the complaint and Project, in addition to Bank policy and guidance. The Compliance Review team also spoke to the Bank, Complainant and Client with the objective of acquiring greater clarification about the issues raised by each. These calls were preceded by the sending of a list of questions with the aim of guiding the discussion. A field visit to Serbia took place between 4 - 7 December 2018. During the visit the Expert had the opportunity to meet with the EPS team, in addition to visiting the EBRD office and holding a meeting with Bankwatch and CEKOR together with some of the complainants. On 6th December 2018 the Expert, accompanied by representatives of Bankwatch and CEKOR, visited Drmno where they met with an additional group of complainants and had the opportunity to speak with affected community members, in addition to seeing specific houses suffering from cracks and where family members have had to leave the area primarily due to poor air quality and associated health concerns.

Position of Relevant Parties

Complainants

9. Issue One:

- The Complaint acknowledges that although the investment is at corporate level and not directed at specific physical assets, the Project has caused harm and has the potential of causing further harm due to the "freeing up (of) resources to allow the Company to focus on and boost the implementation of its long term capital expenditure program".
- The latter according to the Complaint includes lignite mine expansion and construction of several thermal power plants, the most advanced of which is the Kostolac B3 Thermal Power Plant (TPP). The Complainants assert that the EBRD has not used its leverage strategically to influence EPS lignite expansion plans.⁹

⁶ Ibid.p.9

⁷ Ibid.p.10

⁸ PCM RP p.7

⁹ Complaint

10. **Issue Two:** Specific Project issues alleged in the Complaint are:

- The EBRD has failed to ensure the resettlement of mining impacted communities and to assess the strategic impact of its investments on Serbia's energy sector and how it could impact the sector's reliance on lignite.¹⁰
- It is alleged that EBRD management implementation of the PCM CRRs recommendations from the Vreoci and CEKOR's complaints on the Kolubara Environmental Improvement Project have been limited and flawed. ¹¹
- The Complaint furthermore alleges that there was a lack of adequate consultations on the Corporate Resettlement Framework. In addition, regarding the Junkovac village landslide, criminal charges were filed against EPS in 2014; however the court has not initiated official procedures investigating the company. No action has been taken regarding the request of Drmno village for resettlement and resulting intimidation of activists. This is in addition to violation of property and participation rights in the villages of Junkovac, Barosevac, Drmno and Old Kostolac. Furthermore, it is alleged that EPS failed to develop protective zones and comply with the obligation to provide a distance of 300 meters away from mining operations.¹²
- The Complaint also raises the issue of environmental monitoring stating that it is missing in communities residing less than one kilometer from mining operations, while CEKOR and Bankwatch measurements of air quality in Drmno showed severe violation of air quality standards.¹³

11. **Issue Three:** The Bank, according to the Complaint has not used its leverage to ensure that EPS will conduct its business in accordance with EU law, UNECE, Aarhus and Espoo conventions national regulations and Serbia's Energy Community Treaty obligations and other obligations under international law.¹⁴

12. **Issue Four:** Incorrect Categorisation of EPS Restructuring Project. The Complainants assert that EBRD has incorrectly categorized the EPS Restructuring Project giving it a "B" category and that it has underestimated the "significance of its potential adverse future environmental and social impacts".¹⁵

13. **Issue Five:** The Complaint seeks clarity on the application of EBRD Environmental and Social Standards in corporate level finance Projects. The Complaint states it anticipates the PCM to review the implementation of a number of provisions of the policy which is particularly timely in view of the ongoing revision of ESP2014.¹⁶

Bank Management

14. EBRD Management confirms that the 2014 ESP applies to this Project without derogations and that there has been a "mischaracterization of the definition of the Project which actually only entails the provision of a corporate loan for balance sheet restructuring".¹⁷ According to the

¹⁰ Ibid

¹¹ Ibid

¹² Ibid

¹³ Ibid

¹⁴ Ibid

¹⁵ Ibid

¹⁶ Ibid

¹⁷ Bank Management Response

Management Response, none of the proceeds of the loan in question or any other financing provided by EBRD under this Project has been directed to the specific sites mentioned in the Complaint. The Response continues that Bank staff has not appraised these Projects against EBRD Performance Requirements and EBRD Management is thus, not in a position to comment on the issues raised in relation to the facilities in specific Projects. Management specifically states that none of the proceeds of the loan in question or any other financing provided by EBRD under this Project has been directed to Kostolac B3 power plant, the Kostolac desulphurization unit or the Drmno, Radjevo or Field E mines.¹⁸

15. The Bank Response asserts that EBRD has repeatedly acknowledged the wider challenges faced by EPS in bringing its entire operations in line with national and EU requirements. The Response continues that EPS is making slow but steady progress towards meeting EU standards particularly at its thermal power plants. EBRD trusts that it remains important to support Client's continuous improvements in environmental and social sustainability performance in line with relevant laws and good international practice.¹⁹
16. Regarding categorisation, Bank Management Response states that the loan in question has not been used to finance any activities that would require a comprehensive ESIA. As such, EBRD Management maintains that categorizing the Project "B" was appropriate. The Response also adds that this categorisation was confirmed by the independent consultants who carried out the environmental and social appraisal.²⁰

Client

17. The Client in its Response do not address the issue of whether the Project has caused or has the potential for causing harm but only addresses the specific Project issues relating to Kostolac B1-2, protective belts around opencast mines, the expansion of Drmno mine, unsolved issues relating to resettlement of communities in the area of Drmno, and the EIA for Kostolac B3, emphasizing that they are within the bounds of requirements of different agreements.²¹
18. The Client in their Response present arguments regarding the specific points on Projects raised in the Complaint. This includes responding to the issue of desulphurization of Kostolac B1-2, protective belts around opencast mines, expansion of Drmno mine from 9-12 million tons, issues related to resettlement of communities located in Drmno, EIA for Kostolac B3, and State support to Kostolac B3.
19. The Client do not refer to the issue of Project categorization in their response, neither was it highlighted in discussions with EPS. Furthermore, the Client only refers to the implications of Kostolac B3 in relation to the Espoo Convention, but not to the broader issue of adherence to EU regulations.²²

¹⁸ Ibid

¹⁹ Ibid

²⁰ Ibid

²¹ Client Response.

²² Client Response

II. Relevant EBRD Policy Obligations

Potential of the Project to cause harm despite the lack of a specific investment

20. Article 1 of the ESP commits the Bank to “promoting environmentally sound and sustainable development in the full range of its investment and technical cooperation activities”.²³ The ESP also states regarding appraisal: “The EBRD’s environmental and social appraisal includes consideration of three key elements: (i) the environmental and social impacts and issues associated with the Project; (ii) the capacity and commitment of the client to implement the Project in accordance with the relevant PRs; and (iii) to the extent appropriate, the facilities and activities that are associated with the Project.”²⁴
21. The loan in question is subject to the ESP despite it being a corporate loan and not a specific investment. Therefore, the provisions applicable to corporate loans are what should be taken into consideration when analyzing compliance. Specific aspects of such loans are presented below.
22. In the case of corporate loans “the proposed use of proceeds and the environmental and social footprint are largely indeterminate at the time of the EBRD’s decision to invest. The Bank will therefore (i) assess the investment based on the risks and impacts inherent to the particular sector and the context of the business activity, and (ii) assess the client’s capacity to implement the Project in accordance with the PRs.”²⁵
23. Furthermore, as stated in paragraph 14 of PR1: “In cases where clients with multistate operations are seeking general corporate finance, working capital or equity financing, the assessment outlined in paragraphs 7 to 12 of the Policy may not be appropriate. In such cases, the client’s current ESMS and past and current performance will be assessed against the applicable PRs and an ESAP will be developed and implemented at the corporate level (as opposed to the site-specific level) The corporate level assessment will:
 - “Assess the client’s ability to manage and address all relevant social and environmental impacts and issues associated with its operations and facilities against the requirements described in the PRs
 - Assess the client’s compliance record with applicable environmental and social regulatory requirements applicable in the jurisdictions in which the Project operates
 - Identify the client’s main stakeholder groups and current stakeholder engagement activitiesThe exact scope of the corporate assessment will be determined on a case-by-case basis.”²⁶
24. Paragraph 38 of the Policy states: “Where the Project involves general corporate finance, working capital or equity financing for a multi-site company, the client will be required to develop measures at the corporate level (as opposed to the Project specific level) to meet the PRs over a reasonable time period.”²⁷
25. Regarding monitoring, the EBRD reviews the environmental and social performance of Projects and the compliance with the environmental and social commitments as agreed in the legal

²³ EBRD Environmental and Social Policy, p.1

²⁴ Ibid. p.4

²⁵ Ibid. p.4

²⁶ Ibid p.13

²⁷ Ibid p.5

documentation. The extent of monitoring will be commensurate with the environmental and social impacts and issues associated with the Project, including both direct investment and FI Projects.²⁸

Specific Project Issues

26. The ESP clearly indicates what elements should be considered in the case of corporate loans that do not entail specific investments such as the present one. This is referred to in paragraphs 32 and 38 as indicated above, none of which refer to the necessity of assessing specific sites and their conformity with the PRs for the purpose of corporate loans.²⁹

EBRD Commitments to EU and International Law

27. The ESP states that, as a signatory to the European Principles for the Environment it is “committed to promoting the adoption of EU environmental principles, practices and substantive standards by EBRD-financed Projects, where these can be applied at the Project level, regardless of their geographical location”.³⁰ The policy continues that the EBRD “recognizes the ratification of international environmental and social agreements, treaties and conventions by its countries of operations. Within its mandate, the EBRD will seek to structure the Projects it finances so that they are guided by the relevant principles and substantive requirements of international law. The EBRD will not knowingly finance Projects that would contravene country obligations under relevant international treaties and agreements, as identified during Project appraisal.”³¹

Project Categorization

28. The EBRD categorizes each Project to determine the nature and level of environmental and social investigations, information disclosure and stakeholder engagement required. Past and present environmental and social issues and risks associated with Project-related existing facilities will be subject to environmental and social appraisal regardless of the categorization. Environmental and social appraisal requirements may vary depending on the Project and will be determined by the EBRD on a case by case basis.³²

Application of ESP Provisions Regarding Corporate Finance/Loans

29. The Complaint seeks clarity on the application of EBRD Environmental and Social Standards in corporate level finance Projects. Elements specifically pertaining to corporate loans are mentioned in paragraphs 32 and 38 in addition to paragraph 14 of PR 1 of the ESP and are reviewed above.³³

²⁸ Ibid p.6

²⁹ ESP pp. 4-5

³⁰ ESP, p.1

³¹ Ibid., p.2

³² Ibid, p.3

³³ ESP Pp4-5, p.13

III. Observations and Findings

Potential of the Project to cause harm despite the lack of a specific investment

30. The following observations and findings follow Paragraph 27 of the PCM RP, which highlights the nexus between the allegations raised in the Complaint and the question of Bank responsibility under the Policy. While the Expert is aware of the Complainants' argument that the loan proceeds allowed the Client to continue and scale up its activities, there is no evidence available to indicate that the loan amount was specifically used to continue or scale up EPS plans. Should such evidence have been available there would have been a potential implication that the Bank had a responsibility to ensure that the impacts stemming from such a scaling up of activities were appropriately assessed and mitigated for, in order to avoid potential harms. The existence of such evidence would have necessitated examination of specific sites and their social and environmental implications.
31. The loan in question is a corporate loan and since the ESP includes specific provisions pertaining to such a mode of finance, the application of the Policy is therefore thought to be limited to those provisions. Specifically, these provisions are: Did the EBRD adequately assess the investment based on the relevant ESP requirements for corporate loans particularly as stated in paragraph 32? What are the corporate level measures included to allow compliance with the PRs over a reasonable time period? Specific questions that have been posed here are: was the assessment preceding the funding decision based on the analysis of risks and impacts inherent to the particular sector and the context of business activity? Also, were Project related issues, including previous engagement of EPS with external stakeholders, considered in the risk and impact assessment, and were objective risk and impact criteria identified and used?
32. EPS is a company with many challenges; meanwhile, Serbia's energy sector itself, due to historical reasons, is facing underinvestment. This is in addition to the continued existence of legacy issues especially relating to mine planning and resettlement.
33. As stated above, it is against this background, that the IMF asked EBRD and the WB to lead the restructuring process at EPS using both financing and guidance, following which the EBRD and WB agreed a plan with Government of Serbia (GOS) to define EPS restructuring, in addition to other goals for the energy sector. The plan supported the EBRD Project by making it a condition to the Project as well as covenanting its main elements.³⁴
34. In relation to the objective of improving Corporate Governance, the EBRD required the Government to engage a consultant with TC funding to advise on gaps in Corporate Governance, following which the Government and EPS agreed a plan on how to fill these gaps.³⁵ In line with the Bank's engagement with EPS on environmental and social issues, the Bank undertook an Environmental and Social Due Diligence (ESDD) with the assistance of a TC funded consultant, as a result of which, a Corporate E&S Strategy and a company-wide Environmental and Social Action Plan (ESAP) were agreed.
35. The analysis of risks as outlined in the Board document included the following factors: Sovereign Risk (rated Medium/High), Regulatory Risk (rated Low/Medium), Delay in restructuring (rated Medium/High), Credit Risk (rated Low/Medium), and Foreign Exchange risk (Medium/Medium), Interest rate risk (Medium/Medium). Challenging environmental and social

³⁴ Board Document EPS Restructuring p.7

³⁵ Ibid p.10

factors are recognized under “Other Key considerations” but not as risk factors for the Project, although it is acknowledged that implementation of EBRD environmental and social requirements have in the past been mixed. Thus, no Project-related issues including those from previous engagements with external stakeholders with regard to EPS were considered in the risk and impact assessment, and the risk criteria did not include any reference to environmental issues. Bank Monitoring Reports reviewed do not provide an update of this risk analysis included in the Board document.

36. The Compliance Review Expert has reviewed three monitoring reports for this Project produced by EBRD, dating from October 2016, September 2017 and October 2018, respectively. For all three, under the rubric of “Overall environmental impact and issues”, it is stated that the Bank ESD Team is in the process of reviewing the separate environmental reports, and that currently there are no known material environmental issues that need to be addressed.³⁶ These Reports thus contain very little information concerning the progress in implementation of the ESAP various activities.
37. In line with Para 14 PR I, a corporate level assessment was undertaken. The primary tool used to undertake this corporate level assessment was the Environmental Social Due Diligence document (ESDD). As is well known, the purpose of such environmental and social due diligence is to review any potential and social risks associated with a business activity of a potential Client and ensure that the transaction does not carry environmental and social risks which could present a potential liability for the financial institution concerned. The specific questions raised in relation to this Corporate Assessment by the CR are: what were relevant criteria used to assess the capacity of the Client, performance and compliance at the corporate level? In addition, was relevant information regarding the longstanding relationship between the EBRD and the Client, including past PCM complaints taken into account? Also, what is the Client’s compliance record with applicable environmental and social regulatory requirements? Finally, who were the Client’s main stakeholder groups and current stakeholder engagement activities? **It is to be noted as stated earlier that the Policy maintains that the exact scope of the corporate assessment will be determined on a case by case basis.**
38. The ESDD document examines environmental performance and management, occupational health and safety, performance, labor practices and social performance and management as criteria for performance assessment. Under each theme, the Compliance Expert’s analysis indicates that there is much greater focus on the structures of EPS and how they might be affected by the proposed restructuring rather than EPS policies, their implementation and results. The specific recommendations of the ESDD focus on the need to reallocate responsibilities and capacities especially at the corporate level, without clear proposed changes or clarifications to policies. In fact, there are no clear criteria against which EPS performance is measured. With reference to past PCM complaints the ESDD only states that “EPS activities and EBRD’s association with them have been subject to criticism from local and international Civil Society Organizations”.³⁷ The ESDD also fails to identify who are the main stakeholders of EPS although it does criticize current stakeholder activities and recommends the establishment of a corporate grievance mechanism.
39. The ESDD also undertakes a gap analysis of EPS compliance with Performance Requirements, where for most of the PRs, EPS is described as being “partially compliant” The gap analysis falls

³⁶ Monitoring Reports October 2016, September 2017, October 2018

³⁷ ESDD. P.13

short, however, of providing an overall assessment of EPS capacities and policies. For example, under PR1: “The client is responsible to assess the potential environmental and social impacts and issues associated with the Project and developing and implementing procedures for managing and monitoring these impacts and issues”. The comment provided is that an environmental, health and safety social assessment of eleven companies of EPS was undertaken in 2011, based on the results of which comprehensive action plans were developed. It is stated that no proof of the completion of these action plans was provided. The audit was repeated in 2015, however, no information as to completion of the requested actions was available at the time of the preparation of the ESDD. Yet EPS is judged as being partially compliant. Although some actions are proposed, there is no associated timeline for when these actions should be completed or when EPS will be expected to become fully compliant with the PRs.³⁸

40. In view of this, the Compliance Review Experts’ view based on the analysis of this document, despite the objectives it set for itself is that it is rather general and does not sufficiently take into account the legacy issues of EPS. Specifically, there is no risk analysis of social and environmental factors. From document review and interviews, it is possible to conclude that although EBRD recognizes that environmental and social performance constitutes a continuing challenge for EPS, the assessment carried out was not robust enough to point to the inherent risk of weak EPS environmental and social systems, especially as reflected in past practices of the company and previous complaints to EBRD.
41. Based on the results of the ESDD Report, the ESAP defines actions to be implemented in the EPS Restructuring Project to improve performance related to environmental, social, health and safety including a suitable quality environmental, health and social issues (QEHS) management system. The specific questions raised by the CR regarding the ESAP are: To what extent does the ESAP reflect the risk and Client assessments? Does it specify what EPS is required to do to meet the PRs over a specified time period? Is there sufficient clarity as to what aspects of the Client’s operations and facilities should meet the PRs over time? Is reasonable time specified?
42. The ESAP is organized around the various PRs and under each PR is a series of actions. Most but not all proposed actions have a target date originally set for 2016. However, the dates relate to the specific actions, there is no date as to when EPS will be expected to comply with the specific PR. Most actions involve the designation of responsible persons for the specific activity and/or establishing adequate capabilities. Although there is a column entitled environmental and social risks, it is rather a statement of prerequisites for the proposed action rather than an analysis of the potential risk to its implementation or lack thereof.³⁹
43. According to the Board document, EPS has committed to enhancing its environmental and social management systems and will be revising its environmental and social strategy. This strategy includes a new Resettlement Framework, while reinforcing the commitment to implement action plans from country-wide EHS audits, in addition to addressing a number of recommendations from the PCM CR on the Kolubara Improvement Project. A new corporate Stakeholder Engagement Plan (SEP) has also been agreed and adopted by EPS.⁴⁰

³⁸ ESDD, Annex A

³⁹ Environmental and Social Action Plan

⁴⁰ Ibid p.4

44. An Expert consultant team was set up with the purpose of implementing, monitoring and coordinating of activities related to the ESAP and SEP. It was agreed that the team would submit an annual report to EBRD on the implementation of SEP and ESAP provisions 90 days after the end of each year. The purpose of the SEP is to guarantee the implementation of a timely, consistent, comprehensive, coordinated and culturally appropriate approach to consultations and the provision of information about the Project.⁴¹
45. Work on the Corporate Resettlement Framework began in June 2016. After revisions EBRD approved the document on 14 December 2016 and the document became effective in the first quarter of 2017.⁴²
46. The meeting of members of the Expert team, held on December 23rd 2016, commented every activity where status of implementation was taken into account and the associated referenced time limits. Guidelines were provided and further activities agreed with regards to the ESAP Table.⁴³
47. Many activities of the ESAP are directly related to the formation of a strong EHS sector at the corporate level. There are some delays in connection with the formation of the sector and because of this delay it has been necessary to update the ESAP and extend deadlines. Management of the EHS sector defining roles and responsibilities for monitoring activities, communication, and reporting are currently being duplicated, not clearly defined, and do not correspond to the competencies envisaged or planned. It was therefore necessary to update the deadlines.⁴⁴ The Expert team also produced an Annual Report for 2017 which once again acknowledges delays in the implementation of ESAP activities⁴⁵ without a clear indication of when these will be completed, and whether at the end of the process EPS will have complied with all the PRs.
48. The Complainants in a letter to EBRD dated 10th March 2016 comment on the proposed Project ESAP maintaining that it does not clarify how the Project will address antiquated and noncompliant facilities. According to the Complainants related actions envisioned in the Project lack elaboration on this question which appears to result from the limited scope of the ESDD and an overly optimistic assessment of EPS commitment and capacity to bring its operations in compliance with EBRD standards. The Complainants continue that the ESDD failed to acknowledge current specific non-compliances therefore the ESAP lacks specific remedies for dealing with them.⁴⁶
49. Additional observations made by the Complainants on the ESAP include the fact that many of the measures proposed by the Client are not clearly defined or fit for purpose as far as the ESP policy is concerned. They assert that the sole designation of a responsible person is no guarantee that the measures would actually be implemented. They propose additional measures including establishing a responsible person or related team at the corporate level for the coordination and management of all scheduled Projects at relevant thermal power plants for reduction of air emissions in line with BAT and BREF requirements. This is in addition to establishing adequate milestones for the implementation of improvement measures by the end

⁴¹ Annual Report on Implementation of SEP and ESAP Provisions 2016

⁴² Ibid., p.11

⁴³ Ibid p.18

⁴⁴ Ibid.p.19

⁴⁵ Annual Report on Implementation of SEP and ESAP Provisions 2017

⁴⁶ Letter from CEKOR/Bankwatch 10th March 2016

of 2017. They also propose the designation of a responsible person or related team at corporate level for the preparation of all relevant documentation for calculation and monitoring of CO2 emissions with regard to the upcoming CO2 emissions requirements by 2021 and to identify opportunities to increase energy efficiency generation. This is in addition to establishing adequate milestones for CO2 monitoring and defining targets for the improvement of energy efficiency and annually review implemented improvement measures.⁴⁷

50. The Compliance Review Experts' review of the ESAP indicates that most of the actions are at the higher management level and systems, and relate to the production of action plans, and appointment of focal persons for certain actions. The ESAP is largely a reflection of poor due diligence. As a result, there are no measurable indicators for the implementation of actions or evaluating their impact on EPS structures, policies and Projects vis-à-vis the performance standards. Also, information on frequent nonadherence to deadlines acquired from the Expert team Reports and, EPS staff, is an indicator that these timelines were somewhat unrealistic to begin with which is a further cause of delay. Furthermore, according to EPS staff some actions now require legislative changes, and had to be taken out of ESAP. This had not been taken into account at appraisal.

The Corporate SEP is the framework document which will be amended updated as required. It will be supported by divisions and sometimes Project specific SEPs that may be required by the implementation of new EPS Projects or the extension of others, with the goal of having a fit for purpose approach taking into account local circumstances. According to the relevant EPS staff interviewed it was confirmed that the update of stakeholder activity has gone well, including RAP training for EPS employees especially those in the field.

51. Regarding implementation of other actions, the Compliance Review Expert has been informed that, corporate governance activity is close to finalization. It has resulted in detailed recommendations with the involvement of a Steering Group, including Ministry officials to assess reports and finalize the Corporate Governance Action Plan, which is not adopted but nearing completion.
52. It should be noted that it has proven very difficult for the Compliance Review Expert to access monitoring reports of the ESAP implementation. Those that do exist are rather general and do not adequately reflect actual implementation levels. Thus getting a clear view on when the ESAP activities will be completed and related to that, when EPS can be expected to adhere to all the PRs, is rather tenuous.

In view of the above the Compliance Review Expert maintains that the Bank did not undertake an adequate risk assessment and analysis, notably this analysis did not give a sufficient role to environmental and social risk, despite the importance of the latter to the energy sector, the energy business in general, and to Serbia in particular, especially in view of the legacy issues faced by EPS. Also, this risk assessment failed to take into account previous engagement with stakeholders and the types of issues they have been consistently raising over the years, although the Board document makes reference to a previous PCM complaint on the Kolubara Project. The risk criteria used, although objective, failed to include environmental and social

⁴⁷ Ibid

factors. Generally, environmental and social measures of the ESAP have been difficult to garner in great detail due to the paucity of monitoring information on social and environmental aspects.

53. The Compliance Review Expert is of the view that the findings of the ESDD were rather general and that this was in turn reflected in the ESAP which focused on new management structures and enhancing capacities with no reference to measurable indicators regarding the future effectiveness or impact of such changes. Also, although there were dates attached to specific actions there is no overall indication of when EPS was supposed to comply with the specific PR, whether generally or regarding any of its specific facilities.
54. Despite the assessed weaknesses in the quality of application of the various ESP provisions on corporate finance to the EPS Restructuring loan, the Compliance Review Expert is of the view that the Bank did follow these provisions and is, therefore, in compliance with the ESP. The issue is with the lack of clear standards of analysis required by the ESP provisions pertaining to corporate loans, and not on whether the provisions were indeed applied. As will be developed below these provisions are rather broad and do not set adequate standards for requisite assessments and analysis and in fact clearly state that the scope of corporate assessments will be determined on a case by case basis.

Specific Project issues

55. It is alleged in the Complaint that the EBRD has failed to ensure the resettlement of mining impacted communities and to assess the strategic impact of its investments on Serbia's energy sector and how it could impact the sector's reliance on lignite. The Complaint especially raises issues related to Kostolac B1-2 desulphurization, protective belts around mines, Drmno mine expansion and EIA for Kostolac B3 etc.
56. Based on document review, discussions with different stakeholders and observations during the field visit, the Compliance Review Expert is of the view that while there are harms resulting from the implementation of the specific investments mentioned in the Complaint, these cannot be attributed directly to Bank finance and actions under the EPS Restructuring Loan. Legacy issues and capacity constraints have contributed to harm through weak mining planning and resettlement practices, however PCM in line with its mandate is limited to assessing the responsibility and accountability of EBRD in the process. The Compliance Review Expert during the field visit and conversations with impacted populations did observe a wide range of harms, including proximity to the mines in the absence of protective zones, issues with cracks in houses and health and safety issues. In the area of Drmno, the Expert was told that out of 220 houses, 180 have witnessed cracks; this includes houses constructed of reinforced materials. This is in addition to numerous cases of outmigration due to respiratory disease. Community members informed the Expert about the failure of EPS to implement resettlement agreements with communities within agreed timeframes, in spite of worsening living conditions, as EPS mines and infrastructure is approaching at distances shorter than allowed in Spatial Plans (e.g. the villages of Zeoke and Veliki Crljeni).
57. The relevant question to raise here is the extent to which these harms can be attributed directly to Bank actions or omissions under the EPS Restructuring loan. The Compliance Review Expert concludes that there is only an indirect connection between these harms and Bank actions, specifically under the EPS Restructuring Loan, which is not sufficient to attribute full responsibility to the Bank for these harms. In this regard the Bank is in compliance with the ESP.

Commitments to EU Regulations and International Law

58. The CR examined both the ESDD and the ESAP for potential reference and actions regarding bringing EPS operations in line with EU and international regulations. The ESDD states that the company faces a number of environmental and social challenges including those associated with aging and inefficient thermal power plants, future applicable compliance requirements from European regulations and the management of an ongoing land acquisition and resettlement programme at the Kolubara mine. Under the section on environmental resource efficiency the ESDD states that EPS will ensure that EU Best Available Techniques Reference (BREF) requirements will be met in the future and air emissions from the power plants are reduced.⁴⁸
59. In the ESAP under actions related to PR3: Resource efficiency and pollution prevention control, it is proposed to “Establish a responsible person or related team on corporate level for the coordination and management of all scheduled Projects at relevant thermal power plants for reduction of air emissions in line with BAT and BREF requirements. Establish adequate milestones for the implementation of improvement measures by end of 2017.”⁴⁹ This was to be achieved by the second quarter of 2016 and the evaluation criteria set was that there should be a designated responsible person at corporate level for air emission Projects and an improvement programme with milestones until 2017. These are the only references in the ESDD and ESAP to adherence to EU regulations. The CR estimates that such passing reference to the issue is due to the rather weak due diligence undertaken in the context of this Project, most notably as related to the fact that the provisions for corporate finance in the ESP do not have this element of adhesion to EU and international standards as a specific requirement of the requisite analysis and policy provisions of Corporate Finance.⁵⁰
60. In view of the above the CR is of the opinion that the Bank in line with the ESP policy is aware of the need for EPS to comply with EU and international standards within a reasonable time period, and is currently engaging in efforts in that direction. Since, the specific provisions for corporate loans do not refer to this aspect, what constitutes that reasonable time period is not specified. The CR does not maintain, therefore, that the Bank is in noncompliance with the ESP regarding this allegation.

Project Categorization

61. The Compliance Review Expert, after examining this issue, finds that given the lack of physical investments entailed by the Project which could be subject to a full ESIA, the categorization “B” is appropriate. The Expert also reviewed the list of indicative Category “A” Projects as presented in Appendix 2 to the ESP, none of which include a Project which can be likened to EPS Restructuring. Regarding Category “B” Projects, the ESP further states that “Environmental and social appraisal requirements may vary depending on the Project and will be determined by the EBRD on a case by case basis”.⁵¹ The Compliance Review Expert is of the view that since there are no specific guidelines in the ESP for categorization of corporate loans, a “B” categorization is appropriate, especially in the absence of specific investments that could be subject to an ESIA, and since the Policy allows a case by case consideration. The policy provides a certain flexibility

⁴⁸ ESDD,p.19

⁴⁹ ESAP

⁵⁰ ESAP

⁵¹ ESP.p.4

here and it is the elements of appraisal of corporate loans (to be considered further below) which are in question rather than the categorization. In this regard the Expert is of the opinion that the Bank is in compliance with the ESD, pertaining to categorization of the EPS Restructuring loan.

ESD Provisions on Corporate Finance/Loans

62. PCM RP indicates that the CR may “address the findings of non-compliance at the level of EBRD systems or procedures in relation to a relevant EBRD policy to avoid a recurrence of such or similar occurrences”.⁵² While no specific issues of non-compliance are being indicated at this point, the Expert is of the opinion that there is an opportunity to address some of the vagueness in the ESP clauses relating to corporate loans. The Expert has carefully examined the specific clauses in the ESP which refer to corporate finance operations and is of the opinion that indeed they can be characterized as somewhat general, leaving a lot open for interpretation when it comes to their application to specific operations. While this could work in the direction of greater flexibility, it also may signify a measure of inconsistency when applied across specific operations.
63. The provisions referred to are contained in paragraphs 32, 38 and paragraph 14 of PR 1 of the ESP. Some questions that may be raised concerning these provisions relate to the proposed risk assessment. The relevant criteria to be included in such a risk assessment are not specified; neither is whether there is a need to consider specific facilities/operations that have significant environmental and social impacts. Under paragraph 38, the Environmental and Social Policy states that the client will be required to meet the PRs over a “reasonable time period”. The Compliance Review Expert finds that this is a rather broad requirement and leaves a lot of room for interpretation, notably: what constitutes a reasonable time period and who is to define such a period, and the nature of the improvement anticipated at the end of it. Should the risk assessment take into account specific facilities/operations that may have significant environmental and social impacts? Should the scope of improvement be specified? Should all operations expect to meet all of the PRs over time? What should be included in a corporate ESAP? What should an ESAP try to achieve and on what basis is this determined? Should the reasonable time period be specified to reach the PRs be made more specific for each PR?⁵³
64. Further guidance is provided in PR1 which addresses the issue of corporate assessments but ends by stating that the exact scope of the corporate assessment will be determined on a case-by case basis, thus once again leaving quite a margin for determining the extent and nature of corporate assessment without sufficient guidance as to its extent, scope and expected results.
65. In relation to the above, the Compliance Review Expert also reviewed a sample⁵⁴ of corporate loans financed by EBRD, and noted wide differences in approach and analyses, regarding for instance, whether environmental audits of facilities are carried out, environmental categorization, whether a corporate assessment is carried out etc. This only emphasizes the point made above regarding the wide margin allowed by the policy provisions when applied to specific operations.

⁵² PCM Rules of Procedure, p.7

⁵³ These questions are adapted from the Eligibility Assessment Document

⁵⁴ This sample included the PKP Restructuring and Privatisation Project, Cherkizovsky Restructuring, Greece Corporate Restructuring Platform, and Slovenske Elektrarne Restructuring Loan II

66. Another relevant issue is that of categorization of Projects, nothing is mentioned, neither is guidance provided regarding whether Corporate loans will be subject to the same requirements as investment Projects for purposes of categorization.
67. There is also the question of monitoring, where the ESP states that the “extent of monitoring will be commensurate with the environmental and social impacts and issues associated with the Project, including both direct investment and FI Projects.”⁵⁵ Corporate loans and whether they require specific monitoring procedures are not mentioned. As noted above, and in the context of this loan the Compliance Review Expert found it very difficult to access monitoring reports and even those available were not of a quality as to provide a correct assessment of implementation progress.
68. In view of the above, while the Compliance Review Expert finds that the Bank was in compliance with the ESP as regards the categorization, appraisal and monitoring of the loan to EPS, asserts that the nature of the stipulations in the Policy pertaining to Corporate loans, such as the present one, have allowed a certain vagueness as to the extent and nature of their application. In this case, it is the Compliance Review Experts’ view that the result was a weak ESDD, associated risk analysis and ESAP, which do not adequately mirror the magnitude of some of the environmental and social challenges faced by EPS, especially as they continue to be reflected in the series of PCM complaints against EBRD operations supporting the company. The fact that the ESP allows a consideration on a case by case basis for the various provisions only attests to this fact and leaves a wide margin for application of the policy provisions to specific corporate operations.

IV. Conclusion

69. The Compliance Review finds that there are harms associated with EPS activities in Serbia, as witnessed both from previous complaints to PCM and from observations made during the field visit and in conversations with different stakeholders. In this respect, the questions raised by the CR are: what is the relationship between these harms and the EPS Restructuring Loan? What are the requirements of EPS in terms of compliance to the ESP? Specifically, it is argued that the relationship between the loan and the observed harms may be characterized as indirect, and therefore, it is found that the Bank is in compliance with the ESP as regards this specific operation. On requirements for compliance these are as stipulated in the policy provisions for corporate loans which, as repeatedly stated, are quite wide. Meanwhile, the CR in examining the application by the Bank of the specific provisions of the ESP pertaining to corporate loans as in the case of EPS Restructuring, found such application to be somewhat weak. Specifically, the CR examined the issue of risk assessment and found it not to be at the level of what could be reasonably expected in the case of a company like EPS, with a relatively weak record of application of environmental and social standards as derived from the ESP.
70. Similarly, the environmental and social assessment as manifest in the ESDD and resulting ESAP, do not adequately reflect the serious issues faced by EPS regarding social and environmental compliance, especially as evident from previous EBRD complaints. The ESAP largely focuses on changes in management systems, without clear timelines for eventual global adherence to the PRs. Some actions do not have associated timelines, and as stated above, many of these that do, have already been missed.

⁵⁵ ESP p.6

71. The CR maintains that one of the factors underlying the weak risk and environmental and social assessments of EPS and the associated ESAP is the way these are conceptualized in the ESP provisions pertaining to corporate loans. The provisions are rather wide and leave large room for interpretation, and therefore this case by case approach has allowed for variable application of the provisions. More specifically, there is a need to provide guidance in areas such as relevant criteria to be used in a risk assessment and time frame for meeting PRs, in addition to relevant guidance on the process of due diligence and content of ESAPs. Furthermore, there is need to specify what should be applied to Corporate loans in the case of categorization and monitoring. Finally, the Expert maintains that corporate finance activities may have significant environmental and social implications going forward entailing risks and potentially inducing adverse impacts. Application of the policy provisions should be based on a robust risk assessment of the potential environmental and social impacts of the activities rather than depending solely on which financing instrument was used.
72. In the context of the PCM's ongoing policy review, the Bank should provide a clarification of the policy provisions pertaining to Corporate loans, most notably those involving potentially significant environmental and social risks. Appropriate strategic guidance should also be developed regarding how to implement these provisions including, minimum standards for due diligence and subsequent environmental and social actions required. Furthermore, the Bank should ensure the application of such provisions and that, especially in the context of fast disbursing loans, that there is sufficient pressure on Clients to adhere to such reformulated provisions.