

## **EP 2: THE REVISED EQUATOR PRINCIPLES:**

### **Why hard-nosed bankers are embracing soft law principles**

**By Paul Q. Watchman, Angela Delfino and Juliette Addison**

# **THE EQUATOR PRINCIPLES, PART DEUX:**

## **THE WORLD BANK IS NOT ENOUGH**

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### **EXECUTIVE SUMMARY**

This article discusses the Equator Principles in general. More specifically it focuses on the revised Equator Principles, effective from July 2006, and compares those Equator Principles with the first set of Equator Principles. In reviewing the Equator Principles the article aims to achieve five, albeit modest, objectives:

First, to provide a description and comparison of both sets of the Equator Principles and, where considered relevant, an explanation of the differences between each set and why they differ.

Second, to outline the requirements of the Equator Principles for those Equator Banks and Equator Principles Financial Institutions which have adopted them and for borrowers who finance projects by way of borrowing which is subject to the Equator Principles.

Third, to examine some of the reasons given by financial institutions for adopting the Equator Principles and the reasons given by other financial institutions for declining to adopt them.

Fourth, to consider some of the issues which have arisen for lenders, borrowers and affected local communities or which have been raised by NGOs and civil society in respect of the implementation of the Equator Principles.

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<sup>1</sup> The views expressed by the authors are their personal views and not necessarily those of their firm. Paul wishes to thank his former legal associates, Carol Daicic of Freshfields Bruckhaus Deringer and Steven Vaughan (formerly of Freshfields Bruckhaus Deringer and now of Latham & Watkins LLP), for their assistance in carrying out the survey and drafting the report *Banking on Responsibility: Part 2 of the Equator Principles Survey 2006: The Sponsors*, (London: Freshfields Bruckhaus Deringer, July 2006), together with those who contributed to the survey questionnaire and participated in the interviews. This article has drawn in part on the findings of that survey and draft report and of its predecessor, *Banking on Responsibility: Part 1 of Equator Principles Survey 2005: The Banks*, July 2005 (see *infra* at note 2) and also the following articles: Malcolm Forster, Paul Watchman and Charles July, "The Equator Principles - Towards Sustainable Banking? Part 1" (2005) 06 *JIBFL*, pp. 217-222; Malcolm Forster, Paul Watchman and Charles July, "The Equator Principles - Making a Difference? Part 2," (2005) 07 *JIBFL*, pp. 253-258; and Paul Watchman, "Banks, Business and Human Rights," (2006) 02 *JIBFL*, pp. 46-50). Paul also wishes to thank the Law Faculty of the London School of Economics for the opportunity to present the findings and conclusions of these reports and articles regarding the development, implementation and interpretation of the Equator Principles at a Law and Financial Markets Project seminar on 8 November, 2006.

Fifth, to assess the impact of the Equator Principles on the project finance market and in particular, on financial institutions, project sponsors and affected local communities and to question whether from any of these viewpoints, the Equator Principles by any measurement can be said to be a success or a failure.

Finally, the article concludes that whilst there may be a number of outstanding technical and substantive issues which the Equator Principles Financial Institutions need to address, the Equator Principles may be described justly not only as a "*shining beacon for responsible sustainable banking*",<sup>2</sup> but also as a catalyst for a shift in business values towards the development of real corporate responsibility.

## INTRODUCTION

*"It's the environment, stupid"*<sup>3</sup>

Until recently, it could be said that the host planets of bankers and environmentalists were seldom to be seen in the same orbit and that there was, therefore, little risk that their two worlds would collide. This historic separation of the banking and environmental worlds has been expressed figuratively for those who can remember the 1970s (also for those who, by being there, cannot), by Christopher Bray, Head of Environmental Risk Policy Management at Barclays Group, in the following terms: "A few years ago if you spoke to an investment banker about environmental and social issues, they [bankers] would have thought you a hippie."<sup>4</sup> The chasm between these two groups was plain from the equally candid statement of Charles Prince, Chairman and Chief Executive Officer at Citigroup, that "[J]ust a few years ago, you would have been hard-pressed to find a banker and an environmental activist in the same room".<sup>5</sup>

It is clear that despite the disdain or indifference historically shown by bankers towards social or environmental issues, the financial industry has finally woken up to a new dawn and a new day. In fact, for several reasons, some of which will be addressed in section 3 of this article, the financial industry has become much more aware in recent years of the relevance and material importance of taking account of the impact of non-financial considerations.<sup>6</sup> Consequently, issues such as adverse

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<sup>2</sup> *Banking on Responsibility: Part 1 of Equator Principles Survey 2005: The Banks*, (London: Freshfields Bruckhaus Deringer, July 2005), pp. 1, 6 and 34.

<sup>3</sup> Commonly and recently used in articles (see "Global environmental change: It's the environment, stupid!", *Journal of Biogeography*, Volume 31, Number 7, July 2004, pp. 1203-1204(2)) and even a "blogger" (<http://itstheenvironmentstupid.blogspot.com>), this phrase represents a corruption of President Bill Clinton's admonition: "It's the economy, stupid", used to remind his party during the 1992 presidential campaign to keep their focus on George Bush, Senior's economic performance and not be distracted by other issues. The phrase was coined by that campaign's Democratic Party strategist, James Carville.

<sup>4</sup> Anita Hawser, "A Matter of Principles," *Global Finance*, Volume 18, Issue 11, 1 December, 2004, p.2.

<sup>5</sup> Charles Prince, Chairman and Chief Executive Officer at Citigroup, "Balancing economic growth and environmental social responsibility", 2006 available at <http://www.equator-principles.com/bcg.shtml>.

<sup>6</sup> For example, Mercer Investment Consulting, 2006 *Global Fearless Forecast: A consensus forecast of capital markets and industry trends*, (New York: Mercer Investment Consulting, 9 January, 2006); Goldman Sachs Global Investment Research, *Global Energy Introducing the Goldman Sachs Energy Environmental and Social Index*, (UK: The Goldman Sachs Group Inc., 24 February, 2004) which

environmental and social impacts and poor corporate governance, have moved from the periphery to the centre of effective financial decision-making.<sup>7</sup>

This trend in the commercial banking sector follows a related trend in multilateral development banks which requires borrowers to comply with environmental and social safeguards and to be subject to robust accountability mechanisms.<sup>8</sup> The seriousness with which this initiative is taken is demonstrated by the decision of Paul Wolfowitz, President of the World Bank, to criticise Chinese banks for not following their example by insisting on compliance with environmental and human rights standards as a precondition to making loans for infrastructure projects in Africa.<sup>9</sup>

This article analyses one potentially valuable means of addressing environmental and social governance issues in lending - the Equator Principles (EP). The EP form not one but two sets of principles. The first set of the EP (EP1) was conceived with the help of the International Finance Corporation (IFC)<sup>10</sup> in 2002 and launched in 2003. The EP1 were based on the IFC's environmental and social Safeguard Policies and guidelines. However, in large part due to the IFC's review of these policies and their replacement with the new IFC Performance Standards,<sup>11</sup> the EP were revised<sup>12</sup> (involving a lengthy drafting and consultation process between the Equator Banks

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assessed 30 social and environmental criteria in the global energy sector; and Goldman Sachs Global Investment Research, *Capital Markets at the Crossroads, Sustainable Investing: Environmental Focus Prepared for the Clinton Global Initiative Annual Meeting*, (New York: The Goldman Sachs Group Inc., September 2006).

<sup>7</sup> For example, see a report produced for the United Nations Environment Programme (UNEP) Finance Initiative by Freshfields Bruckhaus Deringer, *A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment*, (London: Freshfields Bruckhaus Deringer, October 2005), pp. 10, 12, 13-30; Paul Q. Watchman, Jane-Anstee Wedderburn and Lucas Shipway, "Fiduciary Duties in the 21<sup>st</sup> Century: A UK Perspective: A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment," *Trust Law International*, Volume 19, no. 3, (2005), p. 127; and Paul Q. Watchman, Jane-Anstee Wedderburn and Lucas Shipway, "Integrating Environmental, Social and Governance Considerations into Pensions Investment Decisions: a European Legal Survey," *Journal for European Environmental & Planning Law*, Volume 2, no. 6, (November 2005), pp. 512-530. See also Trucost Plc, *Environmental disclosures: First 100 FTSE All-Share Companies to Report under the new Company Law reporting requirements*, (Bristol: Environment Agency, November 2006), p. 17 and SustainAbility, UNEP and Standard & Poor's, *Tomorrow's Value: The Global Reporters 2006 Survey of Corporate Sustainability Reporting*, (London, Paris: SustainAbility Ltd, UNEP, 2006), pp. 9, 10, 31 and 32.

<sup>8</sup> In the case of the European Bank for Reconstruction and Development and the World Bank's International Finance Corporation (IFC) respectively, the Independent Recourse Mechanism and the Compliance Advisor/Ombudsman specifically assess violations of environmental and social policies.

<sup>9</sup> Conal Walsh, "Is China the New Colonial Power in Africa?", *The Observer*, 1 November, 2006, p. 9; International Centre for Trade and Sustainable Development; "China Vows to Ramp Up Aid, Investment, and Trade with Africa", *Bridges Weekly Trade News Digest*, Volume 10, no. 37, 8 November, 2006; and The New York Times Editorial, "Mr. Wolfowitz and the Bank", *The New York Times*, 2 January, 2007.

<sup>10</sup> The IFC is the private sector investment arm of the World Bank Group.

<sup>11</sup> The IFC Safeguard policies were revised in order to improve their clarity, accessibility and implementation. The new IFC Performance Standards (see *infra* at Table 3) were approved by the IFC Board of Directors on 21 February, 2006 and they manage and improve social and environmental performance through an outcomes approach by the IFC and its clients.

<sup>12</sup> The revisions reflect the new IFC Performance Standards on Social and Environmental Sustainability (see *infra* at Table 3), feedback from stakeholders in the first three years of implementation of the EP and best project finance management practices in respect of handling social and environmental risk. The revisions committee was chaired by Jon Williams, Head of Sustainable Development at HSBC and the drafting was taken forward by Shawn Miller, of Citigroup and André Abadie of ABN Amro.

(EB),<sup>13</sup> the IFC and prominent NGOs) to reflect the IFC's change in approach. The updated set of the EP (EP2)<sup>14</sup> has been open for adoption from July 2006 by the Equator Principles Financial Institutions (together with the EB, the EPFI). The EP are not a detailed set of enforceable legal norms but a general, voluntary<sup>15</sup> framework of ten broad principles<sup>16</sup> applicable to project finance transactions only<sup>17</sup> which are underpinned by IFC Performance Standards, guidelines and policies. Under the EP, the EPFI undertake not to provide loans to a project unless sponsors can demonstrate that the project will be constructed and operated in accordance with sound social and environmental management practices. There is no minimum level of requirement for entry to the EP and there can be some divergence amongst the EPFI as to how the EP should be interpreted or implemented.

It is, however, important to stress that the EP are only one of a number of initiatives, whether voluntary, legislative or imposed by professional standards,<sup>18</sup> albeit a critical one. Arguably, these initiatives together have caused a fundamental shift of business and financial values towards greater importance being attributed by the commercial

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<sup>13</sup> Originally, there were 10 such banks: ABN Amro, Barclays, Calyon, Citigroup, Credit Suisse First Boston, HVB Group, Rabobank, Royal Bank of Scotland, West LB and Westpac.

<sup>14</sup> In *Banking on Responsibility: Part 1 (2005)*, see *supra* at note 2, pp. 14-22, we made a number of recommendations ranging from good housekeeping and best practice recommendations to proposals which were, frankly, too aspirational or advanced for the EB to consider adopting in the short to medium term. Of those recommendations, 11 were fully accepted and implemented and 5 were accepted and implemented in part.

<sup>15</sup> From time to time, one of the EPFI assumes the position of "secretariat bank". From November 2006, the secretariat bank has been Mizuho Corporate Bank (previously, this role has been held by Citigroup (from 2003) and ING (from May 2005)). One of the roles of the secretariat bank is to manage the EP website (see <http://www.equator-principles.com>).

<sup>16</sup> As the EP are not mandatory and there is no enforcement mechanism, it is not open to a third party to take action against an EPFI to enforce compliance with the EP. This can be contrasted with the Office of the Compliance Advisor Ombudsman (CAO), which is an independent recourse mechanism for the IFC and the Multilateral Investment Guarantee Agency and has been very effective. NGOs and others criticise the lack of an enforcement mechanism for the EP, claiming that it results in a general inconsistency of application of the EP, an accountability void and also diminishes the robustness of the EP.

<sup>17</sup> See *infra* at Section 1 (c).

<sup>18</sup> Others include: (i) the ten principles of the UN Global Compact; the UNEP Finance Initiative (FI); (ii) the six UN Principles of Responsible Investment; (iii) the Draft Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights, E/CN.4/Sub.2/2003/12 (2003); (iv) the Carbon Disclosure Project; (v) the Companies Act 2006 (2006 c.46) and the directive that it implements (Directive 2003/51/EC of the European Parliament and of the Council of 18.6.2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings; (vi) the OECD Guidelines for Multinational Enterprises; (vii) the Voluntary Principles on Security and Human Rights which are six voluntary principles with the aim of guiding the United States, the United Kingdom, the Netherlands and Norway governments and extractive and energy companies as to how to maintain the safety and security of their operations in a way that respects human rights and fundamental freedoms (see [www.voluntaryprinciples.org/principles/index.php](http://www.voluntaryprinciples.org/principles/index.php)); and (viii) the OECD's Recommendation on Common Approaches on Environment and Officially Supported Export Credits, officially adopted by 28 countries in 2003 and currently under revision (for further information, see [http://www.oecd.org/document/56/0,2340,en\\_2649\\_34181\\_21688824\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/56/0,2340,en_2649_34181_21688824_1_1_1_1,00.html)). Also relevant are the recently implemented Financial Accounting Standards Board (FASB) Interpretation No. 47 Accounting for Conditional Asset Retirement Obligations (FIN 47). FIN 47 was established to fill a perceived gap left by FASB Financing Accounting Standard 143 and requires US companies to account for the future decommissioning or "retirement" costs of their assets as soon as they have enough information to reasonably estimate that cost.

financial world and financial institutions towards environmental, social and governance (ESG) considerations.<sup>19</sup> Further, they have resulted in both a re-definition of the relationship between ESG issues and financial decision-making by a wide range of institutions (including the promotion by banks of human rights values),<sup>20</sup> and a broad acceptance amongst a significant number of banks and investors of the virtues of sustainable finance or banking.

It is now more than three years since the EB adopted the original EP (EP1). Consequently, we consider it an appropriate time to carry out an objective assessment of the implementation of the EP and the conduct of the EPFI which have adopted them. During this short period of time, project finance practice has evolved considerably due to the EP and the initial vision of the EB and the IFC. The number of the EPFI that have adopted the EP1 and the EP2 has increased more than fourfold to 45 in total.

With the exception of Westpac, it is worth noting that the original EP banks were dominated by a small number of very large, North Western hemisphere commercial banks. The homogeneity and geographical domination of that founding group of banks has been challenged even if it has not been finally broken by recent developments, for example, the adoption of the EP by more local and regional banks<sup>21</sup> and some of the global EPFI extending their operations aggressively in Asia,<sup>22</sup> Africa<sup>23</sup> and South America.<sup>24</sup>

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<sup>19</sup> This is evidenced by: (i) the adoption by over 3,000 companies of the UN Global Compact; (ii) the fact that global investors who responded to the Carbon Disclosure Project questionnaire own more than US \$31.5 trillion in assets; (iii) the adoption of the Principles of Responsible Investment by signatories representing over US \$5B in assets under management; and (iv) the fact that over 160 financial institutions have joined the UNEP FI including Dexia, HSBC, WestLB and Barclays.

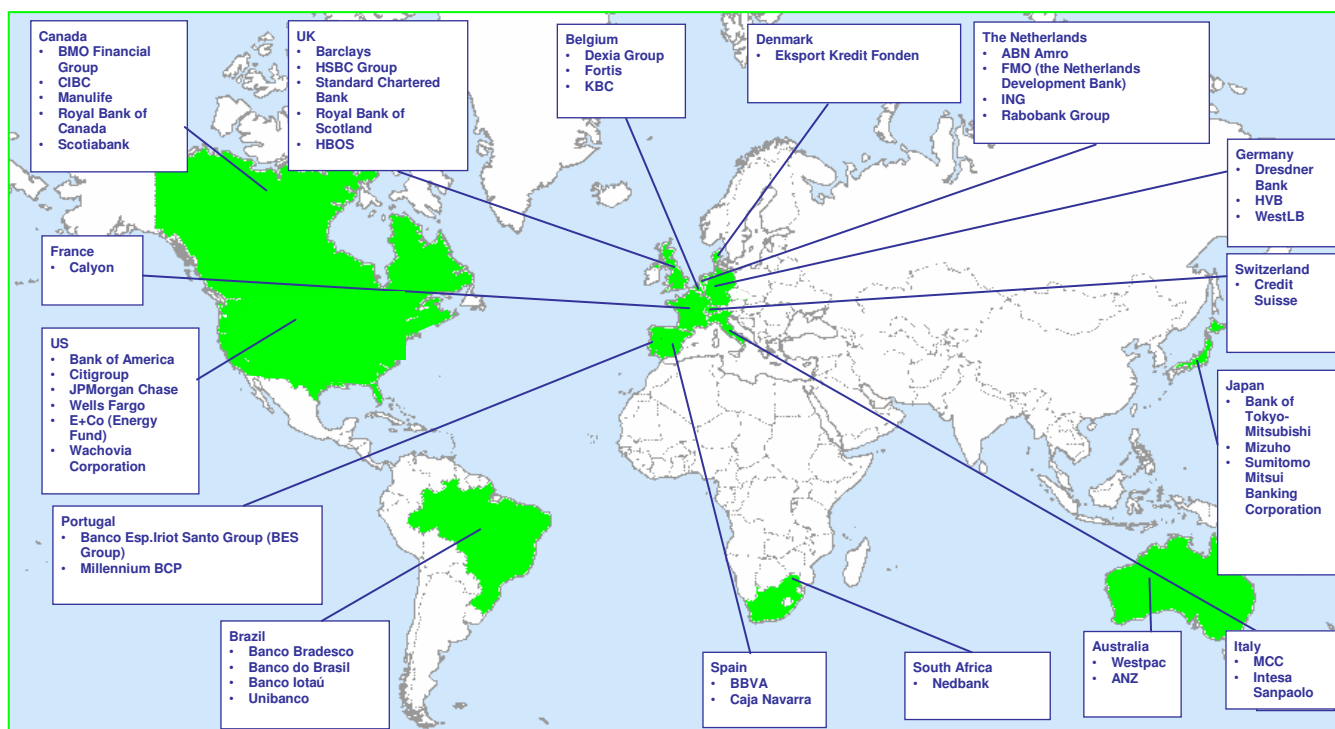
<sup>20</sup> For example, HSBC "strive to conduct our business in an ethical way and consistently uphold global standards, such as the UN Universal Declaration of Human Rights, the UN Global Compact and the Global Sullivan Principles," (HSBC Holdings Plc, *HSBC Corporate Social Responsibility Report 2005*, (London: HSBC Holdings Plc, April 2006), p. 6. Also, ABN Amro noted that one element of its Business Principle was "we respect Human Rights and the Environment" (*ABN Amro Sustainability Report 2005*, (The Netherlands: ABN Amro Holding N.V., 2006), p. 58). It also declared its respect for human rights and their integration into its own operations, guided by the standards of various international treaties and voluntary initiatives in its Human Rights Position Statement published in December 2005 and that it will "strive within our sphere of influence to uphold and promote human rights, take full responsibility for our own operations... So we will only engage with our business partners who are deemed responsible and share our belief in human rights." ([www.abnamro.com/com/about/sd/sd\\_policies.jsp](http://www.abnamro.com/com/about/sd/sd_policies.jsp)).

<sup>21</sup> Including ANZ which adopted the EP on 15 December, 2006 and which "has monitored the progress of the Equator Principles over the past few years and... [is] pleased that our policies and processes are now sufficiently advanced to adopt the Principles over 2007..." (see ANZ, *ANZ Corporate Responsibility Report 2006*, (Australia: ANZ Banking Group Limited, 2006), p. 36 available at [www.anz.com](http://www.anz.com)).

<sup>22</sup> In December 2005, The Royal Bank of Scotland Group plc (RBS) led a consortium (including Merrill Lynch and Hong Kong billionaire Li Ka-shing) to complete the acquisition for US \$3.1B (of which RBS invested US \$1.6B) of a 10% share in the Bank of China Limited (BOC) allowing RBS and BOC to form a cooperative partnership to, amongst other things, consolidate BOC's distribution strength and RBS's product skills and to work together in key operational areas, (see [http://rbs.client.shareholder.com/investor\\_relations/announcements/ReleaseDetail.cfm?ReleaseID=171099](http://rbs.client.shareholder.com/investor_relations/announcements/ReleaseDetail.cfm?ReleaseID=171099)).

<sup>23</sup> Barclays sealed its £2.6B takeover of Absa, South Africa's largest retail bank, by its acquisition of a 54% stake on 27 July, 2005 (for further, see Caroline Merrell, "Barclays mends fences with African Initiative," *The Times*, 14 October, 2006, p. 70).

## Map 1 - Detailing Geographic Spread of the EPFI as at 11 January 2007



**Key**  
■ Jurisdictions within which institutions have adopted the EP

**Table 1: EPFI as at 11 January 2007**

Australia	ANZ Westpac Banking Corporation
Belgium	Dexia Group Fortis KBC Group
Brazil	Banco Bradesco SA Banco do Brasil Banco Itaú Unibanco
Canada	BMO Financial Group CIBC – Canadian Imperial Bank of Commerce Manulife Group Royal Bank of Canada Scotiabank
Denmark	Eksport Kredit Fonden (Export Credit Agency (ECA))
France	Calyon

<sup>24</sup> HSBC Holdings Plc on 23 November, 2006 completed its acquisition for US \$1.77B of Grupo Banistmo S.A., the largest financial services company in Central America, based in Panama (see [http://www.hsbc.com/hsbc/news\\_room/news/news-archive-2006?cp=/public/groupsite/news\\_room/2006\\_archive/hsbc\\_completes\\_acquisition\\_of\\_grupo\\_banistmo.jhtml&isPc=true](http://www.hsbc.com/hsbc/news_room/news/news-archive-2006?cp=/public/groupsite/news_room/2006_archive/hsbc_completes_acquisition_of_grupo_banistmo.jhtml&isPc=true)).

Germany	Dresdner Bank AG HypoVereinsbank (HVB) <sup>25</sup> WestLB AG
Italy	Intesa Sanpaolo <sup>26</sup> MCC
Japan	Bank of Tokyo-Mitsubishi Mizuho Corporate Bank Sumitomo Mitsui Banking Corporation
The Netherlands	ABN Amro Bank, N.V. FMO (the Netherlands Development Finance Company) ING Group NV Rabobank Group
Portugal	Banco Espírito Santo - BES Group Millennium BCP
South Africa	Nedbank
Spain	BBVA Caja Navarra
Switzerland	Credit Suisse
United Kingdom	Barclays HBOS HSBC Group The Royal Bank of Scotland Standard Chartered Bank
United States of America	Bank of America Citigroup E+Co (Energy Fund) JPMorgan Chase Wachovia Corporation Wells Fargo & Company

Nevertheless, as can be seen from Map 1 above, in many of the countries where project finance is being used to finance large scale energy, water and extractive projects, such as Russia, India, China, the Middle East and Central and South America (with the exception of Brazil), there are no local or regional EPFI.

## 1. DIFFERENCES BETWEEN THE EP1 AND THE EP2

The principal differences between EP1 and EP2 are listed in Table 2 below. The most important differences are also subsequently described in some detail below and at Appendix 1.

<sup>25</sup> HVB and UniCredit merged in June 2005. For further information, see <http://www.hvb.lt/en/content/index/>.

<sup>26</sup> Intesa Sanpaolo was created on 1 January, 2007 following the merger of Banca Intesa and Sanpaolo IMI.



**Table 2: Differences between the EP1 and the EP2**

<b>Issue</b>	<b>EP1</b>	<b>EP2</b>
<b>Eligible Parties</b>	Equator Banks	Equator Principles Financial Institutions
<b>Financial Threshold</b>	US \$50M	<b>US \$10M</b>
<b>Object of Assessment</b>	Projects only	Projects <b>plus expansions to and upgrades of projects if the social or environmental impact of the expansion or upgrade is significant</b>
<b>Scope of Activities</b>	Lending	Lending <b>plus advisory activities</b>
<b>Scope of Assessment</b>	Environmental assessment (EA) only	Environmental assessment <b>plus social assessment (SEA)</b>
<b>Action Plan and Management System (APMS)</b>	Environmental Management Plan (EMP)	<b>Action Plan (AP) and Social and Environmental Management System (SEMS)</b>
<b>Independent Expert Review</b>	EA, EMP and consultation	<b>SEA and AP compliance and consultation</b>
<b>Consultation</b>	In a structured and culturally appropriate way with project affected groups Broad community support for project EA and EMP to take account of consultations Consultation subject to Independent Expert Review	<b>With project affected communities</b> <b>Prior informed consultation (not prior informed consent)<sup>27</sup> for projects with significant adverse impacts</b> <b>Consultation process and results to be documented in AP</b>
<b>Grievance Procedures</b>	No requirement	<b>New requirement for borrower to establish grievance procedure for project affected communities throughout the project life cycle</b>
<b>Annual Reporting Obligations</b>	No requirement	<b>New requirement for at least annual reporting by the EPFI</b>
<b>Legal Compliance Covenants</b>	No requirement	<b>New requirement on borrower to comply with local, state and host country social and environmental laws, regulations and permits in all material respects</b>
<b>Action Plan Compliance Covenant</b>	Borrower to comply with EMP	<b>Borrower to comply with AP (where applicable) in all material respects</b>
<b>Reporting Compliance Covenant</b>	Borrower to provide regular reports on compliance with EMP	<b>Borrower to provide regular reports of compliance with AP and laws, regulations and permits</b>
<b>Decommissioning Covenant</b>	Borrower to decommission facilities in accordance with a Decommissioning Plan, where applicable	<b>Borrower to decommission where applicable and where appropriate</b>
<b>Remedial Steps to Remedy</b>	Lender to engage with borrower	<b>Reserving its rights to exercise</b>

<sup>27</sup> See *infra* at Section 1 (h).

<b>Covenant Breach</b>	to remedy non-compliance with covenants when borrower in default	<b>remedies for non-compliance or default, the EPFI discretion to work with borrower to bring it into compliance with covenants</b>
<b>Appointment of Independent Expert</b>	Lender right to appoint an independent environmental expert to provide additional monitoring and reporting services	<b>The EPFI discretion to require the appointment of independent experts over the life of the loan</b>
<b>Streamlining Assessment</b>	No requirement	<b>Adopts a streamlined approach to assessment of social and environmental impacts in applying EP2 to countries, principally High-Income OECD countries, which are presumed to have existing high standards for assessing and addressing social and environmental impacts IFC Performance Standards (defined at Table 3 below), World Bank Pollution Prevention and Abatement Handbook (PPAH) and IFC Environment Health and Safety Guidelines do not apply to High Income OECD countries.</b>

#### **a. Eligible Parties**

The EP have now been adopted by export credit agencies (ECA) such as Eksport Kredit Fonden, national and industry sector development companies and multi-lateral lenders as well as retail and investment banks. The change from EB to EPFI simply reflects that fact and the view of the original signatories to the EP that there should be no qualifying criteria or membership qualification of financial institutions adopting the EP. This view was taken not only because of a desire to build up critical mass, and hence influence in the project finance world quickly, but because of an understanding that not all EPFI would be able to bring the same resources and commitment to the development of the EP. Although there has been some criticism of "free riders", the leading players amongst the EPFI have always wanted the EP to be inclusive. Rather than deterring the local or regional banks from adopting the EP by applying unnecessarily high standards, the leading EPFI have attempted to achieve general consensus by pitching standards at a level which, it is hoped, all participants can achieve.

#### **b. Financial Threshold**

The reduction of the financial threshold from US \$50M to US \$10M is perhaps the most important change from the EP1 to the EP2, albeit that some of the participants

had already abandoned the financial threshold altogether<sup>28</sup> or had done so in mining or other extractive activities, where considerable environmental or social harm could be wrought quite cheaply.<sup>29</sup> In project finance terms, US \$10 million is not a large amount of money and below this threshold, it must be questionable whether project finance as a form of financing is sensible. Again, this was a concession to the smaller local or regional banks which could not reconcile themselves to there being no de minimis financial threshold and again shows sympathy amongst the larger EPFI for the smaller EPFI and an unwillingness to pursue public or NGO approbation at the expense of undermining the solidarity of the EP community as a whole.<sup>30</sup>

In saying that, there remains the problem of destructive projects carried out "on the cheap" in developing countries. For example, whereas the lowering of the financial threshold to US \$10M would now catch the Kainantu Gold Project in Papua New Guinea, it must be open to question whether country or industry specific policies and thresholds need to be developed by the EPFI to address the worst cases of social and environmental harm and to provide for meaningful social and environmental assessment of extractive and other destructive projects in developing countries such as the Sudan, Angola, Zimbabwe, Indonesia and Myanmar.

### c. Object of Assessment

The EP apply to project finance transactions only<sup>31</sup> and were designed to address issues which had arisen from criticism of project finance lending specifically. For example, project finance offers a rare opportunity in banking to focus on a project and to tailor the borrower's covenants to meet the particular needs of the lender. Some (such as Christopher Bray, Head of Environmental Risk Policy Management at Barclays Group) are wary about attempts to apply a risk management framework such as the EP to scenarios for which the EP were not developed (i.e. non project finance transactions) as this may run the risk that the EP may not deliver adequate or appropriate risk management and mitigation. Consequently, there is a danger that, by implication, the EP may be seen to have failed in some respect which might, in turn, damage the perception of the EP. Incidentally, it should be noted that, notwithstanding the restriction of the EP to project finance alone, there are a number of EPFI<sup>32</sup> (and non-EPFI) which have adopted a general principle of sustainable or responsible banking<sup>33</sup> via various environmental credit risk management processes or

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<sup>28</sup> In the year after adoption of EP1, ABN Amro reported that it reviewed 100% of relevant transactions according to the EP1 (notwithstanding the (then) threshold limit of US \$50M)), Michelle Chan-Fishel (Friends of the Earth-US) for BankTrack, *Unproven Principles: The Equator Principles at Year Two: An Anniversary Assessment*, (Utrecht: BankTrack, June 2005), p. 7.

<sup>29</sup> ABN Amro has already extended the application of the EP by including all corporate lending in the oil, gas and mining sectors (see *Banking on Responsibility: Part 1* (2005), see *supra* at note 2, p. 119).

<sup>30</sup> It should be noted however that some smaller regional banks, such as Banco Itaú and Banco Itaú BBA, exceed EP2 requirements by applying social and environmental criteria to all projects with capital costs of more than R\$5M (US \$2.3M).

<sup>31</sup> There is, however, some doubt as to whether the EP apply, or would apply, to non-lenders, such as security trustees.

<sup>32</sup> For instance, EPFI such as HSBC, Goldman Sachs, Wachovia and E+Co. Also, see *infra* at note 33.

<sup>33</sup> Best practice examples include: HSBC which applies its basic policy to "project advisory roles, corporate lending where the end use of proceeds is a project and to other forms of financial assistance such as bonding and guarantees directly linked to projects,"; Citigroup which applies an EP-derived policy to corporate loans and debt securities underwriting where the specific use of proceeds is known; and JPMorgan Chase which applies its basic environmental and social policy to all loans, debt and

which apply an "Equator Lite" test<sup>34</sup> to all their banking decision-making. As the content and application of "Equator Lite" policies will differ from institution to institution, some commentators have called for greater definitional clarity for this term so as not to undermine, by association, the integrity of the EP. Greater certainty may also present a challenge to those EPFI which have adopted the EP but actually engage in very limited project finance transactions.<sup>35</sup>

On the other hand, the fact that the EP apply to project finance only means that there is some doubt as to whether they will cover "hybrid" loans used for infrastructure projects such as the financing of toll roads and airports or project finance initiative (PFI) projects generally. Furthermore, the restriction in the scope of the EP to project finance alone, albeit that some expansions and upgrades which have significant adverse impacts on the project are included, leaves it open to borrowers and lenders to circumvent the EP by adopting other methods of financing (for instance, which do not involve lending on a no recourse or a limited recourse basis as required by the definition "project finance" under EP2)<sup>36</sup> or by re-financing the project after closing or completion of construction. There is little evidence of this happening on a large scale but, in practice, there have been several major projects which have been funded by general corporate lending, structured finance (such as swaps or derivatives) or through the bond market.<sup>37</sup> For instance, one banking myth that has been recounted to us on several occasions refers to the reported practice of a sponsor self-financing (rather than project financing) a large scale project to take the "heat" (which would otherwise be generated by NGOs and civil society organisations) away from the EPFI for funding the project. Allegedly, once the project is completed and operational, the EPFI then provide general funding to the borrower to cover the costs of the project. Of course, it is perfectly possible that, in the examples given above, these non-project finance methods of funding were chosen, not to evade the EP, but for wholly legitimate reasons. They may well have objectively been the best option for that particular project in the circumstances at the time however, at present, it is not possible for us to determine whether, regardless of the EP, such financing methods would have been used in any event.

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equity underwriting, financial advisories and project linked derivative transactions where the use of proceeds is designated for potentially damaging projects (BankTrack, *Equator Principles II; NGO Comments on the Proposed Revision of the Equator Principles*, (Utrecht: BankTrack, 26 April, 2006), p. 6).

<sup>34</sup> "Equator Lite" describes the ad hoc application by individual banks of a less comprehensive version of the EP which takes accounts of some, but not all, of the environmental and social impacts (*Banking on Responsibility: Part 1* (2005), see *supra* at note 2, p. 6).

<sup>35</sup> See *infra* at Conclusions, paragraph 6.

<sup>36</sup> See *infra* at Appendix 1 at "Definition of project financing".

<sup>37</sup> The Three Gorges Construction Project to construct a dam of the Yangtze River in China received funding from several different sources including policy loans from the China Development Bank, funding from the Three Gorges Construction Funds, power revenues from the existing Gezhouba Hydropower Plant, loans from domestic and foreign commercial banks, export credits, bond issues and an estimated US \$20B from a tax on household electricity. Similarly, critics (such as Friends of the Earth: see [http://www.foe.co.uk/resource/briefings/barclays\\_karahnjukar.pdf](http://www.foe.co.uk/resource/briefings/barclays_karahnjukar.pdf)), also cite the Karahnjukar Hydroelectric Scheme in the Iceland Central Highlands, a colossal project to create nine dams, three reservoirs, seven channels and 16 tunnels to divert glacial rivers to provide water to power a 630 megawatt hydropower plant (the electricity generated therein will be used to provide power for an Alcoa aluminum smelter). Also, see *supra* at note 9 and *infra* at note 62 (Frey Bentos).

On expansion and upgrade of projects, it has been clear since the adoption of the EP1 that staged or phased projects, (for example, the phased roll-out of motorways or adding capacity or fuel mixes to existing power stations), was an issue which has had to be managed more firmly by the EB which had adopted a fairly pragmatic approach to such developments. This change explicitly recognises the need for re-assessment of the expanded or upgraded project as a whole and not on a piecemeal basis. However, the obligation to assess the whole project is limited by the social or environmental impact being “*significant*”. This threshold is higher than a “*material*” impact and gives the EPFI wide subjective discretion in determining whether an impact is sufficiently negative, detrimental or material to qualify as being a “*significant*” impact. It is unclear why the EPFI have adopted such a high threshold but it could be due to a genuine reluctance to re-open social and environmental assessment of a phased or staged project that has been approved or constructed in part. Doing so might run the risk that the part of the project which has already been developed is called into question or that it might lead to potentially lengthy and costly delays.

#### **d. Scope of Activities**

Extending the EP2 to advisory activities should address a number of criticisms of the EP1. First, this change should mean that the EPFI becomes involved at an earlier stage so that it might influence the categorisation of the project, choice of consultants and other advisers and the scope of due diligence of the project. Becoming involved only at a later stage when these matters have been largely determined limits the ability of the EPFI to influence the project as the personnel and parameters for the project will have already become established.<sup>38</sup> Second, facilitating the earlier involvement of the EPFI with the project should allow the EPFI to better guide the project sponsors through the key issues, such as human rights, biodiversity or involuntary displacement of local people or indigenous tribes which the sponsor must be able, at the very least, to address cogently.<sup>39</sup>

However, it appears that categorisation of a project *at the point of assessment* under the EP only explicitly deals with the social and environmental impacts of the project as a whole (i.e. both development/construction and operation/use stages) and does not expressly address (save where there is a qualifying expansion or upgrade as described (see paragraph (c) above)) whether there may be a re-categorisation of the project to reflect the *operational impacts* where these have become more or less significant during the life of the project. Furthermore, the fact that projects with minimal or no adverse impacts will not be subject to further assessment beyond their identification as such,<sup>40</sup> suggests that a project initially assessed as a Category C project but whose subsequent activities during the course of its life have impacts such that it would be more appropriate to classify it as a Category A or B project, would not be so re-assessed. If this is the case, it may further encourage the reported practice of “categorisation-creep” whereby EPFI may be tempted to place projects in lower risk

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<sup>38</sup> See *Banking on Responsibility: Part 1 (2005)*, see *supra* at note 2, pp. 10-12, 92-95.

<sup>39</sup> *Ibid.*, at pp. 95-104.

<sup>40</sup> See IFC, *IFC Performance Standards on Social and Environmental Sustainability*, Performance Standard 1, 30 April, 2006, paragraph 11, p. 3 available at <http://www.ifc.org/ifcext/enviro.nsf/Content/PerformanceStandards>.

categories to reduce costs, time and effort.<sup>41</sup> This trend is also reinforced by the EPFI, first, overlooking the impact (and secondary consequences) of social risk on a project which otherwise has a relatively low environmental impact due to lack of specialist knowledge.<sup>42</sup> Second, by the EPFI subjectively benchmarking their ventures against a handful of "Category A Super Projects"<sup>43</sup> instead of against industry norms, such that the former will often be deemed to lack the complexity or uniqueness necessary to merit such a categorisation.<sup>44</sup> And third, this practice may be due to the EPFI making an overly optimistic evaluation of the risks as the process of categorising projects necessarily will involve some element of judgement as to which equally qualified professional advisers might legitimately and reasonably hold different opinions. Therefore, it appears that whilst the Social and Environment Assessment (SEA) will take into account the adverse risks and impacts of all the key stages of the project cycle (including pre-construction, construction, operation, decommissioning and closure),<sup>45</sup> it is a "once and for all", static footprint<sup>46</sup> assessment which will be revisited only in the event of an expansion/upgrade as described above.

### e. Scope of Assessment

With the underpinning of the IFC Performance Standards (as defined below at Table 3), social assessment has moved into the mainstream with environmental assessment and can no longer be regarded as an adjunct to environmental assessment or restricted to socio-economic impact.

**Table 3: IFC Performance Standards on Social and Environmental Sustainability (IFC Performance Standards)**

Performance Standard 1:	Social and Environmental Assessment and Management System
Performance Standard 2:	Labour and Working Conditions
Performance Standard 3:	Pollution Prevention and Abatement
Performance Standard 4:	Community Health Safety and Security
Performance Standard 5:	Land Acquisition and Involuntary Resettlement
Performance Standard 6:	Biodiversity Conservation and Sustainable Natural Resources Management
Performance Standard 7:	Indigenous People
Performance Standard 8:	Cultural Heritage

Lars Thunell, Executive Vice President of the IFC has observed: "*the new IFC standards are stronger, better and more comprehensive than those of any other international financial institution working with the private sector.*"<sup>47</sup>

<sup>41</sup> Crescencia Maurer of the World Resources Institute commented on the existence of this practice (see *Banking on Responsibility: Part 1, (2005)*, see *supra* at note 2, p. 89). Contrast with the "precautionary approach" adopted by some public bodies who err on the side of caution by upgrading rather than downgrading projects in the event of doubt (pp. 90-91).

<sup>42</sup> *Ibid.*, at p. 91.

<sup>43</sup> For example, Sakhalin II and Frey Bentos.

<sup>44</sup> See *Banking on Responsibility: Part 1, (2005)*, see *supra* at note 2, p. 91.

<sup>45</sup> See *Banking on Responsibility: Part 1, (2005)*, see *supra* at note 2, p. 2.

<sup>46</sup> See "Malcolm Forster, Paul Watchman and Charles July, "Making a Difference?", (see *supra* at note 1, p. 253).

<sup>47</sup> Lucie Giraud and Corrie Shanahan, IFC Press release, "IFC Adopts New Environmental and Social Standards", Washington 21 February, 2006 (available at <http://www.ifc.org/ifcext/pressroom/ifcpressroom.nsf/PressRelease?openform&52EFAA32056BEF828525711C0078AD94> ).

Few would disagree with Lars Thunell's endorsement of the IFC Performance Standards.<sup>48</sup> Nevertheless, there is much less enthusiasm for the new EP2. For example, the EPFI have been criticised for not adopting the sustainability policies which underpin the new IFC Performance Standards.<sup>49</sup> BankTrack, for example, reported that the EP2 fail to seize the chance presented by the IFC Performance Standards Review and to broaden and deepen their approach: "*It is our sense [BankTrack states] that the EPFI have failed to grasp this opportunity.... the overall approach is based on establishing the lowest common denominator.*"<sup>50</sup>

There may be some truth in BankTrack's criticism. However, as we have noted, there is a strong desire amongst the leading and the largest global EPFI to maintain solidarity and not to alienate the local and regional EPFI. Given that desire, this criticism may be regarded as a little insensitive. Clearly there is some value in preventing a schism amongst the EPFI, (which was always a real possibility if the vanguard of reforming EPFI were to push too hard or too fast). However, rather than a missed opportunity, the EP2 should be recognised as an important advance on the EP1 and as a platform on which each of the EPFI can build solid social and environmental policy foundations.

#### **f. Action Plan and Management System (APMS)**

The borrower must prepare an Action Plan (AP) for all Category A<sup>51</sup> projects and Category B projects in non-OECD countries and non High-Income OECD countries. The AP does not need to follow the SEA slavishly, but draws on its conclusions to address the relevant findings of the SEA.

The AP describes and prioritises actions needed to implement mitigation measures, corrective actions and monitoring measures necessary to manage social and environmental risks identified by the SEA. In addition to the AP, borrowers are to build on and develop Social and Environmental Management Systems (SEMS) which address those identified impacts, risks and actions required to comply with host country social and environmental laws and regulations and the requirements of the applicable IFC Performance Standards and industry specific Environmental Health and Safety (EHS) Guidelines as defined by the AP.

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<sup>48</sup> Some NGOs and other organisations consider that the IFC Performance Standards could perhaps have gone further to protect human rights more explicitly (for example, see Forest Peoples Programme, "A brief and preliminary assessment of the IFC's new Safeguard Policy framework", May 2006 (available at [http://www.forestpeoples.org/documents/ifi\\_igo/ifc\\_safegd\\_fpp\\_brief\\_may06\\_eng.shtml](http://www.forestpeoples.org/documents/ifi_igo/ifc_safegd_fpp_brief_may06_eng.shtml)) and Bank Information Center Press Release: "IFC's New Standards - A Risky Step for People and Planet", 21 February, 2006, (available at <http://www.bicusa.org/en/Article.2650.aspx>)).

<sup>49</sup> A. Durbin and J. Frijns, "Few Signs of Equator Principles' Success – The Equator Principles Have Been Improved But Successful Implementation Remains the True Litmus Test," *The Banker*, 7 August, 2006, p. 8.

<sup>50</sup> See BankTrack, *Equator Principles II, NGO comments on the Proposed Revision of the Equator Principles*, see *supra* at note 33, p. 3. This report was the outcome of a meeting in London on 19 April, 2006 between representatives from 18 EPFI together with a delegation of civil society organisations including representatives from 12 NGOs to discuss EP2 and illustrates their concerns and constructive comments. It was coordinated by Johan Frijns of BankTrack.

<sup>51</sup> For the different categories of projects, see *infra* at Section 2 and Table 5.

## **g. Independent Review**

For all Category A projects and, where appropriate, Category B projects, the EPFI can require independent review by a social or environmental expert not directly associated with the borrower. The scope of the review which the independent expert may be requested to carry out includes the SEA, AP and consultation process documentation. The purpose of the review is to assist the EPFI in their due diligence of the development and operation of the project and in respect of compliance with the EP.

## **h. Consultation**

The EP2 state that for all Category A projects and, as appropriate, Category B projects located in non-OECD countries and non High-Income OECD countries, there is an obligation on the borrower or third party expert to consult with “*project affected communities*”<sup>52</sup> in a “*structured and culturally appropriate manner*”. As many projects are located in pre-literate non High-Income OECD or non-OECD countries, the emphasis on the consultation being “structured and culturally appropriate” is of great importance.

This requirement stipulates that the consultation must be in a manner which is appropriate to the location of the project and the local communities. The objectives of the consultation are to ensure that project affected communities have the opportunity to express their views on project risks, impacts and mitigation measures and that the sponsor may consider and respond to them. Effective consultation should be based on: (i) the prior disclosure of relevant and adequate information (including draft documents and plans); (ii) should begin early in the SEA process; (iii) should focus on the social and environmental risks and adverse impacts and the proposed measures and actions to address these; and (iv) should be carried out on an ongoing basis as risks and impacts arise.<sup>53</sup> Cultural appreciation appears to imply that a borrower or expert considers which form of communication may be necessary, what language or languages should be adopted what the affected communities' decision process is and where meetings should be held.

The building or operation of a Category A or Category B project may result in displacement of indigenous people or irrevocable, adverse environmental or social change. It is only appropriate, therefore, that affected communities have an opportunity to make their views known through effective consultation. Consequently, the EP2 provides that for projects with “significant adverse impacts” on affected communities, there should be “*free, prior and informed consultation.*” This is an interesting procedural concept, developed in the context of the review of the World Bank Group’s activities in the extractive industries sector,<sup>54</sup> and is now a key part of

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<sup>52</sup> “Project affected communities” are communities of the local population within the project’s area of influence who are likely to be adversely affected by the project (see note 4 to *Principle 5* of the EP2).

<sup>53</sup> IFC, *IFC, Guidance Note 1, Social and Environmental Assessment and Management Systems*, paragraph 21, p.16 (see *infra* at note 78).

<sup>54</sup> In 2000, the World Bank Group announced that it would carry out a comprehensive review of its activities in oil, gas and mining production (the extractive industries sector), prompted largely by concerns expressed by a variety of stakeholders, primarily environmental and human rights organisations. The review included an independent stakeholder consultation process and report prepared by Dr. Emil Salim (former Indonesian State Minister for Population and Environment). The report made various recommendations to which the World Bank Group Management responded. The



the EP such that the borrower must satisfy the EPFI that the informed participation of the affected communities had been adequately incorporated into the project. However, under the EP, there is no requirement to establish that broad community support has been obtained for the project.<sup>55</sup>

It should also be noted that “free, prior and informed consultation” is not the same as, or as demanding, as the established public international law concept of “*free, prior and informed consent*” contained in various legal sources. These include Article 6 of the International Labour Organisation’s Convention Concerning Indigenous and Tribal Peoples in Independent Countries – (No. 169),<sup>56</sup> Article 8(j) of the Convention on Biological Diversity,<sup>57</sup> the Cartagena Protocol on Bio-Safety<sup>58</sup> and also the legislation of countries such as the Philippines, Venezuela, Malaysia or Peru.<sup>59</sup> The common understanding of “free, prior and informed consent” is that it gives local people a formal role in the consultation process and some form of veto power. It is intended to secure the rights of indigenous peoples and local communities. It should be noted that, whilst “free, prior and informed consultation” under the EP2 is not identical to that of “free, prior and informed consent,” several components of the IFC Performance Standards bear a strong resemblance to the consent concept (for instance, IFC Performance Standard 7 states the EPFI “will enter into good faith negotiation with the affected communities of Indigenous Peoples, and document their informed participation and the successful outcome of the negotiation”).<sup>60</sup>

## **i. Grievance Procedures**

In the light of several high profile, demanding and complex ventures (for example, Sakhalin II<sup>61</sup> and Frey Bentos),<sup>62</sup> there has been a call for sponsors and the EPFI to

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World Bank Group concluded it would only support extractive industry projects where there has been a process of free, prior and informed consultation with affected communities that leads to the affected community’s broad support for the project (see World Bank Group, *Striking a Better Balance – The World Bank Group and Extractive Industries: The Final Report of the Extractive Industries Review; World Bank Group Management Response*, 17 September, 2004, pp. v, 7, 9, 21, 22, 23 and 31 (available at [http://www.ifc.org/ifcext/eir.nsf/AttachmentsByTitle/FinalManagementResponse/\\$FILE/finaeirmanagementresponse.pdf](http://www.ifc.org/ifcext/eir.nsf/AttachmentsByTitle/FinalManagementResponse/$FILE/finaeirmanagementresponse.pdf))).

<sup>55</sup> Contrast with the World Bank Group’s position (see *Ibid*).

<sup>56</sup> 28 ILM 1382 (1989).

<sup>57</sup> 31 ILM 822 (1992).

<sup>58</sup> 39 ILM 1027 (2000).

<sup>59</sup> In a different context, the principle of prior informed consent has received widespread support in relation to transboundary movements of hazardous waste and substances, and has been adopted in a range of instruments, including, *inter alia*, the Convention on the Control of Transboundary Movement of Hazardous Wastes and their Disposal (1989 Basel Convention) 28 ILM 657 (1989); the African, Caribbean and Pacific States-European Community: Fourth Lomé Convention (1989 Lomé Convention) 29 ILM 783 (1990); and the Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade (Rotterdam) (1998 Chemicals Convention) 38 ILM 1 (1999).

<sup>60</sup> See IFC, *IFC Performance Standards on Social and Environmental Sustainability*, Performance Standard 7, paragraph 13, p. 31, (see *supra* at note 40).

<sup>61</sup> The Sakhalin II saga has been reported to have turned the island of Sakhalin, off Russia’s far eastern frontier, into a “battleground between the Kremlin and the world’s largest oil and gas companies” (see Arkady Ostrovsky, “Kremlin makes life difficult for Sakhalin,” *FT.com*, 22 November, 2006 (available at [http://www.sakhalinenergy.com/docs/media/en/194/FT\\_22-11-06\\_en\\_no%20map.doc](http://www.sakhalinenergy.com/docs/media/en/194/FT_22-11-06_en_no%20map.doc))). The project is around 80% completed and is subject to various investigations by the Russian government, not least into the doubling of project costs recently revealed by Shell which will mean, under the original 1994

become more transparent and accountable to both the communities affected directly by such projects and to civil society generally. This reform acknowledges criticism of the need for sponsors to provide effective grievance procedures but falls short of addressing the wider question of EPFI transparency and accountability in implementing the EP.<sup>63</sup>

#### **j. Annual Reporting Obligations**

The EP2 require the EPFI to provide periodic public reports at least annually. The report is to cover implementation of the EP processes and the experience of the EPFI, subject to the requirements of client confidentiality. At a minimum, it is stated that the report should address the number of transactions screened by the EPFI and the categorisation of each transaction and information on the implementation of the EP. In addition, the EPFI report may include a breakdown of transactions and categorisations by sector or region.

#### **k. Legal Compliance Covenants**

There are 4 new borrower covenants requiring compliance with:

1. local, state and host country social and environmental *laws, regulations and permits in all material respects*;
2. *the AP in all material respects*;
3. duty to provide regular reports on *compliance with the AP and laws, regulations and permits*; and
4. *the Decommissioning Plan*.

It is clearly important that these covenants do not have "hair" trigger events of default<sup>64</sup> and that lenders and borrowers have sufficient scope to remedy breaches of covenants when they arise. Thus, in addition to qualifying the breach of the legal and

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production-sharing agreement, that Russia's revenues from the project will be smaller and much delayed. Commentators have suggested that the Kremlin used legal pretexts (i.e. breaches of environmental law including felling protected forest, violating water codes and threatening the very existence of the 100 remaining critically endangered Western Gray Whales) to cajole Shell, Mitsui and Mitsubishi into selling a 50%-plus-one-share stake in Sakhalin II to the Russian State owned Gazprom for US \$7.5B (reducing their shares in the project by half) (*BBC News/Business*, "Gazprom grabs Sakhalin gas stake", 21 December, 2006).

<sup>62</sup> This is the case of two major paper mill projects (sponsored by Finnish Botnia and Spanish ENCE) near the riverside town of Frey Bentos, Uruguay, which have been criticised intensely due to their need to extract extremely large quantities of water from the Río Uruguay with the consequent risk of spillage of bleach, noise pollution and emissions. A formal complaint by the Centre for Human Rights and Environment (CEDHA) in April 2006 to the IFC Ombudsman alleging social and environmental concerns was received sympathetically by the IFC who on 9 May, 2006 published an action plan detailing remaining steps for environmental and social diligence. Shortly afterwards, ING withdrew from the project (taking US \$480M of funding with it) and was replaced by Calyon who has since incurred as much, if not more, NGO vitriol. The IFC Board approved the direct financing and guarantees for the Botnia mill on 21 November, 2006 (with only one vote against) and the IFC confirmed it would provide US \$170M in financing, accompanied by a guarantee from the Multilateral Investment Guarantee Agency of up to US \$350M to commercial lenders. The Spanish sponsored mill has since decided to relocate, and its financing is likely to follow at a later date.

<sup>63</sup> On the need for an ombudsman or external expert advisors see *Banking on Responsibility: Part 1 (2005)*, see *supra* at note 2, p. 22.

<sup>64</sup> *Banking on Responsibility: Part 1 (2005)*, see *supra* at note 2, pp. 113-116.

AP compliance covenants with a materiality threshold, the EP2 provide for intervention by the lender to take steps with the borrower to remedy events of default arising from non-compliance with these covenants. These covenants simply represent a basis upon which to add more complex and stringent obligations (if required by the EPFI) in due course, resulting in an agreement tailored to the particular project and the needs of its lenders.

## I. Streamlining Assessment

An important difference between the EP1 and the EP2 is that for the EP2, there has been a conscious decision (which accords with current practice in countries such as the United Kingdom where the EP are effectively ignored in PFI fundings), to streamline the environmental and social assessment process for High-Income OECD countries.<sup>65</sup>

In the case of High-Income OECD countries, the baseline requirement for a Social and Environmental Assessment (SEA) of a Category A or Category B project differs from non-OECD or non-High-Income OECD countries<sup>66</sup> on the basis that the local laws in High-Income OECD countries regarding environmental and social assessment are likely to be more exacting than in non-OECD countries or non-High-Income OECD countries.<sup>67</sup> The baseline standard for a non-OECD country or a non-High-Income OECD country is the IFC Performance Standards plus any applicable industry IFC EHS Guidelines.<sup>68</sup> In the case of High-Income OECD countries the baseline for the SEA is the local or national law on the generally reasonable (but in some cases highly questionable), grounds that in High-Income OECD countries, the laws relating to environmental protection and the safeguarding of social matters, such as human rights and property rights, tend to be more stringent and robust than the IFC Performance Standards and the EHS Guidelines. Consequently, unlike EP1, under EP2, the IFC Performance Standards, World Bank Pollution Prevention and Abatement Handbook (PPAH) and IFC EHS Guidelines do not apply to High-Income OECD countries. However, EPFI or borrowers for projects in such countries may use the IFC guidance notes as useful points of reference when seeking further guidance on or interpretation of the IFC Performance Standards.<sup>69</sup>

As stated above, this division is a rather crude simplification of a complex situation. For example, first, it does not show an appreciation of the very different OECD High-Income country environmental, social and governance standards and their different

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<sup>65</sup> These are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, the Republic of Korea, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom and the United States of America (<http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20421402~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html>) and for thresholds, see Annex III at <http://www.oecd.org/dataoecd/45/48/37124663.pdf>).

<sup>66</sup> These include Afghanistan, Bangladesh, Nepal, Papua New Guinea, India, Ghana, Nigeria etc. (see <http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20421402~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html>).

<sup>67</sup> See Equator Principles (July 2006) *Principle 3: Applicable Social and Environmental Standards*, p. 2 (available at [http://www.equator-principles.com/documents/Equator\\_Principles.pdf](http://www.equator-principles.com/documents/Equator_Principles.pdf)).

<sup>68</sup> *Ibid.*, at p. 3.

<sup>69</sup> See Equator Principles (July 2006), note to Exhibit III (available at p.8 of [http://www.equator-principles.com/documents/Equator\\_Principles.pdf](http://www.equator-principles.com/documents/Equator_Principles.pdf)).

enforcement regimes and practices. For example, Germany, Greece, Italy, Spain, the Netherlands, and the United Kingdom are all European Union (EU) Member States and are all High-Income OECD countries. However, notwithstanding the OECD categorisation, some of these countries are known to have less impressive records than others in transposing and implementing EU social and environmental directives and regulations<sup>70</sup> and equally, some are renowned for taking a lax approach to the enforcement of local environmental and labour laws.<sup>71</sup>

Second, the division also fails to recognise the importance of public international law in that a number of High-Income OECD countries have not ratified key environmental and social protection treaties and protocols or do not properly enforce them. For example, the United States and Australia have not ratified the "Kyoto Protocol"<sup>72</sup> on the reduction of the emission of greenhouse gases<sup>73</sup> and the United States has not ratified the Convention on Biological Diversity.<sup>74</sup> Similarly, the OECD division also underestimates the importance of public international law, particularly in coastal and transnational boundary developments,<sup>75</sup> or where the host country fails to embed responsibility for their implementation in independent tribunals or an impartial judiciary.<sup>76</sup>

Third, insufficient guidance is given as to how to assess linear projects which may pass through High-Income OECD countries, non High-Income OECD countries and non-OECD countries (i.e. IFC guidance (which, as stated above, does not apply to High-Income OECD countries) states that the SEA should consider "transboundary" effects<sup>77</sup> and that if these are significantly adverse, the IFC will assist with notification to the competent authorities of the affected countries)<sup>78</sup> but does not indicate the de minimis threshold for streamlining linear projects. It is not currently clear whether streamlining would apply to a project where, for example, 60% of the pipeline passes through a High-Income OECD country and the remaining 40% through a non-OECD country. Given that projects financed by project finance banks are typified by their

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<sup>70</sup> For instance: the EU Environmental Impact Assessment Directives (Directive 85/337/EEC as amended); the EC Parental Leave Directive (96/34/EC) of 3 June, 1996; the EC Council Directive No 93/104/EC of 23 November, 1993 concerning certain aspects of the organisation of working time; and Directive 2003/87/EC of the European Parliament and of the Council establishing a scheme for greenhouse gas emission allowance trading within the Community, OJ L 275, 25.10.2003, 13 p.32.14 as amended by Directive 2004/101/EC., 15OJ L. 338, 13.11.2004, p.1816.

<sup>71</sup> A comprehensive overview of the evolution and enforcement of labour laws in the EU can be found in the European Commission's Labour Laws (1992-2003). Volume 1 can be found at: [http://ec.europa.eu/employment\\_social/labour\\_law/docs/generalreport\\_en.pdf](http://ec.europa.eu/employment_social/labour_law/docs/generalreport_en.pdf). Volume 2 is available at: [http://ec.europa.eu/employment\\_social/emplweb/publications/publication\\_en.cfm?id=59](http://ec.europa.eu/employment_social/emplweb/publications/publication_en.cfm?id=59). See also European Commission Green Paper, Modernising labour law to meet the challenges of the 21st century, COM (2006) 708 final, for a summary of the current and complex challenges facing labour law and its enforcement.

<sup>72</sup> Protocol to the United Nations Framework Convention on Climate Change, 37 I.L.M. 22 (1998).

<sup>73</sup> Australia signed the Protocol on 29 April, 1998 and the United States on 12 November, 1998. (See [http://unfccc.int/files/kyoto\\_protocol/background/status\\_of\\_ratification/application/pdf/kp\\_rat\\_131206.pdf](http://unfccc.int/files/kyoto_protocol/background/status_of_ratification/application/pdf/kp_rat_131206.pdf)).

<sup>74</sup> Convention on Biological Diversity 1760 UNTS 79; 31 ILM 818 (1992).

<sup>75</sup> For example, Sakhalin II (see *supra* at note 61).

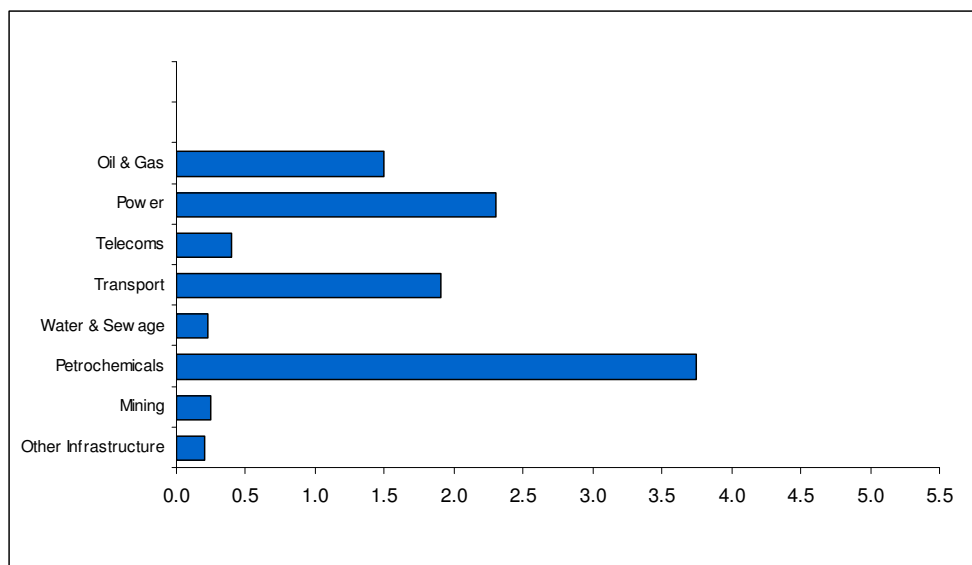
<sup>76</sup> *Ibid.*

<sup>77</sup> For example, the pollution of air or international waterways as well as global impacts such as the emission of greenhouse gases.

<sup>78</sup> See IFC, *IFC, Guidance Note 1, Social and Environmental Assessment and Management Systems*, 30 April, 2006, paragraph 20, p.8.

transboundary nature e.g. pipelines, power lines, railways, tolls roads etc. (as illustrated by Table 4 below which shows EPFI debt financing by sector, many of which lend themselves to transboundary projects), this is an area that is likely to require further clarification.

**Table 4: EPFI Debt Financing by Sector (US \$B)<sup>79</sup>**



## 2. WHAT DO THE EP REQUIRE OF THE EPFI?

As most of the EPFI have now adopted the EP2, it is proposed only to comment on the EP2 and any material differences between the EP1 and the EP2. As with the EP1, the EP2 requires projects to be categorised as Category A, B or C projects in accordance with the potential social and environmental impacts which the project presents to society or the environment.

### Categorisation of Projects

**Table 5: Categorisation of Projects Under the EP2**

Category A	High Risk	Projects with <b>potential significant adverse social or environmental impacts</b> that are <b>diverse, irreversible or unprecedented</b>
Category B	Medium Risk	Projects with <b>potential limited adverse social and environmental impacts</b> that are <b>few in number, generally site specific, largely reversible and readily addressed through mitigation measures</b>
Category C	Low/No Risk	Projects with <b>minimal or no social or environmental impacts</b>

<sup>79</sup> Simon Ellis and Vander Caceres, "Equator Principles Financing (see *infra* at note 133, p. 74).

As can be seen from Table 5 above, Categories A and C are relatively straightforward, representing the highest and lowest risk projects respectively. However, if a project is categorised as a Category B project, it can be seen that the requirements applicable to it will differ depending upon whether: (i) it is a non-OECD country; (ii) it is a non-High-Income OECD country; or (iii) regardless of whether it is (i) or (ii), it is considered appropriate to subject the Category B project to that particular requirement.<sup>80</sup> For instance, it can be seen from Table 6 below that (i) grievance procedures are required for Category B projects in non-OECD countries and non-High-Income OECD countries or where considered appropriate whereas (ii) independent monitoring is required at the discretion of the EPFI where the EPFI considers it appropriate to require this.

### 3. WHY HAVE THE EPFI ADOPTED THE EP?

In an earlier survey of the banks and other financial institutions which had adopted the first set of the EP,<sup>81</sup> we identified a long list of reasons why the EB had signed the EP. These included but were not limited to protecting their reputation,<sup>82</sup> a high level of commitment from Chairmen, Chief Executives and Board of Directors,<sup>83</sup> preservation of the business from potential loss of retail customers,<sup>84</sup> creating a level playing field by the adoption of an industry standard for social and environmental assessment,<sup>85</sup> the hope of creating a virtuous circle whereby sponsors and EB would bring better and more robust project proposals forward to the EB as they recognised the power of the EB due to the sponsors' need to borrow and the bank's need to syndicate loans,<sup>86</sup> good corporate governance based upon the need for sustainable or responsible banking underpinned by sustainable development,<sup>87</sup> and a desire to reduce political risk to projects by addressing social and environmental issues in a thorough and detailed manner which would, by exceeding minimum legal compliance, be acceptable to the project host state or states.<sup>88</sup>

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<sup>80</sup> Appropriate Category B projects are referred to as "Big B" projects in "Malcolm Forster, Paul Watchman and Charles July, "Towards Sustainable Banking?" (see *supra* at note 1, p. 218).

<sup>81</sup> See *Banking on Responsibility: Part 1 (2005)* (see *supra* at note 2, pp. 50-64) and Malcolm Forster, Paul Watchman and Charles July, "Towards Sustainable Banking?", (see *supra* at note 1, pp. 217-222 at pp. 218-221).

<sup>82</sup> See *Banking on Responsibility: Part 1, (2005)* (see *supra* at note 2, pp. 1, 33, 50, 51-54, 89, 134-135).

<sup>83</sup> As exemplified by Charles Prince's statement, Chairman and Chief Executive, Global Corporate and Investment Bank, Citigroup on the first anniversary of EP1 as follows: "[The Equator Principles are] one of the most important things that the banking industry has done in the past couple of years," (Demetri Sevastopulo, "Environment groups hold banks to their green promises", *FT.com*, 4 June, 2004.) Also, see *Banking on Responsibility: Part 1, (2005)* (see *supra* at note 2, pp. 7, 9, 50, 56, 57 and 78).

<sup>84</sup> See *Banking on Responsibility: Part 1 (2005)* (see *supra* at note 2, pp. 44, 50, 57 and 58).

<sup>85</sup> *Ibid.*, at pp. 33, 50, 59-62, 69 and 75.

<sup>86</sup> See *Banking on Responsibility: Part 1 (2005)*, see *supra* at note 2, pp. 2, 9, 50, 59 and 62-63.

<sup>87</sup> *Ibid.*, at pp. 7, 50, 57 and 62 which reveals that most of the banks surveyed saw the EP as a milestone rather than as the end of the road towards the attainment of sustainable development objectives.

<sup>88</sup> See *Banking on Responsibility: Part 1 (2005)*, see *supra* at note 2, pp. 10, 34, 50, 59, 64 and 92.

**Table 6: Requirements of the EPFI for Category A and Category B projects**

Requirement	Category A	Category B
Environmental and Social Impact Assessment (ESIA)	All Category A	All Category B
Action Plan and Management System	All Category A	Category B*
Public Consultation	All Category A	Category B*#
Grievance Procedures	All Category A	Category B*#
Independent Expert Review	All Category A	Category B#
Independent Monitoring	All Category A	Category B#
Annual Reporting Obligations	All Category	All Category B
Loan Covenants: <ul style="list-style-type: none"> <li>• Materially comply with applicable social and environmental laws, regulations and permits</li> <li>• Materially comply with the Action Plan and Monitoring/Management Systems</li> <li>• Compliance and enforcement mechanisms</li> <li>• Decommissioning Plan</li> <li>• Compliance with Decommissioning Plan</li> </ul>	All Category A	Category B*#

**KEY**

\* Non-OECD countries and non High-Income OECD countries.

# Considered appropriate (at the EPFI's discretion) to subject the Category B project to the requirement.

In some cases, one EPFI would give multiple reasons for signing the EP. For example, Jon Williams, Head of Group Sustainable Development at HSBC has stated *“the reputation of the Bank is linked to the reputation of its clients. No one client and no one piece of business is worth risking the reputation of the Bank.”*<sup>89</sup> In contrast, his former Chairman, Sir John Bond emphasised the moral and ethical importance of responsible and sustainable banking (of which the EP forms only a part) and the need for HSBC to change as follows: *“Our heart is in the right place, but we are in the foothills looking up at the mountains. We have started the long journey and we intend to complete it.”*<sup>90</sup>

Equally, Gary Hoffman, the Group Vice Chairman and Head of Corporate and Social Responsibility of Barclays recently stated the business case for Barclays adopting the Equator Principles: *“There are good commercial reasons why we need to sign up to these principles. Customers are now taking the issues much more seriously.”*<sup>91</sup> If, for

<sup>89</sup> See *Banking on Responsibility: Part 1 (2005)*, see *supra* at note 2, p. 52 and also cited in Paul Watchman, "Beyond the Equator", *Environmental Finance*, June 2005, pp. 16-17 available at <http://www.banktrack.org/doc/File/policies%20and%20processes/Equator%20Principles/050601%20Beyond%20Equator%20.pdf>.

<sup>90</sup> From the text of a speech by Sir John Bond, Group Chairman, HSBC Holdings plc, at the HSBC Climate Group Launch, 27 April, 2004. The full text of the speech is available at [http://www.hsbc.com/hsbc/news\\_room](http://www.hsbc.com/hsbc/news_room).

<sup>91</sup> See Caroline Merrell, "Barclays mends fences with African Initiative," see *supra* at note 23, p. 70.

Gary Hoffman, the principal reason for Barclays adopting the EP is a matter of avoiding customers voting with their feet and abandoning the bank, for Christopher Bray, Head of Environmental Risk Policy Management at Barclays Group, there were two other good reasons for adopting the EP: first, for Barclays, adoption of the EP was an incremental and logical step to take as the EP, whilst not representing a "quantum shift" from existing Barclays policies, nevertheless required some amendment to their practices; and second, it assisted Barclays in terms of its obligations under Basel II as he describes below:

*“Many banks like ourselves have been integrating environmental issues into their credit risk management process for over a decade. A significant development is how this fits with capital requirements related to Basel II. The sentiment proposed in the Accord clearly indicates that environmental risk issues are now positioned as mainstream business considerations for the sector, challenging institutions to ensure their policies and procedures reflect this expectation.”*<sup>92</sup>

A reason not put forward by banks in our first survey for adopting the EP was to develop a close relationship with the other EPFI. Nedbank however, makes crystal clear that it adopted the EP to become “[the Equator Banks] partner bank of choice for the other Equator Banks in African deals”.<sup>93</sup> Consequently, it may be speculated that establishing or preserving working relationships with the EPFI may also have been an important motivating factor for a number of local or regional banks adopting the EP.

It is important to note that the principal reasons given by the vast majority of the EPFI for adopting either set of the EP were genuine, even hard-nosed, banking, financial or business reasons rather than zeal or fervour for corporate social responsibility or socially responsible investment. This is relevant because it makes the attachment of the EPFI to the EP more fixed as the EP appear to be ingrained in traditional banking beliefs rather than viewed as exotic species in which only head office or a cadre of specialists have any interest in nurturing.

#### **4. WHY HAVE OTHER FINANCIAL INSTITUTIONS NOT ADOPTED THE EP?<sup>94</sup>**

The reasons given by a number of leading project finance banks for not adopting the EP ranged from scepticism about the value of the EP,<sup>95</sup> a feeling that the EP were nothing new and that there was more than a whiff of hypocrisy about at least some of the EPFI adopting the EP given their lack of importance and track record outside

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<sup>92</sup> See Environmental Resources Management, *Credit Risk Management – Banking Industry Integrating Environmental and Social Issues – How Much and How Fast?*, 2004, p. 5 available at [www.erm.com](http://www.erm.com). Also, see *Banking on Responsibility: Part 1 (2005)*, see *supra* at note 2, pp. 63-64.

<sup>93</sup> Press release issued by Nedbank Media Relations, "Nedbank is the First African Bank to Adopt the Equator Principles", 10 November 2005, p.1, [www.nedbank.co.za](http://www.nedbank.co.za)

<sup>94</sup> See *Banking on Responsibility: Part 1 (2005)* (see *supra* at note 2, pp. 65-69) and Malcolm Forster, Paul Watchman and Charles July, "Towards Sustainable Banking?", (see *supra* at note 1, pp. 217-222 at pp. 221-222).

<sup>95</sup> See *Banking on Responsibility: Part 1 (2005)*, see *supra* at note 2, pp. 1, 2 and 65-66.



Europe and North America as project finance lenders,<sup>96</sup> a desire to increase market share by holding themselves out as being free of the stifling bureaucracy of the EPFI and the EP red tape (as exemplified by the recent "launch" of "CE Bank" which held itself out as a specialist in unscrupulous investments),<sup>97</sup> fear that if they adopted the EP for one part of their banking business, project finance, it would lead to contagion of other parts of banking which could not be stopped,<sup>98</sup> to finally the need to review internal processes and procedures to align them with the EP.<sup>99</sup>

From Table 7 below, it can be seen that in addition to the important French duo of project finance lenders which remain outside the EP, there are an important group of Middle East and Asian banks and financial institutions which have not adopted the EP.

The reasons for any financial institutions not adopting the EP differ. For instance, most ECAs (save for the Danish ECA, Eksport Kredit Fonden) have not adopted the EP because they apply the OECD's Recommendation on Common Approaches on Environment and Officially Supported Export Credits (the Recommendation)<sup>100</sup> and have developed their own environmental and social policies in accordance with the Recommendation. By way of example, the French ECA, Coface, has developed policies which include specific environmental guidelines on thermal power plants, large dams, oil and gas and construction activities amongst other subjects.<sup>101</sup> Similarly, the Japan Bank for International Cooperation (JBIC), for example, has social and environmental policies which in most respects (transparency, auditing, accountability and respect for cultural beliefs and value systems) are far more developed than the EP.<sup>102</sup> Furthermore, as most of the projects carried out by JBIC are also co-financed by one or more EPFIs, environmental and social review for those projects has often been completed by both JBIC and the EPFIs to satisfy both JBIC's guidelines and the EP.

On the other hand, a number of the non-EPFI have participated in EP project lending and some sponsors and lenders are developing and operating projects to EP standards even if they fall outside the EP or there is no intention to borrow from an EPFI. It is

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<sup>96</sup> *Ibid.*, at pp. 66-67.

<sup>97</sup> The launch of the bank caused considerable outrage, speculation and enthusiasm in the press for several weeks in October 2006 "due to the fact that the bank prided itself on its ability to invest, unfettered by ethical considerations, in the arms industry, oil and gas, nuclear power, agrochemicals and companies violating their workers' rights. The Belgian NGO (Netwerk Vlaanderen) behind the bank revealed it was a hoax on 17 October, 2006 (Netwerk Vlaanderen, Press Release, "CE Bank reveals its true colours," 17 October, 2006, available at [www.kassa-kassa.be/home-en.php](http://www.kassa-kassa.be/home-en.php)). Also, see *Banking on Responsibility: Part 1 (2005)* (see *supra* at note 2, pp. 65 and 68).

<sup>98</sup> See *Banking on Responsibility: Part 1 (2005)*, see *supra* at note 2, pp. 65 and 68.

<sup>99</sup> *Ibid.*, at pp. 65 and 67.

<sup>100</sup> See *supra* at note 18, paragraph (viii).

<sup>101</sup> For further information, see [http://www.coface.fr/dmt/en/\\_docs/environmentGB.pdf](http://www.coface.fr/dmt/en/_docs/environmentGB.pdf).

<sup>102</sup> JBIC places a premium on stakeholder participation (e.g. local communities who will be affected by projects), requiring the project proponents to obtain stakeholders' participation from the project planning stage; also, the JBIC checklist for completion now includes social considerations pertaining to resettlement, indigenous people and women and JBIC is required to disclose publicly such items as the category classification of the project prior to loan approval. For further information, see the JBIC Guidelines for Confirmation of Environmental and Social Considerations (the Guidelines) which were established in April 2002 and have been implemented from October 2003 as <http://www.jbic.go.jp/english/environ/guide/eguide/pdf/guide.pdf>.

not unusual for, Middle Eastern banks, for example, to insist on projects being developed to EP standards, albeit that no EPFI is involved. Similarly, it is well known that several Chinese banks have or are increasingly developing a much more robust reputation for social and environmental management.

**Table 7: Non-EPFI involved in Equator Projects in order of Top Project Finance Lenders, H1 2006**<sup>103</sup>

Bank or Financial Institution	Amount of Lending (US \$M)	Share of Market (%)
JBIC	4,735	26.87
Public Investment Fund	2,547	14.45
BNP Paribas	890.95	5.06
Société Générale	877.22	4.98
Gulf International Bank	696.58	3.95
Saudi Hollandi Bank	646.53	3.67
Islamic Development Bank	605.53	3.44
Apicorp	521.28	2.96
Saudi British Bank	404.91	2.30
Grupa Santander	309.79	1.76
<b>TOTAL</b>	<b>12,234.79</b>	<b>69.44</b>

*Note: JBIC and some of the above non-EPFI apply social and environmental policies which exceed the EP.*<sup>104</sup>

It would appear from our present research, that fears that there would be a significant amount of "bottom feeding" (i.e. non-EP local or regional banks offering sponsors a less stringent approach to social and environmental assessment), may be unproven, unfounded or a little exaggerated.

In the last year to 18 months, some notable project finance lenders, such as HBOS,<sup>105</sup> Bank of Tokyo-Mitsubishi (BTMU),<sup>106</sup> Sumitomo Mitsui Banking Corporation (SMBC)<sup>107</sup> and Dresdner Bank<sup>108</sup> have adopted the EP. Nonetheless, some major project finance lenders and financial institutions with a reputation for strong ethical, social and environmental beliefs still remain firmly outside the EP circle.

## 5. WHAT IMPACT HAVE THE EP HAD ON PROJECT FINANCE AND LENDING?

*"The Equator Principles are now part of the lexicon of the financial world".*  
Christopher Bray<sup>109</sup>

There is an abundance of fulsome praise from the financial industry for the EP and the EPFI. Kirsty Jenkinson, Associate Director, Governance & Sustainable Investment of

<sup>103</sup> Simon Ellis and Vander Caceres, "Equator Principles Financing", (see *infra* at note 133, p. 75).

<sup>104</sup> Also see *supra* at Section 4, paragraph 4 and *infra* at "Note" at Chart 1 of this article.

<sup>105</sup> On 15 August, 2006 (www.equator-principles.com).

<sup>106</sup> On 22 December, 2005 (www.equator-principles.com).

<sup>107</sup> On 23 January, 2006 – it also established an Environmental Analysis Department within the Credit Department of its International Banking Unit to strengthen its commitment to social and environmental responsibility ((www.equator-principles.com).

<sup>108</sup> On 20 July, 2006 (www.equator-principles.com).

<sup>109</sup> See *Banking on Responsibility: Part 2 (2006)*, see *supra* at note 1, p. 34.

F&C Asset Management, for example, stated "*the Equator Principles have done more for sustainable financing in the banking sector than anything else*".<sup>110</sup> She joins distinguished company. Charles Prince, Chief Executive of Citigroup has opined "*the Equator Principles are one of the most important things that the banking industry has done in the past couple of years*"<sup>111</sup> and Peter Woicke, formerly Executive Vice-President of the IFC and Managing Director of the World Bank added that the "[*Equator*] Principles have proven more successful than anyone could have imagined".<sup>112</sup>

On the other hand, NGOs, such as BankTrack,<sup>113</sup> Amnesty International,<sup>114</sup> Friends of the Earth<sup>115</sup> and WWF<sup>116</sup> have been more sceptical as to the benefits to be derived from the EP. They criticise the scope<sup>117</sup> of the EP, the lack of accountability of the EPFI<sup>118</sup> and the lack of policy underpinning for the EP (for instance, several EPFI have not adopted the IFC policies underlying the IFC Performance Standards).<sup>119</sup> They also berate the EPFI for failing to apply the EP consistently<sup>120</sup> and for a failure to be as transparent<sup>121</sup> about how they have implemented the EP in specific cases as they might be, even if it is acknowledged grudgingly that the EPFI have legal and professional duties of confidentiality towards their clients.<sup>122</sup> Finally, they deride the lack of an independent body to review and to enforce compliance with the EP and if, necessary, to impose *formal* sanctions.<sup>123</sup> Of course, it must always be borne in mind that the EPFI have adopted the EP for a wide variety of reasons (see Section 3 above) and that, even if there are no formal sanctions for their breach, the majority of EPFI

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<sup>110</sup> *Ibid.*, at p. 6.

<sup>111</sup> Demetri Sevastopulo, "Environment groups hold banks to their green promises", see *supra* at note 83.

<sup>112</sup> "Equator Principles Celebrate First Anniversary", *Financial Times*, 4 June, 2004 available at <http://www.equator-principles.com/epcfa.shtml>.

<sup>113</sup> BankTrack, *Principles, Profits or just PR? Triple P Investments under the Equator Principles: An Anniversary Assessment*, (Amsterdam, BankTrack), 4 June, 2004; BankTrack, *Unproven Principles: The Equator Principles at Year Two*, 2005, see *supra* at note 28. A full list of BankTrack publications see <http://www.banktrack.org/?show=86&visitor=1>.

<sup>114</sup> Amnesty International, *Human Rights, Trade and Investment Matters*, (London: Amnesty International UK May, 2006); available at <http://www.amnestyusa.org/business/HRTradeInvestmentMatters.pdf>.

<sup>115</sup> Jennifer Bates (Friends of the Earth), *A Big Deal? Corporate Social Responsibility and the Finance Sector in Europe*, (London: Friends of the Earth, September 2004), pp. 1, 3, 23 and 24.

<sup>116</sup> See WWF "Banks adopt environmental guidelines - but are they enough?," 5 June 2003 (Surrey: WWF, 2006) available at [http://www.wwf.org.uk/news/n\\_0000000905.asp](http://www.wwf.org.uk/news/n_0000000905.asp) and WWF, *Shaping the Future of Sustainable Finance*, (Surrey: WWF, 2006).

<sup>117</sup> See WWF *Shaping the Future of Sustainable Finance* see *supra* at note 116, p.74, Collevechio Declaration on Financial Institutions and Sustainability (Collevechio Declaration), Commitments no. 1 and 2, and *Equator Principles II – NGO Comments on the Proposed Revision of the Equator Principles*, ("*Equator Principles II – NGO Comments*") see *supra* at note 33, pp. 5 and 12.

<sup>118</sup> See WWF *Shaping the Future of Sustainable Finance* see *supra* at note 116, p.77, Collevechio Declaration, Commitment no. 4, and *Equator Principles II – NGO Comments* see *supra* at note 33, p.11.

<sup>119</sup> See WWF *Shaping the Future of Sustainable Finance* see *supra* at note 116, p.74 and *Equator Principles II – NGO Comments* see *supra* at note 33, p.12.

<sup>120</sup> See WWF *Shaping the Future of Sustainable Finance* see *supra* at note 116, p.74.

<sup>121</sup> See WWF *Shaping the Future of Sustainable Finance* see *supra* at note 116, p.76, Collevechio Declaration, Commitment no. 5, and *Equator Principles II – NGO Comments* see *supra* at note 33, p.9.

<sup>122</sup> See WWF *Shaping the Future of Sustainable Finance* see *supra* at note 116, p.66 and Collevechio Declaration, Commitment no. 5.

<sup>123</sup> See WWF *Shaping the Future of Sustainable Finance* see *supra* at note 116, p.77 and *Equator Principles II – NGO Comments* see *supra* at note 33, pp.7 and 8.

consider the potential *informal* sanctions of such breach (e.g. bad publicity, allegations of hypocrisy, loss of retail customers amongst others) to be a very real consideration.<sup>124</sup>

How do we reconcile these differences in views of the EPFI: greenwash or real success? Moving social and environmental concerns into the banking mainstream or cynical exercise? Much depends on what benchmark is fixed and what goals are set to judge success.

On the plus side of the equation is the large number of the EPFI which have adopted the EP (originally 10 in 2003, there are now currently 45 EPFI as discussed on page 5 of this article). Also, although opinions and the basis for measurement differ, it is often cited that, collectively, the EPFI now represent around 85% of the world's cross-border project finance.<sup>125</sup> Less commonly known is the finding that the total debt amount for EP debt financing in emerging markets was 93% for the first half of 2006.<sup>126</sup> This figure comprised the amount of debt underwritten by the EPFI in the emerging markets and by several non-EPFI involved in "Equator-compliant" projects (where at least one mandated lead arranger was an EPFI).<sup>127</sup> Consequently, it could be said that, "*most of the project financing is being carried out in some form or another under the Equator Bank Principles*"<sup>128</sup>: a remarkable achievement given that the EP are entirely voluntary and that they have only been in existence since 2003. Further, out of the top ten project finance banks globally in terms of debt underwritten, six of them are EPFI (see Chart 1 below) which demonstrates the reach of the EP extends to some of the leading banks in the world. Such EP dominance is particularly evident given the need for syndication of finance for major projects so that the influence of the EPFI on the project finance market may be ubiquitous. In other fields of banking activity their influence is increasingly being felt as discussed already in this article.

Another positive is the number of Chairmen and Chief Executive Officers who have spoken for and continue to speak up for the EP and the success social and environmental assessment has brought to the financial bottom line of banks. For example, *John Varley, Group Chief Executive Officer of Barclays*, reporting that Barclays had posted a record financial year in 2005, a record performance in the area of corporate responsibility and their highest ever ranking in the "Business in the Community, Companies that Count Index", stated recently that "*a strong performance as a responsible corporate citizen does not conflict with strong financial performance*".<sup>129</sup>

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<sup>124</sup> For an example of an informal (in that it is not imposed by an independent EP enforcement body) but very significant sanction, see the quote from André Abadie, Head of Sustainability Business Advisory, ABN Amro (*infra* at p. 29 of this article).

<sup>125</sup> Oliver Balch, "Building a better world (for investors and whales)", 3 July, 2006, *The Banker* p. 54, available at <http://www.equator-principles.com/bbw.shtml>.

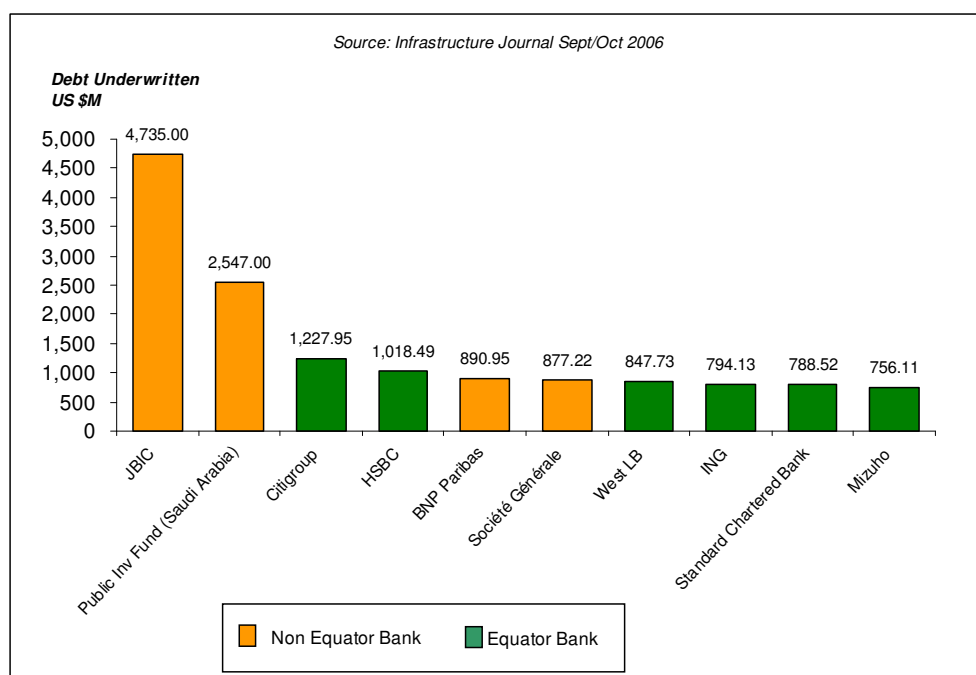
<sup>126</sup> Being projects in non-OECD and low income OECD countries. See Simon Ellis and Vander Caceres "Equator Principles Financing: The International Fallout", see *infra* at note 133, p. 73.

<sup>127</sup> *Ibid.*, at p. 73.

<sup>128</sup> See Simon Ellis and Vander Caceres "Equator Principles Financing: The International Fallout", see *infra* at note 133, p. 73.

<sup>129</sup> From the text of John Varley's (Group Chief Executive Officer of Barclays) speech to the Fifth Ethical Corporation Summit, London on 31 May, 2006 (available at

**Chart 1: Top 10 Project Finance Banks In Equator Projects: H1, 2006<sup>130</sup>**



Note: JBIC and some of the above non-EPFI apply social and environmental policies which exceed the EP.<sup>131</sup>

This is demonstrated in Table 8 below which illustrates that, the top ten EPFI in the first half of 2006 represented a share of nearly 80% of the lending market. When this is considered in the light of the oft-cited statistic that the EPFI represent over 85% of the market,<sup>132</sup> this indicates that the EPFI do not seem to be adversely affected by the EP in any way, indeed, quite the contrary: powerful testimony for the corporate social responsibility lobby.

**Table 8: EPFI in order of Top Project Finance Lenders, H1 2006<sup>133</sup>**

Project Finance Lender	Amount of Lending (US \$M)	Share of Market (%)
Citigroup	1,227.95	12.18
HSBC	1,018.49	10.10
WestLB	847.73	8.41
ING	794.13	7.88
Standard Chartered Bank	788.52	7.82
Mizuho Financial Group	756.11	7.50
SMBC	746.66	7.40
Calyon	643.58	6.38
Royal Bank of Scotland	545.81	5.41
BOTM	527.20	5.23
<b>TOTAL</b>	<b>7,896.18</b>	<b>78.31</b>

<http://www.ethicalcorp.com/content.asp?ContentID=4338> under "Barclays believes that business ethics are key ingredient to their record financial performance").

<sup>130</sup> Simon Ellis and Vander Caceres, "Equator Principles Financing: The International Fallout", see *infra* at note 133, pp. 74-75.

<sup>131</sup> Also see *supra* at Section 4, paragraph 4 and "Note" at Table 7 of this article.

<sup>132</sup> Oliver Balch, "Building a better world (for investors and whales)", see *supra* at note 125.

<sup>133</sup> See Simon Ellis and Vander Caceres, "Equator Principles Financing: The International Fallout", *Infrastructure Journal*, September/October 2006, pp. 73-76 at p. 74.

## 6. WHAT IMPACT HAVE THE EP HAD ON PROJECTS, PROJECT SPONSORS AND PROJECT AFFECTED LOCAL COMMUNITIES?

*“It is entirely appropriate that the EPFI support good projects. It is in the interests of all those concerned to abide by the Equator Principles”*

Charles Lawton, General Counsel, Rio Tinto.<sup>134</sup>

*“It is amazing how few clients realise that not following the Equator Principles could lead to an event of default and acceleration of the loan.”*

André Abadie, Head of Sustainability Business Advisory, ABN Amro.<sup>135</sup>

*"The nexus between financial services, investment and sustainable development is steadily becoming evident. The Equator Principles reflect a growing awareness of this nexus and could lead to projects that are better not only for the financial sector, but also for the environment and human health and welfare".*

William L Thomas, Pillsbury Winthrop LLP.<sup>136</sup>

*"The Equator Banks believe this [the Principles] will lead to more secure investments on the part of our customers and safer loans on the part of the banks. Because if you finance something that's dirty or something that harms people, there is [a] likelihood that the host government or local people will interfere with it or even take it away from you"*

Christopher Beale, former Global Head of Projects and Structured Trade Finance, Citigroup.<sup>137</sup>

This section focuses first on the impact of the EP on projects and project sponsors and second on communities.

### a. Effect on Projects and Project Sponsors

The first point that has to be made is that, given their historically late engagement with the sponsor, the power of banks to influence projects and their sponsors is often much more limited than NGOs and civil society appreciate. Large scale projects, particularly transboundary linear projects, such as oil and gas pipelines, take years of planning and negotiation with governments and regulators before a bank is called in simply to provide advice (and then only subsequently to lend money to the project). As a consequence, banks are often left with a simple choice to fund or participate in

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<sup>134</sup> See *Banking on Responsibility: Part 2 (2006)*, see *supra* at note 109, p. 33.

<sup>135</sup> *Ibid.*, at p. 37.

<sup>136</sup> William L. Thomas, "Equator – Risk and Sustainability," *Project Finance International Yearbook 2004*, pp. 10-16, at p. 16.

<sup>137</sup> Michael M. Phillips and Mitchell Pacelle, "Banks Accept 'Equator Principles' – Citigroup, Barclays, Others to Shun Projects Hurting Environment, Livelihoods", *The Wall Street Journal*, 4 June, 2003, p. 2.

the funding of a project or to reject any involvement. Hopefully, with the extension of the EP to the advisory role of the EPFI, this lack of influence over sponsors and projects may diminish, in least in part, as the banks are brought into the project loop at an earlier stage in the project life cycle.

The second point is that information on the positive impacts of the EP is scant and difficult to find. This is due to the fact that information in this area tends to be partial, sporadic and not necessarily representative of the full picture concerning a project; a “snapshot” in time rather than a balanced review of the impacts of the project (a sentiment with which we and others fully concur). Furthermore, certain projects tend to receive far more attention than others, perhaps due in part to the fact that NGOs tend to get involved in certain cases – and not others – because they have been requested to do so by movements and other organisations on the ground. This highly biased selection process means that many projects which perhaps ought to receive stakeholder attention avoid the spotlight whilst others remain permanently under its glare as coverage about it increases. For the above reasons, it is comparatively straightforward to identify those projects which the NGOs find highly questionable: Sakhalin II, the Chad-Cameroon pipeline, the TXU coal power plants and the Frey Bontos paper mills are a few obvious examples. The focus of BankTrack, Greenpeace, Friends of the Earth, WWF, Human Rights Watch and the army of NGOs, often is the negative rather than the positive aspects of such projects, on bad news rather than good. In reality, one finds NGO opposition is often based upon political rather than social or environmental grounds (for instance, to developments such as dams and nuclear power stations). Consequently, it is therefore often difficult for the EPFI to satisfy such NGOs by adopting a particular social or environmental objective, given this underlying political agenda.

However, neither the EPFI nor sponsors help themselves in this regard. The approach of some NGOs in turning a blind eye to the positive impacts of the EP is reinforced by the EPFI which, except in the highest profile cases, evince a reluctance (no doubt, partly based on fears of legal or professional disciplinary sanctions for breaching client confidentiality), to make transparent their dealings with clients in respect of the EP. The approaches adopted by NGOs and the EPFI are matched in some cases by an understandable reluctance on the part of some sponsors to discuss their projects openly with outsiders, even very high profile projects, where a candid exchange of views may have been more beneficial to all parties.

In making these broad reservations, it is nevertheless possible to point to sources of information from which it may be inferred or claimed that the EP have improved the nature of the project or reduced its social or environmental impacts. For the reasons given above, authenticity of some of the information, however, is difficult to test satisfactorily.

Of course, it is difficult to consider the impact of the EP upon certain major projects due to the chronology of events (for instance, if their construction began before EP1 were adopted). However, it is clear that the EP have had an impact upon more recent projects. Similarly, it appears that the EP have also opened less formal lines of communication between banks and NGOs. For instance, Citigroup's meeting in 2005 with the Rainforest Action Network and Friends of the Earth to discuss Citigroup's implementation of the EP represents considerable progress, so clearly expressed by

Charles Prince, Chairman and Chief Executive Officer at Citigroup at the beginning of this article.<sup>138</sup>

Evidence of a virtuous circle where sponsors bring more robust projects to environmentally and socially robust EPFI for testing is rather circumstantial at the moment, although that is not to say that it is not impressive and material circumstantial evidence.<sup>139</sup> For example, a number of the EPFI have informed us that sponsors have approached them because of their robust approach as an EPFI in enforcing the EP.

Also, the number of occasions where the EPFI are rejecting high-risk project finance deals is slowly increasing, demonstrating a new found independence for the EPFI. For instance, whilst rejection of projects is not the only or even a clear measure of robustness in enforcing the EP, Barclays' latest corporate responsibility report reveals that they rejected two of the six high risk project finance deals considered in 2005 and overall, chose not to participate in 25 out of a total of 68 project finance transactions.<sup>140</sup>

#### **b. Effect on Communities**

For communities there is again some evidence of extractive industry sponsors seriously re-considering their security arrangements and seeking to impose change on their security providers to give greater emphasis to due process and human rights.<sup>141</sup> Together with the emergence of a greater need to carry out proper consultation with local communities and to ensure that there are ways for the community to obtain redress for grievances, this shows some progress.<sup>142</sup> Such progress is illustrated, for instance, by the establishment of industry standards for the provision of security with respect for human rights under the Voluntary Principles on Security and Human Rights.<sup>143</sup> Many of the 16 global extractive companies who have adopted these principles have incorporated them into contractual agreements with host government agencies to govern security conduct.

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<sup>138</sup> See *supra* at p. 2 of this article.

<sup>139</sup> To borrow the words of Richard Burrett, Head of Sustainable Development Business Group, ABN Amro: "the legacy of the Equator Principles will be what they cause banks to do outside project finance" Christopher Wright, "Conservation you can Bank on," *Ecosystem Marketplace*, 31 January, 2006, p. 4 (available at <http://www.equator-principles.com/documents/ConservationYouCanBankOn.pdf>).

<sup>140</sup> Oliver Balch, "Building a better world (for investors and whales)," see *supra* at note 125, p. 54.

<sup>141</sup> For example, in the case of companies like Shell (<http://www.shell.com/home/Framework?siteId=home> follow Environment and Society hyperlink).

<sup>142</sup> As exemplified in the case of Sakhalin and see Principles 5 and 6 of EP2 at Table 2 above and Appendix 1 below.

<sup>143</sup> See *supra* at note 18, paragraph (vii).



## CONCLUSIONS

*“Principles are only as good as the commitment behind them.”*

### Bank Track<sup>144</sup>

The changes put forward by the EP2 represent very substantive progress over the EP1 and those involved in the process of amending the EP should be congratulated for their efforts. However, the EP are only as good as the commitment of the EPFI to their consistent implementation and interpretation. When discussing the EP2, it is worth noting that they provide the basic foundations upon which an EPFI can erect gothic edifices of policies to human rights or biodiversity or any other social or environmental issue. Banks such as ABN Amro, HSBC, Mizuho and West LB, for example, have gone beyond the EP to adopt sustainable banking for their banking activities as a whole as discussed above.

However, when a step is taken outside the world of project finance, the influence the EPFI have had on business generally and their wider importance can be appreciated fully. The EPFI together are an exemplar for other industries and businesses and have had a profound effect in driving businesses as well as banks towards more responsible business or sustainable capitalism.<sup>145</sup> If banks such as Citigroup and ABN Amro amongst others, which only a few years ago were vilified by NGOs across the globe, can adopt and implement principles such as the EP, it can be hoped that companies in other business sectors will feel equipped to follow suit.

Further, some banks have had a profound effect on "cleaning and greening" not only their own supply chains but, by using what influence they do exercise, also those of their own service providers and borrowers. If, for example, an EPFI agreed to incorporate terms into their tender documents and contracts with their panel for the supply of legal services that, when awarding instructions, they would consider only firms that demonstrate a commitment to carbon reduction, diversity, community development, education, philanthropy, the protection of human rights or other social and environmental values identified in the EPFI's Corporate and Social Responsibility reports, there is no doubt that would shift the tectonic plates of the legal world. Consequently, it is no coincidence for example, that the recent interest of legal firms in reporting on their corporate and social responsibility has arisen at a time when governmental bodies and major financial institutions such as AXA and Barclays are starting to ask them to demonstrate their social and environmental commitment and credentials through their own corporate and social reports.<sup>146</sup>

The EP are arguably the most important change to banking practice which has occurred in recent memory. At long last, banks and advisers are committing real money and human resources to meet the challenges which the EP present and the IFC

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<sup>144</sup> BankTrack founding members quoted in BankTrack, *Principles, Profits or just PR?*, 2004, see *supra* at note 113, p. 8.

<sup>145</sup> Lynn Sharp Paine, *Value Shift: Why Companies Must Merge Social and Financial Imperatives to Achieve Superior Performance* (New York: McGraw-Hill, 2004) and Paul Watchman, "Banks, Businesses and Human Rights," see *supra* at note 1, pp. 46-50.

<sup>146</sup> It has become standard practice amongst the large financial institutions to send environmental and social assessment questionnaires to suppliers of goods and services (including law firms).

and the EPFI are running awareness and training programmes for the EPFI and other interested parties.<sup>147</sup> However, there is still some way to go if the EP are to become the touchstone for sustainable banking, so, where do we go from here?

First, we must recognise that risks, whether financial, legal, regulatory, political, environmental or social, have become tied together in a Gordian knot. Projects such as Sakhalin II, the Chad-Cameroon pipelines, the TXU coal plants and the Frey Bentos paper and pulp mills show that these risks cannot be easily separated. Over-ambitious legal agreements which seek to protect projects from the rule of law or deny state sovereignty for substantial periods of time may help reduce legal risk but also focus and increase political, regulatory and other risks.

Second, we must accept that there are some outstanding technical and non-technical problems with the EP. These include the independence of consultants, difficulties embedding the EP in the EPFI and securing firm commitment from operational banking staff. Equally, there is a list of projects which are funded by the EPFI or where the EPFI evince an enthusiasm to fund which are questionable in terms of the commitments given by the EPFI. There are also "free riders" and those EPFI who do so little project finance work that adoption of the EP may appear to be a cynical PR exercise. That there is some hypocrisy, a relative absence of commitment and some poor decision-making is almost bound to be the case, given such a large number of diverse financial institutions. However, it looks like the EP are here to stay, representing both a permanent feature of the project finance landscape and a work in progress.

"Après nous, le deluge": Madame Pompadour, mistress of Louis XIV, is credited with this stark forecast of the world after death. It may not be quite as daunting a prospect as losing a Sun King but the prospect of not maintaining and improving on the work done by the EPFI in respect of the EP during the last three years, of returning to the world of project finance prior to 2003 and the introduction of the first set of the EP, is very bleak. It would amount to a retreat, if not to the Dark Ages, then certainly to an age when, as Christopher Bray has observed (as quoted earlier at page 2 of this article), bankers treated those discussing the importance of environmental and social matters to financial decision-making with a high degree of suspicion.

In the leading vanguard of the EPFI in the 21<sup>st</sup> century, sustainable finance or responsible banking has been accepted and is being embedded in those financial institutions as quickly as possible. Huge resources are being made available to raise awareness and train members of the EPFI on the EP and how the environmental and social impacts of projects and lending decisions should be measured and assessed.<sup>148</sup> It has been said repeatedly from the highest level of those banks to very senior

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<sup>147</sup> At the beginning of June 2006, the IFC completed a lengthy competitive bidding process which concluded with the selection and training by the IFC of four firms tasked to deliver external training on the IFC Performance Standards. The four firms will be predominantly using IFC material and are to address the training needs of the EPFI as a first priority, and thereafter, expand the training to cover the needs of other stakeholders. The four firms are: (i) Environmental Resources Management (ERM) - Washington, DC ([www.erm.com](http://www.erm.com)); (ii) Overseas Development Institute (ODI) - London, UK ([www.odi.org.uk](http://www.odi.org.uk)); (iii) Scott Wilson - London, UK ([www.scottwilson.com](http://www.scottwilson.com)); and (iv) Sustainable Finance Limited (SFL) ([www.sustainablefinance.co.uk](http://www.sustainablefinance.co.uk)). See ([http://www.ifc.org/ifcext/enviro.nsf/Content/EnvSocStandards\\_Training\\_3.1.2007](http://www.ifc.org/ifcext/enviro.nsf/Content/EnvSocStandards_Training_3.1.2007))

<sup>148</sup> Paul Watchman, "The Equator Principles: Raising the Bar on Social Impact Assessments?", pp. 15-17 of Amnesty International, *Human Rights, Trade and Investment Matters*, (see *supra* at note 114).

bankers working at the coal face of finance and creating record profits for their employers that it can be a career-limiting move not to embrace the challenges of the EP and the new corporate social responsibility or sustainable banking values which underpin the way we live now.<sup>149</sup>

Since the EP have achieved so much in such a short period of time, it is perhaps time for the NGO community to acknowledge that success and also that NGOs played a large part in that success. It is also time for the NGOs to turn their attention to those banks which do not recognise the importance of social and environmental factors in financial decision-making. To fail to do so, and to continue to focus on minutiae of the EP and the performance in implementing the EP of those EPFI which have been brave enough to put their heads above the parapet, risks throwing a very healthy and bouncy baby with so much promise out with the bath water. If BankTrack, Friends of the Earth and WWF wish to point to a fitting legacy for their campaigning activities in the early 21st century, there is none better than the EP. The EP are not greenwash. They have revolutionised project finance and have been a force for good throughout the financial world. Mistakes have been made and will continue to be made. Transparency and accountability still need to be addressed properly. Hypocrisy remains difficult to stifle. However, for the present moment, it is time to rejoice that a small number of dedicated people at IFC, EPFI and within the NGO community have changed the world for the better, so far thankfully, without taking Shakespeare's advice to dispatch the lawyers.

**Paul Q. Watchman, Partner**  
**Angela Delfino, Associate**  
**Juliette Addison, Associate**

**LeBoeuf, Lamb, Greene & MacRae**

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<sup>149</sup> Anthony Trollope, *The Way We Live Now*, (New York: Harper & Bros, 1875).

## Appendix 1

### Detailed Comparison of EP1 v EP2

	EP1	EP2	Comments
<b>Heading</b>	" <i>An industry approach</i> for financial institutions in determining, assessing and managing environmental & social risk in project financing."	" <i>A financial industry benchmark</i> for determining, assessing and managing environmental & social risk in project financing."	This amendment arguably reinforces the intention that the principles are intended to be the "common baseline and framework" for implementation by EPFI of their own policies and standards.
<b>Preamble</b>	"Aspirational" wording <sup>150</sup> included.	Certain "aspirational" aspects in the existing principles deleted as EPFI see EPI 1 as less of an aim and more of a "process."	NGOs have criticised this as an attempt to restrict the application of EP2.
	Commitment to "not provide loans directly to projects where the borrower will not or is unable to comply with <i>our environmental and social policies and processes.</i> "	Same but reference to " <i>our respective policies and procedures that implement the Equator Principles</i> "	Certain NGOs consider this amendment as a <i>de facto</i> acceptance that endorsing banks may choose to implement the EP "as they see fit."

<sup>150</sup> Such as: references to '... foster our ability to document and manage our risk exposures ... thereby allowing us to engage proactively with our stakeholders on environmental and social policy issues' and 'Adherence to these principles will allow us to work with our customers in their management of environmental and social policy issues relating to their investments in the merging markets'.

	EP1	EP2	Comments
<b>Definition of project financing</b>	Not expressed	Explicit limitation of the principles to " <i>Project finance</i> " which is expressly defined by reference to Basel II definition. <sup>151</sup>	<ul style="list-style-type: none"> <li>• The extension of the Equator Principles to lending other than project financing continues to be a matter in the sole discretion of individual financial institutions.</li> <li>• Despite the inclusion of the definition of "Project finance" by reference to Basel II, the scope of the new principles limits their application to "new project financings" and certain expansions or upgrades only (see Transitional provisions below).</li> </ul>
<b>Definition of adopters</b>	N/A. Reference to "financiers", "financial institutions" and "banks".	New reference to " <i>Equator Principles Financial Institutions</i> " (EPFI)	Reflects the fact that certain adopters of the principles are not solely private banks e.g. Manulife is predominantly an

<sup>151</sup> **Project finance** is "a method of funding in which the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security for the exposure. This type of financing is usually for large, complex and expensive installations that might include, for example, power plants, chemical processing plants, mines, transportation infrastructure, environment and telecommunications infrastructure. Project finance may take the form of financing of the construction of a new capital installation, or refinancing of an existing installation, with or without improvements. In such transactions, the lender is usually paid solely or almost exclusively out of the money generated by the contracts for the facility's output, such as the electricity sold by a power plant. The borrower is usually an SPE (Special Purpose Entity) that is not permitted to perform any function other than developing, owning and operating the installation. The consequence is that repayment depends primarily on the project's cash flow and on the collateral value of the project's assets." *Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards ("Basel II")*, November 2005 (available at <http://www.bis.org/publ/bcbs118.pdf>).

	EP1	EP2	Comments
			insurance company; EKF is a Danish export credit agency <sup>152</sup> ; and E+Co is an energy fund.
<b>Start Date</b>	4 June, 2003	6 July, 2006 <sup>153</sup>	According to <a href="http://www.equator-principles.com">http://www.equator-principles.com</a> , the EPFI have agreed that, where some projects have been marketed and reviewed, but await approval or completion of due diligence between 6 July, 2006 and 6 January, 2007, the EP1 may still be used with the previous IFC Safeguard Policies. From 7 January, 2007 onwards, the EPFI will expect all due diligence to be undertaken using the EP2 and the new IFC Performance Standards, if applicable.
<b>Transitional provisions</b>	N/A	<p>EP2 has a new "<i>Scope</i>" section such that EP2 will:</p> <ul style="list-style-type: none"> <li>• apply to all "new project financings";</li> <li>• are expressly not intended to be applied retrospectively; and</li> <li>• apply to certain expansions or upgrades of an existing project</li> </ul>	<ul style="list-style-type: none"> <li>• As there are no explicit transitional provisions, there could be projects under review which straddle the application of the EP1 and the EP2 (see "<i>Start Date</i>" comments above).</li> <li>• The meaning of "new project financings" is unclear as the definition of "Project finance" provided in</li> </ul>

<sup>152</sup> For instance, the European Investment Bank subscribes to the EP outside the European Union and BG Group, a sponsor, has "endorsed" the principles.

<sup>153</sup> This is not explicit in the Principles themselves. Refer to [www.equator-principles.com](http://www.equator-principles.com). The new revised principles were released on this website around 8 March, 2006.

	EP1	EP2	Comments
			footnote 1 of the EP2 includes " <i>refinancing of an existing installation, with or without improvements.</i> "
<b>Structure</b>	Preamble; Statement of Principles and Exhibits I, II and III.	<ul style="list-style-type: none"> <li>• New "Scope" section (see above) and new 'Disclaimer.'</li> <li>• Exhibit I – Environmental and Social Screening Process</li> <li>• Exhibit II – Illustrative List of Potential Social and Environmental Impacts and Risks</li> <li>• Exhibit III – new IFC Performance</li> </ul>	<ul style="list-style-type: none"> <li>• The EP2 incorporates the new IFC Performance Standards but <b>not:</b> (a) the IFC Sustainability Policy; nor (b) the IFC guidance notes that accompany the Performance Standards.</li> <li>• EPFI or borrowers may use the guidance notes as a useful reference point when seeking further guidance or interpretation of the IFC Performance Standards (see <i>note to Exhibit III</i>).</li> <li>• Exhibit I – Categorisation of projects. This reflects the new wording of IFC Category A, B and C projects.</li> <li>• Exhibit II – essentially the same as the EP1's subject to a number of additional Impacts and Risks (see "<i>List of Impacts and Risks</i>" below).</li> <li>• Exhibit II replaces the former Exhibit</li> </ul>

	EP1	EP2	Comments
		Standards on Social and Environmental Sustainability	II containing the former IFC Safeguard Policies (see “ <i>Relevant Laws and Standards</i> ” below).
		<ul style="list-style-type: none"> <li>Exhibit IV – World Bank and IFC Industry-Specific Guidelines</li> </ul>	<ul style="list-style-type: none"> <li>Same as the EP1 Exhibit III.</li> </ul>
<b>Threshold application</b>	Applies to projects with a total capital cost of US \$50M or over ( <i>Principle 9</i> )	Applies to projects with a total capital cost of US \$10M or over	<ul style="list-style-type: none"> <li>This is somewhat a compromise amendment to placate the fevers of the smaller and regional banks who feared the removal of any threshold would be going too far. Many institutions already apply the EP to projects irrespective of the amount funded (e.g. ABN Amro). This amendment fails to acknowledge the truth that the cost of a project is only indirectly linked to the potential social and environmental impact or harm that it may pose. NGOs and other have argued there should be no monetary threshold whatsoever.</li> <li>Clarification of “<i>total capital costs</i>” might be useful to ensure that the term includes an aggregate sum of money lent over time as well as a one off payment (for example, in mining projects, there may be smaller</li> </ul>



	EP1	EP2	Comments
			amounts of money lent over a number of stages) to prevent EPFI from circumventing this by "drip feeding" small amounts over time into a project.
		Threshold applies at least to all "new" project financings	It is unclear from the drafting whether the new US \$10M or more threshold also applies to all project financings covering expansion or upgrade of existing projects. Common sense would suggest this is the case.
<b>Application to "New project financings" and certain expansions and upgrades</b>	N/A	<p>New principles will apply to:</p> <ul style="list-style-type: none"> <li>• all "<i>new</i>" project financings;</li> <li>• all "Project finance" covering expansion or upgrade of an existing project where changes in scale or scope create "<i>significant</i>" social and/or environment impacts or "<i>significantly change the nature or degree</i>" of an existing project.</li> </ul>	<ul style="list-style-type: none"> <li>• In a sense, these are welcome changes as it was unclear under the EP1 whether their application extended to staged projects or upgrades. However, this new statement of intent is not sufficiently detailed for any worthwhile analysis of its potential application.</li> <li>• The EP2 appears to distinguish between construction of new capital installations and refinancing of existing installations undergoing expansion or upgrade. In respect of the latter, the tests of "<i>significant</i>" social and/or environmental impacts</li> </ul>

	EP1	EP2	Comments
			<p>or "<i>significantly change the nature or degree</i>" of an existing project must be met for the principles to apply. Definitions are not provided for these terms. Further, it prompts the question as to who determines whether the criteria are met; is it in the sole discretion of the relevant EPFI? How can this decision be made without expert advice and query should the advice be independent?</p>
<p><b>Extension to project finance advisory activities</b></p>	N/A	<p>Extension of the principles to project finance advisory activities as well as arranging. The EPFI will request that the client communicates to them their intention to adhere to the requirements of the EP2 when "<i>subsequently seeking future financing</i>".</p>	<ul style="list-style-type: none"> <li>• This appears to require follow-on financing to be EP compliant in the future.</li> <li>• This commitment is welcomed as it means that sponsors should address EP matters at an earlier stage. However, it has attracted criticism from NGOs because there is no requirement that the client's confirmation to adhere to the requirements of the EP when seeking future refinancing be covenanted in existing loan documentation.</li> <li>• NGOs continue to call for the EP2 to extend beyond project finance.</li> </ul>

	EP1	EP2	Comments
<b>Categorisation</b>	The financial institution categorises the construction and operational risk of a project according to internal guidelines based upon environmental and social screening criteria of the IFC (as set out in Exhibit I) ( <i>Principle 1</i> ).	Largely the same as the EP1 but consistent with the new IFC criteria contained within new Exhibit 1 ( <i>Principle 1</i> ).	A <b>major amendment</b> to the new IFC categorisation criteria is the express requirement to consider “ <b>social</b> ” <b>as well as environmental impacts</b> .
<b>Social and Environmental Assessment</b>	The borrower must complete an Environment Assessment for all Category A and B projects to the satisfaction of the financial institutions ( <i>Principle 2</i> ).	<ul style="list-style-type: none"> <li>• Same, but the reference is now to a "<b><i>Social and Environmental Assessment</i></b>" (SEA) (see below for new definition).</li> <li>• Additional requirement for the SEA to be disclosed in certain circumstances. (see "<b><i>Consultation</i></b>" below (<i>Principle 5</i>)).</li> <li>• There is an inclusion of a new definition of SEA as a "process" that determines the social and environmental impacts and risks (including labour, health and safety) of a proposed project in its area of influence.</li> </ul>	<ul style="list-style-type: none"> <li>• SEA only needs to be disclosed in certain circumstances (see "<b><i>Consultation</i></b>" below (<i>Principle 5</i>)).</li> <li>• Despite the express reference in the new EP2 (<i>Principle 1</i>) to the need for the EPFI social and environmental review, there is a rider to the definition in footnote 2 which states that for the purposes of EP compliance, this will be "<b><i>an adequate, accurate and objective</i></b>" evaluation and presentation of the issues, "<b><i>whether prepared by the borrower,</i></b></li> </ul>

	EP1	EP2	Comments
			<i>consultants or external experts".</i> This has been criticised for pre-supposing the robustness of the SEA (which might be unjustified, particularly if it is prepared by the borrower only) and it is suggested that the SEA should always be undertaken by independent environmental and social assessment experts not affiliated with the project, particularly for highly risky projects.
			<ul style="list-style-type: none"> <li>In addition, one of the criticisms of the EP1 by NGOs, is that it was unclear whether financial institutions could simply rely on the environmental and social review conducted by the project borrower or third party expert. This amendment in itself does not place any new obligation on the EPFI to carry out its own review of the SEA (but see "<i>Independent Review</i>" below)</li> </ul>
<b>List of Impacts and Risks</b>	Prescriptive, detailed list of 17 issues to be considered, as applicable ( <i>Principle 3</i> ).	<ul style="list-style-type: none"> <li>Substantially similar list, save;               <ul style="list-style-type: none"> <li>(a) that it is illustrative only (refer to "note" in Exhibit II) and not necessarily wholly relevant for all</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>These changes are preferable as they confer broader protection of human rights and communities; they also require a consultation. However, it</li> </ul>

	EP1	EP2	Comments
		<p>projects; and</p> <p>(b) for: (i) replacement of "development" with "management" and inclusion of "(including sustainable resource management through appropriate independent certification systems" in limb (g); (ii) for insertion of "human rights and community" at limb (d); (iii) insertion of "and management" of dangerous substances at limb (i); (iv) broadening limb (q) to require "consultation" with affected parties in the design, review and implementation of the project and (v) broadening limb (n) to include "impacts on affected communities, and disadvantaged or vulnerable groups" and on indigenous peoples "and their unique cultural systems and values" at limb (o) (<i>Exhibit II</i>);.</p>	<p>could be argued that there has been little change from the list of issues in the EP1 to the EP2.</p>
		<ul style="list-style-type: none"> <li>• Additional requirement for the SEA to propose mitigation measures relevant and appropriate to the nature and scale of the project (<i>Principle 2</i>).</li> </ul>	<ul style="list-style-type: none"> <li>• This is a welcome amendment.</li> </ul>
<b>Relevant laws and standards</b>	For all countries, the EA is to address compliance with:	<ul style="list-style-type: none"> <li>• <b>General</b> - The SEA must assess compliance with: (i) applicable host</li> </ul>	<ul style="list-style-type: none"> <li>• This amendment fails to include reference to international supra-</li> </ul>

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	<ul style="list-style-type: none"> <li>(i) local laws, regulations and permits required by the project;</li> <li>(ii) minimum standards under the World Bank and IFC Guidelines (<i>Exhibit III</i>); and</li> <li>(iii) (Refer to "note" in <i>Principle 3</i>).</li> </ul>	country laws, regulations and permits; and (ii) the relevant social and environmental impacts and risks of the project ( <i>Principles 2 and 3</i> ).	<p>national laws, such as EU law. Query does this mean that certain international laws are not included thereby the EP2 fails to capture certain international laws, customary law and norms etc?</p> <ul style="list-style-type: none"> <li>• Also, will this distinction create illogical discrepancies in standards across jurisdictions? For instance, sophisticated sponsors often commit to applying the highest standard of laws and standards to their projects. Under the EP2, there could be a difference in standards applied in the project country and the country where the loan will be drawn.</li> </ul>
	Consideration of IFC Safeguard Policies (Exhibit II) for low and middle-income countries only. <sup>154</sup>	<ul style="list-style-type: none"> <li>• <b>For High-Income OECD Countries:</b> Completion of a SEA (or its equivalent) in compliance with local or national laws is an acceptable substitute to the IFC Performance Standards (<i>Principle 3 and Exhibit III</i>)</li> </ul>	<ul style="list-style-type: none"> <li>• These amendments mean that the IFC Performance Standards, World Bank PPAH and IFC Environment Health and Safety Guidelines <b>do not apply to High-Income OECD Countries.</b><sup>155</sup> The reason for this amendment is</li> </ul>

<sup>154</sup> As defined by the World Bank Development Indicator Database.

<sup>155</sup> High-Income OECD countries are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, the Republic of, of Korea, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom and the United States (see *supra* at note 65).

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		and the World Bank PPAH and Guidelines ( <i>Exhibit IV</i> ).	apparently to avoid conflicts between the EP and the IFC where the IFC only apply their policies to emerging markets.
		<ul style="list-style-type: none"> <li>• <b>For non-OECD countries, and non High-Income OECD countries:</b> SEA may refer to (if relevant): <ul style="list-style-type: none"> <li>(i) local or national laws, applicable international treaties and agreements and other issues listed in <i>Exhibit II</i>;</li> <li>(ii) applicable IFC Performance Standards (<i>Exhibit III</i>); and</li> <li>(iii) The World Bank PPAH and IFC Environmental Health and Safety Guidelines (<i>Exhibit IV</i>).</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• There exists the potential for differential application of the EP based on the location of the project. EP2 fail to take into account, for example, the lack of link between a country's wealth and their record of human rights abuses or the fact that certain international or supra-national laws have not been adopted in certain High-Income OECD countries e.g. climate change conventions in Australia or the United States.<sup>156</sup></li> </ul>
<b>Deviations</b>	The EA must address to the satisfaction of the financial institution the project's overall compliance with (or justified deviations from) the relevant World Bank and IFC Policies and Safeguards (refer to <i>note in Principle 3</i> ).	Same for the SEA in non-OECD countries and non High-Income OECD countries.	This obligation will now not apply to projects in High-Income OECD countries.
<b>Action Plans and</b>	An environmental management plan	<ul style="list-style-type: none"> <li>• For all Category A and Category B</li> </ul>	<ul style="list-style-type: none"> <li>• A SEA and APMS is now required for</li> </ul>

<sup>156</sup> See *supra* at note 73.

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<b>Management Systems (APMS)</b>	<p>(<i>EMP</i>) must be prepared for all Category A projects and as considered appropriate for Category B projects. The <i>EMP</i> must address mitigation, action plans, monitoring management of risk and schedules.</p> <p>N/A</p>	<p>projects located in non-OECD countries and those located in non High-Income OECD countries, the borrower must prepare an Action Plan (<i>AP</i>) drawing on the conclusion of the SEA and a Social and Environmental Management System (<i>Principle 4</i>).</p> <ul style="list-style-type: none"> <li>A new obligation is placed on borrowers to establish a social and environmental management system that addressed impacts, risk and corrective actions required to comply with applicable laws and requirements of applicable IFC Performance Standards and the Guidelines as defined in the Action Plan (<i>Principle 4</i>).</li> </ul>	<p>both Category A and Category B projects. However, it is unclear from the drafting in respect of Category A projects at least, whether this requirement applies to all Category A projects or just those located in non High-Income OECD countries.</p> <ul style="list-style-type: none"> <li>“<i>Action Plan</i>” is defined as ranging from a brief description of routine mitigation measures to a series of documents/plans. The level of details and complexity and the priority of measures and actions will depend on each project.</li> </ul>
<b>Independent review</b>	<ul style="list-style-type: none"> <li>For Category A projects, the EA and</li> </ul>	For all Category A projects and, as	Expert review of the SEA and AP is to



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	EMP will be subject to independent expert review ( <i>Principle 5</i> ).	appropriate, for Category B projects, the SEA and AP will be subject to independent expert review ( <i>Principle 4</i> ).	now also apply to appropriate Category B projects.  It was unclear under the EP1 whether the reference to independent expert review for Category A projects in the EP1 Principle 5 applied to the EA and EMP as a whole or only to the discrete consultation process. The drafting in Principles 4 and 5 of EP2 clarifies the position.
<b>Consultation</b>	For Category A and appropriate Category B projects, there is an obligation on the borrower or third party expert to consult, in <i>a structured and culturally appropriate way with project affected groups</i> . Including indigenous peoples and local NGOs.	For all Category A projects and, as appropriate, Category B projects located in non-OECD countries and non High-Income OECD countries, there is an obligation on the borrower or third party expert to consult with <i>project affected communities in a structured and culturally appropriate manner</i> ( <i>Principle 5</i> ).	<ul style="list-style-type: none"> <li>• EPFI contend that these changes represent a proposed strengthening of the requirements for consultation. However, certain NGOs claim that IFC Performance Standard 1 is a dilution of the requirements that were present in former Safeguard Policy OP 4.01 (Environmental Assessment) and call for the former standards to be reinstated.</li> <li>• A new definition of "<i>project affected communities</i>" is included in Footnote 4 to include communities of the local population within the project's area of influence who are likely to be adversely affected by the project.</li> </ul>

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			Where such consultation needs to be undertaken in a structured manner, the EPFI may require the preparation of a Public Consultation and Disclosure Plan (PCDP).
			<ul style="list-style-type: none"> <li>NB. In respect of Category A projects, it is unclear from the drafting whether this requirement applies to all Category A projects or just those Category A in non-OECD countries and non High-Income OECD countries but logic dictates that this should be case.</li> </ul>
		<ul style="list-style-type: none"> <li>There is a new requirement for projects with "<i>significant adverse impacts</i>" on affected communities for the consultation process to ensure "<i>free, prior and informed consultation</i>"<sup>157</sup> not "<i>free, prior and informed consent</i>" and facilitate their informed participation as a means to establish, to the satisfaction of the EPFI, whether a project has adequately incorporated affected</li> </ul>	<ul style="list-style-type: none"> <li>Query does the reference to "significant adverse impacts" restrict the application of this requirement to Category A projects only as per the definition of "Category A" in Exhibit 1 of the EP2?</li> <li>"Consultation" is required to apply to the entire project process and not to the early stages of the project alone, and needs to be tailored to each</li> </ul>

<sup>157</sup> 'Free' is defined as free of external manipulation, inference or coercion and intimidation; 'prior' is defined as 'timely disclosure of information' and 'informed' is defined as 'relevant, understandable and accessible information'. This is not the same as "free, prior and informed consent" (see Section 1 (h) above).

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		communities' concerns ( <i>Principle 5</i> ).	<p>project. The new EP2 do not incorporate "broad community support" as this is considered an institutional commitment in IFC Policy (and not included in the IFC's Performance Standards) which are not within the ambit of the EP2.</p> <ul style="list-style-type: none"> <li>• NGOs would also like to see an obligation on the borrower to engage in free, prior and informed consultation in the event that there are major changes to the project proposal.</li> </ul>
	<ul style="list-style-type: none"> <li>• The EA, or a summary is to be made available to the public for a reasonable minimum period in local language in a culturally appropriate manner. The EA and EMP will take account of such consultations and for Category A projects be subject to independent expert review (<i>Principle 5</i>)</li> </ul>	Same, save for reference to a " <i>non technical</i> " summary and the need to <i>document the process and results of the consultation on the SEA (Principle 5)</i> not the consultation recommendations.	There is <i>no mention of disclosure of the draft or final AP which NGOs see as a weakness of EP2</i> . Further, NGOs would prefer to see the release of any additional non-confidential information and a clearly defined set minimum period for disclosure (e.g. 60 days) of this information.
<b>Grievance procedure</b>	N/A	The borrower is under an obligation to establish <i>appropriate procedures</i> in order to receive and address concerns or grievances raised by individuals or groups from <i>project-affected communities</i> about the project's social and environmental	While this is a welcome and positive change, the EP2 <i>do not require the lender to have a similar grievance procedure</i> which has led to criticism by NGOs. However, it is understood that the EPFI are unlikely to adopt a shared

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		performance throughout the project (including construction and operation phases) ( <i>Principle 6</i> ).	accountability mechanism in the short term.
<b>Compliance Covenants</b>	N/A  <ul style="list-style-type: none"> <li>• Covenant on the borrower to comply with the EMP (Principle 6(a))</li> <li>• Covenant on the borrower to provide regular reports on compliance with the EMP (Principle 6 (b))</li> </ul>	<ul style="list-style-type: none"> <li>• A new covenant by the borrower to comply with all relevant local, state and host country social and environmental laws, regulations and permits in all material respects (<i>Principle 7(a)</i>).</li> </ul> <p>This is now limited to compliance with the APMS (where applicable) “<i>in all material respects</i>” (<i>Principle 7(b)</i>).</p> <p>“<i>Periodic reports</i>” must be provided at least annually and is extended beyond compliance with the APMS to also include relevant local, state and host country social and environmental laws,</p>	<ul style="list-style-type: none"> <li>• Similarly as stated above, this amendment fails to include reference to supra-national laws and public international law, codes of conduct or best industry practice, World Bank and IFC Policies and Handouts, does not state that compliance is required of all laws (not just those in force and binding at the date of the agreement or project commencement) and is limited to compliance in all material respects (not full compliance).</li> </ul> <p>It is not clear whether any agreements between the borrower and the affected community following the consultation process will be incorporated into the AP and therefore covenanted.</p> <p>It is probably captured when considering compliance with the AP but it may be helpful to extend the drafting to include compliance with applicable World Bank and IFC Performance Standards and policies and guidelines. Also, query</p>

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		regulations and permits ( <i>Principle 7(c)</i> ).	whether supra-national laws should be captured here.
	<ul style="list-style-type: none"> <li>As for the EP2, save no requirement where “appropriate” (<i>Principle 6(c)</i>).</li> </ul>	Borrower to decommission “the facilities, where applicable and appropriate, in accordance with an agreed decommissioning plan ( <i>Principle 7 (d)</i> ).	
<b>Discretion to appoint independent experts</b>	As necessary, <i>lenders have appointed an independent environmental expert to provide additional monitoring and reporting services (Principle 7)</i>	The EPFI have <b><i>the right to require appointment of an independent environmental and/or social expert to ensure ongoing monitoring and reporting to the EPFI over the life of the loan (Principle 8)</i></b> .	This implies that the EPFI would require the borrower to appoint the independent expert. The drafting does not provide any further guidance on the extent of the expert’s duty of care and these are issues that the EPFI and the borrower would need to consider upon engagement.
<b>Bringing the borrower into compliance</b>	Where the borrower is not in compliance with its social and environmental covenants such that any debt financing would be in default, the financial institution will engage with the borrower to bring it back into compliance ( <i>Principle 8</i> )	<ul style="list-style-type: none"> <li>Deletion to the reference of "such that any debt financing would be in default" and the obligation on the EPFI is watered down to bring the borrower back into compliance "<b><i>to the extent feasible</i></b>".</li> <li>Inclusion of new wording to cover the situation where the borrower fails to re-establish compliance that the <b><i>EPFI “reserve[s] the right to exercise remedies, as they consider appropriate” (Principle 8)</i></b>.</li> </ul>	The drafting states the EPFI will work with the borrower to bring it back into compliance to the “ <b><i>extent feasible</i></b> ”. This is vague and leaves broad discretion to the EPFI whether, and how much, compliance should be required. However, it does make it clearer to the borrower that where compliance is not established, the EPFI has the right to exercise remedies as appropriate.

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<b>Reporting Obligations</b>	N/A	Each of the EPFI commits to report publicly at least annually about its <i>“implementation processes and experiences”</i> . As a minimum, this should include the <i>number of transactions screened and the categorisation accorded to each transaction (Principle 10)</i> .	<ul style="list-style-type: none"> <li>• This is another positive change, but does not cover in sufficient detail the data to be made available. There is also a carve out for confidentiality which may water down the effect of the new principle. However, it should help to identify "free riders" who have adopted the principles and yet do not participate in projects to which the EP apply.</li> <li>• NGOs are likely to continue to call for greater disclosure of the number of projects rejected on the ground of general environmental or social concerns, explanation of any deviations from general standards, information about loans suspended and an assessment of implementation systems generally.</li> </ul>