

Issue paper

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EBRD and Sostanj Unit 6 - serious questions about EBRD project appraisal

On April 14 2011 Slovene Minister of Economy, Ms Darja Radic, presented the Slovene government with a report on the management of the TES 6 project, for which the EBRD last year approved a EUR 100 million loan with a further EUR 100 million syndicated to commercial banks. The report – which is unfortunately not publicly available, thus we rely on the Minister's presentation - outlines a number of shortcomings in the project.

This report led the government to conclude that it would only support a state guarantee for the European Investment Bank loan of EUR 440 million if the economic efficiency of the project can be improved. The Minister also declared that because of the reports' findings she will send them to the Commission for the Prevention of Corruption, the General Police Directorate and the public prosecutor. This has important implications for the EBRD's involvement in the project and raises questions about the project appraisal process that led the EBRD to approve the project.

The report's findings

- The construction of TES has not been managed transparently, and decisions were made by a circle of people who presented the project as a 'fait accompli' to those that actually had to decide on the project. There are strong suspicions that TES management breached legislation in carrying out individual acts in connection with the project (as outlined below). Important decisions like signing contracts with suppliers worth hundreds of millions of euros were made without having conducted a proper investment study and analyzing the effects of the project. Investment programmes were made only after signing some of the contracts. The information on the investment was never presented in a way that would enable decision-makers (supervisors or even the government) to find the optimal solutions from an economic, technological and environmental point of view.
- The siting of Unit 6 was not conducted in line with legislation. Siting should be based on a Strategic Environmental Assessment, which would search for the optimal variant among possible solutions, accounting for environmental impacts and space. Instead the decision was based on pre-selected technology and an environmental report that merely highlighted that particular variant's advantages. Furthermore, TES 6 was never included in the energy policy of the country. Even at this stage of implementation, Unit 6 is not included in the current Resolution on the National Energy Programme, Official Journal of the Republic of Slovenia no. 57/2004.
- Constructing Unit 6 is both economically and financially high-risk. Even minor changes in input data may cause a significant reduction in the internal rate of return and a negative net present value. The investment is very sensitive to the price of coal, and the price of coal is very low in the current investment programme. There is a high risk that the Velenje mine will not be able to guarantee such a price. The current price in the investment plan is 2.25 EUR/GJ, even though currently lignite is already sold at 2.7 EUR/GJ. If the price increases 10 percent, the investment is negative. A second important element is the price of emission allowances. The investment programme estimates these at 20

EUR/t CO₂. If the price of allowances is higher by just 10 percent, then the investment is again negative. The third element is electricity sales price and if this price is only 10 percent lower than currently planned, the investment is not profitable. The last element is the total amount of investment: if it increases by EUR 100 million, the investment is negative. If more than one of these elements changes for the worse, and by a relatively small margin, the investment may be uneconomical.

- Holding Slovenske Elektrarne (HES), TES's parent company, and TES are not exempt from EU and Slovene public procurement rules, which means that they severely breached the legislation by issuing calls for suppliers without following public procurement rules.

The Slovene Government's decisions

HSE must now appoint a special auditor to comprehensively audit the individual management activities of TES and initiate all other appropriate verification procedures of infringements with the competent authorities.

Given the project's high degree of risk and considering the state's exposure as owner of HSE, the Government is not prepared to take additional risk in issuing a state guarantee for TES 6 of EUR 440 million unless the investor is prepared to redraft a new investment programme accounting for all project costs (including the costs of decommissioning facilities blocks 4, 5, 6 and the gas turbines), with a thorough analysis of both the potential to achieve reasonable prices for coal at 2.25 EUR / GJ and as well for other input parameters of the investment. This programme must prove that all the conditions are fulfilled to achieve a return on investment in accordance with the sectoral policy for the energy sector (which is 9 percent).

HSE and TES must ensure that procurement procedures are followed as outlined in the Law on Public Procurement in the water, energy, transport and postal services (UIRS, No. 128/06, 16/08 and 19/10).

Recommendations for the EBRD

The EBRD needs to review its involvement in the project, and also examine why the bank did not notice these weaknesses in its project appraisal process e.g. on public procurement procedures and economic viability.

The EBRD is requested to ask TES and the Slovene government to disclose publicly the recent reports on TES 6.