

Briefing paper
Concerns over the EBRD's proposed loan to Kuwait Energy
May 2013

Information Released by EBRD

Project Title: KEC Gas Flaring Project

Loan: \$40 million

Project Description: To finance its operations in Egypt and Ukraine, including the reduction in associated petroleum gas (APG) flaring, and capital expenditure for environmental improvements and for field development. As part of the Project the Bank will assist the company in developing a company-wide approach to reduce APG flaring in its operations and in promoting equal opportunities in the workplace for women within the Company.

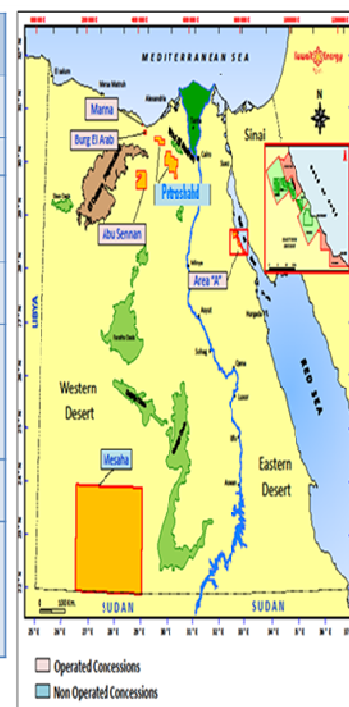
EBRD Finance:

Up to USD 40 million Loan, part of a larger USD 165 million reserve based facility.

Limited further materials are provided in the Project Summary Documents.¹

¹ <http://www.ebrd.com/pages/project/psd/2013/44927.shtml>

Field Overview	Area A	Petroshahd	Abu Sennan	Burg El Arab	Mesha (Block 6)
Location	Eastern Desert	Western Desert	Western Desert	Western Desert	Western Desert
Type	Onshore	Onshore	Onshore	Onshore	Onshore
Operator	Kuwait Energy	Sipetrol (50.5%)	Kuwait Energy	Kuwait Energy	Melrose Resources (40%)
KE Revenue Interest	70%	49.5%	50%	75%	15%
Other Parties	Petrogas (30%)	Sipetrol (50.5%)	Dover (28%) Beach Energy (22%)	Gharib Oil Fields (25%)	Hellenic Petroleum (30%) Beach Energy (15%)
Contract Date	August 2002	July 2007	Jun 2007	December 1996	Oct 2007
Contract Type	Production & Exploration Service Agreements	Development Leases	Concession agreement, PSA* & Development Leases	Development Leases	Concession agreement, PSA*



Concerns

Accuracy of EBRD materials

The EBRD Project Summary Document is titled “KEC Gas Flaring Reduction Project” and mostly refers to the target company as “KEC”, with two references to “Kuwait Energy International Ltd”.

However, according to both Kuwait Energy's own website and past IFC documents, in 2011 Kuwait Energy Company KSCC (“KEC”) was restructured. A new company “Kuwait Energy plc” was incorporated in Jersey and took on all the assets and liabilities of KEC.² Since then, IFC loans have been to the latter.

The PSD references to a “Kuwait Energy International Ltd” appear inaccurate - no such company seems to exist according to company annual reports listing of subsidiaries and associated companies. The only “KEC International Ltd” is an unrelated India-based infrastructure company.

It is unclear whether with “KEC”, the EBRD is referring to the Jersey holding company

² <http://www.kec.com.kw/Default.aspx?pageId=286&mid=5581>

<http://www.ifc.org/ifcext/spiwebsite1.nsf/DocsByUNIDForPrint/0C2635ACE857CFAC852579E60068A7BF?opendocument>

Kuwait Energy plc, or to the initial Kuwait Energy Company KSCC.

At best, the EBRD is using outdated names for the company it intends to lend to, and failing to correctly identify the country where the company it intends to contract a loan to is incorporated.

Gas Flaring

The PSD is titled “KEC Gas Flaring Reduction Project”, and implies that reducing associated gas flaring is the priority in Egypt and Ukraine. However, documents produced by Kuwait Energy and existing financiers make no references whatsoever to any plans to reduce flaring in Ukraine.

Moreover, a careful reading of the PSD indicates that even in Egypt, actual action to reduce flaring depends on negotiations with the Egyptian government. Thus, there is no guarantee that any reduction in gas flaring will take place.

Furthermore, beyond the €65,000 Technical Co-operation funding to assess potential reductions in gas flaring, it is unclear whether any significant portion of the \$40 million EBRD loan would go towards reducing gas flaring.

Finally, it is doubtful whether the EBRD's participation is leading to any additionality in terms of reduced gas flaring. IFC Project Documentation disclosed in April 2012 shows Kuwait Energy already committing under Performance Standard 3 to a process of negotiating with the Egyptian government over reducing gas flaring, irregardless of EBRD financing:

“The [Area A] asset represents the single largest air emissions source across the Kuwait Energy operated portfolio. The group is currently in negotiations with the General Petroleum Company, a national E&P operator, to re-inject flare gas to existing or alternative reservoirs, with supporting design studies currently under way to develop the flare elimination project. The group expects to commence re-injection operations at the ‘Area A’ asset within six months of completing negotiations with the General Petroleum Company.”³

Categorisation & “Field development”

We are concerned that this project was categorised as B on the basis of a supposed focus on a reduction of gas flaring. The PSD appears to have been written to de-emphasise the “field development” elements, and highlight “reduction in gas flaring” and “environmental improvements”. Yet apart from the phrase “capital expenditure for environmental improvements”, there is no elaboration on what this latter actually entails.

There are thus concerns that a project essentially focused on expanding extraction of fossil fuels was packaged in a wrapper of reduction in flaring and environmental improvements to reduce the necessary scrutiny and assessments.

In reality, Kuwait Energy is expanding its extraction and exploratory drilling in most of its Egyptian blocks, including Area A, ERQ/Petroshahd, Abu Sennan and Burg El Arab. In 2012, most of the company's \$119.8 million of capital expenditure in 2012 went on drilling 49 Development Wells and 7 Exploration Wells.⁴ Plans for 2013 intend to continue this trend.

Neither are Kuwait Energy's holdings in Egypt all existing brownfield assets – the enormous Mesaha licence covers exploration drilling in an entirely untouched part of the country in the deep south, on the border with Sudan.

The EBRD's loan, the IFC and additionality

The EBRD's proposed \$40 million loan is to form part of a larger \$165 million reserve based facility - that already achieved financial close on 19 December 2012. According to Kuwait Energy, “the Group also refinanced its senior debt arrangements through a reserve based lending facility of up to US\$165 million from a syndicate of international banks including the International Finance Corporation and Deutsche Bank.”⁵⁶ The refinancing element was specifically to repay previous IFC loans arranged in 2009⁷ and 2010⁸. It appears that the EBRD's proposed loan would thus contribute to a refinancing of Kuwait

<http://www.ifc.org/ifcext/spiwebsite1.nsf/DocsByUNIDForPrint/0C2635ACE857CFAC852579E60068A7BF?opendocument>

4 <http://www.kec.com.kw/Data/site16/PDF/Final%20Annual%20Report%20KEC.pdf>

5 <http://www.kec.com.kw/Data/site16/PDF/Final%20Annual%20Report%20KEC.pdf>

6 <http://www.kec.com.kw/Default.aspx?nid=6144&pageId=139>

7 <http://www.ifc.org/ifcext/spiwebsite1.nsf/ProjectDisplay/ESRS28068>

8 <http://www.ifc.org/ifcext/spiwebsite1.nsf/ProjectDisplay/ESRS29306>

Energy's previous debts, and thus to previous Kuwait Energy activities that were not assessed by the EBRD.

Moreover, given that the \$165 million reserve based facility was already completed in December 2012, it is unclear whether the EBRD's participation is predicated on buying out one of the existing lenders and how it contributes to leveraging any additional financing.⁹

In Egypt, the EBRD is proposing to contribute \$40 million towards an existing IFC-led loan for Citadel Capital/ERC's Mostorod Refinery¹⁰ and to add \$40 million to an existing IFC-led reserve based facility for Kuwait Energy.

Given that these represent the Bank's initial forays into energy lending in Egypt, there are concerns that the EBRD is trying to rapidly build up a portfolio of profit-making oil/gas projects by joining those already financed by the IFC, rather than examining where the Bank actually adds value or brings additionality.

In terms of additionality, the Transition Impacts listed in the PSD are almost all either already taking place in Egypt [(i) Competition in the oil sector in Egypt], or taking place through Kuwait Energy's existing plans [(ii) (1) exploring flaring reductions,; (2) promoting equal opportunities for women; (iv) Policy dialogue with Egyptian government over flaring reduction.]

The only potential additional Transition Impact would be increasing disclosure of payments – but as explained below, this demand is so low that it represents a *weakening* not a strengthening of international best practice.

Production and Exploration Services Agreement for Area A

The PSD lists as one of the Transition Impacts of the EBRD's participation: “Setting Standards for Business through the disclosure of payments to Egyptian, Ukrainian and other authorities in line with the principles of the Extractive Industry Transparency Initiative”.

⁹ The initial draw down of \$60 million was completed in 2012, with a further \$50 million drawn down by the time the 2012 Annual Report was published. This only leaves \$55 million to be drawn down at the time of writing.

¹⁰ <http://ecesar.com/en/2013/05/07/315251/>

At this stage in history, best practice on transparency in the oil sector is broader than merely disclosure of payments to authorities, also including online publishing of contracts signed. A number of jurisdictions and companies have begun to publish their oil contracts, with transparency written into constitutions and becoming “a best practice globally”.¹¹ The IMF recommends full publication of contracts, noting that contract terms tend to be widely known within the industry, so there is no commercial advantage lost by publications.¹²

By financing a project without requiring contract disclosure, the EBRD is in effect *weakening* international best practice on transparency. Kuwait Energy is unlikely to publish the contracts of its own accord, given that the company also ignores best practice in not publishing its Environmental & Social Impact Assessments online.

Egypt & Article I Concerns

Given the high levels of torture, repression, state violence, manipulation of government institutions and the proposed NGO Law, Egypt does not currently comply with the minimum principles of democracy and pluralism set out in Article 1 of the Agreement Establishing the Bank. Nor is it on a path to comply with these requirements.

Indeed, since the EBRD country assessment for Egypt approved on October 31 2012, the situation with regards to Article 1 has continually deteriorated, especially with regard to Annex 1 “Notional factors and sub-components for the political assessment”, Factor 14. Freedom from harassment, intimidation and torture. As of March 2013, the European Union Parliament passed a resolution opposing European Union financing without significant progress on human rights. A more in depth examination of the breaches is included in ECESR’s Issue Paper on the Egyptian Refinery Project in Egypt.¹³

Many EBRD staff and Executive Directors at the EBRD AGM in Istanbul held major doubts about Egypt’s compliance with Article I. While Article I is clearly an elastic concept, it surely cannot stretch this far if it is to maintain any credibility.

11 <http://futurechallenges.org/searchlight/informing-the-people-oil-contracts-demystified/>

12 IMF, ‘Guide to Resource Revenue Transparency, 2007’, p.14

<http://www.imf.org/external/np/pp/2007/eng/101907g.pdf>

13 <http://ecesr.com/en/2013/05/07/315251/>

Fossil Fuels

Given the urgency to take action on climate change, and the EBRD's public commitment to supporting a transition away from fossil fuels towards renewable energy, the Bank should not be financing a project like this. Investigating the project has shown that the EBRD financing would evidently primarily support expanded fossil fuel extraction through the field development activities, with reduction in gas flaring a side matter if it happens at all.

Oil & gas projects in Egypt are one of few sectors that do not have difficulty in attracting investment – as evidenced by the fact that the EBRD plans to join two existing financing consortiums with Kuwait Energy and Mostorod. In comparison, Egypt has massive renewable capacity but limited infrastructure and available funding.

Having an upstream oil & gas project as one of the EBRD's first deals in Egypt does not set a good precedent for the institution, and publically reveals the claims to be prioritising renewable energy in its North African expansion as a sham.

Conclusion

Given these concerns, we feel that the Board should not approve the EBRD's financing of Kuwait Energy at the moment.

It is highly doubtful whether the EBRD's participation would improve the project, given the stage at which it is joining and the lack of any clear additionality. The Project Summary Documents are unreliable and do not reveal enough information for the necessary assessment of impacts. Starting off its investments into Egypt with lending to upstream oil & gas would set a terrible precedent

The politically situation in Egypt is extremely violent, and the government is moving away from compliance with Article I. The EBRD's financing of this project will not create any moves towards the principles of Article I, but instead assure the government that it can get away with continuing the current trend of increased repression and authoritarianism.