



**Thermal Power Plant
Šoštanj**

Slovenia

Complaints Mechanism - Complaints Mechanism - Complaints Mechanism - Complaints Mechanism

Complaint SG/F/2012/01

CONCLUSIONS REPORT

October 2013

EIB Complaints Mechanism

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External Distribution

Complainants:

Service

Borrower: HSE

Beneficiary: TEŠ

FOCUS

Environmental Law

Internal Distribution

Management Committee

Secretary General

Inspector General

EIB services concerned

The EIB Complaints Mechanism

The EIB Complaints Mechanism intends to provide the public with a tool enabling alternative and pre-emptive resolution of disputes in cases whereby the public feels that the EIB Group did something wrong, i.e. if they consider that the EIB committed an act of maladministration. When exercising the right to bring a complaint against the EIB, any member of the public has access to a two-tiered procedure, one internal – the Complaints Mechanism Division (EIB-CM) - and one external – the European Ombudsman (EO).

Complainants that are not satisfied with the EIB-CM's reply have the opportunity to submit a confirmatory complaint within 15 days of the receipt of that reply. In addition, complainants who are not satisfied with the outcome of the procedure before the EIB-CM and who do not wish to make a confirmatory complaint have the right to lodge a complaint of maladministration against the EIB with the European Ombudsman.

The EO was "created" by the Maastricht Treaty of 1992 as an EU institution to which any EU citizen or entity may appeal to investigate any EU institution or body on the grounds of maladministration. Maladministration means poor or failed administration. This occurs when the EIB Group fails to act in accordance with the applicable legislation and/or established policies, standards and procedures, fails to respect the principles of good administration or violates human rights. Some examples, as set by the European Ombudsman, are: administrative irregularities, unfairness, discrimination, abuse of power, failure to reply, refusal to provide information, unnecessary delay. Maladministration may also relate to the environmental or social impacts of the EIB Group activities and to project cycle related policies and other applicable policies of the EIB.

The EIB Complaints Mechanism intends to not only address non-compliance by the EIB to its policies and procedures but to endeavour to solve the problem(s) raised by Complainants such as those regarding the implementation of projects.

For further and more detailed information regarding the EIB Complaints Mechanism please visit our website: <http://www.eib.org/about/accountability/complaints/index.htm>

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CONCLUSIONS REPORT

EXECUTIVE SUMMARY

Thermo-Electric Power Plant - Sostanj

Complainants: [REDACTED] FOCUS and [REDACTED] on behalf of Environmental Law Service

Date received: 28 February 2011 / 9 January 2012

Project Status: Signed and fully disbursed

Board Reports: 27 September 2007 and 15 December 2009

Contracts Amount: EUR 550 million (The Bank signed two Finance Contracts: FC1 EUR 110 million guaranteed by commercial banks; FC2 EUR 440 Million, guaranteed by the Republic of Slovenia)

SUMMARY OF ALLEGATIONS

1. Failure to obtain Government support to the project

The Complainants allege that the project missed clear government support because it was not listed as a priority investment project. At the time of the Bank's Board approval, the government was conducting studies on the project and a decision had not been taken yet.

2. Failure to comply with the national regulatory framework on the expected rate of return on investments.

The Complainants question the economic viability of the project and challenge the financial and economic due diligence carried out by the Bank. The Complainants also allege that if certain project assumptions were revised, then the profitability of the project would not meet the national requirements established for public sector projects. In addition, the project does not meet the returns requested for energy projects exploiting fossil fuels (9%). As a result, the project would be in breach of one of the conditions attached to the State Act that regulates the Guarantee granted by the Republic of Slovenia.

3. Alleged gaps in the EIB's due diligence of the Project

4. Allegations concerning the governance of the Project (lack of transparency, lack of supervision, conflict of interest, breach of Slovenian national law)

CLAIM

The Complainants request the following:

- EIB should withdraw the approval of the project
- EIB should recall the previously disbursed amounts

FINDINGS

1. Ungrounded allegation
2. Partially grounded allegation
3. Inadmissible allegation
4. Partially grounded allegation

RECOMMENDATIONS

Enhanced monitoring of the compliance of the project with national legislation on the profitability of energy projects exploiting fossil fuel.

Improved and systematic communication of project's profitability figures to the EIB Board of Directors.

1. THE COMPLAINT

- 1.1 On 28 February 2011, _____ behalf of Focus, a Slovenian NGO, brought a complaint by email to the EIB Complaints inbox concerning the decision by the EIB to grant financial assistance to the Thermal Power Plant Project in Šoštanj, Republic of Slovenia (the Project). The complainant attached a letter addressed to the EIB Secretary General claiming that the EIB should withdraw its approval to the project and recall the previously disbursed finances as, in her opinion, the EIB committed an instance of maladministration when approving the project.
- 1.2 Besides allegations concerning the environmental impact of the Project, _____ argued that the Project lacked clear support from the Slovenian Government. In that regard, she observed that the Energy Program of Slovenia did not list TEŠ 6 as a priority project for Slovenia and that the Government was at that moment conducting studies on which it would base its conclusion to support the project or not. The complainant drew the attention of the Bank to the fact that, although the Project did appear on the list of national development projects adopted by the former Government, the list had not been coordinated with the National Energy Program and had never received support from the Slovenian Parliament.
- 1.3 On 15 March 2011, the EIB Complaints Mechanism (EIB-CM) acknowledged receipt of the complaint and informed the complainant of the launch of a review into the case as well as of the date by which the complainant might expect a reply from the EIB-CM. On 12 May 2011 the EIB-CM informed the complainant of the fact that, due the complexity of the inquiry, it was necessary to extend the period for the handling of the complaint in accordance with article 10.2 of Title IV "Rules of Procedure" of the EIB Complaints Mechanism Principles, Terms of Reference and Rules of Procedure (CMPTR). On 6 October 2011, the EIB-CM contacted the complainant again to assure her that, although it was not in a position to provide a reply by the expected date, it would do its best to provide her with the formal reply as soon as possible.
- 1.4 Meanwhile, on 9 January 2012, _____ brought a second complaint against the TEŠ 6 project on behalf of Environmental Law Service, a Czech NGO co-operating with Focus. In this second complaint, Environmental Law Service challenged the environmental impact of the project, its compliance with the EU *acquis* in the field of procurement as well as the overall governance of the project, including the assessment of its economic feasibility. For ease of reference, the present Conclusion Report deals only with the allegations concerning the overall governance of the Project, including considerations on the compliance of the contested operation with national law concerning the profitability of investment projects and the EIB's due diligence of the economic feasibility of the project. Two separate Conclusions reports present the EIB-CM findings and conclusions regarding the Environmental and Procurement allegations.
- 1.5 In their letter, the Complainants recalled the statutory duty of the EIB to ensure the rational use of its funds and questioned the economic feasibility of the Project. The Complainants recalled that an independent analysis prepared by the Dutch consultancy CE Delft¹ in November 2011 (the Delft Report²) had revealed a number of methodological mistakes in the investment plan of the Project. According to the Complainants, the calculations made by CE Delft showed that the internal rate of return was lower in reality than the one estimated by the project promoter. Among the other mistakes highlighted by the Delft Report, the Complainants emphasised that lignite prices, lignite consumption at TEŠ 6 after 2028 and CO2 costs had been underestimated by the project promoter while the expected demand for the electricity produced by the plant had been overestimated, thus leading to a higher expected rate of return for the new unit than what could have been realistically possible.
- 1.6 With regard to the State Guarantee, the Complainants argued that the Slovenian Decree on the uniform methodology for the preparation and treatment of investment documentation in the field of public finance (Official Gazette RS, No. 60/2006) requires the expected rate of return on investments to exceed 7%. Moreover, in April 2011 the Slovenian government had required a rate of return on investments of 9%, in line with the sector policy for the energy sector and considering the high degree of risk of the project.

¹ <http://www.cedelft.eu>

² <http://bankwatch.org/sites/default/files/Sostanj-TEŠ6-economics.pdf>

The Complainants concluded that the EIB should execute a proper assessment of the economic profitability of the project to ensure that the Project complies with national rules set up for this kind of investments. Moreover, the Complainants claimed full disclosure of all evidence of the fact that all economic aspects of the project have been taken in consideration should be disclosed.

- 1.7 On 24 January 2012, the EIB-CM acknowledged receipt of the second complaint and informed the Complainants of the launch of a review into their case as well as of the date by which they might expect a reply from the Bank. On 19 March 2012, the EIB-CM informed the complainant of the rationale behind the necessity to extend the timeframe for the handling the complaint in accordance with article 10.2 of Title IV EIB CMPTR.

2. BACKGROUND INFORMATION

2.1 The Project

- 2.1.1 The project concerns the construction of a 600 MW super critical, lignite-fired steam turbine power plant and associated cooling tower, stack, flue gas desulphurisation, wastewater treatment and control systems and connection to an existing substation. According to the Board report, the power plant will operate in cogeneration mode, supplying heat to the local district heating system. It would largely replace the existing lignite-fired generating capacity operating at low conversion efficiencies (26-33%). As a result, lignite consumption and CO₂ emissions would remain at current levels, but electricity production is expected to increase by more than 30%.
- 2.1.2 The promoter of the project is Holding Slovenske Elektrarne d.o.o. (HSE), a state-owned holding company that generates and supplies over half of Slovenia's inland electricity consumption. HSE was established as a limited private company by law adopted by the Government of the Republic of Slovenia on 26 July 2001. The project is implemented by the national electricity company - Termoelektrarna Šoštanj (TEŠ). TEŠ is owned by HSE.

- 2.1.3 The project is expected to contribute to security of electricity supply (physically and with respect to oil price volatility) and will support a diverse energy mix in the Slovenian power sector. It will also exploit indigenous fuel resources and support employment in a convergence region, all of which are important EU policy objectives. The financial structure of the project includes also a EUR 200 m EBRD financing and up to EUR 475 m own funds. The security of the Bank's loan consists of commercial banks guarantees for EUR 110 million and a State Guarantee for the balance (EUR 440 million).

2.2 The project cycle

- 2.2.1 At the *Pre-Appraisal stage*, the Appraisal authorisation report (Fact Sheet A - FSA), issued on 7 March 2007, established that, from a financial perspective, the Project was competitive with alternative coal-fire or natural gas fired generation. Although the project was not the best economic option, it was economically comparable to the next best alternative on the basis of also considering 'security of supply from endogenous fuel sources' and 'impact on social and economic cohesion'. The FSA identified as the main risk to the financial profitability of the project "...the exposure to regulatory risks concerning the environment, competition with other generators and the risk of not being able to externalise CO₂ costs on consumers". According to the FSA, "offsetting these risks is the likelihood that electricity prices in the EU will track the rising costs of production including CO₂ emissions and that exposure to competition from lower cost generation will remain limited by the availability of indigenous resources in the region and security of supply constraints...The risk of the project becoming a stranded asset is therefore considered to be low. The project's financial discounted generating cost is estimated to be 41.1 EUR/MWh, which is competitive with other sources of coal-fired generation in Europe under the baseline scenarios".

2.2.2 On 11 July 2007, the EIB services issued the Appraisal Report for the Project. The Appraisal report emphasised, as positive aspects of the project³:

- (i) its compliance with the Bank's conditions for financing of new coal/lignite power stations,
- (ii) the contribution to security of supply and diversity of the energy mix in the Slovenian power sector, exploiting indigenous sources of fuel and supporting employment in a convergence region and
- (iii) the increase of the efficiency of electricity production by more than 30% in relation to the power plant replaced.

Among the negative aspects, the EIB services highlighted that (i) coal-fired generation was 7% more expensive than gas-fired generation⁴, (ii) the economic profitability of the project and the cost of the electricity produced was exposed to regulatory risk of the EU climate policy. The use of advanced materials in the construction of the project was not yet fully proven for large-scale lignite plants. The EIB services, therefore concluded that performance below standard of any of these components would negatively impact the profitability of the project.

2.2.3 With regard to the Financial and Economic Profitability, the Appraisal Report indicated that the project's discounted generating cost was estimated to be 43 EUR/MWh, excluding the purchase of CO₂ emission allowances under the EU ETS. The analysis of the EIB services was based on the assumption that free allowances would be permitted for part of the project's emissions between 2013 and 2020 and emissions trading would start in 2020, when the project's discounted generating cost would rise to around 60 EUR/MWh, about 5% more expensive than gas-fired generation and 10% more expensive than new coal-fired generation based on imported coal elsewhere in Europe. The main risk identified was the exposure of the economic profitability to the instability of CO₂ price while, the Appraisal Report observed that *"...the project is expected to remain financially profitable as electricity prices track the rising costs of production including CO₂ emissions"*. The discounted economic generating cost, including environmental externalities, was therefore estimated to be 79.9 EUR/MWh⁵ while gas-fired generation under the same scenario would be estimated at 64.8 EUR/MWh. Adding a penalty for gas price volatility and security of supply risks, the discounted cost of the CCGT alternative rose to 74.8 EUR/MWh (5 EUR/MWh or 7% less expensive than the proposed project). The EIB services highlighted that this comparison did not include other benefits which were difficult to quantify as the avoidance of the social and economic impacts of a rapid downsizing of the mine.

2.2.4 The text of the Appraisal Report does not make any reference to the Economic and Financial Returns calculated for the project. However, the report attaches a table with the discounted cash flows of the Financial and Economic benefits of the project. The discounted cash flow show positive Net Present Values (NPV) for the projections of the Financial Benefits at 20 and 25 years discounted at 5 and 10%. However, the NPV of the Economic Benefits for the different scenarios are negative in all the cases.

2.2.5 The Appraisal Report considered the Project to be in line with the Resolution of Slovenia's National Energy Program, with the Ordinance on the strategy of Spatial Planning, which provided for further development of electricity production in the location of the project (in addition to the EIB standards for financing new coal/lignite power stations).

2.2.6 On 27 September 2007, the EIB Board of Directors approved the proposal to provide a loan of EUR 350 million to TEŠ to carry out the project. As main project risk to the project's financial profitability, the proposal to the EIB Board of Directors indicated *"the inability to fully pass the cost of CO₂ emissions to consumers"* but reassured that, historically, electricity prices had tracked the rising costs of production

³ The Appraisal Report lists as key factors supporting the project:

- the replacement of inefficient technology,
- the economic competitiveness of the chosen technology vis-à-vis gas-fired generation under moderate CO₂ price scenarios (18 EUR/t CO₂),
- the avoidance of gas price risks,
- the contribution to the security of supply through indigenous fuel sources³,
- the contribution to a diversified mix of generation in Slovenia over the next 20 years; and
- the support to employment in a convergence region.

According to the Appraisal Report, even taking into account environmental externalities, the project would generate electricity at a modestly higher economic cost compared to an alternative gas-fired plant and increases in the cost of allowances might negatively impact on the financial profitability of the project.

⁴ The Appraisal Report states that the Promoter had looked into alternatives as a new coal-fired power plant based on imported coal, but deemed these options as less competitive than the project due to high overland coal transportation costs. Another alternative, an 800 MW gas-fired CCGT was rejected due to gas transmission constraints continuing into the medium term.

⁵ This estimate excludes the price volatility penalty normally applied to coal fuel due to the price independence of the locally produced lignite. The non-GHG pollution costs were assumed to be 14 698 EUR/t for particulates, 3442 EUR/t for SO_x, 3054 EUR/t for NO_x. The CO₂ price base case scenario started at 25 EUR/t in 2010 up to 45 EUR/t by 2030.

including CO₂ emissions. The proposal further elaborated on the unfeasibility of a gas alternative to the Project.⁶ The Board Report did not make any reference to the Financial and Economic Rate of Returns. During the inquiry of the EIB-CM, the services pointed out to the EIB-CM that "... neither of the Board Reports indicated a rate of return calculation, as this was and continues to be the standard practice in the Energy Department for projects in which the key economic indicator is a comparison to the discounted cost of the best alternative". On the same day, the EIB signed a Finance Contract (FC1) with TES. The total cost of the Project was estimated to be equal to 796,100,000 EUR with 446,100,000 EUR financed by own funds of the Borrower and the rest (EUR 350 m) to be covered by the EIB loan.

- 2.2.7 On 30 October 2009, the EIB services updated the Appraisal Report (the updated Report) following request by the Promoter for additional financing. The updated Report stressed that there had been no change to the technical description of the project but the EIB services observed that the total project cost, including interest during construction and price contingencies, was now estimated in EUR 1 200 M, representing a 50% increase over the original cost estimate. The new cost estimate was "based on the outcome of negotiations between TEŠ and the preferred bidder...completed on 14 September 2009". The reasons for such a significant increase are, according to the EIB competent services:
- Higher costs of raw materials such as steel and copper; and
 - The outcome of limited competition in the tender process
- 2.2.8 The updated Report stated that the financial and economic profitability of the project had not changed significantly and, in financial terms including the estimated cost of EU allowances, the electricity from the project would be 9% more expensive than energy produced by gas-fired generation. The updated Report reiterated that the project was not expected to be competitive on the European wholesale electricity markets except under high oil price scenarios and that it was highly exposed to the volatility of CO₂ price.
- 2.2.9 After the update, the Project's discounted generating cost, including the purchase of CO₂ emission allowances for the EU ETS, was estimated to be 85 EUR/MWh, i.e. about 9% more expensive than the cost of electricity from gas-fired generation under the same conditions. The EIB services concluded that, by assuming an average tariff of 80 EUR/MWh, the estimated financial rate of return would be 3.5%. The economic generating cost including environmental externalities, was also updated (93 EUR/MWh against 79 EUR/MWh for a gas-fired plant, which – according to the EIB services – would reach 89 EUR/MWh if a penalty for gas price volatility and security of supply risks are counted in) and resulted to be 5% more expensive than the alternative. The economic rate of return was estimated to be 4%. The updated Report reiterated that the comparison did not include benefits specific to the project and difficult to quantify, namely the avoidance of the social and economic impacts of a downsizing employment at the local mine, if the plant would not be built. Both IRRs calculated (the Financial IRR – 3.5% - and the Economic IRR – 4%), are below the hurdle rate used by the Bank - 5% - as discount rate.
- 2.2.10 On 15 December 2009, the EIB Board of Directors approved an Update of the Board Report based on the findings of the updated Appraisal Report. The Board authorised an increase of EUR 200 m, up to a total of EUR 550 m. The updated report to the Board stated that "... despite the cost increase its financial and economic performance [of the project] has not changed significantly compared to the first appraisal".
- 2.2.11 On 22 April 2010, the EIB signed a second Finance Contract (FC2) with TES, borrower and financial beneficiary of the contested lending operation. The FC2 stipulates that, as a condition precedent for disbursement under the Contract, the Republic of Slovenia approves and executes a guarantee agreement. In particular, the disbursement of the first Tranche is conditional upon receipt by the EIB of the original copy of the Guarantee Agreement as well as of a legal opinion by the State Attorney's Office of the Republic of Slovenia on the due execution by the Guarantor of the Guarantor Agreement and on the validity and enforceability of the provisions of the Guarantee Agreement.⁷ Finally, the FC2 stipulates the Borrower shall comply in all respects with all laws to which it or the Project is subject.

⁶ Limitation in gas imports to Slovenia due to the capacity of the transmission pipelines from Italy and Austria and constraints imposed by transit agreements with Croatia suggested that, taking domestic demand growth into consideration, the construction of a new cross-border transmission pipeline would be necessary before further expansion of natural gas in the electricity sector. The proposal to the EIB Board of Directors concluded that "until such time (no sooner than 2012) the construction of more than 400 MW of base load gas-fired power will not be possible".

⁷ With regard to disbursements of other tranches, they are conditional upon receipt by the EIB of a copy of any other document which the Bank has notified the Borrower is necessary in connection with the security or the latter's validity or enforceability.

- 2.2.12 On 23 February 2012 the Slovenian Government adopted a resolution supporting the proposal for the Act on Guarantees. As of February 2012 the project for the construction of Unit 6 was already in the course of implementation, contracts for the supply of equipment had already been concluded and consequently, the costs already invested in the project and the potential damages arising from the termination of already concluded contracts were too high for the Government to withdraw from the project. On 18 July 2012, the Slovenian Parliament adopted the State Guarantee Act⁸ establishing the conditions of the State Guarantee to be provided to the EIB.
- 2.2.13 On 30 November 2012 the Agreement of the Rules Governing the Relationships Regarding the Project of Constructing the 600 MW Replacement Unit 6 in TEŠ was signed by TES and the Government. The EIB and the Republic of Slovenia signed the Guarantee Agreement on 4 and 6 December 2012, respectively. The Guarantee Agreement was ratified by the Slovenian Parliament on 21 December 2012. The legal opinion of the State Attorney's Office was received by the EIB on 4 January 2013.
- 2.2.14 The first tranche of the loan was disbursed in February 2011. The second tranche was disbursed in March 2013, after TEŠ had signed a letter confirming the compliance with all the conditions set in the Act regulating the State Guarantee and providing additional undertakings to comply with the said conditions.

3. STAKEHOLDERS' ENGAGEMENT

- 3.1 On 25 January 2012, the Complainants contacted the Communications Department of the EIB with a view to requesting two meetings: one with the EIB-CM staff, whereby to discuss the content of the Complaints and the timeframe for handling them, and another one with the Vice-President responsible for the Bank's operations in the country as well as other relevant EIB staff, to discuss the economic feasibility of the project and the Bank's commitment to the loan.
- 3.2 In its reply of 17 February 2012, the EIB Communications Department observed that it was for the relevant Slovenian authorities to autonomously decide on the future steps regarding the project and thus suggested to divert the meeting request to such institutions. In addition, the EIB competent services found that, whereas the economic feasibility of the project was one of the issues currently handled by the EIB-CM within the framework of its inquiry into the second complaint, it did not appear appropriate to have a meeting at this stage.
- 3.3 As part of its stakeholders' engagement and within the framework of the preliminary assessment of the second complaint, on 1st of March 2012, the EIB-CM met with I on behalf of ELS, on behalf of Focus as well as on behalf of CEE Bankwatch and on behalf of the Bellona Foundation. The objectives of the meeting were:
- to better understand the Complainants' allegations and gather additional information/documentation from the Complainants; and
 - to explain the nature and scope of the inquiry carried out by the EIB-CM and the further steps of the complaint procedure to the Complainants.
- 3.4 During this meeting, the EIB-CM received a press release of 23 February 2012 concerning the conclusions of the third regular meeting of the Slovenian Government with regard to the issue of a State Guarantee for the Project. Furthermore, the complainants provided additional information on the interim report of the Slovenian Commission for the Prevention of Corruption (SCPC). The Complainants supported the initiative of the EIB-CM to engage with the SCPC to get additional information on the inquiry of the SCPC as well as on the expected date for its final report; a meeting with representatives of the SCPC was thus held at the latter's premises on 20 March 2012. Further information on the inquiry of the SCPC is provided in §5 of this Report.

⁸ Act Regulating the Guarantee of the Republic of Slovenia for liabilities under the long-term loan of 440 million euros made to Termoelektrarna Šoštanj D.O.O. by the European Investment Bank for financing the Termoelektrarna Šoštanj 600 MW replacement unit 6 installation project (ZPODPTEŠ)

- 3.5 With regard to the allegations concerning the assessment of the economic feasibility of the project, during the stakeholders' engagement, the Complainants emphasised that the Delft Report offered a detailed analysis of the concerns about the compliance of the Project with national law. It is to be noted that the Delft Report contains information that sometimes differs from that processed by the EIB competent services; for instance, according to the Delft Report, Unit 4 would be shut down completely and Unit 5 would be put in cold stand-by. Concerning the issue of the impact of the project on the employment in the region, the Delft Report expands on the nearby located Premogovnik Velenje coal mine and explains that its owner would be the same as the owner of the Šoštanj Thermal Power Plant.
- 3.6 The Delft Report concludes that a number of methodological mistakes and unsubstantiated claims had been made in the investment plan, including the following:
- the estimate of the investment plan for the lignite prices was too low and income of subsidiary companies should have not been included;
 - the estimate of efficiency in electricity production from 2028 was too high;
 - oil consumption was not considered in terms of calculation of CO₂ costs and the investment plan incorrectly assumed that emissions for heat generation and process emissions from the desulphurisation unit would receive free allocations until 2054 (while the Delft Report assumes that they will be auctioned from 2020 onwards);
 - the increase of mine efficiency and the market for extra electric power output were not substantiated.
- 3.7 As a result of the analysis carried out by the Delft Report, the Complainants argued that correcting the methodological mistakes of TES amended investment plan (IP4) would lower the Internal Rate of Return (IRR) from 7,59% to 6,91%, i.e. below the thresholds respectively established by law as well as by the Slovenian Government in April 2011. The Complainants stressed that the Delft Report illustrates how, if one applies additional factors to the estimate (higher lignite prices, lower operating hours and both these factors together), the IRR gradually drops down (6.27%, 5,84%, 5.12%).

4. EXCHANGE OF CORRESPONDENCE BETWEEN THE EIB AND THE COMPLAINANTS

- 4.1 On 13 March 2012, the Complainants⁹ wrote an email to the EIB's Management Committee concerning the irregularities in the Šoštanj project in Slovenia, alleging gaps in the due diligence of the Bank. The Complainants referred to the Interim Report of the SCPC and stressed its conclusions concerning the lack of transparency, the lack of supervision and the political and lobbying influences affecting the project. The Complainants also highlighted the high risk of corruption and conflict of interests in the project.
- 4.2 In their letter, the Complainants emphasised that the SCPC called on the Slovenian Prosecutor General to establish a special group to further investigate the case and that the Inspector General of the EIB and the Chief Compliance Officer of the EBRD were investigating possible unlawful activities connected to the project and the integrity of the client. In addition to that, the letter further expanded on the issue of the economic feasibility of the project, by emphasising that the internal rate of return calculated in IP4 at 7,59% would not satisfy the requirement of a minimum discount rate of 9% set by the Slovene Energy Sector Policy of April 2011. On the basis of this consideration, the Complainants argued that the EIB due diligence of the project had been called into question and requested the EIB Board of Directors to suspend disbursement on this operation during the non-judicial proceedings initiated by their complaints.
- 4.3 On 18 April 2012, [redacted] acting on behalf of Association SHERPA, Focus Association for Sustainable Development and CEE Bankwatch Network, sent a letter to the Bank's Vice-Presidents and copied to the Director-General of the European Anti-Fraud Office (OLAF). In his letter, [redacted] referred to the 2011 conviction of one of [redacted] subsidiaries in Switzerland in relation to corruption of foreign public officials in three different countries and the actions taken by the IFI community vis-à-vis this company. In addition to that, he recalled the publication of the interim report of the SCPC and emphasised that there were several on-going investigations (the National Investigations

⁹ It is to be noted that the letter was co-signed by representatives of Greenpeace Slovenia.

Office in Slovenia, the police in the town of Celje, Slovenia, the European Commission¹⁰, and the non-judicial mechanisms of the EIB and the EBRD) into the alleged irregularities of the project. In view of the above, on called upon the EIB to take precautionary actions in relation to the project as, *inter alia*, the suspension of disbursements.

- 4.4 On 28 November 2012 Greenpeace wrote a letter to the EIB President to call on the EIB to freeze funds for the project until the completion of the OLAF investigation. The letter referred to the complaints already received by the EIB and to the fact that Greenpeace had actively supported the Complainants' efforts, as for instance in the correspondence referred to in §§4.1 and 4.2 of this Report. Greenpeace underlined the investigation launched in June 2012 by OLAF as well as those initiated by the EIB and urged the Bank to wait for the conclusions of the on-going investigations including those carried out by the national enforcement authorities before proceeding to the financing of the project. According to Greenpeace, failure to do so would entail the breach of the EIB's internal policies and could be considered as an improper use of EIB funds. It is to be noted that the letter of Greenpeace also reiterated the Complainants' arguments on the economic profitability of the projects based on the Delft Report.
- 4.5 On 14 December 2012, Greenpeace and Focus wrote a new letter to the EIB President calling on the EIB to stop disbursement of funds for the project. The Complainants took the view that the new investment plan prepared in September 2012 (IP5) did not meet the conditions attached to the State Guarantee as:
- Investment costs were not lowered;
 - There was no contract to define the maximum price of lignite at 2.25 EUR/GJ between TEŠ and the Velenje coal mine was signed; and
 - The project did not reach a positive net present value at a 9 % discount rate, i.e. the rate required by the energy policy for fossil fuel projects - including TEŠ 6 - because they carry a high risk.
- In addition, Greenpeace and Focus expressed their concern about the fact that the new investment plan took into consideration the price of carbon as expected in the Slovene draft of the National Energy Programme and expressed the view that, if the carbon price was taken from the scenarios from the EU 2050 Energy Roadmap, the net present value of the project remained deeply negative in all cases.
- 4.6 The Complainants attached to their letter an independent expert opinion on the amended investment plan commissioned to ¹ , Faculty of Economics, and University of Ljubljana – Slovenia. Prof. had concluded that certain assumptions of the new investment plan (such as CO2 credit prices, improved performance, prices of coal) were too optimistic and that the plan had therefore failed to control overall hazards and risks that the project was exposed to (e.g. changed interest rates, outstanding long-term coal supply contract at fixed and binding prices). At the same time, according to the expert opinion, the new investment plan made no reference to the minimum discount rate criterion stipulated in the sector policy of the Republic of Slovenia for the energy industry (9%), at which the net present value of the project was negative. Prof. Kešeljevič highlighted as additional project risks:
- Increased risk of higher cost of financing due to changes in the policies for hedging interest rates;
 - Changes of the price of electricity;
 - Capability of the Velenje Coal Mine to achieve the target price of coal;
 - Unrealistic presentation of the actual situation of interdependence of the coal mine and TEŠ 6 and consequently the possibility of transfer pricing;
 - Increase of CO2 emission allowances prices in accordance with the EU's long-term goals to reduce greenhouse gas emissions; and
 - Failure to achieve the anticipated increased efficiency foreseen in the amended investment plan.
- 4.7 In line with the previous correspondence from the Complainants, this letter expressly referred to the decision of the Slovenian Government of February 2012 setting conditions for the issue of the State guarantee required by the EIB for its loan. Greenpeace and FOCUS concluded that the EIB had failed to ensure support to an economically sound project. As a result, they called on the EIB to stop any further disbursement of funds.

¹⁰ The letter provides the CHAP identification number of the two infringement complaints lodged by the complainants with the European Commission: the first one submitted by Environmental Law Service in October 2011 - CHAP(2011)3041) and the second one submitted by Focus in November 2011 - CHAP(2011)03253.

5. OTHER INVESTIGATIONS

5.1 *The Interim Report of the SCPC*

- 5.1.1 The Interim Report on the findings and position of the SCPC was issued on 17 February 2012. The SCPC Interim Report refers to the need by the Government, competent Ministries and the Capital Assets Management Agency to adopt a position on the findings of existing audits of the project, to implement suitable measures in order to remedy established irregularities and to reduce the risk of their reoccurrence. The SCPC found that the project had been designed and executed in a non-transparent manner, with a lack of supervision and under pressure of political and lobbying influences, due to which large risk of corruption and conflict of interest were established in relation to the project.
- 5.1.2 Among those risks the SCPC Interim Report highlighted suspected criminal offences, conflict of interest and violation of the provisions concerning lobbying, omissions by public officials and lack of response by national authorities in the exercise of their competence. The SCPC transferred documentation concerning suspected criminal offences to the National investigation Office and the Police Directorate of Celje and intended to propose the establishment of a specialised investigative group in accordance with article 160a of the Criminal Procedure Act to the new Specialised State Prosecutor's Office.
- 5.1.3 The SCPC found that violations of provisions in the field of lobbying were committed; however the SCPC Interim Report did not identify the regulation infringed by the facts referred to and namely the participation of HSE in the drafting of the proposal of the Act regulating the Guarantee of the Republic of Slovenia. The SCPC, however, alleged that the drafting process was not carried out in a transparent manner.
- 5.1.4 In addition to that, the SCPC Interim Report referred to the findings of an audit carried out by PwC and took note of the Decision of the Government of the Republic of Slovenia of 14 April 2011 charging HSE with addressing the shortcomings identified in the audit. The SCPC reported that such measures had not been implemented by HSE because the latter considered that it was not competent for adopting them; following a request of the SCPC, by letter of 24 December 2011 the Government informed the SCPC of the fact that the Decision of 14 April 2011 did not specify a time-frame for reporting. As a result, the SCPC found that the Government had not adopted any measure for the implementation of its Decision.

Table I - The PWC audit

On 9 March 2011, PwC Slovenia issued a report aiming at reviewing certain investments, contracts and business transactions in TES, for the use of HSE's Supervisory Board and Audit Committee. The investments on which HSE had ordered a review included 7 items:

Investment in Unit 6
Investment in Two Gas Turbines
Direct Sales of Electricity
Investment in New Telecommunications Hub and Administrative Building
The Procedures for Specific Contract Selections
Awards to Employees of TES in connection with the Construction of Unit 6
Electronic Document Management System for the purposes of Contract Management

The review included an action plan of measures to be taken in order to rectify the shortcomings identified with recommendations in each of the items under review.

- 5.1.5 The SCPC Interim Report also referred to allegations of corruptions which fall outside the scope of the inquiry of the EIB-CM and could not confirm alleged violations relating to the construction of facilities as part of TES 6 without suitable building and environmental permits voiced by publications in the media. Finally, the SCPC recommended that any decision to continue the project must include procedures for remedy of previous irregularities, the implementation of additional mechanisms of monitoring, supervision and consistent transparency and avoidance of a conflict of interest during its execution.

It is to be noted that the inquiry of the SCPC did not assess the economic and environmental aspects of the project but focused on the issue of suspected corruption, conflict of interest, illicit lobbying and other risks of corruptive and unethical actions in the concerned case.

- 5.1.6 Finally, from the Interim Report as well as the stakeholders' engagement referred to in §3.4 of this Report, it results that the inquiry of the SCPC was carried out in line with the Integrity and Prevention of Corruption Act 84/1s, a piece of Slovenian legislation (now amended) which, in its previous draft, limited the competences and options of the SCPC in the area of obtaining data and determining violations. As a result, the SCPC could only document its inquiry in the Interim Report and inform the Government and other competent authorities of the risks of the Project.

5.2 *Investigations into alleged corruption*

- 5.2.1 In line with the duties of information established by the EIB Anti-Fraud Policy, in May 2011 the EIB-CM liaised with the Fraud Investigations Division of the EIB Inspectorate General (IG/IN) in order to provide it with all information received from the complainants. Following the submission of the second complaint, the EIB-CM co-ordinated with IG/IN for the organisation of the meeting with the SCPC referred to in §3.4 of this Report.
- 5.2.2 During its inquiry, the EIB-CM was informed of the decision of OLAF to open an investigation case in relation to allegations of corruption and conflict of interest. In line with its mandate, IG/IN monitors the on-going investigations into alleged corruption and liaises with the competent authorities.

6. THE SUBMISSION OF THE BORROWER

6.1 *Information on the SCPC Interim Report*

- 6.1.1 In a letter of 19 March 2012, TES informed the EIB of the fact that the SCPC had adopted its interim findings and observations in relation to the project and that its report was published on its website. The Borrower emphasised that the findings of the SCPC were not final and that they had no implications for the project or the financing agreement but that, nevertheless, it had considered appropriate to inform the Bank about it. In its correspondence, the Borrower highlighted that the SCPC had limited competence under the regulatory framework applying to the case and was likely not to issue a final report. Nevertheless, the Borrower stated that both TES and HSE had taken actions to ensure greater transparency and supervision of the project.
- 6.1.2 On 1 May 2012, TES sent further correspondence to the EIB concerning the investigations of SCPC. The Borrower took the view that the majority of the findings¹¹ of the PwC Report did not relate to the construction of Unit 6 and stated that it had discussed the content of this report with the EBRD. As such, the Borrower suggested the EIB to liaise with the co-financing institution and expressed its availability to further discuss directly with EIB. In the letter, TES elaborated on the allegations contained in the Interim Report of the SCPC and concluded that the Project was very open to the public and that it enjoyed the support of the majority of the local community; it also provided a list of actions taken to enhance transparency of the project.¹²

¹¹ The Borrower uses the term "irregularities"

¹² The list included:

- co-operation with the SCPC during its inquiry;
- establishment of a Committee for active supervision of the project reporting to HSE, TES and the supervisory board, responsible – together with the management of the project – for preparing the quarterly reports to Slovenian Government and the Capital Assets Management Agency of the Republic of Slovenia;
- Amendments to the contract with Alstom;
- Amendment to the National Investment Programme 4 (NIP4): more substantial description of the quantity of coal, ecology and economics of the project as well as risk analysis.
- Publication of NIP4, study about the quantity of coal from company IMT Montan, summary of study about the viability of renewal of Units 4 and 5 of company Evonik on the websites of HSE and TES, which are updated;
- Appointment of six members to the Supervisory Board and inclusion of an independent expert confirmed by the EBRD;
- Adoption of a more transparent and more hierarchic project organisation.
- Establishment of a Project Council, a consultation body consisting of members of local communities and members of NGOs. NGOs which are strongly opposing the Project decided not to sit in the Project Council.
- Organisation of a suppliers' conference together with the Slovenian Chamber of Commerce and Industry and Alstom whereby "all the potential suppliers and sub-suppliers" were informed of the "possibilities and conditions for cooperation on the Project";
- Regular organisation of "Days of Open Doors" to inform the public about the progress of the Project;

6.2 Correspondence after the issue of the State Guarantee

- 6.2.1 On 7 February 2013, TES sent a letter to the EIB President, whereby it explained that the Project was completed up to 74% and stressed its difficult credit position after having practically exhausted the sources of interim financing and given the fact the disbursement of funds from the EIB loan was a pre-condition for disbursement of the remaining available funds under the EBRD loan. Moreover, it underlined the impact of further delays in the financial assistance to the Project on the implementation of the latter¹³ and on the business of TES, HSE and of the supplier of coal Premogovnik Velenje d.d as well as on the stability of energy sector of Slovenia and on the latter's macroeconomic situation.
- 6.2.2 The letter emphasised that the Project had been thoroughly assessed by the various financial institutions, which continue to monitor the Project, and that it was compliant with all conditions precedent for the disbursement of the credit stipulated in the finance contract (as proved by the evidence delivered to the Bank including the sovereign Guarantee of the Republic of Slovenia). The Borrower found the allegations made by the complainants as broad and unfounded and concluded that they could not, in the absence of other obstacles and considering the terms and conditions of the Finance Contract, prevent disbursements.
- 6.2.3 On 12 February 2013, the Borrower sent another letter to the EIB President addressing, *inter alia*, the complainants' concerns about the economic feasibility of the Project. In particular, TES stated that the Revised investment programme REV 5 was prepared in accordance with the Decree on the uniform methodology for the preparation and treatment of investment documentation in the field of public finance and that economic indicators showed that the project was acceptable, considering that the internal rate of return (7.75%) was higher than the average price of financing sources and that the return on equity (14.97%) was higher than in comparable projects and exceeding the value envisaged in the Slovenian Energy Sector Policy (9%). Finally, TES explained that *"the valuation procedure also included elaboration of the sensitivity analyses in dependence to changes in the price of coal, ... in the selling price of electric energy, ... in the price of emission allowances and ... in the value of investment"*. On 19 February 2013, the Slovenian Ministry of Finance sent a letter to the EIB President stressing that TES and the Republic of Slovenia had completed all procedures under the Finance Contract and the Guarantee Agreement and that the Borrower had to recur to considerable bridge-financing for the on-going operations.
- 6.2.4 On 25 February 2013, the Borrower sent a letter to the EIB whereby it took the view that the allegations made by the complainants did not affect its ability to lawfully request the disbursement of the credit under the Finance Contract and that the project has been carried out and will be further implemented in compliance with all applicable law as well as with EIB policies. The Borrower also confirmed that the State Guarantee was in full force and effect and that the conditions set in article 1.2 of the Act regulating the State Guarantee were met or would be met at the requested time. In addition to the obligations stemming from the Finance Contract, TES made some additional undertakings to the EIB, qualifying as "obligations" under the Finance Contract; among those, in the light of the present inquiry, it is worth noting the following:
- To comply with the conditions set forth in article 1.2 of the Act regulating the State Guarantee;
 - To promptly inform the EIB of a genuine allegation, complaint made to the competent public authorities or the Borrower.

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- Establishment of the function of Internal Revision, organised and leaded by HSE;
 - Organisation of site visits for more than 50 organised groups including members of the National Council of the Republic of Slovenia;
 - Co-operation with the prosecution authorities within the framework of their investigations into "some operations from the past years", including assumptions of uneconomic decisions, wrong decision for other investments in the past and major irregularities in connection with the purchase of computer equipment. The Borrower clarified that the persons responsible for such irregularities were not anymore employed by TES.

¹³ As evidence of the impact of further delays in the disbursement, the Borrower provided the EIB with a letter of ALSTOM of 7 February 2013 informing of the impossibility to maintain its activities in case the payment schedule could not be restored by 28 February 2013, resulting in the increase of the cost and of the delay of the completion date.

7. APPLICABLE REGULATORY FRAMEWORK

7.1 *The Scope of the EIB-CM*

- 7.1.1 The EIB Complaints Mechanism applies to complaints of maladministration brought against the EIB Group (article 4.1 of Title II "Principles" of the EIB CMPTR) and that complaints may concern any alleged maladministration of the EIB Group in its actions and/or omissions (article 4.1 of Title IV "Rules of Procedure" of the EIB CMPTR).
- 7.1.2 Another relevant provision in the light of the allegations made by the complainant is established by article 2.3 of Title IV "Rules of Procedure" - CMPTR pursuant to which the CM is not competent to investigate complaints concerning International organisations, Community institutions and bodies, national, regional or local authorities. In addition to that, it is worth recalling that article 2.5 of Title IV of the CMPTR establishes that the EIB-CM cannot deal with complaints which have already been brought to other administrative or judicial review mechanisms or which have already been settled by them.
- 7.1.3 Finally, article 9.3 of Title IV of the EIB CMPTR establishes that *"In case the complaint alleges concern violation of EU legislation in the projects located within the European Union, the EIB-CM may inform the Secretary General of the European Commission about the complaint and forwards the final Conclusions Report"*.

7.2 *National law*

- 7.2.1 Article 1.2 of the Act regulating the Guarantee of the Republic of Slovenia for liabilities under the long-term loan of 440 M EUR made to TES by the EIB for financing the TES 600 MW Replacement Unit 6 installation (State Guarantee Act or SGA) stipulates that "the Republic of Slovenia shall provide the guarantee...under the following basic conditions:
...before the signature of the guarantee contract, TES and the minister responsible for the energy sector and the minister responsible for finance shall conclude the contract on the arrangement of relationships, which shall set out the context of the implementation of the project concerning:
- the reduction of the investment value of the project;
 - the conclusion of the contract between TES and Premogovnik Velenje (Velenje Coal Mine) on long-term coal supply, including maximum price,
 - the deadlines for the completion of the project
 - achieving¹⁴ the profitability of the project in accordance with the sectoral policy in the energy sector;"

Article 2.2 of the SGA establishes that the ministry responsible for finance shall see to the implementation of this Act and to the exercise of all rights and obligations of the Republic of Slovenia arising therefrom.

- 7.2.2 The Slovenian Sector Policy for the Energy Sector is implemented by the Ministry of Economy, partly through the Energy Directorate and partly through the Internal Market Directorate. The Energy policy pursues three key objectives: security, competitiveness and sustainability of the energy supply. For the period up to 2030, the energy policy of the Republic of Slovenia sets the following objectives:
- increasing strategic and operational security of energy services supply;
 - ensuring competitive economy and available and accessible energy or energy services;
 - promoting environmental sustainability and combating climate change;
 - ensuring social cohesion.

When defining the mechanisms in the field of competitive energy supply, the Energy policy establishes that for competitive energy supply and economic operation, it is necessary that the minimal discount rate for investments in facilities for electricity generation from fossil fuels amounts to 9% and that the lowest required return on capital (the key operation objective) for all companies, under direct or indirect majority state-ownership amounts to 9%¹⁵.

¹⁴ The translated copy received by the Bank makes reference to "archiving"; the EIB-CM considers that this is a typo mistake and it should read "Achieving"

¹⁵ Additionally the Policy establishes that each investment exceeding EUR 50 M must have an investment programme audited by a reputable foreign consultancy company.

7.2.3 The Decree on a single methodology for the preparation and processing of investment documentation in the field of public finance (Decree 60/06) provides for the preparation and processing of investment documents for all investment projects and other measures financed under the rules governing public finance. The decree sets a common methodology for the preparation and treatment of investment documentation including minimum criteria for determining the effectiveness of projects.¹⁶

7.2.4 Art. 5 of the Decree 60/06 establishes the methodology to carry out the evaluation of investments depending on the type of investment documentation; paragraph 3 of this article stipulates that the general discount rate referred to in art. 8 of the Decree 60/06 shall be followed in investment project evaluation. Article 8 of the Decree establishes that the general discount rate shall be 7% and that the minister responsible for finance may, together with the minister responsible for development, determine another discount rate or social discount rate in accordance with changes in the economic conditions, which shall then be published in the Budget Memorandum of the Republic of Slovenia.

7.3 *The Agreement between TES and the Republic of Slovenia*

7.3.1 On 30 November 2012, the Republic of Slovenia represented by the Ministers of Finance and Energy on one hand and TES on the other hand signed the Agreement on the rules governing the relationships regarding the project of constructing the 600MW replacement Unit 6 in TES (the Agreement), in line with article 1.2 of the SGA; pursuant to the Agreement, the latter governs the relationships between the Parties regarding the implementation of the Project or the requirements which TES, in its capacity of investor, must comply with as stipulated in the SGA.

7.3.2 Among the commitments and warranties of TES, TES:

- warrants that total investment value of the Project will be lower than the final value of the Project; (article 4 of the Agreement)
- undertakes to conclude a contract on a long-term supply of coal with Premogovnik Velenje d.d. or to conclude an adequate annex to the existing contracts on a long-term coal supply at a maximum price defined in an Amended investment programme – NIP 5; (article 5 of the Agreement)
- warrants that the Project will be finished in accordance with the time schedule as defined in NIP 5, i.e. by 15 February 2016 at the latest, when the operating permit must be obtained. (article 6 of the Agreement)
- warrants that the Project's return on equity shall be 9% or within the framework defined in the sectorial policy of the Republic of Slovenia for the field of energy or in the documents governing the management of capital investment in the Republic of Slovenia for companies doing business in the field of energy.

7.3.3 Pursuant to article 10 of the Agreement, TES undertakes to submit a report on its compliance with the obligations laid down in the Agreement to the Ministries of Finance and Energy by 30 June of each year. Article 11 stipulates that, in case of breach of any of the obligations or warrants laid down in the Agreement and in case the Government should decide not to exempt TES pursuant to article 13 of the Agreement (breach due to objective and justified reasons), TES must pay the Republic of Slovenia liquidated damages in the amount of 1.000 EUR per day of breach until a maximum of 100.000 EUR. Article 12 extends the same penalties to the Management of TES and the project leadership, which – in case of breach and in the absence of the governmental exemption, must resign without any delay and is not entitled to severance pay. Finally, article 14 attributes the supervision over the implementation of the provisions of the Agreement to the Ministry of Finance and the Ministry of Energy which exercises it on behalf of the Republic of Slovenia.

¹⁶ Article 3 of the Decree stipulates that it applies to the preparation and treatment of investment documentation when such investments concern the acquisition, construction, modernisation, renovation and major maintenance of fixed assets, when they require government guarantees or simply when having a significant financial impact on the budget.

8. METHODOLOGY OF THE INQUIRY

- 8.1 As part of its inquiry into the complaint, the EIB-CM has reviewed the relevant project documents, including the correspondence with the Complainants and the further information provided by it, the applicable regulatory framework, TEŠ investment programmes (revisions 4 and 5), the Project Appraisal Reports, the Bank's Board Reports, the Finance Contract, the Bank's Operational Manuals and other documents attesting the EIB's due diligence of the project. Meetings took place with the services responsible for the project appraisal and monitoring to understand the background and the status of implementation of the project as well as to exchange views on the issues raised by the complaint. The meetings were followed by an exchange of emails to clarify further points. A first Initial Assessment Report was circulated to the services in July 2012; a revised version was submitted to the concerned services for comments in early February 2013.
- 8.2 The EIB-CM engaged with the Complainants on more than one occasion since the first Complaint was received in 2011. In addition to the stakeholders meeting of 1st March 2012, the EIB-CM met with them during the annual meeting organised by the Bank between the EIB's Board members and the Civil Society organisations on 4 February 2013 in Luxembourg. By that time, TEŠ had submitted a final disbursement request for the remaining funding of the project. Based on the need of the Bank to take a decision on the request for disbursement of funds to the contested project and given the work performed as part of the EIB-CM's initial assessment, the EIB-CM provided the EIB Management Committee with its initial assessment and decided to complete the investigative work. Accordingly it proceeded directly to the drafting of the Conclusions report, with a view not to further delay the completion of its inquiry.
- 8.3 The information collected was considered sufficient to form an opinion on the key allegations presented by the Complainants on Governance matters and assess whether maladministration by the EIB had occurred. The key findings and conclusions are presented below.

9. FINDINGS AND CONCLUSIONS

9.1 Allegation concerning the failure to obtain Government support

Findings

- 9.1.1 Concerning the Government support to the project, the EIB-CM notices that the Bank's Project Appraisal report of 27 September 2007 and its revised version of 30 October 2009 make the following reference: *"The project is in line with Resolution on Slovenia's national Energy Program and in line with the Ordinance on the strategy of the Spatial Planning, which provide for the further development of electricity production on the present location"*. The Note submitted to the Board of Directors for approval on 15 December 2009 indicates *"The Government has confirmed the TEŠ project as the priority investment in line with Slovenia's national Energy Programme"*. It also indicated that *"Security would consist of a State Guarantee..."*
- 9.1.2 The EIB-CM also notices that TEŠ is the subsidiary of HSE, a public-owned enterprise. HSE was established as a limited private company by law adopted by the Government of the Republic of Slovenia on 26 July 2001. The share capital represents the investment of its sole shareholder, the Republic of Slovenia. As part of the Governance Structure, there is a Supervisory Board, which is currently composed of 7 members; 4 of them are appointed by the owner.
- 9.1.3 The Revised Investment Programme prepared by TEŠ (Rev. 4) (IP4) indicates that *"it [the revised investment plan] contains all requirement and proposals derived from letters and decisions of the Ministry of Economy and the Government of the Republic of Slovenia. In particular, we took into account the decision of the 130th regular meeting of the Government of the Republic of Slovenia held on 14 April 2011, where the Government adopted, under Item III-8A, the following decision: The Government of the Republic of Slovenia is willing to take on an additional risk by issuing a state guarantee for the project of Unit 6 at TEŠ in the amount of EUR 440 million"*

- 9.1.4 On 23 February 2012, the Slovenian Government adopted a resolution supporting the proposal for issuing the Act on Guarantees. Subsequently, the SGA was approved on 18 July 2012 by the Slovenian Parliament. The EIB and the Republic of Slovenia signed the Guarantee Agreement respectively on 4 and 6 December 2012. The Agreement was ratified by the Slovenian Parliament in December 2012.

EIB-CM Conclusions

- 9.1.5 The information gathered during the EIB-CM's assessment shows that on several occasions during the project cycle, the Slovenian government has expressed support, directly or indirectly, to the Project. The signature of the Guarantee Agreement ratified by the Parliament expresses a clear support to the Project by the government and the national assembly.

- 9.1.6 The EIB-CM concludes that his allegation is therefore not grounded.

9.2 Allegation concerning failure to comply with the national regulatory framework on the expected rate of return on investments

Findings

- 9.2.1 Since the first contact established with the EIB-CM, the Complainants have challenged the compliance of the Project with the national legislation concerning its profitability, which is referred to in §7.2 of this Report, including the SGA.
- 9.2.2 From the information reviewed by the EIB-CM and as confirmed by the General Manager of HSE and the Managing Director of TES in the letter referred to in §6.2.3 of this Report, the rate of return calculated by the Promoter is above the threshold imposed by the Decree 60/06, while it seems that the same estimate does not attain the threshold required by the 2011 Slovenian Energy Policy, as referred to in §7.2.2 of this Report. On the contrary, the calculations made by TES seem to provide reassurance about the compliance of the Project with the 9% threshold of the lowest required return on capital established by the 2011 Slovenian Energy Policy.
- 9.2.3 In this context, it is appropriate to emphasise that – besides the above-mentioned national standards – pursuant to the SGA, the achievement of the profitability of the project in accordance with the sector policy in the energy sector was a condition for the issue of the State Guarantee and that the Guarantee Agreement was ratified by the Slovenian Parliament in December 2012, thus justifying the legitimate expectation of the EIB that the condition for the issue of the Guarantee had been attained to the satisfaction of the institution (the Slovenian Parliament) which had initially established such condition. On the other hand, one could not fail to notice that, once ratified, the Guarantee is unconditional and irrevocable.
- 9.2.4 Finally, it is important to recall that, when determining the commitments and warranties of TES in the light of the implementation of the State Guarantee, the Agreement between TES and the Republic of Slovenia referred to in §7.3.3 leaves two alternatives with regard to project's profitability (expressed as return on equity and no longer as rate of return) i.e. either to respect the 9% threshold or to respect the framework defined in the sector policy of the Republic of Slovenia for the field of energy or in the documents governing the management of capital investment in the Republic of Slovenia for companies doing business in the field of energy.

EIB-CM Conclusions

- 9.2.5 The Guarantee Agreement was signed by the Government and ratified by the national Parliament, as confirmed by the legal opinion issued by the Attorney General's Office of the Guarantor in December 2012. The EIB-CM therefore takes note of the fact that the national competent authorities have already performed a review of the compliance of the project with national law with regard to the fulfilment of the requirements established by the SGA. In the light of the principle of subsidiarity and having regard to the competence and mandate of the EIB within the EU, the Bank endeavours to liaise with the competent authorities of the Member State in question to ensure that the obligations stemming from its finance contract are respected by the Borrower.

- 9.2.6 Once the Slovenian competent authorities have confirmed the conformity of the State Guarantee with the national legislation, the EIB-CM is not in a position to intervene as it could not grant the complainants an external means for appealing against decisions of national authorities. When deemed necessary, the EIB-CM may however inform the Secretary General of the European Commission, as for instance when the interpretation given by the competent national authority raises doubts about the conformity of the said decision or of the national legislation with the EU *acquis*, in line with the considerations made in §7.1.3 of this Report.
- 9.2.7 With regard to the Agreement between TEŠ and the Government of Slovenia, the EIB-CM cannot fail to notice that the requirement established by the SGA concerning the achievement of the profitability of the project in accordance with the sector policy in the energy sector (including the minimum discount rate of 9% for investments in facilities for electricity production from fossil fuels) has been incorporated in the Agreement as an option and not as an obligation¹⁷.
- 9.2.8 However, as reported above in § 6.2.4, it must be noted that TES made some additional undertakings to the EIB, qualifying as "obligations" under the Finance Contract, including to comply with the conditions set forth in article 1.2 of the Act regulating the State Guarantee.

9.3 Review of the EIB's due diligence with regard to the profitability of the project

Findings

- 9.3.1 Given the allegations concerning the profitability of the project and the several occasions in which the Complainants challenged the EIB's due diligence as shown by the correspondence referred to in §4 of this Report, the EIB-CM reviewed the project documents prepared during the project cycle to form its reasoned opinion on the due diligence carried out by the EIB on this matter.
- 9.3.2 §2.2 of this Report summarises the process followed by the Bank at the different stages of the Project cycle to analyse the profitability of the project. At this point, it should be highlighted that the profitability analysis presented by the Complainants (the Delft Report and the analysis referred to in § 4.6) have been carried out taking into consideration the financial assumptions of the Based Model elaborated by TEŠ in the IP4 and IP5.
- 9.3.3 When requested to comment on the assessments submitted by the Complainants, the Bank's services indicated that *"the profitability figures quoted by TEŠ cannot be directly compared to the financial profitability of the project as assessed by the Bank. The IRR estimated by TEŠ takes into account the full cost and revenues of the Šoštanj Power plant complex while the Banks' analysis focussed on the project it has financed – namely new unit 6. In addition there are a number of differences in the assumptions underpinning this calculation..."*. One example of the assumptions that differ from that processed by the Complainants is that, according to the Delft Report, Unit 4 would be shut down completely and Unit 5 would be put in cold stand-by. In addition, the financial projections of the Bank are based on data provided in the initial projections of the promoter of 2007. The last version of the TEŠ Investment Plan (IP5) is dated 12 September 2012.
- 9.3.4 The EIB-CM also notes that the financial models prepared by TEŠ have been audited by an independent and professional reviewer, and that the Complainants do not challenge either the structure or the financial calculations of the TES model. The report prepared by [redacted] of the University of Ljubljana acknowledges that *"our [the University] calculations also confirm the correctness of the calculations above [the ones calculated by TES IP5]"*. Finally, the Board Report stated the project was sub-optimal compared to the best alternative based on 5% discount rate.

¹⁷ The EIB-CM notices the difference observed between the return of the project in the NIP 5 (7.75%) and the required return of the sector energy policy of 9%. Indeed, TEŠ has used as a discount factor the 7% indicated in the Decree on the uniform methodology for the preparation and treatment of investment documentation in the field of public finance. In the case under consideration, the EIB-CM considers that the discount factor of the sectoral energy policy might supersede the one of the Decree of public finance because the SGA makes a specific reference to apply the profitability parameters of the energy sector.

EIB-CM Conclusions

- 9.3.5 The Bank has carried out the profitability analysis of the project based on its own technical and financial assumptions and cash flow projections. The Bank's analysis must therefore be considered within the context of the decision-making process of the Bank and does not compare to the analysis carried out by the Complainants, which is based on the profitability parameters established by the national legislation.
- 9.3.6 The assessment of the EIB due diligence concerning the financial and economic profitability of the Project shows that since the beginning of the project cycle the EIB services identified factors of success of the project (the supply of indigenous fuel resources and the employment effect in a convergence region), as well as constraints (less profitability than gas-fired generation and the exposure to regulatory risks connected with EU climate policy). For the sake of transparency with all the parties involved, §2.2 of this report provides a very detailed view of the process followed by the Bank's services during the due diligence period.
- 9.3.7 As a result, the Financial and Economic viability of the Board reports discussed by the EIB's Board, mentioned several factors that would justify the investment made by the Bank, including a least cost analysis and the positive social impact of the project. Key aspects related to the profitability of the project, in particular the comparison of the discounted cost of the best alternative is well elaborated and clearly presented in the Board Report. However, the text informing about the financial and economic viability of the project was not sufficiently explicit on the negative returns achieved by the Bank's internal calculations. The Board report of 2007 does not mention any financial nor economic rate of return, and the Board report of 2009 does not make any reference either to the IRR (Internal rate of return) of 3.5% and ERR (Economic rate of return) of 4% as per the Appraisal Report. Both of them are below the discount rate of 5%, which is the hurdle rate used by the Bank.
- 9.3.8 Both IRR and ERR are key element for the decision-making process of the Bank. Low or negative IRRs do not prevent the Bank to carry out certain operations if duly justified, particularly if the project results in high economic and social benefits. Yet, the ERR calculated by the Bank in this project is also below the hurdle rate of 5% used by the Bank. This key element of the decision process was not clearly presented in the Board Report. This might not have influenced the final decision taken by the Bank because other elements were clearly presented; however, it prevented a clear and transparent discussion of this matter, which might have had an impact on the decisions related to the terms and conditions of the Bank's loan.

9.4 *Allegations concerning the governance of the Project*

Findings

- 9.4.1 The audit performed by PwC and the interim findings of the SCPC highlighted a number of shortcomings that have impacted on the economic profitability of the Project and on the overall governance of the Project by TEŠ management. The former provides a detailed assessment of the situation in the beginning of 2011 and the actions to be taken with a view to strengthening the governance of the project. From the information provided in the Interim Report of SCPC and reported in the present Report, the measures recommended were not implemented by the Promoter because the latter considered that it was not competent for adopting them while the Government had not specified a time-frame for reporting on the implementation.
- 9.4.2 Although the EIB-CM was informed that a dossier was transferred by the SCPC to the National Investigation Office from the information gathered during the inquiry, no action was yet taken by the national enforcement authorities on the above allegations. In addition to that, it is to be noted that the investigative and coercive powers of the SCPC were limited in the present case as a result of the applicable regulatory framework; from the stakeholders' engagement referred to in §2.4 of this Report, it appeared that the SCPC considered its investigation completed and it did not envisage to issue a final Report.
- 9.4.3 Finally, it is worth recalling that an inquiry of OLAF into alleged corruption is pending.

EIB-CM Conclusions

- 9.4.4 The on-going procedures (National Prosecution Office, OLAF) are followed up by the Fraud Investigations Division of the EIB Inspectorate General in order to ensure prompt reaction from the Bank in case of any negative development for the Project.
- 9.4.5 In line with the considerations made in §7.1.2 of this Report, when the same allegations submitted to the EIB-CM are handled (or have been handled) by the competent national and/or international review procedure, the allegations is deemed inadmissible and the EIB conforms its position to that expressed by the competent authority. As a result, it is recommended that the EIB competent services carry out a regular follow-up of the pending procedures.

10. RECOMMENDATIONS

In the light of its findings and conclusions, the EIB-CM makes the following recommendations:

- The EIB operational services should pro-actively engage in the monitoring of the Project's compliance with the Finance contract and the fulfilment of the additional undertaking made by TES in its letter to the EIB of 25 February 2013 to comply with the conditions set forth in article 1.2 of the Act regulating the State Guarantee.
- The EIB shall ensure an improved and systematic communication on profitability figures of the project to the EIB Board of Directors, as key element for the decision-making process of the Bank. Although the EIB may decide to support a project whose profitability figures are below the hurdle rate used by the Bank, a clear and transparent discussion on the profitability of the project is crucial as this might impact decisions related to the terms and conditions of the Bank's assistance.

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Complaints Mechanism
24 October 2013

R. Rando
Complaints Officer
24 October 2013

LIST OF ACRONYMS

CCS: Carbon Capture and Storage
CMPTR: Complaints Mechanism Principles, Terms of Reference and Rules of Procedure
EC: European Commission
EIB-CM: EIB Complaints Mechanism
FSA: Appraisal Authorisation
IP: Investment Plan
IRR: Internal Rate of Return
OLAF: European Anti-Fraud Office
PIN: Preliminary Information Notice
SMISP: Slovenian Ministry of Infrastructure and Spatial Planning
SCPC: Slovenian Commission for the Prevention of Corruption
SGA: State Guarantee Act

