

**USG Position on the African Development Bank's investment in
ESKOM Medupi Coal Fired Power Project
November 25, 2009**

South Africa is working very hard to manage its extremely challenging task of delivering essential services to its population. Strong energy infrastructure is a critical element of that task. Clearly, investments in power generation have not kept pace with the needs of the economy, and the current tariff structure does not allow Eskom to fund needed investments. With the construction of this power plant, South Africa will begin to benefit from a more reliable source of power and from fewer blackouts that could negatively affect economic output, as happened in 2008.

South Africa has a strong vision for meeting longer-term energy sector needs and in particular, the United States government (USG) welcomes the proposals for a feed-in tariff for renewable energy that the national energy regulator is considering and for establishing grid operator rules that provide fair access for renewable sources of energy. The USG also welcomes the preparation of a long-term Integrated Resource Plan currently being readied for consideration by the South African cabinet that includes concentrated solar power, cogeneration, solar water heaters, wind power, demand side management, nuclear power, and the shut down of old inefficient power plants. It would be ideal to release this to the public shortly.

These efforts demonstrate a strong commitment by the South African authorities to address sustainable energy. However, the success of this bold vision is critically dependent on whether the tariff structure in South Africa is fundamentally restructured so that there are adequate revenues to fund capital investment and adequate incentives for replicating renewable and energy efficiency investments, while at the same time the poorest are provided with targeted subsidies. This is understandably difficult in any nation, but perhaps more so in South Africa, whose citizens have become accustomed to either very cheap energy or still lack access to reliable electricity.

Turning to the specific project, the USG has a number of concerns about the adequacy of the environmental impact assessment, the retroactive procurement, and the adequacy of the efforts to mitigate the impact of the significant CO₂ and SO₂ emissions.

First, on environmental issues, four observations are to be made:

1. *Associated facilities*: The United States reviewed carefully the environmental impact assessment (EIA) and found several deficient areas. It is the view of the USG that the EIA should assess two key associated facilities which are needed for the project to operate: (1) the planned construction of a water transfer system needed to supply half of the water needs for the power plant (Crocodile West Transfer Water Scheme, with an estimated cost of \$1.5 billion), and (2) the expansion of the Grootegeeluk coal mine being used to supply the power plant (estimated cost of roughly \$900 million). The World Bank and AfDB do not consider these to be associated facilities. However, they are essential for the project to operate and will have significant environmental impacts. Therefore, these facilities should be subject to a full environmental impact assessment. The USG urges the Bank to broaden its definition of "associated facilities" so that it

would cover facilities such as these. The Inter-American Development Bank's policy provides a good model in a peer institution.

2. *Cumulative Impacts:* The 4800 MW Kusile coal fired power plant, which is currently under construction, is just 50km from the Medupi plant, according to AfDB staff. The impacts from this plant should have been included in the assessment of cumulative impacts.
3. *Local particulates:* Modeling studies indicate that SOX levels will exceed World Bank standards. Although the project is flue gas desulphurization-ready, the AfDB proposal does not include a loan covenant requiring Eskom to install this equipment if the emissions exceed those standards. The USG hopes that this can be negotiated in the loan agreement.
4. *Encouraging local standards:* Finally, the USG understands and is encouraged that South African law requires that the EIAs for impacts will be done eventually, consistent with South African laws, and that a cumulative impact assessment of the coal power projects on both sides of the South Africa-Botswana border will also be undertaken. However, they should have been done in advance of consideration by the Board. This transparency is a significant component of the AfDB's value added in such a large, complex project.

Second, on procurement issues, the USG is concerned that the project is not compliant with the Bank's Procurement Rules. Given that roughly 95% of the procurement has already been completed, the Bank's retroactive financing requirements on the Procurement Rules should apply. The technical annex and staff responses to our questions acknowledge multiple important inconsistencies with AfDB Procurement Rules. The non-compliance with the Bank's Procurement Rules on advance contracting and retroactive financing should have prohibited AfDB financing of this project. The adverse impact of these violations of the international competitive bidding provisions of the Rules is demonstrated by the fact that there was only one "compliant" bidder each for the very large-value contracts for boilers and turbines. It is probable that the various irregularities discouraged bidders (and it is possible that other potential bidders were not even aware of this tender, which was issued by invitation), and it will never be known if Eskom received the best deal possible, as would have been the case if the AfDB's Procurement Rules had been followed. While the Bank's efforts to explain the lapses are noted, they do not mitigate them. The USG welcomes staff confirmation that the fraud and corruption provisions (Sections 1.14 and 1.15 in their entirety) of the Procurement Rules will apply to the financing and would urge the Bank and Eskom to work together to ensure that the AfDB Procurement Rules will be applied in any future AfDB financed project.

Third, as the historic United Nations meeting in Copenhagen to address climate change approaches, the USG is looking for the multilateral development banks to play an important role assisting developing countries in lowering their greenhouse trajectories. The AfDB risks undermining its potential for having an effective future role in climate finance when it does not actively engage with host governments well upstream of coal projects to explore the potential for developing alternatives that would reduce the need for them. On the contrary, this plant has already been under construction for a year and a half. At a minimum, the AfDB and its shareholders would have been better served by ensuring that the timing of this project coincided with that of the World Bank board consideration. This would have allowed a more coordinated

and effective response by the two MDBs and their Boards to the climate-related concerns raised by this project, which at 26 million tons of CO₂ per year, will rank as one of the largest sources of carbon emissions in the world.

In addition to engaging with project sponsors upstream, the USG would like the Bank to work with coal project sponsors to plan and implement actions that would offset the project's emissions. As noted, the South Africans have put together a fairly ambitious set of policy and programmatic measures with implications for limiting power sector emissions. These reductions, however, total less than half of the emissions projected to be added by the Medupi project. We do not have information about the net positive or negative effect on power sector emissions of other planned actions.

In closing, the USG remains impressed with South Africa's efforts to improve the lives of its people and its vision for sustainable energy. The USG commends South Africa's concrete proposals for developing renewables, an ambitious energy efficiency program, shutting down inefficient coal power projects as new capacity is added, and reformed regulatory and tariff structures. However, given concerns as stated above on this project -- adequacy of the environmental impact assessment, procurement policy violations, and inadequate efforts to address CO₂ emissions -- the United States wishes to be recorded as abstaining.