AFRICAN DEVELOPMENT BANK GROUP

DIRECTOR GENERAL - SOUTHERN AFRICA REGIONAL DEVELOPMENT AND BUSINESS DELIVERY OFFICE (RDGS)

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Ms. Amy Giliam Thorp
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Dear Ms. Thorp,

CONCERNS REGARDING LOANS TO ESKOM FOR MEDUPI THERMAL POWER PLANT IN SOUTH AFRICA

Reference is made to your letter dated 19 October 2022, in which you requested the African Development Bank (hereafter "the Bank") to respond to specific questions therein. Regarding the Bank's involvement in Medupi Power Project (hereafter "the Project"), we wish to clarify as follows.

The Project operation was approved by the African Development Bank Board of Directors on 25 November 2009. The operation comprised two financing instruments, a ZAR loan amounting to ZAR10,630,000,000 and a EUR loan amounting to EUR930,000,000. The Loan Agreement was subsequently signed on 11 December 2009. In the Loan Agreement, Eskom (as Borrower) undertook to:

a. *Implement and operate the Project in accordance with the provisions of the agreed construction and operation Environmental and Social Management Plan/Environmental Management Plan (ESMPs/EMPs), <u>in compliance with the national system</u>;*
b. *Provide to the Bank, the Air quality permit granted by the Department of Environmental Affairs (DEA);*
c. *Submit to the Bank the Borrower's strategic endorsement and timing on Flue Gas Desulphurization (FGD) retrofit;*
d. *Submit to the Bank the water permit from the Department of Water Affairs (DWA) for Mokolo Dam phase one and the integrated water permit for Crocodile water transfer scheme; and*
e. *Provide to the Bank evidence of adequately compensating the affected people residing in the servitude of the phase one transmission line".*

The Bank has Environmental and Social Assessment Procedures (ESAPs) for improving the Bank's decision-making and project results by ensuring that Bank-financed operations conform to the requirements laid out in the operational safeguards and are thus sustainable. During the appraisal phase, the Environmental and Social Impact Assessments (ESIAs) are reviewed and cleared by the Safeguards and Compliance Division. For Medupi Power Project, a category 1 project in terms of the Bank's ESAP, the ESIA summaries were disclosed for 120 days before Board deliberations. The Bank's current Environmental and Social policy requires disclosure of the full ESIA documents 120 days before Board deliberations. At project implementation phase, Eskom was in accordance with the Loan Agreement conditions and undertakings, required to ensure implementation of the agreed Environmental and Social Management Plan (ESMP) to address adverse impacts, while monitoring the project impacts and results. Eskom complied and continues to comply with all the undertakings as prescribed in the Loan Agreement, including compliance with the ESMP prepared in accordance with the applicable national system.

In addition, the Bank's Board of Directors established the Independent Review Mechanism (IRM) with a mandate to provide people adversely affected by a project financed by the Bank Group with an independent mechanism through which they can file complaints to the Bank Group regarding alleged non-compliance with its policies and procedures. The IRM intervenes when people or communities affected submit a complaint. The IRM serves as a recourse instrument for project affected people to resolve their grievances in Bank financed projects.

During implementation of the Medupi Power Project, the Bank received a complaint alleging non-compliance with the Bank's Environmental and Social policy. The complaint was received in September 2010 in accordance with the Operating Rules and Procedures of the Independent Review Mechanism. On 15 July 2011, the Bank's Board of Directors authorized a compliance review of the alleged instances of non-compliance. The Project has been under IRM monitoring, and five (5) IRM Monitoring Reports have since been approved by the Board of Directors, with the fifth report approved in December 2021. The IRM in its Fourth Monitoring Report of June 2020 concluded that 12 of the 14 Action Plan items had been completed, leaving only two pending actions requiring compliance. This attests to IRM effectiveness in ensuring implementation of the project's Management Action Plan. The pending Action Plan items are: (i) the Risk to public health due to emissions, in particular the installation of flue gas desulphurization (FGD) equipment for future compliance with minimum emissions standards; and (ii) the Compliance with the Integrated Water Resources Management Policy, and these are all related to the delayed installation of the FGD systems.

The IRM decided to suspend monitoring the two pending action items until 2026 because Eskom indicated that the activities relating to the two actions would be implemented between 2022 and 2026. That is, the retrofitting of the six generating units with FGD systems had been postponed until 2026-2027, and the construction of the Mokolo-Crocodile Water Augmentation Project Phase 2A (MCWAP-2A) was scheduled to begin in March 2022 and to deliver water to Medupi Project by October 2026. As such, the IRM (which makes decisions independent of Bank management) decided it would be unproductive for IRM to continue to monitor a situation which was not likely to change until 2026. As such, the decision by the National Air Quality Officer not to approve Eskom's application to have the compliance timeframes postponed from 1 April 2025 to 1 April 2030 is not the basis of IRM's decision. It should be noted that IRM's monitoring mandate focuses on monitoring implementation of AfDB's management action plan and does not extend to monitoring Eskom's on-going compliance with national laws or regulations.

Regarding compliance with minimum Sulphur Dioxide (SO_2) emissions standards, the Environmental Authorization prescribed as a specific condition, that Eskom shall install, commission, and operate any required SO2 abatement measures that may be necessary to ensure compliance with applicable emission or ambient air quality standards published in terms of the National Environmental Management: Air Quality Act, 2004 (Act No. 39 of 2004). In accordance with the Construction Environmental Management Plan (CEMP), the Project was designed to be FGD ready. The decision and timing for FGD retrofit was to be based on ambient air quality monitoring results and approved minimum emissions limit standards. These standards were approved in March 2010 and took effect from 1 April 2010 (five months after financing of the Project was approved by the Bank).

In accordance with the approved standards, the Project was categorized as an “existing plant”, with a minimum SO2 emissions standard limit of 3,500 mg/Nm3. In terms of compliance timeframes, existing plants were required to comply with the 3,500mg/Nm3 with effect from 1 April 2010 and comply with the limit for new plants within 10 years from 1 April 2010. However, Section 6(1) of the minimum emissions standard provided for an application for the postponement of the compliance timeframes by up to five (5) years for new plants. Eskom’s application for a postponement of compliance timeframes to 1 April 2025 was granted based on the justifications that Eskom provided to the relevant authorities. It is worth noting that such postponement to comply with minimum emissions limit of new plants may, in accordance with the provisions of the regulations, be reviewed from time to time and withdrawn should ambient air quality conditions in the affected area of the plant not conform to ambient air quality standards. In terms of current legislation and decisions from competent authorities, the Project is currently required to comply with the 3,500mg/Nm3 minimum SO2 emissions limit until 31 March 2025. Eskom currently complies with this requirement despite the delayed installation of FGD equipment. As from 1 April 2025, the Project will be required to comply with the minimum SO2 emissions limit for new plants of 1,000mg/Nm3.

Despite the suspension of IRM monitoring, Bank Management continues to engage in dialogue with Eskom and raising the Bank’s concern that without the installation of SO2 abatement technology by 31 March 2025, the Medupi Power Plant will not comply with the 1,000mg/Nm3 minimum SO2 emissions limits. The Bank, and other financing partners, continues to encourage Eskom to investigate other options including technical alternatives (i.e., the remedial and contingency plans referred to in your letter) for ensuring compliance with regulations from 1 April 2025 until SO2 abatement technology is installed and operational. The decision to investigate other technical alternatives to wet-FGD technology, which was initially deemed to be the only technology capable of reducing SO2 emissions to the original minimum emissions limit of 500mg/Nm3 was made after the minimum emissions limit in the standards was increased to 1,000mg/Nm3. Eskom’s strategy includes: (i) application for the postponement of the compliance timeframes from 1 April 2025 to 2030. This was not granted but Eskom is appealing the decision; (ii) technology agnostic Engineering Procurement Contract (EPC) procurement strategy for SO2 abatement technology that could be implemented quicker; and (iii) Coal Sulphur reduction research project. Notwithstanding the fact that the Bank no longer finances new coal-based investments, the Bank will consider financing the installation of Medupi FGD retrofit in order to mitigate subsisting environmental and social obligations in operations to which the Bank is/was a lender.

With regard to the Medupi Power Project meeting the broader objectives of the Bank, it should be noted that the Bank’s purpose is to contributes to sustainable economic development and social progress of its member countries in Africa. At approval of the financing operation in November 2009, and way ahead of the Paris Agreement in December 2015, the priority of the South African Government was to catapult the country into a higher and sustainable growth trajectory by 2014. However, the electricity supply and related infrastructure bottlenecks, during the time, posed significant constraints to private investment in the mining and the manufacturing sectors. For example, in January 2008, the unprecedented South Africa power crisis, led to the world's three largest gold mining companies and the two biggest platinum mining companies (which together accounted for more than half the global platinum supply), to shut down and cease production for five days. The losses during the closure were estimated at ZAR200 million per day. The design of Medupi Power Station was based on supercritical technology, which is allowed for financing under the 2015 Paris Agreement due to very high efficiencies compared to subcritical coal fired plants, which comprise the majority of Eskom's power generation fleet. The significant implementation delays, cost overruns, and non-cost reflective tariffs, have negatively impacted the Medupi Power Project's financial viability but economically, the project is still highly beneficial to the country by enhancing security of supplies.

The Project was approved under the Bank's Energy Sector Policy (2012), which was forward looking in its emphasis on energy for all and promotion of cleaner energy technologies – a good foundation for the initial years of Africa's energy transition. However, there have since been several important developments in the energy sector that influence the Bank's current approach in the development of the African energy sector. These include the Paris Agreement and the increasing cost competitiveness of solar and wind energy along with emerging developments in energy storage technology. The Bank has not financed a new coal operation project since 2009 and through the Energy Sector Policy Addendum of October 2021, the Bank will no longer finance new coal projects. However, the Bank will support Regional Member Countries dependent on coal for energy production, in developing just energy transition plans, and in financing operations that mitigate subsisting environmental and social obligations in operating projects to which the Bank is/was a lender. The Bank will therefore consider financing the Medupi Project FGD retrofit in the future.

Attached is an Annexure with responses to the specific questions raised in your letter.

Please accept the assurance of my highest regards

for DG

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