

GUIDANCE TO EPFIS ON INCORPORATING ENVIRONMENTAL AND SOCIAL CONSIDERATIONS INTO LOAN DOCUMENTATION

Disclaimer: This guidance document has been prepared for use by the EPFI Network. The document is not to be viewed as a required legal framework, but rather a guidance document to assist EPFIs in incorporating environmental and social considerations into project finance loan documentation, as appropriate. As such, it does not refer to any specific Law. If this document is used by an EPFI it would be considered prudent to take in to account national law of the host country(ies) to which it is applied. The structure of the loan agreement, including timescales for receipt of reports and monitoring frequency, will depend on the nature of the project and complexity of the environmental and social risks (i.e. category of the project).

INTRODUCTION

The loan agreement, sometimes called an investment agreement, is a key legal document that provides Equator Principles Financial Institutions (EPFIs) the formal opportunity to require the Borrower to address environmental and social issues throughout the Project Cycle, especially following Financial Close and subsequent drawdowns. An important strength of the Principles is the incorporation of covenants linked to compliance as outlined in Principle 8. For all Category A and B projects, the Borrower will covenant in financing documentation:

- a) to comply with all relevant host country social and environmental laws, regulations and permits in all material respects;
- b) to comply with the Action Plan (where applicable) during the construction and operation of the project in all material respects;
- c) to provide periodic reports in a format agreed with EPFIs (with the frequency of these reports proportionate to the severity of impacts, or as required by law, but not less than annually), prepared by in-house staff or third party experts, that i) document compliance with the Action Plan (where applicable), and ii) provide representation of compliance with relevant local, state and host country social and environmental laws, regulations and permits; and
- d) to decommission the facilities, where applicable and appropriate, in accordance with an agreed decommissioning plan.

Where a Borrower is not in compliance with its social and environmental covenants, EPFIs will work with the Borrower to bring it back into compliance to the extent feasible, and if the Borrower fails to re-establish compliance within an agreed grace period, EPFIs reserve the right to seek repayment, as they consider appropriate.

There are numerous ways EPFIs may structure a project-specific loan agreement to incorporate appropriate environmental and social considerations that are consistent with Equator Principles requirements. Indeed, the structure of the loan agreement will depend on the business, sector, and complexity of environmental and social risks. Furthermore, some EPFIs may wish to detail environmental and social considerations in other project agreements referenced in the loan document.

The following sections outline the key components of a loan agreement and provide a number of commonly used environmental and social clauses that EPFIs may use as they relate to a specific project finance transaction.

KEY COMPONENTS OF A LOAN AGREEMENT

Definitions Section – an important component of any legal agreement is the agreed definition of specific terms. EPFIs should ensure that environmental and social standards applicable to a project are specifically defined in the loan agreement. Environmental and social terms commonly used in loan agreements are outlined in the final section of this guidance document, “Glossary of Terms”.

Representations and Warranties – a series of statements of fact made by one party on the basis of which the other party undertakes to enter into the agreement. The representations will typically cover such matters as the legality and enforceability of documentation, the compliance with relevant environmental and social laws, the financial condition of the Borrower, and the absence of any material litigation or other proceedings against the Borrower. Material inaccuracies in Borrower representations will normally constitute an Event of Default under the loan agreement.

Conditions Precedent – a set of pre-conditions that must be satisfied before the borrower can request drawdown, or before other credit facilities can be made available under a loan agreement. Conditions Precedent can be used to require borrowers to make certain progress on environmental and social issues before disbursement.

Covenants – the promises made by the Borrower to undertake certain actions (positive covenant) or to refrain from taking certain actions (negative covenant). Compliance with environmental and social laws and regulations, and the project’s Environmental and Social Action Plan, is a key covenant of project finance agreements. Reporting requirements should also be included as a covenant. Material non compliances with the covenants will normally constitute an Event of Default under the loan agreement.

Event of Default - an event that entitles the Lenders to cancel a commitment, declare all amounts owed by the Borrower to become immediately due and payable, and/or enforce security. For projects with complex environmental or social issues, the Lenders and Borrower may want to include specific environmental or social Events of Default that may for instance refer to specific remedy periods.

ENVIRONMENTAL AND SOCIAL CLAUSES

Note: This section outlines environmental and social clauses that are commonly included in loan agreements, and is intended to be used as a reference tool for EPFIs. Relevant clauses will depend on the nature of the project and complexity of the environmental and social risks and, EPFIs may differ in the type of environmental and social clause preferred (e.g. representation vs covenant).

Terms which are included in brackets should be specifically defined in the Definitions section of the loan agreement (see “Glossary of Terms” at the end of the guidance document).

REPRESENTATIONS AND WARRANTIES

1. There is no [Environmental or Social Claim] outstanding, pending or likely to occur in respect of, or in connection with the Project, which [Environmental or Social Claim] has or is reasonably likely to have a Material Adverse Effect on the implementation or operation of the Project in accordance with the [IFC Standards].
2. The Project has at all time complied and currently complies with and will continue during all phases of construction and operation, to comply with all applicable [Environmental and Social Requirements], and has obtained and complies with all necessary environmental licenses and conditions therein.
3. The Borrower has produced to the Lenders all relevant reports and information on social and environmental issues.
4. The Borrower has appointed an [Independent Environmental (or Social) Consultant] who will provide to the Lenders relevant monitoring reports satisfactory to the Agent¹ on the implementation of the [Environmental and Social Management Plan] and [Environmental and Social Action Plan] on a semi-annual basis² during construction and on an annual basis during operation. These reports should be received within 3 months of the reporting period.

¹ The Agent will be acting on behalf of all Lenders. In some situations, an EPFI may be appointed as an “Environmental Agent” to ensure that all Equator Principles requirements are met.

² Monitoring frequency will depend on the nature and scale of the project, and may be more frequent for Category A projects (e.g., quarterly monitoring during construction periods).

CONDITIONS PRECEDENT

I. Conditions Precedent to initial disbursement

1. Permits

- a) Certified copies of all government or administrative approvals required for the Project [Environmental and Social Permits], unless in light of the status of the Project, is not yet required to be obtained
- b) Opinion issued by counsel acceptable to the Agent that the Project has obtained all permits and approvals necessary for ownership, construction and operation of the Project or, for any permits and approvals not obtained, that such permits and approvals will be obtained in the ordinary course prior to the time when required.

2. Reports

Delivery of the following with respect to:

- a) ESIA's and Environmental and Social Management Plans:
 - i) A certified copy of an [ESIA] report³;
 - ii) A report from the [Independent Environmental (or Social) Consultant] evaluating and confirming that the [Environmental and Social Management Plan] for the construction phase of the Project is operational and complies with all [Environmental and Social Requirements], and to the extent any aspect of the [Environmental and Social Management System] for the construction phase of the Project is to be implemented at a later date, all arrangements necessary for such timely implementation have been made through the [Environmental and Social Action Plan];
 - iii) An [Environmental and Social Action Plan] responding to or addressing arrangements and recommendations of Project or Lender consultants to the extent necessary to achieve compliance with [Environmental and Social Requirements];
 - iv) Required reports of the Technical Consultant, the [Independent Environmental (or Social) Consultant] and the Insurance Consultant have been received, and

³ When the ESIA does not meet international standards, taking into account all relevant issues identified in the IFC Performance Standards, it should be supplemented by additional studies to meet international standards.

recommendations implemented to the extent necessary to achieve compliance with all [Environmental and Social Requirements];

- v) A reliance certificate from the Technical Consultant, [Independent Environmental (or Social) Consultant] and Insurance Consultant entitling the Agent and the Lenders to rely on the reports and plans prepared by these consultants.
- b) Lenders' Independent Consultant Review
- i) The [ESIA], [Environmental and Social Management Plan] and [Environmental and Social Action Plan] have been reviewed by the [Independent Environmental (or Social) Consultant]; and
 - ii) Delivery of appointment letters, including, without limitation, agreed scope of work, in relation to the Technical Consultant, the [Independent Environmental (or Social) Consultant] and the Insurance Consultant, for the purposes of identification only initialled for and on behalf of the Borrower and the Agent⁴;
- c) Monitoring
- i) The Borrower and Lenders have agreed on the form and substance of Terms of Reference for the [Independent Monitoring Consultant], including the form of any reports required to be produced on or before such date pursuant to such Terms of Reference;
 - ii) The Borrower has appointed the [Independent Monitoring Consultant], such [Independent Monitoring Consultant] satisfactory to Lenders; and
 - iii) The [Independent Monitoring Consultant] has commenced its work in accordance with the Terms of Reference applicable to it.

3. Absence of Threat

- a) The Borrower shall have certified that it has no reason to believe that any [Environmental and Social Permits] could reasonably be expected to be revoked.
- b) No Event of Default: No environmental or social risks or events shall have occurred that would result in an Event of Default or Potential Event of Default.

⁴ In the event that financial advisors have already structured the due diligence, Mandated Lead Arrangers may want to include this CP for duty of care.

4. Confirmation of Compliance

- a) Client is in material compliance with all applicable Covenants⁵;
- b) The applicable Representations and Warranties to be made or repeated are true and correct in all material respects by reference to the facts and circumstances then existing.

II. Conditions Precedent to all disbursements⁶

1. Delivery of a certificate from the Borrower, certifying that the [Environmental and Social Management Plan] for the Project is operational and complies with all [Environmental and Social Requirements],
2. Delivery from the Borrower of a completeness status for the actions referenced in the [Environmental and Social Action Plan] that should have been carried out as of the date of the disbursement, to the satisfaction of the Agent.

III. Conditions Precedent to completion

1. A report from the [Independent Environmental (or Social) Consultant] confirming:
 - a) that the [Completion Test] has evaluated and confirmed compliance of the project with [Environmental and Social Requirements], including full implementation of the [Environmental and Social Management Plan] and [Environmental and Social Action Plan];
 - b) that the [Environmental and Social Management Plan] updated for the operation phase of the Project is operational and complies with all [Environmental and Social Requirements] and to the extent any aspect of the [Environmental and Social Management System] for the operation phase of the Project is to be implemented at a later date, all arrangements necessary for such timely implementation have been made through the [Environmental and Social Action Plan];
 - c) whether in relation to the Project there are any:
 - i) past or existing adverse risks or impacts relating to environmental or social issues that have not been addressed by one or more [Corrective Action Plans], or
 - ii) known or threatened [Environmental or Social Claim].

⁵ Covenants must include all environmental and social covenants as required by the Equator Principles.

⁶ Conditions Precedent to all disbursements may be considered, depending on the sensitivity of the project.

COVENANTS

1. Positive Covenants:

- a) Compliance with all relevant [Environmental and Social Requirements] in all material respects;
- b) Carry out the Project in accordance with the agreed [Development Plan] subject to any modifications that the [Independent Environmental (or Social) Consultant] may agree to in writing subject to Agent approval;
- c) Compliance with the [Environmental and Social Action Plan] and with the [Environmental and Social Management Plan] during the construction and operation of the Project, subject to any modifications that the [Independent Environmental (or Social) Consultant] may agree to in writing subject to Agent approval;
- d) Delivery of progress reports, (i) prepared by the Borrower's in-house staff or third party experts, during the construction phase and operations phase post-Completion, and (ii) prepared by the [Independent Environmental (or Social) Consultant] during the construction phase and during the operations phase (including on-site visits to the Project), in each case that
 - i) document compliance with the [Environmental and Social Management Plan], where applicable, and
 - ii) certify material Project compliance with all [Environmental and Social Requirements]⁷;
- e) Operate, maintain and repair, or ensure that the operation, maintenance and repair of the Production facilities is in accordance with good industry practice for projects of this type;
- f) Right of the Lenders, or representatives, to access and inspect property and books and records, as appropriate;
- g) Decommissioning of the facilities, where applicable and appropriate, in accordance with an agreed [Decommissioning Plan], to be reviewed by the [Independent Environmental (or Social) Consultant] and satisfactory to the Agent;

⁷ See Glossary of Terms.

- h) Respond to releases of [Environmental Contaminants] as required by [Environmental and Social Requirements] through a [Corrective Action Plan]; and
- i) Respond to any protests or challenges to the Project or its construction, permitting or operation.

2. Negative Covenants:

- a) Limitations on modification or termination of the Major Project Documents; and
- b) Limitations on material modification of the [Development Plan], the [Environmental and Social Management Plan] and/or the nature and scope of the Project.

EVENTS OF DEFAULT

- 1. An [Environmental or Social Claim] is brought against the Borrower which individually or in the aggregate could reasonably be expected to result in a Material Adverse Effect on the implementation or operation of the Project in accordance with the [IFC Standards].
- 2. Non-compliance with or breach of any environmental or social covenants of Borrower in the Agreement. Borrower typically has a right to cure breaches of affirmative covenants within a fixed amount of time (e.g., 30 days) but no right to cure breaches of negative covenants.
- 3. Truth of environmental or social representations and warranties in all material respects.

REPORTING REQUIREMENTS

The Company shall provide:

1. Pre-Closing Reports

- a) Provide a report, dated within [30] days before the Closing Date, from the [Independent Environmental (or Social) Consultant], assessing the Project's compliance with the applicable [Environmental and Social Requirements] along with a customary reliance certificate entitling Agent and Lenders to rely upon the report.

2. Pre-Completion Reports

- a) Prior to the [Physical Completion Date], provide at least [semi-annually] a progress report prepared by the Borrower that shall contain:

- i) Details of compliance (or any non-compliance) with [Environmental and Social Requirements] applicable to the Borrower or the Project, and implementation of the [Environmental and Social Management Plan] and [Environmental and Social Action Plan] during the period to which the report relates;
 - ii) Details of the actions, including timeframe for completion, which the Borrower has taken or intends to take in order to rectify non-compliance, if any, during the period to which the report relates, as presented in a [Corrective Action Plan];
- b) Prior to the [Physical Completion Date] provide at least [semi annually]⁸ a report prepared by the [Independent Environmental (or Social) Consultant], reviewing the information listed above and assessing compliance with applicable [Environmental and Social Requirements] along with a customary reliance certificate entitling Agent and Lenders to rely upon the report.

3. Operational Reports

- a) After the [Physical Completion Date], provide at least [annually] an Operational Report that shall contain:
- i) Details of compliance (or any non-compliance) with [Environmental and Social Requirements] applicable to the Borrower or the Project, and implementation of the [Environmental and Social Management Plan] and [Environmental and Social Action Plan] during the period to which the report relates;
 - ii) Details of the actions, including timeframe for completion, which the Borrower has taken or intends to take in order to rectify non-compliance, if any, during the period to which the report relates, as presented in a [Corrective Action Plan];
- b) After the [Physical Completion Date] provide at least [annually] a report prepared by the [Independent Environmental (or Social) Consultant], reviewing the information listed above and assessing compliance with applicable [Environmental and Social Requirements] along with a customary reliance certificate entitling Agent and Lenders to rely upon the report.
- c) After the [Physical Completion Date] provide ad hoc reports prepared by the [Independent Environmental (or Social) Consultant], reviewing the reports and [Corrective Action Plan] prepared by the Borrower as per items 4 to 7 below.

⁸ The frequency of reporting may be increased depending upon the sensitivity of the project.

4. Environmental or Social Claims

- a) After becoming aware of the same, promptly provide to the Agent details of any material environmental proceeding, claim, liability or regulatory action which is likely to result in:
 - i) A liability exceeding USD [xxx] (other than a claim for workers compensation)
 - ii) A material delay to the Completion Date, or material impairment of the operation of the Project; or
 - iii) has or, if adversely determined, is likely to have a Material Adverse Effect on the implementation or operation of the Project in accordance with the [IFC Standards]..
- b) the Borrower will subsequently present a report satisfactory to the Agent specifying the outcome of the Borrower's investigation into such event, and, if requested by the Agent, including a [Corrective Action Plan].

5. Environmental Contaminants

- a) After becoming aware of the same, promptly notify the Agent of any material event resulting in the release of an [Environmental Contaminant].
- b) The Borrower will subsequently present a report satisfactory to the Agent specifying the outcome of the Borrower's investigation into such event, and, if requested by the Agent, including a [Corrective Action Plan].

6. Occupational Health and Safety

- a) After becoming aware of the same, promptly notify to the Agent of any material event resulting in death or multiple injury.
- b) The Borrower will subsequently present a report satisfactory to the Agent specifying the outcome of the Borrower's investigation into such event, and, if requested by the Agent, including a [Corrective Action Plan].

7. Significant Social Grievance or Protest

- a) After becoming aware of the same, promptly notify the Agent of any significant community or worker-related protest directed to the Project which can potentially have a Material Adverse Effect on the Project or can potentially result in national or international media attention.

- b) The Borrower will subsequently present a report satisfactory to the Agent specifying the outcome of the Borrower's investigation into such event, and, if requested by the Agent, including a [Corrective Action Plan].

8. Other

- a) The Borrower shall, upon the request of the Agent acting reasonably, provide such other information on any measures or monitoring undertaken by the Borrower or on behalf of the Borrower in compliance with [Environmental and Social Requirements].

GLOSSARY OF TERMS

Note: This glossary has been prepared as a reference tool for many of the terms contained in this Guidance document. Each EPFI may utilize, or amend, such definitions as deemed appropriate, and incorporate such terms into project-specific loan agreements.

“Completion (or Completion Date)” occurs when a defined set of technical (including environmental and social) and financial tests have been met as stipulated in the financing documents.

“Completion Test” means the milestone achieved by the project marking the end of the design, development and construction phases of the Project Cycle, and the start of the operational phase. The test confirms the project's ability to perform as planned and generate the expected cash flows. For projects requiring an Independent Environmental (or Social) Consultant, completion from an environmental and social perspective will only occur when the Independent Environmental (or Social) Consultant has deemed that the project meets all the required performance criteria as defined by the project-specific Environmental and Social Requirements.

“Corrective Action Plan” means a plan to correct and remedy all damage and adverse consequences caused by any failure by the Project to comply with any applicable Environmental and Social Requirements.

“Decommissioning Plan” means a plan to retire the physical facilities of the Project, including decontamination, dismantlement, rehabilitation, landscaping and monitoring.

“Development Plan” means the description of the physical facilities of the Project as described in the ESIA and engineering documents as the same may be amended from time to time in accordance herewith.

“ESIA” means the environmental and social impact assessment prepared by [xxx] dated [xxx] (and approved by local authorities on [xxx]) The ESIA – sometimes referred to as an EIA or SEA – focuses on the significant issues of a project, and predicts and assesses the project’s likely positive and negative impacts. Impact assessments include baseline data, alternatives analysis and preliminary management program.

“Environmental Contaminant” means any substance (whether a solid, liquid, gas and whether or not combined with any one or more other substances), activity or other phenomenon that is capable of causing harm to man or any other living organism supported by the environment, or damaging the environment or public health.

“Environmental and Social Action Plan” means the environmental and social Action Plan (AP) prepared by the Borrower, or third party expert, which addresses the relevant findings, and draws on the conclusions of the Assessment. The AP will describe and prioritise the actions needed to implement mitigation measures, corrective actions and monitoring measures necessary to manage the impacts and risks identified in the Assessment. The AP may range from a brief description of routine mitigation measures to a series of specific plans.

“Environmental Law” means any host-country governmental law, rule, regulation, order, writ, judgment, injunction or decree relating to pollution or protection of the environment, all local laws and regulations related to Environmental or Social Matters, and any specific agreements entered into with any competent authorities which include commitments related to Environmental or Social Matters.

“Environmental and Social Management Plan” means the environmental and social management plan of the Company dated [xxx], a copy of which is attached hereto as Schedule X (*Environmental and Social Management Plan*), as amended from time to time, *provided* that the Independent Environmental (or Social) Consultant shall have evaluated and confirmed that any material amendments are in compliance in all material respects with the requirements of the IFC Standards and the ESIA.

“Environmental and Social Management System” means an environmental, social, health and safety management system (which term may refer to the system for the construction phase of the Project or the system for the operational phase of the Project, or to both systems collectively, as the context may require) as described in system manuals and related source documents, including policies, management programs and plans, procedures, requirements, performance indicators, responsibilities, training and periodic audits and inspections with respect to Environmental or Social Matters designed to identify, assess and manage risk in respect to the Project on an ongoing basis.

“Environmental or Social Matter” means those environmental and social aspects identified in the ESIA, which are considered relevant to the Project components.

“Environmental and Social Requirements” means, collectively, Environmental Law, Social Law, the IFC Performance Standards and the project-relevant IFC Environmental Health and Safety (EHS) Guidelines in force at the time of the agreement.

“Environmental or Social Claim” means any litigation, arbitral proceedings or administrative proceedings relating to:

- (a) any applicable Environmental and Social Requirements; or
- (b) any Authorisation relating to applicable Environmental and Social Requirements.



“Environmental and Social Permits” means any permit, approval, identification number, license or other authorization required under any Environmental or Social Law.

“Equator Principles” means those principles so entitled and described in “The ‘Equator Principles’ — A financial industry benchmark for determining, assessing and managing social and environmental risk in project financing” (July 2006) and available at: http://www.equator-principles.com/resources/equator_principles.pdf, as adopted in such form by certain financial institutions.

“Financial Close” is the date when all documentary and other Conditions Precedent to first drawdown under a project loan agreement are satisfied.

“IFC Standards” means, collectively, the International Finance Corporation’s (IFC) Performance Standards on Social and Environmental Sustainability dated April 30, 2006 and the project-relevant IFC Environmental Health and Safety (EHS) Guidelines in force at the time of the agreement.

“Independent Environmental (or Social) Consultant” means [xyz firm], in respect of Environmental and Social Matters pursuant to the Mandate Letter agreed with Lenders.

“Independent Monitoring Consultant” means [xyz firm], in respect of environmental and social matters or in either case, such other person as may from time to time be appointed for, and on behalf of, the Lenders.

“Physical Completion Date” is the date when the project is physically functioning, but not yet fully generating cash flow.

“Project Cycle” means the progression of a project from design and planning, construction, operations, and decommissioning or closure.

ENVIRONMENTAL AND SOCIAL ACTION PLAN – TEMPLATE EXAMPLE

Introduction

The following template provides an example of the format used by IFC for an Environmental and Social Action Plan (Action Plan). The Action Plan may range from a brief description of routine mitigation measures to a series of specific management plans, and should build on the Environmental and Social Management Plan prepared as part of the ESIA. Each EPFI may utilize, or amend, the format as deemed appropriate. **Note: The actions included and timeframes proposed in the template below are for illustrative purposes only, and may not be relevant to every project.**

Item	IFC Performance Standard	Action	Timetable
1	PS 1	Design an Environmental and Social Management System (ESMS) for the Project, for both the Construction and Operation phases, to ensure ongoing compliance with requisite environmental, health and safety and social standards (i.e., adopted environmental, social, health and safety standards (ESHS), Company commitments as outlined in ESIA) and to meet [host country] legal requirements, IFC Performance Standards, and EHS Guidelines.	- Construction Phase ESMS to be implemented by [xxx] - Operations Phase ESMS to be implemented prior to the start of operations
2	PS1	Design and implement a Public Consultation and Disclosure Plan or Community Engagement Plan to ensure a) consultation and disclosure of ESIA and Management Plan documentation, and b) ongoing community engagement during Construction and Operation phases	a) Prior to construction b) ongoing
3	PS1	Establish, and report on progress, related to the Project's Grievance Mechanism system during both Construction and Operation phases	a) quarterly during Construction Phase, and b) annually thereafter
4	PS 2	Incorporate the requirements of PS2 into a Human Resources policy.	By [xxx]

Item	IFC Performance Standard	Action	Timetable
5	PS 4	Prepare a site-specific Emergency Preparedness and Response Plan, specifically dealing with accidents involving management and transportation of explosive materials, landslides and other accidents potentially affecting third parties, including workers and local communities	Six months before Operation
6	PS 5	Prepare a Resettlement Action Plan to manage land acquisition-related impacts for (a) the local road upgrade to the plant site, and (b) the corridor for the high-tension transmission line.	(a) Prior to start road enlargement (b) Prior to Construction of the transmission line
7	PS 6	Preparation of a Biodiversity Action Plan in accordance with Performance Standard 6	Prior to Construction
8	PS 7	Develop an Indigenous Peoples Development Plan to provide a structured approach to implementation of community development projects.	Prior to financial close or Prior to first disbursement
9	PS 8	Develop a 'chance find' procedure to be provided to all contractors and included in the terms of their contracts to ensure proper handling of any such discoveries.	Prior to Construction
10	PS 1	Submit monitoring reports relating to compliance with applicable standards and monitoring requirements including air emissions, ambient air quality, noise and vibrations, effluent quality, groundwater quality and level in community wells and dedicated monitoring wells, and solid wastes.	Quarterly during Construction and Annually during Operation