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On the Effectiveness of Global Private Regulation: The Implementation of the Equator
Principles by Multinational Banks

By
Ariel Meyerstein

A dissertation submitted in fulfillment of the requirements for the degree of
Doctorate in Philosophy
in
Jurisprudence and Social Policy Program

Committee in Charge:
Professor Robert A. Kagan (chair)
Professor Martin Shapiro
Professor Neil Fligstein
Professor Andrew Guzman

Spring 2011

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ABSTRACT

On the Effectiveness of Global Private Regulation: The Implementation of the Equator Principles by Multinational Banks

by

Ariel Meyerstein

Doctor of Philosophy in Jurisprudence and Social Policy

University of California, Berkeley

Professor Robert A. Kagan, Chair

This dissertation presents one of the first empirical studies of the implementation of the Equator Principles by some of the largest private financial institutions in the world. These banks created this regime of private global governance to standardize industry approaches to risk management of large-scale infrastructure projects. Particularly when constructed in weak regulatory environments, these projects historically have been criticized for their adverse impacts on local populations, including environmental degradation and forced resettlement. To prevent such “problem projects” from being financed, banks adopting the Equator Principles commit to imposing on their borrowers World Bank environmental and social risk management standards and procedures, and pledge to withhold or withdraw funding from any project found not to be compliant with these standards. Using the EPs as a case study, this dissertation explores different ways to evaluate the effectiveness of self-regulation. Overall, the study finds that a majority of the 24 surveyed institutions, which constitute a representative sample of the larger population of participating institutions along key criteria, made considerable organizational changes to implement the Principles. Though key stakeholders—a global network of NGOs—have been less than satisfied with the EPs, there is considerable evidence that they have made a substantial impact on the project finance industry.

The study also uses the example of the Equator Principles as a further empirical setting in which to analyze a long-standing debate across several fields: whether (and to what extent) isomorphic external pressures from institutional environments, the power of reputational concerns, and the quest for organizational legitimacy are sufficient forces to shape organizational behavior absent strong mechanisms of enforcement. Though the challenges of data gathering and measurability constrain the researcher’s ability to draw strong conclusions with respect to causality, the study offers considerable evidence of the influence of external actors on bank behavior and the force of reputational concerns as a driver of “compliance.”

Improvements, we said, are, as a rule, bought at the price of social dislocation. If the rate of dislocation is too great, the community must succumb in the process. . . . But nothing saved the common people of England from the impact of the Industrial Revolution. A blind faith in spontaneous progress had taken hold of people's minds, and with the fanaticism of sectarians the most enlightened pressed forward for boundless and unregulated change in society. The effects on the lives of the people were awful beyond description. Indeed, human society would have been annihilated but for protective countermoves which blunted the action of this self-destructive mechanism.

Karl Polyani, *The Great Transformation* (Polanyi 1956)

The interest of the dealers, however, in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the public.... The proposal of any new law or regulation of commerce which comes from this order [merchants and master manufacturers], ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it.

Adam Smith – *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776)

Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible. This is a fundamentally subversive doctrine.

Milton Friedman – *Capitalism and Freedom* (Friedman 1962)

Dedication

To my wife Alison, who graciously tolerated the presence of this text—my “mistress”—in our lives for so many months.

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INTRODUCTION

Like many sectors of the global economy, there is a large crack in the metaphorical dam of regulation of foreign direct investment in large-scale infrastructure projects, such as mines, oil pipelines and hydroelectric dams. Although criticism of hydroelectric dams dates back to the 1970s (Khagram 2004), broader awareness of the failures of governance in the arena of infrastructure investment came to prominence towards the end of the 20th century as part of a larger cascade of criticism of global institutions. These criticisms originated in a growing awareness of the increased role played by international organizations and transnational corporations in global affairs, leading to a tidal wave of demands for increased accountability of these institutions to the individuals and communities whose lives their activities were affecting (Wade 1997; Keck 1998; Newell 2000; Newell 2002; Darrow 2003; Keohane 2003; Khagram 2004). These demands crystallized into an explosion of initiatives and various forms of governance in the global public sphere that have sought to fill the perceived “governance deficit” and power imbalance created by the expansion of economic globalization and the inability of governments to regulate increasingly powerful transnational corporations (TNCS) (Newell 2000; Newell 2002).

This dissertation focuses on one such initiative: the Equator Principles (EPs), a voluntary code of conduct sponsored by global financial institutions to standardize their due diligence of the environmental and social risks associated with the large-scale infrastructure projects they finance. Unlike other industry associations, the focus on a financial industry initiative is particularly important given the role of financial institutions in the global economy, as demonstrated so painfully by the global financial crisis that emerged in 2008. Much of that crisis can be attributed to a lack of self-policing by banks combined with ineffective enforcement by national regulators. Furthermore, the financial industry is unique in that it plays a significant, indeed an essential role, in the enabling of other corporate activities that implicate human rights and environmental violations. Peter Woicke, then executive vice-president of the World Bank Group’s International Financial Corporation, correctly described this impact at the creation of the Equator Principles:

[m]ost voluntary codes affect just one industry. The Equator Principles will affect how project finance is conducted in dozens of industries, ranging from forestry and manufacturing to infrastructure and extractive industries. This represents far and away the biggest response by the private sector to the globalization debate. . . . The amount of investment [the Equator Principles] will affect is massive. Even if you use an extremely conservative estimate, [the Equator Principles] will change the rules of the game for about \$100 billion in global investment over the next 10 years (quoted in (Benjamin C. Esty 2005).

If self-regulation by financial institutions can be effective, it can serve as a powerful lever through which global policy objectives might be attained. It is for these reasons that this dissertation presents a study of the origins and effectiveness of the EPs as a case study of private global governance.

Diagnosing “problem projects”

On 20 April 2010, the International Court of Justice handed down its opinion in *Pulp Mills on the River Uruguay*, a dispute between Argentina and Uruguay over the latter country’s 2005 authorization of the construction of one of the largest paper pulp mill projects in the world on the banks of the Uruguay River bordering Argentina.¹ The World Court’s judgment dealt with Argentina’s complaints that in authorizing the construction of the pulp mills over Argentina’s strenuous objections, Uruguay breached its obligation under the 1975 Statute of the River Uruguay. The bilateral treaty binds each country to notify and consult with the other before authorizing construction that might potentially affect their shared water resource.² The project site is outside of the town of Fray Bentos, Uruguay, located in the heart of one of Argentina and Uruguay’s most prominent tourist regions. Though many on the Uruguayan side of the river saw the pulp mills as a source of jobs and economic development (together, the mills represented an investment of \$1.7 billion, the largest in Uruguay’s history), to those on the Argentine side the mills represented only a threat to agriculture and tourism from the feared polluting effects of the mills’ effluents.³ Although the actual environmental impact of the plants remains a matter of heated controversy, the residents of nearby Gualeguaychú, Argentina, have been convinced of the mills’ harmful effects from the start. Indeed, shortly after the Finnish construction company Botnia and the Spanish Empresa Nacional de Celulosa de España (ENCE) announced their plans to build the mills, a local and transnational social movement formed to oppose the projects (Lotila 2010). These opponents have pressed their views through mass protests and a transnational advocacy campaign against every sponsor and funder associated with the projects, including the, as well as the World Bank’s International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA).⁴ The principal complaint of the movement was about the inadequacy of the due diligence conducted before funding and construction began, which the activists claimed had failed to account for and properly mitigate severe potential environmental and social impacts that would pose grave threats to the local communities of Gualeguaychú and Fray Bentos, among others. The movement made an initial

¹ *Paper Pulp Mills on the River Uruguay* (Arg. v. Uru.) (Judgment of Apr. 20, 2010), available at <http://www.icj-cij.org/docket/files/135/15877.pdf>.

² Statute of the River Uruguay, Uru.-Arg. art. 60, para. 1, Feb. 26, 1975, 1982 U.N.T.S. 339 (entered into force Sept. 18, 1976). The Administrative Commission of the River Uruguay (CARU) is a bilateral mechanism established by the 1975 treaty to provide joint management of the river, but it has not been able to prevent or resolve this conflict.

³ The combined production of the two pulp mills, one sponsored by Botnia [of Finland] and one by ENCE [of Spain] would be the world’s largest production of Kraft System paper pulp, utilizing Elemental Chlorine Free technology, which environmental groups claim is a second-rate technology that both the European Union and World Bank policies recommend should be replaced by a Total Chlorine Free process. The plants are expected to employ 3,000 workers during construction and 300 low-paying long-term wage workers in a region that is extremely rich in natural resources and heavily reliant on tourism and fisheries for local livelihoods. See generally CEDHA, *Paper Pulp Mills*, at http://www.cedha.org.ar/en/initiatives/paper_pulp_mills/ (last visited December 18, 2010).

⁴ The IFC is the division of the World Bank Group that finances private sector investment, facilitating access to capital in international financial markets and advising businesses and governments. See International Finance Corporation, <http://www.ifc.org>; MIGA is the World Bank’s loan guarantee agency, offering political risk insurance and other guarantees on loans.

very dramatic presentation of its views on April 30, 2005, when a large group of 10,000-20,000 people blocked the international Libertador General San Martín Bridge (between Gualeguaychú and Fray Bentos) to protest the mills' construction.

The movement's transnational advocacy has been spearheaded by the Argentina-based Center for Human Rights and Environment (CEDHA), which first directed its complaints to the IFC's Compliance Advisory Ombudsman (CAO) of the World Bank⁵ in August 2005 with a complaint supported by the governor and vice-governor of Entre Rios province in Argentina, several civil society organizations, and close to 40,000 individual signatures.⁶ The complaint alleged, among other things, that the IFC's failed to properly consult the local communities before approving the project for funding, and that the impacts of the project would affect the lives of over 110,000 residents of Fray Bentos and Gualeguaychu, as well as hundreds of others dependent on the river's water. In response to the Complaint, the CAO eventually released a Preliminary Report and an Audit, which criticized the procedures the IFC followed pertaining to the project.⁷ But later assessments found that the technical safety requirements of the mills had in fact been fulfilled and the quality of the water and the air in the region would not be jeopardized by their construction, although final approval would be subject to further consultations. As they had in response to many other project developments over several years, the residents of Gualeguaychú responded to this news by blocking Route 136 and the General San Martín Bridge with rubble, logs and vehicles. In addition to interrupting construction activities, the blockade forcibly detoured large traffic flows of Argentinians who typically vacation in Uruguay during that time of year, diverting them to the next bridge (which later was also blockaded).

These complaints against the multilateral institutions' support of the projects was only the start of the advocacy campaign's global efforts to create chains of accountability binding the foreign and transnational institutions and interests supporting the projects to the local communities who would be affected by them. Indeed, what is significant about the Paper Pulp Mills controversy is the exhaustive list of legal and quasi-legal mechanisms the opponents of the projects utilized in their attempts to create this accountability: national courts in Argentina and Uruguay, the Inter-American Commission on Human Rights, and the Organization for Economic Cooperation and Development's Guidelines for Multinational Enterprises' National Contact

⁵ The Compliance Advisor Ombudsman is an independent recourse mechanism for the IFC, reporting directly to the President of the World Bank Group. It can use mediation, audits of social and environmental project performance, and advice to the President to address complaints from affected communities. See Compliance Advisor Ombudsman, at <http://www.cao-ombudsman.org/> (last visited November 18, 2010).

⁶ See CAO Complaint, September 2005, at http://www.cedha.org.ar/en/initiatives/paper_pulp_mills/cao-complaint-letter.doc (alleging numerous violation of IFC Policies with respect to "Category A" projects (those deemed to have significant adverse environmental impacts that are sensitive, diverse, or unprecedented)).

⁷ See CAO, Audit of IFC's and MIGA's Due Diligence for two Pulp Mills in Uruguay (22 February 2006) at 1, http://www.cedha.org.ar/en/initiatives/paper_pulp_mills/cao-final-audit-report-eng.pdf (finding that "IFC's due diligence to satisfy itself that the EAs were complete in all material respects prior to disclosure was inadequate and not in compliance with the organization's Disclosure Policy, resulting in disclosure of EAs that were not complete.")

Points in Finland, Sweden and Norway, among others.⁸ Ultimately, however, *none* of these mechanisms, including the ICJ, was in the position to actually help these communities or resolve the conflict between two otherwise cooperative neighboring states (never mind the broader conflict between local communities, the project sponsors and their financial backers). The negative publicity brought by the transnational campaigns and the mere initiation of some of these accountability mechanisms was however too much for some of the funders to bear. Nevertheless, the circumstances surrounding the *Paper Pulp Mills case* illustrate perfectly the fractured nature of global governance over foreign direct investment in large-scale infrastructure projects, and the inadequacy of current accountability mechanisms and governance regimes (Bridgeman 2008).

Though there has been little actual violence related to the pulp mills conflict, the ongoing tensions are paradigmatic of “problem projects” in that they can create cross-border controversies where it remains very unclear exactly where the responsibility for regulation truly lies. Indeed, there are far too many examples of problem projects that serve as the epicenters of conflicts throughout the world, some of them violent.⁹ For example, civil and ethnic conflict in Burma has escalated along with the proposed plans by Thai, Chinese and Burmese companies to generate electricity for Thailand by developing a cascade of five dams on the Salween River that runs between Burma, Thailand and China.¹⁰ According to International Rivers, an NGO, the proposed dams in Burma are located in active civil war zones and militarization has increased in these areas since project development started, which allegedly occurred in secret and without any community involvement or consultation.

Other “problem projects” serve as sources of social division and upheaval within national borders, often forcefully dislocating people from their homes, ancestral lands and way of life, and in some instances threatening to destroy irreplaceable cultural sites, unique habitats or species. For example, the proposed Iisu dam in Turkey threatens to flood more than eighty

⁸ See generally, CEDHA, *Paper Pulp Mills*, available at http://www.cedha.org.ar/en/initiatives/paper_pulp_mills/ (last visited November 18, 2010).

⁹ See (Wright 2007) for a useful overview of the human rights implications of dozens of infrastructure projects worldwide.

¹⁰ The Salween (known as the Nu River in China and the Thanlwin River in Burma), the longest undammed river in Asia, runs from the Tibetan mountains in Burma through to the Andaman Sea off the west coast of Thailand and supports almost 10 million people—mostly ethnic minorities—with its rich fisheries and fertile farmland. International Rivers reports that ethnic minority groups, who are already marginalized and repressed by the Burmese military junta, are “not only being systematically and forcibly moved from their homes, but also robbed, tortured, raped or executed.” See International Rivers, *Salween Dams*, at <http://www.internationalrivers.org/southeast-asia/burma/salween-dams> (last visited December 18, 2010). NGOs warn that local ethnic groups, particularly in regions that are not ethnically Burmese and typically enjoy considerable autonomy over their own affairs, could lash back in resentment at what are perceived to be deals that do not provide any local benefits and worse, trample on their rights in the process. Indeed, in April 2010, a series of bombs exploded at the site of a controversial hydropower project sponsored by a Chinese company. As one expert explained the violence, “[w]hen you're in a situation where you can't retaliate against your own government, you can retaliate against perhaps investment by outsiders.” Reuters, *China risks backlash with Myanmar investments*, July 9, 2010, at <http://af.reuters.com/article/energyOilNews/idAFTOE66804H20100709?sp=true>.

villages, including the ancient settlement of Hasankeyf, a cultural heritage site.¹¹ Depending on the local context, threats to one type of treasured resource often are inseparable from threats to the others.

For the most part, then, the complaints are not *between* sovereign states but between, on the one hand, marginalized populations (often indigenous peoples and minority groups) within countries, and on the other hand, the governments that are supposed to represent their interests and/or the companies building the projects by government invitation or often even with outright participation by the government through profit-sharing agreements. These complaints have increased along with the increased use of project finance as a tool for investment in both developed and developing countries. For several decades such investment was the exclusive provenance of multilateral lenders like the World Bank and other regional development institutions, but in the last two decades also became a staple of private financial institutions. With the spread of project finance, along with privatization to developing economies, regulatory issues became more acute: the regulatory frameworks in place in developing countries are not up to the task of enforcing international or national environmental and human rights laws relevant to the development of large-scale infrastructure projects.

Though problem projects typically put down roots in the soil of developing countries with weak regulatory capacity, the world's most advanced economies, including the United States, are not immune from their effects. One such conflict is brewing in pristine Bristol Bay, Alaska, where a conglomerate of mining companies is facing opposition from local residents, including indigenous peoples, to its plans to develop a 2-mile wide-open pit copper and gold mine that locals claim will ruin their salmon fisheries industry.¹² Canada, too, despite its relatively progressive policy stances on sustainability in investments abroad, struggles with its own homegrown problem projects, such as ecologically destructive tar sands on the lands of its indigenous peoples.¹³ The tar sands controversy demonstrates that problem projects are not

¹¹ The Ilisu dam in Turkey is one of the most controversial dam projects in the world. After initially supporting the hydroelectric project with a proposed US \$627 million in loan guarantees, several European export credit agencies (from Germany, Austria, and Switzerland) cancelled their support for the project on the Tigris river, citing the project's failures to meet World Bank standards. According to Hermes, the German export credit agency, the Turkish government had not adequately explained how it would relocate the ruins or presented sufficient plans for relocating and compensating displaced villagers. See Delphine Strauss and Chris Bryant, *European states pull plug on Ilisu dam insurance*, Financial Times, July 8, 2009.

¹² See Edwin Dobb, *Alaska's Choice: Salmon or Gold*, NATIONAL GEOGRAPHIC (December 2010), 101-125. As some have formulated it, the project pits two kinds of wealth against one another: the gains of "finite wealth" (including the US \$100-500 billion estimated total value of the Pebble mineral deposit and the estimated 2,000 mine-construction jobs and 800-1000 operational jobs it would produce) versus the loss of "sustainable wealth" (the US \$120 million estimated annual value of the Bristol Bay salmon fishery and the 11,572 resident and nonresident workers in the fish harvesting and processing industry who depend on the fishery for their livelihood).

¹³ RBS has provided \$7.5 billion to companies involved in tar sands mining in Canada, a practice that has been criticized for its negative impact on climate change (it is three times more carbon intensive than obtaining conventional oil), Canadian ecosystems and the indigenous communities living in project areas, who are blaming it for the abnormal rates of cancers they are developing. See *Cashing in on Tar Sands – RBS, UK Banks and Canada's 'Blood Oil'*, at http://www.banktrack.org/download/cashing_in_on_tar_sands_rbs_uk_banks_and_canada_s_blood_oil_ (last visited December 15, 2010).

solely the product of companies from emerging economies operating in developing states with weak regulatory capacity (so-called “South-South investment”); the tar sands projects’ greatest financial support comes from the Royal Bank of Scotland (RBS), one of the largest banks in the world, which is headquartered in London, which is arguably the global capital of the sustainability and corporate social responsibility industries.

In addition, the Bristol Bay controversy reveals that problem projects do not simply present breakdowns in regulatory oversight or enforcement. It is tempting to characterize the conflict in Bristol Bay as one between “finite wealth” (x billion dollars in mineral deposits extracted and x number of jobs created) and “sustainable wealth” (x million dollars in the salmon fishery industry, x number jobs it sustains). However, this and other problem projects are almost always also fueled by a much larger, harder to quantify battle between “nature” and “industrialization.” To develop or not to develop, that is the question. But this question begets another, because human development is complex concept that means different things to different people. While for some the relevant question about problem projects may be “can we build large projects sustainably?” for others the better question is, “should we build large projects at all?”

Problem projects, in all of their complexity, go to the heart of the conflict between competing visions of human development in the age of economic globalization and all the ancillary questions related to that debate: who gets to develop themselves or *be developed* (and by whom and how), and how is progress measured? The Vedanta mining project in India is a perfect case in point: the Indian government had supported the project—the largest foreign investment in the country at the time—because the mineral resources in the east of the country were under-developed and the proposed giant aluminum refinery would provide over 20,000 jobs. Members of the Adivasi tribe, local farmers in Orissa (one of Indian’s poorest states) saw things differently. They were concerned foremost with losing not only a sacred site (the mountain near the proposed mine site) but their sustainable way of life and traditional tribal values. As one tribe member among the 800 allegedly facing forcible displacement to allow room for the project, remarked, “We will not allow the company to mine our land, our sacred place. Any compensation they offer is worthless to us.”¹⁴

Furthermore, where should accountability lie for the trials and errors, oversights or abuses that occur along the way in large-scale infrastructure development? Who has a say in the vindication of a projected-affected population’s property rights, right to development, a clean environment, adequate working conditions while working on projects, or the right to be consulted on the very authorization for development plans to move forward? While in most instances, particularly in the developing world, it seems as if accountability is completely absent, in some instances national institutions in emerging markets make an effort to contain and manage these immense conflicts. In the case of Vedanta, in August 2010 a government report found that the British sponsor had violated national forestry protection laws, prompting Environment Minister Jairam Ramesh to announce that the government would initiate legal

¹⁴ See BBC News, *India court okays mining projects*, September 29, 2008, India’s Supreme Court ruled in favor of the controversial mining projects (one sponsored by Sterlite Industries, the Indian fully-owned subsidiary of UK-based Vedanta and another by South Korean Posco) in August 2008, ordering Sterlite to invest US \$2.5 million, or ten percent of the profit earned from the project, for the development of the Adivasi people.

action against the company. The Minister noted that the tribes were “completely dependent” on the forest where the proposed mine would be built, and thus, any violation of their habitat and homes would be unacceptable.¹⁵

Sometimes problem projects test the stress points of democratic governments by calling into question who has the final say over development of national resources: executive planning authorities, environmental protection agencies, regional governments, local zoning boards, national courts or international courts and adjudicative processes? When do a country’s growth needs trump minority property rights or environmentally sensitive areas? When is a resource so precious and vital to the ecosystem that its vitality trumps national economic progress? These challenging questions are at the forefront of the long-standing tug-of-war over the Belo Monte dam planned for the Amazon, a project intended to respond to Brazil’s tremendous projected energy needs in the next decade. Activists argue that the dam threatens grave environmental degradation and social upheaval: building the dam would involve diverting water to an artificial reservoir by digging two huge canals that “would involve moving more earth than was dug for the Panama Canal.” It is projected that diversion of the river and flooding effects combined would affect the livelihood of approximately 45,000 people. To meet the project’s generating capacity, additional dams would need to be constructed further up the Xingu River, endangering tropical rainforest lands home to twenty-four indigenous groups.¹⁶ On top of this, NGOs argue that the project is not the most energy efficient solution for Brazil’s needs and is too financially risky for the country.

This opposition has led to a stalemate lasting several years. Brazil’s environmental protection agency, IBAMA, initially issued a preliminary license for preparatory work for the project to begin, but Federal Judge Antonio Carlos de Almeida Campelo issued an injunction to suspend the preliminary license for the dam and cancel the auction because it violated Brazil’s constitution. Almeida’s decision, however, was overturned by a regional appellate court several

¹⁵ See *India rejects Vedanta plans to mine tribal land*, BBC News, August 24, 2010, available at <http://www.bbc.co.uk/news/world-south-asia-11067678>.

¹⁶ See International Rivers and Amazon Watch, *Press Release: Belo Monte auction goes forward after court overrules second injunction; Massive Protests Underway Today in Nine Cities in Brazil (Brasilia, Brazil)*, April 20, 2010, at <http://www.internationalrivers.org/node/5296> (last visited December 18, 2010). Similarly, in Ecuador, national regulatory processes and legal checks appeared to operate properly with respect to the Baba dam project, but were ultimately undermined by the political will of the national government. The Ecuadorian Ministry of the Environment granted a permit for the project in November 2006, but environmental groups swiftly challenged this with an *amparo* lawsuit alleging that the environmental and social impact assessments were incomplete and inaccurate. In December 2008, the Constitutional Tribunal of Ecuador ruled that the manner in which the Baba project had been authorized and implemented constituted a violation of human rights, including the rights to a healthy environment, to consultation, and to citizen participation and ordered the Ministry of the Environment to revise the Baba dam project’s environmental and social impact studies and ordered the government to conduct an audit of the project and to closely monitor its development. Subsequently, however, the Ecuadorian government has pushed ahead with project development even though most of the court-ordered revisions have not been completed and the Ecuadorian Comptroller Office’s official audit criticized the project’s design, concluding that the plans for the entire project were incomplete and lacked proper environmental mitigation measures related to sediment accumulation. See AIDA Press Release, *Constitutional Court Orders Change in Environmental License for Baba Dam, Ecuador*, January 8, 2009, at http://www.aida-americas.org/sites/default/files/Baba_PR_01_2009_en_0.pdf (last visited December 15, 2010).

days later. After a few more days, opponents got a second injunction against the project issued, but this too was subsequently overturned by the Appellate Court prompting concerns of political interference by the federal government. However, a few weeks later, on April 1, 2011, the Inter-American Commission on Human Rights (IACHR), part of the Organization of American States, issued precautionary measures in response to a November 2010 complaint against the project. In the decision, the IACHR announced that the Brazilian government had to comply with its obligations to undertake a consultation process that is “free, prior, informed, of good faith and culturally appropriate” with the indigenous peoples potentially threatened by the project.¹⁷ In addition to the IACHR’s decision, further attention was brought to the Belo Monte dispute by James Cameron, the Hollywood director, who compared the situation of the indigenous Juruna and Arara peoples of the region to the plight of the fictional tribe in his blockbuster movie, *Avatar*.

These interventions illustrate another phenomenon related to problem projects: when national institutions appear to fail to adequately address citizen concerns, particularly those of historically marginalized groups such as indigenous peoples, project sponsors and governments must contend with the globalized accountability promised by international human rights and environmental law (Keck 1998). Thus, even when national institutions nominally address insufficiencies with some approximation of the rule of law, if local and transnational activists are dissatisfied they can go “over the heads” of national institutions by seeking accountability from transnational regimes and courts, directly from private actors, or in the global court of public opinion and from market forces.¹⁸

Of course, even when national institutions do appear to serve justice by holding private actors accountable, the harsh reality is that the punishments often fall far short of the damage wrought by the offense: even the largest of judgments in the most generous of jurisdictions for such awards (the United States) are only equivalent to mere error remainders on a transnational

¹⁷ See Amazon Watch, *Press Release: Organization of American States Requests Immediate Suspension of Belo Monte Dam in the Brazilian Amazon* (April 5, 2011), at <http://amazonwatch.org/news/2011/0405-oas-requests-immediate-suspension-of-belo-monte-dam> (last visited April 14, 2011).

¹⁸ For example, following the Indian environment ministry’s decision, Vedanta’s share price on the FTSE100 slid by 10%, losing 300 million British pounds of its market capitalization, a loss the UK’s Local Authority Pension Fund Forum (LAPFF), which represents 52 schemes with a combined EURO 100 billion, blamed on the company’s environmental and social governance issues that the LAPFF had lobbied the firm to address, but which it had ignored. The LAPFF chairman, Sir Ian Greenwood explained that the Vedanta experience “is clear evidence of why laggards ignore these matters at their peril and to the detriment of their shareholders. Good management of these issues can clearly have a direct impact on business strategy and, by extension, financial performance.” See Hugh Wheelan, *UK pension funds slam Vedanta on ESG issues as share price tanks*, Responsible Investor.com, August 29, 2010, available at http://www.responsible-investor.com/home/article/uk_vedanta/. The reversal of fortune followed a several-year-long transnational campaign by celebrities and environmental groups and even entangled the Church of England, which held a \$4.1 million stake in Vedanta. See Alastair Lawson, *India mine rows embroils Church of England*, BBC News July 26, 2009, available at http://news.bbc.co.uk/2/hi/south_asia/8167223.stm. A consortium of environmental and human rights NGOs also filed a lawsuit against the British Treasury related to the project and the Church of England eventually decided to sell its shares. See William MacNamara, *Rights Protests Aim to Swamp Vedanta AGM*, *Financial Times*, July 27, 2010, available at <http://www.ft.com/cms/s/0/2057cf74-99b5-11df-a852-00144feab49a.html>.

corporation's balances sheets, perhaps no more than a week's earnings.¹⁹ Meanwhile the social effects of the initial harm are felt long after, as is poignantly illustrated by the lingering effects of the devastation wrought by the Bhopal chemical plant disaster from decades ago.²⁰

A Taxonomy of Global Private Governance: Regulating Beyond (and without) the State

The diverse regulatory phenomena that have emerged in response to global regulatory gaps have been typologized as transnational "new governance" or "regulatory standard-setting" (Abbott 2009) and "civil regulation" or "private regulation" (Vogel 2007). They are direct responses to a series of missed opportunities by state actors to collectively create effective regimes of global international business regulation (Moon 2008),²¹ leading to a "new global public domain" that does not "replace states" so much as "embed systems of governance in broader global frameworks of social capacity and agency that did not previously exist" (Ruggie 2004). Indeed, a few of the more well-known initiatives were created in close collaboration with state actors, including the Fair Labor Association (originally the Apparel Industry Partnership promoted by the Clinton Administration), the Extractive Industries Transparency Initiative and Ethical Trading Initiative (both started by the United Kingdom), and the Principles on Security and Human Rights, started with cooperation of the United States and several other governments. Other initiatives were created under the auspices of multilateral international organizations, such as the Organization for Economic Cooperation and Development's Guidelines for Multinational Enterprises and the United Nation's Global Compact (Moon 2008)(Moon & Vogel, 2008: 314-17). Though the Equator Principles are in many ways closer to pure industry self-regulation, such a taxonomy obscures the very extensive role played by the International Financial Corporation (IFC), the private-lending arm of the World Bank Group, in developing them, and thus, the EPs can be seen as emblematic of this public institutional support as well.

It is appropriate then that others have theorized these new arrangements of regulatory power as the emergence of a complex "governance triangle" (Abbott 2009), in which international standards are now created, implemented, monitored and enforced by varying combinations of states, firms and NGOs seeking to transform whole supply chains and global networks of operations spanning multiple jurisdictions (Bartley 2003). Others have also referred collectively to these new forms of governance as the "new" corporate social responsibility,

¹⁹ For example, following two decades of legal battles, the Supreme Court vacated a previous judgment for punitive damages of \$2.5 billion faced by Exxon for the 1989 *Valdez* oil spill in Alaska and limiting its liability to the \$507.5 million in compensatory damages it was assessed, which according to Timothy Egan in the NY Times is "in a good year, just a single week's profit for the company." See Timothy Egan, *Groundhog Day for Oil*, NY Times, May 5, 2010; see also *Exxon Shipping Co. v. Baker*, 128 S. Ct. 2605 (2008).

²⁰ For example, according to official figures published by the Indian government, 3,500 people were killed immediately by the Bhopal disaster, with subsequent deaths reaching over 15,000. Because Union Carbide abandoned the plant after the explosion without cleaning it up, locals have been exposed to contamination through their water supply, but there have been no repercussions for Dow Chemical, which bought Carbide after the disaster. In August 2010, several of the senior Indian managers of the plant at the time of the incident were given two-year prison sentences and a small fines – paltry punishments akin to those for traffic violations. A settlement of \$470 million was reached at one point, but victims do not think it's satisfactory.

²¹ (Khanna 2009).

identifying seven ideal types (Auld 2008).²² There are now over 300 such initiatives attempting to introduce governance into nearly every major global economic sector, including energy, the extractive industries, forestry,²³ chemicals, textiles, apparel, footwear, sporting goods, coffee, and cocoa.²⁴ One of the most prominent – but also most criticized regimes – is the United Nations Global Compact, which had accumulated over 8,700 participants, of which 6,200 were corporate signatories.²⁵ More than 2,300 corporations have endorsed the Business Charter for Sustainable Development created by the International Chamber of Commerce, and over 46,000 firms’ operational plants have received certification as compliant with the International Standards Organization’s 14001 Standard on environmental management systems.

Unlike previous efforts at CSR, which were largely about corporate philanthropy, often in pursuit of creating positive publicity about a corporation to counter other publicity, the “new” CSR is about “internalizing a firm’s negative externalities” and directly addressing the problems that arise from a company’s core business activities (Auld 2008). Thus, the scope of the business practices in question can no longer be cubby-holed into discrete problem areas. Rather, they involve labor, environmental and social developmental concerns anywhere within a corporations

²² (1) individual firm efforts (thousands of examples); (2) individual firm and individual NGO agreements; (3) public private partnerships between government or international organizations and firms (EPA star preferred treatment, U.S. voluntary standards program, the Global Compact, United Nations Environment Program Financial Initiative, United Nations Principles for Responsible Investment); (4) information-based approaches (Global Reporting Initiative); (5) environmental management systems (EMSs) (ISO 14001); (6) industry association corporate codes of conduct (Responsible Care, Equator Principles, American Forest and Paper Association’s Sustainable Forestry Initiative, Australian Forestry Standard); and (7) private-sector *hard law* typologized as non-state market-driven (NSMD) governance (Forest Stewardship Council, Marine Stewardship Council, Fairtrade Labeling Organizations).

This list of ideal types can usefully be compared with a similar but less inclusive list of ideal types of voluntary regulation on the domestic level: “public voluntary programs,” i.e. initiatives formally sponsored by the United States government (Global Climate Challenge, the 33/50 Program, Climate Wise and Strategic Goals), “industry associations,” i.e., programs created by and for specific industries (Responsible Care, Sustainable Slopes), “third-party initiatives,” namely those sponsored and run by independent organizations such as the International Standards Organization (ISO 9000 and 14001), and finally, “firm-structured initiatives,” i.e., independent adoption of environmental management systems by individual firms (Nicole Darnall 2005)). Another typology has been developed by (Nicole Darnall 2005), who analyzed voluntary environmental programs in the United States for their signaling accuracy. They divided respondents into (1) information, assistance and awareness programs; (2) environmental pledges; (3) voluntary reporting (with and without sanctions); and (4) performance monitoring (with and without sanctions), which were sponsored by either (a) government, (b) industry associations or (c) third-parties. These authors concluded that there were “no statistically significant differences among program sponsors” (Schepers 2009), page 84.

²³ There are thirty five forestry certification schemes alone under the Programme for the Endorsement of Forest Certification (PEFC), which has 200 million hectares under its governance; an additional 112.85 million hectares are covered by the smaller and more NGO-dominated governance of the Forestry Stewardship Council, which is perceived as less corporatist than the PEFC and is perceived as more legitimate (Rivera 2008).

²⁴ For a list of 31 multistakeholder industry initiatives, see Ethical Corporation, *Guide to Industry Initiatives in Corporate Social Responsibility* (2009), available at www.ethicalcorp.com/initiatives (last visited 8 October 2010).

²⁵ See *Ten Years of Setting the Record Straight*, at <http://unglobalcompact.wordpress.com/2010/11/> (last visited 5 November 2010).

“sphere of influence.”²⁶ Many of the new initiatives aim to transform entire corporate cultures and approaches to risk management; indeed, the business models of entire industries are purportedly transforming before our eyes, or at least, that is the stated goal. Of course, when these numbers (see Table A) are compared to the total numbers of transnational corporations (TNCs) in the world—at the end of 2007 there were some 79,000 TNCs engaged in international production, with about 790,000 affiliates abroad, with value added by foreign affiliates accounting for an estimated 11 percent of world GDP (UNCTAD 2009)—it becomes clear that we are witnessing the mere infancy of the era of corporate social responsibility and the gestation period of the era of corporate social accountability.

Table A: Participation Levels in Selected Multi-stakeholder Initiatives

Initiative	Entities
ISO 14001 Certification	129,199
United Nations Global Compact	6,200
Global Reporting Initiative	2,667
Forest Stewardship Council	913 forest management and chain of custody certificates
Marine Stewardship Council	52 fisheries or fisheries in assessment
Partnerships for Sustainable Development	332 partnerships registered on the UN Commission for Sustainable Development
SA 8000	1,373 certified facilities
Ethical Trading Initiative	43
Fair Labor Association	21 “Participating Companies”; 2,900 licensees selling goods to FLA affiliated colleges and universities
Extractive Industries Transparency Initiative	37 companies (including an additional nine that are members of the International Council on Mining and Metals)
Voluntary Principles on Security and Human Rights	17 corporate participants; several NGO participants and other observers; several “participating” governments (Netherlands, Norway, United Kingdom, United States of America); several “engaged” governments (Canada, Colombia, Switzerland) ²⁷

²⁶ See *Draft Guiding Principles for the Implementation of the United Nations ‘Protect, Respect and Remedy Framework’*, at <http://www.reports-and-materials.org/Ruggie-UN-draft-Guiding-Principles-22-Nov-2010.pdf> (last visited December 17, 2010). According to the *Draft Guidelines*,

The scope of the corporate responsibility to respect human rights extends across a business enterprise’s own activities and through its relationships with other parties, such as business partners, entities in its value chain, other non-State actors and State agents. Particular country and local contexts may affect the human rights risks of an enterprise’s activities and relationships.

‘Influence’, where defined as ‘leverage’, is not a basis for attributing responsibility to business enterprises for adverse human rights impacts. Rather, a business enterprise’s leverage over third parties becomes relevant in identifying what it can reasonably do to prevent and mitigate its potential human rights impacts or help remediate any actual impacts for which it is responsible.

Draft Guidelines at Part III, no. 12.

²⁷ Adapted from (Clapp 2009).

What is “New” about Global Private Regulation

In studying these new regulatory spaces and structures, it is useful to keep certain analytic distinctions in mind, which hold true to greater and lesser extents depending on the type of governance regime in question. Two important elements worth noting are the regimes’ relationship to state authority and the regulatory aims of the regimes.

Although some regimes are sponsored and managed (or co-managed) by public authority, most private regulation on the global level does not have such direct linkages to state actors. This does not mean, however, that these regimes develop in complete isolation from state power or that states’ roles as regulators domestically or internationally are on a track towards irrelevance or obsolescence; rather, the state or collections of states in international organizations now often times play more “subtle” roles as “catalyst, coordinator, and supporter of diverse regulatory activities” (Abbott 2009). In addition, the state’s influence is now typically more in the background since many of the forms of private global governance have been adopted partially motivated by an urge to preempt state regulation, litigation or other state-based regulatory powers (*Id.*). In some instances, this supportive role is more visible with regimes being jump-started to life by state or relying on state agencies for financial support or inspiration,²⁸ but even these new regulatory regimes do not derive their authority from states nor are they in any way held accountable to them (Bernstein 2007; Abbott 2009).

Still, private governance of course cannot escape the world’s politico-legal boundaries; by necessity they operate within or overlap with domestic and international regulatory environments, which may affect the scope of their power and how it is exercised (Bernstein 2007). Indeed, there is some evidence that particular national contexts shape the overall institutional environment in which transnational regimes operate thereby having a salient effect on the effectiveness of such regimes, particularly in low-income countries (Espach 2006).²⁹ It is no doubt for this reason that the UN Special Representative’s proposed Guiding Principles adopt

²⁸ A prime example is the FLA, an NGO “dedicated to ending sweatshop conditions in factories worldwide,” with membership including human rights, labor, women’s rights and consumer advocacy groups, as well as 179 colleges and universities, 39 participating companies and 1,262 collegiate licensees, is a prime example. It grew out of the 1996 ‘White House Apparel Industry Partnership’, a voluntary task force of 18 members, including clothing and shoe manufacturers, consumer, corporate social responsibility and human rights organisations, and labour unions charged with identifying an industry-wide strategy to eliminate global apparel sweatshops. This group later presented President Bill Clinton with a report containing a ‘Workplace Code of Conduct’ (‘the code’) and ‘Principles of Monitoring’ (‘the principles’) for the apparel industry. (Hemphill, 2004). After a splinter of some of the original constituents, both the code, which is based on the International Labor Organization’s labor standards and addresses a variety of apparel industry employment-related issues, and the principles were later incorporated into the FLA. The principles direct companies to establish standards for their suppliers, monitor compliance through data collection and internal audits, solicit compliance information from employees, labor, human rights and religious groups, and establish a mediation mechanism (Hemphill, 2004). In 2006, the FLA’s Independent External Monitoring (IEM) program conducted 147 independent factory audits.

²⁹ For example, in comparing the effectiveness of forestry certification regimes in Brazil and Argentina, Espach (2006) found that the effectiveness of private environmental regulatory programs is likely to vary dramatically across developing countries, regardless of similar levels of demand in export markets and advocacy by transnational NGOs or transnational corporations, noting in particular the effect of local supply-side conditions at the industry level on program success.

a framework (“Protect, Respect, Remedy”) that still places human rights accountability foremost at the door step of state actors.

In addition to their relationship to sovereign authority, transnational new governance regimes can also vary considerably in what their goals are and how they seek to achieve them. Some, such as eco-labeling schemes, emulate “command and control” regulation in that they are static and set a fixed standard of environmental or other performance (labor, etc) that firms must achieve before they receive certification. Other regimes, however, such as environmental management systems (e.g., ISO 14001), are far more dynamic, aiming not at specific standards or measures of quality but at achieving “collective goals and values” through a process in which “adaptation, inclusion, and learning occur over time and across a wide range of stakeholders” (Auld 2009).

Private Governance as Public Policy – The “Greenwashing” Debate

In the wake of the financial crisis, the United States Securities and Exchange Commission promptly eliminated its voluntary supervision program for investment banks. Its Chairman announced at that time that “[t]he last six months have made it abundantly clear that voluntary regulation does not work” (Labaton 2008; Toffel 2010). In March 2009, the EPA discontinued its leading voluntary program, *Performance Track*, following media reports disparaging its legitimacy (Toffel 2010).³⁰ This reaction was not new, but merely reaffirmed what has been the conventional wisdom and economists’ long-held skepticism of collective action, which predicts that private actors will not comply with self-imposed obligations in the absence of some mechanism to compel compliance through rewards or punishments (Olson 1965; Hardin 1968). Indeed, the more trenchant contemporary critiques of CSR and self-regulation suggest that they are nothing more than increasingly sophisticated “greenwashing” by corporations to demonstrate environmental and social commitments publicly while privately continuing past practices (Hoffman 1997; Vogel 2005). This is evident in the debate that raged on the tenth anniversary of one of the largest, most well-known initiatives, the United Nations Global Compact, which came under fire for its failure to de-list a Chinese company heavily invested in conflict-torn Sudan.³¹

But it must be recognized that the science of studying self-regulating institutions is in its relative infancy, particularly with respect to those regimes established to respond to the

³⁰ See Environmental Protection Agency, Next Steps for the National Environmental Performance Track Program and the Future of Environmental Leadership Programs, March 16, 2009, *available at* <http://www.epa.gov/performance-track/downloads/PerformanceTrackNextStepsMemoExternal-text.pdf> (last accessed 12 October 2010).

³¹ See Jon Entine, UN Global Compact: Ten years of greenwashing?, Ethical Corporation, November 9, 2010, at <http://www.ethicalcorp.com/content.asp?ContentID=7142#addcomment> (last visited December 18, 2010) and Elaine Cohen, *UN Global Compact: Celebrating Ten Years of What?*, CSRWire, November 23, 2010, at http://www.csrwire.com/csr/live/commentary_detail/3325-The-UN-Global-Compact-celebrates-10-years-of-what- (last visited December 18, 2010), and the official response to Entine from the Global Compact Office about the track-record of the Global Compact. See Global Compact Office, *Ten Years of Setting the Record Straight*, at <http://unglobalcompact.wordpress.com/2010/11/> (last visited 5 November 2010).

exigencies of governance arising from economic globalization. With the exception of Elinor Ostrom's foundational work on successful self-regulation of commonly held resources (Ostrom 1990) and Joseph Rees study of industry self-regulation in the nuclear power industry (Rees 1994), as of the year 2000, little research had been done on the potential for industry self-regulation, particularly by industry associations or other regimes with limited coercive power (King and Lenox 2000; Coglianese and Nash 2006). As King and Lennox noted, even lacking much evidence, at the time scholars and government officials recommended the support of self-regulation by industry of environmental programs (Gunningham 1995), which is perhaps readily explained by politics – particularly the power of the business lobby in the United States.

The passage of a decade has allowed both for the proliferation of many more regimes of self-regulation on the domestic and global levels and for scholars to catch-up to the phenomenon.³² Political scientists and business school management scholars have developed a robust literature that primarily confirms the long-held skepticism of self-regulating institutions. Building on previous work in economics (Olson 1965; Hardin 1968; Grief 1997), these studies demonstrate that in the absence of some form of “sword,” e.g., a monitoring or enforcement mechanism (third-party monitoring, public disclosure of audit information) or sanctioning mechanisms, firms will not likely achieve high levels of compliance with voluntary regulation (DiMaggio 1983; Suchman 1995).³³ There is a separate strain of research, however, following in the tradition of neoinstitutionalists (Rees 1994; Gunningham 1995; Nash 1997), which thinks that sanctions are not needed for compliance because the institutional structure of self-regulation can control behavior through more informal coercive, normative and mimetic processes that can change actors' preferences and values over time (Lyon and Maxwell 2007; Darnall 2008). More recently, scholars have suggested that by focusing exclusively on *outcomes* (e.g., reduction in toxic emissions), much of the research has potentially missed this long-term view of self-regulation's promise, namely, its power to initiate socialization *processes* that facilitate learning and dissemination of best practices, thereby planting the seeds for *long-term* improvement (Vogel 2007).

³² Even with the continued rapid pace of globalization and transnationalization of business entities, much regulation remains “command and control” in nature, providing regulation scholars with much to study. Such work often focuses on one national context at a time, often because the national frame imposes an important control on the research (Hutter & Jones, 2007) (focusing on businesses in the food sector in the UK), (Howard-Grenville, Nash, & Coglianese, 2008) (looking at the United States' Environmental Protection Agency's National Environmental Performance Track program), (Parker & Lehman Nielsen, 2005) (examining implementation of internal compliance systems by Australian corporations; (King & Lenox, 2000) (analyzing participation of firms in chemical industry's Responsible Care program as implemented in the United States); (Welch, Mazur, & Bretschneider, 2000) (study of U.S. Department of Energy's Climate Wise Program), (Potoski & Prakash, 2005) (analysis of compliance with ISO 14001 in U.S. facilities in relation to Clean Air Act), (Dasgupta, Hettige, & Wheeler, 2000), (Dalhstrom, Howes, Leinster, & Skea, 2003) (analyzing performance among British facilities with respect to ISO 14001 and EMAS certification requirements).

³³ Consistent with these critiques, international relations scholars have long argued that States increasingly choose “soft law” instruments to govern certain common issues precisely because they do not impose significant costs to establish or when violated. Because they lack coercive sanctions, international relations scholars often are pessimistic about the power of “soft law” to influence state behavior.

This substantial literature on “effectiveness,” with only a few exceptions has focused on *domestic* initiatives, those sponsored by the U.S. Environmental Protection Agency primarily to address pollution.³⁴ But the literature on *transnational* new governance and global civil regulation remains partial and incomplete. Indeed, as David Vogel notes in a review essay, the entire body of literature focusing on voluntary codes suffers from two “significant weaknesses”: first, “relatively few civil regulations have been studied in-depth; indeed, more research has been published on the FSC and forestry codes than on all other codes combined,” and second, “too few studies examine the global impact of civil regulations,” focusing instead on only the United States and other developed countries. Moreover, Vogel observes, there are few scholarly studies of the “effectiveness of most civil regulations,” and “the extent of actual business compliance.” According to Vogel, we need to get inside the “black box” of firms to better understand how civil regulations have changed their behaviors” (Vogel 2007). While Virginia Haufler’s early analysis of industry self-regulation on the global level noted some anecdotal evidence of improved industry practice, her appraisal on the whole was very skeptical of the actual and potential impact of voluntary regulation by global business (specifically standards for environmental protection, worker rights, and data privacy). At that time she noted in particular that “the problems that self-regulation attempts to address are often problems of national governance, and it is there that most responsibility still rests” (Haufler 2001). But this returns us to the initial crux of the problem: the globalization of supply chains and transactions has stretched the limits of national regulation, thus demanding regulation on the global level. The history of attempts at such regulation between states, however, is not encouraging (Vogel 2006).

Thus, driving this quest for enhanced empirical knowledge are important policy questions. These policy concerns have been sharply brought into focus by the work of the United Nations’ Secretary-General’s Special Representative on Business and Human Rights, John Ruggie, who has led a multi-year consultation on developing a new global approach to corporate liability for human rights violations. Given that Ruggie started his mandate informed of the Human Rights Commission’s disapproval of the previous effort to create a new international treaty of “hard law,” the “Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights,” which would impose binding legal obligations on corporate actors, he has advocated for a hybrid approach (“Protect, Respect and Remedy”) that proposes to rely on the conglomerate effect of existing international treaties addressing states’ responsibilities to “protect” human rights and soft law agreements combined with emergent voluntary initiatives in the private sector that draw upon corporations’ obligations to “respect” them. While this pragmatic compromise may be the best way forward, it is nonetheless very much an experiment: neither the advocates for, nor the opponents against, reliance on private regulation of corporate conduct can marshal much evidence to prove or disprove the extent to which such regimes are effectively dealing with existing governance gaps. The question remains, then: does global self-regulation *work*?

Thus far, the effectiveness of self-regulation on the global level is under fire: for example, global initiatives in the extractive industry sector—the Extractive Industries

³⁴ For an overview of voluntary environmental regime literature, see articles in the Symposium issue of the *Policy Studies Journal* (Koehler 2007) and (Williamson 2010) for the U.S. context in particular.

Transparency Initiative (EITI) and the Voluntary Principles on Security and Human rights—which include some of the world’s biggest energy and mining companies, including Rio Tinto, Shell, BP, ExxonMobil, Anglo American, Chevron and Statoil, have faced recent legitimacy challenges.³⁵ The limits of global labor monitoring regimes have also been detailed comprehensively.³⁶

Some initiatives—such as the Forestry Stewardship Council (FSC)—appear successful on an initial glance, but on further inspection it is clear that their success is likely contingent upon their modest scope. The FSC seems to have improved management of temperate forests, especially in North America and Europe, but the most egregious practices take place in tropical forests, only 2.4% of which are certified by either FSC or another private certification scheme. A broader view suggests then that the FSC fails to address “the most critical forestry governance failure, namely the accelerating rate of tropical deforestation. In fact, only 6-8% of global timber production is traded and most of this trade occurs between environmentally sensitive developed countries, rather than from developing countries to developed ones, thus weakening the international leverage of western firms and activists” (Banktrack 2007; Banktrack 2010).

With the effectiveness of these new forms of global governance very much open to debate, it is important to subject them to empirical inquiry. To begin to fill the empirical vacuum around these global voluntary regimes, this dissertation provides an intensive look at the Equator Principles and their effects on the project finance sector. Though NGOs initially welcomed the development of the EPs, they have remained critical throughout the eight years the EPs have been in effect (Banktrack 2010). Critics have voiced myriad complaints about the EPs, but the main frustrations center around the same issues that plague other voluntary initiatives, namely, that their voluntary nature facilitates rampant cheating, or “shirking.” And though the EPs’ substantial revision in 2006 introduced a disclosure requirement (Principle 10), critics do not think the demands of Principle 10 are stringent enough, nor are they satisfied with the regime’s governance structures or handling of non-compliant institutions. Despite the EPs’ ascendance to the status of global “best practice,” these persisting concerns are viewed by the activist community as fatal flaws, exposing the EP regime and the EPFIs who have adopted it to legitimacy challenges (Barnett 2007; Auld 2008).

This is a profound threat because the theory is that in adopting CSR initiatives, individual firms are in part seeking to enhance their respective individual reputations (Prakash and Potoski 2007; Barnett 2008). Furthermore, it is argued that industry reputation or the reputation of a regulatory regime—whether good or bad—is shared among its members. Thus, all threats to a regime’s legitimacy affects all who seek the reputational benefit from being part of it (Olson 1965; Hardin 1968; Ostrom 1990). If the regime cannot establish its legitimacy and prevent its dilution by free-riders, those outside the regime will no longer be able to tell the difference

³⁵ In March 2010, the Voluntary Principles, which set standards for company use of security personnel in hostile environments, was saved from a crisis by a last minute intervention by the United States government (Seidman 2007).

³⁶ For a fascinating description of the limits of traditional monitoring systems, see T. A. Frank, “Confessions of a Sweatshop Inspector,” *Washington Monthly* 40, no. 4 (April 2008): 34–37. On the limits of monitoring approaches, even by well-financed, well-trained and committed auditors (Seidman 2007).

between those truly committed to higher standards of environmental and social risk management and the laggards, essentially making the EP “brand” worthless (Akerlof, 1970).

Research Goals

This dissertation uses the EPs as an opportunity to evaluate several empirical and theoretical questions related to regimes of private authority. Drawing upon over two dozen qualitative interviews with bank personnel and others in the project finance industry, as well as responses to a global survey about evolving bank practices, my primary focus is on defining and then measuring “effectiveness” in the context of voluntary regimes, using the EPs as a test case. I follow a burgeoning scholarly re-assessment that argues that too narrow a focus on outcomes might overlook other beneficial byproducts of voluntary regimes, such as the initiation of a socialization process that can pay great dividends in the long-run (Lyon and Maxwell 2007; Darnall 2008). I argue that any study of “effectiveness” must also analyze “processes,” including individual institutional structural change (the adoption of new policies, procedures and organizational structures to facilitate implementation of the EPs by their adopting institutions, i.e., large multinational banks), the evolutionary growth of a regime’s structure, governance and mandates, its utility as a mechanism for social learning and enhancing the relationships and collaboration among the participating institutions, and the regime’s broader impacts on non-participating institutions, sectors and fields of economic activity.

A second set of closely-related questions are also explored here through the experience of the adopting institutions – the Equator Principles Financial Institutions (EPFIs). These questions concern the role of reputation in driving compliance. While the drive for legitimacy and to improve and maintain an individual firm’s or an industry’s collective reputation have been identified as primary drivers for compliance with voluntary regimes lacking centralized enforcement mechanisms, there has been little empirical attention to how reputational dynamics operate both on an individual firm and between individual firms and entire industries. With this in mind, as a secondary goal, I analyze these reputational dynamics in the context of the EPFIs. Finally, the data collected here will be analyzed with attention to the insights of neoinstitutionalism and its emphasis on the powers of isomorphic pressures in firms’ institutional environments to shape organizational change and behavior.

Overview of Chapters and Summary of Findings and Conclusions

Chapter 1 begins with a survey of the diverse academic literature that serves as an intellectual foundation for this research, principally the contributions from economics, political science, sociology, international relations and management studies that have explained the origins of, institutionalization of, and compliance with self-regulating institutions. Following economic theories that posit that firms seldom engage in collective action efforts beyond their narrow self-interest *unless* socially constrained by strong institutional pressures in the form of monitoring and sanctions for lack of cooperation (Wilson 1999), scholars have predicted that *absent these strong institutional mechanisms*, self-regulation is unlikely to prevent opportunism and thus fail to promote superior environmental performance. If such stronger enforcement

mechanisms are not imposed, it is expected that “laggard” institutions will “free-ride” on program benefits, which in the case of self-regulation is typically the benefit of gaining a “green” reputation and technical assistance (King & Lenox, 2000; Rivera & de Leon, 2004; Toffel, 2005)). Thus, once formed, the challenge of self-regulation is compliance. While it may be possible for shirking to be combated purely through normative, mimetic or coercive pressures applied by other firms or stakeholders in organizations’ institutional environments, particularly those in close proximity, i.e., in the same industry or geographic area (DiMaggio & Powell, 1983), there is deep skepticism that such pressures are sufficient. Many argue that to be effective, such “governance clubs” need to adopt a variety of enforcement mechanisms, borrowing from the tool-kit of “command and control” regulation (Sinclair, 1997) and impose sanctions or other costs on members to extract compliance.

The chapter then delves further into the question of “measuring effectiveness” as it has been developed in the literature. In addition to the practical constraints imposed on this research, recent studies of voluntary programs have suggested that the focus on outcomes has perhaps been misplaced, and has risked missing their real impacts of voluntary programs. Taking a cue from these theoretical insights, this study proceeds from the perspective that any study of *effectiveness* must include data on the *various modalities* in which voluntary programs can be *effective*. Exclusive attention to *outcomes* risks failing to appreciate the full impact of a voluntary program on the relevant regulatory space. Therefore, it is proposed that there are six distinct ways to measure a voluntary regime’s impact or effectiveness: (1) individual commitment in applying the standards of the regime; (2) outcome effectiveness; (3) utility of the regime as a mechanism for social learning among participants and non-participants; (4) external effects of the regime on the industry or sector (specifically on the practices of non-participating institutions); (5) governance of the regime (transparency of process, etc); and (6) political legitimacy. In this study of the Equator Principles, emphasis is placed in particular on evaluating implementation of the EP norms through changes EPFIs have made in their policies, procedures and organizational structures related to environmental and social risk management (ESRM) also known in the industry as environmental and social governance (ESG), including the development of new procedures and institutional mechanisms, hiring new staff, and training existing staff.

With this theoretical foundation in place, Chapter 2 provides further necessary historical and conceptual background to facilitate the reader’s navigation of the two rather esoteric areas comprising the terrain of this dissertation: the origins and development of the international legal principles of sustainable development and the origins and evolution of the financial activity known as project finance. Because the EPs emerged out of the intersection, or some would say collision, of the historical trajectories of these concepts and activities, this background is arguably required reading for anyone seeking to understand the governance issue the Equator Principles are trying to address.

Chapter 3 adds to this background understanding by describing the ruling “governance gap” relating to the global regulation of transnational corporations, and more specifically, with respect to foreign direct investment and the finance of large-scale infrastructure projects.

Chapter 4 then focuses more specifically on the pre-history to the Equator Principles themselves. It recounts the important milestones in the historical integration of the principles of

sustainable development into infrastructure development, focusing first on the evolution of accountability mechanisms within multilateral institutions (principally the World Bank) and then the extension of these trends in the private sector, leading to the formation of the Equator Principles in 2003 by several of the leading project finance banks. Along with the pre-history described in Chapter 2, the origin story of the EPs fits neatly within the theoretical constructs of the institutionalization of self-regulation. NGOs targeted prominent actors with a history of funding controversial projects; as the pressure mounted, a few of these institutions—who held disproportionate market share in the project finance market—reacted strategically to protect the industry’s reputation and to create a level playing field that would ensure that any steps towards enhanced environmental and social risk management that they took would not cause them to lose market share to less socially responsible banks. Chapter 4 also discusses the normative content of the EPs and how they operate in project finance transactions. Chapter 5 carries the narrative forward, discussing the critical reception and evolution of the EPs in response to NGO criticism.

Chapter 6 presents the methodology used in this study. It first discusses the measurement challenges inherent to studying global self-regulation generally and those particular to this research. After discussing selection biases and other methodological issues, the chapter demonstrates that the sample of 24 banks surveyed in this study is fairly representative of the larger population of EPFIs across several key variables related to reputational exposure that neoinstitutional theories have identified as significant.

Despite the apparent consilience in the social sciences on the dynamics of collective reputation, or the quest for organizational legitimacy, as a driver of the formation of and compliance with self-regulating institutions, there is little empirical work investigating the foundations of these theories. To confirm these theorized relationships, Chapter 7 discusses the responses to several survey questions about the operation of reputational dynamics among the EPFIs, as well as their own subjective understandings of how reputation works. As will be discussed, the survey data offers numerous points of support for theories about the formation of self-regulating institutions, the power of external stakeholders to apply normative pressures on organizations, and the operation of reputational concerns as a driver of behavior.

Chapter 8 presents the heart of the heart of the research – the inquiry into the effectiveness of the EP regime. With respect to *individual bank commitment*, the data, taken as a whole, shows significant trends towards implementation levels that go well-beyond superficial or formal adoption of the EPs. On an individual level and collectively, banks have adopted procedures and created new organizational structures to facilitate ESRM review of projects at early stages of project development, something simply not done in the past. Moreover, for many banks, projects are scrutinized by environmental and social risk personnel, whose approval and recommendations (in some institutions) is necessary before any final credit approval. When there are conflicting views within credit committees (including perhaps the views of ESRM personnel), most institutions insist on consensus being reached or rely on final decisions to be made by quasi-appellate mechanisms involving the highest levels of the institution, demonstrating both the seriousness of ESRM review as well as the depth of institutional concerns over reputational risk.

The chapter then explores *outcome effectiveness*. This analysis is problematized both by the lack of credible data on individual projects and by the inherent subjectivity of project

outcomes and the subjectivity of the very practice of environmental and social impact assessment, which has been likened more to art than science. Future in-depth studies of various projects in different jurisdictions could usefully illuminate just where problems arise and how they can be addressed by the banks and others involved in project development.

There is some evidence of the EPs' success by other measures of effectiveness, however. As noted, recent research has de-emphasized outcome effectiveness and has placed more stress on the capacity of self-regulation regimes to engender a social interactive process among its participants, which can yield long-term benefits that a short-term outcomes-based analysis might overlook. This also coheres with the insights from "social network theory," which argues that networks facilitate knowledge diffusion because they "provide their members with pre-existing modes of communication, enhancing the potential for collaboration, information exchange, and mutual observation" (Tashman 2010). As the central actor in the network, the EP Steering Committee, Secretariat and now the EP Association, have the potential to serve as "focal points" of knowledge and influence (Olson 1965). Arguably, an important step toward fostering a community of social interactive processes to facilitate norm diffusion is the creation of a self-sustaining architecture for such activities, such as governance structures. The study found some evidence of participants actively working to support the regime and build its capacity for disseminating best practices. The more formal a mechanism that is established, the greater potential for growth. Overall, the research suggests that the EPFIs have become part of an increasingly congealed collective working together to maintain the regime they have established, and in the process overcoming, in part, the natural tendencies of competitors. Indeed, there is evidence of increased contact and discussion among participants about issues of environmental and social governance. The clearest evidence of this regime-building evolution is the formalization of the banks' relationships in the Equator Principles Association and the creation of formal governance rules and membership fees. These add to the costs inherent to instituting more rigorous environmental and social risk review. These additional costs, so the theory goes, makes compliance more costly. Accordingly, more faith can be put into the claims of actors expending such costs, because it would only be rational to do so if there was some substance to them and not mere window-dressing.

Measurement of the external effects of the regime are difficult to come by, but there is evidence that the EPs have been accepted by other industry actors—from the mining sector to the hydroelectric power sector, as well as other major players, such as the International Financial Corporation at the World Bank and several national export credit agencies—as *the benchmark* for environmental and social governance and risk assessment in the private sector.

Thus, by several process-based measures, the EPs have made an impact on the field of project finance. Chapter 9 then considers another measure of regime "effectiveness" by evaluating the Equator Principles in light of Abbott and Snidal's positive model of the "governance triangle" (Abbott 2009). It is argued that the combined effects of the Equator banks, the IFC and the NGOs provide the four "competencies" identified by Ken Abbott and Duncan Snidal's model as necessary (albeit not sufficient) for "effective" transnational governance. Finally, the last section of the chapter considers another important aspect of evaluating self-regulation: political legitimacy. This section situates the EPs within the paradigm of "non-state market driven" governance presented by Graeme Auld, Christina Balboa,

Steven Bernstein, and Benjamin Cashore (Auld 2009). This analysis concludes that, despite the NGOs' persisting critiques, the EPs have evolved beyond the status of a "weak system" within Cashore and Bernstein's framework, but remain paused at the precipice of becoming a system with "fully fledged political legitimacy." They have been globally recognized as *the* benchmark for ESRM practice in the project finance sector by the multilateral international organizations (IFC), government agencies (ECAs and DFIs), and industry associations, and while the NGOs remain dissatisfied with numerous aspects of the regime, they have not completely abandoned it as a vehicle for governance.

The Conclusion reiterates the major findings of the research and then looks beyond the confines of the study to consider some of the implications of the rise of the Equator Principles and other forms of private governance in the financial sector from the perspective of global administrative law. It raises some normative questions regarding the relationship between the market and governance—between banks and their various stakeholders: clients, populations affected by the projects they finance, the NGOs who seek to represent these populations' interests, and the host governments who hold political power over these populations. It concludes by observing that the future of global governance is one of shared responsibilities between all of these actors.

CHAPTER 1: THEORETICAL FOUNDATIONS FOR THE STUDY OF GLOBAL PRIVATE GOVERNANCE

Beyond presenting a history and analysis of sustainability in the financial sector, the broader purpose of this study is to present the example of the Equator Principles as a case study of one form of global private governance, or self-regulation. Scholars have focused on self-regulation and voluntary programs aimed at improving private sector performance for nearly two decades, but most of this work has focused on domestic programs. The dynamics in both the domestic and international realms are arguably very similar, and so this chapter reviews the theory and experiences related to domestic voluntary programs and self-regulation. Scholars have explored a few main questions with respect to self-regulating institutions: First, under what circumstances do self-regulating institutions arise and how can we explain actors' willingness to participate in them? Second, how do self-regulating regimes gain power and influence the behavior of their participants? Third, are self-regulating regimes effective? This chapter presents a survey of the theoretical constructs offered by economics, political science, sociology, management studies and international relations used to explain the origins of, institutionalization of, and compliance with self-regulating institutions.

The Demand for Governance: The Logic of Collective Action and the Rise of Self-Regulation

All research into the problems of governance is in many ways conducted in the shadow of Hobbes' *Leviathan* (1660) and its pessimistic view of the potential for cooperation absent the presence of a Sovereign, or regulator with a monopoly on coercive power to enforce social norms or legal rules. But it is precisely in such a situation of imperfect coercive power that much governance is conducted, particularly in the international sphere which lacks a global sovereign. The problems inherent to these situations of imperfect governance follow what have been identified as a logic of "collective action" (Hardin 1968), which is evident on all levels of human activity, from the playground to realm of international relations. The challenges to collective action are exacerbated in the context of environmental problems, which present the world's governments and population with one giant "tragedy of the commons" (Hardin 1968) and a series of "free-rider" problems.

In Hardin's (1968) classic depiction of the commons, one herdsman cannot exclude others from increasing their flock size (non-excludability) while the commons can support only a limited number of sheep. This increases the incentives fueling each individual herdsman's rational impulse to increase his flock size before all others do the same (rivalry), which eventually leads to the (premature) degradation of the commons. To avert this "tragedy of the commons," Hardin prescribed "mutual coercion, mutually agreed upon" (Hardin 1968) i.e., the development of rules to enhance excludability (barriers to entry or use such as assigning property rights limiting the size of the group permitted to use the commons) and to limit rivalry (normative principles to alter the behavior of those who gain entrance, such as a rule specifying the amount each can consume).

Another similar but analytically distinct “commons” problem is that of the “free-rider” (Olson 1965). Whereas in Hardin’s elegantly illustrated scenario there is a fear of overconsumption, i.e., the demand for public goods outmatches the supply, in the “free-rider” scenario the benefits extractable from a public good exceed the cost of supplying that good, and individual actors, left to themselves, prefer to enjoy the benefits without paying their equal share of the costs (e.g., clean air and water) (Young 2009). Here the challenge is to create cost-sharing mechanisms that induce each individual actor benefitting from the public good to pay a fair share of the costs for supplying the good (Sandler 1992).

These two fundamental dilemmas are the root causes of the demand for most governance over common resources. Elinor Ostrom’s foundational work in the self-regulation of small-scale, commonly held resources, including water, forests and fisheries demonstrates that such institutions and rules can and do arise in the context of commonly-held natural resources (Ostrom 1990; Ostrom, Gardner et al. 1994). Although the environmental and social issues arising from specific large-scale infrastructure projects can involve resources that are “held” in common, as it were, between project developers and the local populations affected by a project, the larger problems of environmental regulation that are implicated by the global market for large-scale infrastructure development cannot readily be equated with the small-scale commonly held-resources Ostrom studied. In these more complicated contexts involving a more diffuse set of actors, other explanations have been offered for the rise of self-regulatory institutions: the “risk of common sanctions” and informational asymmetries (Toffel 2009).

The first explanation offered by strategic actor approaches is the risk of common sanctions. The individual firms in a given industry may come to appreciate that their fates are intertwined by a government’s decision to regulate the industry as whole based on the perceived collective performance of its constitutive members. Thus, external observers often view individual firms’ reputations as joined to those of their competitors (King and Lenox 2000). Indeed, it seems evident that industries as a whole can acquire bad reputations (e.g., the tobacco industry or the financial industry following the 2007 financial crisis), even if there are individual “good apples” amongst a bunch of “bad ones” (Barnett 2008). Thus, both impending government regulation and NGO activism can instill a sense of a “shared fate” among firms that may stimulate these actors, who are almost always competitors, to consider collective action to forestall apparently imminent common sanctions (Toffel 2009). Additional incentives and benefits have been identified that can be seen as variations on this primary motivation, including firms’ hopes at shaping future regulations, or improving relations with government and with other stakeholders, including consumers, investors, civil society and other firms in an industry (Khanna 2001).

The tendency of actors to respond to such external pressures has been elaborately theorized by neoinstitutional sociology (DiMaggio 1983; Oliver 1991; Suchman 1995). Institutionalism argues that actors are driven by the imperative for their behavior to appear legitimate, i.e. “desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions” (Suchman 1995). According to neoinstitutionalist theories, the institutional environments in which organizations and actors find themselves exert coercive, normative, and mimetic pressures that have an isomorphic effect, leading businesses

that operate in the same organization field to adopt similar structures and strategies (DiMaggio 1983). Importantly, neoinstitutionalism focuses on the spectrum of behavior that actors can adopt to attain legitimacy, recognizing that they can symbolically conform to institutional demands without making substantive changes (Meyer 1991). This also leads to the insight that actors can have varying levels of conformity (or cooperation) over time, which stands in contrast to the dichotomy of action – cooperate or not cooperate – hypothesized by the collective action theory discussed above (Delmas 2010). Consistent with this approach, regulation scholars speak of a firm’s “social license to operate,” the notion that industrial facilities must comply with the tacit expectations of regulators, local communities, and the public to continue operating, in other words, to maintain legitimacy (Kagan 2003; Kagan 2004; Thornton 2005).

There are plenty of examples of such institutional pressures in action: rechargeable battery manufactures formed a recycling corporation when faced with a regulatory threat of landfill bans and end-of-life take-back requirements (Toffel 2004); the pulp and paper industry association established a voluntary agreement with the United States Environmental Protection Agency when faced with more rigorous waste management standards (Delmas 2001); and electric utilities created the Climate Challenge in cooperation with the EPA to forestall new legislation related to climate change (Welch 2000).

Neoinstitutionalism also posits that, in addition to the constant pressures of an institutional environment that tend to substantiate and reinforce particular institutions and practices, rapid and dramatic change in an organizational field is particularly likely following some exogenous shock to the field, such as a major accident or other event that rapidly changes an industry’s self-image or its public perception (Hoffman 1999). It is in these moments that innovation by individual firms or productive inter-firm coordination, such as the creation of a self-regulating institution, is most likely to occur. This is confirmed by the historical experience across a wide variety of industries in the United States. This is clearly what happened among nuclear facilities’ executives in the United States following the Three Mile Island accident. These executives organized to create the Institute of Nuclear Power Operation, which develops standards, conducts inspections, and investigates accidents (Rees 1994). A similar pattern was followed in the oil industry following the Exxon Valdez spill, which led to the creation of the “Valdez principles,” eventually renamed the CERES Principles (Nash 1997). It is also evident in the creation of the Chemical Industry’s Responsible Care program, which emerged out of concerns by several different national chemical associations over the possibility of new national laws following the explosion of the Dow Chemical plant at Bhopal, India in 1984 (King and Lenox 2000).

Because the likelihood that firms perceive an imminent common sanction increases the more similar they consider themselves to be (Toffel 2009), and because the threat of multilateral action by governments is less likely (Vogel 2007), it stands to reason that such coordination on a global level would be less common. However, other institutional pressures have substituted for government inaction; where governments have failed to instill sufficient fear in industry, global coalitions of ever more sophisticated activists and non-governmental organizations increasingly have stepped-in proposing innovative, often multi-stakeholder solutions (Keck 1998). For example, the Forest Certification Council emerged directly out of the frustration by

environmental groups at what they considered to be the complete failure of governments at the 1992 Rio Earth Summit to conclude a binding international treaty on forestry issues. Similarly, the International Tropical Timber Organization developed to overcome objections by timber-exporting countries that more rigorous certification mechanisms would present non-tariff barriers to trade (Bartley 2003).

As international relations scholars Abbott and Snidal observe, firms have inherent advantages in the bargaining game over the whether a governance scheme is created and what form it takes: large firms in particular have a “first mover *preemption* advantage”; that is, because they are “directly involved in the production processes at issue,” they can “promulgate and (uniquely) implement standards through their internal management systems and other forms of operational capacity,” enabling them to “blunt political pressures and preempt alternative forms of regulation by adopting standards that are minimally sufficient” (Abbott 2009). Abbott and Snidal point out that many of the global self-regulating firm and industry codes of the 1980s-90s appear to have resulted from such a strategy, which, they note, has other benefits as well: preemption can “disarm NGOs and public advocates by undermining their case for external regulation, split moderate NGOs from more radical ones, and divert NGO attention to firms that have not adopted any standards—although there exists the countervailing possibility that preemptive action will raise a firm’s or industry’s prominence as a target for activists” (Abbott 2009).

The second common motivation for self-regulation derives from the problem of market inefficiencies caused by information asymmetries identified by George Akerlof’s classic study of the “market for lemons” (Akerlof, 1970). As Akerlof explained, if there is no credible way for outside observers to distinguish higher quality goods from lower quality ones, the lower quality “lemons” will eventually flood the high quality market, forcing out the higher quality goods. By creating institutions to bridge such information asymmetries, firms seek to stave off the threat of the market for lemons dominating the marketplace. The relative environmental impact or quality of a particular product or set of industrial practices are often hidden from end-users, who often want assurance as to the quality that is hidden from their direct experience, creating an information asymmetry (Potoski & Prakash, 2005). An institution can be created, however, to disseminate information about the goods, thus bridging this asymmetry.

It is important to note that significant differences between firms means that not all firms within a particular industry or field of action face the same pressures from external stakeholders or will benefit equally from changes to collective reputations. Some firms belong to a privileged group, the members of which experience reputational gains and losses disproportionately to non-privileged firms because of the scope of their businesses and what they have at stake in the rise and fall of the industry’s reputation (Olson 1965). Because of this heterogeneity and resulting disequilibrium, the privileged group members have extra incentives to improve the overall reputation of the industry (King and Lenox 2000; Potoski and Prakash 2005), which they might do by unilaterally forming a self-regulating institution (or governance “club”), through which greater control can be exerted over the industry’s shared reputation. By forming the governance club, the party with the more complete information (the producer of the good or service) attempts to signal the enhanced quality of its goods or services by making visible to the end user the

expenditures (e.g., formation of the club and the costs of membership) it has made that would have been rational to make only if it were in fact telling the truth about its products or services; in other words, these extra expenditures made would only be profitable to those firms that actually have higher quality products that will generate enough income to cover the expenses (Toffel 2009).

Insights from International Relations: The Power of Information and Reputation in Compliance

The effectiveness of global civil regulation is roughly comparable to “soft law” international treaties that rely on “naming and shaming” of non-compliant countries (Vogel 2009). Indeed, it is perhaps useful to draw explicit parallels between the literature on the self-regulation of private corporate actors in management studies, political science and environmental studies to the closely-related study of compliance with international law and international regimes by state actors, and more specifically, their compliance with “soft law” agreements (Abbott and Snidal 2000). As in the other disciplines grounded in strategic actor models, international relations scholarship has developed a theoretical paradigm that highlights the power of information to create focal points around which state actors can coordinate their behavior (Snidal 1985).

Building on previous work, a recent more elaborate and nuanced rational choice theory of international law argues that reputation can provide state-actors with an incentive to comply with international obligations even when other modes of securing compliance, such as reciprocity and sanctions, fail to do so (Guzman, 2008). Reputation is particularly helpful, according to Guzman, in understanding compliance with obligations relating to global public goods, such as the environment and human rights. Similar to the drive to self-regulation to fulfill information asymmetries, at the center of reputation-based compliance is information about various states’ behavior. The reputational theory of compliance is grounded in disclosure of information—if other actors do not know a state has not complied with its obligations they cannot negatively adjust their view of its reputation for compliance. Similarly, others have argued that in the absence of a global sovereign or a centralized enforcement authority capable of definitively determining legal rights, the true role of international courts, is not one of enforcement or sanctioning, but rather, of providing information that generates “focal points” around which state actors can coordinate their behavior (Lipson 1991; Ginsburg 2004; McAdams and Nadler 2005). This dynamic has been observed in processes of collective learning in soft law environmental regimes (Raustiala 2000), competition between neighboring or peer states seeking to improve their reputations as friendly to foreign direct investment (Guzman 2002) or credit-worthy in the eyes of multilateral financial institutions (Simmons 2000), as well as in transgovernmental governance networks, which operate chiefly through information sharing, collective learning and peer review processes (Slaughter 2001).

If information is the key ingredient for evaluating reputation and generating focal points, then uncertainty – the absence of information – also plays a central role in defining a state’s

potential reputational costs and benefits.³⁷ Uncertainty about legal norms or the actual current or future behavior of other states lowers the incentive to comply by reducing the costs of a violation: inferences about reputation become harder to make, which in turn lowers the reputational costs of a particular action, thereby tempting states to breach because the reputational sanctions are reduced (Guzman 2008). As Guzman notes, states can increase the flow of information through a variety of mechanisms, but the relationship between reputational costs and disclosure also creates a temptation to manipulate the information that is disclosed. The central role played by information, according to Guzman, explains “why states expend so much effort to influence the perceptions of other states and non-state actors, including through official denials (whether true or not) regarding their conduct, participation in debates about existing rules of international law, and claims about the stakes involved in decisions” (99). The more successful states are in their efforts, the lower the reputational consequences of a breach. This also explains the work of human rights and other NGOs, according to Guzman, whose reports on state conduct reduce the uncertainty around their compliance, thereby increasing the costs of violation. NGOs, accordingly, also cherish their credibility, since an organization perceived to be overly-partisan can lose credibility, thus devaluing the information they convey, which in turn impacts a suspected violating-state’s reputational costs less (thereby working against the NGO’s overall goal of generating greater compliance).

The Institutionalization of Self-Regulation

Closely related to the question of which dilemmas give rise to the emergence of self-regulating institutions is the question of how such institutions gain power—i.e., attract participants? Scholars have arrived at a variety of characteristics—both external and internal—that are associated with participation in self-regulating institutions of various kinds that track the insights of both neoinstitutionalist theories and the logic of collective action.

As noted, external pressures in an organization’s institutional environment, whether from government or other stakeholders, such as NGOs, are a significant driver of participation. Accordingly, empirical studies have found a statistically significant association between higher participation in voluntary environmental programs (government-sponsored initiatives) and heightened institutional pressures (Khanna 2001; Rivera 2006). But as suggested above, not all firms are affected equally by these pressures. Thus, studies indicate that larger, publicly traded firms that are more visible because of market share or brand name are also more likely to participate in self-regulatory programs (because they attract a greater share of the institutional pressures, be they regulatory or from other stakeholders) (Edelman 1990; King and Lenox 2000; Khanna 2001; Rivera 2006; Koehler 2007; Marx 2008). More nuance has been added by other research; for example, in the case of global forest certification, Cashore and others argue that NGO pressure alone cannot explain support for certification schemes since there is variation between companies in different countries; thus, country-specific factors, including place within

³⁷ The reputational costs of violating a particular commitment depend on “(1) the severity of the violation, (2) the reasons for the violation, (3) the extent to which other states know of the violation, and (4) the clarity of the commitment and the violation” (Guzman 2002).

the global economy, the structure of the domestic forestry sector and the history of forestry on the public agenda explain these differences (Cashore 2004).

Adverse Selection and Free-riding

Just as larger, more visible firms with larger market shares or involvement in a particular field of activity have increased incentives to create and join self-regulating institutions, so too do “dirtier firms”: they can gain knowledge of best practices from participation and also gain reputational “insurance.” That is, by joining, they can project a more legitimate public face than is deserved by their underlying practices, thereby forestalling criticism (King and Lenox 2000). This tendency is known as the problem of “adverse selection” (Lenox and Nash 2003) and is explained by the simple fact that, unlike Hardin’s commons, industry reputations are not common-pool resources. Once a firm “consumes” a positive (or negative) reputation by enjoying goodwill (or suffering negative treatment) from stakeholders who view the industry, and thus, the firm, in a good or bad light, the industry’s reputation can still be consumed by other firms, regardless of their actual individual compliance (Prakash and Potoski 2007). Thus, the set of rules or the institution devised to solve the initial commons problem related to resources or collective reputation can themselves be thought of as public goods with the attendant free-rider incentives (Toffel 2009). In other words, these “bad apples” can free-ride off of the reputational benefits conferred by participation in the self-regulating institution while “shirking” in their own implementation of its rules.

Existing Theories on Measuring Effectiveness

Recent work in political science has theorized on the nature and behavior of governance “clubs” and voluntary programs and has developed a framework for distinguishing the effective voluntary programs from the ineffective ones ((King and Lenox 2000; Prakash and Potoski 2006). These scholars define effective clubs as ones that are able to *induce participants to take progressive environmental action beyond what they would otherwise take unilaterally*. Furthermore, as David Vogel and others emphasize, “any realistic assessment of civil regulation should compare it not to an ideal world of effective global economic governance, but to actual policy alternatives”(Vogel 2007; Auld 2008). Indeed, others note that “one should not compare ‘imperfect’ voluntary clubs with a ‘perfect’ governmental regulation or vice versa. If we accept that all institutions can fail, the scholarly and policy challenge is to identify the conditions and institutions that lead to success and failure” (Prakash and Potoski 2007).

The challenge, however, lies in measuring program participants’ performance and by extension, programs’ overall effectiveness. “Effectiveness,” however, is a complex concept that requires further explication. Moreover, there are methodological challenges present here, as in most studies, in isolating the effects of the program from other causal factors. The latter challenge is discussed first below.

Ideally, to study the *effects* of a voluntary program on environmental or other performance, it would be hoped to somehow isolate the “program effects” as a variable: “measuring the impact of participation on an environmental outcome involves determining the change in that outcome that would not have occurred in the absence of the program” (Khanna

2009). It is not sufficient, however, simply to look at a before and after picture of program participants' environmental performance. First, firms are not randomly selected to participate in voluntary programs; rather, a firm chooses to participate based on various characteristics that (*inter alia*, size, market share, type and visibility of business, institutional pressures) that might explain both the decision to participate in a program and environmental outcomes (Khanna 2009). Accordingly, the decision to participate must be taken into account to isolate program effects by conducting a "with-and-without analysis," i.e., studying both participants and non-participants, in order to isolate the causal effect of a particular program (Khanna 2001; Khanna 2009). However, this also assumes that the various factors influencing the decision to participate and the environmental outcome are observable, which is not always the case (e.g., a manager's personal preferences for compliance) (Delmas 2009; Khanna 2009).

In pursuit of this experimental ideal, a great bulk of the literature on voluntary programs has defined effectiveness through a focus on *outcome metrics* (often reduction of pollution levels). However, the availability of public data, in part because many voluntary programs lack monitoring and reporting requirements (Koehler 2007) has limited empirical work to analyzing a few measures of performance (Khanna 2009) and also explains why so much of research into voluntary programs have focused on the question of participation (Koehler 2007).

The focus on outcome metrics in studies of domestic voluntary regulation has led to a rather dismal view of their effectiveness. Khanna and Keith (Khanna 2009)) present a review of eighteen studies of nine different types of voluntary programs, including "public voluntary programs," i.e. initiatives formally sponsored by the United States government (Global Climate Challenge, the 33/50 Program, Climate Wise and Strategic Goals), "industry associations," i.e., programs created by and for specific industries (Responsible Care, Sustainable Slopes), "third-party initiatives," namely those sponsored and run by independent organizations such as the International Standards Organization (ISO 9000 and 14001), and finally, "firm-structured initiatives," i.e., independent adoption of environmental management systems by individual firms (Khanna 2009)). The review concludes that public voluntary programs (government-sponsored programs) were found to be "largely ineffective, with the notable exception of the 33/50 program for some samples and sectors," and that industry association programs also did not appear to enhance the environmental performance of firms, while the third-party ISO program "has encouraged participants to improve their environmental performance relative to nonparticipants" (Khanna 2009). As Tashman notes, another study by Cashore and others found that effective forest certification accreditation programs tend to have third-party oversight, performance standards, and credible sanctions for firms that do not meet program objectives (Tashman 2010). A meta-analysis of both first party and third-party audited voluntary programs (Darnall 2008) noted that the most important conditions for effective strictly voluntary programs are (i) specific performance-based standards; (ii) periodic third-party audits of individual companies; and (iii) rewards that publicly recognize the performance obtained by each participants following third-party verification.

The availability and measurability of data is exacerbated in the case of global voluntary programs such as the Equator Principles. Unlike more conventional research into the effectiveness of a voluntary environmental program in reducing participating plants' pollution output, study of the impact of corporate codes like the EPs, which seek to produce less-

quantifiable outcomes, present measurement challenges for researchers, forcing investigators to identify proxy variables that are correlated or associated with the underlying variables of concern (Borck 2008). In other words, measuring levels of compliance with the EPs is inherently difficult because of the nature of the obligations imposed by the norms. Furthermore, many of the EP norms fall on the project sponsor to carry out, putting the bank in the position of doing due diligence to ensure that the sponsor has met its obligations.

More importantly, however, the purpose of the norms is to create an *approach* to project assessment—processes of review—that does not yield concrete results as much as it aims to achieve *non-results*, if done successfully, that is; if a bank does not demand compliance or lets certain of the borrower's obligations slide, this will *only* become a problem if the issue ignored or glossed over becomes a much bigger problem later on, which is far from a certainty and is contingent on many actors and factors beyond the bank's control. Moreover, many problems develop during the construction phase, putting borrower's environmental management plans to the test; should things go awry, this may or may not reflect any laxity in the quality of the bank's due diligence in reviewing the project, but rather, reinforces the inherent complexity of large infrastructure projects and the difficulties in constructing them without complications (Aizawa, 2007).

Indeed, in addition to the complex array of actors involved in eradicating “problem projects,” the vary dependent variable of “problem projects” is inherently unstable because of the competing perspectives of the actors engaged:

information on the positive impacts of the EP is scant and difficult to find. This is due to the fact that information in this area tends to be partial, sporadic and not necessarily representative of the full picture concerning a project; a “snapshot” in time rather than a balanced review of the impacts of the project (a sentiment with which we and others fully concur). Furthermore, certain projects tend to receive far more attention than others, perhaps due in part to the fact that NGOs tend to get involved in certain cases – and not others – because they have been requested to do so by movements and other organisations on the ground. This highly biased selection process means that many projects which perhaps ought to receive stakeholder attention avoid the spotlight whilst others remain permanently under its glare as coverage about it increases. . . . The focus of BankTrack, Greenpeace, Friends of the Earth, WWF, Human Rights Watch and the army of NGOs, often is the negative rather than the positive aspects of such projects, on bad news rather than good. In reality, one finds NGO opposition is often based upon political rather than social or environmental grounds (for instance, to developments such as dams and nuclear power stations). Consequently, it is therefore often difficult for the EPFI to satisfy such NGOs by adopting a particular social or environmental objective, given this underlying political agenda.

However, neither the EPFI nor sponsors help themselves in this regard. The approach of some NGOs in turning a blind eye to the positive impacts of the EP is reinforced by the EPFI which, except in the highest profile cases, evince a reluctance (no doubt, partly based on fears of legal or professional disciplinary

sanctions for breaching client confidentiality), to make transparent their dealings with clients in respect of the EP. The approaches adopted by NGOs and the EPFI are matched in some cases by an understandable reluctance on the part of some sponsors to discuss their projects openly with outsiders, even very high profile projects, where a candid exchange of views may have been more beneficial to all parties (Watchman 2007).

A perfect example is the San Antonio dam on the Amazon River which is currently under construction and is much-heralded for its mitigation of environmental and social risks. The dam will displace 1,400 families, which has raised the ire of an activist group, Movement of the Dam Affected, that has tried to spark protests among those targeted for displacement to no avail. One explanation offered for the lack of interest among the soon-to-be-displaced persons is that they currently often live in wooden shacks but the builders of the San Antonio dam are building new riverside communities for them that will include streetlights, and row homes with running water. These plans have caused some families in surrounding areas not targeted for resettlement to try to move into the targeted area in the hopes of benefitting from these new homes.³⁸

Moreover, the construction of large projects is rife with unintended consequences. For example, the local population of Porto Velho could supply only 30% of the 12,000 workers needed to construct San Antonio. In less well-managed dam constructions, outsiders or foreign workers would be brought in to supplement this shortfall, leading to a wide array of social problems. Anticipating this, the builders of San Antonio dam created a job-training program that has trained 20,000 people. Presently, around 80% of all workers are local, with some people's incomes rising from \$110 a month to close to \$750 monthly. Still, like any boom-town development, there are other unintended (although somewhat foreseeable) effects from large-project construction: upriver from San Antonio the French utility GDF Suez SA (one of the largest water companies in the world) is partnering with a Brazilian company to build another low-impact dam (there are 24 currently planned for the Amazon). On weekends, project workers head into the nearby town of Jaci Parana. This influx has converted Jaci Parana, an ordinarily sleepy place, into a violent center of prostitution. Whether this is a positive or negative development is likely dependent on who you ask.

Finally, an additional challenge posed by studying the EPs and corporations more generally is that, citing their legal fiduciary duties of client confidentiality, EPFIs and non-EPFIs are very guarded about their ESRM practices, particularly as they relate to specific projects and borrowers. This guardedness makes the study of "on the ground implementation"— i.e., outcomes, very difficult.

These limitations counsel towards a focus on *process metrics* (adoption of particular management practices within institutions). In addition to these practical realities, recent studies of voluntary programs have suggested that the focus on outcomes has perhaps been misplaced, risking missing their real impacts in three potential ways. First, by focusing on *rate or extent of environmental enhancement*, what is missed is that participation in the VEP maybe be a *post-*

³⁸ See Wall Street Journal, "Brazil is Getting New Dam," Thursday October 7, 2010, at A1, A20.

implementation decision (Darnall 2008). For example, there is empirical evidence in the case of ISO 14001 (King, Lenox & Terlaak 2006) and in the Environmental Protection Agency's 33/50 program (Khanna & Damon, 1999), that many participants implemented performance-improving environmental practices *prior* to the existence of the VEP, which suggests that firms may use participation in a voluntary program as a vehicle to capitalize on the reputational benefits of programs based on *previously implemented* improvements (King, Lenox & Terlaak, 2006). Thus, in some instances the traditional concern among neo-institutional theorists about a decoupling between substance and symbol may be compensated for by (re)coupling *after* the VEP is developed. Significantly, this is a benefit offered uniquely by the voluntary regime, since absent the regime these improvements could not be credibly communicated (Darnall and Sides 2008).

Second, the focus on *outcomes* may have overlooked evidence related to the importance of the socialization process initiated by the creation of a voluntary program that involves external peer and industry-wide forces that pressure program participants to self-regulate in order to gain or maintain a collective “green” reputation among their corporate peers, regulators, and other stakeholders, including consumers and civil society organizations (Darnall 2008). Scholars have theorized that the flexible structures of voluntary programs enable participants to foster collaborative relationships that promote shared learning and capacity development, building tools and knowledge that can contribute towards better environmental management in the long-term, which developments can evade short-term outcome driven analyses (Nicole Darnall 2005).

Indeed, in analyzing patterns of decoupling between structural commitments and concrete practices in States' acculturation of global human rights norms and practices, Ryan Goodman and Derek Jinks argue that all decoupling is not necessarily bad; some decoupling is problematic, some is benign and some can even be facilitative, and thus, when acculturation (i.e., norm diffusion) leads to a big implementation gap, the analysis does not end but rather, the real question to ask is whether this gap can be expected to narrow over time (Goodman 2008). According to Goodman and Jinks, in the context of State acculturation, there is substantial evidence that in many cases it would, but this will (in the case of States) depend on or be fueled by (1) domestic political opportunity structures (relative openness of institutionalized political system; stability of elite alignments supporting the polity; presence of elite allies for a given movement or issue; the state's capacity and propensity for repression, (2) the civilizing force of hypocrisy, i.e., internal and external audience effects, including consistency in public commitments; (3) escalating demands by global civil society; (4) evolutionary learning – all of which *might* have analogues in the particular industry contexts (p. 733-34) (Goodman 2008).

Third, and more significantly, Lyon and Maxwell (Lyon and Maxwell 2007) re-orient studies of voluntary programs to consider their *broader impact*, hypothesizing that if information on pollution abatement techniques diffuses to nonparticipants as well as participants, then the empirical studies evaluating public voluntary programs (PVPs) (i.e., those sponsored by governments) have arguably pursued empirical strategies that cannot possibly identify the true impact of these programs. If a public voluntary program is effective in disseminating information about pollution prevention throughout the manufacturing sector, then all firms would be reducing their emissions at roughly the same rate—which appears to be the case. There

would be no evidence that the program participants performed better than non-participants, even if the program was achieving meaningful goals (Lyon & Maxwell, 2007: 745).

Others argue similarly that to study the “new corporate social responsibility” requires an evolutionary perspective, as opposed to a static one because while a static definition may be easier to operationalize, “it can limit understanding of dynamic change within firms, the interaction of CSR choices with the broader public policy arena and organizational fields ... and the motivations for support (Auld 2008). These factors are the most important for understanding the sources of behavioral change/commitment and whether and how the CSR innovation might lead to direct change or to learning that ultimately is influential through other policy innovations and/or governmental processes.” Abbott and Snidal concur: they note that

In examining a highly political activity like regulation, effectiveness must be conceptualized broadly. Concrete means-ends effectiveness is crucial, although even that is complex: effectiveness may turn not only on material factors (e.g., resources), but also on subjective factors that influence legitimacy and public appeal. Effective regulatory institutions must balance the interest of stakeholders and instantiate prevailing norms. Finally, to advance the public interest, institutions must adopt structures and procedures that are open, transparent and fair.

It is difficult to assess effectiveness in any of these senses by measuring real-world impact: too many variables influence the outputs and effects of regulation, and the counterfactuals are too complex. We therefore ask what attributes, capacities, and skills—what inputs or “competencies”—an institution needs to operate successfully throughout the regulatory process. By identifying competencies that are *necessary* to effectiveness, we can conclude that schemes lacking one or more of those competencies are likely to be ineffective. However, the competencies we identify are not *sufficient*: a scheme that possess all of them might still be paralyzed by infighting, adopt an ineffective monitoring systems or otherwise fail (Abbott 2009).

Taking a cue from these theoretical insights, this study has proceeded from the perspective that any study of *effectiveness* must include data on the *various modalities* in which voluntary programs can be effective. Exclusive attention to *outcomes* risks failing to appreciate the full impact of a voluntary program on the relevant regulatory space. This study proposes that there are six distinct ways to measure a voluntary regime’s impact or effectiveness:

- (1) individual commitment in applying the standards of the regime;
- (2) outcome effectiveness;
- (3) utility of the regime as a mechanism for social learning among participants and non-participants;
- (4) external effects of the regime on the industry or sector (specifically on the practices of non-participating institutions);

(5) governance of the regime (transparency of process, etc)

(6) political legitimacy

Particular emphasis will be placed on demonstrating implementation of the EP norms through changes EPFIs have made in their policies, procedures and organizational structures related to environmental and social risk management (ESRM) also known in the industry as environmental and social governance (ESG), including the development of new procedures and institutional mechanisms, hiring new staff, and training existing staff. Although this data will not be easily standardized across the various institutions, general conclusions may still be drawn as to the extent and depth of adoption across various institutions.

Strong swords and weak swords

In light of these tendencies, much of the literature on self-regulation has in fact been quite skeptical of the power to combat free-riding and “shirking” absent some coercive mechanism, such as auditing, monitoring or sanctions (Grief 1997; King and Lenox 2000; Khanna 2001; Lenox and Nash 2003; Prakash and Potoski 2007; Khanna 2009). The challenge for industry clubs and self-regulating institutions, then, is one of maintaining credibility and legitimacy, to ensure that their industry-club brand name remains pure, i.e. that it not get diluted by “laggards” who join the club but fail to meet the standards of membership. The question becomes, then, what membership requirements and performance standards are necessary to ensure for program legitimacy?

Prakash and Potoski have created ideal types of programs based on combinations of possible “swords,” i.e., the teeth of a voluntary regime that could coerce compliance. These possible swords include third-party monitoring without public disclosure, third-party monitoring with public disclosure, and sanctioning by club administrators: “strong sword” programs, which impose all three possible forms of obligations on club members, “medium sword” programs, which require third-party auditing with public disclosure of results and “weak sword” programs, which require only third-party audits without public disclosures, but do not impose sanctions, and “no sword” programs, which lack all three components (Potoski & Prakash, 2005).³⁹

Initial scholarship on voluntary programs analyzed the implementation of the Responsible Care program in the U.S chemical industry. Responsible Care was perhaps the first truly global industry self-regulation regime, emerging in the 1990s following an earlier 1985 initiative launched as a response by the Canadian chemical industry to public concerns. Responsible Care is now managed by the International Council of Chemical Associations and is

³⁹ Elsewhere these scholars theorize that not all auditing and certification schemes are created equal; they come in at least four strains of credibility, ordered from least credible to most credible: first-party (self-certification), second-party (certified from a manager from a different unit of the same company, a different firm within the same industry, or certified by customers), third-party (certification by an external auditor but paid for by the company), and fourth-party (certification by external auditor not paid for by the company) (Potoski and Prakash 2005). There are virtually no examples of fourth-party certification, so best practice appears to be third-party. The authors also note that first- and second-party auditing are not considered credible.

accepted by domestic associations in 53 countries, where more than 90% of the world chemicals (in volume) are manufactured.⁴⁰ Responsible Care has ten guiding principles that participating institutions adopt towards the purpose of exceeding the legally required regulatory mandates in all aspects of health, safety and environmental protection. The early work on Responsible Care found that despite strong normative, mimetic and coercive pressures from within the Responsible Care regime and the broader chemical manufacturing communities, there was *little to no improvement* of environmental performance of participants in the program, which had no means of enforcement,⁴¹ leading to the conjecture that voluntary programs cannot succeed without some means of sanctioning members who are prone to shirk (King and Lenox 2000).

Later research by Prakash and Potoski argued however that even a relatively “weak sword” program, such as ISO 14001, which has only third-party monitoring *without* public disclosure of the audit information, may be enough to combat shirking by club members. They reason that the introduction of an outside observer changes team dynamics and improves performance of individual actors, and thus, even when there is no public disclosure, firm managers may be influenced by external audits because they wish to avoid “looking bad,” to other colleagues, particularly when outside observers are doing the evaluating (Potoski and Prakash 2005).

They found support for their hypothesis by comparing ISO 14001 – an environmental management system – with the chemical industry’s Responsible Care (as implemented by firms in the United States). Several salient differences between the two regimes suggested that ISO 14001 would not work as successfully as Responsible Care, i.e., there would be considerably more incentives and opportunities for firms to “shirk” in their implementation of ISO 14001 (Potoski and Prakash 2005). First, Responsible Care benefited from important normative, coercive and mimetic pressures that could potentially counter the incentives to shirk (King & Lenox, 2000). Noting that actors often have non-instrumental reasons for complying with law and are generally more prone to comply if they view the law in question as fair, they claim that firms may join and follow ISO 14001 because its goals resonate with firm cultural values (Potoski and Prakash 2005). However, because ISO 14001 is not sponsored by an industry association comprised of homogenous actors, they hypothesized that its participants would be less susceptible to norm-diffusive pressures. They further hypothesized that this might imply that homogenous actors within the same industry will on average be more susceptible to these pressures. Furthermore, unlike the American Chemistry Council, which managed Responsible care, ISO 14001 lacks the information to identify and shame shirkers because it does not require participants to submit compliance or audit reports. A final obstacle to robust compliance with ISO 14001 is that its standards are not as specific or detailed as Responsible Care’s, thus

⁴⁰ Responsible Care, “Who We Are,” “What We Do” at <http://www.responsiblecare.org> (last visited January 11, 2009).

⁴¹ As Prakash and Potoski note, ACC does not share this information with external stakeholders. Thus, Responsible Care has features “to reduce information asymmetries between the *association and participating firms*, but neither between *external stakeholders and program participants* nor between *external stakeholders and the association*.” Moreover, they point out that the ACC does not sanction non-compliance, thereby limiting the likelihood that its access to firms’ compliance information would mitigate shirking.

weakening its ability to serve as medium for diffusion of best practices that might be emulated through mimetic processes or isomorphism (Powell 1983). Given these constraints, Potoski and Prakash assumed that if they observed compliance with ISO 14001, that it was likely due to monitoring via the third-party audits that were conducted (Potoski and Prakash 2005).

According to Potoski and Prakash, the salient feature of the third-party audits in the ISO 14001 regime is that they place non-trivial costs on those seeking their certification. These audits can be very expensive, and the requirement for annual recertification mitigates in part what is lost by having the auditing be third-party as opposed to a more stringent monitoring and enforcement regime (i.e., one with public disclosure of audit information) (Potoski and Prakash 2005). The costs of the third-party audits, then, are this regime's "teeth." Thus, Potoski and Prakash conclude that it is clearly essential to any voluntary regime's success and legitimacy that membership exact *real costs* from members so that the decision to join the regime remains a meaningful signal that conveys useful information to external stakeholders about the commitments of the regime's members.

Given the reality of free-riding, there are a number of examples of governance clubs and self-regulating institutions whose architectures were forced to evolve over time to enhance their legitimacy either by raising the bar for membership or by demanding increasingly credible auditing and certification from members. For example, when it was first introduced, Responsible Care program appeared to have fallen prey to "adverse selection," with empirical studies of it concluding that in the period 1991-1996, members of Responsible Care were improving more slowly than non-members with respect to reduction of harmful toxic emissions, and while the environmental performance of the chemical industry as a whole improved following the inception of the program, absolute improvement among members was not any faster than that of non-members (King and Lenox 2000). Another development apparently emerged out of competition between two self-regulation regimes—the Fair Labor Association (FLA) and the Worker Rights Consortium (WRC). The FLA initially lacked well-developed mandatory standards or independent verification of compliance, but when the WRC was created to investigate and report labor code violations at particular factories, the FLA developed a mandatory third-party auditing system, which it implemented in 2003 (Auld 2008).

It is no doubt in part due to the possibility for such evolutionary trajectories that some scholars put emphasis on the importance of the social interactive process instantiated by self-regulating institutions. Their thinking in part is that a relatively weak sword program will draw in more participants with its low bar for performance, but that this same program may later evolve to have stronger swords. If it does, its larger captive audience brought in by the early weak swords may allow it to have a broader impact if and when its requirements for compliance are raised and subject to greater, more rigorous scrutiny.

With this theoretical background as foundation, the next chapter explores the origins, development and evolution of the Equator Principles. As I will show, the story of the development of the EPs fits neatly within the theoretical constructs above and many other examples of the institutionalization of self-regulation: NGOs targeted prominent actors with a history of funding controversial projects; as the pressure mounted, a few of these institutions—

who held disproportionate market share in the project finance market—reacted strategically to protect the industry’s reputation and to create a level playing field that would ensure that any steps towards enhanced environmental and social risk management these market leaders took would not cause them to lose market share to less socially responsible banks. This strategic pre-emption, it will be seen, also locked-in a seat for these banks at the global negotiating table for future discussions of the further development of standards and best practices not only for commercial banks, but for development institutions as well.

This loose collection of competitor institutions congealed overtime through the efforts of the leading banks, the International Financial Corporation, and their NGO interlocutors, and grew from a concentrated network of the largest most active banks in mainly developed countries in North America and Western Europe to a comprehensive global regime including banks from emerging markets on nearly every continent. The EPFIs have gone from fiercely independent institutions to a legalized governance Association with formal membership dues and responsibilities, but more importantly, with strategy committees focused on planning for future policy changes. After discussing this history, setting out the research design and reporting on the findings of my study regarding the EPs’ effectiveness, in Chapter 9 I revisit this question of institutionalization and evolution in attempt to take stock of whether the EPs have achieved “political legitimacy,” where how the regime might evolve in the future.

CHAPTER 2: THE ORIGINS OF A GOVERNANCE GAP – A HISTORY OF INFRASTRUCTURE PROJECTS AND THE RISE OF SUSTAINABLE DEVELOPMENT

The people of Gualeguaychú and Fray Bentos distinguished themselves in the scope and technical sophistication of their transnational advocacy, but the elemental struggles of against the pulp mills are not unique: for decades, all over the world, indigenous peoples and other communities have seen “mega-development” projects built in their backyards, most often without their consultation, let alone consent. The inherent financial risks of developing large-scale infrastructure projects have caused international interest in financing them to rise and fall with the unpredictable waves of global economic conditions of the last twenty years. But the demand-side has always remained steady and will in fact only increase dramatically in the future. Indeed, according to the World Bank, nearly 90% of population growth in the last few decades occurred in densely populated urban areas; these populations doubled from 1970 to 2000 (Bank 2006). It is predicted that this doubling will be doubled again by 2030 (Bank 2006). Developing countries’ rapidly obsolescing technology will be incapable of sufficiently handling this population boom, nor is there enough local capital to develop infrastructure internally, thus leading to a continued and ever increasing demand for foreign investment in infrastructure (Orr 2008).

But large-scale development does not come without costs, particularly externalities disproportionately suffered by local populations near the project sites. It is to mitigate these costs that concept of “sustainable development” was born. In 1987, the World Commission on Environment and Development (The Brundtland Commission) in its report, *Our Common Future*, defined sustainable development as “development that meets the needs of the present without comprising the ability of future generations to meet their own needs.”⁴² This simplistic definition is clear enough, but it obscures and oversimplifies the complicated history and internal contradictions of the concept of sustainable development. What is perhaps often overlooked is the central tension between the need of developing countries for economic growth and the simultaneous advancement of increasingly progressive approaches (through the development of international environmental law) to constraining the negative impacts of industrial development on the environment and society. This tension resides in the official title of the Brundtland Commission and the United Nations’ General Assembly’s reception of its report in General Assembly Resolution 187 of the Forty-Second Session (11 December 1987), which called for a conference in Brazil on the “environment *and* development.” This conference—what would become the Rio “Earth Summit”—was intended “to promote the further development of international environmental law, taking into account the Declaration of the UN Conference on the Human Environment, *as well as the special needs and concerns of the developing countries*” (Schrijver 2008). These special needs and concerns, according to Schrijver, were the worries that newly developing international environmental policy would create trade restrictions that would be prioritized over poverty reduction efforts (Schrijver 2008).

But as developing country governments have worried over the interference with trade by environmental law, citizens in the developing world and empathic civil society groups in the

⁴² Available at <http://www.worldinbalance.net/agreements/1987-brundtland.php>

“Global North” have focused their concerns on the externalities of large-scale development, giving rise to a transnational movement that has directed its ire towards the financiers of these projects, including the World Bank and other multilateral development institutions, as well as private commercial banks. This movement has helped midwife the creation in these institutions of new internal policies, procedures, and accountability mechanisms intended to limit the unintended harms of large-scale development.

Before exploring this history in greater detail, this chapter offers necessary background information about project finance as a financial practice as well as a brief tour through the history of its uses, signposting the trends in investment in infrastructure development by bilateral, multilateral and private funders over the second half of the twentieth century. It then explores the other history necessary to understanding the development of accountability mechanisms for large-scale infrastructure investment—the emergence and evolution of the bundle of norms comprising the idea of sustainable development. Finally, it focuses on the more recent developments in this quarter-century history: the evolution of accountability mechanisms in multilateral development institutions in the mid-to-late 1990s, and, ultimately, the spread of these concerns to the private sector with the establishment of the Equator Principles in 2003.

Understanding Project Finance

Project finance refers to either non-recourse or limited recourse loan structures used most often to fund the construction or enhancement of capital-intensive, typically infrastructure-related projects and facilities, in which the debt and equity invested in the project are repaid from the project’s own cash flow. This means that lenders to such projects base their credit appraisals of such loans on the projected success and revenues of the project itself, rather than on the assets or credit rating of the project sponsor (Buljevich 1999; Smith 2003).⁴³ Because of the complexity and often massive size of these endeavors, the project finance technique serves to

⁴³ The Equator Principles define project finance as it is defined by the Basel Committee on Banking Supervision:

a method of funding in which the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security for the exposure. This type of financing is usually for large, complex and expensive installations that might include, for example, power plants, chemical processing plants, mines, transportation infrastructure, environment, and telecommunications infrastructure. Project finance may take the form of financing of the construction of a new capital installation, or refinancing of an existing installation, with or without improvements. In such transactions, the lender is usually paid solely or almost exclusively out of the money generated by the contracts for the facility’s output, such as the electricity sold by a power plant. The borrower is usually an SPE (Special Purpose Entity) that is not permitted to perform any function other than developing, owning, and operating the installation. The consequence is that repayment depends primarily on the project’s cash flow and on the collateral value of the project’s assets.

Equator Principles Preamble, note 1 (quoting Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards (“Basel II”), November 2005), *available at* www.equator-principles.com (last visited November 20, 2010).

spread risk around in ways that are beneficial to both the borrower and the lender. This delicate balancing has led many to liken the structuring of these deals more to the creativity of art than the cold-calculation of financial balance sheets.⁴⁴

The primary distinguishing characteristic of contemporary project finance is what is alternately referred to as the special purpose entity, vehicle or corporation (SPE, SPV or SPC), which is an entity created by the sponsor/borrower to shield its own assets from lenders. The sponsor/borrower becomes the primary shareholder in the SPE by contributing equity, which is then combined with smaller shares of equity from other partners, including often a government entity, but none of the shares held is large enough so that the SPE could for legal or accounting purposes be considered a subsidiary of any of the partners in the joint venture. To these contributions of equity banks add debt financing in the form of syndicated loans. Often, because the financing is routed directly to the SPE, it does not even appear on the sponsor/borrower's balance sheets (giving rise to the name "off-balance sheet" projects). Because of this arrangement, the sponsor's credit rating, and thus future access to financial markets, is shielded from any negative project outcomes (Smith 2003).

The appeal of project finance for developing country governments and entities is readily understandable, as they often lack the capital to fund projects outright and also do not have sufficient credit-worthiness to support the levels of debt required to finance such projects. If they are considered credit-worthy, they usually do not want to carry the risks associated with such projects, particularly the exposure of their credit rating for future financing (Buljevich 1999). Typically, government entities participate to some degree in the SPE through profit-sharing agreements (PSAs), which divide the project revenues among the participants, with the costs of production usually paid-out before profits are shared (thereby limiting risk to the SPE even further). Under such arrangements, the government partner only risks seeing a reduction of its share of the future cash flow, which can only be threatened if the project's development costs increase unexpectedly.

The benefits to borrowers of project finance facilities or loans also flow from the fact that almost all loans for such projects are syndicated among a group of banks and arranged collectively into one large loan to the borrower, typically managed by a "lead arranger," which allows the borrower to raise much more capital than any single bank would be willing to lend at substantially lower cost and more efficiently than would otherwise be possible from multiple sources pursued individually (Smith 2003). Moreover, this structure means that the borrower has to enter the international loan market fewer times while its visibility is enhanced by the syndication, thus potentially improving future access to financing (Smith 2003).

The benefits to lenders in participating in syndicated loans to projects are also plentiful and mainly can be attributed to the strength and security of not operating in isolation. Lenders can better diversify their portfolios, they can have access to lending they could not have had access to on an individual basis, the risk of borrower default against a syndicated loan is lowered by the enhanced penalties to borrowers (namely, a limiting of access to the financial markets in

⁴⁴ See Arturo Olvera Vega, *Risk Allocation in Infrastructure Financing*, THE JOURNAL OF PROJECT FINANCE, Volume 3, No. 2 (Summer 1997), at 40.

the future), the legal protections offered by syndicates are more robust, and finally, participation in a syndicate offers banks quick access to enhanced expertise, market exposure, and market visibility without incurring unsavory risks (and without necessarily having such expertise or natural exposure individually) (Smith 2003).

Of course, the primary benefit to lenders is their fees. Commercial banks play three roles in relation to project finance: as advisors, as arrangers, and as lenders. As advisors, bankers structure deals over a course of anywhere from six months to two years or longer (the “mandate” process). Advisors receive a monthly fee and a percentage of the total invested capital that varies with the complexity and size of the deal. Arrangers work to raise capital for project deals in return for a fee that, like the advisor’s fee, is paid at the financial close of the project. Finally, as lenders, banks contribute capital to projects (Benjamin C. Esty 2005).

The Apportionment of Risks

As noted, project finance is a risky business. The size of most projects alone is enough to create inherent risks: in most industrial sectors, project investments can exceed \$1 billion (Sorge 2004). But the structure of project finance loans limits the risk of the project firm (the one actually building the project) to its own equity stake in the SPE (usually 20-40%), leaving the bulk of the risk (usually 60-80%) in the hands of the banks.

Risks (and cash flow) also vary considerably over the course of projects’ main phases – construction and operation. The construction phase sees most of the capital invested and also much of the more difficult to manage risk, but very little or no cash flow. At this stage, project sponsors face a variety of risks related to the technical aspects of completing the construction, including the environmental and social externalities produced, concerns over delays caused by various disruptions, either of raw materials or other productivity problems. Banks face several kinds of risk as well:

A common approach to sustainable development would help reduce three important risks. First, there is deal risk or the probability the deal will be delayed or terminated prior to financial close. There is a very large opportunity to cost to spending three years working on a deal rather than one or two years. And there is an even bigger cost if the deal never closes because it is stopped by local or international NGOs. Then there is credit risk. A poorly structured deal is more likely to default after financial close. Projects that harm the local environment or indigenous people can result in government action against the project or civil disorder, both of which can cause default. If sponsors follow bank policies for sensitive projects they might well enjoy faster implementations, avoid the specter of costly interruptions, delays, and retrenchments, and generate project revenue streams earlier. Finally, a common approach will also mitigate reputation risk, the risk that a bad project will damage the bank’s franchise value in a wide variety of other contexts quoted in (Benjamin C. Esty 2005), at 5.

A study of emerging market commercial banks conducted by the International Financial Corporation in 2005 confirmed these fears: ninety-four percent of the emerging market banks

surveyed perceived “disruption of operations” as a primary risk faced by their clients, and eighty-three percent were concerned about environmental legal issues clients could potentially face (IFC 2007). It was precisely this kind of risk that some of the banks adopting the Equator Principles had in mind when they sought to create an industry-wide approach to risk-mitigation.

Once construction is completed, project risk largely entails suffering fluctuations in the market for project outputs, or changes in the regulatory framework of the host country, from slight changes to the tax regime, labor or environmental laws to threats of expropriation (“political risk”) (Buljevich 1999; Smith 2003; Sorge 2004). One tool used to reduce political (also known as “sovereign risk”) is the involvement of official bilateral (e.g., export credit agencies or national banks) or multilateral sources (e.g., the World Bank or regional development banks). These institutions reduce uncertainty and risk in several ways, including by extending a “political umbrella” over the project by stabilizing the regulatory environment. They do this in various ways: by leveraging their political power, relationships and the carrot of future official development financing to the host country, offering project sponsors political risk insurance or other loan guarantees against certain political developments, or by direct participation in the loan syndicate (“co-financing”) (Smith 2003).⁴⁵

Given these varied and shifting sources of risk, a core component of project financing is identifying, quantifying and allocating risks in proportions that are acceptable to all participants. Often project sponsors hire banks in an advisory role to assist in this complex task, but the banks with sufficient experience and expertise to serve in this role is severely limited. The resulting concentration of highly competent banks is viewed by some with concern:

Relatively few financial institutions seem to have the necessary legal, accounting, tax, financial, and technical skills, either at their head offices or at strategically located regional offices, to become major players. When this constraint is combined with the need for large-scale financing in various maturities, the capability of effective syndicate leadership, and close sponsor contact, it is not surprising that the number of major participants is limited. As a result of the high barriers to entry, project financing has emerged as something of an oligopolistic market in that it is dominated by those few major banks with financial and technical resources and the experience and expertise to evaluate the risks and devise suitable financing packages. Because of their reputation and power in the market, the leadership in most project financings is likely to involve at least one of the major players. Other banks may rely on the 10 to 12 international banks that constitute the top tier in project financing, in the same way that smaller banks may look first to the lead arranger and then to the borrower in making a decision to participate in a loan syndication or in lending to a sovereign borrower. Such reliance, without adequate recourse, is clearly unhealthy and may well lead to a suboptimal allocation of financial resources in project financings worldwide (Smith 2003).

⁴⁵ With “co-financing,” the multilateral typically makes a loan for its own account (“A Loan”) and a loan for the commercial lenders (“B Loan”), thereby extending the “political umbrella” to the commercial lenders.

In the abstract, any market tending towards oligopoly should be viewed with considerable suspicion and dealt with cautiously. However, in the project finance sector these dynamics perhaps ironically provide for particularly useful conditions for the implementation of self-regulation and standards-coordination.

Balancing Growth and Sustainability

Before project finance became a widespread tool of the private banking world, it was the bread-and-butter of multilateral development policy and investment. The obsession with large-scale infrastructure all started in the mid-twentieth century with a new theory of economic growth (exogenous growth theory) developed by Robert Solow and T.W. Swann, which argued that the diminishing productivity returns of capital due to the obsolescence over time of technology and production processes leads economies eventually to reach a “steady state” wherein no new increase in capital will lead to more economic growth. To overcome or preempt this devolution to steady state, the model argued that countries should continue inventing new technology allowing for increased production with fewer resources (Solow 1956). Thus, starting with the Marshall Plan's reconstruction of Europe, conventional wisdom in development circles and particularly in the then newly-created International Bank for Reconstruction and Development (IBRD), the largest arm of the World Bank Group, considered investment in large-scale capital projects to be the foundation of economic development. Of course, if you are a bank, which it cannot be forgotten the World Bank is, then its very good if your core business is to make loans for colossal projects. In fact, the IBRD's first loan to fifteen third world countries was for big dam projects (Khagram 2004).⁴⁶

For a variety of reasons, the role of the World Bank is central to the history of sustainable project finance generally and to its development in the private sector. As a public institution with 187 Member States on its Board and with a development-focused agenda, it was the most natural source for investment in large-scale projects and, as a result, the most immediate target for the deep criticism of its work in this arena. Because of this development focus and concomitant vulnerability to civil society demands, the Bank has been, albeit reluctantly at times, at the *avant garde* in developing the standards and practices that have come to define sustainable project finance, even if these are not always implemented in practice. In addition, it has been the Bank's fluctuating appetite for funding such projects that created the vacuums in capital at various points in time that the private sector would seek to fill. Moreover, it was in part due to the Bank's advice and lending conditions that led many countries to privatize whole infrastructure sectors, generating even more room for private sector involvement.

The IBRD began financing large dams in the 1950s to the tune of over \$1 billion per year. The IBRD's involvement in infrastructure sectors grew slowly from 1970 to 1975 (from

⁴⁶ World Commission on Dams, "Dams and development: a new framework for decision-making" (2001), http://www.unep.org/dams/WCD/report/WCD_DAMS%20report.pdf. From roughly 1970 to 1985, the peak years of large dam construction, the average rose to \$2 billion per year, but was closer to \$4 billion globally when financing by the Asian, Inter-American, and African Development Banks, as well as bilateral funding for hydropower, is included.

\$1.5 billion to \$2 billion per year, or half of the Bank's balance sheet), before exploding in the period between 1975 and 1987, quadrupling to almost \$8.5 billion and remaining about half of its overall lending activity. This rapid increase can be attributed in part to the Bank's overall growth: between 1970 and 1985, thirty five countries joined the Bank, including many needing vast infrastructure investments, such as Bangladesh, Hungary, Mozambique, Papua New Guinea, Romania, and Zimbabwe. After hovering around 40 percent of the IBRD's activity until the late 1990s, the IBRD's involvement in infrastructure investment of all kinds declined sharply in the 1999-2003 period to \$5.7 billion per year, or less than 30% of total lending (an all-time-low).

The sharp decline of the mid-to-late 1990s was for a variety of mutually reinforcing reasons. First, the emergence in the 1990s of a global market for private infrastructure investment suggested that public institutions like the Bank would no longer be required to invest in this area. This global market for privately-funded project finance was spurred by three trends: privatization and deregulation of many industrial sectors all over the world and the continued globalization of financial markets (Sorge 2004; Esty 2007). Market reforms in developing countries led to the privatization of what traditionally were public sector industries, facilitated by harmonization of tax regimes and a lowering of restrictions on foreign capital, all of which created the conditions for long-term private capital flows to infrastructure projects, including power plants, roads, ports and telecommunication (Bank 2004). Multinational corporations and their financiers, large multinational banks from OECD countries responded to this demand by increasing the financing of infrastructure in developing countries by nine-fold between 1990 and 1997, with annual project finance volumes multiplying from less than \$5 billion to over \$50 billion (Bank 2004). During this period, nearly three-quarters of all commercial infrastructure financing in developing countries came from the United States, France, the United Kingdom, Germany, the Netherlands and Japan. Despite this increased participation, it is important to keep in perspective the fact that project finance investments typically represent only a small fraction (approximately 1% - 5%) of most bank financing activities (Banktrack 2007).⁴⁷

Multilateral and bilateral financing of private entities in developing countries also experienced dramatic growth during this period, nearly tripling from US\$ 9 billion to US\$25 billion (IFC 2002). A major contributor to these trends was the International Financial Corporation—the private lending arm of the World Bank Group—which during the 1990s accounted for nearly one-quarter of the total multilateral- and bilateral financing to private sector entities in developing countries.⁴⁸ By 1998, the IFC had committed more than \$23.9 billion of its funds and had arranged \$17 billion in syndications and underwriting for 2,067 companies in 134 developing countries (Corporation 1998). This contribution only continued to grow over time: in 2005, the IFC financed two hundred and thirty-six projects across sixty-seven

⁴⁷ According to Banktrack, in 2006 the global project finance market had a volume of only US\$ 181 billion, compared with US\$ 3,881 billion for the global syndicated loans market and US\$ 7,653 billion for the global bond and equity market, meaning that the EPs apply to no more than 1% of an average bank's financing activities. Nonetheless, project finance is relied upon is applied more frequently in some specific sectors than in others. For example, the electricity sector accounts for 32% of all project finance in 2006, the transport sector for 24%, oil & gas for 15% and petrochemicals for 11%.

⁴⁸ IFC (2002), *The Environmental and Social Challenges of Private Sector Projects*, International Finance Corporation, Washington D.C, 2002.

developing countries, amounting to \$5.4 billion in financing of IFC's own account.⁴⁹ Along with the IBRD's departure from the scene, this boom in private financing was mirrored by a drastic decline in other official sources of aid to governments, which dropped forty-percent between 1991 and 1997.

Another reason for the Bank's declining appetite for infrastructure investment was that it had endured fierce attacks in the early and mid-1990s against its image and reputation for its handling of several large-scale projects. Because the Bank's involvement in infrastructure development also had historically led to mixed-results in terms of poverty-reduction, the Bank simultaneously undertook some soul-searching, leading to a "strategic shift" in its philosophy and agenda that supposedly moved it from a focus on large capital projects to investment in institution-building, public administration, education, health and fighting corruption.

Though the Bank has expanded its focus on institution-building and corruption-fighting, its waning interest in large projects turned out to be only temporary. Only a few short years later, infrastructure was back on the Bank's agenda in 2003 as there had been a general decline in private investment following several unsuccessful experiments in the privatization of a number of industries (independent power producers in Indonesia, Pakistan and elsewhere, water privatizations in Bolivia, Tanzania and Philippines, toll roads in Latin America) and there had been a general shrinking of financial markets in the early 2000s following the East Asian financial crisis. Following this hiccup, however, investment in infrastructure was once again seen as enabling economic growth and poverty reduction, meaning that since 2003, the Bank's infrastructure lending has been gradually recovering and approaching the level of the 1987-98 period (Bank 2006), driven in part by a return to financing hydroelectric dams, such as the Bujagali dam in Uganda, Bumbuna in Sierra Leone, Felou in Senegal, Nam Theun 2 in Laos, and Rampur in India.⁵⁰ The Bank's financing of fossil fuel projects has also reached all-time highs.⁵¹

⁴⁹ IFC (2005), *Annual Report 2005*, International Finance Corporation, Washington D.C., 2005.

⁵⁰ The Bank in recent years has reevaluated its relationship to hydropower in particular. See Leslie Berliant, *World Bank Puts Hydropower Back Into Favor, NGOs Do Not*, SOLVE CLIMATE NEWS (July 31, 2009), available at <http://solveclimate.com/blog/20090731/world-bank-puts-hydropower-back-favor-ngos-do-not> (last visited November 28, 2010); see also World Bank, *Directions in Hydropower: Scaling up for Development*, WATER WORKING NOTES #21 (June 2009), available at http://www-wds.worldbank.org/external/default/WDSPContentServer/WDSP/IB/2009/06/22/000333038_20090622001502/Rend ered/PDF/490170NWP0Box31directionshydropower.pdf (last visited November 28, 2010).

⁵¹ Analysis published in April 2010 by the Bank Information Center (BIC) showed that the World Bank Group's finance for fossil fuels had surpassed all previous levels to \$4.7 billion in the first ten months of financial year 2010, representing a significant jump from the previous record of \$3.1 billion in the whole of FY2008. In particular, since FY2007, the Bank has provided \$6.5 billion for coal, largely to middle-income countries, which is the approximate amount it has committed to its Climate Investment Funds. The Bank explained in a progress report on its Strategic Framework for Development and Climate Change (SFDCC) that this increase in its share of fossil fuel investment (versus renewable or energy efficient investment) "is in large part due to the impact of the [financial] crisis on the ability of African countries to finance their conventional energy development programmes, necessitating WBG support to coal power projects in Botswana and South Africa." Critics argue, however, that this is a post-facto re-casting of pre-financial crisis commitments, and also note that apparent commitments to limit investment in fossil fuels are belied by other statements suggesting that coal will remain in the mix of the Bank's portfolio for some time into the future. These trends, critics argue, potentially undermine the Bank's attempts to transform its energy portfolio, half of which, according to the SFDCC's projected targets, would go to "low carbon"

Indeed, investment in large-scale infrastructure remains more popular than ever: in mid-2008, before the deepening of the global financial crisis, infrastructure spending was enjoying the “biggest boom in history” and the largest it had ever been relative to world Gross Domestic Product.⁵² When the financial crisis became more severe later that year, private investment funds for infrastructure dried-up, but sovereign spending escalated because infrastructure investment continues to be seen as a steroidal injection for weak economies. Already in November 2008, China’s State Council passed a \$586 billion stimulus plan aimed primarily at investment, the Obama administration’s economic stimulus plan of \$787 billion, passed several months later in February 2009, promising sweeping investments in energy, schools, housing and transport to provide, among other things, jobs (Flyvbjerg 2009). A similar Economic Recovery Plan based in infrastructure spending was initiated by the European Commission in November 2006 and approved by the European Council in December 2008.⁵³ In early 2011, the Obama administration revealed plans for a domestic Infrastructure Bank to support infrastructure development all over the United States.

Large-scale infrastructure remains big business in developing markets as well: India developed a \$475 billion infrastructure stimulus plan following the economic crisis and Brazil has plans to build 24 dams in the Amazon this decade at a cost of roughly \$100 billion. The nation already gets 80% of its power from dams but wants to boost its capacity by 60% by 2019 to keep-up with its economy, which is growing nearly as fast as China’s.⁵⁴ The dams will likely spur Brazil’s economy in other ways: canals included in their designs will open previously impassable rapids to barge traffic, enabling soybean farmers and loggers to bring their good to market.⁵⁵

Perhaps not coincidentally, it was not long after the era when large-scale projects became so prominent in developing economies (the early and mid-1970s) that developing countries began to re-fashion their collective bargaining power in the United Nations, and talk of a “New International Economic Order” (NIEO) first emerged (Bhagwati 1977).⁵⁶ In addition to aspiring to re-balance what were perceived as inequalities endemic to the international legal order, the developing states’ demands focused on establishing under international law their unfettered

investments by 2011. *See World Bank clings to fossil fuels, stumbles on clean energy Bretton Woods Project, 17 June 2010, update 71, at* www.brettonwoodsproject.org/art-566379 (last visited December 22, 2010).

⁵² *Economist*, 7 June 2008, at 80.

⁵³ *See* European Commission, A European Economic Recovery Plan (November 28, 2006), Comm 800 (2008), *at* http://ec.europa.eu/economy_finance/publications/publication13504_en.pdf (last visited December 18, 2010); The Council of the European Union, Presidency Conclusions (February 13, 2009) (announcing approval of Recovery Plan on 11 and 12 December 2008), *at* <http://register.consilium.europa.eu/pdf/en/08/st17/st17271-re01.en08.pdf> (last visited December 18, 2010).

⁵⁴ *Amazon is Getting a New Dam*, WALL STREET JOURNAL, A1,A20, October 7, 2010.

⁵⁵ *Id.*

⁵⁶ *See, e.g.,* Declaration on the Establishment of a New International Economic Order, UN Doc. GA res. 3201 (S-VI) (1 May 1974); Programme of Action on the Establishment of a New International Economic Order, UN Doc. GA res 3202 (S-VI) (1 May 1974). Both were adopted at a Special Session of the United Nations General Assembly following a proposal of 95 developing countries.

sovereignty over their own natural resources.⁵⁷ The momentum from the NIEO led eventually to the birth pangs of the international articulation of the concept of sustainable development (Schrijver 2008).

Origins of Sustainable Development and the Evolution of Environmental Impact Assessment

Some elements of what would later become core principles of the norm of sustainable development were put into place before the rise of the NIEO. The first of these is the concept of “free, prior and informed consent,” which has its earliest origins in medical ethics as interpreted by the United States Military Tribunal at Nuremberg in the *Doctor’s Trial*. There the court articulated the ten principles for research and experimentation to be carried out on human beings that came to be known as the “Nuremberg Code of 1947.”⁵⁸

A crucial development toward the implementation of the concept of “free, prior and informed consent” within the context of large-scale projects was the development of the practice of “environmental impact statements,” by a ground-breaking piece of legislation in the United States – the National Environmental Policy Act of 1969 (NEPA).⁵⁹ In NEPA, Congress “recognize[d] the profound impact of man’s activity on the interrelations of all components of the natural environment, particularly the profound influences of population growth, high-density urbanization, industrial expansion, resource exploitation, and new and expanding technological advances,” and the “critical importance of restoring and maintaining environmental quality to the overall welfare and development of man.” NEPA declared that it would be Federal policy to “use all practicable means and measures, including financial and technical assistance, in a manner calculated to foster and promote the general welfare, to create and maintain conditions under which man and nature can exist in productive harmony, and fulfill the social, economic, and other requirements of present and future generations of Americans.”⁶⁰ NEPA created a three-stage process whereby any action of the Federal government that would fall under NEPA would need to be assessed for its environmental impact. Significant to contemporary environmental and social risk management, a significant part of this process is the preparation of an Environmental Impact Statement (EIS). Indeed, NEPA is the ancestor of all contemporary environmental and social impact assessment practices: since its inception, impact assessment spread not only to the state level in the United States (so-called “little NEPAs,” such as California’s Environmental Quality Act (CEQA) of 1973), but also all over the world, initially to Canada (1973), Australia (1974), West Germany (1975), France (1976), and China (1979), and

⁵⁷ See generally Progressive Development of the Principles and Norms of International Law Relating to the New International Economic Order, Report of the Secretary-General, UN Doc. A/39/504/Add.1, 23 October 1984.

⁵⁸ See TRIALS OF WAR CRIMINALS BEFORE THE NUREMBERG MILITARY TRIBUNALS UNDER CONTROL COUNCIL LAW NO. 10. NUREMBERG, OCTOBER 1946–APRIL 1949 (WASHINGTON, D.C., UNITED STATES GOVERNMENT PRINTING OFFICE, 1949-1953) at 181; A U.S. circuit court recently ruled that informed consent to medical testing is a specific, universal, and obligatory legal norm, and is thus part of the “law of nations,” and accordingly actionable under the Alien Tort Statute. See *Abdullahi v. Pfizer, Inc.*, 562 F.3d 163 (2d Cir. 2009).

⁵⁹ P.L. 91-190 Stat., 83 Stat. 852 (January 1, 1970), codified as amended at 42 U.S.C. §§ 4321-47 (2006)) [hereinafter NEPA].

⁶⁰ 42 U.S.C. § 4331 (a).

later to post-Soviet bloc countries in the early-to-mid-1990s, as well as to Africa and South America so that by 1996, more than 100 countries had environmental impact assessments systems of some form (Wood 2003; Glasson 2005). Some countries, like the Philippines, adopted legislative language similar to Section 102(2)(c) of NEPA, while others, such as China, developed their own culturally and politically appropriate system (Vancley 1995).

Following quickly on the initial foundation laid by the Nuremberg Code and NEPA, the international articulation of the norms of sustainable development grew more explicitly out of the Declaration of the United Nations Conference on the Human Environment, adopted at Stockholm on 16 June 1972. This statement would later be amplified and clarified in the subsequent 1992 Rio Conference, which was attended by all 176 UN Member States and more than fifty intergovernmental organizations. The Rio Conference gave birth to a number of important developments, including the UN Framework Convention on Climate Change, the Convention on Biological Diversity, the start of negotiations on an Anti-Desertification Convention, a non-binding declaration on forests, and most significantly, the non-binding Rio Declaration on Environment and Development (the “Earth Charter”), consisting of twenty-seven principles, and Agenda 21, which consisted of an 800-page plan of action for the next century (Schrijver 2008).

The Rio Declaration’s most important principles, among others, were: Principle 1 (“Human beings are at the centre of concerns for sustainable development. They are entitled to a healthy and productive life in harmony with nature”); Principle 2, which enshrined sovereignty over natural resources (building upon the most important of the Stockholm Principles—Principle 21—with the addition of the words “and developmental,” a reflection of developing countries’ hopes that environmental policy would not obstruct development policy); Principle 3 (“The right to development must be fulfilled so as to equitably meet developmental and environmental needs of present and future generations”); Principles 4 to 7, which emphasized close co-ordination of development and environmental conservation with the necessity of an integrated approach⁶¹; Principle 10, establishing the norm of public participation and access to information; Principle 15, the “precautionary principle,” and Principle 17, calling for the installation of environmental impact assessment as a national instrument to be undertaken for “proposed activities that are likely to have a significant adverse impact on the environment and are subject to a decision of a competent national authority” (Schrijver 2008).

Riding on the coattails of the Rio Conference was the UN World Conference on Human Rights held in Vienna in 1993 to celebrate the 45th anniversary of the Universal Declaration of Human Rights – the founding document of international human rights law. Though many fractures along cultural lines (between the West and Asia and Islamic countries) emerged leading up to and during this conference. However, this did not prevent the conference from affirming the “right to development” that had been previously articulated in a 1986 UN General Assembly

⁶¹ In particular, Principle 4 states that “[i]n order to achieve sustainable development, environmental protection shall constitute an integral part of the development process and cannot be considered in isolation from it.” This concept is now seeing global implementation through the practice of Strategic Environmental Assessment, discussed below.

resolution (Schrijver 2008), drawing upon the normative force of existing human rights treaties.⁶² The Declaration on the Right to Development stated that

The right to development is an inalienable human right by virtue of which every person and all peoples are entitled to participate in, contribute to, and enjoy economic, social, cultural and political development, in which all human rights and fundamental freedoms can be fully realized.⁶³

The Vienna Conference reiterated this earlier statement in the Vienna Declaration and Programme of Action, adding in a mix of the sustainable development terminology espoused the year before in Rio:

The right to development as established in the Declaration on the Right to Development, as a universal and inalienable right and an integral part of fundamental human rights . . . should be fulfilled so as to meet equitably the developmental and environmental needs of present and future generations.⁶⁴

It is useful to focus on three of the Rio Declaration's principles—public participation in decision-making processes, the precautionary approach, and good governance—because these later become the most meaningful for grass roots opposition to large-scale development projects sponsored by the World Bank and other financial institutions.

The first principle, and arguably the most important, is public participation. Rio Principle 10 states:

Environmental issues are best handled with participation of all concerned citizens, at the relevant level. At the national level, each individual shall have appropriate access to information concerning the environment that is held by public authorities, including information on hazardous materials and activities in their communities, and the opportunity to participate in decision-making processes. States shall facilitate and encourage public awareness and participation by making

⁶² See Declaration on the Right to Development, UN Doc. A/RES/41/128 (4 December 1986), adopted with 146 votes for, one against (the United States) and 8 abstentions by other Western States. The 1948 Universal Declaration of Human Rights hints at a right to development in Articles 25-28, UN Doc. GA Res. 217A (III), (10 December 1948); The International Covenant on Social and Economic Rights, 16 December 1966, entered into force on 3 January 1976, 999 UNTS 3, 6 ILM 360 (1967) acknowledges in Article 11 that all people have a right to “a reasonable standard of living,” and its Article 1 (which it holds in common with the International Covenant on Civil and Political Rights, 16 December 1966, entered into force 23 March 1976, 999 UNTS 171, 6 ILM 368 (1967)), states that all peoples, based on the right to self-determination, should be able to “freely pursue their economic, social and cultural development,” and that “[i]n no case may a people be deprived of its own means of subsistence.” The African Charter on Human and Peoples' Rights, 27 June 1981, entered into force on 21 October 1986, 1520 UNTS 217, 21 ILM 59 (1982), explicitly recognizes the right to development.

⁶³ Declaration on the Right to Development, UN Doc. A/RES/41/128 (1986).

⁶⁴ Vienna Declaration and Programme of Action, adopted on 25 June 1993, UN Doc. A/CONF.157/23, 32 ILM 1661 (1993).

information widely available. Effective access to judicial and administrative proceedings, including redress and remedy, shall be provided.

Rio Principle 10 has its intellectual foundations in the concept of self-determination found in earlier international legal instruments, such as the International Labor Organization's Convention No. 169 On Indigenous and Tribal Peoples of 1989,⁶⁵ and is closely related to the concept of "free, prior and informed consent" (FPIC), which has been recognized in numerous international treaties and affirmed by their interpretive bodies, including the 1976 International Covenants on Human Rights and the International Covenant on Economic, Social and Cultural Rights,⁶⁶ the 1969 International Convention on the Elimination of Racial Discrimination,⁶⁷ the Inter-American

⁶⁵ Article 16 of the Convention states:

1. Subject to the following paragraphs of this Article, the peoples concerned shall not be removed from the lands which they occupy.

2. Where the relocation of these peoples is considered necessary as an exceptional measure, such relocation shall take place only with their free and informed consent. Where their consent cannot be obtained, such relocation shall take place only following appropriate procedures established by national laws and regulations, including public inquiries where appropriate, which provide the opportunity for effective representation of the peoples concerned.

3. Whenever possible, these peoples shall have the right to return to their traditional lands, as soon as the grounds for relocation cease to exist.

4. When such return is not possible, as determined by agreement or, in the absence of such agreement, through appropriate procedures, these peoples shall be provided in all possible cases with lands of quality and legal status at least equal to that of the lands previously occupied by them, suitable to provide for their present needs and future development. Where the peoples concerned express a preference for compensation in money or in kind, they shall be so compensated under appropriate guarantees.

5. Persons thus relocated shall be fully compensated for any resulting loss or injury. Convention on Indigenous and Tribal Peoples, at <http://www.ilo.org/ilolex/english/convdisp1.htm> (last visited December 15, 2010). The Convention has been ratified by 22 countries. See <http://www.ilo.org/ilolex/english/convdisp1.htm> (last visited December 15, 2010).

⁶⁶ The International Covenant on Civil and Political Rights (ICCPR) and the International Covenant on Economic, Social and Cultural Rights are binding treaties that acknowledge indigenous peoples' right to self-determination and to freely determine their political status, freely pursue their economic, social and cultural development, and freely dispose of their natural wealth and resources through opportunities to engage in consultations and to agree or reject proposals for development. In the submission regarding *Poma Poma v Peru*, the Human Rights Committee of the ICCPR held that Article 27 requires free, prior and informed consent for any minority group, including non-indigenous peoples, when the State acts in a way that that substantially compromises or interferes with a group's culturally significant economic activities. Human Rights Committee, para. 7.6-7.7. April 2009.

⁶⁷ The United Nations (UN) Committee on the Elimination of Racial Discrimination, which interprets the Convention, recommends that to fulfill their obligations under the Convention, States should "ensure that members of indigenous peoples have equal rights in respect of effective participation in public life and that no decisions directly relating to their rights and interests are taken without their informed consent." [cite]

Declaration on the Rights of Indigenous Peoples. Following the Rio Declaration, numerous other treaties and declarations also recognized the importance of participation by individuals and indigenous peoples in particular.⁶⁸ Subsequently, the World Commission on Dams made FPIC a foundation of its Strategic Priorities, and its importance was affirmed by the independent World Bank's Extractive Industries Review (see Chapter 4). Numerous international court decisions have also reaffirmed the importance of FPIC.⁶⁹ In addition, FPIC has been integrated into national legislation or recognized in national jurisprudence in numerous countries throughout the world, including in the Philippines, Australia, India, Colombia, Venezuela and Canada. Most recently, the United Nations Declaration on the Rights of Indigenous Peoples (2007) has explicitly affirmed this and related rights.⁷⁰ It should be clear that the concept enshrined in

⁶⁸ The principle of prior informed consent has received widespread support in relation to transboundary movements of hazardous waste and substances, and has been adopted in a range of instruments, including, *inter alia*, the Convention on the Control of Transboundary Movement of Hazardous Wastes and their Disposal (1989 Basel Convention) 28 ILM 657 (1989); the African, Caribbean and Pacific States-European Community: Fourth Lomé Convention (1989 Lomé Convention) 29 ILM 783 (1990); United Nations Convention to Combat Desertification in Those Countries Experiencing Serious Drought and/or Desertification, Particularly in Africa, arts. 4 & 5, Paris, 14 October 1994, entered into force 26 December 1996, 1954 UNTS 3; the Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade (Rotterdam) (1998 Chemicals Convention) 38 ILM 1 (1999); Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters, Aarhus, Denmark, 25 June 1998, entered into force on 30 October 2001, 2161 UNTS 447. See United Nations Economic Commission for Europe, <http://www.unece.org/env/pp/>. The Aarhus Convention contains three broad pillars – access to information, public participation and access to justice. See <http://www.unece.org/env/pp/contentofaarhus.htm>. In 2002, a compliance procedure was created, and in 2004, the Complaints Committee began receiving communications from NGOs alleging non-compliance with the Convention. <http://www.unece.org/env/pp/ccBackground.htm> (last visited December 21, 2010); Declaration on the Rights of Indigenous Peoples, G.A. Res. 61/295, at art. 32, U.N. Doc. A/RES/61/295 (Sept. 13, 2007); Rodolfo Stavenhagen, Report of the Special Rapporteur on the Situation of Human Rights and Fundamental Freedoms of Indigenous People, ¶ 66, submitted in accordance with Commission resolution 2001/65, U.N. Doc. E/CN.4/2003/90 (Jan. 21, 2003) (providing that “[f]ree, prior and informed consent is essential for the [protection of] human rights of indigenous peoples in relation to major development projects”).

⁶⁹ The Inter-American Court has developed considerable jurisprudence on FPIC, with several decisions stating that indigenous peoples' informed consent is required in relation to activities that affect their traditional territories. For instance, in the case of the *Saramaka People v. Suriname*, the Inter-American Court held that large-scale development projects that would have a major impact within an indigenous peoples' territory can only proceed with their free, prior and informed consent according to their customs and traditions. See *Case of the Saramaka People v. Suriname*, 2007 Inter-Am. Ct. H.R. (ser. C) No. 172, at ¶ 137 (Nov. 28, 2007); see also *Case of the Mayagna (Sumo) Community of Awas Tingni v. the Republic of Nicaragua*, Inter-Am. C.H.R., Series C, No. 79 (31 August 2001); *Case 11.140, Inter-Am. C.H.R., Report No. 75/02 (27 December 2002)*; *Case 12.053, Inter-Am. C.H.R., Preliminary Report No. 96/03 (24 October 2003)*; See also *Social and Economic Rights Action Center & the Center for Economic and Social Rights v. Nigeria*, Communication No. 155/96, African Commission on Human and People's Rights, (October 27, 2001) (holding that the Ogoni people of Nigeria had suffered violations of their rights under the African Charter on Human and Peoples' Rights, including their right to health (Article 16) and right to a general satisfactory environment favorable to development (Article 24), among others, resulting from the Nigerian government's failure to prevent pollution and ecological degradation related to oil infrastructure development. The Commission held further that Nigeria's failure to monitor oil activities and involve local communities in decisions violated the right of the Ogoni people to freely dispose of their wealth and natural resources (Article 21));

⁷⁰ G.A. Res. 61/295, U.N. Doc. A/RES/61/295, (13 Sept. 2007), Preamble, available at <http://www.un-documents.net/a61r295.htm> (last visited December 15, 2010); Six articles in the Declaration make explicit reference

Principle 10 of the Rio Declaration – public participation – has grown to be a backbone of sustainable development policies and procedures.

Despite these developments, however, it remains an open question whether the norm of FPIC has achieved the status of customary international law. To be considered custom, a rule must be “generally accepted as a rule of conduct,” which can only be demonstrated if state *practice* is consistent with the rule and states act according to the rule out of a sense of legal obligation, rather than out of a sense of moral or political compulsion.⁷¹ The two main obstacles to FPIC attaining the status of custom is that state practice of the rule is not nearly extensive enough, furthermore, in the places where it is applied to some degree, its application has not been consistent. The interpretation of what FPIC entails remains very much open to debate and further evolution, particularly between civil society, the World Bank, and the commercial banks studied here.⁷² In fact, it was one of the key elements of the IFC’s 2010-2011 review of its Performance Standards (which are discussed in Chapter 4).

to FPIC, although only two, Articles 10 (on forced relocation) and 29 (on hazardous waste storage), clearly prohibit any government action without the consent of the affected indigenous community. Article 32 states that indigenous people shall not be removed from their ancestral lands without their free, prior and informed consent and that States shall work to obtain FPIC before approving projects that affect indigenous peoples’ lands and resources. Article 10 states: “No relocation shall take place without the free, prior and informed consent of the indigenous peoples concerned and after agreement on just and fair compensation and, where possible, with the option of return.” The Declaration was adopted with 144 countries voting in its favor.

⁷¹ See American Law Institute. *Restatement of the Law, Third, the Foreign Relations Law of the United States*. St. Paul, Minn.: American Law Institute Publishers, 1987, §102(2) (“[c]ustomary international law results from a general and consistent practice of states followed by them from a sense of legal obligation”). As the Reporter’s Note explains, “[n]o definition of customary law has received universal agreement, but the essence of Subsection (2) has wide acceptance.” *Id.*, § 102, Reporter’s Notes, 2. The *Restatement’s* formulation is based on Article 38 of the Statute of the International Court of Justice. See *Statute of the International Court of Justice*. 3 Bevans 1179; 59 Stat. 1031; T.S. 993; 39 AJIL Supp. 215 (1945).

⁷² In its most recent Progress Report on its Review of its Performance Standards, which form the normative basis of the Equator Principles, the IFC stated the following about the variations between the UN-sponsored formulation of “free, prior and informed *consent*” and its own standard of “free, prior and informed *consultation* plus Broad Community Support,” which it essentially claims comes down to a matter of semantics:

For projects affecting Indigenous Peoples, IFC’s current Performance Standard 7 requires

the client to engage in a process of Free, Prior, and Informed Consultation (FPIConsultation) which leads to the informed participation of the affected community. This is similar to the World Bank’s practice, through Operational Policy 4.10. IFC also requires an elevated form of client consultation called Good Faith Negotiation (GFN) in addition to FPIConsultation where projects are to be located on traditional or customary lands under use by Indigenous Peoples. The principles of consultation has been challenged in recent years, with Indigenous Peoples and their advocates arguing that they should have a right to Free, Prior, and Informed Consent (FPIConsent) in development-related decision making. This principle has been endorsed by the UN and by some other multilateral development banks. IFC’s position is therefore perceived by some to be out of step with the international community. A review of standards and practices related to FPIConsent globally shows that it is functionally equivalent to FPIConsultation as implemented by IFC in terms of legitimacy of process with desired results. There is broad agreement that FPIConsent does not mean local veto power or consensus among all concerned stakeholders. There are both political and conceptual arguments for adopting the term

The second Rio Declaration norm, the precautionary approach, is found in Principle 15:

[i]n order to protect the environment, the precautionary approach shall be widely applied by States according to their capabilities. Where there are threats of serious or irreparable damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation.⁷³

As Schrijver observes, while in the absence of any authoritative pronouncement by an international judicial body it is unclear whether the precautionary principle/approach has matured into a norm of customary international law, there can be no doubt that the “basic ingredients” of the principle have “become part of the corpus of environmental treaty law, as attested to in the wide inclusion of the principle in various international agreements” (2008, 194-195). A prime example is the precautionary principle’s further evolution in 1991 in the United Nations Economic Commission for Europe’s (UNECE) Espoo Convention on Environmental Impact Assessment, which made environmental impact assessment obligatory for certain projects with transboundary effects (which now has forty-four State-Parties).⁷⁴ An additional Protocol on Strategic Environmental Assessment (the Kiev Protocol) was signed by thirty-five governments and the European Community in May 2003 in Kiev, Ukraine, entered into force on 11 July 2010, and currently has thirty-eight signatories and nineteen States Parties.⁷⁵ The precautionary principle has also made its way into the foundation of European Union law, enshrined in Article

“FPIConsent,” however, IFC is of the view that it needs to better understand how its practice should change if it were to implement the concept of FPIConsultation. The recommendation is therefore to retain the language of FPIConsultation and GFN, and continue to consult with internal and external stakeholders on this issue. A final decision on “consent” will be made by October 2010, before the next version of the Sustainability Framework is presented to CODE and subsequently to the Board of Directors for approval.

See International Financial Corporation, Progress Report on IFC’s Policy and Performance Standards on Social and Environmental Sustainability, and Policy on Disclosure of Information – Review and Update Process (April 14, 2010), pp. 10-11, at [http://www.ifc.org/ifcext/policyreview.nsf/AttachmentsByTitle/Phase2_CODEReport/\\$FILE/Compounded+CODE_Progress+Report+on+IFC's+Sustainability+Framework_Review+and+Update.pdf](http://www.ifc.org/ifcext/policyreview.nsf/AttachmentsByTitle/Phase2_CODEReport/$FILE/Compounded+CODE_Progress+Report+on+IFC's+Sustainability+Framework_Review+and+Update.pdf) (last visited December 22, 2010).

⁷³ Principle 15, Rio Declaration.

⁷⁴ Convention on Environmental Impact Assessment in a Transboundary Context, done at Espoo (Finland), on 25 February 1991.

⁷⁵ The United Nations Economic Council for Europe http://www.unece.org/press/pr2010/10env_p22e.htm Though negotiated by UNECE Member States and signed by European Ministers of Environment, the Kiev Protocol will be open for signature by all United Nations Member States following approval by States Parties to the Protocol in June 2011. The States Parties will at that time also undertake to define how Espoo Convention’s compliance mechanism, as overseen by its Implementation Committee compliance mechanism under the Espoo Convention, operated by its Implementation Committee, will be extended to review States’ compliance with the Protocol. Protocol on Strategic Environmental Assessment to the Convention on Environmental Impact Assessment in a Transboundary Context, UN Doc. ECE/MP.EIA/2003/2., Kiev, 21 May 2003, Entry into force, 11 July 2010, in accordance with article 24(1).

174(2) of the EC Treaty.⁷⁶ It has been elaborated upon further in the SEA Directive, which entered into force on 21 July 2001 after 20 years of discussion within the EU. As of 21 July 2004, all EU Member States had to incorporate the SEA Directive into their national legislation (Albrecht 2005).

Indeed, in the *Paper Pulp Mills case*, the International Court of Justice held that the practice of EIA “has gained so much acceptance among states that it may now be considered a requirement under general international law to undertake an environmental impact assessment where there is a risk that the proposed industrial activity may have a significant adverse impact in a transboundary context, in particular, on a shared resource,”⁷⁷ although it observed that general international law does not specify the scope and content of an EIA.⁷⁸ As is discussed below, impact assessment has also grown to become the centerpiece of all World Bank and privately financed infrastructure development, finding expression in the Bank’s Environmental and Social Safeguard Policies⁷⁹ and the IFC’s Performance Standards.⁸⁰

Other elements of the concept of sustainable development, as first articulated by the Rio Declaration, are also worth noting. The norm of “good governance” is enshrined in several of the Rio Declaration’s Principles, which effectively direct states to take primary responsibility for legislating for development and managing the impacts of development on the environment. For example, Principle 11 calls on states to “enact effective environmental legislation.” However, consistent with the above tension between global environmental concerns and the agenda of developing states not to be thwarted in their efforts for economic growth by overly restrictive environmental regulation, Principle 11 qualifies that “[e]nvironmental standards, management objectives and priorities should *reflect the environmental and development context to which they apply*. Standards applied by some countries *may be inappropriate and of unwarranted economic and social cost* to other countries, *in particular developing countries*.” Continuing with this theme, Principle 12 calls on states to cooperate to promote the policy preference of an “open international economic system” that is presumed to “lead to economic growth and sustainable development in all countries,” while simultaneously striving to “to better address the problems of environmental degradation.” Tied into this imperative is the prohibition against the adoption by

⁷⁶ Environmental law did not feature in the early efforts of European integration. It was not until 1971-1972 that the Commission announced that environmental protection as an important element of the European Communities. The precautionary principle and the principle of prevention were included in Article 174(2) of the EC Treaty, and the principle of sustainable development is found in Article 2 of the EC Treaty and Article 2 of the EU Treaty. Article 6 of the EC Treaty also establishes that environmental protection requirements have to be integrated into the definition and implementation of the Communities’ policies and activities. (Michael Schmidt 2005)

⁷⁷ *Pulp Mills on the River Uruguay (Arg. v. Uru.)*, ¶ 204 (Judgment of Apr. 20, 2010), available at <http://www.icj-cij.org/docket/files/135/15877.pdf> (last visited June 10, 2010).

⁷⁸ *Id.* ¶ 205. Indeed, there is wide variation in the capacity of developing countries and countries in transition to implement EIA regulations or guidelines even if they have adopted them, leading to uneven application or no application at all. (Glasson 2005), p. 292-296. Even in the United States, implementation of NEPA has been patchy (Vanclay 1995).

⁷⁹ See Operational Policy/Bank Policy 4.01, *Environmental Assessment* (January 1999) at <http://siteresources.worldbank.org/EXTOPMANUAL/Resources/EntireOpManualExternal.pdf?resourceurlname=EntireOpManualExternal.pdf> (last visited December 22, 2010).

⁸⁰ See Performance Standard 1: Social and Environmental Assessment and Management System.

states of trade policy measures “for environmental purposes” that in fact serve as a “means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade.” In addition, Principle 12 cautions that “[u]nilateral actions to deal with environmental challenges outside the jurisdiction of the importing country should be avoided.” Rather, Principle 12 calls for transboundary or global environmental problems to be addressed, “as far as possible,” by “international consensus.”

Finally, Principle 13 calls on states to “develop national law regarding liability and compensation for the victims of pollution and other environmental damage” and to “cooperate in an expeditious and more determined manner to develop further international law regarding liability and compensation for adverse effects of environmental damage caused by activities within their jurisdiction or control to areas beyond their jurisdiction.” It is in the implementation of Principle 13 that the international community and individual states have effectively abdicated responsibility, creating a vacuum of law and authority.

The latest evolution of the concept of sustainable development, and more particularly, the practice of impact assessment, is “strategic environmental assessment” (SEA). SEA expands impact assessment and widens its scope and application from project level inquiry to be incorporated into the national policy and program planning stages (Glasson 2005). SEA regulations have been implemented to varying degrees in the United States, EU Member States, New Zealand, Canada, and South Africa, and are frequently used in Hong Kong (Glasson 2005). The ascendance of SEA is evidenced further by its inclusion as one of the “targets” for the United Nations’ Millennium Development Goal 7 (“ensure environmental sustainability”).⁸¹

⁸¹ Target 7.A calls on countries to “integrate the principles of sustainable development into country *policies and programmes* and reverse the loss of environmental resources.” See Millennium Development Goals, at <http://www.un.org/millenniumgoals/envIRON.shtml> (last visited December 21, 2010).

CHAPTER 3: ARCHITECTURE OF A “GOVERNANCE GAP”

Despite the extensive history of the principles of sustainable development, the governance of the environmental and social impacts of large-scale infrastructure projects is woefully incomplete. The governance of these projects is in truth a subset of a much broader global governance gap, namely, the regulation of transnational corporations (TNCs). As one commentator describes the situation:

The problem of the multinational corporation has been at the centre of transnational policy discussion for the greater part of the last half-century. For the last decade, attempts to create a hard law and harmonized regulatory structures for multinational corporations have been effectively blocked by a great alliance of business and developed state interests. The most prominent among these failures has been the United Nations’ *Draft Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights* [].⁸² Moreover, attempts to stretch national law to bring the transnational activities of multinational corporations under the regulatory control of at least some states has been largely unsuccessful, except perhaps within the academic literature (Backer 2009).

This section surveys some of the components comprising the patchwork of regulatory forces that touch upon this domain of governance at the international and national levels. In doing so, it delves further into the challenges of implementing norms of sustainable development—particularly impact assessment—in both developed and developing country contexts. Before discussing the challenges of impact assessment, however, a brief tour is taken through the global legal regime relating to the regulation of foreign direct investment and TNCs.

The rise of the neoliberal foreign investment regime

To better understand the governance gaps that emerged in the past and still persist today, it is useful to briefly acknowledge an international legal regime that “almost was,” which is a reflection on the clash during the last quarter of the 20th century between international institutions and civil society. In the late 1990s, a new international agreement was in the works that sought to establish a new understanding on foreign direct investment (FDI), the key source for most development projects outside of multilateral funding institutions like the World Bank. Despite being a major driver of economic globalization, FDI, unlike cross-border trade (regulated first by GATT and now by the WTO), has never been subject to a comprehensive multilateral governance regime. In fact, international trade had been growing faster than world economic output in every decade after 1950, but FDI flows have been out-pacing trade flows on

⁸² The Draft Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights, E/CN.4/Sub.2/2003/12 (2003) were cut short in their development when the Human Rights Council voted to reject them. Following this process, the UN Secretary-General’s Special Representative for Business and Human Rights, Professor John Ruggie of Harvard’s Kennedy School of Government, was given a mandate to develop a new framework for understanding and addressing the human rights impacts of corporate actors. See discussion below.

average since the mid-1980s (Neumayer 1999). Despite the heavier traffic in investment flows, however, the scope and reach of supranational regulation of FDI has not kept pace with that of world trade, which in moving from the GATT to the WTO brought under its reach not only trade in services (as under GATT), but also “behind-the-border” regulatory areas previously thought to be beyond the review of intergovernmental institutions, including intellectual property rights, health and safety regulations, and technical standards (still other issues, including competition policy, foreign investment, labor and environmental standards were scheduled for future negotiation (Kahler 2009).

For decades, developed countries had long been the main source and recipient of FDI. However, developing countries in the 1980s entered into fierce competition to incentivize investment from multinational corporations, adopting policies that lowered previous barriers to FDI, thereby doubling their intake of FDI from twenty percent of global flows in the 1980s to forty percent in the 1990s. This dramatic change was also a natural byproduct of a dramatic global drop-off in official development assistance (ODA) from over sixty-four percent of developing country net resource flows in 1988 to only twenty-three percent in 1997 (Neumayer 1999). The domestic regulatory policy changes and incentivization was accompanied by an explosion in the negotiation of international investment agreements (IIAs), the total of which had grown to 1300 by 1996, 1000 entering into force after 1990 (UNCTAD 1998). Currently there are approximately 2600 IIAs in force; twenty-five percent of these IIAs are between developing countries.⁸³

Recognizing the growing importance of FDI flows and the nascent haphazard regime of thousands of bilateral treaties, the Council of Ministers of the Organization for Economic Cooperation and Development (OECD), an international organization of the then-twenty-five leading economies in the world, ordered a study on the feasibility of a multilateral framework on investment, which report received approval in 1994, leading to the start of negotiations between the Member States in 1995 to create a Draft Multilateral Agreement on Investment (MAI).⁸⁴ Though the OECD’s structure included a tri-partite consultation of state, employee and employer representatives, it had not yet found a way to incorporate NGOs into its consultative processes. This oversight became one of the Achilles heels of the MAI negotiations, which broke down in 1998 in part due to fierce opposition by international NGOs and labor unions, who were vehemently opposed to what they perceived to be the MAI’s attempt to solidify liberalization of

⁸³ UNCTAD, IIA Monitor No. 3 (2007), Recent Developments in International Investment Agreements (2006-June 2007), UNCTAD/WEB/ITE/IIA/2007/6, 21 January 2008, at http://www.unctad.org/en/docs/webiteia20076_en.pdf

⁸⁴ In February 2002, the OECD released a large archive of documents related to the MAI negotiation and drafting process. Though theoretically the increase in FDI flows and the emergence of a chaotic framework of uncoordinated BITs suggested the need for a comprehensive and systemic approach to regulating FDI flow, at the same time, it has been suggested that the increase in FDI flows in the absence of such a regime (and the empirical evidence that BITs *do not* influence FDI flow) challenges the actual need for such an agreement. See (Neumayer 1999). According to some, the Draft MAI was a continuation of an effort started already in 1988 to turn non-binding investment agreements into binding ones to “lock in the process of liberalization” (Tieleman 2000) p. 8, note 4.

foreign investment to the detriment of developing economies (Neumayer 1999; Tieleman 2000). The more crushing blow, however, came from the concerns expressed by the parliaments of various Member States, including Canada, the UK, and France (Neumayer 1999). A major concern raised by all critics of the MAI process was clearly legitimate: the OECD and the Member States had failed to conduct the negotiations with adequate transparency, and more importantly, because the negotiations were conducted under the auspices of the OECD, essentially a “club” of developed countries, developing countries and their constituents had been effectively denied a seat at the negotiating table (Neumayer 1999). Several years later, the WTO’s Doha round of negotiations originally was slated to include discussion of the relationship between trade and investment, but the July 2004 agreement did not address the issue (Kahler 2009).

The relatively quiet still birth of the MAI is a far less known event than the raucous “Battle in Seattle,” the confrontation that occurred at the World Trade Organization’s 1999 Ministerial meeting, which was overwhelmed by 50,000-100,000 activists who were pressing to make international trade more “fair.” Nevertheless, both have their place in the history of the larger tidal wave of global activism seeking to reform economic globalization and the international institutions undergirding it, which reached a high-water mark at the end of the twentieth century (Keohane 2003). The main thrust of the activist community’s complaints were both procedural and substantive. They focused on the lack of legitimacy of global institutions due to perceived procedural deficiencies—the “democracy deficits” and the lack of accountability and transparency in their governance structures and decision-making processes—and the alleged resulting effects of their policies in low and median-income countries (e.g., structural adjustment for IMF, labor issues, trade protectionism by developed countries at WTO). Indeed, a broad ideological shift occurred in the final years of the 20th century that reacted against the neoliberalism of the past two decades, both within national economies and on the global stage, making it safe to once again consider policies that sought to moderate the effects of market excesses (Robert O’Brien 2003). It is out of this zeitgeist of increasing demands for sustainability and accountability of global institutions that the dramatic changes occurred in the financing of large infrastructure projects by both public and private banks.

Intersection of Investment Regime and Host Country Regulation

With the MAI defeated, all that remained were the IIAs, which are aimed at facilitating investment between two or more countries by establishing predictable investment climates and enabling transnational recourse to investment arbitration when governments abridge their commitments. Concerns have arisen, however, over the imbalance of rights in the current investment treaty regime. Critics argue that investors protected by BITs are given the status of super-citizens, with multiple avenues of dispute resolution made available to them by the BITs, while citizens of host countries affected by investment have little to no recourse against the

impacts of these investments.⁸⁵ In fact, the early investment agreements did not have any references to social issues, such as labor, human rights or the environment; such references only began to appear in the 1990s (following the example of post-NAFTA U.S.-Canadian IIAs), but these references often do not create independently enforceable rights or obligations.⁸⁶ Mann

⁸⁵ A case in point is the dispute involving gold mining in El Salvador. Vancouver-based Pacific Rim claimed to have discovered gold deposits and submitted an application for a mining permit, but the conservative government of Antonio Saca rejected Pacific Rim's environmental impact statement and denied the permit. In March 2009, left-leaning Mauricio Funes came to power and also backed denial of the permits based on the analysis of external review of Pacific Rim's EIA conducted by an independent U.S.-based hydro-geologist and geochemist. Following this denial, Pacific Rim filed a claim under the Central American Free Trade Agreement to file an arbitration claim (through its U.S.-based subsidiary) at the International Center for the Settlement of Investment Disputes at the World Bank (ICSID). In its ICSID claim, Pacific Rim is seeking damages approaching \$100 million (which is almost double the amount of all U.S. foreign aid to El Salvador, where 34% of the population subsists on less than \$2 per day). The CAFTA claim exacerbated national conflicts over mining, leading to the death of a three anti-mining activists, including a woman who was eight months pregnant and holding a two-year old child when she was shot. President Funes condemned the murders and remained steadfast in denying the claims, stating that "[n]o one has convinced us that there are ways to extract minerals and metals, especially metals, without contaminating the environment and affecting public health." Because mining only contributes roughly 0.4% to El Salvador's GDP (and the proposed mine would have a project life of only six years), the industry has less traction and national governments, according to Oxfam, are "less justified in ignoring or overriding local communities' opposition to proposed mining projects." See Kevin Gallagher, *Stop private firms exploiting poor states*, Guardian, February 5, 2010.

According to Pacific Rim's counsel, however, Pacific Rim is "led by a group of geologists who are dedicated to 'green mining and sustainable development' and who searched all over for an appropriate site whose geology would allow for 'extremely clean, underground mining, with very limited surface disturbance and virtually no possibility of ground water contamination.'" Pacific Rim claims the proposed project would have "set new standards for environmentally clean gold mining in the Americas," and further, the project "would easily meet the regulatory requirements of any developed country where gold is mined (including, for example, Sweden, Canada, and the United States), while also bringing enormous economic benefits to an especially impoverished region of an already poor country." However, Pacific Rim alleges that the Government of Ecuador never ruled on its application for a mining permit, nor have the countries applicable environmental laws changed; rather, "in the midst of a difficult election campaign, then-President Saca – attempting to outflank his opposition on the left – announced that his Administration would not grant any more mining permits," which in Pacific Rim's view constitutes arbitrary treatment giving rise to violations of Ecuador's treaty obligations under CAFTA. See Alexandre de Gramont, "Mining for facts: PacRim Cayman LLC v. El Salvador," Columbia FDI Perspectives No. 29 (September 8, 2010), available at <http://www.vcc.columbia.edu/content/mining-facts-pacrim-cayman-llc-v-el-salvador> (last visited December 12, 2010).

⁸⁶ As Howard Mann observes, "one may take it as a given that the pre-1990 IIAs, about one third of the current total, will have no such references," while the majority of such references in post-1990 agreements come from in which the United States, Canada or some European country is one state party, whereas as "South-south agreements do not appear to have such provisions, or at least not in significant quantity." (Mann 2008). Mann notes only two post-1990 references regarding human rights: in the preambular paragraph of the European Free Trade-Singapore Agreement of 2002, and in Article 2.7.d of the COMESA Agreement (a regional agreement between Eastern and South African states), which lists human rights among other social issues, including (i) environmental impact and social impact assessments, (ii) labor standards, (iii) respect for human rights, (iv) conduct in conflict zones, (v) corruption (vi) subsidies, as matters over which the COMESA Council will have the capacity to make recommendations for the development of common minimum standards relating to investment areas. According to Mann, the COMESA clause represents the first time any investment agreement has expressly included human rights issues as a potential operative issue, though he notes that this mention falls short of explicit standards, it does link

notes that several US agreements impose more extensive labor obligations states parties, particularly regarding the right of association and unionization, and basic health and safety standards and that recognition of core labor standards is becoming more common (Mann 2008). Labor provisions have never been at the center of any investor-state disputes, but a few NAFTA tribunals have reviewed state application of environmental laws to foreign investments (Mann 2008). While it has been claimed that in promising to reduce the political risk of certain regulatory environments, BITs can restrict the power of host country governments to regulate for the public good in the areas of public health, the environment, and labor and human rights, but this fear has not been proven out by the jurisprudence: there have been few claims by foreign investors that have succeeded on the grounds that regulation passed for the purpose of promoting public health and safety is discriminatory to foreign investors.

More acute concerns have also been raised about another risk mitigation tool used in foreign direct investment—the proliferation of “stabilization clauses” in host country agreements (Bridgeman 2008). Stabilization clauses come in a few different varieties, varying in the extent to which they restrict host countries in their regulatory capacity vis-à-vis specific foreign investments and investors (Shemberg 2008).⁸⁷ The concerns over stabilization clauses came to a head with BP’s Baku-Tibilisi-Ceyhan (BTC) pipeline project, the contracts for which had, *inter alia*, severely constrained host governments from regulating the project with respect to human rights concerns and prohibited human rights claims in national courts by individuals affected by the project (Reyes 2006). Transnational activism against the project and the stabilization clauses in particular led BP to issue a “Human Rights Undertaking,” a set of amendments to its contracts to free the host governments (of Azerbaijan, Turkey and Georgia) from the restraints previously imposed by the host government agreements.⁸⁸

Beyond such special arrangements for foreign investors, there is generalized malaise in regulation of TNCs, particularly in developing states that are in the role of hosting the investment or business activities. These states may view regulation as “a trade-off against economic growth,” and otherwise may lack the “information, resources, and technical competence to manage complex regulation” of TNCs (Abbott 2009). Compounding the capacity issue and explicit legal restraints, the adequate enforcement of environmental and human rights standards in developing countries may be further constrained by corruption and market forces (Bridgeman 2008). Corruption has been highlighted as a major global issue, but particularly so in the context of extractive industries projects. These concerns gave rise to a global movement—Publish What

human rights to investment. See Art. 7.2, Investment Agreement for the COMESA Common Investment Area, 2007 (not yet in force), available at http://www.comesa.int/investment/regimes/investment_area/Folder.2007-11-06.4315/Multilanguage_content.2007-11-07.1023/en

⁸⁷ Freezing clauses “freeze” host state law with respect to the project over the course of its operation; Economic equilibrium clauses require the investor to comply with changes in the legal framework, but also require that the investor be compensated for the costs of compliance in the form of adjusted tariffs, extension of the concession, tax reductions, or monetary compensation; hybrid clauses share qualities of both of the other kinds and require the state to restore the investor to the same position it had prior to changes in law, including, as stated in the contract, by exemptions from new laws (Shemberg 2008)

⁸⁸ BTC Human Rights Undertaking, 22 September 2003, available at <http://subsites.bp.com/caspian/Human%20Rights%20Undertaking.pdf> (last visited November 6, 2010).

You Pay—and subsequently, a public-private governance regime (the Extractive Industries Transparency Initiative) involving 31 governments designed to reduce the negative impacts from undisclosed payments from companies to governments (Witness 2009).⁸⁹ A separate concern is the so-called “race to the bottom” of market competition between potential host country governments seeking to attract foreign investors; large multinational corporations can pit countries against one another by threatening to take business elsewhere if the investment regime is not to their liking, leading governments to forestall application of environmental and social standards if they perceive that multinationals would find these overly burdensome (Bridgeman 2008).⁹⁰ It also has been argued that governments may have adopted IIAs at unprecedented rates out of similar competitive impulses (Guzman 2006). Some countries in Latin America, including Bolivia, Venezuela and Ecuador, have since had second thoughts over the bargains they struck, as they started to face an unwanted number of investment claims, which led them to denounce the ICSID Convention.

The other potential source of regulation over transnational financial flows and the activities of TNCs is from home country regulations with extraterritorial reach (Backer 2008; Backer 2009). Perhaps the most heralded of such mechanisms is the United States’ 1789 Alien Tort Statute (ATS), which has been used to bring common law tort claims against TNCs for violations of the “law of nations” committed abroad. Arguably, this recourse has fallen far short of the initial promise it perhaps once held: of the dozens of cases brought since 1997, there have been no judgments handed down against corporations, and there have been only three settlements (of undisclosed amounts). In addition, the viability of this mechanism against corporate actors has perhaps now been all but completely foreclosed by recent decisions in the United States Court of Appeals for the Second Circuit.⁹¹ There has also been much discussion in the academic

⁸⁹ Incidentally, after celebrating a milestone with Azerbaijan becoming the first certified EITI Compliant country, the EITI had its legitimacy tested when its board faced a decision about whether to eject 18 countries who had not met a deadline to complete external verification of their progress in implementing the initiative. Certification entails third-party verification of implementation of the initiative through working with the private sector and civil society groups to produce regular, audited reports of payments to the government by oil, gas and mining companies, which data allows citizens to monitor payments. The EITI board rejected the option of granting a blanket extension to all countries and instead engaged in a case-by-case review to determine if the difficulties the countries faced in meeting the deadline were exceptional and unforeseen. It ultimately granted a six-month extension to 16 countries and resolved to eject two candidates for membership, Equatorial Guinea and Sao Tom and Principe. Publish What You Pay International, *Countries served notice by oil and mining transparency initiative* (16 April 2010), available at <http://www.publishwhatyoupay.org/en/resources/countries-served-notice-oil-and-mining-transparency-initiative> (last visited 9 October 2010); see also Global Witness, *Five Challenges for the EITI to Deliver*, Mar. 3, 2009.

⁹⁰ As Abbott and Snidal point out, the existence of a so-called “race to the bottom” is somewhat controversial; they note that this phrasing can encompass not only a competitive decrease in standards but also pressures preventing states from raising standards. See (Abbott and Snidal 2001), 352-352; (Abbott 2009), n.26.

⁹¹ See *Khulumani v. Barclay Nat’l Bank Ltd.*, 504 F.3d 254 (2nd Cir. 2008), *aff’d without op.*, *Am. Isuzu Motors, Inc. v. Ntsebeza*, 128 S. Ct. 2424 (2008) (recusal of four Justices left the Supreme Court without a quorum to grant certiorari). For discussion of the case’s import to ATCA litigation see Jonathan Drimmer, *The Aiding and Abetting Conundrum Under the Alien Tort Claims Act*, LexisNexis Expert Commentary, at <http://www.steptoe.com/assets/attachments/3492.pdf> (last visited December 21, 2010); see also *Kiobel v. Royal Dutch Petroleum Co.*, 621 F.3d 111 (2nd Cir. 2010) (determining that international law determines the scope of

literature in the United States and Europe regarding the challenges confronting the development of various civil remedies (Backer 2009). It is beyond the scope of this dissertation to address these efforts in greater detail, but suffice it to say that an effective mechanism for settling such disputes has yet to develop.

There have been strides made at the transnational level—the work of the OECD in its revision of its Guidelines for Multinational Enterprises (“OECD Guidelines”), and the work of the United Nations Secretary-General’s Special Representative for Business and Human Rights, but it remains to be seen what their true effect will be. The OECD Guidelines are perhaps the most prominent effort at transnational regulation of TNCs. They are a multilateral effort endorsed by all of the OECD Member States expressing their shared expectations of TNC conduct at home and abroad, but they are a “soft law” instrument and thus not legally binding on adopting countries. There is nonetheless an enforcement framework of national bodies called National Contact Points (NCPs) who receive complaints detailing alleged violations of the Guidelines by corporations based in Member States for conduct committed either at home or abroad. However, the NCPs on the whole have been much criticized for their purported “capture” by business interests, failures in due process and delays in processing complaints (Backer 2009). There is much anticipation that there could be dramatic improvements to the NCP system during the ongoing update of the Guidelines, which is scheduled to finish in mid-2011. Another initiative of the OECD Member States with direct applicability to project finance is the OECD’s Recommendation on Common Approaches on Environment and Officially Supported Export Credits, which was officially adopted by twenty-eight countries in 2001, revised substantially in 2003 and 2007, and is currently under further revision.⁹²

In addition to the OECD Guidelines’ update, the most intensive focus on transnational actors has been the work of the United Nations Secretary-General’s Special Representative on Business and Human Rights, Professor John Ruggie, who has worked steadfastly for several years (2005-2011) to develop a new framework for addressing corporate human rights impacts. He developed a framework called “Protect, Respect and Remedy,” that simultaneously points to the obligations and responsibilities of states and corporate actors vis-à-vis corporate conduct with human rights impacts.⁹³ As noted above, this new framework places considerable faith in the

liability under the ATCA and concluding that “the relatively few international treaties that impose particular obligations on corporations do not establish corporate liability as a “specific, universal, and obligatory” norm of customary international law,” and while those treaties “suggest a trend towards imposing corporate liability in *some special* contexts, no trend is detectable outside such narrow applications in specialized treaties, and there is nothing to demonstrate that corporate liability has yet been recognized as a norm of the customary international law of human rights”).

⁹² See generally OECD, Trade and Agricultural Directorate, “About Environment and Export Credits,” at http://www.oecd.org/departement/0,3355,en_2649_34181_1_1_1_1_1,00.html (last visited December 17, 2010). The Common Approaches have been severely criticized by NGOs in their various iterations. See generally Letter to OECD from OECDWatch and Amnesty International regarding Review of the Common Approaches, January 12, 2010, available at <http://www.halifaxinitiative.org/content/letter-oecd-eca-watch-and-amnesty-international-re-review-common-approaches-january-12-2010> (last visited December 17, 2010).

⁹³ See Draft Guiding Principles for the Implementation of the United Nations ‘Protect, Respect and Remedy Framework’, available at <http://www.reports-and-materials.org/Ruggie-UN-draft-Guiding-Principles-22-Nov-2010.pdf> (last visited December 17, 2010).

power of global private regulation to contribute to creating accountability for corporate human rights abuses.

Transnational and Home Country Regulation of the Financial Sector

There is a form of transnational governance relating to banking, but it does not address environmental and social impacts of bank investments, only the adequacy of capital reserves. The Basel Committee on Banking Supervision at the Bank for International Settlements (BIS) was created in 1930 to assist with the enforcement of German interwar reparations payments and then reinvented itself several times as a locus of central banker dialogues (Kahler 2009). NGOs have pushed for the Basel Committee to enhance its mandate to cover non-financial issues, specifically to integrate sustainability requirements into its capital directives, but this plea thus far has fallen on deaf ears.⁹⁴ In lieu of more concrete coordination on these issues in transnational regulatory networks, the United Nations has sponsored several initiatives with direct applicability to the financial sector, including the UNEP Financial Initiative and the Principles for Responsible Investment. Of course, the UN Global Compact and the Global Reporting Initiative are as directly applicable to financial institutions as they are to other transnational corporate entities. The Carbon Disclosure Project is also of relevance.

There are other fits and starts at enhanced oversight of the financial sector. The European Commission's Sixth Environment Action Programme identified the main challenge facing regulation of the financial services industry in particular as one of disclosure:

The financial sector's lending and investment activities have significant indirect environmental impacts by determining which companies and activities have access to finance and the conditions attached. Facilitating disclosure of relevant information by the financial sector and companies could create an incentive for "greener" behaviour The Commission will work to help the financial sector by encouraging the systematic incorporation of environmental cost elements into financial reports (Richardson 2005).

As Richardson notes, several countries have passed legislation since 2000 requiring pension funds to disclose their policies on environmental, social and ethical considerations, including Australia, Austria, Belgium, France, Germany, Spain and the United Kingdom (Richardson 2005). In addition, the European Commission in 2001 extend its Eco-Label Regulation and Eco-Management and Audit Scheme to the financial sector (Richardson 2005). More radical

⁹⁴Banktrack, *Submission to the Basel Committee – Comments on the documents: "Strengthening the resilience of the banking sector" and "International framework for liquidity risk measurement, standards and monitoring,"* (originally submitted to the European Commission as contribution to the EU Capital Requirements Directive consultation) (2010), available at http://www.banktrack.org/download/submission_to_the_basel_committee/100415_submission_to_the_basel_committee.pdf (last visited December 15, 2010). According to Banktrack, sustainability concerns are directly correlated with financial risks and the overall stability of the financial system and society at large and they should therefore be extended beyond their most obvious application in project finance to other forms of financing.

legislative schemes, such as a proposed amendment to include sustainable development as one of the main aspects of the British financial regulator's mandate, have not received enough support (Richardson 2005).

Furthermore, while numerous voluntary initiatives have emerged over the years, these have been largely aspirational commitments or policy-discussion forums with little to no concrete implementation mechanisms (Richardson 2005).⁹⁵ In this same time period, national regulation of financiers also regressed, rather than progressed in the United States. In 1996, in response to court judgments (*United States v. Fleet Factors* (11th Cir, 1990)) assessing liability the United States banking industry lobbied the 104th Congress to reign in funder liability flowing from suits for the clean-up of contaminated Superfund sites under CERCLA while the mutual fund industry fought off regulations that sought to force disclosure of how mutual funds vote as shareholders (Richardson 2008).⁹⁶ The Dodd-Frank Wall Street Reform and Consumer Protection Act passed by the United States Congress in 2010 created a range of new regulatory demands on the financial sector, including mandatory reporting by U.S.-extractive companies of payments to foreign governments, but the Securities Exchange Commission, the regulator responsible for monitoring such disclosures, has yet to publish its implementing instructions, so it remains to be seen how rigorously this will be enforced.⁹⁷

⁹⁵ The most well-known of these are the Wolfsberg Principles (2000) and the London Principles of Sustainable Finance (2002). The Wolfsberg Principles were developed by an association of eleven global banks formed in 2000 at the Château Wolfsberg in Switzerland. The association aims to develop industry standards and related products for “Know Your Customer, Anti-Money Laundering and Counter Terrorist Financing policies.” See *The Wolfsberg Principles*, available at <http://www.wolfsberg-principles.com/index.html> (last visited November 12, 2010); see also Mark Pieth and Gemma Aiolfi, *The Private Sector Becomes Active: The Wolfsberg Process*, available at <http://www.wolfsberg-principles.com/pdf/Wolfsberg-Process.pdf> (last visited November 12, 2010). The London Principles created by the Corporation of London to advocate measures to improve financiers' engagement with environmental and social issues. See, *Financing the Future* - http://www.cityoflondon.gov.uk/NR/rdonlyres/13F2434D-2209-4836-AEE3-D5C2E6A5F75E/0/SUS_financingfuture.pdf (last visited December 15, 2010).

Other initiatives of less renown include the Environmental Bankers Association, a trade association established in 1994 in the United States to represent the financial services industry (“including including bank and non-bank financial institutions, insurers, asset management firms and those who provide services to them”) in response to “heightened sensitivity to environmental risk issues, and the need for environmental risk management, sustainable development, and due diligence policies and procedures in financial institutions.” The EBA meets bi-annually “to promote the exchange of environmental risk management and sustainable development lending information and technical expertise” as well as to provide networking opportunities. See The Environmental Bankers Association, “About,” at <http://www.envirobank.org/about.php> (last visited December 15, 2010). A similar organization, the *Verein für Umweltmanagement in Banken, Sparkassen und Versicherungen* (Association for Environmental Management in Banks, Savings Banks and Insurance Companies) facilitates information exchange and dialogue among financial entities in Germany. See <http://www.vfu.de> (last visited December 15, 2010).

⁹⁶ See Asset Conservation, Lender Liability and Deposit Insurance Protection Act of 1996, Pub. L. No. 104-208, 110 Stat. 3009. Also relevant are the Financial Accounting Standards Board (FASB) Interpretation No. 47 – Accounting for Conditional Asset Retirement Obligations (2005). The FASB was designated by the Securities and Exchange Commission in 1973 to develop accounting standards for publicly listed companies in the United States. Interpretation No. 47 requires US companies to account for the future decommissioning or “retirement” costs of their assets as soon as they have enough information to reasonably estimate that cost (Watchman 2007).

⁹⁷ See § 1504 – Disclosure of Payments by Resource Extraction Issuers.

Project-sponsor and other actor initiatives

There have also been self-regulatory developments in industries directly related to project finance, but these have not gone beyond the articulation of codes and principles. For example, the mining and metals industry has adopted several voluntary codes of conduct. Fourteen of the largest mining and metal companies and twenty-four national mining and global commodities associations formed The International Council on Mining and Metals (ICMM) in 2001, which called upon its members to integrate sustainable development principles into company policies and practices. That same year, the Mineral Policy Center created the Guidelines on Responsible Mining. In the following year, The International Cyanide Management Institute developed the International Cyanide Management Code and The Mining, Minerals, and the Sustainable Development project created the Guidelines on Sustainable Development and Mining (Langdon 2007). A related transnational public-private scheme is the Voluntary Principles on Security and Human Rights, which are six voluntary principles developed in 2000 by the governments of the United States, the United Kingdom, the Netherlands and Norway in cooperation with several NGOs and extractive and energy companies with the aim of providing companies with guidance on how to maintain the safety and security of their operations in a way that respects human rights.⁹⁸

Similarly, the hydropower industry's association very recently published its recommended final draft Hydropower Sustainability Assessment Protocol (IHA Protocol) a sustainability assessment framework.⁹⁹ The Banktrack network of NGOs has severely criticized this framework, however, on procedural and substantive grounds. Banktrack notes that the document was created in an exclusionary process without the input of dam-affected populations or NGOs based in developing countries. Banktrack claims that the draft Protocol fails to define "any minimal requirements of sustainability or a bottom-line of acceptability for hydropower projects," fails to require "respect for human rights, international conventions and national laws," and in general, "falls behind relevant social and environmental standards which international organizations have adopted and governments have committed to."¹⁰⁰ As Banktrack notes, none of the institutions that were part of the Forum that developed the Protocol have yet to endorse it publicly.

The above discussion hopefully illustrates the gaps in the global regulatory environment related to TNCS, FDI and the financial sector in particular. It should be clear that the combination of schemes described cannot and does not sufficiently govern the myriad problems connected with FDI and TNCs and leaves much room for improvement.

⁹⁸ See www.voluntaryprinciples.org/principles/index.php.

⁹⁹ See IHA, at http://www.hydropower.org/sustainable_hydropower/IHA_Sustainability_Assessment_Protocol.html (last visited December 23, 2010).

¹⁰⁰ Banktrack, *Voluntary approach will not resolve dam conflicts – A Critique of the International Hydropower Association's New Assessment Protocol* (October 2010), available at http://www.banktrack.org/download/voluntary_approach_will_not_resolve_dam_conflicts/101106_voluntary_approach_will_not_resolve_dam_conflicts.pdf; see also Peter Bosshard, *The dam industry, the World Commission on Dams and the HSAF Process*, *Water Alternatives* 3(2): 58-70 (2010).

The tensions within national regulation of environmental and social impacts

A particularly challenging aspect of large-scale infrastructure development is that it is often undertaken as part of national growth strategies for the supposed benefit of an entire country, but the project must be located somewhere, and inevitably, that somewhere is in someone's backyard. This problem is not new. During the eighteenth century, the central governments of both France and the United Kingdom sought to increase agricultural production to keep pace with population growth. The strategy pursued in both countries was to extend the amount of land under cultivation through the draining and reclaiming of low-lying areas (and through irrigation projects in France) (Kagan 2001). However, the regulatory frameworks governing these processes could not have been more different. In contrast to the United Kingdom, where property rights and legal rules for compensating dispossessed landowners were relatively clear and were enforced fairly consistently by the King's Bench (judges trained centrally in London and financed by the monarchy), the situation in France was nothing short of a disaster, as Kagan recounts from Jean-Laurent Rosenthal's *The Fruits of Revolution* (1992):

In France local opponents of irrigation and reclamation projects repeatedly brought lawsuits against the developers who had been chartered by the royal government. Litigation over each project typically lasted for years. Judges had to slog through a confusing legal tangle of ill-defined feudal property rights, local privileges, and easements. Project opponents who lost in one court often appealed to another, extending the litigation until the developer simply gave up. When the royal government in Paris sought to replace the lengthy proceedings with a streamlined administrative process, a fragmented welter of politically entrenched local courts, church authorities, nobles, and local governments managed to block the reforms (Kagan 2001).

As Kagan explains, it was not until the French Revolution established the legal and political primacy of the National Assembly that progress was made. The National Assembly created a central bureaucracy that was hierarchically organized, systematized property laws, and took over the finance and supervision of the judiciary (which became highly deferential to the bureaucracy and national legislature on policy matters). In addition, local village councils voted on proposed draining projects and disputes were sent to specialized administrative offices (Kagan 2001). As Kagan notes, while the French Revolution sought to centralize political authority, the American Revolution sought the opposite: to limit the power of the distant federal government. The federal and state constitutions achieved this by granting a significant degree of power to democratically elected local governments, by guaranteeing individual property rights and other individual protections against governmental power, and by fortifying judicial power to enforce these rights (208). The legal regime put into place following the American Revolution thus created a governance structure not unlike pre-Revolutionary France with fragmented governmental power leading to drawn-out administrative and adjudicatory processes to resolve conflicts over and opposition to large projects (*Id.*).

As Kagan points out, new projects are not always "unmitigated boons"; rather, local impacts can give rise to local opposition, and can insist (often through the courts or

administrative processes) that proposed projects be subjected to “rational justification,” leading at times to sober reflection that might lead to better projects (or different plans entirely). But this is not always the case: such heightened scrutiny can also make planning “less rational.” According to Kagan, “trying to ensure governmental accountability through adversarial legalism is an inherently clumsy method of striking a sensible balance between environmental and economic development concerns, for it often results in outcomes that are shaped less by rational dialogue than by agonizing, lengthy wars of legal attrition” (209). As a result, Kagan points out, whole or part of industries (logging on federal land in the Pacific Northwest in the 1980s and 1990s, construction of nuclear power plants in the 1970s and 1980s) have ground to a halt either because projects were tied-up in lengthy litigation over environmental and other concerns or because developers “often simply gave up,” which has at times given rise to business counter-reactions to obstruct environmental measures (213).

Indeed, the advent of comprehensive environmental impact assessment has not quickened the pace of project review and development. A 2003 comparative study of the implementation of EIA in seven jurisdictions (the United States, the United Kingdom, Canada, The Netherlands, Australia, New Zealand, and South Africa) shows that the concerns that have always followed EIA have not abated. The most common concern remains that of delays in project approvals resulting from EIA. These complaints have been most forcefully expressed in the jurisdictions with the most formalized systems with the greatest number of steps (the United States, Canada and Australia), but the other systems also face substantial criticism on these grounds as well (Wood 2003). Another issue that is also often at play—particularly in the United States’ decentralized and fragmented system—is a tension between different levels of planning: local vs. regional vs. national (Kagan 2001).

The dual and often interrelated problems of delay and jurisdictional planning has helped power the innovation and evolution of *strategic* environmental assessment, which front-loads impact assessment from the level of individual projects to the level of “policies, plans and programs” (Wood 2003). Arguably, the United States’ NEPA has always called for SEA, as has California’s “little NEPA,” the CEQA, but the fragmented nature of the U.S. political system slows what would perhaps otherwise be a streamlined process (Kagan 2001). The Commission of the European Communities’ fifth environmental action program noted already in 1992 that it seemed “only logical, if not essential” given the goal of sustainable development, to “apply an assessment of the environmental implications of all relevant policies, plans and programmes” ((Wood 2003). This was eventually mandated at the level of EU law with the articulation of the SEA Directive of 2001.

Table 1 Comparison of SEA and EIA

EIA	SEA
Applied to specific and relatively short-term (life-cycle) projects and their specifications.	Applied to policies, plans and programs with a broad and long-term strategic perspective.
Takes place at early stage of project planning once parameters are set.	Ideally, takes place at an early stage in strategic planning.
Considers limited range of project alternatives.	Considers a broad range of alternative scenarios.
Usually prepared and/or funded by the project proponents.	Conducted independently of any specific project proponent.
Focus on obtaining project permission, and rarely with feedback to policy, plan or program consideration.	Focus on decision on policy, plan and program implications for future lower-level decisions.
Well-defined, linear process with clear beginning and end (e.g. from feasibility to project approval).	Multi-stage, iterative process with feedback loops.
Preparation of an EIA document with prescribed format and contents is usually mandatory. This document provides a baseline reference for monitoring.	May not be formally documented.
Emphasis on mitigating environmental and social impacts of a specific project, but with identification of some project opportunities, off-sets, etc.	Emphasis on meeting balanced environmental, social and economic objectives in policies, plans and programs. Includes identifying macro-level development outcomes.
Limited review of cumulative impact, often confined to phases of a specific project. Does not cover regional-scale developments or multiple projects.	Inherently incorporates consideration of cumulative impacts.

Source: OECD 2006.

Source: (Xie 2009).

SEA is wonderful in theory, but if EIA is difficult to achieve in practice, the task of applying SEA can seem Herculean. As noted above, SEA is still an idea in its infancy even in high-income countries with highly-developed legal and regulatory systems. A recent study of SEA implementation in East and Southeast Asian countries also shows the relative infancy of its implementation—and its potential mismatch for developing contexts. The study reviewed and compared SEA practices in seven countries (China, Indonesia, Lao PDR, Malaysia, Philippines, Thailand and Vietnam). The study found these countries to be in various stages of establishing and implementing SEA systems. It noted the views of earlier studies and that of a 2006 OECD report, which warned that a guiding principle of SEA is that it should be “fit for purpose, adapted to the context and circumstances of countries and political culture, traditions and institutional arrangements.” The study suggested that more thought had to be given to the wisdom of transposing SEA writ large from developed regulatory systems to those still developing (Xie 2009).

Generally speaking, however, in developing countries the problems are of an entirely different nature: in most instances, even effective *project*-level impact assessment remains a

distant dream. Indeed, a recent World Bank survey of thirty-two oil-producing developing countries¹⁰¹ found that most of the countries surveyed had a “sufficiently appropriate, but largely theoretical, environmental policy and legal framework” in place for managing impacts of the oil and gas industry, which in most instances were transposed into their national legislation from the regulatory systems in more developed countries, and furthermore, that most of the countries had dedicated institutions in place for managing the environmental and social impacts of the oil and gas industry, such as a ministry of environment. However, these systems existed primarily “on paper,” and the institutions on the whole were found to be “empty boxes” whose regulatory effectiveness are “compromised by the lack of a sufficiently organized administrative structure that enables efficient regulatory compliance and enforcement,” and are further undermined by “the lack of the human and financial resources needed for effective environmental governance.” In 89 percent of the countries responding, the responsible institutions for environmental management have little (74 percent) or insufficient (15 percent) resources (budget, staff, training, technology, information systems, and so forth) to effectively implement their strategies and fulfill their regulatory mandate” (Iocca 2010). Indeed, the survey found that in many countries, much of the emphasis of any impact assessment process “appears to be directed toward regulatory approval of oil and gas projects rather than toward developing a life-cycle approach for minimizing environmental and social impacts across the entire project life” (Iocca 2010).

Moreover, the survey found most governments lacking in their implementation of principles of public disclosure and consultation. Typically, little is disclosed to the general public and affected communities, and what “consultation” occurs is more often than not simply a top-down dissemination of information about proposed projects. Furthermore, in most countries there is a lack of clarity about the potential impact on decision-making that could be had by consultation, thus depleting public confidence in the value of engaging in what little process exists. The survey also found that while governments “appear to recognize the need to consult early on in the oil and gas development phase,” consultation focuses “more on the amount to be negotiated as compensation than on establishing communication links for managing environmental impacts throughout the project cycle,” as if operating under the assumption that project approval is a foregone conclusion (Iocca 2010).

In addition, the governments surveyed claim to recognize the need to consider diversity and linguistic and cultural differences during the consultation process, but “less than half” of those surveyed have ratified ILO Convention 169 and its provisions regarding indigenous peoples and extractive industry projects. Consequently, few of the governments surveyed have implemented specific laws and regulations detailing the practical aspects of involving indigenous peoples in the review and approval of projects, which often are situated on the frontiers of the indigenous communities’ lands (and this despite the signing in September 2007 of the United

¹⁰¹ The countries surveyed were assessed in comparison to “ideal” governance benchmarks synthesized from the practices of Brazil, Canada, Italy, Malaysia, and Norway. The surveyed countries included: Argentina, Algeria, Angola, Afghanistan, Colombia, Egypt, Arab Rep. Cameroon, Azerbaijan, Ecuador, Syrian Arab Republic, Congo, Rep. Cambodia, Mexico, Yemen, Rep. Gabon, China, Peru, Mauritania, Indonesia, Trinidad and Tobago, Nigeria, Kazakhstan, Venezuela, R.B. de São Tomé and Príncipe, Papua New Guinea, Philippines, and Thailand. See (Iocca 2010)

Nations Declaration on the Rights of Indigenous Peoples by 144 States) (Iocca 2010). The policies surveyed also generally lacked means of communicating with stakeholders. This means that the results of project review processes—and what impact, if any, consultation had on the processes—are poorly communicated, and are communicated following substantial delay if at all, thereby missing a further opportunity to build public confidence in engaging in the process (Iocca 2010). Despite these shortcomings, according to the survey “most governments” had not developed a commitment to establish centralized information systems that might ameliorate some of these problems.

Summary

The goal of this chapter has been to impress upon the reader the scope of the “governance gap” related to the regulation of investment in large-scale infrastructure projects, particularly in developing countries with weak regulatory capacities. Developing countries have long suffered from a lack of resources and capacity to enforce the environmental regulatory frameworks some of them have in place *on the books*. Other pressures, such as corruption and the “race-to-the-bottom” to make foreign investors feel more welcome also continue to contribute to the general malaise in developing country environments with respect to the regulation of large-scale infrastructure. Over time, the recognition of the limited capacity of host countries to scale-up their regulatory powers has led transnational activists to shift their focus from the “demand” side of the infrastructure investment equation to the “supply” side: multilateral development institutions and private financial institutions. The efforts to transform the “supply” side are recounted in the next Chapter.

CHAPTER 4: THE EVOLUTION OF SUSTAINABILITY AND ACCOUNTABILITY IN PROJECT FINANCE

This chapter surveys the historical evolution of the development and application of the nascent principles of sustainable development described in the previous chapter. Following the Stockholm Conference in 1972 through the Johannesburg Summit of 2003, these principles were wielded by a growing movement of transnational activists opposed to the vision of development being promoted by the World Bank in developing countries. This narrative leads directly into the formation of the Equator Principles: all of the founding institutions of the EPs had been targeted by public advocacy campaigns as transnational activists sought to hold private actors to the same rules as public multilateral institutions. The story of the World Bank's gradual reform has been told before, but it is worth repeating schematically have as backdrop of the emergence of the EPs.

The evolution of accountability and sustainability within multilateral development institutions

As noted above, the transnational norm of sustainable development began to coalesce in the early 1970s. The first true focus on the issue from a global governance perspective came at the United Nations Conference on the Human Environment at Stockholm in 1972. In advance of the conference, the World Bank felt compelled to formulate a position, particularly, as economist Robert Wade notes, because “many in the environmental movement were saying that economic growth should be stopped, an idea fundamentally opposed to the Bank’s mission” (Wade 1997). The Bank made a strong showing at the Stockholm Conference: Robert McNamara, the World Bank’s President delivered the keynote address and senior Bank official Mahbub ul Haq helped to convince developing country governments, to overcome their reservations about attending the conference because of concerns over sovereignty (Khagram 2004).

Immediately following Stockholm, the Bank created an Office of Environmental Affairs, though this remained under-staffed throughout the decade. The environmental specialists in the office were brought into project analysis considerably late in the development cycle, well past the stage where environmental concerns could influence project design, and the unit was focused on occupational health and safety related to large factories as opposed to the large-scale human and ecological effects resulting from the kinds of large projects the bank had been financing as a cornerstone of its development work (Khagram 2004). This slowly began to change, however. With the increased pressure applied by various indigenous peoples in opposition to Bank-financed projects from the mid-1970s onward. The Chico dam in the Philippines was the first project to face sustained opposition, compelling McNamara to announce that “no funding of projects would take place in the face of continued opposition from the people.” This affirmed for resident Bank sociologist Michael Cernea the need to articulate a policy on resettlement, which in February 1980 would become Operational Manual Statement (OMS) No. 2.33, “Social Issues Associated with Involuntary Resettlement in Bank-Financed Projects” (Khagram 2004). This new protocol stated that “the Bank’s general policy is to help the borrower to ensure that after a reasonable transition period, the displaced people regain at least their previous standard of living and that so far as possible, they be economically and socially integrated into host

communities” (Bank 1980). Two years later this statement was updated to focus specifically on tribal peoples: “As a general policy, the Bank will not assist development projects that knowingly involve encroachment on traditional territories being used or occupied by tribal people, unless adequate safeguards are provided” (Bank 1982). As Khagram points out, much of these developments were a direct result of the impact of NGOs engaging the World Bank’s sympathetic staff, like Cernea, who then were empowered to lead their own internal reform agendas (Khagram 2004).¹⁰²

From 1983 onwards, several NGOs including the National Resources Defense Council, the National Wildlife Federation and the Environmental Defense Fund orchestrated a campaign targeting multilateral development banks that publicized the disastrous effects of a handful of large-scale projects in the hopes of instigating Member States to demand the Bank to reform. The tactic worked: in the United States, Europe and Japan there was considerable focus on the issue, with over twenty hearings held on the topic before six Congressional subcommittees over the course of four years (Wade 1997). The United States went so far as to threaten to withhold funding (and at one point actually withholding funding) unless its environmental reforms were integrated into the Bank’s policies (Schaper 2007).¹⁰³ This pressure led the Bank in 1984 to

¹⁰² One of the obstacles long inhibiting more proactive involvement by the Bank were its own Articles of Association. As the Bank’s own two decade review of its investment in infrastructure explains:

The Bank is also often criticized for not being effective at listening and communicating with stakeholders. While the reality is more complex, there is however some basis to these criticisms. Historically, a narrow interpretation of the Bank’s Articles of Agreement made Bank staff reluctant to systematically assess and consider political risks or the political environment in which a proposed project or reform would occur. The Bank’s Articles of Agreement prohibit the Bank and its officers from “interfering in the political affairs of any member”, and from taking decisions influenced by the political characters of its members.

In appraising and supporting implementation of major infrastructure projects, the Bank therefore tended not to pay much attention to political risk considerations. Communications around projects were limited to press releases issued after a project was approved or, in some cases, to efforts to control damage in response to criticisms from civil society organizations (CSOs). Partly as a consequence of this approach, Bank support for large-scale infrastructure projects often became wrought in political controversy.

Over time, external scrutiny intensified, in part facilitated by the rise of the internet and email, by increasing democratization in the world, by the dramatic growth of CSOs, and by the 24-hour news cycle. As external suspicions worsened and negative campaigns intensified, it became clear that the lack of stakeholder support incurred high costs to the Bank and its clients in terms of monetary losses, time delays, and project cancellations, not to mention large intangible impacts on reputation, trust and goodwill (Bank 2006), ¶ 136-138.

¹⁰³ In 1989, the United States made its own strides domestically towards further institutionalizing some of the nascent principles of sustainable development within public finance. With the Pelosi amendment to the International Development and Finance Act of 1989, the Congress effectively made World Bank OMS 2.36 a requirement of federal law, requiring that from 1991 onwards, United States Executive Directors of multilateral development banks could not approve loans for projects unless project preparation included sufficient environmental impact analysis that had been made available to the U.S. directors, federal agencies, and the general public for at

elaborate further on its environmental policy in OMS 2.36 (“Environmental Aspects of Bank Work”), which stated that the Bank would “endeavour to ensure that . . . each project affecting renewable natural resources does not exceed the regenerative capacities of the environment,” and further, that the Bank “would not finance any projects that . . . would severely harm or create irreversible environmental deterioration” nor “displace people or seriously disadvantage certain vulnerable groups without undertaking mitigatory measures” (Wade 1997). Once this policy was articulated, the transnational coalition of campaigners used it to hold the Bank accountable, forcing the Bank to suspend loan disbursements in 1985 to Brazil’s Polynoreste Project because of its impact on the environment and indigenous peoples (Khagram 2004).

The momentum of the new transnational environmental movement continued into the last decade of the 20th century with even more energy than in preceding decades, at least when measured by the proliferation of new forms of governance and accountability that emerged during this period.

The main impetus for bank reform in this period was the Sardar Sarovar dam project on the Narmada river in Gujarat, India, which came under sharp global criticism particularly for its displacement of over 120,00 people. This led several of the Bank’s Executive Directors to suggest to then Bank President Barber Conable that he commission Bradford Morse, a retired ambassador to the United Nations Development Program and former U.S. Congressman, to conduct a review of the project (Shihata 2000). The subsequent *Morse Report*, submitted to the Bank’s Board in June 1992, concluded that the Bank had failed to integrate its policies into enforceable provisions in the loan documentation for the project and recommended that the Bank review its procedures to ensure for their full implementation. The Bank’s Board issued a response that acknowledged several failings and proposed, among other things, a review of its handling of resettlement issues across its portfolio. This response did not satisfy the Morse Commission or NGOs, who publicly threatened to work towards cutting-off the Bank’s funding (Shihata 2000). Shortly thereafter, in November 1992, an internal bank memorandum generated by a Portfolio Management Task Force, the so-called “Wapenhans Report,” excoriated what became known as the Bank’s “approval culture” (Darrow 2003). The “approval culture” emerged out of the Bank’s internal need to prove its indispensable role as a development institution, leading it to prefer large projects (involving large amounts of money) and to push them through approval to the neglect of proper project evaluation.

The first major institutional reform was the creation in 1993 of the World Bank’s Inspection Panel in the IBRD – the bank’s public lending arm. For the first time, individuals in communities affected by Bank projects could initiate complaints about the manner in which projects were created and any adverse effects they may have engendered (Shihata 2000). A complaint before the Inspection Panel requires the Bank to review the extent to which the Bank followed its own operational policies during the project’s development. The Inspection Panel is far from perfect. First, it should be noted that complaints do not initiate a comprehensive review of the project in light of international environmental law or human rights law. The Panel

least 120 days prior to the approval date (prior to the Pelosi amendment, the public notice period varied and was typically less than 120 days).

consists of three permanent members, each of whom serves for five years (and none of whom could have served in any capacity for the World Bank in the two years preceding their selection, nor work for the Bank again afterward). To be reviewed, a complaint must demonstrate that it has exhausted other remedies within the Bank by giving Bank staff a reasonable opportunity to respond to the allegations raised. After providing Bank management an opportunity to respond, the Panel makes its recommendation as to whether the complaint warrants an investigation. In addition, only the Board of Executive Directors has exclusive authority to authorize or deny a full investigation, which led to “significant polarization” of the Panel in its first years (Bridgeman 2008) (four of the initial eleven recommendations for investigations were not approved by the Board). However, after an investigation and changes made in 1999, the Board has approved every Panel recommendation.¹⁰⁴ A further difficulty with the operation of the Panel is that those found in non-compliance (the Bank’s management) are the same persons charged with implementing the Panel’s recommendations. Nevertheless, it is argued that “pressure can build to implement the recommendations because of the costs to the institution’s credibility and legitimacy when high-profile recommendations are not implemented” (Bridgeman 2008), p. 210.

By this time, the World Bank had created a series of Operational Policies. These became formally known as the Environmental and Social Safeguard Policies in 1997 (Wright 2007).¹⁰⁵ The core element of these policies is the Operational Policy on Environmental Assessment (OP 4.01), which created a detailed process for project assessment, review and implementation, environmental screening, public consultation, information disclosure and implementation requirements. Different thematic Operational Policies addressed different areas of potential project impact. The central component of the Safeguard Policies is the environmental screening process that foremost categorizes projects according to their environmental and social impacts—

¹⁰⁴ As of November 2010, the Inspection Panel had received seventy complaints, 7 of which it did not register because they were outside the scope of its mandate, fourteen of which it found ineligible for an investigation, ten of which it withheld ruling on whether to recommend an investigation for a variety of reasons, and twenty-two of which it investigated (the eligibility for review of the last four complaints, all filed after May 2010, is still pending). See Summary of Inspection Panel Cases (November 8, 2010), available at http://siteresources.worldbank.org/EXTINSPECTIONPANEL/Resources/Panel_Cases_2010_Nov_8.pdf (last visited November 15, 2010).

¹⁰⁵ The Policies cover environmental assessment, which is the cornerstone of the other policies, the protection and restoration of natural habitats and their functions (it is Bank policy to not support projects involving significant conversion or degradation of critical habitats), pest management (regarding the use of harmful chemical pest controls), forests, projects build on shared international waterways (requiring notification to other countries and encouraging negotiation of agreements), Indigenous Peoples (“to ensure that indigenous peoples do not suffer adverse effects” from Bank-financed projects, “and that they receive culturally compatible social and economic benefits” and that efforts to address issues pertaining to indigenous peoples “must be based on the informed participation of the indigenous people themselves”), involuntary resettlement (mandating that involuntary resettlement be avoided or minimized “where feasible,” that all viable design alternatives be explored, and that where involuntary resettlement is carried out, affected people “should be assisted in their efforts to improve their livelihoods and standards of living or at least to restore them”), projects in Disputed Areas (requiring the Bank to attain the agreement of both governments involved in the dispute before proceeding with a proposed project), and cultural property (Operational Policy Note designed to safeguard sites having archeological, historical, religious, and unique natural values).

into Categories A, B, C—which then dictates the scope of environmental assessment and the level of public engagement required as part of the project planning process. It should be noted that not all stakeholders viewed the “conversion process” undertaken by the Bank in a positive light.¹⁰⁶

Throughout this period, these internal reforms began to bleed over to the IFC, the Bank’s private-lending arm. Trailing the IBRD by over fifteen years, the IFC hired its first environmental specialist in the late 1980s. Before that time, the IFC had relied on the World Bank’s policies and staff for such any environmental impact assessments, although it seems that this model was under-resourced and ineffective; indeed, until this time, the IFC had been satisfied to allow the World Bank to lend to large development projects, while it its main development impact to be lending to projects that would be financially profitable (Wright 2007). After an internal review process, it began to conduct ad hoc environmental due diligence of projects in the early 1990s (Wright 2007). Over time, however, the ranks of these specialists expanded to over 100 due to the continued pressure exerted by the NGO community, advances in environmental science, regulatory developments in the United States and the European Union, and a shifting ethos towards “sustainability” (Wright 2007).

Christopher Wright’s discourse analysis of IFC policy changes argues that the IFC’s evolution has been informed by two competing but not mutually-exclusive discourses about its role as a multilateral development bank that finances private sector development in developing countries. The first discourse—the “safeguards” discourse—emerges out of the civil society advocacy campaign literature, which calls upon the IFC to act as a “facilitator and regulator” of private sector development for the purpose of promoting the public interest in developing countries by selecting projects based foremost on their developmental impact; the second discourse—the “sustainability” discourse—is one that had been promoted by key executives in the late 1990s, but Wright argues its acceptance can be explained by the fact that the “concept of

¹⁰⁶ According to the Environmental Defense Fund, the so-called “conversion process” was initiated “largely as a reaction to the Inspection Panel’s work” and entailed converting “detailed directives with clear requirements to which Bank staff could be held accountable” to “vague, shorter, and more ‘Panel proof’ policies.” Practically speaking, the conversion process divided the existing Operational Directives into mandatory Operational Policies (OP) and voluntary Bank Procedures (BP) (“best practice statements that ‘would be nice to have’”). EDF notes that civil society groups were largely disappointed by the policy revisions, which they claimed ignored their recommendations and, with the exception of the Information Disclosure Policy, “dropped key requirements, contained vague language that left much to the interpretation and sole discretion of Bank staff, and effectively weakened social and environmental protections for World Bank project lending.” *See id.* at Indeed, although the World Bank was for a time at the avant-garde with respect to environmental and social risk assessment and governance, other institutions have started to surpass it with respect to specific issues, according to a study done by the Environmental Defense Fund. In particular, EDF notes that several private banks including Citigroup, ABN AMRO, Bank of America and HSBC have stronger biodiversity conservation and forest protection policies and the OPIC, the U.S. export credit agency, applies more rigorous standards to the large dams it finances and to ensure for biodiversity conservation. In addition, the policies of the European Bank for Reconstruction and Development, the UK export credit agency, ECGD, ABN AMRO and others explicitly address principles of democracy and human rights. Finally, corporations such as Alcoa, BP, DuPont and Shell have set greenhouse gas emissions reduction targets that are higher than those indicated by the Bank. *See* http://www.edf.org/documents/4279_RetreatSafeguardPolicies_0105.pdf (last visited December 15, 2010).

‘sustainability’ conformed to the financial-technocratic policy discourse embedded in its organizational structure and professional culture,” and that this second discourse effectively “depoliticize[ed] environmental and social issues and legitimiz[ed] a commercial orientation” of the IFC’s public mandate, and may over time come to “redefine the terms upon which multilateral financing to the private sector engages with environmental and social issues” (Wright 2007).

The biggest institutional reform for the IFC during this period came in 1995 when environmental NGOs alleged in an Inspection Panel claim that the IFC violated World Bank environmental and social policies in its development of the Pangué dam project in Chile (IFC; Parks 2007). The ensuing controversy led to an independent report that harshly criticized the IFC’s conduct, which then instigated further internal reflection and re-examination of its own policies and procedures (Parks 2007). The IFC formally incorporated nine of the World Bank’s ten Environmental and Social Safeguard Policies into its own operational procedures and identified the World Bank’s Pollution Prevention and Abatement Handbook and Occupational Health and Safety Guidelines as benchmarks for IFC’s private sector projects. Furthermore, it introduced the Procedures for Environmental and Social Review, which outlined the internal procedures by which environmental specialists would assess environmental assessments provided by borrowers.

In 1999, the Compliance/Advisor Ombudsman (CAO) was established in the IFC to oversee its work and that of the Multilateral Guarantee Investment Agency (MIGA), the World Bank’s investment insurance agency (Bradlow 2001; Darrow 2003; Bradlow 2005). The CAO receives complaints from individuals and communities that believe they are, or may be, adversely affected by IFC-funded and MIGA-covered projects and reports these complaints and their resolution directly to the President of the World Bank Group. Complaints accepted as eligible for assessment by the CAO Ombudsman, and/or appraisal or audit by CAO Compliance, are referred to as “cases.” Since 2000, the CAO has found 67 of the 100 complaints submitted to it eligible for review (Corporation 2010).

Over the course of the last decade, the IFC has continually reviewed its application of the Safeguard Policies, publishing reviews in 2003 and 2005 (IFC 2003; IFC 2005). The 2003 review concluded that the system supporting the implementation of the Safeguard Policies was weak, lacked proper monitoring and was poorly integrated into IFC’s core business processes (IFC 2003). Following these reviews, the IFC completely overhauled its assessment policies from pre-appraisal to the supervision stages of the investment cycle (Simms 2008), converting the Safeguard Policies into the Performance Standards. The Performance Standards have themselves undergone subsequent reviews, including one that remains in progress through 2011. The IFC also invested heavily in training investment and advisory staff to deal with environmental and social issues and instituted a new information tracking system to organize comments from internal and external stakeholders (Simms 2008). Commentators note that the move to the Performance Standards represented a key shift “from minimum compliance to secure the loan, in which the client typically outsourced the task of demonstrating compliance to a consultant; to working with the client throughout the life of the loan, where the client has

greater ownership of the process and greater commitment to positive outcomes” (Simms 2008).¹⁰⁷ In 2006, the IFC decided to extend its required environmental and social risk review to its financial intermediaries (FIs) as well, who, depending on the risk level, must apply the Performance Standards or national law through their own environmental and social management systems. As Morgera notes, this was an innovation of the 2006 review, since until that time, the IFC had engaged its FIs primarily only through trainings (Morgera 2007).

In the ongoing review of the Performance Standards beyond PS2, several issues have been discussed and refined, but perhaps one of the most controversial issues remains the World Bank and IFC’s application of the concept of “free, prior and informed consent,” which consistently has been applied by the World Bank in the Performance Standards as “informed consultation,” much to the chagrin of the NGO community.¹⁰⁸ The further harmonization of the Performance Standards’ articulation of the FPIC concept could have profound impacts on the environmental and social risk due diligence of the private sector as well, because the EPs have until now tracked virtually all changes made to the Performance Standards, and would likely feel pressured to keep up with this evolution as well.

The World Commission on Dams and the Extractive Industries Review

The transnational civil society movement that encouraged institutional change at the World Bank simultaneously led to the creation of the World Commission on Dams (WCD). The WCD is perhaps underappreciated now for what it was: among the very first examples of multi-stakeholder global governance, what is also referred to as “multi-stakeholder initiatives” (Dubash 2010) a transnational merging of the governmental, civil society and private sectors, which at the time was an unprecedented approach to governance, though it has since then become quite commonplace (Ottaway 2001). Brokered by the World Bank and the World Conservation Union (IUCN), the WCD was established in May 1998 and consisted of twelve members chosen from a cross-section of interests, views and institutions who relied in their work on four regional public consultations, and a permanent Forum of sixty-eight members from thirty-six countries. The

¹⁰⁷ The IFC subsequently undertook an evaluation of its application of its new policy framework to 250 projects, which found that despite concerns about increased costs, the direct costs had been modest and spread over three fiscal years and that in general, costs of projects—with the exception of Category B projects—did not increase significantly (and Category B project costs associated with more stringent review did not increase beyond proportion to the overall rise in costs of processing such projects). Furthermore, seventy-two percent of clients surveyed felt that the cost in meeting the Performance Standards’ requirements would not impact their decision to seek financing from the IFC in the future (Simms 2008).

¹⁰⁸ Performance Standard 7 recognizes that “Indigenous Peoples, as social groups with identities that are distinct from dominant groups in national societies, are often among the most marginalized and vulnerable segments of the population. Their economic, social and legal status often limits their capacity to defend their interests in, and rights to, lands and natural and cultural resources, and may restrict their ability to participate in and benefit from development.” *IFC’s Performance Standards on Social & Environmental Sustainability Performance*” (2006), p. 28, available at [http://www.ifc.org/ifcext/sustainability.nsf/AttachmentsByTitle/pol_PerformanceStandards2006_full/\\$FILE/IFC+Performance+Standards.pdf](http://www.ifc.org/ifcext/sustainability.nsf/AttachmentsByTitle/pol_PerformanceStandards2006_full/$FILE/IFC+Performance+Standards.pdf) (last visited December 17, 2010). For a general discussion of the issues involved in applying FPIC, see (Lehr 2010); *see also* (Morgera 2007).

Commission also pioneered a new funding model: fifty-four public, private and civil society organizations contributed to its operations.

Over the course of its two-year mandate, it completed in-depth case studies of eight large dams on five continents, focused on dam-building in three countries in depth, conducted a cross-check survey of 125 large dams in fifty-six countries, conducted seventeen thematic reviews and consulted 1,400 participants in four consultations, accepting 950 submissions by individuals and interested institutions and organizations. At the time of its work, hydroelectric dams generated almost twenty percent of the world's electricity; in 63 countries, the proportion was higher than 50 percent. In 75 countries, dams were built to control floods and 12 percent of all dams had water supply functions, supporting 30-40 percent of the world's irrigated areas, and 12-16 percent of global food production (2010).

Despite these substantial contributions, the WCD found dams often fell short of their productivity targets, and worse, they had led to the irreversible loss of species and ecosystems and the displacement of 40–80 million people worldwide had been displaced by dams. In most cases, such forced displacement robbed people of former livelihoods and left them even poorer than before because resettlement programs focused on physical relocation but did not pay enough attention to economic and social development. The WCD's principal conclusion was that while "dams have made an important and significant contribution to human development . . . in too many cases, an unacceptable and often unnecessary price has been paid to secure those benefits, especially in social and environmental terms, by people displaced, by communities downstream, by taxpayers and by the natural environment."¹⁰⁹ The Report also articulated seven "strategic priorities" to guide decisionmaking around dams: (1) gaining public acceptance; (2) comprehensive needs and options assessment; (3) addressing existing dams; (4) sustaining rivers and livelihoods; (5) recognizing entitlements and sharing benefits; (6) ensuring compliance; and (7) sharing rivers for peace, development and security. It also introduced "criteria checklists"—a step-by-step process for decisionmaking at various stages of project development. Finally, it offered twenty-six "guidelines for good practice" explaining in greater depth the implementation of the "strategic priorities."¹¹⁰

The WCD left a two-fold legacy in the form of the processes it instigated and its final report. The continuation of the WCD Forum, now over 120 members strong, and the United Nations Environment Program's (UNEP) Dams and Development Project (DDP) had for several years (2001-2007) promoted a global dialogue on improving decision-making, planning and management of dams and their alternatives based on the WCD's core values and now offers country-level policy advice on these issues.¹¹¹ The WCD published its final report, *Dams and development: a new framework for decision-making*, in 2000. The broader contribution of the WCD, some have argued, was its role as an agent of normative change:

¹⁰⁹ WCD report at

¹¹⁰ [http://www.unep.org/dams/WCD/report/WCD_DAMS %20report.pdf](http://www.unep.org/dams/WCD/report/WCD_DAMS%20report.pdf)

¹¹¹ See United Nations Environment Program Dams and Development Project - What did the World Commission on Dams do?, <http://www.unep.org/dams/documents/Default.asp?DocumentID=663>

The WCD introduced several significant concepts, most important of which, perhaps, was the articulation of a “rights and risks” perspective that embedded infrastructure decisions within a human rights framing. In order to implement this approach, the WCD recommended a procedurally dense decision-making approach, organised around disclosure, consultation, and dialogue.

There is some evidence that these ideas and principles have been influential. The WCD has been a significant discursive tool in global water debates to give meaning to notions of participation and toward defining what Conca calls “water democracy” (Conca, 2005). Bradlow (2001) suggests that the WCD contributed to an ongoing shift in development decision-making that blurs the line between political and technical approaches through a procedural approach. Consistent with this view, the WCD has also been read as an important contribution to winning acceptance for the idea of “free, prior and informed consent” for indigenous peoples, as enshrined in the United Nations Declaration on the Rights of Indigenous Peoples.

The difference between these normative propositions and the WCD’s regulative pronouncements is that there is no expectation that they will be adopted and implemented in a formal way. Instead, it is more likely that such norms will be socialised through engagement with the underlying ideas over time, in what Sikkink and Finnemore (1998) call a normative life cycle of emergence, propagation, and adoption (Dubash 2010).

Indeed, in the time since its publication, there has been widespread acceptance of the report and its conclusions, which several actors have attempted to apply in project assessments.¹¹²

In the same year as the WCD’s publication of its final report, a stir was caused at the World Bank Group Annual Meetings in October 2000 in Prague when a coalition of NGOs

¹¹² Germany, Nepal, South Africa, Sweden and Vietnam have instituted dialogue processes to integrate WCD recommendations into national policies; the OECD and the European Union issued a statement “recognize[ing] the value” of the WCD’s strategic priorities in relation to hydropower development; the Swiss export credit agency, SERV, imposes WCD strategic priorities as an operational requirement for project developers; the United States Overseas Private Investment Corporation (OPIC) incorporates the WCD’s strategic priorities into its project screening and environmental assessment criteria; the Swedish and German bilateral aid agencies have adopted the WCD’s recommendations and have been supporting their aid recipient-countries and project developers to implement them. The World Bank and the International Hydropower Association (IHA) have endorsed the WCD’s Strategic Priorities, despite remaining critical of some of the specific recommendations. Both the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD), the two largest public banks in Europe, announced in 2005 that they would consider the WCD recommendations in their funding decisions, while not being bound to implementing them. In May 2005, HSBC bank developed a water sector policy making the WCD guidelines compliance a necessary step in project approval. Finally, the Member States of the European Union have decided that carbon credits from large dams can be sold on the European market only if the projects comply with the WCD recommendations. International Carbon Investors & Services, a group of international banks and other bodies involved in carbon trading, also require WCD compliance for large hydropower projects (Network 2009).

expressed their concern about World Bank Group's involvement in extractive industries projects and called for a moratorium on the funding of such projects. This prompted then-World Bank President James D. Wolfensohn to offer to engage in an investigation of the Bank's investment in extractives, leading to the announcement following its Annual Meetings in 2000 that it would engage in a comprehensive review of its activities in the extractive industries sector (oil, gas, and mining production). The review, which came to be known as the Extractive Industries Review (EIR), was a multi-stakeholder consultation process headed by Dr. Emil Salim, a former Minister for Population and Environment for Indonesia. The consultation was accompanied by a comprehensive internal study by the independent evaluation units of the IBRD, IFC and Multilateral Investment Guarantee Agency,¹¹³ as well as a separate report by the CAO.¹¹⁴ In the final report of the EIR, Dr. Salim recommended that the Bank end all coal mining investments immediately and phase out by 2008 all of its oil investments.¹¹⁵

The Bank Management was not quite ready to accept these recommendations outright. Its response to the Review in April 2004,¹¹⁶ became a further source of conflict between it and civil society. The Bank's Management was not in complete consensus with respect to all issues, principally the EIR's recommendation that the Bank withdraw from financing oil and coal projects in developing countries, which met with sharp resistance by Directors from several countries. The Management's response emphasized two messages from the Review with which it agreed: that extractive industries "can contribute to sustainable development, but only if projects are implemented well and preserve the rights of affected people, and if the benefits they generate are well-used," and that there is a continuing role for the World Bank in supporting the extractive industries "provided its involvement can help ensure that extractive industries contribute to poverty reduction and sustainable development." The Management indicated that it would be more selective in its future investments in the extractive industries, placing greater emphasis on the needs of the poor, good governance and promoting environmentally and socially sustainable development, and would also increase its support for renewable energies. At the time approximately 5% of its budget was in extractives and it pledged to an annual growth of 20% in its commitments to renewable energy and energy efficiency. The Management Response also

¹¹³ Andrés Liebenenthal, Roland Michelitsch, Ethel Tarazona, *Extractive Industries and Sustainable Development: An Evaluation of The World Bank Group Experience* (Washington, D.C. World Bank, 2005), at [http://www.ifc.org/ifcext/oeg.nsf/AttachmentsByTitle/ei_report/\\$FILE/Extractive+Industries+and+Sustainable+Development.pdf](http://www.ifc.org/ifcext/oeg.nsf/AttachmentsByTitle/ei_report/$FILE/Extractive+Industries+and+Sustainable+Development.pdf) (last visited December 17, 2010).

¹¹⁴ *Insuring Responsible Investments? A review of the application of MIGA's Environmental and Social Review Procedures* (Final Report, December 2002), at <http://www.cao-ombudsman.org/howwework/advisor/documents/MIGAreportofCAO-WebPDF03-05-03.pdf> (last visited December 12, 2010) (see findings, page 24).

¹¹⁵ See generally *The World Bank Group and the Extractive Industries: The Final Report of the Extractive Industries Review* (Chairman's Summary from the Meeting of the Executive Director's, August 3, 2004), at [http://www.ifc.org/ifcext/eir.nsf/AttachmentsByTitle/FinalResponse/\\$FILE/EIRFinalResponse.pdf](http://www.ifc.org/ifcext/eir.nsf/AttachmentsByTitle/FinalResponse/$FILE/EIRFinalResponse.pdf) (last visited December 17, 2010).

¹¹⁶ See *Striking a Better Balance – The World Bank Group and the Extractive Industries: The Final Report of the Extractive Industries Review – The Management Response* (September 17, 2004), at <http://siteresources.worldbank.org/INTOGMC/Resources/finaeirmanagementresponseexecsum.pdf> (last visited December 17, 2010).

emphasized that it would ensure that the adverse effects of projects on indigenous peoples be avoided, and if they could not be avoided, they would be minimized, mitigated and compensated for.

NGOs, for their part, saw the Management's response as, *inter alia*, failing to address recommendations regarding human rights; a "watering down of the recommendation on indigenous and community consent to read "free prior informed *consultation*" (as opposed to "free prior informed *consent*")"; lacking clarity in its definition of "significant projects" for which revenue transparency will be required; and lacking a requirement for the disclosure of contracts for "non-significant" projects.¹¹⁷ The Bank's Board did agree, however, that the World Bank Group would remain engaged with all stakeholders and would conduct an annual review of the institution's progress towards achieving the objectives the Management Response had outlined. To facilitate this ongoing process, an Extractive Industry Advisory Group was formed consisting of government, industry, and civil society representatives (4-5 each).

The extension of sustainability to the private sector – the pre-history of the Equator Principles

It was in the same period of the World Commission on Dams and the Extractive Industries Review that the "anti-" or "alter-" globalization" movement (also known as the "global justice movement") reached its apex at the "Battle of Seattle" in November 1999, with activists violently protesting against the perceived harms threatened by what activists describe as the neoliberal agenda of the World Trade Organization and other international organizations' policies. The global justice movement upgraded its organizational capacity by founding the World Social Forum in Brazil in January 2001 as a counter to the World Economic Forum held annually in Davos, Switzerland, which is emblematic, in the eyes of the global justice movement, of all that is wrong about global governance: its an exclusive and top-down process driven by elites. It was also during this same period that the OECD first substantially updated its Guidelines on Multinational Enterprises (in 2000). At the turn of the new millennium, the entire world, it seemed, was increasingly focused on the role of the private sector in facilitating global injustice and inequality.

In-step with this shift, civil society advocacy sought to build on its accomplishments vis-à-vis multilateral development banks and focus on private financiers of large development projects. This intent manifested itself in several very public advocacy campaigns discussed below, but a more formal statement of purposes was not explicitly promoted until the World Economic Forum in Davos in January 2003, when a coalition of several NGOs (with approximately 100 signatories) launched the Collevocchio Declaration on Financial Institutions and Sustainability. The Collevocchio Declaration recognized the "role and responsibility" of financial institutions for "channeling financial flows, creating financial markets and influencing international policies in ways that are too often unaccountable to citizens, and harmful to the environment, human rights, and social equity," and acknowledged that "like all corporations, [financial institutions] exist as creations of society to act in the public interest," and accordingly,

¹¹⁷ Bank Information Center, "Energy and Extractive Industries" at <http://www.bicusa.org/en/Issue.Concerns.6.aspx> (last visited 5 July 2010).

they “should promote the restoration and protection of the environment, and promote universal human rights and social justice,” which principles “should be inherent in the way that they offer financial products and services, and conduct their businesses.”¹¹⁸ The Declaration identified six principles that the signatory organizations argued should be the pillars of financial institutions’ investment strategies and policies. These principles and aspirations remain the benchmark in the eyes of civil society against which all multilateral and private financial activity is measured:

Commitment to Sustainability. [Financial Institutions (FIs)] must expand their missions from ones that prioritize profit maximization to a vision of social and environmental sustainability. A commitment to sustainability would require FIs to fully integrate the consideration of ecological limits, social equity and economic justice into corporate strategies and core business areas (including credit, investing, underwriting, advising), to put sustainability objectives on an equal footing to shareholder maximization and client satisfaction, and to actively strive to finance transactions that promote sustainability.

Commitment to ‘Do No Harm.’ FIs should commit to do no harm by preventing and minimizing the environmentally and/or socially detrimental impacts of their portfolios and their operations. FIs should create policies, procedures and standards based on the Precautionary Principle to minimize environmental and social harm, improve social and environmental conditions where they and their clients operate, and avoid involvement in transactions that undermine sustainability

Commitment to Responsibility. FIs should bear full responsibility for the environmental and social impacts of their transactions. FIs must also pay their full and fair share of the risks they accept and create. This includes financial risks, as well as social and environmental costs that are borne by communities.

Commitment to Accountability. FIs must be accountable to their stakeholders, particularly those that are affected by the companies and activities they finance. Accountability means that stakeholders must have an influential voice in financial decisions that affect the quality of their environments and their lives -- both through ensuring that stakeholders rights are protected by law, and through practices and procedures adopted by FIs themselves.

Commitment to Transparency. FIs must be transparent to stakeholders, not only through robust, regular and standardized disclosure, but also by being responsive to stakeholder needs for specialized information on FIs’ policies, procedures and transactions. Commercial confidentiality should not be used as an excuse deny stakeholders information.

¹¹⁸ The Collevicchio Declaration, at <http://www.foe.org/camps/intl/declaration.html> (last visited December 12, 2010).

Commitment to Sustainable Markets and Governance. FIs should ensure that markets are more capable of fostering sustainability by actively supporting public policy, regulatory and/or market mechanisms which facilitate sustainability and that foster the full cost accounting of social and environmental externalities.

The Collevocchio Declaration made a formal pronouncement of what the NGOs had been planning as a deliberate strategy since the late 1990s: “[t]he shift of NGO attention from [multilateral development banks] to [export credit agencies] and eventually to private banks” (Schaper 2007). Collevocchio signified the formal end of the prevailing conventional understanding until that time that commercial banks could play by different rules than their multilateral development institution counterparts.¹¹⁹ Indeed, the years immediately before the Declaration produced what is perhaps the greatest morality play of transnational activism against international financial institutions: the Rainforest Action Network’s (RAN) three-year campaign starting in April 2000 against Citigroup, which at the time was the recognized market leader in project finance, particularly for its loans to the coal industry and fossil fuel pipelines and for its underwriting of stocks and bonds in the energy sector (O’Sullivan 2009).

Citigroup was not targeted merely for being the most active project finance lender, but also for the types of projects in which it was involved: it was actively engaged in financing the Chad-Cameroon pipeline, and the Oleoducto de Crudos Pesados pipeline (in Ecuador) and Camisea gas fields in Peru as well as the Three Gorges Dam in China—the world’s largest and one of the most controversial hydroelectric projects, which was predicted would displace over 1 million people.¹²⁰

The campaign consisted of consumer boycotts, media campaigns, the occupation of local Citigroup branch offices in the United States, shareholder resolutions, and disruption of Citigroup CEO Sandy Weill’s speeches (O’Sullivan 2009; Spitzeck 2009). Perhaps the most well-publicized aspect of the campaign were the television commercials aired on local New York TV channels to educate consumers about Citigroup’s investment policies that featured celebrities

¹¹⁹ There was an earlier gesture towards a heightened sensitivity to environmental concerns in private sector decision-making in 1991 when the United Nations Environment Program, just a few months in advance of the Rio Summit, facilitated the launch of the “Statement by Banks on the Environment and Sustainable Development” in New York by a small group of commercial banks, including Deutsche Bank, HSBC Holdings, Natwest, Royal Bank of Canada, and Westpac. The purpose of the Statement was to increase awareness in the banking industry of the environmental agenda. This led to the formation of the UNEP’s Finance Initiative, which has since grown to encompass a wide swath of the financial services industry and the insurance industry and now includes over 180 signatories from 40 countries. United Nations Environment Program Finance Initiative – Background, <http://www.unepfi.org/about/background/index.html>. Real changes in bank policies and procedures did not occur, however, until civil society organizations stepped-up the heat.

¹²⁰ The World Bank had itself withheld funding due to environmental and social risk concerns, as did the Asian Development Bank (ADB) and the United States Overseas Private Investment Corporation (OPIC) (although the Canadian, Brazilian and several European export credit agencies did offer support to the tune of \$1.4 billion to their own construction and hydroelectric companies involved in the project and the China Development Bank and China Export-Import Bank issued bonds through several large commercial banks (including Goldman Sachs, HSBC, JPMorgan Chase, Morgan Stanley Dean Witter, Deutsche Bank, BNP Paribas, and Barclays), raising concerns that the bonds could be used to fund the dam (Wright and Rwabizambuga 2006).

cutting up their Citigroup credit cards (which at the time constituted 18% of Citigroup's business) and encouraging them to do the same (Benjamin C. Esty 2005). The campaign also got quite personal: RAN organized for 2,500 pictures and letters from children to be sent to CEO Sandy Weill asking him to stop financing global warming and forest destruction, papered Weill's hometown of Greenwich, Connecticut with "Wanted" posters featuring Weill, and even took out an ad featuring Weill's photo tagged with the line "Put a face on global warming and forest destruction" that was purposefully placed in the International Herald Tribune so it would follow him as he traveled with his family on a European vacation.¹²¹ Finally, hours before the start of a planned protest at an April 2003 Citigroup shareholder meeting, Citigroup called for a "cease-fire of campaign activities and a period of negotiations towards a permanent policy on environmental standards" (O'Sullivan 2009).¹²² In 2004, RAN declared victory as Citigroup announced comprehensive new environmental policies.

Other campaigns sprang up against several other leading lenders in this period as well. Indeed, the targeted institutions were a "who's who" of project finance lenders globally and in various regions. In fact, at the time, the core group of what would become the original four Equator Principles Financial Institutions (EPFIs) (Citibank, ABN Amro, WestLB and Barclays) controlled "about 17% of the bank debt market," and the larger group of ten original adopting institutions at the launch of the EPs held 30% (Nelthorpe 2003). The Dutch chapter of Friends of the Earth, Milieudefensie, collaborated with other NGOs to target Dutch giant ABN Amro for its lengthy involvement as a co-financier of mines in Papua New Guinea operated by Freeport-McMoRan, as well as for its involvement in the financing (alongside other Dutch commercial lenders) of the conversion of Indonesian forests to oil palm plantations (O'Sullivan 2009). In Germany, West Deutsche Landesbank (West LB), a quasi-public institution, became the target of German NGOs and parliamentarians' criticism for its involvement in the Oleoducto Crudos Pesados pipeline that Citigroup had also been funding (Nelthorpe 2003), and which in September 2002 had been found by an independent report written by Dr. Robert Goodland, former chief of the Environmental Department of the World Bank (and author of many of its environmental policies) to be in compliance with all four applicable World Bank Social and Environmental Safeguard Policies.¹²³ Finally, Barclay's name was being run through the mud over its involvement with Asia Pulp and Paper's large-scale forestry projects (O'Sullivan 2009).

¹²¹ See *A Hostile Climate: RBC's response to RAN's campaign to clean up Canada's biggest bank*, TARSANDSWATCH.ORG (Jan. 14, 2010), at <http://www.tarsandswatch.org/hostile-climate-rbc-s-response-ran-s-campaign-clean-canada-s-biggest-bank> (last visited 26 Aug. 2010).

¹²² Citi also eventually declined support from the Camisea project, along with the U.S. OPIC, and the U.S. Export-Import Bank. Other institutions, including the Inter American Development Bank, the Andean Economic Development Corporation, the Brazilian Development Bank, and export credit agencies from Italy, Argentina and Belgium did not agree with the negative environmental impact assessments of the natural gas fields and continued funding the project (Wright and Rwabizambaga 2006).

¹²³ See <http://www.ens-newswire.com/ens/sep2002/2002-09-13-19.html#anchor1> (last visited 4 October 2010).

Table 4.1 – *Top 5 Lenders by Region, 1999-2002*

	1999	2000	2001	2002
Asia Pacific Top 5				
1	ANZ Investment Bank	<i>ABN Amro</i>	Mizuho	<i>Citigroup</i>
2	Bank of America	JP Morgan*	<i>Citigroup</i>	SG Korea Development Bank
3	National Australia Bank	Bank of America	ANZ	Royal Bank of Scotland
4	<i>Citigroup</i>	<i>Citigroup</i>	UFJ	ANZ
5	<i>ABN Amro</i>	Barclays Capital	Sumitomo Mitsui	
Americas Top 5				
1	Chase	<i>Citigroup</i>	<i>Citigroup</i>	<i>Citigroup</i>
2	<i>Citigroup</i>	Bank of America	<i>WestLB</i>	<i>WestLB</i>
3	Bank of America	Credit Suisse	CSFB	Mizuho Bank of Tokyo
4	Credit Suisse	SG	BNP Paribas	Mitsubishi
5	SG	Deutsche	SG	Commerzbank
EMEA Top 5 (Europe, Middle East & Africa)				
1	Deutsche Bank	<i>ABN Amro</i>	<i>Citigroup</i>	SG Royal Bank of Scotland
2	Chase	SG	Deutsche	Barclays Capital
3	<i>Barclays Capital</i>	<i>WestLB</i>	JP Morgan	<i>WestLB</i>
4	SG	JP Morgan	IntesaBCI	HBOS
5	<i>ABN Amro</i>	Deutsche	<i>Barclays Capital</i>	

(Source: Project Finance International League Leaders' Tables, 1999-2002; BOLD = current EPFI; bold + italic = founding EPFI).

The Birth of the Equator Principles

In 2002, Herman Mulder, the Chair of Group Risk Committee at ABN Amro, faced a proposal to lend to a project in Latin America. In his view, the project appeared sound from an economic perspective, but the project sponsor had asked the bank to approve waiving its internal environmental standards (specifically related to conducting an environmental impact assessment) because another U.S. bank was prepared to do the same. According to Mulder, he told the loan officer that the Bank would not be prepared to do so and declined the credit request; this decision caused considerable criticism within the bank, particularly considering the amount in fees that the decision had caused the bank to forego.¹²⁴ Shortly thereafter, Mulder met with the IFC's executive vice-president, Peter Woicke, to discuss the growing intensity of the criticism against commercial bank lending to projects. This meeting led to the organization among the ten leading commercial lenders of a broader discussion co-chaired by ABN Amro and the IFC, which took

¹²⁴ Interview with Herman Mulder (notes on file with author).

place in London in October 2002.¹²⁵ As the situation Herman Mulder found himself in reflects, there was a challenge presented by how to approach complex projects with difficult environmental and social issues. The bank lacked a systematic approach to them, and the principled stance of simply turning down such risky projects also was not an effective solution: it did not improve the projects (and thus, the environment) nor did it generate revenues for the bank. To make matters worse, projects the bank declined would be financed by other banks. The situation was untenable and there was a need to level the playing field (as well as offer some response to the various NGO campaigns).¹²⁶

Four of the banks present – ABN Amro, Barclays, Citi (then Citigroup) and West LB gave presentations and then volunteered to form a working group to explore the creation of an industry standard for environmental and social review procedures for commercial banks (Wright 2007). This group, which came to be known as the “Gang of Four,” then collaborated over several months with a technical advisor at the IFC to find a suitable set of procedures for commercial lenders, learning from the template of the IFC’s Environmental and Social Safeguard Policies, Pollution Prevention and Abatement Guidelines (these have evolved into what is currently known as the Performance Standards) and risk categorization screening criteria (Wright 2007).¹²⁷ There were natural ties between these banks and the IFC: six of the ten (and all four of the working group) had participated in IFC syndications that year through their “B Loan” division (Wright 2007). The group seized upon the notion of basing their new framework on the IFC’s Performance Standards after recognizing the considerable utility of having one common standard applicable throughout the entire project finance industry (Wright 2007).

A follow-up meeting was hosted close to Greenwich (near central London) by Citigroup in February 2003 to discuss these draft standards, dubbed the “Greenwich Principles” (Wright 2007). These draft standards received the tentative support of the other banks present at the meeting, subject to further consultation with their respective legal departments, corporate relations staff, senior management and select clients. A draft was also later shared with several NGOs, who responded positively in principle to the creation of the standards while pointing out a number of problems with them in light of the principles announced in the Collevocchio Declaration, principally regarding the governance of the standards and their implementation. Specifically, the NGOs were concerned that the standards lacked any form of enforcement mechanism or even a reporting requirement that would ensure transparency and accountability. The NGOs also complained that there was no central secretariat called for in the draft framework, which they thought would facilitate communication between the banks and the various stakeholders interested in the standards’ implementation in various projects (Wright 2007) (a one person secretariat was later added).

¹²⁵ Statement of Suellen Lazarus, Senior Adviser, ABN AMRO Bank, House Committee on Finance Services, Hearing on “The Fight against Global Poverty and Inequality: The World Bank’s Approach to the Core Labor Standards and Employment Creation” (October 3, 2007).

¹²⁶ *Id.* at 1, available at <http://financialservices.house.gov/hearing110/lazarus.pdf> (last visited 8 October 2010).

¹²⁷ See generally “About the EPs,” available at http://www.equator-principles.com/documents/About_the_Equator_Principles.pdf (last visited December 6, 2010).

While the draft standards were initially proposed to apply only to projects developed in the emerging markets (i.e., developing countries), it was later decided that there should be one global standard, that is, on both sides of the Equator, which led the working group to change the standards' name accordingly to the Equator Principles. In April 2003 they held a further consultation with NGOs in London and met once more in May at West LB's headquarters in Dusseldorf, where the IFC gave further presentations on its application of its Safeguard Policies and offered to provide capacity training to adopting banks in environmental screening and risk management practices (Wright 2007). On June 4, 2003, the senior executives of ten commercial banks (see Table 4.2)—met at the IFC in Washington, D.C and formally adopted the Equator Principles. At the announcement, Peter Woicke, then IFC's executive vice-president, called the move "unprecedented," noting that

[m]ost voluntary codes affect just one industry. The Equator Principles will affect how project finance is conducted in dozens of industries, ranging from forestry and manufacturing to infrastructure and extractive industries. This represents far and away the biggest response by the private sector to the globalization debate. . . . The amount of investment [the Equator Principles] will affect is massive. Even if you use an extremely conservative estimate, [the Equator Principles] will change the rules of the game for about \$100 billion in global investment over the next 10 years (quoted in (Benjamin C. Esty 2005), at 7.

Despite this rhetoric, there were some initial questions raised about the seriousness of the adopting institutions, as is the case with all voluntary regulation. These reservations n criticism are set forth in detail below. Before reaching these critiques, the following section describes the EPs' normative content.

Table 4.2 *The first 10 EPFIs*

BANK	Country	2003 RANK (mid-year, based on <i>Dealogic's</i> ranking of amount lent)	2002 Rank (Project Finance International)	2001 Rank (Project Finance International)	PROJECTS	Percent of Total Loans Arranged in 2002 (Project Finance International)
Citigroup	U.S.	1	1	1	35	10%
The Royal Bank of Scotland	U.K.	2	3	15	32	5.2
HypoVereinsbank	Germany	3	8	26	38	2.3
WestLB	Germany	7	4	2	28	4.7
ABN Amro	Netherlands	8	11	8	24	2.3
Crédit Lyonnais	France	11	14	14	26	1.7
Barclays	U.K.	15	5	10	22	4.1
Westpac	Australia	28	63	53	13	0.3
Rabobank	Netherlands	47	NR	NR	12	0.0
Credit Suisse First Boston	Switzerland	97	51	5	4	0.4
						Percent of Total Market in 2002: 31.4%

SOURCE: adapted from *Wall Street Journal* (June 4, 2003) and (Esty 2007)

Normative Content of the Equator Principles

The Principles are based on the International Financial Corporation's Environmental and Social Performance Standards. They call for various measures to be taken by project sponsors (the borrowers) and the adopting institutions themselves to ensure that the projects they finance are "developed in a manner that is socially responsible and reflect sound environmental management practices." Following a 2006 revision, which is discussed below, the Principles now apply to all new project financings globally with total project capital costs of US\$10 million or more, across all industry sectors, and extend to banks' advisory activities as well.

The ten principles correspond loosely to the various phases of the project finance lending cycle, which also relate to the banks' project development cycle. The first phase is the lender's due diligence (EPs 1, 2, 3, & 7), which occurs during the pre-construction activities of project design and permitting. The second phase is loan negotiation and documentation (Principles 4 & 8). The third phase is portfolio management (Principle 9), which correlates with project implementation. The disclosure, consultation, and grievance mechanism requirements (Principle 5 and 6) may apply throughout the lending cycle, depending on the impacts of the project on

local communities (Aizawa, 2007). Since their initial introduction, the Principles have been translated into Chinese, French, Japanese, Portuguese, Russian and Spanish.

When developing projects in high-income OECD countries, borrowers can streamline their review, that is, refer only to national law as the applicable environmental and social standards governing the project. Although some critics have pointed out that the national law even in high-income countries is no guarantee against “problem projects.”¹²⁸

But when a project is being developed in an emerging market context, i.e., a non-OECD country or low-income OECD country, the EPs insist that project sponsors also “take into account” [check quote] the International Financial Corporation’s Performance Standards on Social and Environmental Sustainability, which include detailed environmental assessment policies and procedures related to specific thematic areas: (1) Social and Environmental Assessment and Management systems; (2) Labor and Working Conditions; (3) Pollution Prevention and Abatement; (4) Community Health, Safety and Security; (5) Land Acquisition and Involuntary Resettlement; (6) Biodiversity Conservation and Sustainable Natural Resource Management; (7) Indigenous Peoples; and (8) Cultural Heritage. In addition, the EPs also reference the IFC’s Environmental, Health and Safety (EHS)² Guidelines, which identify the performance levels and measures normally acceptable and applicable to projects in emerging markets.¹²⁹ The following chart¹³⁰ summarizes the core obligations imposed by the EPs:

¹²⁸ For example, EPFIs have provided financing to Iceland’s Karahnjukar hydropower project – a hydropower scheme based in the Icelandic highlands, the second largest remaining wilderness in Europe. The scheme will be comprised of nine dams, three reservoirs, seven channels and 16 tunnels that will divert several glacial rivers in the Highlands to provide water to run a hydropower plant that will generate electricity for an aluminum smelter operated by Alcoa. Iceland’s Planning Authority initially had rejected the environmental impact assessment for the project, but this ruling was overturned by the Environment Minister. Environmental NGOs complain that the project would have substantial impact on several species, including reindeer, geese and seal, and others have raised concerns about the socio-economic impacts of the project, which will rely heavily on foreign workers, will provide few jobs for Icelanders after completion, and takes substantial risks on the future price of aluminum: the hydropower plant will be relying largely on the Alcoa smelter, and if the price of aluminum does not rise considerably to meet the project’s estimates, Icelanders might ultimately be subsidizing Alcoa’s electricity. See Friends of the Earth and International Rivers Network, *Briefing: Barclays and the Karahnjukar project* (2004), at http://www.foe.co.uk/resource/briefings/barclays_karahnjukar.pdf (last visited December 21, 2010). It must be emphasized, however, that the project is not strictly being financed through “project finance,” although Barclays, which is helping to arrange the \$400 million loan to the project, has stated it will apply the Equator Principles to the project. Equally controversial is RBS’ financing of tar sands in Canada. See *supra* note 13.

¹²⁹ Some have noted that the EPs choice to divide between High-Income OECD, Low-Income OECD and Non-OECD countries “is a rather crude simplification of a complex situation,” as it overlooks the variation in implementation of environmental, social and governance standards even among High-Income OECD countries in the EU. Moreover, this division underestimates the importance of public international law and the fact that “key environmental and social protection treaties and protocols” have not been ratified by a number of High-Income countries (e.g., the United States and the Kyoto Protocol on the reduction of greenhouse gas emissions – see http://unfccc.int/kyoto_protocol/status_of_ratification/items/2613.php, or the Convention on Biological Diversity – see <http://www.cbd.int/information/parties.shtml>). Finally, Watchman et al highlight that “insufficient guidance” has been given with regard to how to assess the transboundary effects of linear projects that might pass through both High-Income OECD and non-OECD countries, such as pipelines:

It is not currently clear whether streamlining would apply to a project where, for example, 60% of the pipeline passes through a High-Income OECD country and the remaining 40% through a non-

Table 4.3 – *Summary of EP Requirements*

Category	EP Requirement
A - Projects with potential significant adverse social or environmental impacts that are diverse, irreversible or unprecedented	<ol style="list-style-type: none"> 1. Categorization by EPFI [EP 1] 2. Borrower conducts a Social and Environmental Assessment process [EP 2] 3. Social and environmental covenants in financing documentation 4. In addition, for projects in non OECD-countries and non High-Income OECD countries: <ul style="list-style-type: none"> - Assessments conform to IFC Performance Standards and EHS Guidelines - The borrower prepares an Action Plan, and implements it through its Social and Environmental Management System - Borrower, government or third party carries out consultation with affected communities [EP 5]¹³¹ - Disclosure of project information for a reasonable minimum period [EP 5] - Grievance mechanism [EP 6] - Independent review of Assessment [EP 7] - Independent monitoring and reporting [EP 9]
B - Projects with potential limited adverse social or environmental impacts that are few in number, generally site-specific, largely reversible	<ol style="list-style-type: none"> 1. Assessment, Action Plan and Management System requirements are same as Category A projects 2. Social and environmental covenants in financing documentation readily addressed through mitigation measures [EP 8].

OECD country. Given that projects financed by project finance banks are typified by their transboundary nature e.g. pipelines, power lines, railways, tolls roads etc.

(Watchman 2007).

¹³⁰ Adapted from (Aizawa, 2007).

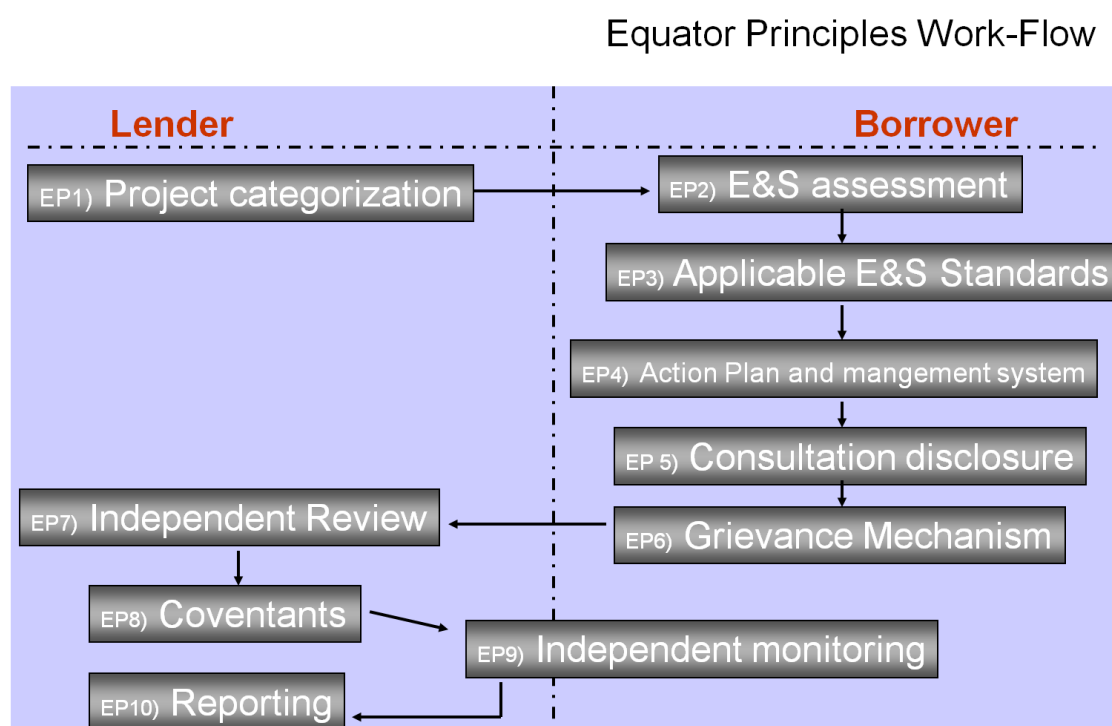
¹³¹ According to EP 5,

Consultation should be “free” (free of external manipulation, interference or coercion, and intimidation), “prior” (timely disclosure of information) and “informed” (relevant, understandable and accessible information), and apply to the entire project process and not to the early stages of the project alone. The borrower will tailor its consultation process to the language preferences of the affected communities, their decision-making processes, and the needs of disadvantaged or vulnerable groups. Consultation with Indigenous Peoples must conform to specific and detailed requirements as found in Performance Standard 7. Furthermore, the special rights of Indigenous Peoples as recognised by host-country legislation will need to be addressed.

and readily addressed through mitigation measures	<p>3. In addition, for projects in non OECD-countries and non High-Income OECD countries:</p> <ul style="list-style-type: none"> - Consultation and disclosure of information as appropriate [EP 5] - Grievance mechanism as appropriate [EP 6] - Independent review of Assessment as appropriate [EP 7] - Independent monitoring and reporting as appropriate [EP 9]
C – Projects with minimal or no social or environmental impacts	No specific requirements

Another way to illustrate the governance of projects falling under the EPs' scope is the division of responsibilities between lender and borrower:

Table 4.4 – *Obligations of Parties in EP-covered Transactions*



CHAPTER 5: CRITICAL RECEPTION AND EVOLUTION OF THE EQUATOR PRINCIPLES

Initial Reactions

When the Equator Principles were first announced some of the original Collevecchio Declaration NGOs criticized them on a number of grounds.¹³² They released a statement articulating these concerns, which compared the Equator Principles to the aspirations and demands of the Collevecchio Declaration. Most of these concerns related primarily to the Equator Principles' scope, the ways they would be implemented, and how they would be enforced. The NGOs announced that they would not endorse the Principles at that time because they did not go "far enough" and failed to live up to the spirit of the "do no harm" Principle in the Collevecchio Declaration. In particular, the NGOs pointed out that the EPs did not mention any "no-go zones/categorical prohibitions," and furthermore, that while Collevecchio emphasizes the precautionary approach, the EPs were focused more on mitigation.

Noting that the EPs applied only to project finance structured deals, the NGOs encouraged the banks to review all segments of their portfolios and create appropriate environmental and social review policies for other forms of corporate lending beyond project finance (in particular, they noted, mining and forestry are not typically done with project finance but are two of the sectors that raise some of the most sensitive issues). Some of the original non-adopting institutions, such as ANZ Investment Bank, had similar concerns related to applying the EPs to other deal structures, such as bonds:

While there is some rationale for excluding project bonds given the nature of the fixed income market, it is still possible to submit project bond issues to the same up front social and environmental reviews as project loans. Even though bond deals involve many fewer covenants than bank loans, which would clearly make enforcement of the provisions more difficult, they should be subject to the same standards. It's a matter of keeping the playing field level between bank loans and project bonds.

While we do not rule out adopting the Equator Principles in future, we are currently creating a policy framework that will be consistent with our own corporate values and will apply to all asset classes, not just to project finance (Esty 2007).¹³³

A further concern of the NGOs highlighted implementation. They pointed out that the IFC itself, with over 30 environmental staff, has a poor track record of implementing its Safeguard Policies (as was clear from its choice to fund the Oleoducto Crudos Pesados project in Ecuador). The NGOs asserted that the EPFIs must "prove that they are serious about implementation by

¹³² These included: Rainforest Action Network (USA), Friends of the Earth (USA), Friends of the Earth (UK), World Wildlife Fund (UK), Amazon Watch (USA), Berne Declaration (Switzerland), Urgewald (Germany), and Campagna Reforma el Banco Mundial (Italy).

¹³³ It should be noted that ANZ Investment Bank eventually adopted the Equator Principles following their revision in 2006.

rejecting unsuitable projects, increasing staff resources, disclosing their Environmental Management Systems (how they implement and monitor the EPs and who's responsible), disclosing social and environmental loan covenants, etc.”

In addition, the NGOs expressed about the EPs' lack of enforcement mechanisms, which they also related to the EPs' lack of transparency. The NGOs observed that the lack of transparency requirements prevented endorsing institutions, peer banks and the public from monitoring the EPs' implementation. In this regard the NGOs stated that the EPs should have incorporated the IFC's disclosure policies along with the other integrated policies.

In response, the banks suggested at the time that the semi-cooperative nature of project finance lending, that is, lending by syndicates of several banks, served as a form of enforcement. As Citi's Shawn Miller, director of environmental and social risk management, and current chair of the EP Steering Committee said: “[i]n some ways the Equator banks hold each other accountable. If a signatory is not upholding the standards, other banks will find out quite quickly as project financings are usually financed by more than just one financial institution. We all want to ensure that, as a group, we are upholding the Equator standards and maintaining the integrity of the process” (Gaskin 2007). Similarly, Mike Cleary, the head of project and structured debt at Westpac Banking Corporation (Westpac) notes that the syndicated structure of most project finance deals is enough to de facto force Equator compliance on every bank in the sector: “Because so many banks – up to 85 per cent of the market – have signed up, even those banks that haven't signed have to comply because the projects begin to evolve in response to the compliance requirements from major banking partners” (Gaskin 2007). If a non-EPFI holds most of a non-compliant project's debt and wishes to “sell it down,” i.e., share its burden (and financial risk) with other institutions, it will need to access secondary markets, which might mean making the deal EP compliant (Gaskin 2007). But NGOs, such as Friends of the Earth, do not consider this sufficient:

...the only accountability mechanism from the banks' point of view, that they pointed to, was the fact that “well if there are going to be four Equator banks and they're all involved in one deal, right, all of us will actually have to agree on how the deal is categorized. And that is our accountability because we're going to have to sit down and say ‘do you agree this is a B?’ ‘Yes, it's a B’, ‘okay, alright.’ See now we're keeping each other accountable.’ That was the extent to which they did accountability (quoted in (O'Sullivan 2009)

The NGOs pointed out other “critical loopholes,” as well, namely, that the EPs did not “explicitly state that all projects must comply with IFC guidelines, but rather emphasize[] the need for Environmental Assessments, including watered-down language like “generally consistent” [with IFC criteria] and “reasonable minimum period” that could lead to poor implementation because of their vague formulations.

The NGOs also characterized the EPs as “weak on social issues,” just as the IFC policies, when compared to those of the World Bank, were relatively weak on social issues, the EPs were even “less robust” than the IFC policies. They noted that the “late January version of the EPs referenced ‘human rights,’ but was replaced by ‘socially responsible’ in the late February draft.

In this regard, the NGOs feared that the IFC standards would be “limiting,” and would stand in the way of the implementation of more robust standards such as those put forward by the World Commission on Dams guidelines, ABN Amro’s forest policies or those proposed by WWF-Friends of the Earth, and the categorical exclusions adopted by some export credit agencies, such as the U.S. OPIC or the IFC. Another concern that had emerged early on focused on the governance of the EP regime and the perceived disorganization of the EPFIs and their lack of a coordinated structure, which made it difficult for the NGOs to know where accountability and governance lay, or who was responsible for the stewardship of the regime (O’Sullivan 2009). Finally, the NGOs decried the allocation of responsibility proposed by the EPs, noting that “most of the responsibility” rested with the borrower/project sponsor and that there was no mechanism like the IFC’s Compliance Advisor Ombudsman for affected communities to have recourse to the banks themselves in cases where standards were not being implemented.¹³⁴

In short, in the words of Ilyse Hogue of Rainforest Action Network, the EPs could be considered a good first step, “only if there is a second, third, and fourth step” (Esty 2007). In the months following the creation of the EPs, a new coalition of NGOs—Banktrack—to monitor sustainability practices in the financial sector. Banktrack quickly designated itself as a watchdog of the Equator Principles Financial Institutions, releasing report after report analyzing the banks’ implementation and apparent commitment levels.¹³⁵

Early Tests of the EPs’ Legitimacy: Problematic Policy Stances and Infamous Problem Projects

In addition to these structural and procedural concerns, the banks faced an early legitimacy crisis when some of the leading institutions interjected themselves into the World Bank’s Extractive Industries Review (see Chapter 4)¹³⁶ Eleven EPFIs called upon World Bank President James Wolfensohn to reject some of the EIR’s conclusions, principally, the recommendation that the Bank withdraw immediately from the coal sector and phase out its financing of oil projects by 2008.¹³⁷ The EPFIs were also critical of the incorporation of the concept of free, prior and informed *consent* into Bank policies because of the leverage this would

¹³⁴ See *First-Ever Banking Principles Won't Protect Environment or Human Rights, Groups Say*, CSRWire (June 5, 2003), available at http://www.csrwire.com/press_releases/19485-First-Ever-Banking-Principles-Won-t-Protect-Environment-or-Human-Rights-Groups-Say (last visited December 21, 2010).

¹³⁵ See, e.g., Banktrack, *Good faith, Good Practice Implementation and Accountability of the Equator Principles* (December 2003); Banktrack, *No U-turn allowed: Recommendations to the Equator Banks* (January 2004), Michelle Chan-Fishel (Friends of the Earth), *Unproven Principles: The Equator Principles at Year Two An anniversary assessment* (June 2005) (all publications available at <http://www.banktrack.org/show/pages/publications> (last visited November 8, 2010)).

¹³⁶ Banktrack, Press Release, May 17th 2004, *Banktrack slams Equator banks for trying to block higher environmental policies at World Bank*, available at http://www.banktrack.org/download/banktrack_slams_equator_banks_for_trying_to_block_higher_environmental_policies_at_world_bank/040517_ep_banks_and_the_eir_ww.pdf (last visited November 5, 2010).

¹³⁷ See Press Release – Eleven Banks Speak Out on the Extractive Industries Review, May 5, 2004 (Washington, D.C.), available at ; see also Letter from EPFIs to World Bank President James Wolfensohn, April 14, 2004, available at http://www.equator-principles.com/documents/EIR_Banks_Letter.pdf (last visited November 28, 2010).

give to project-affected communities over project sponsors' (and often government) plans. Perhaps more boldly, the EPFIs insisted that due to their adoption of the IFC Safeguard Policies and sector guidelines that in the future they be consulted on any changes to the IFC's policies. Friends of the Earth UK noted that only eleven of twenty-one EPFIs signed the letter and that "some non signatory banks expressed concern to us about the Equator group turning into a joint lobby group. That would indeed be a grave mistake, further eroding the already questionable status of the Principles."

The other major difficulties faced by the EPFIs in the early years related to some of their involvement in financing some of the largest and most controversial infrastructure projects being developed in the world at the time. Three projects in particular became a focal point of NGO criticism: the Baku-Tablisi-Ceyhan (BTC) oil pipeline stretching from Azerbaijan through Georgia and into Turkey, the Sakhalin II project in Eastern Russia (the world's largest integrated gas pipeline and the first liquefied natural gas plant in Russia, making it key to the country's energy policy),¹³⁸ and the paper pulp mills on the Uruguay River discussed in the Introduction. To track these and other projects, Banktrack created a special section of its website featuring "dodgy deals," which serves as a clearinghouse for information on controversial projects, including NGO activities and complaints as well as an opportunity for banks to respond to concerns.¹³⁹

The Growth and spread of EPs with the Equator Principles II (2006)

By its first anniversary in June 2004, twenty-five financial institutions had adopted the EPs, including Unibanco, the first emerging market (and South American) bank to adopt. A little over a year later, in November 2005, the first African bank—South Africa's Nedbank—adopted. Between 2004 and 2006, the EPFIs participated in the IFC's review and update of its

¹³⁸ The project involves three offshore oil and gas platforms and subsea pipelines to shore and additional 800 km of pipelines to what will be one of the world's largest natural gas liquefaction and oil export facilities. The original consortium consisted of a 55 percent ownership by Royal Dutch Shell, which was then ostensibly forced to sell a 50%-plus-one stake to the Russian oil company, Gazprom. It has been argued that this sale of \$7.5 billion, which "coincided with an agreement that alleged environmental violations raised by the Kremlin could be sorted out at no extra cost and with no delay to the wider project" will be seen by critics as evidence the charges were trumped up to put pressure on Shell to sell its stake. The European Union and others who have expressed concern will also note that a doubling of the Sakhalin-2 budget to \$20bn - previously dismissed as unacceptable by the Russian government - has also been agreed by Gazprom." See Terry Macalister, "Thin Smile from Shell as it sells Sakhalin stake," GUARDIAN (April 19, 2007), available at <http://www.guardian.co.uk/business/2007/apr/19/oilandpetrol.news> (last visited November 12, 2010). Just two years later, however, Russia, whose oil and gas sector was responsible for 64% of its export revenues in 2007, found itself in deep financial straits as commodity prices plummeted and could no longer develop the project on its own, so it apparently invited Shell back in to help develop two other projects (Sakhalin 3 and 4). Garry White, *Russia invites Shell back to Sakhalin as finances plummet – Credit crunch forces embarrassing climbdown on resource nationalism*, THE TELEGRAPH (June 28, 2009), available at <http://www.telegraph.co.uk/finance/newsbysector/energy/5676869/Russia-invites-Shell-back-to-Sakhalin-as-finances-plummet.html> (last visited November 12, 2010).

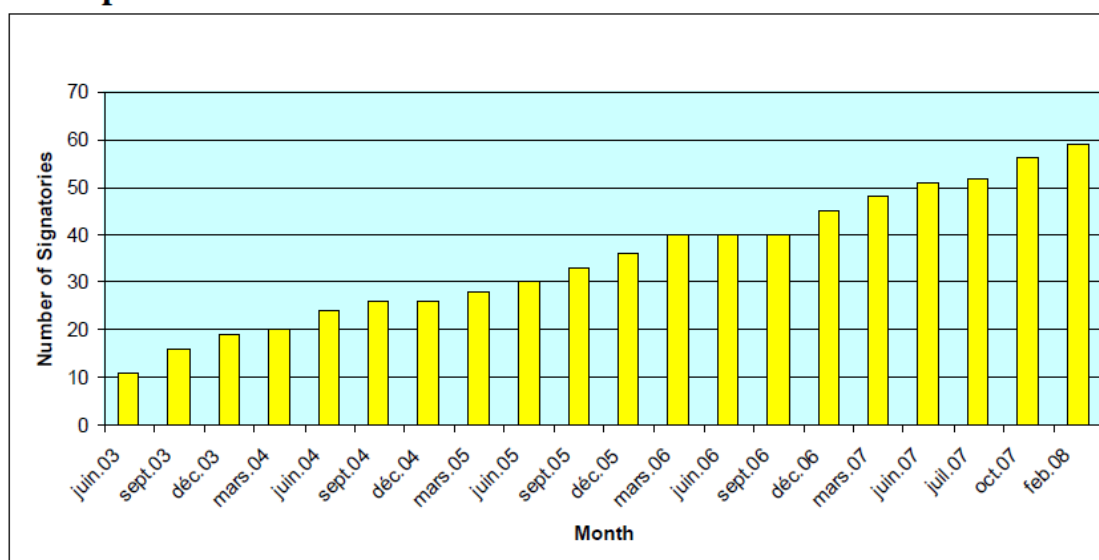
¹³⁹ See Banktrack, "Dodgy deals," available at <http://www.banktrack.org/show/pages/home> (last visited November 12, 2010).

Performance Standards, during which time the EPFIs consulted further with NGOs and clients about the proposed changes.

When in February 2006 the IFC adopted its new Performance Standards (effective April 30, 2006), the EPFIs conducted a further consultation from March to May 2006 with NGOs, clients, industry associations, and export credit agencies on the Equator Principles II (EPII), which was to be based on the IFC's updated Performance Standards. The most important revisions were the lowering of the project size threshold from fifty to ten million; the extension of the EPs to advisory activities; the inclusion under coverage of upgrades and expansions of existing projects (over those not built under EP review); and perhaps most importantly, the EPs' first set of "teeth": Equator Principle 10 – the requirement to report annually on progress and performance—and more robust public consultation standards.

EPII launched on July 6, 2006, at which time forty institutions re-adopted the EPs. When the IFC later updated its Environmental Health and Safety Guidelines in April 2007, the EPFIs incorporated this revision into the EPs as well. In 2007, nearly three-quarters of all project finance in emerging markets was covered by the EPs, representing 53 billion of the 75 billion dollars granted in loans to these countries.¹⁴⁰

Table 5.1 – *Growth of the EPs by Number of Adopting Institutions (Simms 2007)*



Source: (Simms 2007) (data through February 2008, including all but 12 EPFI adoptions).

¹⁴⁰ "Equator Principles Celebrate Five Years of Positive Environmental Impact and Improved Business Practices," May 8, 2008, at www.equator-principles.com (In 2007, US\$52.9 billion of project finance debt in emerging market economies was subject to the Equator Principles, representing over 70 percent of all such financing in emerging markets).

In December 2007, the Steering Committee of the EPFIs published its Management Structure on its website. The Management Structure was an organizational governance structure among the Steering Committee members and a newly-created modest secretariat staff (of one person) that divided-up the work of administering, strengthening and growing the EP regime. This governance structure included subcommittees known as Working Groups that focus on various substantive aspects of maintaining and enhancing the EP regime, including Working Groups on (a) adoption, (b) best practice, (c) climate change, (d) outreach (divided again by region), (e) scope review – corporate loans, (f) scope review – export finance, (g) social risks, (h) stakeholders—NGOs, (i) stakeholders—SRI (socially responsible investment), and (j) stakeholders—industry outreach.

In the EPs' sixth year, in September 2008, Bank Itau-Unibanco S/A, a Brazilian bank that is one of the largest emerging market banks in the world, took the role of Steering Committee Chair. The following month, the first domestic Chinese institution (Industrial Bank) adopted the EPs. The following year, beginning in October, the Steering Committee of the EPFIs participated in the IFC Performance Standards review, which is still ongoing through 2011.

The EPFIs' ad hoc governance structure became even more institutionalized in July 2010 when the EPFIs created the "Equator Principles Association," a legally binding governance structure complete with bylaws, voting mechanisms, membership dues, and rules for excluding members found not to be complying with the obligations of membership.¹⁴¹ Thus, the EPs have drastically improved their operational capacity, one of the four competencies necessary for "effectiveness" (Abbott 2009).

¹⁴¹ See Equator Principles Association Rule 5.

Table 5.1 – *Equator Principles Association governance structure*

Position/Committee/Working Group	Banks Involved	REMIT
Steering Committee *Citigroup is current chair of Steering Committee	Barclays, BNP Paribas, Credit Agricole Corporate & Investment Bank, Credit Suisse, Citi, HSBC, ING, Itau Unibanco S/A, Mizuho, RBS, Societe Generale, Standard Bank Group, The Bank of Tokyo-Mitsubishi UFJ, UniCredit Bank AG, WestLB	
Best Practice	Banco Bradesco, BNP Paribas, BTMU, Citi, Dexia, EDC, HSBC, ING, JP Morgan, KBC, Mizuho, Rabobank, SMBC, Standard Chartered	This Working Group develops and reviews best practice for applying environmental and social risk review procedures to corporate loans.
Communications	Citi, ING, Mizuho, RBS, UniCredit Bank AG	This Working Group exists to support and develop the communications strategy for the EP Association. The working group also advises the Steering Committee on the ways in which new communication tools can be used to receive feedback from stakeholders on the future development of the EP Association.
OUTREACH		
Africa	ABSA, Barclays, BMCE, Credit Agricole, CIB, First Rand, Societe Generale, Standard Bank	These sub-Working Groups develop and implement strategies to communicate, support and train, in cooperation with multilateral institutions and development agencies/banks, other financial institutions in all regions of the world which undertake project finance and could benefit from adopting the EPs (ongoing).
Asia	ANZ, Citi, EKF, FMO, Mizuho, RBS, SMBC, Standard Chartered, The Bank of Tokyo-Mitsubishi UFJ, UniCredit Bank AG	
Central and Eastern Europe	ABN AMRO, RBS, WestLB, UniCredit Bank AG	
Latin America	Citi, Itau Unibanco S/A	
North America	Citi	
STAKEHOLDER ENGAGEMENT		
Export Credit Agencies	ING, Societe Generale, UniCredit Bank AG	This Working Group maintains a dialogue with export credit agencies and the OECD (ongoing).
Industry	Credit Agricole Corporate & Investment Bank, UniCredit Bank AG, Scotiabank	This Working Group seeks to develop a strategy for communicating with clients and industry associations for whom the EPs are relevant (ongoing).
Civil Society	Barclays, BNP Paribas, Citi, Credit Agricole, CIB, Credit Suisse, Dexia, ING, Nedbank, RBS, Societe	This Working Group provides a forum for dialogue and communication with the NGOs for

	Generale, UniCredit Bank AG, WestLB	whom the EPs are relevant (ongoing).
THEMATIC AREAS		
Biodiversity	Banco Itau, BNP Paribas, CIBC, Citi, EDC, KfW, Mizuho, Standard Bank, Standard Chartered, UniCredit Bank AG	This Working Group engages with the International Finance Corporation regarding incorporation of biodiversity and ecosystem services into the Performance Standards and to share good practice in risk management of biodiversity issues.
Climate Change	Bank of Tokyo-Mitsubishi UFJ, Barclays, BNP Paribas, Citi, Dexia, FMO, HSBC, UniCredit Bank AG, ING, Itau Unibanco S/A, Mizuho, RBS, Standard Bank Group, Standard Chartered, WestLB	This Working Group engages with the International Finance Corporation regarding implementation of their climate change strategy into the Performance Standards and to share good practice in climate risk management practices.
Social Risks	ANZ, Barclays, Citi, Credit Agricole CIB, Dexia, EFIC, EKF, HSBC, ING, Itau Unibanco S/A, JP Morgan, Mizuho, RBS, TD Bank Financial Group, UniCredit Bank AG, WestLB	This Working Group is working to understand emerging practices in social risk management in project finance.

Source: Equator Principles, “About the EPs”¹⁴²

Persisting Concerns

A number of the initial criticisms raised by NGOs remain unaddressed. Prior to a meeting between NGOs and the EPFIs in February 2010, a group of NGOs¹⁴³ released a statement addressing what they perceived as the lingering issues facing the EP regime and calling upon the EPFIs to “reinvigorate the pioneering spirit and strong ambitions that led to the launch of the Principles in 2003” and to adopt a number of improvements. The basic complaints on the whole remained the same as in the past: (1) Transparency at the project,¹⁴⁴ bank,¹⁴⁵ and

¹⁴² At <http://www.equator-principles.com/abouttheeps.shtml> (last visited December 18, 2010).

¹⁴³ The signers of the comments included NGOs from Argentina, Australia, Austria, Belgium, Benin, Brazil, China, Ecuador, France, Gabon, Germany, Hong Kong, India, Italy, Japan, Myanmar, Nepal, Netherlands, Norway, Pakistan, Philippines, South Africa, Spain, Switzerland, Thailand, United Kingdom, and the United States.

¹⁴⁴ With respect to transparency on the project level, Banktrack made several specific demands: to require clients through financing covenants to identify which projects are being conducted under Equator and the names of the financial institutions supporting the project; to stipulate that project-specific environmental and social information and documents should be removed from the purview of blanket confidentiality agreements often signed during the pre-financing phase and to allow for the release of these documents to external stakeholders so that they might be able to meaningfully engage in the consultation and monitoring processes; make available the environmental and social loan covenants so that local communities can know which specific environmental and social conditions are supposed to be addressed by the sponsor; make available all environmental and social reports and plan prepared “by or for the bank,” including “but not limited to Environmental and Social Impact Analyses, Community Consultation plans and reports, Environmental and Social Management Plans, Environmental and

initiative-levels¹⁴⁶; (2) accountability¹⁴⁷ and enforcement¹⁴⁸; (3) the scope¹⁴⁹ of the EPs (i.e., their reach beyond project finance transactions); and (4) the need to address issues of climate change.¹⁵⁰

Social Action Plans, Corrective Action Plans and Decommissioning Plans” and should, upon request, also release “lenders’ independent consultant reviews, environmental and social certificates and progress reports, and consultant reports on the client’s compliance with Action Plans or social and environmental requirements”; and finally, require the project sponsors to provide information on the “precise functioning of the grievance mechanism established for a particular project” (Banktrack 2010), p. 4.

¹⁴⁵ The NGOs demanded that the banks should report on compliance, “including which projects are not in compliance with Equator standards and what corrective actions the bank and/or client is taking to remedy this” (Banktrack 2010), p. .

¹⁴⁶ With respect to transparency at the initiative level, the under-signed NGOs demanded that the EPFIs establish a “stringent set of reporting obligations for adopting banks,” and new adopters, which should include “targets for implementation, precise information on the commitment made by a bank if this commitment exceeds the core Principles; detailed information on the Equator portfolio of each bank—composition, trends, regional and sectoral breakdown, names of projects and sponsors—and contact information for anyone wishing to enquire about the banks implementation of the Principles” (Banktrack 2010), p.

¹⁴⁷ Banktrack also called on the EPFIs to make external third-party verification mandatory and for every EP-covered deal to be announced as such, with each institution involved in EP-covered projects to list that they are being financed “under Equator” on their websites or on the EPFIs’ collective website, and for the EPFIs to create an online information disclosure tool that will “allow external stakeholders to easily access all publicly available information from banks, project sponsors and other parties involved, *and* to identify which information is still not in the public domain as required. This includes providing the contact details of all parties involved in the deal.”

In addition, drawing on the United Nations Secretary-General’s Special Representative on Business and Human Rights’ new global human rights framework (“protect, respect, remedy”), Banktrack emphasized further that the EP regime needed to implement an accountability, compliance and dispute-settlement mechanism, which demand it described as being “as old as the Principles itself,” and as having been “rejected by the EPFIs ever since,” which rejection Banktrack “strongly believe[s] . . . undermines the legitimacy of the Principles and denies EPFIs a valuable additional source of information on how the Principles play out in individual transactions” (Banktrack 2010); *see also* Principles 20 (“[w]here business enterprises identify that they have been responsible for adverse impacts, they should provide for or cooperate in their remediation through legitimate processes”), 28 (“Collaborative industry or multi-stakeholder initiatives in this domain should also provide for effective grievance mechanisms”), and 29 (“[e]ffectiveness criteria for non-judicial grievance mechanisms”) of the Draft Guiding Principles for the Implementation of the United Nations ‘Protect, Respect and Remedy Framework’, available at <http://www.reports-and-materials.org/Ruggie-UN-draft-Guiding-Principles-22-Nov-2010.pdf> (last visited December 17, 2010). The NGOs recommended that the EPFIs bring their business practices in-line with the multilateral development institutions that have adopted such mechanisms, such as the World Bank’s Inspection Panel or the IFC’s CAO (see Chapter 4). The Banktrack NGOs also called upon the EPFIs to “develop robust criteria for the establishment and proper functioning of the project-level grievance mechanisms mandated by Principle 6 of the Principles, and oblige all project sponsors to publicly report on the organisation and effectiveness of these mechanisms,” which they not should meet the standards identified by Prof. Ruggie’s work, namely, that they should be “legitimate, accessible, predictable, equitable, rights-compatible, and transparent” (Banktrack 2010).

¹⁴⁸ Banktrack also called on the EPFIs to develop a procedure to “delist” banks not meeting new transparency and accountability requirements or “banks that repeatedly have problems with compliance,” and to move the EP website from a “self-congratulatory advertising platform into a portal that explicitly fosters public accountability and debate on the effect of the Principles,” which change could occur, they propose, if the site were paid for by the EPFIs but managed by “an independent third party, paid for by the EPFIs, and overseen by a board that includes representatives of external stakeholders” (Banktrack 2010). Banktrack further encouraged the banks to consider establishing a panel of experts or to create joint field research between NGOs/EPFIs and project

Other commentators have noted the need for more concrete metrics:

The appeal to a framework devoid of metrics renders monitoring meaningless. Without objective verifiable metrics to measure performance, banks are able to interpret almost anything in their favor. For example, the requirements of “free, prior and informed consultation” and “broad community support” mentioned in the fifth principle offer no specific guidance as to what might constitute such consultation or support. Does the provision of summaries of environmental and social assessments constitute adequate information for consultation? Who gets to decide what information goes into the summary? In the zones where indigenous peoples live, what measure constitutes “prior consultation”? Is sixty days (the time most frequently mentioned in the document) sufficient? Does someone translate the technical jargon of a report to a language that indigenous people might understand? Most importantly in such consultation, what level of support constitutes “broad community support”? Is 50% plus one sufficient? Does it

sponsors for the purpose of reaching “balanced conclusions on the quality of project level implementation” and for setting best practices for the future.

¹⁴⁹ In addition, Banktrack called on the EPFIs to extend the scope of the Principles to other business products and projects, regardless of the financing model used, arguing that banks cannot treat certain impacts as “material” in some business lines but not others, such as in corporate lending, asset management and initial public offerings. Banktrack called on the banks to make this expansion mandatory as opposed to merely producing best practice papers. For example, a recent study showed that as of June 2009, the asset managers of BNP Paribas, Deutsche Bank and ING owned or managed shares in PetroChina worth a total value of US \$191.73 million. PetroChina’s operations in Sudan and dealings with the Sudanese government are very controversial for the role they play in fueling the conflict there. *See generally*, Maaïke Kokke, Roos van Os & Kristóf Rác (Centre for Research on Multinational Corporations), *Investing Responsibly: A Financial Puzzle – The Limited Scope of Sustainable Asset Management*, at http://www.banktrack.org/download/investing_responsibly_a_financial_puzzle/100920_investing_responsibly_a_financial_puzzle.pdf (last visited December 21, 2010).

¹⁵⁰ Banktrack also called on the EPFIs to “stop financing climate change,” noting that the only obligation imposed by the EPs at the moment is to “promote the reduction of project-related greenhouse gas (GHG) emissions in a manner appropriate to the nature and scale of project operations and impacts,” which is largely left in the hands of the sponsor, who must “quantify direct emissions from the facilities ... and evaluate technically and financially feasible and cost-effective options to reduce or offset project-related GHG emissions during the design and operation of the project.” Banktrack notes that too much discretion is placed in the sponsors’ hands, and “indirect emissions” are not adequately defined, as they are understood only as “resulting from energy use in the production process and not resulting from the ultimate combustion of a product of a specific project (oil, gas, coal fuel)” (Banktrack 2010). Banktrack points out that the EPs currently do not prevent banks from financing oil and gas projects or coal plants, which will emit billions of tons of greenhouse gases into the atmosphere. Accordingly, Banktrack called upon the EPFIs to make climate change an “integral part of all risk assessments” and to “commit to a process of continuously tightening the conditions for financing under the Principles, if required, to meet the challenges posed by an unfolding climate crisis” (Banktrack 2010). This should include the adoption of new principles that categorically exclude the financing of all new coal, oil and gas extraction and delivery projects and all new coal-fired power plants, as well as a framework for measuring financed emissions and the setting of reduction targets for each bank, that is, not just tied to project-specific emissions, but at the corporate level as well. In addition, Banktrack urged the EPFIs to set “stringent climate best practices in each sector” with continuous improvement upwards, and “stipulate that meeting these will be a prerequisite for obtaining finance,” as well as avoiding a set of predetermined “negative practices” (Banktrack 2010), p. 6-7.

have to be a larger majority? In cases where multiple solutions are supported by different community factions, if the borrower's solution gets the largest support (though less than 50%), does that constitute broad support? These are significant issues, and there needs to be clear, observable metrics in place so that all parties can be in agreement with the decision of the lending bank. The alternative, and current state of affairs, is constant and open debate regarding the status of projects vis-à-vis EP standards (Schepers).

Schepers also bemoans the fact that compliance with many of the EP requirements seem to be determined by the project sponsors, although this is not entirely accurate; EP7 requires the lending EPFIs to hire “an independent social or environmental expert not directly associated with the borrower” to review the impact assessment, Action Plan and consultation process documentation in “order to assist EPFI's due diligence, and assess Equator Principles compliance.”

Others have also noted that implementation of the EPs with respect to social issues “lags substantially behind environmental issues,” which they note is “due to the historically greater emphasis given to environmental issues [and] the generally greater acceptance of environmental issues as an investment risk,” as well as the “relative difficulty of finding labour specialists on the ground who can support clients to undertake due diligence assessments, develop action plans, and conduct periodic monitoring” (Simms 2008). This duty currently falls on the project engineers or managers, who have little expertise in labor rights and industrial relations, or human resources management (Simms 2008). Simms' analysis is focused specifically on labor issues, and she raises several grounds for concern. In reviewing EPFI policy statements on social issues, she notes that they often do not specifically mention labor issues or any specific tools related to managing labor-related risks (only five of the institutions' reports at that time included such policies in their reports) (Simms 2008).

The Equator Principles as “Communitarian Regulation”

Like the large dams they seek to indirectly regulate, there are potential sources of stress fractures along two dimensions built into the EPs' architecture. The first dimension concerns the relative independence of the individual EPFIs from each other and from the EP Association. The second dimension concerns where the EP regime falls along the spectrum of flexibility and rigidity, or in the terminology of regulation scholars, between the inherent natures of “responsive” regulation and “command and control” regulation. Arguably, these same tensions manifest themselves in various degrees in any form of “communitarian” or “responsive” regulation (Braithwaite 2000). Perhaps unsurprisingly, the ongoing debate over both the effectiveness and the legitimacy of the Equator Principles can be traced to these tensions, particularly the differential between the Equator Principles' simultaneously modest and ambitious aims and external stakeholders' expansive expectations of what is needed to properly regulate the development of large-scale infrastructure projects.

With respect to the first dimension—the relative independence of the EPFIs from the EP Association and from each other—an interesting parallel can be drawn to self-regulatory efforts

in the nuclear power industry. As Joseph Rees notes, whatever else “communitarian regulator” may mean, it certainly implies that the regime must promote “a close integration between regulator and regulated” and be “responsive” to the concerns of the regulated community to be accepted as legitimate by it, while also promoting a separation between regulator and regulated in order to protect against corrupting industrial forces, thereby ensuring credibility with external stakeholders and the government (Rees 1994). These tensions, as Rees notes, quoting Philip Selznick’s *Moral Commonwealth*, are inherent to “communal” life:

A common life is not a fused life: in a fused life there would be no need for regulation or governance, no need to take account of individual differences, no need for adjustment, reciprocity, or cooperation. The tacit assumption here is that people and groups participate in any community, large or small, as individuated and self-regarding entities. They are independent as well as interdependent.

The distinctive function of community, then, is the reconciliation of partial with general perspectives.... [It is] to regulate, discipline, and, especially, to channel self-regarding conduct, thereby binding it, so far as possible, to comprehensive interests and ideals.

What we prize in community is not unity of any sort, at any cost, but unity that preserves the integrity of persons, groups, and institutions. Thus understood, community is profoundly federalist in spirit and structure. It is a unity of unities.

Similar dynamics exist within the EPFI community, but in somewhat different ways. In this regard, it is important to emphasize the spirit underlying the founding of the EPs, namely, that adopting institutions intend for the EPs to “serve as a *common baseline and framework*” for the EPFIs’ “implementation of [their] *individual*, internal environmental, and social procedures and standards.” This loose collaboration brings together competitor institutions, but at the same insists and ensures that they be allowed to maintain their independence and freedom to develop policies they find appropriate (“each institution . . . *individually* declares that it has or will put in place internal policies and processes that are consistent with the Equator Principles”). Further examples of this attitude are apparent in the disclosure requirement in EP 10. To clarify the contours of the reporting requirement the Steering Committee circulated a “Guidance Note” on disclosure, which emphasizes at the top, in bold letters:

Disclaimer: This guidance document has been prepared for use by the EPFI Network. The document is not to be viewed as a required reporting framework, but rather a guidance document to assist EPFIs in development of their own EP implementation and reporting methodologies, if needed.¹⁵¹

Unlike the nuclear power industry, however, the initial impulse behind this distance, and the reason that prevents the EPs from forming a more “perfect union,” has to do more with both the

¹⁵¹ “Guidance to EPFIs on Equator Principles Implementation Reporting,” available at http://www.equator-principles.com/documents/EPReporting_2007-06-12.pdf (last visited December 6, 2010).

nature of the Principles themselves and the nature of the EPFIs as commercial actors. The nature of the Principles themselves—an extension of the logic of environmental impact assessment itself—dictates that banks can be expected only to implement *systems* for environmental and social due diligence, which naturally will vary with differences in internal organizational structures, politics and culture. The nature of the EPFIs as commercial banks imposes different limits as to the form the EPs and the EP Association can take. The primary concern here has been one of anti-competitive concerns: whether highly collaborative coordination among major corporate actors would violate antitrust laws either in the United States or Europe. Out of concern for potential violations, the recently created EP Association Rules state that

i) The EPFIs and Associates recognise the importance of complying with applicable law on agreements, concerted practices or exchange of information which may restrict competition (“Competition Law”) and of ensuring that the Principles are not used for any purpose which may breach Competition Laws. Each EPFI and Associate shall therefore, in particular:

ii) avoid exchanges or disclosures of confidential or competitively sensitive information in relation to their respective businesses or the projects in relation to which they are providing or contemplating provision of Project Finance or Project Advisory Services;

ii) avoid any co-ordination of its commercial strategies with other EPFIs or Associates;

iii) refrain from using the Principles or this Association as a cover or opportunity for anti-competitive behaviour such as price-fixing, market sharing or the exclusion of actual or potential competitors;

iv) not make collective decisions on the pricing of Project Finance in which they are separately involved or the supply of other services (including Project Finance Advisory Services), although they will co-operate on the finalisation of financing documentation in a manner consistent with lawful and ordinary business practice in the sector at the relevant time; and

v) take advice from their internal legal or compliance department in the event they consider that anti-competition issues could arise in the context of their dealings with other members of the Association.

....

f) Each EPFI and Associate is individually responsible for its own internal procedures to achieve compliance with the Principles and to adhere to the reporting requirements (see Rules 5j and 5k respectively) and for communications with Stakeholders regarding any such matters. The Association, its Steering Committee, Working Groups and Chair do not have the authority or the capacity

to respond to Stakeholder concerns about the implementation of the Principles by individual EPFIs or Associates or in respect of particular projects.¹⁵²

The second dimension of tension—between flexible and rigid rules—also is related to the qualities of the EPs and their adopting institutions. Flexibility in the precision of the rules required for adoption by each institution and how such rules are enforced by each EPFI is an inherent byproduct of the nature of environmental and social risk review and the identity of the institutions involved. The goal of the EPs is to heighten attention to ESRM issues during project development as a means of increasing the accountability of institutions to affected populations. But these private commercial institutions are not willing to subject themselves—at least not at this stage—to the kinds of judicial or quasi-judicial mechanisms ordinarily left to the provenance of government regulators and courts. Thus, the EPs “do not create any rights in, or liability to, any person, public or private,” nor are there any mechanisms—other than the court of public opinion—for affected groups to directly challenge individual bank decisions. Still, despite the lack of rigid application criteria or enforcement mechanisms, the EPs do draw a firm line in the sand, declaring that adopting institutions “will not provide loans directly to projects where the borrower will not or is unable to comply with our environmental and social policies and processes.”¹⁵³

Both of these tensions—and their interrelatedness—were quite clear throughout my interview process and also came through in the survey responses. The final survey question asked respondents for their view as to whether an “external monitoring or central enforcement mechanism will ever develop for the Equator Principles,” and why they believed or did not believe that this might come to pass. Interestingly, 42 percent (10 banks) said that such mechanisms would develop, while 58 percent (14 banks) did not see such developments as likely. In their written explanations, banks offered a variety of explanations as to why such mechanisms were unlikely, which often related both to the commercial nature of the EPFIs, the nature of ESRM, and the “voluntary” nature of the regime itself. Thus, EPFIs cited “confidentiality restraints,” or that the nature of project finance was “too complex [to monitor or enforce],” or such mechanisms would be “difficult to manage” or enforce, particularly because of their voluntary nature and the relationship between the voluntary norms and governmental regulation:

- “[b]ecause the implementation of such Principles, as well as CSR criteria, must remain a voluntary engagement”
- “EPs present a framework. There is no uniform approach to serve as a benchmark for monitoring. Additionally with underlying qualitative assessments there will always be different opinions what is in line with EPs or not”

¹⁵² See Equator Principles Association Rule 4, entitled “Lawful Co-operation and Disclosure of Information,” at http://www.equator-principles.com/documents/EP_Governance_Rules_June%202010.pdf (last visited December 20, 2010).

¹⁵³ See Equator Principles Preamble.

- *“As it is a voluntary initiative, and is not supported by legislation in many countries across the world, although these may be more reason as to why it should be enforced, these will act as barriers to enforcement”*
- *Difficult to manage due to the commercial nature of the banking industry. At some point of maturity assurance will be sought after*
- *Eventually this might happen if the groups gets larger and differences in application more apparent – leading to reputation risk to the “Equator Principles” brand. It is also a longstanding request from civil society. However, EPFIs will remain individual commercial organizations and a central mechanism cannot infringe on this.*
- *Currently the EP's are voluntary, so it does not appear likely that the enforcement mechanism could be applied to all banks. Given all the pressure on EP banks are under to disclose transaction information etc. it will probably become likely. Also the number of EP banks continues to grow which would require increased monitoring or central enforcement.*
- *Who has the authority, ability, funds, and capacity to monitor and enforce the actions of 68 banks globally? Who would pay for that? How would you get client's approval to disclose confidential information to a third party?*
- *Based on both the current intent and structure of the EP Initiative I do not believe that such is conceivable at least in the near future. On a project level monitoring of compliance with the EPs is often undertaken or confirmed by an external 3rd party. Implementation of the EPs at individual EPFIs is sometimes assessed, monitored or confirmed by external 3rd parties at the discretion of the EPFI. Potentially at some point a consensus may emerge among EPFIs that a requirement is appropriate for external 3rd party verification, or whatever one may want to call it, of EP implementation. But I do not believe that within the structure of the EP Initiative capacity would be developed to undertake such. What certainly will continue to be strongly resisted is any kind of a grievance mechanism or ombudsman office at the EP Initiative level which has enforcement or power over the activities of individual EPFIs. Such things are only viewed as appropriate for public institutions such as developmental ones, not in the commercial FI market. Otherwise everything should be oriented on the project level and EPFIs commit through the EP to see that appropriate mechanisms such as these are in place at individual projects. No bank will ever want to be put into a position of judging another. EP sets out a due diligence process for banks to follow in funding a project, but it is very subjective and many value judgments are used. Therefore how can a central enforcer judge what is right or wrong when it is the Bank's choice whether it follows the due diligence process or not. External audits rather than monitoring are more likely to enable banks to learn and*

improve. Whacking through enforcement would lead to FI's withdrawing from the EP.

As should be clear, the commercial nature of the banks places limits on a centralized enforcement mechanism because of confidentiality concerns. Other limits on such a mechanism have to do with the peer/competitor nature of the banks: who would pay for such a mechanism; what would undergird its enforcement authority; which bank(s) would wish to “sit in judgment” of others?

It is also apparent, however, that the banks themselves recognize the need for external validation of their practices to protect the nascent “EP brand name,” a need that will only increase with the enlargement of the EPFI community. A similar need was seen in the nuclear facility industry, not only for the limited goal of maintaining the industry’s reputation but also to facilitate the critical goal of learning *from* collective experiences. Even more importantly, monitoring was seen as necessary to “institutionaliz[e] responsibility” in individual CEOs and nuclear plant managers, which the INPO attempted to do with its investigations system and its release of public “scorecards” and rankings of nuclear facilities, which it hoped would motivate CEOs to strive for better performance, fueled by concern over their relative positions vis-à-vis other facilities (Rees 1994).

As these responses and other information gleamed from the survey show, individual institutions are already having their disclosure statements regarding EP-implementation audited by external parties. NGOs like Banktrack have also consistently produced ‘scorecards’ on various facets of EP-related performance, including adoption of policies and the extent of EPFI fulfillment of the reporting requirement. Whether these inchoate and ad hoc tools are enough to achieve “governance,” and consequently sufficient to maintain the EPs legitimacy, are separate questions I hope to begin to address below.

CHAPTER 6: RESEARCH DESIGN

Preliminary discussion

There are a variety of methodological issues that arise from attempting to study what are some of the most sensitive business transactions on the planet. The primary obstacles to such research are the putative research subjects themselves: large transnational corporate entities that are frequently the target of negative public relations campaigns on the basis of their relationship to these business transactions, who feel legally bound as fiduciaries of their clients to not violate any duties of confidentiality arising out of these transactions. These realities place constraints on any attempt to study these institutions' internal practices going to the heart of these highly controversial projects.

It was also assumed that the sensitivity of these issues would impede significant participation in the research, and thus, that any empirical evidence uncovered would almost certainly be partial and might also have limited explanatory power; indeed, for a good part of the research period it remained in doubt whether the researcher's access to these institutions would be broad enough to make embarking on the research worthwhile. Still, there seemed to be tremendous merit in both shining a light on a developing system of governance with an eye towards evaluating its effectiveness, which has been a matter of great debate in the public sphere, while simultaneously doing empirical work that could perhaps contribute to – but of course not offer to resolve – the longstanding debates about the efficacy of self-regulating institutions generally, which has also been central to global debates about the governance of many important issues ranging from climate change to human rights.

Data and Methodology

Beginning in the Fall of 2007, efforts were made to reach out to various individuals at EPFIs. These outreach efforts came to fruition in April 2008 with a meeting in Washington, D.C. with a former World Bank employee who at the time advised one of the leading EPFIs. The meeting was used to explore the feasibility of conducting an empirical study of the banks and led to a further series of conversations with a member of the Steering Committee of the EPFIs in July 2008. These conversations led to an agreement with the Steering Committee (after an official referendum on the issue among Steering Committee members) to conduct an empirical study consisting of at least one and possibly two phases: (1) a qualitative interview phase followed by (2) an online survey instrument phase. It was arranged that access initially would be given to all members of the Steering Committee and that if the Committee was satisfied with the way the research was conducted, it would provide direct access through its email listserv to *all* EPFIs. After some delay, an invitation letter was circulated in April 2009 to the Steering Committee banks, and interviews were scheduled throughout May, June, July and September. In order to refine areas of inquiry for the Steering Committee Phase I interviews, a series of preparatory interviews were conducted with knowledgeable individuals in the project finance sector, including project finance staff at the International Finance Corporation actively engaged in assisting EPFIs with capacity development and outreach; activists at NGOs, and environmental and social risk consultants at several leading consulting firms.

Interviews were conducted at eight institutions located in New York (1), Paris (3), and Germany (2), with further interviews conducted over the phone with bankers in Italy (1) and Japan (1). At most banks, two individuals were interviewed because I anticipated that there might be broad variation between the knowledge and expertise of environmental and social risk personnel on implementation of the EPs as compared to that of “front office” or “business side” bankers, i.e., individuals on a project finance transactional team responsible for generating new deals and arranging them with clients. Thus, to get a broad understanding of how the norms of the EPs were being institutionalized and implemented across all aspects of the institutions’ project finance activities, interviews were arranged with both kinds of employees. All interviews were recorded with the permission of respondents and typically lasted about one-hour or slightly more. The interviews followed a semi-structured format, beginning with a script of questions but allowing room for tangents when necessary.

The interview process was very helpful in gaining an “insider’s” perspective on the project finance industry and the challenges in implementing the Equator Principles. The interviews were used to help refine the general areas of inquiry into more specific questions that could be asked of the larger EPFI population through the survey instrument during Phase II.

Following the successful completion of the interview phase, the initial results of the survey were shared with the Steering Committee, which then voted on whether to allow the study to progress to Phase II. This permission was granted in theory, subject to approval of the survey instrument itself. An online survey instrument was then prepared in draft form and was then reviewed by several of the members of the Steering Committee as well as the EPFI’s Secretariat staff person in the fall of 2009. Their review was to ensure that the questions asked were appropriate and would be palatable, and thus more likely to be answered, by the EPFIs. After further refinement, the survey instrument was circulated among the Steering Committee, which finally approved the survey instrument in revised form for circulation to all EPFIs in March 2010.

The researcher chose to work closely with the EPFI Steering Committee as a means of ensuring that the survey would be circulated among all EPFIs. Indeed, it was believed that respondents would primarily consist of those EPFIs who were most committed to implementing the EPs (Nicole Darnall 2005). It was further anticipated that respondents would overstate the extent of their implementation efforts. To combat this (and as a means of enticing participation because of the confidentiality concerns discussed above), the survey gathered the data anonymously.

The survey launched in late March 2010 and remained open through late June 2010. The Equator Principles Secretariat circulated invitation letters to all EPFIs – then numbering 65 institutions. It was expected that the EP contact point, typically an environmental and social risk manager, would be the respondent because of their extensive knowledge of institutional practices related to ESRM. In the ensuing weeks, the EPFI Secretariat sent out one additional reminder email, but did not permit further reminder emails to be circulated. The researcher attempted to circulate additional reminders to the complete list of EPFIs based on email addresses found through publicly available documents, but the compiled lists were impartial and may have contained inaccuracies. Over the course of the survey period, forty-two institutions opened the survey instrument, with twenty-four banks fully completing the questionnaire, yielding a 35

percent response rate, which is a bit higher than the twenty percent rate identified as typical for surveys of quality managers, of which the EPFI ESRM managers are a variety (although it should be kept in mind that these other studies had much larger N and sample sizes) (Naveh 2004). Those that opened the survey but did not complete it (18 banks) likely either decided not to participate only upon opening the survey itself or intended to participate and hoped to complete it at a later date, but did not find the time to do so before the survey period closed. Once the survey data was collected, the researcher re-coded the data to facilitate statistical analysis. Fisher's exact tests and a gamma index were used to examine the association between pairs of variables. The variables included in the analysis fall into three key groupings: (1) reputational exposure variables and experience with external stakeholders; (2) reputational exposure variables and understandings of shared reputation; and (3) reputational exposure variables and measures of implementation (see Chapter 6 and Statistical Appendix).

Data Limitations

The data suffers from two layers of selection bias. First, the sample is non-random, which flows from the decisions, as explained in the methodology discussion, to focus only on participants in the EPs, thus excluding other multinational banks. To evaluate how participation in the EPs is associated with increased levels of environmental and social risk management, it is necessary to determine what would have been the firms' practices in the absence of participation in the EPs (actual levels of ESRM practices could be compared with estimated counter-factual levels). If adoption of the EPs were random across all banks, a simple comparison of average levels of ESRM exhibited by EPFIs and non-EPFIs would establish the "effect" of being an EPFI. But adopting the EPs is not random; rather it is driven by a self-selecting process, likely determined by key bank criteria.

As discussed, this selection bias makes it difficult to draw any conclusions regarding the causal effect of participation in the EPs as a driver of the organizational changes observed; any number of confounding variables (such as bank characteristics) may be equally or more responsible for the observed changes (Khanna 2009).¹⁵⁴ Where possible, the survey attempted to

¹⁵⁴ For example, previous research conducted a large-N study of adopters and non-adopters, finding that "financial institutions that adopted the EP show a significantly higher score on their CSR policies, are significantly larger, and carry some extra costs, compared to parties who did not adopt" (Scholtens 2007). For these scholars, "the combination of observing larger banks adopting the EP and observing lower operational profits for these banks suggests that: (1) adopting the EP is not window dressing, but exhibits real costs; and (2) for larger banks the benefits of signing up—which we think of as being reduced risk, albeit not observable in the financial data—outweigh these costs." These results confirmed for Scholtens and Dan their perception that CSR behavior is most often displayed by banks that are in the spotlight. A potential gap in Scholtens and Dan's analysis, however, is it does not clarify the causal relationship between the observed "higher costs" for EPFIs and compliance with the EPs (or even costs related to CSR activities more generally). Indeed, little is known about how much, if any, the banks spend on implementing the EPs or other CSR costs. Were the higher costs observed by Scholtens and Dans incurred in implementing the EPs themselves or are they attributable to generalized operating costs that are unrelated to implementation with the EPs? As Scholtens and Dan point out, project finance is such a small aspect of any bank's business. With this in mind, it is much more likely that higher operational costs are attributable to non-EP-specific costs of doing business.

compensate for this difficulty by asking questions that put the respondents in the position of evaluating causation as part of their responses.¹⁵⁵

A second layer of potential selection bias lies in the low response rate and the self-selection by respondents to choose to participate in the survey. The researcher anticipated the low-response rate from the start of the study, but accepted that it might be inherent to the exploratory nature of the project, particularly given the confidentiality concerns of the research subjects. This second layer of bias ordinarily would tend to inhibit the power of any extrapolation from the experiences of the sample to the broader EPFI population, but, as discussed below, the sample is in fact quite representative along a number of important factors.

Sample Validity

The superficial representativeness of this sample is discussed along several characteristics that neoinstitutional theory suggests are significant, including year of adoption, governance level of country of origin and the type of institution. The significance of these variables is discussed below.

Year of adoption. The 24 respondents comprise a cross-section of institutions that adopted the EPs, with adopters in 2003-2006 being considered “early” adopters and those following 2006 being considered “late” adopters. This is a significant variable to focus on because of the theory in neoinstitutionalist literature, initially formulated by (DiMaggio 1983) and confirmed in numerous instances (Naveh 2004), that early adopters are serious about efficiency gains and make substantive innovations, while late adopters are more interested in gaining the legitimacy from adopting these innovations (Naveh 2004; Delmas 2010).

The challenge in attempting to confirm this theory is that institutions’ internal practices evolve over time, as do external pressures; what might have been purely superficial adoption of some or all of the Equator Principles could develop later into a real, substantive internalization of the norms and a concrete application of them through new policies and procedures. In addition, unlike other industries or institutional environments in which the external normative pressure is generated predominantly by the competitive interactions of actors in a field, which, while ever-present and potentially powerful, nonetheless operate in a passive way, in the case at hand there are *active* external stakeholders in the form of NGOs whose activities might only increase after adoption. Indeed, my survey data indicates that most actors (fifty-eight percent) did experience an increase in NGO pressure following adoption. Moreover, it is feasible that the collective nature of the EP regime, once established, means that the pressures and standards of behavior established in the earlier years are additive; thus, a late-adopter enters the game when the stakes—acceptable levels of sustainable practices—have already been raised considerably. Of course, a late-adopting institution is not hidden from view during the period prior to its adoption, and thus, they are subject to these same industry-wide pressures. Finally, some banks waited to

¹⁵⁵ For example, one question asked respondents to “Please select the statement that best reflects the evolution of your institution’s ESRM structures,” and gave them the answer choice of: “We designated personnel and/or created a department to review projects for ESRM because we were adopting the Equator Principles.”

adopt until they felt that their internal procedures were EP-compliant, rather than adopt the EPs and then begin bringing their policies and practices into conformity.

Governance Levels in Country of Origin. Neoinstitutional theory observes that actors might be influenced by normative environmental pressures, such as advocacy by NGOs. Such pressures flow more readily in institutional environments and societies that are open and democratic. In fact, a previous study of adoption rates of EPFIs observed that there was a concentration of early adopters' incorporated or headquartered in institutional environments with strong "voice and accountability" (high levels of protection of civil liberties) and "government effectiveness" (high bureaucratic competence and quality of public service delivery), i.e., OECD countries in Europe and North America. Early adoption was much lower, they found, in institutional environments with weak regulatory pressure and reduced civil society scrutiny, thus removing the major impetus in adopting a code like the EPs, reputational gains (Wright and Rwabizambuga 2006).

It should be kept in mind, however, that the vast majority of the most active banks in project finance (and finance generally) have traditionally been concentrated in North America and Western Europe. The sample of institutions studied here is consistent in this regard: there is a relationship between governance level and number of projects banks they estimate that they finance yearly ($p = .039$, FET), as well as between governance level and the estimated total number of "risky" projects financed ($p = .005$, FET) and estimated total number of times serving as an advisor ($p = .059$, FET). This is discussed further below in relation to the banks' perceptions of reputational risk exposure and the origins of the Equator Principles

Table 5.1 – *Governance level and lending activity*

		Non-OECD/ Low-Income	OECD	High-Income OECD
Estimated Projects Reviewed ($p = .08$)	0-10	4		2
	11-29	2		4
	30+	2		10
Estimated Projects Financed ($p = .04$)	0-10	5		2
	11-29	2		4
	30+	1		10
Estimated High Risk Projects ($p = .005$)	0-10	7		5
	11-29	1		0
	30+	0		10
Estimated Times Served as Advisor ($p = .06$)	0-10	6		6
	11-29	1		3
	30+	1		7

Type of Institution (commercial bank, state-owned, export credit agency, development finance institutions (DFI)). It is unclear exactly what significance this criteria might have on bank implementation of the EPs, but it is one of the measurable criteria available through public information, and it might be important to distinguish between purely commercial banks and state institutions, whether they are national banks, export credit agencies (ECAs, e.g., Australia's Export Finance and Insurance Corporation, or EFIC) or development finance institutions (DFIs, e.g., FMO of the Netherlands, EDC of Canada).¹⁵⁶ Because of their public nature and development focus, it might be expected that bilateral DFIs, similar to their multilateral counterparts (e.g., the World Bank and IFC) would be "ahead of the curve" with respect to sustainability. They thus have different institutional endowments and competencies than commercial banks. For this reason, it is important to keep track of them in evaluating the representativeness of the sample. Moreover, the EPs are largely a regime created by and targeted at private commercial banks; the handful of DFIs that have adopted the EPs have likely done so not to improve their reputations, but out of a sense of solidarity or support for the initiative and its aims, as well as to contribute towards the further harmonization and standardization of bank practices in this high-cost area, which is particularly important because of the frequent occurrence of "co-financing," wherein public bilateral or multilateral development institutions cooperate with the private commercial banks in financing projects.

¹⁵⁶ The last of these two kinds of institutions requires some explanation: an ECA is a national institution that exists to promote a country's exports in foreign markets, whether by loans or loan guarantees. A DFI, however, is a more complicated animal, because while it also promotes exports and does so with attention to profitability, it simultaneously seeks to promote economic and social development in the host country receiving the investment. There are multilateral DFIs, such as the IFC, the Inter-American Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank and the Asian Development Bank, but there are also numerous bilateral DFIs (15 in Europe alone) (Advisors 2010). As Simms explains,

Unlike universal and commercial banks, DFIs have no depositors; their investment capital comes exclusively from their shareholders. For the multilateral DFIs, the member countries subscribe capital. For bilaterals, some are wholly owned by government, such as Deutsche Investitions und Entwicklungsgesellschaft (DEG), the German DFI, which is wholly owned by KfW bank group, which provides development loans to governments. Other bilaterals are partly owned by the private sector, such as Compañía Española de Financiación del Desarrollo (COFIDES), the Spanish DFI, which is 39% held by the three largest Spanish private banking groups.

(Simms 2008), p. 5. Many of the bilateral DFIs in Europe have been around since the 1960s and 1970s, and their annual investments correspond to roughly 6% of Official Development Assistance provided by their governments. What is important to note is that the goals of DFIs are not the same as Official Development Assistance, which goes to governments, nor is the same as commercial banks, which go exclusively to private sector projects with attention only to the profitability of the projects for investors: "The approach of the European DFIs is to invest in private sector projects that not only have development impact but are also financially viable. In making investments they are guided by three principles: the need to be additional (going where other investors don't), catalytic (paving the way for others to follow) and sustainable (making sure that investments have long-term viability). This investment approach allows the DFIs to provide access to finance for the private sector in countries where this is a prerequisite for economic development and poverty alleviation" (Advisors 2010).

Leadership Role. This is a potentially significant criteria because assumption of a leadership role suggest more than a passive involvement in the maintenance of the EP regime. Leadership or stewardship can be demonstrated in any number of ways, from membership on the Steering Committee or other Working Groups, to outreach to other institutions, or more passively, such as through participation at the annual IFC Learning Days and related EPFI annual meetings. There are costs involved in undertaking these “extra-curricular” activities, and accordingly, banks that have adopted the EPs merely for symbolical reasons would probably think twice before committing to participation in these ways.

While on the other hand, it could be argued that “laggard” banks might have an interest in steering the regime towards lower standards of membership, thus suggesting an incentive in participating in leadership activities because doing so in some capacities might afford a “laggard” the opportunity to affect the overall direction of the regime toward the “lowest common denominator” thereby lowering their overall costs and required investment in sustainable practices, I think there are strong reasons to reject this possibility. While there are suspicions of the presence of “laggards” in the industry, there is no evidence of any institutions swimming against the current of reform or the regime’s broader objectives and strategies; moreover, whatever few there might be who would be willing to take such an active stance of resistance would almost certainly be drowned-out by the larger and more powerful majority of core institutions who have initiated most of the progressive evolution of standards. More importantly, such reactionary behavior would be open and obvious, and thus detrimental to the counter-reformists banks’ abilities to initiate or participate in loan syndicates. With this in mind, participation in leadership activities is likely a relatively reliable sign of bank commitment to the EPs (although the exact costs of such heightened activity is difficult to quantify).

Table 5.2 – *Representativeness of Sample Along Key Characteristics*

		Study Participants (24)	All EPFI (65) ¹⁵⁷
Year of Adoption	Early (2003-2006)	63 % (15 banks)	61.5 % (40 banks)
	Late (2007-2010)	37 % (9)	38.5 % (25)
Governance Level of Home Country	Non	29.2 % (7)	23% (15)
	Low-income	4.2 % (1)	3 % (2)
	High-income	66.7 % (16)	74% (48)
Type of Institution	Commercial bank	83 % (20)	89.2% (58)
	ECA	8.3 % (2)	7.7% (5)
	State-owned	8.3 % (2)	3.1 % (2)
Leadership Activities	Steering Committee	37.5 % (9)	23% (15)
	Working Group	41.5 % (10)	26% (17)
	No Leadership Role	21 % (5)	46% (30)

Sample Size

A further difficulty with the data is the sample size, which restricts the power of the statistical tests. This means that there is an increased risk of Type II errors, that is, an increased chance of failing to observe effects that are present. Another limitation that might have an effect on the conclusions drawn is the problem of multiple-testing resulting from the exploratory nature of the data testing. The problem of multiple-testing exacerbates the typical false-positive (Type I) error rate, which is equal to the threshold for statistical significance (.05)¹⁵⁸

Nevertheless, in considering these caveats it is important also to keep in mind an important, and distinguishing structural aspect of the project finance market: the loan syndicate structure. As explained in Chapter 1, most large-scale infrastructure projects are co-financed in syndicates of loans arranged by a lead-arranger bank that pull together various sources of capital

¹⁵⁷ The survey closed in early June 2010. This was before BMCE (Morocco) or Eksportfinans (the Norwegian ECA) joined. It is unclear whether ABN Amro and Fortis Bank (Nederland), which as of July 1, 2010 have merged into one entity (ABN Amro) participated separately or together or at all in the survey. For purposes of this analysis, I assume that by time the survey was circulated, these banks had already brought together their ESRM over project finance, and if they responded, they would have done so as one entity. Additionally, as of July 1, 2010 two institutions in the United States (JP Morgan, Wells Fargo) officially elected to change their status to “Associate Institutions,” which was a status newly created by the Association Rules, allowing an institution to adopt the regime “as part of its broader approach to sustainability” despite not being active in project finance, thereby allowing it to affiliate with the EPs (Associates’ names appear with that designation on the List of EPFIs on the Equator Principles website). According to the Association’s Rules, Article 3(f), “Principles 1-9 of the Equator Principles may not all be directly relevant to an Associate, but all Associates are under an obligation to report under Principle 10. An Associate needs to report on the extent to which the Principles are relevant to it.” Accordingly, given this choice and their lack of significant project finance activity, these two banks are removed from the list of EPFIs in the study, leaving 65 institutions.

¹⁵⁸ There are various ways to deal with multiple-testing issues (Benjamini 2000), but I have not adopted them in this study.

from several other institutions. As long as any of these institutions is an EPFI, the EPs apply to the deal. This helps explain how “nearly 95%” of all project finance transactions are now covered by the EPs (Department 2010). Furthermore, the top lead arrangers have traditionally dominated the market. For example, as of April 2007, there were fifty EPFIs; 19 of these (many in the Steering Committee) were in the top 40 lead arrangers of project loans in 2006, responsible for arranging 47% of all project loans. These structural dynamics suggest that the overall effectiveness of the EP regime’s ability to regulate the bulk of the project finance industry rests in the effectiveness in the regime to instill compliance among these core institutions.

CHAPTER 7: EFPI EXPERIENCE WITH EXTERNAL ACTORS AND UNDERSTANDING OF INDIVIDUAL AND COLLECTIVE REPUTATION

Despite the apparent consilience (Wilson 1999) in the social sciences on the dynamics of collective reputation and individual actors' quest for organizational legitimacy drivers of the formation of and compliance with self-regulating institutions, there is little empirical work investigating the foundations of these theories. Much research assumes the relationships and uses proxies of firm behavior to connect the dots back to reputational pressure. Because of the continuing growth of soft law among state actors and the rise of corporate self-regulation and voluntary regimes, it is important to confirm these theoretical assumptions with empirical evidence. It is particularly important in a voluntary regime like the Equator Principles, which, as noted, lack robust monitoring or sanctions, and therefore, rely almost exclusively on reputation-driven normative pressures from stakeholders for enforcement.

To confirm these theorized relationships, this chapter discusses the responses to several survey questions about the operation of reputational dynamics among the EPFIs, as well as their own subjective understandings of how reputation works. In doing so, it considers what previous scholarship about the EPs had theorized and observed anecdotally about their origins. As will be discussed, the survey data offers numerous points of support for theories about the formation of self-regulating institutions, the power of external stakeholders applying normative pressure on organizations to affect change, and the operation of reputational concerns as a driver of behavior.

Formation of the Equator Principles

My research provides further support for the theoretical paradigm discussed in Chapter 1 and confirmed some of the explanations offered by previous research with respect to the Equator Principles' formation (Almaric 2005; Watchman 2007). In the theoretical paradigm presented, there is a privileged group of core actors whose interest in creating self-regulation is greater than others because of their size, visibility, market share, etc. Indeed, earlier studies of the EPs (Wright and Rwabizambuga 2006) identified several factors that they found co-related positively with early adoption of the EPs. Wright and Rwabizambuga noted that there was a concentration of early adopters that were incorporated or headquartered in institutional environments with strong "voice and accountability" (high levels of protection of civil liberties) and "government effectiveness" (high bureaucratic competence and quality of public service delivery), i.e., in Europe and North America. Early adoption was much lower, they found, in institutional environments with weak regulatory pressure and reduced civil society scrutiny, thus removing the major impetus in adopting a code like the EPs, reputational gains (Wright and Rwabizambuga 2006).

Wright and Rwabizambuga also note a correlation between the presence of civil society groups who are members of the Banktrack network and countries with at least one EPFI. Finally, they point out that signatories typically have a global scope of operations and are involved in project finance in a variety of capacities, and therefore have a more visible role in high-risk project finance deals, thereby increasing the likelihood that environmental malpractice may be exposed by stakeholders and cause damage to corporate reputation. In contrast, banks

whose project finance activity is limited to regional markets tended not to adopt. Lending in these regional markets, they observe, is also often dominated by public institutions, which are not the true target audience of the EPs (Wright and Rwabizambuga 2006). In short, following the theoretical paradigm presented above, they conclude that codes of conduct such as the Equator Principle are created “as tools for maintaining or enhancing corporate reputation in institutional environments where it is threatened” (Wright and Rwabizambuga 2006)

Offering some evidence confirming Wright and Rwabizambuga’s analysis, my research shows that a statistically significant higher proportion of banks from high-income OECD countries were early adopters (81%) than the proportion of early adopters from low-income OECD or non-OECD countries (25%) ($p = 0.01$, Welch’s t-test). This finding is consistent with other findings: a higher proportion of banks from high-income countries reported being targeted by a public advocacy campaign (91%) than did those from low-income OECD or non-OECD countries (8%) *prior* to adopting the EPs ($p = 0.01$, Welch’s t-test), and overall (i.e., targeted either before or after adoption) ($p = 0.01$, Welch’s t-test).

There was also an association between levels and riskiness of finance activity and the relative pressure experienced from different stakeholders prior to adoption. For example, the number of estimated projects financed annually was associated with the relative level of pressure banks claimed to have experienced from NGOs in their home countries ($p = .013$, FET). In addition, the number of estimated “high risk” projects financed since 2003 was associated with both (1) the relative pressure felt from shareholders ($p = .018$, FET), and (2) whether an institution was in fact targeted by a public campaign prior to adoption ($p = .037$, FET). These associations suggest that the more exposed banks did “feel the heat” more than others.

Reputational Dynamics

Though most literature on self-regulation posits that actors can overcome collective action problems when pushed by external pressures by stakeholders, to the author’s knowledge, there have not been attempts to gather empirical evidence to confirm these dynamics *from the perspective of the targeted actors*. In other words, do firms that create self-regulating institutions themselves in fact believe that they share a reputation with other actors in the same industry or do they believe they have their own individual reputations, or some mixture of the two? Also, who are the “reputation makers,” the relevant publics and audiences that help to form a firm’s or an industry’s reputation, and which stakeholders exert more influence than others?¹⁵⁹ Does this

¹⁵⁹ There is some anecdotal evidence that these reputational intermediaries can vary by bank and region, thus presenting differently-situated institutions with different options with respect to controversial projects. For example, one of the most controversial projects backed by EPFIs is the Sakhalin II gas pipeline, which has gained notoriety for its potential impacts on local wildlife, particularly whales. The project has been under attack since 2004, when construction started (which was still the very beginning of the EP regime). Because of the intense focus on the project by European NGOs, no European bank, including EPFIs, wanted to be the “environmental bank” on the deal. A Japanese bank representative explained that its status as an EPFI enabled it to beat other competition to become a mandated lead arranger for the project. Unlike many European banks, it was politically feasible for it to do because the Japanese intended to import 70% of Sakhalin’s gas (indeed, the Japanese ECA, JBIC, was supporting the project, which it hoped would diversify the nation’s gas imports, balancing its reliance on Middle East oil), making the Japanese commercial bank’s position very strong and its commitment to the environmental issues

pressure increase, decrease or stay the same following the creation of a self-regulating regime or its adoption by various actors?

A related question arises from the international relations literature, which suggests that while state actors can hold multiple reputations across different issues areas and between different parties, these separate reputations are probably linked and subject to spill-over across categories (Guzman 2006). Like states, private actors, particularly multinational enterprises such as large commercial banks, also have a variety of stakeholders about whom they are concerned. But, like states, are they also concerned about negative reputational spill-over—the chance that a reputation for respecting labor laws could migrate into their reputation for quality control of their production process, or that an NGO’s criticism of them in a local paper on one large project in Country X could affect their overall brand name for unrelated transactions elsewhere in the world in a different area of their business (e.g., consumer banking and credit cards). This section addresses some of these questions as they are reflected in the experience of the EPFIs. Arguably, these actors’ subjective understandings of reputational dynamics could have important policy implications for both regulators and civil society advocates alike: where are these institutions true pressure points and how can pressure against one area of activity affect others?

Bank perception of “shared” reputation

A critical assumption of the strategic mechanisms of the collective action literature and the legitimacy-seeking functions of the neoinstitutionalist literature is that a group of targeted actors might organize self-regulating institutions out of a sense of “shared fate” to either solve information asymmetries or in response to commonly-feared sanctions. To the extent that these responses are based on external actors’ measurement of these targeted actors’ reputations, much of the theoretical paradigm depends on these actors themselves *actually sensing that they have a shared reputation*, whether as an industry or as a smaller subset of actors. But, we have little empirical evidence to prove that this is in fact the way these actors see the world or their particular situations at the moment of self-regulating institutions’ origins. To confirm these assumptions, the survey asked the EPFIs about their own sense of reputation, and how it operated among a larger collective of actors.

unassailable; in contrast, the European banks were only involved because of their backing of a major repeat client/player (Shell).

Interestingly, while European NGOs were primarily focused on the whales, the Japanese NGOs were less concerned about the whales because it forms a regular part of the Japanese diet. The Japanese bank engaged Japanese NGOs on the issues that most concerned them: the over 1000 river crossings of the pipeline and the potential threats presented by oil spills to the pristine Hokaido Island nature reserve, which forms a part of the migratory path of a species of eagle (with Sakhalin being the other end). As the banker explained, “even if a project has a good balance between the economy and the environment, there will be different views on the project,” noting that after the European Bank for Reconstruction and Development pulled-out of the deal, the Royal Bank of Scotland also pulled-out, all because, as the Japanese banker explained, “the British *love* whales.”

Table 7.1 – Bank perception of extent of collective reputation

Please state the extent to which you agree with the following statements: Agree strongly = 1 Agree = 2 Disagree = 3 Disagree Strongly = 4		Early vs. Late Adopters		Governance		Size	
		% of Early (# of Early Adopters out of 15 total)	% of Late Adopters (# of Late Adopters out of 9 total)	% High Income OECD (out of 16 total)	% Low Income/Non-OECD (out of 8 total)	% Global or Regional (out of 21 total)	% National (out of 3 total)
<i>Individual banks have individual reputations</i> Avg. Rating 1.58	Agree strongly	46.6% (7)	44.4% (4)	56.3% (9)	25% (2)	48% (10)	33% (1)
	Agree	53.3% (8)	44.4% (4)	37.5% (6)	75% (6)	53% (11)	33% (1)
	Disagree	0%	11.1% (1)	6.2% (1)	0%	0%	33% (1)
	Disagree Strongly	0%	0%	0%	0%	0%	0%
<i>ALL banks share a common reputation</i> Avg. Rating 2.38	Agree strongly	13.3% (2)	0%	6.2% (1)	12.5% (1)	9.5% (2)	0%
	Agree	53.5% (8)	33.3% (3)	56.3% (9)	25% (2)	43% (9)	100% (2)
	Disagree	33.3% (5)	66.7% (6)	37.5% (6)	62.5% (5)	48% (10)	33% (1)
	Disagree Strongly	0%	0%	0%	0%	33% (7)	0%
<i>Equator Principles banks as a group share a distinct reputation</i> Avg. Rating 1.83	Agree strongly	26.6% (4)	33.3% (3)	25% (4)	37.5% (3)	53% (11)	100% (3)
	Agree	60% (9)	55.5% (5)	62.5% (10)	50% (4)	14% (3)	0%
	Disagree	13.3% (2)	11.1% (1)	12.5% (2)	12.5% (1)	0%	0%
	Disagree Strongly	0%	0%	0%	0%	0%	0%

As Table 7.1 illustrates, banks largely felt that they maintained individual reputations while also sharing a collective reputation (52% of those who either agreed or strongly agreed with the proposition of having individual reputations also agreed that banks share a collective reputation; 47.8% of those who agreed or strongly agreed on individual reputation disagree or disagreed

strongly with the possibility of having a collective reputation). Interestingly, there was an even higher percentage (87%) of those who agreed or strongly agreed on individual reputations who felt that EPFIs shared a distinct reputation, whereas only 13% of those who agreed or strongly agreed on the existence of an individual reputation disagreed or disagreed strongly on the notion of EPFIs sharing a distinct reputation.

Looking more closely at the data, gamma indices show several interesting relationships (see Panel D in Statistical Tests Appendix). In particular, early adopters were very strongly associated with the view that banks have individual reputations, which makes sense given their own decisions to adopt the EPs early to gain as much reputational benefit and market distinction relative to their competitors. In addition, consistent with this finding, the most visible banks—those banks that did the most advising of deals, reviewed the most projects, financed the most projects, and financed the most “high risk” projects—all were associated very strongly with belief in individual reputations. The views on the collective nature of reputation across the entire industry were more parsimonious and less clearly associated with reputational risk variables of a particular type. Quizzically, the view that all EPFIs hold a reputation in common was inversely associated (negatively related) with many of the reputational risk variables (size, high risk projects financed, times served as an advisor to deal, targeted prior to adoption), although not as strongly as some of the variables were associated with the belief in individual reputations.

Bank perception of “relevant publics” or “reputational intermediaries”

Equally important as what the banks think of the extent of their “collective fate” are the views of the external actors who are assessing their reputations, regardless of whether they are individually assessed or assessed collectively. Accordingly, the survey also inquired into the banks’ understandings of which external actors were most relevant to the formation of their reputations (Table 7.2).

Table 7.2 – *Bank perception of external actors’ awareness of bank reputation*
(Agree strongly = 1; Agree = 2; Disagree = 3; Disagree Strongly = 4)

Please state the extent to which you agree with the following statements:	Average Rating
The average consumer is aware of a bank's reputation for ESRM issues	2.88
ONLY NGOs and other banks are aware of a bank's reputation on ESRM issues	2.57
Infrastructure project finance clients are aware of a bank's reputation on ESRM issues.	2.00

To these responses, several banks added the following comments:

- *“The impact is usually marginal on our reputation and not easy to quantify.”*
- *“Definitely average consumer not aware. *Some* infrastructure clients are aware, but not across the board. Mostly it’s NGOs and other banks that are aware.”*

- *“The market in which we operate is very new to the ESRM concept in financing, and the NGOs and clients within these markets are on an educational journey regarding ESRM. Consumers are very much not aware of ESRM requirements and reputations in our market.”*
- *“All major mining and infrastructure clients would understand, [as would] the local media, NGOs and interested stakeholders from a range of areas.”*

In summary, most banks do not think that the average consumer is aware of a bank’s reputation for ESRM issues, but that most infrastructure clients are aware of bank’s reputations for these matters.¹⁶⁰ This coheres with a recent study conducted by EIRIS, a British sustainability research service, which found that there is strong consumer interest in banks with ethical lending practices. EIRIS found that (seventy-three percent of the British public think banks should have ethical lending policies circumscribing investment in controversial sectors or to companies with circumspect track records with respect to human rights and the environment), but consumers are prevented from making informed decisions about where to bank by the lack of information disclosure by banks, which seventy-seven percent surveyed ranked as the highest priority for banks to provide consumers.¹⁶¹ Because the Equator Principles are themselves an effort to check what is perceived as lackluster environmental governance by project sponsors (i.e., bank clients) the NGOs are forced to target consumers in the hopes that campaigning on ESRM issues related to project finance will have reputational spill-over effects or generalized reputational effects that will put enough pressure on banks to continually improve their project finance governance issues. Later in this chapter, I discuss whether the banks themselves believe in the potential for such spill-over effects.

Relative power of external stakeholders

To get confirmation, from the subjective experience of the banks, on which external actors constituted the greatest source of pressure, the survey asked respondents to rank the following external actors in terms of the level of contact and/or pressure they had experienced from them “related to ESRM issues in project finance.”¹⁶²

¹⁶⁰ Understandably, there was greater parity of opinions on the more strongly-worded option (“ONLY NGOs and other banks are aware of a banks’ reputation on ESRM issues”), presumably because agreeing with it completely would have precluded *any* consideration of consumers on the one hand or infrastructure clients on the other.

¹⁶¹ See EIRIS, *Public want banks to lend ethically, survey finds*, 8 November 2010, at <http://www.eiris.org/media.html#UKSurv> (last visited December 7, 2010).

¹⁶² Regrettably, the survey did not canvass the views of the banks on the relative power of their clients, i.e. project sponsors, as external stakeholders.

Table 7.3 – *Bank perception of relative pressure exerted by external actors*

(No contact/pressure = 0; Some contact/pressure = 1; Very little contact/pressure = 2; Intense contact/pressure = 3)

External actor (in descending order of pressure experienced overall)	Average Rating
Transnational non-governmental organizations (NGOs) or coalitions	2.00
NGOs in country of origin	2.00
NGOs in host countries	1.58
News media	1.38
Shareholders	1.13
Regulator in project host countries	1.08
International organization	1.08
Socially responsible investment funds	1.04

As Table 7.3 illustrates, transnational NGOs and NGOs in the banks' home countries exerted the greatest pressure on the banks surveyed.

Reputational Exposure and Subjective Experience of Stakeholder Pressures – Experience with NGOs and public advocacy campaigns

Having anticipated from anecdotal evidence that transnational NGOs and NGOs in home countries would be considered to have exerted the most pressure overall the study then focused in greater detail in the role of NGOs in particular, asking respondents to select the statements that reflected their experiences with NGOs before and after adopting the EPs.¹⁶³

Table 7.4 – *Bank contact with NGOs prior to adoption*

Previous contact with NGOs	Response Percentage (# of Banks)
NGOs had contacted us or PUBLICLY protested our involvement with specific projects	45.8% (11)
NGOs had contacted us or pressured us PRIVATELY	37.5% (9)
NGOs had contacted or publicly protested <i>sponsors</i> regarding specific projects we financed, but did not specifically target <i>OUR</i> institution	16.7% (4)
NGOs had contacted us or applied PUBLIC pressure for us to adopt the Equator Principles	8.3% (2)
We never had any contact with NGOs	29.2% (7)

It is interesting to note that only two institutions reported having faced pressure explicitly to adopt the EPs and that an additional seven institutions (nearly thirty percent) had *no prior contact* with NGOs, whether publicly or in private. This suggests that with respect to these

¹⁶³ Unsurprisingly, there was a highly significant relationship between the relative pressure experienced from NGOs overall and whether banks had been targeted by public campaigns ($p = .007$, FET).

instructions, the pressure to adopt likely came most from market forces and a sense of peer pressure from other banks that adoption was a wise move.

There were also significant associations between whether banks experienced pre-adoption contact and the number of estimated projects financed annually ($p = 0.047$, FET), confirming neoinstitutional insights that the more visible institutions attract the most attention. The survey also inquired in greater detail about the *form* of pressure experienced, focusing on the role of public campaigns against “problem projects,” by asking whether institutions had experienced such campaigns prior to adoption. Just slightly over 50 percent of all EPFIs surveyed reported having been targeted related to specific projects *before* adopting the EPs.

Statistically significant associations were also observed between the governance level of banks’ country of origin and whether banks were targeted *prior* to adoption ($p = 0.03$, FET) or targeted at any point ($p = 0.005$, FET), which a gamma test revealed were also significant.¹⁶⁴ There was also an association between the number of “high-risk” projects undertaken (by the banks’ own estimates) and whether they were targeted *prior* to adoption ($p = 0.04$, FET),¹⁶⁵ which a gamma test also showed to be significant ($\text{gamma} = .71$; $p < .001$).¹⁶⁶ There were also significant associations between whether banks were targeted at *any point* and several of the indicators of the scope of the banks’ financial activity, including the number of projects *reviewed* annually (by the banks’ own estimates) ($p = 0.01$, FET) and the number of high-risk projects funded ($p = .01$, FET). The number of projects *financed* annually (by the banks’ own estimates) was on the border of being significantly associated with having been targeted at any point ($p = .058$, FET).

There were other relationships of note as well. For example, institutional size was associated with the relative level of pressure experienced by banks from NGOs based in their home countries ($p = 0.01$, FET), from transnational NGOs ($p = 0.04$, FET), and host country regulators ($p = 0.04$, FET).¹⁶⁷ The number of projects reviewed annually (by banks’ own estimates) was associated with the relative level of pressure experienced by banks from NGOs in their countries of origin ($p = 0.04$, FET), which the gamma test revealed to be positive and significant, although not as strong as other relationships ($\text{gamma} = 0.43$, $p = 0.03$). There were also positive and significant relationships between the number of projects reviewed relative level of pressure experienced by banks from transnational NGOs ($\text{gamma} = 0.45$, $p = 0.02$), from socially responsible investment funds ($\text{gamma} = 0.51$, $p = 0.01$), and from the media ($\text{gamma} = 0.46$, $p = 0.02$).

¹⁶⁴ “Governance level” by “targeted prior to adoption” ($\text{gamma} = .88$; $p < .001$); “governance level” by “targeted at any point” ($\text{gamma} = .91$, $p < .001$).

¹⁶⁵ Although other data shows that the most intense source of pressure came from transnational NGOs, the reality is that most of the NGO campaigns operate collaboratively, and the Banktrack “network” of NGOs is constituted by several national NGOs in different countries.

¹⁶⁶ Other relationships were also positive, but not as ‘strong’ in that direction, nor as significant, including the number of projects reviewed ($\text{gamma} = .44$, $p = .05$), financed ($\text{gamma} = 0.3$, $p = 0.17$) and the size of the institution ($\text{gamma} = .375$, $p = .24$).

¹⁶⁷ ($\text{Gamma} = 1$, $p = 0$).

Similarly, the number of projects financed also was associated with the relative level of pressure experienced by banks from NGOs in their countries of origin ($p = 0.01$, FET), which the gamma test showed to be a positive and significant relationship ($\text{gamma} = 0.73$, $p < .001$). Thus, the more projects being financed, the higher the level of pressure banks experienced from NGOs in their countries of origin. The estimated number of projects financed was also related positively and significantly to the relative pressure exerted by transnational NGOs ($\text{gamma} = 0.53$, $p = 0.006$), NGOs in host countries ($\text{gamma} = 0.4$, $p = 0.04$) and pressure from socially responsible investment funds ($\text{gamma} = 0.47$, $p = 0.02$). Overall, then, the level of funding activity of banks was a fairly good predictor of how much pressure they would experience.

Finally, the number of high risk projects financed was associated positively and significantly with the relative pressure experienced from transnational NGOs ($\text{gamma} = 0.51$, $p = 0.01$), pressure from NGOs in countries of origin ($\text{gamma} = 0.63$, $p = 0.0019$), NGOs in host countries ($\text{gamma} = 0.46$, $p = .03$), from shareholders ($\text{gamma} = 0.74$, $p = 0.00000115$), from socially responsible investment funds ($\text{gamma} = 0.58$, $p = 0.0045$), and from the media ($\text{gamma} = 0.55$, $p = 0.013$).

In sum, my data offers considerable evidence confirming the neoinstitutionalist paradigm presented in Chapter 1, which suggests that we should see relationships between various bank criteria signifying greater reputational exposure and an increase in normative isomorphic pressures, i.e., subjective experience of pressure from various stakeholders, including the experience of being targeted by public advocacy campaigns. This data confirms again the neoinstitutionalist insight that the larger, more “visible” firms will invite greater external stakeholder pressures.

Motivations for forming the Equator Principles—Testing Earlier Theories

In addition to gathering more data on the concept of reputation as it is experienced by the banks, the survey also inquired into the relative influence (on a scale from “no influence” to strongest influence”) of a variety of factors in the banks’ decisions to adopt the Equator Principles. Previous work on the EPs presented several ideas as to the motivations of the banks who created them, most of which were consistent with the theoretical paradigm discussed in Chapter 1. Amalric and Hauser suggested that the most-risk exposed banks may have created the EPs as a strategic response to an industry threat, their aim being to level the playing field in the industry among players facing similar levels of reputational risk and to simultaneously prevent less-exposed banks from gaining a competitive advantage by funding extremely risk projects.¹⁶⁸ It is clear that this was a real concern among financial institutions; ANZ Investment Bank of

¹⁶⁸ An example of this dynamics is evident in the case of a proposed pulp project by Gunns, an Australian company, in the Tamar Valley in Tasmania. An NGO commissioned an environmental impact assessment that concluded that the local tourism industry would be severely impacted by the harm to the environment from increased road traffic in logging transportation, as well by air pollution and reduced air and water quality. Gunns’ report had concluded differently, predicting substantial benefits to the local economy. One EPFI that initially intended to finance the project withdrew without stating reasons, although an NGO had contact it complaining that it had failed to conduct the appropriate environmental impact assessments. After the bank withdrew it formed a forestry sector policy; in the meantime, however, a non-EPFI stepped-in.

Australia expressed reservations about initial drafts of the EPs because they did not seem to apply to all banks: “No banks from the Middle East, Latin America, or Asia were part of the early discussions. Without them on board, ANZ and other banks, by adopting the Principles, would potentially be at a competitive disadvantage against the regional and domestic banks when bidding for lead arranger mandates in those regions” (Esty 2007).

Another motivation, according to Amalric, may have been for the EPs to serve as a vehicle for centralizing the screening of projects, filling the vacuum left by the retreat of the World Bank from this role (Amalric 2005). A centralized or standardized screening process serves to ameliorate the enhanced credit risk inherent in project finance lending by screening-out the overly-risky projects, screening is expensive and time-consuming, it is efficient to pool-resources, or at the least, standardize the processes of environmental risk management, which unfortunately cuts down inter-bank transaction costs. Almaric also notes that the EPs serve to counter critics of large development projects, giving the EP banks a seat at the table in the debates over appropriate standards.

Another early, informal survey of the EPFIs was conducted by project finance lawyers who often work on such projects. In their survey, the initial adopters offered various and often mixed motivations for why they joined, confirming some of those suggested by Almaric, but also including (1) the philosophical commitments of Chairmen, CEOs or the Board of Directors, (2) a desire to prevent potential loss of retail customers due to past incidents of poor project performance leading to negative publicity, (3) a desire to generate a “virtuous circle” in which sponsors and non-EPFIs respectively would bring better and more robust project proposals forward to the EPFIs in recognition of the power of the EPs (due to the sponsors’ need to borrow and the non-EPFIs need to syndicate loans), (4) a desire to develop good corporate governance based in the need for sustainable banking, and (5) an attempt to minimize political risk to projects by placating host states by exceeding the minimum requirements of legal compliance with respect to environmental and social issues (Watchman, 2005).

The present survey asked respondents to rate the relative influence of various factor for adopting the EPs.

Table 7.5 – *Relative influence of factors as motivation for adopting EPs*

Scale: *No Influence* (1) to *Slight Influence* (2) to *Strong Influence* (3) to *Strongest Influence* (4)

Motivation	Average Rating
An Equator Principles Financial Institution (EPFI) reached out to us	1.43
The International Financial Corporation reached out to us	1.71
We adopted to remain competitive	2.82
We were targeted by public campaigns in the past and wanted to improve our ability to manage risk more effectively	1.96
We were concerned that our national regulator would implement new legal standards for ESRM applicable to projects constructed at home and abroad	1.43

The most influential factor according to the respondents was that they had adopted to “remain competitive.” The second most influential response was “we were targeted by public campaigns in the past and wanted to improve our ability to manage risk more effectively.” A number of institutions added further comments, including:

- *“adoption makes good business sense”*
- *“We want to be one of the most sustainable banks in the world”*
- *“To proactively address uncertainties around environmental and social risks.”*
- *“creation of a level playing field”*
- *“we wanted to be progressive, cultivate relations with banks and take part in standard setting”*
- *“it was a business risk management decision”*
- *“we adopted to apply current best practice”*
- *“We became a signatory to get formal recognition for our social and environmental risk management processes we already had in place”*
- *“We wanted to show our stakeholder in a transparent manner the consistency of our actions with our engagement”*

Conspicuously absent from these motivations—and consistent with the overall narrative of global governance—is evidence that any of the institutions felt any kind of significant pressure from national regulators to improve ESRM practices (one bank reported that it was a “strong influence,” whereas twenty-nine percent (7 banks) said it was a “slight influence,” and fifty-four percent (13 banks) stated that it had “no influence” in their decision at all); rather, this pressure came predominantly from NGOs domestically and abroad, most significantly those acting in transnational coalitions.

These results cohere with the findings of a 2005 IFC survey of 120 financial institutions of various kinds in emerging markets, in which 68 percent of respondents said that the need to “increase their credibility and reputation” was the main reason to consider social and environmental issues in their business practices, while 64 percent of respondents identified investor demand as a leading factor (IFC 2007). My survey also confirmed another finding of the IFC study, which found that “compliance with government regulations, although important, is no longer the top driver,” being replaced by “other incentives,” such as increased value to shareholders, lower risk and better returns, and client demand (IFC 2007).

If reputational concerns and legitimacy-seeking motivate initial adoption of voluntary regimes, it stands to reason—and anecdotal evidence confirms—that NGOs will not be satisfied with the mere adoption of a voluntary regime by institutions, but will demand *action* consistent with the obligations accepted by adoption. This was borne out in my research: fifty-eight percent of the respondents (14 banks) reported an *increase in contact or pressure following adoption* of the EPs, while only twenty-nine percent (7 banks) reported that the level of pressure remained the same and only 1 bank reported that the pressure abated. There were no significant relationships, however, between the reputational risk variables and whether there had been an increase in contact or pressure. This data suggests that to the extent that creating or adopting a self-regulatory institution is a strategic preemptive move to mollify critics and reduce external

stakeholder pressure, this strategy might not be that effective. Rather than take the wind out of critics' sails, adopting a self-regulatory regime seems mostly to embolden stakeholders.

Table 7.6 – *Change in level of NGO pressure/contact post-adoption*

We had no prior contact or pressure and still have none	8.3% (2 banks)
There has been MORE contact and/or pressure	58.3% (14 banks)
There has been LESS contact and/or pressure	1.1 % (1 bank)
No change - the level of prior contact and pressure has remained about the same	29.2% (7 banks)

Perhaps a more precise measure of changes in contact or pressure from NGOs is the increase in public advocacy campaigns against either project finance deals or project-related investments that are not structured as project finance transactions. These questions tried to get more nuanced data on a salient issue that arose during the research and the qualitative interviews: the difference between *project finance loans*, to which EPFIs are required to apply the EPs, and other forms of financing, such as corporate loans, which the EPs do not cover as a matter of requirement (some institutions have for some time gone beyond these requirements and have applied an “EP lite,” review, as they call it, to such transactions as well). The survey asked about both project finance deals and non-project finance deals because, in the words of one respondent, “[t]he external media/NGO world rarely understands project finance – they just protest activities – the finance vehicle doesn’t much matter to them.” In other words, the claim by some banks is that NGOs either do not understand the differences or choose to gloss over them in favor of focusing on any and all problematic *project-related activities*, regardless of financial structuring or whether they officially fall under the Equator Principles’ purview. It is likely not a misunderstanding, however; the hopes of the Collevchio Declaration were to have environmental and social sustainability considerations factored into all elements of financial institutions’ portfolios.¹⁶⁹

¹⁶⁹ At the same time, a major issue that has emerged is the direct investment/ownership of some banks in mining companies, energy firms or other sectors commonly associated with project finance, which investments are *not* covered by the EPs. For example, JPMorgan Chase reportedly owns 5.23% of Lafayette Mining, an Australian company that owns and operates the Rapu Island mine in the Philippines that has come under intense scrutiny by Banktrack, which claims that the project does not have community support and that the environmental and social impact assessments are inadequate in the face of the island’s regular exposure to typhoons, which concern materialized in cyanide spills in October 2005, leading to the revocation of its permit by the Philippines government’s Department of the Environment and Natural Resources (it was later reinstated). Indeed, in JPMorgan Chase’s case, when it adopted the EPs it went beyond mere adoption for project finance and included all loans, debt and equity underwriting and advisory services. As an article in *The Banker* points out, even if share ownership is excluded from the EPs, the ownership in Lafayette certainly undermines the effect of JP Morgan’s comprehensive pledge. *The Banker* reports that the bank has stressed that the investment represented “client funds” not a JP Morgan investment, and thus, it was not up to the bank to dictate where client money was invested. Interestingly, JP Morgan changed its EP status to “Associate” in 2010, which signifies that it does not do project finance but nonetheless supports and respects the Principles. Another EFPI, ABN Amro, is also a shareholder in Lafayette, and several other EPFIs, including ANZ, Standard Bank, as well as Korea First Bank, a subsidiary of Standard

While it is worth keeping in mind the distinction between strictly “project finance” and other project-related financing from a legalistic point of view, from the perspective of “pressure” experienced by institutions, it is perhaps more important to consider *all* campaigns conducted, whether the project in question technically or legitimately earned the ire of the campaigners or not. The data shows that following adoption, there was a modest increase in the numbers of banks reporting that they had been targeted by public advocacy campaigns (from 50% of banks being targeted prior to adoption to 67.7% of banks being targeted after adoption). This is evidence, albeit weak, that the neoinstitutionalist arguments about “early” (and therefore substantive) and “late” (and consequently ceremonial, or de-coupled) adopters’ implementation might not fit well in the context of NGO activism. If external stakeholder pressures were more passive and did not actually *increase* over time, it would make sense to expect early adopters—innovators—to be more serious about implementation and to expect that late adopters would be adopting only in a superficial or “ceremonially” manner without deeper engagement with the norms and practices espoused by the regime (Meyer 1991; Egels-Zandén 2007). However, in this situation, pressure is increasing over time, and in fact, it can be said to be additive, that is, when Citigroup faced its first campaign in 2000, the NGOs were then only breaking ground by seeking to implement their vision for bank sustainability. Campaigns mounted ten years later have a decade of normative evolution to support their arguments; in other words, there is a new “normal” now that adds weight to their claims.

The reputational threat of public advocacy campaigns

The survey inquired further to try to determine the exact impact such campaigns were thought to have or what effects the banks anticipated that they might have. Specifically, I was interested to see if there was any empirical basis for the NGO strategy—as evident from the RAN credit card campaign against Citibank—of targeting large institutions’ consumer business lines to affect change with respect to their corporate and investing business lines. My basic query was as follows: did banks consider there to be linkages or potential spill-over effects between their different business lines, and if so, what could be the potential fall-out from an NGO campaign? From a theoretical perspective, I was curious to see if there were parallels between international relations theories on the spill-over effects and linkages between state actors’ different reputations for different issue areas (Guzman 2008).

To gather some data on these questions, respondents were asked whether, in their view, NGO campaigns posed a greater reputational threat beyond their project finance business (Table X.X). Interestingly, a slight majority (fifty-four percent, or thirteen banks) answered in the negative, while forty-five percent (eleven banks) said that these campaigns did pose risks to their

Chartered, (also an EPFI) are in the syndicate for the Rapu Rapu project (*Id.*). Technically, the EPs do not apply; but ABN Amro, which is not in the syndicate but *is* a shareholder, has developed sector-specific policies outlining risk policies and assessment tools for particular sectors, which a representative notes means that “[d]epending on the risk profile of the deal, the application of these policies will mirror the due diligence procedures conducted for EP transactions.” As the bank representative explained, these sector-specific policies exist to “ensure that the bank’s involvement in any financing of projects, including those not formally covered under the scope of the EP, can be considered responsible” (*Id.*).

other business lines. This proportion was somewhat higher among banks targeted *prior* to adopting (seven of twelve, or fifty-eight percent) and was a bit higher than that among all banks that had been targeted at any point in time (ten of sixteen, or sixty-two percent) ($p = .033$, FET).

I thought that it also was possible that banks who did not have direct experience with campaigns, or had experience with campaigns but had not experienced any spill-over effects, might still have opinions and concerns about the *potential* for reputational spill-over from potential future campaigns. Of those who were targeted *prior* to adopting, sixty-seven percent (six of nine banks) thought there was a potential for spillover. A nearly similar proportion of institutions targeted *at any point* thought there was a potential for reputational spillover. Overall, of those who had replied negatively on the question of reputational spillover (13 banks), eight (sixty-two percent) responded that there was nonetheless the potential for such spill-over effects.¹⁷⁰ Indeed, sixty-two percent (five of eight) of those who had not been targeted at any point believed in the potential for spill-over effects. In sum, the data shows that these institutions—regardless of whether they had been targeted by public advocacy campaigns—on the whole believed that public advocacy campaigns could have a reputational spill-over effect on their other areas of business.

Campaign “Fall-out”

It remained to be seen, however, what the concerns about campaigns was really all about. It was suggested numerous times during the qualitative interviews that the banks could not quantify the harm that would result from a negative campaign against their institution. Rather, interviewees viewed such events as akin to a nuclear reactor meltdown (i.e., that it should be avoided at all costs), the survey explored this issue further, asking what banks subjectively anticipated would be the likely outcomes of a campaign, i.e., assuming that there were indeed reputational spill-over effects (Table X.X). Most interestingly, over fifty-four percent of respondents confessed that they “could not quantify the exact harm that might accrue,” but nonetheless “wish[ed] to avoid such campaigns at all costs.”

Table 7.7 – *Likely outcomes of public advocacy campaigns*

Share prices would fall	33.3% (8 banks)
There would be a chilling effect on our retail and consumer business	41.7% (10 banks)
Other infrastructure clients would be driven away	16.7% (4 banks)
It would damage our reputation for ESRM performance among our peers	62.5% (15 banks)
We cannot quantify the exact harm that might accrue, we wish to avoid such a campaign at all costs	54.2% (13 banks)

¹⁷⁰ Respondents may have been confused by some of these questions: 1 bank that had claimed not to have been targeted either before or after adoption, but nonetheless responded to the question about the *potential* for campaign reputational spillover; in addition, 2 of those who responded initially that campaigns did have a spillover effect also responded to the second question regarding *potential* for spillover; another institution that had previously responding negatively failed to respond to the second question.

It is interesting to learn that nearly seventy percent of all institutions thought that public campaigns could *theoretically* pose greater reputational harm beyond an institution's project finance practice. Even more interestingly, forty-one percent thought that there could be a chilling effect on retail and consumer business, despite the fact that the vast majority of respondents (seventy-five percent) disagreed with the statement that "individual consumers are aware of a bank's ESRM reputation." This suggests a bit of thin rationality among the banks, which might have been encouraged by the very vivid linking of retail business lines with corporate and investment business lines by the RAN campaign against Citigroup.

Another very interesting result is that most of the banks (sixty percent) were concerned that public advocacy campaigns would have a negative effect on the reputation held by an institution among its *peer institutions, i.e., other banks*. This makes sense because project finance is a very "social" lending enterprise, with each institution needing to maintain its credibility among its peers so that when it brings a deal to the international markets to "sell down" its share of the risk, other institutions trust that the deal has been arranged well and that it will not blow-up in their faces. It was also fascinating to see that over fifty percent of the institutions felt that they could not quantify the spill-over effects of a negative campaign, but that they wanted to avoid one at "all costs." This coheres with the results of the previous IFC study, which found that the "overwhelming majority" of emerging market commercial banks (83 percent) ranked the risks of negative publicity and loss of reputation as a more important long-term risk than credit risk" (IFC 2007).

Summary

The survey results on the banks' understandings of reputation are revealing and also supportive of the neoinstitutionalist paradigm presented in Chapter 1. The survey responses on the banks' experiences with external actors and specifically with NGOs prior to their adoption of the EPs provide empirical support for the theorized interaction between external actors and corporate actors that lead to the formation of self-regulating institutions. True to the theorized relationship, the most "visible" firms received the most attention from external actors. The survey also confirmed existing anecdotal evidence suggesting that transnational NGOs and NGOs based in bank home countries were the greatest source of pressure, on average.

Significantly, the study also revealed that a clear majority of banks that experienced a change in contact/pressure following their adoption experienced *increased* pressure from NGOs. The leading survey response regarding banks' motivations in adopting the EPFIs—that they sought to remain "competitive"—provides support for the theoretical claims about the power of external actors to influence firms' behavior. In this respect, it is difficult to ignore the historical evolution of global norms of sustainable development for several decades and their increasing application to multilateral actors and consequently to private actors (see Chapters 3 – 5). The increased pressure on the World Bank in the 1990s to conform to sustainable development principles sent a strong warning to private institutions that they were next to be targeted by civil society campaigns. When such campaigns in fact manifested themselves, it was clear to a few leading institutions who had been targeted by such campaigns that these norms were no longer considered applicable solely to public multilateral institutions. External stakeholders and

environmental norms had created a new paradigm for what constituted “appropriate” project finance practices. This caused the institutions most invested in project finance to see that it was to their strategic advantage to standardize business practices to some degree by creating a level playing field so that in the future they would not lose business opportunities to competitors offering infrastructure clients less scrupulous alternatives for developing their projects. Once this new paradigm was created, a logic of appropriateness mixed with a logic of consequences to entice adoption by other institutions who thought that adopting the EPs was necessary to remaining “competitive,” that adopting made “good business sense.

The data also confirmed and elaborated upon existing understandings of the rather intangible and amorphous concepts that are “reputation” and “brand.” Despite not being easily inputted into a cost-benefit analysis (even among the institutions that, more than any organizational form on the planet, specialize in calculating and monetizing various forms of risk). It is clear that reputation is exceedingly important to these institutions. Whereas respondents were split evenly over the proposition that *all* banks share a common reputation, the responses support the theoretical understanding that actors in governance clubs understand themselves to share a common reputation that is distinct from the rest of the industry. At the same time, however, a clear majority of institutions felt that they nevertheless maintained individual reputations. Most significantly, banks were particularly concerned about their reputation among their peer institutions, which speaks to the nature of project finance lending, which is done by necessity in groups to spread risk around.

The findings on the increased pressure following adoption of the EPs and the common view that EPFIs shared a common reputation may point to another useful aspect of a voluntary regimes that has been under-appreciated in prior research: in creating a formalized collective structure, private actors give external stakeholders a single “complaint box” or wider target to which they can address their dissatisfaction.¹⁷¹ This is no small contribution given the limited resources of NGOs; with the greater institutionalization of a voluntary regime NGOs can with increased legitimacy hold all participants collectively responsible.

¹⁷¹ This strategy, however, has itself been criticized by the Executive Director of the UN Global Compact, Georg Kell, who in responding to a complaint by eighty NGOs about the Global Compact’s failure to de-list PetroChina because of its involvement in Sudan, a conflict torn country, argued that he had no intention in interfering with the NGOs’ ongoing advocacy efforts and believes that civil society organization have an “extremely important role to play in persuading companies to respect human right and be more conflict-sensitive,” but that the Global Compact did object to “the use of the UN Global Compact as a vehicle for targeting individual companies because of their willingness to engage in the initiative.” See Letter from Georg Kell to NGOs, January 12, 2009, available at http://www.csrwire.com/press_releases/21657-UN-Global-Compact-Office-Responds-to-NGO-Letter (last visited December 7, 2010).

CHAPTER 8: MEASURING THE EFFECTIVENESS OF THE EQUATOR PRINCIPLES

Considering the structure of the EPs—their lack of a significantly powerful “sword”—in comparison to other self-regulatory programs, it would certainly be more than reasonable to expect that there would be rampant shirking among the EPFIs, that is, little evidence that adopting institutions were taking their commitment to the Principles seriously. The survey results, however, suggest otherwise. This chapter offers evidence of these commitment levels through observations of the EPFIs’ implementation of the EPs as well as measurement of regime-wide interactions that point to an evolution of the EPs into a real governance regime. Specifically, the survey asked about changes made along several different criteria, including: (i) creation/designation of ESRM personnel/departments; (ii) training of personnel in implementation of EPs; (iii) the scope of ESRM due diligence; (iv) the extent of ESRM personnel’s leverage over funding decisions; (v) the handling of controversial funding decisions; (vi) disclosure/reporting of ESRM activities; (vii) auditing of disclosure. The survey and interview data showed that these review processes are not mere window-dressing; ESRM personnel largely operate fairly independently from bonus structures related to project approval and they are given considerable voice in funding decisions—in some cases, the equivalence of a “veto” power. Further, in most institutions, the most challenging projects only get funding by consensus, and when consensus cannot be found, review goes further up the chain of command to the very highest levels of corporate governance. The creation of these heightened review mechanisms suggests that the banks take very seriously potential reputational risks arising out of potentially problematic transactions. While the anonymity of the survey sought to minimize any bias, this information is of course vulnerable to the typical qualifications related to self-reporting data (Parker 2009). Nevertheless, as discussed in greater detail below, the data, taken as a whole, exhibits extensive implementation by a many of the banks studied.

The question remains as to why this is? All signs point to reputational concerns as a driver of this “compliance.” What this research cannot answer because of its design is whether individual firms, driven by their individual reputational concerns alone, would go to the same lengths as they have under the EPs or whether the EPs “add something” that enhances what could be achievable by individual efforts. While determining causality, particularly in qualitative research, is often vexing, the below research suddenly suggests that the considerable transformation of the project finance industry that many have observed *is* a product of the emergence of the EPs and their institutionalization as “best practice” across the industry. This did not happen by all banks merely striving individually to achieve such standards, but rather, it occurred through collective action.

Compliance with “strong sword,” “weak sword” and “no sword” programs

As discussed in Chapter 1, self-regulating institutions often arise to overcome information asymmetries. However, the potential for “adverse selection” and ultimately for “shirking” remain strong because individual organizations can “consume” the collective’s “good” reputation without abiding by its standards of behavior. This gives rise to the need by industry clubs to somehow manage their collective reputation by excluding “bad apples” from the club through various mechanisms, including third-party monitoring *without* public

disclosure; third-party monitoring *with* public disclosure, and finally, sanctioning by club administrators/sponsors (Prakash and Potoski 2006).

As also discussed in Chapter 1, voluntary programs can be described as falling into one of a few ideal types: strong-sword programs, weak sword programs and no sword programs. In comparing Responsible Care, which they termed a “no sword” program, to implementation of ISO 14001, they argued that even a weak sword program such as ISO 14001 could instill compliant behavior among its participants because its weak sword (third-party audits) placed non-trivial costs on those seeking certification (i.e., membership) (Potoski and Prakash 2005). These audits can be very expensive, and the requirement for annual recertification mitigates in part what is lost by having the auditing be third-party as opposed to a more stringent monitoring and enforcement regime (i.e., one with public disclosure) (Potoski and Prakash 2005). The costs of the third-party audits, then, are Responsible Care’s “teeth.” From the example of ISO 14001, Potoski and Prakash conclude that it is clearly essential to any voluntary regime’s success and legitimacy that membership exact *real costs* from members so that the decision to join the regime remains a meaningful signal that conveys useful information to external stakeholders about the commitments of the regime’s members. As noted in Chapter 1, another meta-analysis of both first party and third-party audited voluntary programs observed that the most important conditions for effective strictly voluntary programs are (i) specific performance-based standards; (ii) periodic third-party audits of individual companies; and (iii) rewards that publicly recognize the performance obtained by each participants following third-party verification (Darnall 2008).

The structure of the EPs falls somewhere between Responsible Care and ISO 14001. Like Responsible Care (at least as implemented within the United States), the EPFIs constitute a relatively homogenous group of actors who are organized into a governance structure by a central association, which it is hypothesized should promote isomorphism more than a non-centralized grouping of heterogeneous actors, as such groups are more vulnerable to norm-diffusive pressures. Then again, the homogeneity of the EPFIs only goes so far: they are all banks that carry out project finance transactions, but they come from dozens of different countries and vary tremendously in size and the level of their activity in the sector. In addition to the governance structure of the EPs, the EPFIs are also subject (to varying degrees) to the same NGO pressures that target the industry as a whole, whereas ISO 14001 is a management system applicable across a variety of sectors with different operational practices and management structures. However, similar to ISO 14001, the EPs’ norms and requirements are not as specific as Responsible Care’s, perhaps creating an obstacle to isomorphism. Indeed, my qualitative interviews and the survey research showed that banks develop different structures in general with respect to their credit review process, and in particular with respect to how they integrate ESRM into these processes. Then again, the EPs do reference the IFC’s Performance Standards, which are highly detailed requirements for environmental and social impact assessment, and thus, ultimately the EPs do contain very specific requirements for performance. Moreover, proper implementation of the EPs entails embedding them in borrowers’ loan covenants; thus, whether an individual institution is enforcing these requirements against the borrowers would be easy to check, if only there was greater transparency on the project level basis.

Indeed, the EP Secretariat during the period of this research was not as powerful as the American Chemistry Council, which managed Responsible Care and required its participants to

submit compliance or audit reports that could lead to the identification and shaming of shirkers.¹⁷² Rather, EP 10 requires only that the EPFIs “report publicly at least annually about its Equator Principles implementation processes and experience, taking into account appropriate confidentiality considerations.” The reporting requirement is further qualified as including “at a minimum . . . the number of transactions screened by each EPFI, including the categorisation accorded to transactions (and may include a breakdown by sector or region), and information regarding implementation.” However, this form of auditing – first-party certification – has been described as the least credible kind of certification possible (Potoski and Prakash 2005).¹⁷³ Finally, and significantly, unlike ISO 14001, other than the reporting requirement, there is no mandated annual certification process for the EPs (it was only in late 2010 that a small membership fee and a de-listing sanction were created as possible sanction either for (i) failure to report or (ii) failure to pay the membership fee, but these developed after the survey had finished circulating).

Considering all of this, it was certainly more than reasonable to expect that there would rampant shirking of the EPs, that is, little evidence that adopting institutions were taking their commitment to the Principles seriously. The survey results, however, suggest otherwise. The question remains, then, as to what can explain the evidence of implementation if, as suggested above, the EP regime itself has recourse to only the weakest of “swords” to compel compliance?

The answer almost universally offered during the interview stage and also provided with considerable frequency in the survey results is that reputational concerns drive compliance. What remains an open question – and this research cannot definitely answer it – is what the causal relationship between adopting the EPs and implementation is; would individual firms, driven by their individual reputational concerns alone, go to the same lengths as they have under the EPs? Or do the EPs “add something” that enhances what would be the level of commitment that would be seen by banks’ individual efforts without the impact of a voluntary regime?

Questions of causality are notoriously complex in social science research, particularly in qualitative studies, and accordingly, the following is presented as a limited observation: without making a strong claim of causation, I think this research shows that there clearly has been a transformation of the project finance sector since the introduction of the EPs, and most people in the industry or related to the industry attribute much of this transformation to the

¹⁷² As this research was coming to a close (after the completion of the survey phase) the EPs intensified their common bonds by forming an “Association” with a formal governance structure managed by an Administrator that has a power to “black list” EPFIs that fail to make the requisite disclosures. *See* EP Governance Rules article 5(c) (following two reminders, “if the EPFI or Associate has not Reported Publicly within 18 months, it shall be ‘de-listed’ without further notice – that is, the name of that EPFI or Associate shall be removed by the Administrator from the List of EPFIs and Associates on the Principles’ website and the relevant EPFI or Associate shall no longer be a member of this Association”).

¹⁷³ As these authors note, audit and certification processes come in four varieties (although in practice only the first three are really used by voluntary programs, making third-party certification “best practice”), ranging from the least to most credible as follows: first-party (self-certification), second-party (certified from a manager from a different unit of the same company, a different firm within the same industry, or certified by customers), third-party (certification by an external auditor but paid for by the company), and fourth-party (certification by an external auditor who is not paid for by the company).

institutionalization of the EPs as a the “gold standard” in project finance. In the process, the bar has been raised for individual bank performance in environmental and social risk management. Significantly, because of the size and uncertainty of large infrastructure development, banks always spread the high risks of project finance lending among a cohort or syndicate of banks, this particular financing practice is a highly “social” activity. Perhaps more than typical markets where competitors may be in close competition with each other, here the competitors are almost always also collaborators who need the trust and good faith of other institutions to do deals because no one can bear the risk involved in “going it alone.”

Of course, the proliferation of the EPs and their impressive growth in number of adopting institutions does not attest to the effectiveness and functional utility of the regime. Indeed, as with Responsible Care when it was first introduced, the EPs, as some have worried, could have fallen or might fall victim to “adverse selection.” To explore further beneath the surface of bank adoption of the EPs, this chapter discusses the five metrics through which the effectiveness of the EPs can be measured: (i) individual institutional commitment in applying the EPs; (ii) outcome effectiveness; (ii) utility of the EPs as a mechanism for social learning; (iv) impact of the EPs beyond adopting institutions; and (v) the combination of governance “competencies” suggested by Abbott and Snidal (Abbott 2009), which include independence, representativeness, expertise, and operational capacity.

Individual commitment in applying EPs

Critics of self-regulation and compliance systems argue that they are often implemented partially or symbolically (Egels-Zandén 2007), and thus, they are unlikely to be successful unless they are able to promote a “culture” of compliance within each organization (Parker 2009). Nonetheless, it has been hypothesized that compliance systems might contribute—along with internal values and good management—to improve overall compliance outcomes by improving “compliance management in practice”—how organizational managers and employees “actually manage and respond to compliance issues on a day-to-day basis, whether they notice them, whether they are dealt with according to corporate commitments to compliance, and whether conflicts about compliance are reported up the line and resolved appropriately” (Parker 2009). These authors propose tracking implementation of compliance systems along six elements: (a) a written policy, (b) a dedicated compliance function; (c) a clearly defined system for handling complaints; (d) a clearly defined system for handling compliance failures; (e) training in compliance systems; (f) external review of compliance systems (Parker 2009). A parallel analysis was performed in a cross-sectional meta-study of voluntary environmental programs in the United States, which focused on three types of requirements that were most likely to send accurate signals about the participating institutions’ environmental performance, including (1) “environmental requirements” (e.g., “value and goal statements,” setting of a environmental plans or targets, and management systems); (2) “administrative requirements,” which establish communication between programs and include various forms of written agreements, such as memoranda of understanding and membership pledges; and (3) “conformance requirements,” which are determined through various levels of monitoring and sanctions (Darnall 2004).

The EP’s Association Governance Rules state that the “b) The aim of the Principles is to introduce good practice for financial institutions in the management of social and environmental

risks when providing Project Finance loans or Project Finance Advisory Services.” The Governance Rules further define the Principles as “a framework to require the implementation of standards of good practice in relation to the social and environmental issues arising in projects that are the subject of Project Finance.”¹⁷⁴ Thus, another way—perhaps the best way—of measuring effectiveness is individual institutional commitment measured by complete and full adoption of new management systems that did not exist before, thereby improving each adopting institutions’ process of evaluating the environmental and social risks of projects. Theoretically, this enhanced competence is the means by which “problem projects” would be weeded out from funding consideration—thus contributing to the outcome metric identified above—and would also contribute to improving the approach taken with respect to risky projects that are considered “do-able” despite the risks. As discussed above, it is difficult to attain the data as well as consensus on what are “problem projects” to properly measure instances of when this weeding out process has worked; moreover, as discussed below, the advancement of ESRM review processes to the initial stages of project review has made it difficult for true problem projects to make it to the credit approval stage.

Unlike the measurement of toxic releases in the United States, which is monitored by a governmental body and made publicly available for researchers to analyze, the measurement of individual commitment or “performance” is made difficult in this study because there is no baseline data on “performance” for either EPFIs (or non-EPFIs for that matter): prior to the EPs, there were no reporting requirements, and non-EPFIs are still under no obligation to report about their ESRM systems or policies.¹⁷⁵ Furthermore, unlike toxic release data, there is no demonstrable evidence establishing the exact extent of ESRM due diligence prior to the creation of the EPs in 2003. This study attempted to compensate for the lack of baseline data by prompting respondents to provide their own characterization of their structures and policies prior to adopting the Equator Principles.

The survey then asked about changes made along several different criteria, including: (i) creation/designation of ESRM personnel/departments; (ii) training of personnel in implementation of EPs; (iii) the scope of ESRM due diligence; (iv) the extent of ESRM personnel’s leverage over funding decisions; (v) the handling of controversial funding decisions; (vi) disclosure/reporting of ESRM activities; (vii) auditing of disclosure. Although this information is vulnerable to the typical qualifications related to self-reporting data (Parker 2009), the data, taken as a whole, exhibits extensive implementation by a many of the banks studied.

As will be discussed in greater detail below, the survey responses show that the banks underwent considerable institutional change in their ESRM. Most significantly, seventy-five percent of banks reported making significant changes to their ESRM structures and procedures (and the remaining twenty-five percent reported that they were already benchmarking project review to World Bank standards before adopting the EPs). In addition, fifty-four percent (13 banks) reported that they had “designated personnel and/or created a department to review projects for ESRM *because [they] were adopting the Equator Principles*” (29 percent (7 banks)

¹⁷⁴ Equator Principles Association Governance Rules 3(b) and (c).

¹⁷⁵ There is a further difficulty, discussed in the methodology section, of finding appropriate pairings of institutions to do a comparative “in-group” vs. “out-group” study.

already had designated personnel for reviewing projects prior to adoption). As noted, institutions structure their ESRM and position it relative to their overall credit approval processes in different ways. This variety aside, it appears that most banks have endowed their ESRM personnel and review procedures with a significant stake in the outcome of credit decisions. In addition, for decisions on particularly challenging and risky credit decisions, many banks have created quasi-appellate levels of review going to the very tops of their management structures. This data suggests that the ESRM due diligence is not mere green-washing, but is a substantive and essential component of project approval. The survey also indicates that a complex web of accountability between project sponsors, independent consultants and different banks within a syndicate govern ESRM for given projects. A high proportion of banks also reported conducting training related to ESRM procedures and fulfilling their reporting requirement under EP 10. On the whole, there is substantial evidence that the banks surveyed have engaged in considerable internal implementation of the EPs.

Evolution of ESRM structures and procedures

Circumstantial evidence suggests that while institutions—particularly the industry leaders—were not completely ignorant of environmental and social issues prior to the creation of the EPs, there were virtually no rigorous ESRM systems in place prior to the launch of the EPs and those systems that were in place were perhaps rudimentary compared to what is in place now. These impressions were confirmed by the survey results (see Table 8.1), which show that while forty-one percent of banks surveyed were aware of ESRM issues and would discuss them with potential borrowers, only twenty percent (five of the twenty-four banks) benchmarked their ESRM review to existing World Bank standards, although these institutions did not apply these standards within rigorous systematized due diligence procedures. Only 12 percent (3 banks) of the banks claimed to have formalized processes and designated personnel *prior* to adoption.

Table 8.1 – *State of ESRM structures and procedures prior to adoption of EPs*

Description	Percent of banks (Response Count)
We were aware of ESRM issues and would discuss them with borrowers	41.7% (10)
We benchmarked our evaluation of ESRM issues to World Bank or IFC standards but did NOT have formalized processes or personnel for doing so	20.8% (5)
We benchmarked our evaluation of ESRM issues to World Bank or IFC standards with the use of a formalized process and the assistance of designated personnel	12.5% (3)
Our ESRM structures and procedures looked different before adopting . . . (please explain in the comment box)	8.3% (2)

Following adoption or in preparation for adopting, 75 percent (21 banks) reported having made some changes of varying degrees to their ESRM, with the other 25 percent (6 banks) reporting that they had not made “significant changes.” It should be emphasized, however, that all six of the banks reporting that they did not make significant changes were institutions who reported that they were already benchmarking their ESRM to World Bank standards prior to adopting the EPs. The most common evolution in practices (45.8 percent, 11 banks) involved standardizing procedures in a more formal process that linked review to the EPs and IFC benchmarks and incorporated these standards in detailed loan covenants (see Table 8.2). An additional twenty-five percent (the six banks mentioned above) reported going “beyond Equator” by applying ESRM review to non-project finance transactions as well.

Table 8.2 – *Evolution of ESRM structures and procedures*

Description	Percent of banks (Response Count)
We did not make significant changes	25.0% (6)
We moved our initial ESRM review of projects to earlier in the process (e.g., the marketing stage rather than before credit review) ¹⁷⁶	8.3% (2)
We standardized our procedures in a more formal process that links our review to the EPs and IFC benchmarks and incorporates these standards in detailed loan covenants	45.8% (11)
We not only standardized and formalized our process for project finance loans but for ALL project-related lending (including corporate loans, bridge loans and other instruments)	25.0% (6)

Another indicia of change and individual commitment to implementing the EPs is the creation of designated ESRM personnel or departments. This indicates that banks are “willing to not only state a formal policy of commitment to compliance but are also actually devoting resources to hiring people with the skills and job description to help the organization actively manage compliance” (Parker 2009). Previous research has argued that hiring compliance staff can be a key determinant of whether an organization that has become aware of its need to comply with the law actually develops the capacity to do so effectively (Parker 2002). As noted above, when the adverse environmental and social effects of large scale projects were brought to the World Bank and IFC’s attention, they had to drastically increase their in-house expertise, expanding from having no environmental or other experts working on infrastructure project development to creating whole departments focused on nothing but environmental and social risk review (Khagram 2004; Parks 2007; Wright 2007).

Though Equator Principle 7 mandates independent consultants be hired to review the work of borrower’s environmental and social due diligence, the reports filed by consultants are lengthy and contain highly specialized scientific and other analyses that bankers are not trained to understand. Without in-house personnel knowledgeable about these issues, an institution is not equipped to properly understand the non-financial risks of a project. Thus, the development of in-house expertise is crucial to any bank successfully implementing the EPs and demonstrates an upgrade of their capacity to engage in the highly technical environmental and social risk analysis necessary to properly evaluate large-scale projects beyond financial and credit risk dimensions. The hiring of such experts or the development of special departments also entail non-trivial costs for banks (among other costs of implementation, the costs of environmental

¹⁷⁶ During the interview stage, several interviewees indicated that this was a major change they implemented. This is simply good business practice and careful risk management: when the IFC was changing its internal review procedures, clients were found to be more likely to accept the new sustainability standards if they were informed of them early enough in the project preparation phase; sometimes resistance grew out of being informed only late in the process, which happened because the environmental staff at the IFC initially was not involved in early project planning discussions and investment officers failed to mention the heightened standards for fear of scaring-off clients (Wright 2006).

impact assessments per project can be upwards of US\$600,000-800,000, shared among a syndicate), and accordingly, they are strong indicia of serious commitments.¹⁷⁷

Table 8.3 – *Hiring/creation of ESRM personnel or departments*

We have always had designated personnel reviewing projects for ESRM	29.2% (7 banks)
We designated personnel and/or created a department to review projects for ESRM because we were adopting the Equator Principles	54.2% (13 banks)
We still do not have designated personnel reviewing projects for ESRM - this is done by project finance teams	16.7% (4 banks)

As the above table shows, 29 percent (7 banks) already had designated personnel for reviewing projects prior to adoption. Following adoption or in preparation of it, an additional fifty-four percent (13 banks) reported that they had “designated personnel and/or created a department to review projects for ESRM *because we were adopting the Equator Principles*,” while 16 percent (4 banks) reported that they even after adopting they had not designated any personnel for this function. Of these, two banks reported that they were in the process of doing so, while 3 banks reported that “we think it is most efficient for ESRM to be taken into account by front office project finance teams and credit risk approval committees, and do not feel that it is necessary to have specially-designated personnel working on ESRM review.”

Another question in the survey built upon this one, inquiring as to the relative independence of these staff members from the bonus systems that typically structure bankers’ compensation. It was assumed that the more independent ESRM staff are from the “approval culture” of business-side teams, the more empowered they would be to offer critical feedback on environmental and social risks. Sixty percent (14 banks) reported that their ESRM personnel function outside of the project finance teams’ bonus structures; another twenty-six percent (6 banks) said that their ESRM are not outside of the bonus structures, and just over ten percent (3 banks) reported that their bonus structures are not project-dependent but rather are shared in a more aggregate manner across the project finance department. Thus, most banks have separated the ESRM function from the bonuses structures of the rest of the project finance teams, which suggests at least superficially that they are not incentivized to compromise on their own independent judgment with respect to particular projects, though of course they might feel other internal office and career pressures to not stand in the way of projects that others are ready to finance. My study did not inquire into these dynamics, further, however.

¹⁷⁷ As noted, none of the banks have really quantified the costs of compliance. Some, such as Citi’s Shawn Miller (the current Chair of the EP Association) have argued that there are not really many *new* costs involved with the EPs, at least with respect to lending in developing countries, which often involves co-financing with development finance institutions, like the IFC or an export credit agency, which institutions have required impact assessments for a long time (Gaskin 2007)

Role and scope of ESRM review

It is one thing to create ESRM departments and hire in-house specialists to assist in the project review cycle, it is quite another to empower them with a true voice in the review process – one that is not ignored. Thus, a further significant determinant of commitment to implementing the EPs is the role ESRM personnel play in the project approval cycle; if they have been hired but their role remains marginalized within the project review and approval cycle, they—and, by extension, the bank—is not doing very much to implement the EPs. With this in mind, the survey inquired into the role played by ESRM personnel: what is the scope of their review and how is their input taken into consideration on approval decisions, particularly with respect to projects that might be “judgment calls,” that is, projects that are on the border-line between being too risky to fund, and risky, but fundable, if done carefully. Institutions varied in what place they put the ESRM review during the project review cycle and also in the scope of ESRM personnel’s ‘veto’ power over any given project, as well as in the decision-making processes for potentially controversial projects.

Table 8.4 – *Role of ESRM personnel in project approval cycle*

Description Choices	Percent of banks (Response Count)
We do not have an ESRM department or designated personnel	16.7% (4)
At the marketing stage, ESRM personnel can strongly recommend against pursuing a project further - this advice is generally accepted	45.8% (11)
Before a project is presented to the credit committee for a decision, ESRM personnel must approve it	50.0% (12)
ESRM personnel only offer their input on difficult issues when asked by front office project finance teams	4% (1)
ESRM personnel participate directly in the credit committee decision-making process and must agree with all credit decisions	12.5% (3)
ESRM personnel play a different role in our institution . . . : <ul style="list-style-type: none"> - “ESRM staff act in an advisory capacity from front line staff. The aim is to provide front line and credit personnel with the confidence to made decisions based on E&S issues.” - “We have a dedicated process that refers to escalation procedures that may or may not include ESRM personnel depending on the level of escalation.” - “Our deal flow prescribes that while ESRM is an integral part of our decision making the process runs its own course and may be approved at the same time as credit approval or before or after that; final commitments are always subject to ESRM approval.” - “The ESRM technical service team assess projects as part of initial project due diligence and are intimately engaged with this assessment for all projects. They then submit a separate report as part of an overall project submission to the credit committee.” - “Environmental support from the ESRM department is a condition precedent to all project finance credit approvals.” - “Categorization is used as a filter in the credit process. All high impact projects are referred to ESRM and to a specific ESRM committee who makes recommendation prior to the credit committee” 	25.0% (6)

In sum, then, it seems that a majority of institutions provide their ESRM personnel with extensive leverage over the credit-approval process. This data suggests that the ESRM due diligence is not mere green-washing, but is a substantive and essential component of project approval. It bears repeating, however, that ESRM review is not the only aspect of project review; indeed, the principal concern is with credit risk, although the two are interrelated. As one banker has noted, “it is difficult to say that we have turned down a deal because of EP, because there are always many reasons behind any decision,” moreover, he adds, “because EP introduces enhanced levels of environmental and social impact analysis, and brings these issues at very early stages of the due diligence process, by the time we take a decision on whether or not we want to finance a project, those kinds of issues have already been addressed. This means that deals that are unlikely to be financed because they cannot meet EP criteria are eliminated before they get to the committee that makes the final decision” (Banker 2007).

Tough decisions

If an EPFI primarily reviews non-risky projects (for example, Category C projects, which are defined as projects with “minimal or no social or environmental impacts”), that EPFI’s commitment to the EPs will rarely be tested; thus, it is only the potentially difficult projects (Category A and B projects) that truly test ESRM procedures and implementation of the EPs. Considering this, the survey questioned banks on how they handle situations in which project appraisal gives rise to diverging opinions as to the true nature of the risks involved. The importance of these responses lies not in the particulars of how decision-making varies in each institution, but rather, in the fact that such processes exist at all. Before 2005, such decision making processes did not occur; “reputation” or “risk” committees did not play a large role, if they existed at all. It means that the banks are expending more resources in their scrutiny of complex, potentially harmful projects.

Table 8.5 – *Resolution of difficult decisions*

Question: “When the credit committee faces a difficult decision on a sensitive project with challenging environmental and social risks, what mechanisms are in place to resolve any internal disagreement over credit decisions?”	Percent of banks (Response Count)
The credit committee discusses until it reaches consensus	41.7% (10)
If the credit committee cannot reach consensus, the issue is decided by senior management	41.7% (10)*
<i>We make decisions on sensitive projects differently . . .</i>	
- “Consensus is reached via a Reputational Risk Review Process, which ultimately goes up to the CEO of our institution”	
- “We have group and regional reputational risk committees to consider sensitive issues. Sensitive issue are also scrutinized within the business before escalation as they are usually commercial issues as well...is it good for business if we are involved with 'x' client or in'y' industry.”	37.5% (9)
- “We have an ethics committee and a CSR department that can advice the credit	

committee

- “Decisions for such projects are made at the highest level. Risk Management has a veto position”
- “the projects have to comply with IFC standards and guidelines. we have not accepted non-compliance (yet) ;-). On matters related to reputational risk we follow government guidance etc.”
- “Projects don't usually get to the credit committee unless these issues have been resolved between the PF deal managers and the ESRM technical services group. If credit committee don't accept a deal, they can ask for additional changes, and if those can't be provided, the deal is declined.”
- “Where issues are of huge reputational risk the Reputational Risk Committee needs to support the transaction”
- “all challenging cases are referred to senior management (even if a consensus exists)”
- “ESRM group discusses directly with credit committee”

*three banks selected both responses.

It is important to keep in mind that each bank structures its internal review mechanisms differently. Representatives of senior management (either heads of particular divisions, e.g., the commercial lending division, or members of the Board of Directors) may sit on credit committees in some banks but not in others. Such representatives from senior management might alternatively sit on “reputational risk” or “risk” committees, which my interviews and these responses indicate serve as quasi-appellate review bodies that offer a second layer of consideration when credit committee discussions result in gridlock, ambiguous or conflicted recommendations, or when there is resistance from ESRM committees or personnel either heading into credit committee discussions or in the face of credit committee recommendations. Generally, these secondary levels of review are by default reserved for the most challenging projects with the greatest potential reputational risks. The creation of these heightened review mechanisms suggests that banks take very seriously potential reputational risks arising out of risky transactions.

This does not mean, of course, that bank management will always side on the cautious end of the spectrum with respect to environmental and social risks or will agree with the claims of NGOs that certain harms will result from financing the project. These often are judgment calls (made with heavy reliance on the analysis of independent consultants) both with respect to their eventuality and scope of impact “on the ground” as well as to their potential ramifications for bank reputation. While the technical calculation of environmental and social impacts should be the same for each bank (as they are based on the independent expert’s analysis), the reputational risk analysis might vary depending on the bank, its connection to the host country, the relative level of resulting civil society pressure, and even by the particular environmental or social issue implicated.

Layers of due diligence

Yet another measure of banks' implementation of the EPs is the robustness of their due diligence procedures. Equator Principle 7 requires the appointment of an independent consultant on Category A and Category B projects in weak governance zones,¹⁷⁸ but it seemed that with so much money on the line and so much potential risk at stake that the banks would at times want to be able to "check the work" of even the independent consultants. As I learned, there is a complex web of accountability that arises from the relationships between the project borrower, the consultants, and the syndicate, as well as between the banks within the syndicate. Whether this web of accountability is sufficient in its current form remains an open empirical question.

The survey began to try to understand where accountability lies by asking the banks how they assured themselves that independent consultant reports adequately covered the risks posed by a particular project. Specifically, the survey asked banks about additional steps they took to "feel confident about the reliability of the information in these reports."

Table 8.6 – *Additional layers of due diligence*

Question: "When the credit committee faces a difficult decision on a sensitive project with challenging environmental and social risks, what mechanisms are in place to resolve any internal disagreement over credit decisions?" (select all that apply)	Percent of banks (Response Count)
We take no further steps because we trust the role of the independent consultant	20.8% (5)
We sometimes conduct site visits to see things for ourselves	70.8% (17)
We establish secondary grievance mechanisms and channels of communication to make sure the consultant is not missing anything and the borrower's processes are working	12.5% (3)
We hire a second consultant to double-check the primary consultant's work	29.2% (7)
<p>These choices do not describe our situation . . . :</p> <ul style="list-style-type: none"> - "Next to the consultant's review we undertake our own due diligence and clarify open items with the consultant if necessary." - "We review the competence of the consultant, and compare the reports to international best standards for such reports, as well as use the IFC environmental, health and safety guidelines to ensure all risks have been covered by the report." - "we have sufficient environmental and social in-house engineering expertise so we can come to an own conclusion different to that of an independent review" - "Our ESRM technical services group work through the assessment with the consultant and might request additional work. The team goes to site as a standard procedure. On rare occasions, we will use a second independent 	37.5% (9)

¹⁷⁸ According to Equator Principle 7, for all Category A projects "and, as appropriate, for Category B projects," the banks are required to hire an "independent social or environmental expert not directly associated with the borrower" to review the borrower's environmental and social impact assessment, as well as the Assessment, AP and consultation process documentation in order to assist EPFI's due diligence, and assess Equator Principles compliance.

consultant. This is usually for a deal already on our books as part of an annual review processes.”

- “The ESRM department personnel review the reports and request feedback on any gaps identified. Where the quality of the report is not accepted, a second consultant is used to double-check the primary consultants work.”
- “We check with / question the consultant ourselves.”

As one bank responded,

The “independent consultant” *is* the “second consultant” – usually the client hires a consultant to write an EIA [environmental impact assessment] and the lenders hire an independent consultant to represent the lenders by reviewing the project to ensure it meets IFC standards. These are usually large international consulting bodies, its similar to having a PWC [PricewaterhouseCoopers] or KPMG doing external auditing of your financial statements - trust and reliance on these credible third parties is integral to the whole system working.

Another banker confirmed the level of reliance put on the independent consultants, who he noted often charge between US \$600,000-800,000 for an environmental impact assessment or “gap analysis” to check the project borrower’s EIA. He said that the banks were not about to spend that sum over again to double-check the work of the independent consultant.¹⁷⁹

More significantly, however, this banker, who had close to twenty years of experience, explained that the more difficult issue is not the EIA, but what comes next: the monitoring of the project after the credit phase, when the environmental management plan is supposed to be put into action. As this banker explained, in addition to the role of the independent consultant, one bank within each syndicate serves as the syndicate’s “agent,” also known as the “environmental bank,” and is responsible for all of the paperwork and ensuring that all of the loan covenants in the project contracts are fulfilled. The agent’s fee is a flat fee paid by the project sponsor on a monthly or annual basis. I suggested to one banker that, if his institution were very serious and concerned about ESRM in a given project, that it might wish to assume the role of agent to make sure all goes well. However, this impulse is balanced against the fact that the role of the agent is a relatively thankless job because the fee is not that high relative to other fees, at least in exchange for the amount of work required to earn the fee. The agent’s responsibilities include constant monitoring of information from the project sponsors, checking this information against the loan covenants for compliance, and reporting on compliance to all members of the syndicate. Of course, if anything goes wrong, it is the agent who bears significant responsibility. This again points to the role played by reputation *among banks*—what Bourdieu referred to as “social capital” (Bourdieu 1983)—as a significant check on individual bank behavior.

The difficulty is, however, that after the credit phase, bankers’ interests in ESRM compliance might dwindle significantly, even though it is during actual construction and project

¹⁷⁹ Banker 2 interview (recording on file with author).

operation that most of the social and environmental impacts take their toll on local populations, potentially creating the most problems for project developers.¹⁸⁰ Nevertheless, according to this banker, the “agent” bank takes its role very seriously, and compliance with the increasingly-detailed loan covenants related to the environmental management plan are rigorously enforced by the “agent bank” responsible for checking implementation with loan covenants.¹⁸¹

In terms of other checks on environmental and social impacts during project development, a large percentage of banks (70 percent) reported doing site visits. Some of my interview subjects said these visits typically occur when certain construction completion goals are reached since the further drawing-down of loan funds is often contingent on meeting certain construction deadlines. However, a relatively small-number of banks (12.5%, three banks) offered evidence of establishing complaint mechanisms or secondary lines of communication that would serve to compensate for any breakdowns in information-flow in borrowers’ complaint procedures. I assumed that this would be a reasonable check on the overall compliance of a project—which Equator Principle 6 puts at the feet of the banks themselves—but it might be too complicated to achieve in practice, or this is an area where the banks are simply not willing to expend further resources. Typically, consultants do periodic site visits, which are more frequent at the start of construction and operation (quarterly, perhaps), but drop in frequency (to an annual or bi-annual basis) once the project reaches construction completion and begins operation.

Training

Developing institutional competency in a particular subject matter can only be achieved through learning. Just as banks require individuals with particular expertise in reviewing projects for environmental and social risk issues, so to do front-office bankers need to understand the role played by the EPs in project approval: these bankers are the banks’ representative to potential and existing clients, the actors most affected by the EP requirements. This suggests that front-office staff need to be conversant with these requirements in order to convey their importance to clients and ensure that they are accepted as a part of doing business with that particular bank. More generally, if the norms promoted by the EPs are known only to a handful

¹⁸⁰ Banker 2 interview (recording on file with author).

¹⁸¹ Interview with Banker 2 (recording on file with author). As an important side point, this clearly illustrates what some have observed as the breakdown of the distinction between the description of voluntary norms as “soft” and non-binding and mandatory “hard” law:

The voluntary/mandatory distinction also vanishes when so-called voluntary standards are incorporated within binding contracts, thus forming a private law regime between the parties, and sometimes even a public law regime. This happens, for example, when voluntary standards are referenced in agreements between large multinationals and their suppliers, or when they are referenced in host agreements that actually become a “prevailing legal regime” binding upon the parties – even being ratified as binding treaties among the governments involved.

(Pitts III 2008).

of individuals (senior management, ESRM staff, etc) and are not made known and integrated into the core fabric of project finance business practices, it will be difficult for them to be implemented in a serious manner. Indeed, as should be clear from the responses related to the role played by ESRM personnel in the project approval cycle, several institutions look to the ESRM personnel to perform an advisory or trouble-shooting role, which in turn requires that the front office bankers understand when it is and is not necessary to escalate the level at which a particular project will be reviewed. Considering this, another way of measuring institutional implementation is by looking at the extent to which banks trained their personnel so they could implement the Equator Principles. Overall, twenty-three institutions (96%) conducted some form of training, while only 1 bank did not. Still, it is important to realize that, like all education, theoretical classroom sessions or printed materials can only go so far in conveying practical knowledge. As one banker emphasized the real learning happens every day on the job as you encounter new projects with different problems.¹⁸²

Disclosure and other Policies

In 2006, the Equator Principles were reborn as the “Equator Principles 2” to keep pace with developments in the IFC’s Performance Standards (described in Chapter 5). A significant aspect of the revision was considered to be an enhancement: the newly created Equator Principle 10 required EPFIs to “commit[] to report publicly at least annually about its Equator Principles implementation processes and experience, taking into account appropriate confidentiality consideration [sic].” EP 10 further clarifies in a footnote that “such reporting should at a minimum include the number of transactions screened by each EPFI, including the categorization accorded to transactions (and may include a breakdown by sector or region), and information regarding implementation.” In May 2007, the EPFIs released a guidance note (“Guidance to EPFIs on Equator Principles Implementation Reporting”), which established minimum requirements for reporting and provides further suggestions on the extent of information to be disclosed as well as different formats for presenting this information.¹⁸³

The requirement for disclosure of EP-related activities has been treated by NGOs as both a means to an end and an end in itself. On the one hand, NGOs have tracked overall disclosure

¹⁸² “Banker 2” interview (recording on file with author).

¹⁸³ See Principle 10: EPFI Reporting: “Each EPFI adopting the Equator Principles commits to report at least annually about its Equator Principles implementation processes and experience, taking into account appropriate confidentiality considerations.” Footnote 6 goes on to clarify that “Such reporting should at a minimum include the number of transactions screened by each EPFI, including the categorization accorded to transactions (and may include a breakdown by sector or region), and information regarding implementation.” The implementation discussion can be reported in a variety of ways, including a “[d]escription of how the Equator Principles have been incorporated into the EPFI’s credit and risk management policies and procedures, as required by the Equator Principles,” or of “[r]esponsibility for Equator Principles implementation within each EPFI (perhaps including identifying responsibility within each Project Finance business and/or within the Credit and Risk chain, or inclusion of a Equator Principles responsibility chart),” which can include, as relevant, discussion “relating to escalation of Equator Principles decisionmaking to higher authority levels within each EPFI’s organization” or a discussion of “internal adoption processes and implementation efforts and timetables, and staff training to ensure that the EPFI’s staff are fully informed of the Equator Principles standards.”

progress while at the same time criticizing the reporting requirements as not being comprehensive enough, and therefore, not useful to communities affected by projects or by the publish at large, which has an interest in wishing to independently assess whether the EPs are being properly implemented by independent banks.¹⁸⁴ In particular, a glaring criticism of the EP reporting requirement is that, in contrast to the disclosure requirements at some multilateral lenders (e.g. the Asian Development Bank), which require the public disclosure of *all* projects *under review* for financing, the EP requirement is a post-hoc disclosure of only the aggregate results of such reviews. A related critique, which goes to the heart of perceived inadequacy of IFC Performance Standards as well, is what the NGOs consider to be a “watered-down” version of the principle of free, prior and informed consent.

The functional import of this critique is quite valid: how can people comment on project viability or protest projects without sufficient advance knowledge; moreover, how can consultation (let alone consent) occur without sufficient advance release of information. The banks counter, however, that disclosure brushes up against the banks’ fiduciary duties; revealing project information, the banks argue, would be highly unprofessional, if not illegal (Gaskin 2007), which is why the reporting requirement’s Guidance Note prescribes that annual reporting on EP implementation “tak[e] into account appropriate confidentiality considerations.”

Banktrack’s Report, *Silence of the Banks*, assessed the state of the EPFIs’ fulfillment of the EP 10 obligations as of 2007. At the time, fifty-eight EFPIs were included in the study, eleven of whom (19%) had adopted less than a year prior (and thus were in the “grace period” for reporting according to EP 10) and 47 of whom had adopted more than one year prior.¹⁸⁵ Banktrack reported that “of the 47 EPFIs that have adopted the EPs more than one year prior, 9 institutions (19%) met the minimum requirements and 19 (40%) exceeded them; 19 institutions (40%) did not meet the minimum requirements. Of these EPFIs that did not meet the requirements, 7 did report and 12 did not report at all” (*Id.*).

¹⁸⁴ See BankTrack, *Silence of the Banks*, at 7. Such information, Banktrack argues, should include: “performance data,” i.e., reporting not only on the categorization of projects but on “the number of projects rejected on EP related environmental and social concerns, an explanation of any deviations from standards, information about loans suspended or called in due to non-compliance with EP prescribed environmental and social requirements, and a breakdown of core business activities by sector and region”; “process data,” i.e., information on banks’ “processes and systems in place to implement the EPs be part of the mandatory EP reporting requirement”; and “project-level data,” i.e., a one-paragraph synopsis for Category A projects including “what information the client is required to publicly disclose, and when it should be released,” as well as producing upon request the impact assessments and supplementary documentation, any “non-confidential project-related information, including information on the purpose, nature and scale of project and any risks to and potential impacts on communities,” the “draft and final Action Plans” and “bank-generated and third-party-generated reviews, monitoring and compliance reports developed under Principle 7 and Principle 8(c); environmental and social loan covenants developed under Principle 8; and draft and final decommissioning plans developed under Principle 8(d)” *Silence of the Banks*, at 8.

¹⁸⁵ Banktrack reported at the time that “Only one of the EPFIs with *less than one year of adoption* reported on the implementation of the Equator Principles. One other EPFI reported on the different projects for the past year (presenting names and environmental assessments) but not on the implementation of the Equator Principles itself. The rest of the EPFIs in this category did not report on the implementation of the Equator Principles or the efforts to implement them or on their application (BankTrack, 8).

Table 8.7 – *Implementation of EP 10 – Reporting as Measured by Banktrack (NGO)*

Reporting as of 2007		
47 Reporting, 11 in grace period (58 total)		
Not meeting minimum	Meeting Minimum	Exceeding Minimum
40% (19)	19% (9)	40% (19)
*12 did not report at all		

The value of transparency in the realm of corporate social responsibility is paramount. As Banktrack suggests, greater transparency can empower affected communities with the knowledge they need to better understand projects, and by extension, to protest against development they view as detrimental.

Nevertheless, my interview research helped contextualize the reporting requirement further. Notably, several interviewees explained that the data on projects – particular the numbers of projects rejected – is not necessarily as revealing as might be hoped. As several banks’ CSR reports make clear (see, e.g., Citibank and Barclays), projects can be rejected on any number of grounds, not just these related to environmental or social-risks. As one financial expert noted, “an absolute no would be unlikely based on the principles alone” (Gaskin 2007). In fact, data shows that the banks were split 50-50 on whether they had ever rejected a project *primarily* on ESRM issues. Indeed, credit approval committees often reject projects because project sponsors’ backgrounds not only raise questions about their capacity for environmental and social risk management, but also about their credit histories and general business practices. Others have noted that getting to a “no” stage is pretty unlikely because few banks would let negotiations progress to that point (Gaskin 2007). Moreover, it is rare that projects are considered solely on an absolute yes or no basis; rather, “[o]nce the assessment has been done, if there are elements of a project that breach the standards, the response is not to refuse the project but to put processes in place to manage it so it does become compliant” (Gaskin 2007). In other words, projects are often problematic for a variety of reasons and figures on rejection of projects must be taken with a grain of salt; they are not likely truly revelatory of the depth of banks’ commitment to ESRM as much as they point to the banks’ appreciation of a variety of risks, including reputational risk.

To the extent that disclosure is the key to other objectives, it only forwards those objectives to the extent that it can be relied upon; thus, the information asymmetry dilemma that serves as an initial impetus for the creation of voluntary regimes (particularly for certification) repeats itself even once disclosure has been made – how do stakeholders know that the disclosure is accurate and reliable? With this in mind, a further problem with placing too much emphasis on the EP reporting requirement is that because of confidentiality concerns, EP reporting comes in the least credible fashion according to the schema described by Prakash and Potoski: it is first-party auditing (indeed, these authors contend that first- and second-party auditing is definitively *not* credible). That being the case, there is evidence of individual banks supplementing their first-party auditing with external, third-party auditing, which Prakash and Potoski characterize as the gold standard among voluntary programs (because in practice there is no fourth-party certification—external auditors not paid for by the firm). Generally, assurance

auditors from large accounting firms read EPFIs' corporate social responsibility (and other) reports to verify that the contents disclosed are accurate.

The survey inquired into what level of disclosure the banks had engaged in and also whether banks used external auditing firms to verify the disclosures in their CSR reports. The content of the information disclosed in the banks' reporting is not valuable in and of itself (compared to disclosure of project-level information well in advance of financial closure), but it is costly in the sense that it requires resources to produce this reporting. Even greater resources are expended in hiring external auditors to certify the disclosures. Thus, under signaling theory's insight, the outlay of non-trivial costs increases the likelihood that the information related to those costs is accurate. As noted, what we do *not* have here is evidence that banks made certain funding decisions related to particular categorizations of projects; what we do have here, and which arguably is significant, is evidence that they engaged in the process of categorization, which is the first—and essential—step in environmental and social risk management.

Table 8.8 – *Implementation of EP 10 – Reporting Requirement*

Details of Disclosure	Percentage (# of banks)
Number of projects reviewed and categorization	20.8% (5)
Number of projects reviewed, categorization and sector	16.7% (4)
Number of projects reviewed, categorization and region	8.3% (2)
Number of projects reviewed, categorization, sector, and region	37.5% (9)
We made no disclosures in our last sustainability report because we were in the first-year grace period	16.7% (4)

In addition to these figures, 70 percent (17 banks) reported using auditors to verify their disclosures. An assurer for a major EPFI has argued, however, that the value of assurance is sometimes limited by the roles played by a bank in different syndicates. If a bank that has hired an assurer has not acted as the lead arranger or the environmental bank for the deals on which it is reporting, it may have limited information available to the assurer regarding project implementation data.¹⁸⁶ Regarding post-financial close, however, the Agent bank is supposed to update all syndicate members of any issues reported by consultants, so all syndicate members should have this information.

Reputational Exposure and Implementation

As discussed above, implementation was measured by whether banks (1) made significant changes to their ESRM procedures, (2) hired or designated ESRM personnel; (3) gave a considerable role to ESRM personnel in the credit approval process; (4) implemented secondary layers of due diligence; (5) trained their personnel regarding ESRM; (5) disclosed their ESRM implementation in their annual reports in compliance with EP 10; (6) had at any point based project rejection primarily on ESRM considerations ; (7) had engaged in leadership activities to sustain the EP regime; (8) had been involved in outreach to their peer institutions.

There were statistically significant associations between the governance level of bank country of origin and whether they had hired ESRM personnel ($p = 0.05$, FET), the level of ESRM procedures engaged-in following adoption ($p = 0.04$, FET), and implementation of the minimum reporting obligation of EP 10 ($p = 0.01$, FET) as well as reporting beyond the

¹⁸⁶ Esther Rodriguez, *The Reality of the Equator Principles: Reporting and Assurance*, at http://www.carbonsmart.co.uk/?q=webfm_send/2 (last visited November 24, 2010).

minimum obligation ($p = 0.01$, FET). There was also an association between fulfilling the minimum reporting obligation and the estimated number of projects reviewed ($p = 0.04$, FET). The estimated number of “high risk” projects financed was also associated with reporting beyond the minimum requirements ($p = 0.05$, FET) and with banks rejecting projects primarily out of concern for ESRM issues ($p = 0.02$, FET). Banks targeted prior to adoption were also associated with the level of ESRM procedures engaged-in following adoption ($p = 0.05$, FET), and banks targeted after adoption were associated with having rejected projects primarily for ESRM issues ($p = 0.03$, FET). Finally, there was an association between the year of adoption and fulfillment of the minimal reporting requirement ($p = 0.02$, FET).¹⁸⁷

This data broadly supports the neoinstitutionalist paradigm: those banks most exposed to reputational pressures, whether because they were headquartered in a relatively open society that enables NGOs and their criticism to flourish, or because they simply reviewed more projects or tended to finance riskier ones, showed high levels of implementation. It is striking that there is a such a close relationship between a bank being targeted and the extent to which it later engages in ESRM review, suggesting that at least for several banks, such public campaigns had in fact taught them a lesson. Similarly, the significant association between banks being targeted *after* adoption and their having rejected projects primarily on the basis of ESRM review suggests that the follow-up work and increase in pressure applied by NGOs even after the decision to adopt is not all for naught.

Challenges to Implementation

Closely related to the question of implementation is an account of the internal dynamics that contribute to or impede compliance with the Equator Principles, and, indeed, voluntary regimes more broadly construed. Among the internal factors identified by the literature are managerial incentives, organizational culture, organizational identity, organizational self-monitoring and personal affiliations and commitments of employees (Howard-Grenville 2008). However, very little of the large-N studies in the regulation and management literatures that study the effectiveness of voluntary programs has focused on the internal politics and dynamics of organizations, which are often treated as single-cell organisms. As David Vogel has observed, there are “few scholarly studies of the effectiveness of most civil regulations,” and “[w]e know much more about what codes require and why firms have subscribed to them than we do about the extent of actual business compliance. . . . We need to get inside the “black box” of firms to better understand how civil regulations have changed their behaviors” (Vogel 2007). There are presumably norm-entrepreneurs (Keck 1998) within each organization that promote certain norms that must then become institutionalized in the larger organization. This is what happened at the World Bank (Wade 1997; Khagram 2004; Sarfaty 2009) and IFC (Wright 2006; Parks 2007). Nevertheless, as the experiences of these institutions show, internal constraints, such as

¹⁸⁷ When gamma tests were run, the variables in highest agreement were the estimated number of “high risk” projects undertaken with: the level of leadership activities pursued ($\text{gamma} = .7$, $p = .0001$).

resources or long-standing organizational culture can either minimize or facilitate the spread and internalization of new norms and practices (Wright 2006; Sarfaty 2009)

There was evidence that the initial EPFIs were driven to sustainability by visionary leadership of CEOs—to which visions they were driven at least partly by intensive transnational activist campaigning. Some bankers at key institutions perhaps came by their commitments differently, such as Chris Beale of Citigroup, who self-defines as “not a tree hugger, but someone with a green streak, concerned about environmental issues, and who wants my kids to enjoy healthy air and clean environment” (Heal 2008). But the level of targeting—and thus acute awareness—of the need for changes has not been equal at all institutions, particularly smaller ones that are less active in project finance. Moreover, for many institutions ESRM practices were quite new, and like all top-down initiatives within organizations, required “buy-in” from employees at lower pay-scales who are most instrumental to the internalization of the new norms within the corporate culture.

Accordingly, my intuition in approaching the EPFIs in their attempts to implement the EPs was that there might be cultural rifts within institutions between “hard-nosed bankers” (Watchman 2007) and the environmental and social risk managers who were hired specifically to work on these issues. I assumed that the bankers on the transactional side of the business, who interact with clients and try to “seal deals” (to attain deal-related bonuses), might be resistant to these new norms because they saw them as fundamentally opposed (or even mildly detrimental to) their strategic interests. The extensive reviews required could be perceived as (a) impediments to their work and more importantly (b) their profits. To my surprise, the front-office bankers I met during my interviews of Steering Committee banks were nearly universally far more knowledgeable about the details of ESRM than I had anticipated and, more unexpectedly, appeared completely “on message” with respect to the utility of these new practices, although there was one banker at a prominent European bank who expressed a bit more frustration and impatience with the enhanced environmental and social risk procedures.¹⁸⁸ This is perhaps understandable because these individuals were very experienced players in the project finance sector who were operating at the very top echelon of their field. Still, these are the individuals heading the business development side of many of the most active project finance practices.

To gain a better empirical grasp on these dynamics, the survey asked about the challenges the banks’ faced in implementing the EPs within their institution (see Table 8.10).

¹⁸⁸ This banker worked within a large bank that claimed to have been compliant with the norms later embodied in the EPs long before the bank had adopted the EPs, though, like many of its peer institutions, the bank had only recently implemented a formalized ESRM review process and organizational structure. The banker noted that project approval cycles used to last up to six months or a year but were now routinely stretching to up to two years. He observed that if this continued it might radically alter the attractiveness of doing project finance. Banker 2 interview (recording on file with author).

Table 8.9 – *Challenges to Implementation*

	Persistent and most challenging Percentage (banks)	Persistent, more challenging than other sources	Infrequent, but significant source of challenge	Infrequent, mild source of challenge	Never a source of challenge	Rating Average Scale: 0 – 4
Insufficient resources	12.5 % (3)	12.5% (3)	29.2% (7)	41.7% (10)	4.2% (1)	1.88
Resistance by front-office bankers	8.3% (2)	16.7% (4)	20.8 % (5)	37.5 % (9)	16.7% (4)	1.63
Resistance from Board or senior management	4.2% (1)	0.0% (0)	20.8% (5)	20.8 % (5)	54.2% (13)	0.79
Resistance from borrowers	8.3% (2)	16.7% (4)	25.0 (6)	37.5% (9)	12.5% (3)	1.71
Disagreement with syndicate members	4.2% (1)	0.0% (0)	20.8% (5)	58.3 % (14)	16.7% (4)	1.17

Several interesting trends are present. First, only 1 institution stated that the Board of Directors or senior management’s resistance had been “persistent” and “most challenging,” whereas the remaining institutions thought that the Board and management’s resistance was either “infrequent, but significant” sources of challenges (5 banks, twenty percent), “infrequent, mild” sources of challenges (5 banks, twenty percent) or “never” a source of challenges (13 banks, over fifty percent). This lends some support to the earlier anecdotal findings that there has been strong CEO leadership in this area (Watchman 2007; Heal 2008). Also unsurprisingly, “insufficient resources,” (10 banks, forty-one percent) “resistance by front-office bankers,” (11 banks, forty-five percent) and “resistance from borrowers” (12 banks, fifty percent) combined to be the more frequent and significant sources of challenges to implementation.

Another significant dynamic requiring further exploration is that between banks in a given syndicate. As a sustainability report assurer has explained,

It may be the case (and very frequently it is) that the consortium of banks includes both EP banks and non EP banks. The role played by the FI in the project is essential as it can shape and influence others in the consortium. The level of influence and the amount of money lent correlate each other. For example, a non EP FI may be the lead arranger FI for a project in China. EP FIs may also be part of the consortium, but playing a minor role, e.g. by providing a minimum loan. In this case the degree of influence of the EP FI over the non EP FI might be minimal. In theory, the EP FI should exert enough influence over the other banks and encourage them to apply the EP. In some cases, the EP FI will be successful and in others, it won’t. In the latter, the EP FI needs to reconsider very carefully the risks involved in such a deal and withdrawal at that stage should be an option. In practice many EP banks have been in that situation before and therefore withdrawn from such deals. If, on the other hand, the project financing is being

led by an EP bank together with other non EP banks, the facility documentation should ensure that non EP banks cannot waive a breach of the EP covenants.¹⁸⁹

I began inquiring about these dynamics during the qualitative interviews. Several banks acknowledged that there could be tense intra-syndicate dynamics between EPFIs and non-EPFIs and that quasi-voting procedures were implemented to assure consensus on various issues. It was difficult to assess either through survey questions or the interviews how these inter-syndicate dynamics resolved themselves, i.e., whether there were stable and consistent mechanisms for resolving conflicting visions of ESRM implementation once a syndicate had formed.

Summary: Analysis on individual commitment

The data, taken as a whole, shows significant trends towards implementation levels that go well-beyond superficial or formal adoption of the EPs. On an individual level and collectively, banks have adopted procedures and created new organizational structures to facilitate ESRM review of projects at early stages of project development, something simply not done in the past. Moreover, for many banks, projects are scrutinized by environmental and social risk personnel, whose approval and recommendations (in some institutions) is necessary before any final credit approval. When there are conflicting views within credit committees (including perhaps the views of ESRM personnel), most institutions insist on consensus being reached or rely on final decisions to be made by quasi-appellate mechanisms involving the highest levels of the institution, demonstrating both the seriousness of ESRM review as well as the depth of institutional concerns over reputational risk.

It should also be borne in mind that these institutions appear to be quite well-evolved along their sustainability trajectory compared to many other banks, particularly commercial banks. In 2005, the IFC conducted a study of various financial institutions to assess the state of the market in terms of environmental and social governance (IFC 2007). The study collected implementation data regarding banks' policies and procedures, not unlike the research presented here. The IFC study found that

The 2005 survey revealed that many commercial banks have undertaken steps to identify social and environmental risk and/or opportunities (71 percent), have developed procedures to integrate social and environmental considerations into project screening and client assessment (57 percent), have articulated objectives for environmental risk management (57 percent), and have designed a formal sustainability policy (39 percent).

However, a closer look reveals that the systems developed do not always go beyond written policies and formulated objectives to allocate sufficient resources for implementation. Only 36 percent of respondents from commercial banks have developed an action plan and allocated resources for implementation, and have specified criteria for reviewing and screening investments. Even fewer

¹⁸⁹ Rodriguez, http://www.carbonsmart.co.uk/?q=webfm_send/2

banks have established a monitoring and evaluation procedure for their management systems (32 percent), defined and assigned responsibilities for social and environmental management (29 percent), or identified internal training needs (25 percent). Only 18 percent have created a management department or unit dedicated to social and environmental management. Only 11 percent of banks have undertaken initiatives to raise awareness of sustainability management efforts both internally and with stakeholders. And 11 percent have established incentive schemes to motivate their investment staff to pay attention to social and environmental issues. The 2005 IFC survey confirms that implementation of SEMS' is being led by foreign and international banks in emerging markets (IFC 2007).

Outcome effectiveness

In the context of the Equator Principles, outcome effectiveness presumably would be equivalent to EPFIs exhibiting zero tolerance for the funding of "problem projects." It must be kept in mind that the achievement of this outcome in this context relies not only on the EPFIs but on the borrowers, i.e., the project sponsors. While it is true that the Preamble of the EPs requires banks not to sponsor projects that do not meet the EPs criteria or to cut funding for projects that turn out to be risk-filled, research into the dynamic between banks and sponsors is very difficult to do from a desk. Furthermore, what other information could be gleaned from interviews or other investigations is barred by confidentiality concerns of all parties to the transaction. Thus, while data on outcome effectiveness could be informative, it was judged to be too difficult to procure for this study.

Nevertheless, my research attempted to get some measure of this dynamic by enquiring about EPFIs' recourse to calling events of default and refusing to finance a project on the basis of insufficiencies discovered following ESRM review. An event of default is defined in loan agreements as one of several occurrences that allow the lenders to assert greater control over the project by being involved with the borrower and other project sponsors to solve any problems or to demand repayment, depending on what stage a project is in. Thus, if a project is still under construction, this may also lead to a lender calling for a freeze on the lending of further funds (a "drawstop"), and if it is already in operation, it may lead a lender to demand that all net cash flow go directly to the payment of debt or be put into escrow under the lender's control. A lender may also elect 'waiver', that is, to ignore the event of default ((Yescombe 2002). As has now become best practice in the project finance sector pursuant to Equator Principles 8, loan documentation includes detailed covenants on ESRM performance which, if broken, could lead to events of default.¹⁹⁰

The survey asked: "Have you ever had to threaten to call an event of default because of a borrower's failure to comply with the Equator Principles?" Of the reporting institutions, 83

¹⁹⁰ See Equator Principles' Best Practices Working Group's *Guidance to EPFIs on Incorporating Environmental and Social Considerations into Loan Documentation*, <http://www.equator-principles.com/bestpractices.shtml> (last visited December 20, 2010).

percent (twenty banks) replied that they had never had to threaten an event of default, while 16.7 percent (four banks) responded that their threat to call an event of default prompted the borrower to get the project into EP-compliance, and only 4.2 percent (one bank) reported that the borrower did not respond proactively to the threat, that default was called and that the borrower then sought financing from another source.

A related question asked whether banks had ever rejected financing a project *primarily* due to ESRM concerns. On this issue banks were split 50-50, and several banks offered further commentary:

- *We will only finance projects where our clients agree and show commitment to comply with the Equator Principles.*
- *If a project doesn't comply with ESRS it never reaches Credit Committee. Transactors do work with willing clients to reach compliance.*
- *Equator Principles compliance is negotiated and indicated to clients at the upfront engagement stage, therefore it is a non-negotiable in the financing of a project of that nature.*
- *it has never been that clear cut - but possibly yes*
- *not EP is the main reason. Project and their sponsors unable or unwilling to implement EP standards usually have many more issues than just EP.*

These comments demonstrate the interrelationship between ESRM and credit decisions. A complicated, overly-risky project whose project sponsor evidences a lack of preparedness to plan for and address the myriad environmental and social risk issues presented by a particular project creates considerable doubt among potential funders as to the likelihood that the project will be built without costly delays, if not arrested completely in its development, or otherwise targeted, either by civil society groups or by government regulators for non-compliance with environmental laws. As one financial expert noted in an earlier report, “an absolute no would be unlikely based on the principles alone,” whereas another commented that getting to a “no” stage is pretty unlikely because few banks would let negotiations progress to that point (Gaskin 2007). Moreover, it is rare that projects are considered solely on an absolute yes or no basis; rather, “[o]nce the assessment has been done, if there are elements of a project that breach the standards, the response is not to refuse the project but to put processes in place to manage it so it does become compliant” (Gaskin 2007).

While it is indeed true that banks have financial sanctions at their disposal to enforce the EPs once a loan has been disbursed (charging default interest rates, preventing further drawdowns of funds, or asking for repayment), one financial analysis noted a lurking Catch-22 within this proposed enforcement mechanism: “Once a project is up and running the impact of withdrawing financial support could be huge. The other problem is that the environmental and social impact of a project collapsing may well be as drastic as carrying on” (Cashore, Egan et al. 2007).

It should also be born in mind, however, that whether a project does or does not meet the standards outlined in the EPs can be a highly subjective question, one that the banks and borrowers rely tremendously upon independent experts to answer. In my interviews, I was

overwhelmed by the extent to which the banks rely on independent consultants. Considering the risks involved, I assumed that it was perhaps rather careless of these institutions not to do further checking on such important issues. However, the extreme reliance on independent consultants of course make sense: the requirement under EP 7 for an *external consultant* is of course preferred over (1) only the borrower's consultant being the source of ESR review or (2) an employee of the financial institution itself reviewing for ESR as the primary source, as both of these alternatives would present potential conflicts of interest and moral hazards towards lenient, less scrupulous reviews. My survey found, however, that there nevertheless were varying degrees of utilization of other verification methods to "check the work" of even the independent consultants (see discussion of layers of due diligence earlier in the chapter).

Indeed, subjectivity is infused in the entire process of risk management. For example, the duty to consult populations to be affected by Category A projects (projects that carry "potential *significant* adverse social or environmental impacts") introduces a gray area of interpretation that has and will likely lead to "patchy application" in practice.¹⁹¹ But even aside from the standard's ambiguity, the very practice of environmental impact assessment has been described as a mix between "science" and "art": "there are within the [EIA] process itself many key decisions to be made which will almost certainly not be based upon the rational principles of value free objectivity" (Wood 2003). As the Council on Environmental Quality, the body in charge of interpreting the requirements of the United States' NEPA observed in 1990, the twentieth anniversary of NEPA's passage:

Because NEPA was not designed to control specific kinds or sources of pollution, its benefit to society is difficult to quantify. The act was designed primarily to institutionalize in the federal government an *anticipatory concern* for the quality of the human environment, that is, *an attitude, a heightened state of environmental awareness*, that, unlike pollution abatement, is measurable only subjectively and qualitatively.

In addition to subjectivity, conducting a rigorous social and environmental impact assessment is contingent on many local factors, as one experienced environmental consultant emphasized:

Keep in mind that there are some unseen factors that limit SEIAs [social and environmental impact assessments], including capacity to conduct one at a local level, host government cooperation and transparency, attention/professionalism of civil society actors and involvement (or lack thereof . . .) of potential lenders. I know some of the stuff I have written isn't what I would consider to be compliant, but it is very, very hard going to a place like Tajikistan or the Central African Republic and trying to develop a[n] international standard SEIA. That isn't an

¹⁹¹ See the editorial comment, 'Application of Equator Principles Lands Adherents in Hot Water', *The Banker*, 5 March 2007.

excuse for bad work, but something that I think the most critical NGOs often forget.¹⁹²

The consultant went on to note that his company almost always relies on local consultants because it is “often very hard to find people who understand the local context and the international requirements,” but that even finding quality consultants and local support is not sufficient:

The basic point is that in order to fully integrate the principles of environmental and social responsibility in large investments, there are a lot of variables beyond just the quality of the consultant and the intentions of the company. It isn’t just a question of black/white. I think EPs and IFC standards are a lot about governance (the broadest meaning of the word) and external consultants (or one company, really) can’t change “governance” through one ESIA or project. Again, that isn’t meant to be an excuse for bad work, but more of an observation that I don’t see acknowledged when I read the indignant NGO critiques. That said, there is still a lot of bad work, which is why the EPs were developed, from what I understand (*Id.*)

The thrust of this comment affirms what said before; proper implementation of the EPs – good outcomes – implicates a variety of actors beyond the financiers. Moreover, “governance” demands attention to complex social structures and phenomena beyond narrow considerations of pollution.

Utility as mechanism for social learning, focal point generation

As noted above, more recent research into voluntary regulation has emphasized its capacity to engender a social interactive process among its participants, which can yield long-term benefits that a short-term outcomes-based analysis might overlook. This also coheres with the insights from “social network theory,” which argues that networks facilitate knowledge diffusion because they “provide their members with pre-existing modes of communication, enhancing the potential for collaboration, information exchange, and mutual observation” (Tashman 2010). As the central actor in the network, the EP Steering Committee, Secretariat and now the EP Association, have the potential to serve as “focal points” of knowledge and influence (Tashman 2010). In addition, empirical research also has shown that business associations in developing countries have, under certain conditions, contributed to economic development “without intending anything more than defense of their members’ interests” (Doner 2000). These associations can provide two different kinds of benefits to members and society at large: providing “‘market-supporting’ activities,” including the “promotion of property rights, infrastructure, and cleaner bureaucracies,” as well as “‘market complementing’” activities, including reducing inflation, setting standards for agricultural exports, promoting training, and

¹⁹² Email exchange from July 23, 2009 with environmental and social risk consultant (on file with author).

reconciling differences between upstream and downstream parts of value chains (Doner 2000) , p. 278. These contributions, however, depend on associations being “productive,” and sufficiently strong, namely, having high member density, the ability to provide valuable resources to members and the capacity to mediate member interests (Doner 2000).

With these theoretical and empirical contributions in mind, yet another way of analyzing the effectiveness of a regime of private regulation is to measure its operation as a mechanism for social learning: has the regime centralized and coordinated the resources of would-be competitors and has it effectively disseminated knowledge and norms that might otherwise find barriers to widespread dissemination. In other words, has there been knowledge transfer and norm diffusion among participants (and beyond) that would otherwise not have occurred in the absence of the voluntary program coming into existence?

There is anecdotal evidence that the Responsible Care program transformed the chemical industry in just this way: “Under Responsible Care, the old chemical industry ethos of ‘every company for itself’ has given way to a culture of sharing and mutual aid. With the reputation of the industry only as strong as the weakest member, companies have a vested interest in ensuring best practices are broadly shared” (Barnett 2008). Others have noted similar transformations of the interactions between nuclear facilities in the United States (Rees 1994). Indeed, this is the primary function served by the United Nations Global Compact, which is now the world’s largest corporate social responsibility initiative.

The question is how such transformations can be measured? One marker of such an evolutionary trajectory is whether competitors have become more intertwined in an increasingly formalized and quasi-legalized governance structure and whether, out of recognition of their shared fate, participants in the industry or regime have sought to help maintain this governance structure rather than let it whither through neglect or opposition. Of course, creating and maintaining an ineffectual governance club is not necessarily a feat deserving of recognition, particularly if the club runs more like a cabal with ulterior motives, such as ‘greenwashing’ an industry’s reputation. To demonstrate that the governance structure of the regime is providing a benefit to its members (and by extension, society at large) it would be necessary to document ways in which individual firms experienced capacity development or at the least norm diffusion *through* participation in the regime that *would not likely have occurred otherwise*.

Prior to undertaking my research there was anecdotal evidence that this had been the case with the Equator Principles. Building on these intuitions, my research tried to quantify the various “regime-building” activities in which EPFIS participated. First, the survey tried to measure individual EPFIs’ contributions to the regime, what could be described as expressions of their “civic duty” to help build and maintain the governance structure or community of which they were a part. Of the respondents, 37 percent (9 banks) reported that they had served on the Steering Committee and 54 percent (13 banks) reported that they had served as members of one of the thematic working groups (seven of these were also Steering Committee members). Thirteen banks (54 percent) also reached out to other institutions, either to a non-adopting institution to encourage them to adopt, or to an adopting institution to provide capacity development. In addition, several banks noted their participation in both the IFC’s Community of Learning event. The EPFIs Annual Meetings, which are scheduled for the same week of the

IFC event, as well as participation in conference calls and other organizational and planning activities.

Another way of gauging the extent to which the EP regime has facilitated social learning is to measure the levels of contact and discussion between banks before adoption and after adoption. Project finance lending is necessarily a very social enterprise: very few projects can be developed without accessing international credit markets and very few banks wish to take on all of the credit risk that financing large projects entails. Thus, there are competitive advantages to being a bank that has the expertise necessary to serve as a lead arranger of large deals or to act in an advisory role, both activities that garner fees beyond that which a mere participant in a syndicate would earn. Accordingly, it is in individual institutions' strategic interests to keep such expertise to themselves so that they are always viewed as a necessary participant to most deals. On the one hand, this would suggest that banks would not be in a hurry to disseminate expertise and capacity to conduct extensive ESRM due diligence; on the other hand, to the extent that the strategy of leading banks in creating the EPs has been to "set a level playing field," a primary goal would be dissemination of norms and practices supportive of the Equator Principles becoming the gold standard in the industry.

Table 8.10 – *Contact with peer banks before and after adopting*

	Before Adopting	After Adopting
No contact	16% (4 banks)	4 % (1 bank)
Infrequent, informal one-on-one	50 % (12 banks)	17 % (4 banks)
Regular contact through formal meetings	33% (8 banks)	78 % (18 banks)

To the extent that this latter imperative has trumped more individualistic strategic goals, we should see increased contact and dissemination of knowledge between EPFIs. The survey measured the level of contact that institutions had with their peers regarding ESRM issues both before and after implementing the EPs. Before adopting, 16 percent (4 banks) reported "no contact" with their peers; 50 percent (12 banks) reported "infrequent, informal one-on-one discussions" with their peers, and 33 percent (8 banks) reported "Regular contact through formal meetings." The data shows that after adopting, there was a clear increase in the number of banks reporting more regular and formalized contact with their peers: only 1 bank reported having "no contact" after adoption, whereas 17 percent (4 banks) reported "infrequent, informal one-on-one discussions" and 78 percent (18 banks) reported "regular contact through formal meetings." There is also evidence that individual institutions assisted in capacity development of other institutions considering adoption: 20 percent (5 banks) of respondents had received help from other institutions in capacity development in preparation for adopting the EPs. In addition, another 8 banks received help from the IFC, although it is unclear whether this was assistance targeted to the institution alone or more passive capacity learning achieved through attendance at the IFC's Community of Learning event, which is open to all (Wright 2007).

An interesting question emerges from these responses: it might be suggested that the extensive involvement of the IFC is the real root cause of extensive spread of the EPs and related norms. After all, the IFC was integral in founding the EPs and the EPs refer back to the IFC's own Performance Standards. It is a difficult counter-factual to entertain, but one wonders what the state of ESRM practices in commercial banks would be if the EPs never developed and the IFC was continuing its engagement of the private sector financial institutions as it did before the EPs were created. It is interesting to note that before the EPs reached a critical mass (approximately 2006, after the adoption of the revised EPII by forty banks), the IFC had only done outreach on an ad hoc basis by engaging the financial intermediaries it interacted with on B loans to projects. That is, the IFC's influence was limited to those banks it worked with on deals. In 2007, however, the IFC hosted its first Community of Learning event, which approximately 80-100 banks have attended every year since. Other initiatives targeting the financial sector, primarily the United Nations Environment Program's Financial Initiative, have operated since 1992, but this network has never achieved been the same level of sustained activity, interaction and cooperation *between* large banks as that experienced since the launch of the EPs.

Arguably an important step toward fostering a community of social interactive processes to facilitate norm diffusion is the creation of a self-sustaining architecture for such activities, such as governance structures. The more formal a mechanism that is established, the greater potential for growth. Overall, the research suggests that the EPFIs have become part of an increasingly congealed collective working together to maintain the regime they have established, overcoming, in the process, the natural tendencies of competitors. Indeed, the Equator Principles Association's newly-adopted Governance Rules state:

3) Objects of the Association and Purpose of the Principles

a) The objects of the Association are to:

- i) promote and encourage the adoption of the Principles by further financial institutions;
- ii) promote and encourage the implementation of the Principles by the EPFIs and Associates in a manner that accords with good international banking practice and all applicable law and that offers reasonable consistency of approach;
- iii) develop the Principles as the EPFIs and Associates consider appropriate, having regard to developments in international good practice, the evolution of sustainability standards and the practices and the views of Stakeholders;
- iv) maintain contact and share expertise with international financial institutions and other bodies who have developed their own social and environmental standards;
- v) engage an Administrator to manage the Equator Principles website and provide such other administrative services as the Association requires for the above purposes;
- vi) accept subscriptions and donations for all or any of the purposes specified above and to manage, invest or expend all monies belonging to the Association;

- vii) hold any monies of the Association not immediately required for its purposes in a deposit account subject to such conditions (if any) as may be imposed by law or determined by the Steering Committee;
- viii) invest any surplus monies of the Association in investments approved by the Steering Committee; and
- ix) do all such other things as will further the above.

In furtherance of the Associations' objectives, the EPFIs launched on a Strategic Review in October 2010. The purpose of the review is "take stock of the current state of the EPs and develop a better understanding of the challenges and successes to-date"; "identify perceived areas of strength and weakness in the current EP framework through engagement with EPFIs and other stakeholders including clients and industry, civil society, and financial sector peers"; "prioritise recommended action points that will lead to the successful implementation of the vision/plan, and prepare for a likely update of the EPs in 2011 following the conclusion of the IFC Performance Standards Review and Update process."

Regime's impact beyond participants

Voluntary regime impact can also be measured for its effects on a given industry or "field" of economic activity (Bourdieu 1983; Powell 1983; Meyer 1991; Fligstein 1996; Fligstein 2005). Has the regime's existence led to learning and socialization *beyond* the regime's participants, leading to knowledge transfer and an overall dissemination of norms beyond participating institutions that would otherwise not have occurred? Has it changed the "rules of the game," altering field dynamics between its constituent actors? Arguably, impact should be measured not based solely on changes experienced by similar actors who are nonetheless outside of the regime (i.e., non-adopting banks), but also other kinds of actors who are also engaged involved in the field's activity. In this case, these other actors would include various kinds of financial institutions engaged in project finance (development finance institutions, both bilateral and multilateral, export credit agencies, private equity funds, etc), project sponsors, project finance lawyers, environmental and social risk consultants, and perhaps even NGOs involved in monitoring project finance.

Impact on Non-EPFIs

This inquiry is also difficult because of the lack of information available on the practices of non-participating peer institutions, but I attempted to get a glimpse of this through my inquiry into activities undertaken by EPFIs to engage others in the sector. Over fifty-four percent of respondents (13 banks) had been active in "outreach to a non-adopting institution to encourage them to adopt the EPs," and twenty percent of respondents (five banks) had done "outreach to a non-adopting institution to provide capacity development." This would suggest that the EP regime's benefits were not limited to adopting institutions. Indeed, there is a Working Group committed to outreach that has several members divided into regional foci. The EPFIs have also

sponsored conferences to expand adoption in geographic sectors not known for heightened attention to sustainability, including India, Russia, China and the Middle East.¹⁹³ In fact, the EPs, while conducting their own outreach efforts, simultaneously “coordinate closely” with the IFC on outreach activities in the emerging markets:

In late 2006, IFC outlined its outreach activities directed to Brazil, Russia, India, and China. The Chinese banking sector, which provided approximately 80% of the capital to both state-owned and domestic private enterprises, offered a great appeal to IFC and EPFI outreach teams. Starting in about 2006, several EPFIs with commercial interest in China began to visit the country in an effort to persuade Chinese banks to adopt the Equator Principles. These EPFIs also called on MEP to introduce and emphasize the importance of the Principles (Aizawa 2010).

An interview with an IFC staff person emphasized the unique collaborative dynamic between the IFC and the EPFIs, emphasizing that while governments prefer to speak to the IFC because of its public multilateral nature, commercial banks often prefer to speak to peer institutions about adopting new ESRM practices, to learn from their more relevant experience. Because of this added value, the IFC has often involved EPFIs in its outreach activities.¹⁹⁴ This strategy has yielded rewards over the years, as a number of Middle Eastern banks have adopted the EPs and in 2008 the Industrial Bank of China adopted the EPs.¹⁹⁵

Although it was not deduced from my data, there is also evidence of the EPs’ impact, extending even beyond the private sector. A prime example is the alignment of many of the world’s leading export credit agencies’ (of Australia, Canada, Denmark, Norway and U.S.) policies with the EPs, as well as those of a few development finance institutions, including FMO, the Netherlands development finance institution and EDC (the Canadian development corporation).¹⁹⁶ A few ECAs adhere to the OECD’s Recommendation on Common Approaches on Environment and Officially Supported Export Credits or have developed their own

¹⁹³ A superficial look by a Malaysian commentator noted that in April 2010, a “quick review of ten established Islamic banks in various countries” shows that only one in ten mentioned sustainability in their annual reports. See Nik Sharihazal Sulaiman, *Sustainability and Equator Principles in Islamic Banking*, The Edge – Malaysia, April 19, 2019.

¹⁹⁴ Phone interview with IFC staff person (November 19, 2010).

¹⁹⁵ This came amidst much broader changes in China, most importantly its adoption of a Green Credit Policy in 2007, the purpose of which is to guide loan financing away from high-pollution, high-consumption companies and projects towards energy efficiency and conservation. The Policy (a) requires commercial banks to take into consideration borrowers’ environmental performance when extending credit to new enterprises and existing companies (e.g., by not granting credit to enterprises that fail environmental impact assessments or inspections required by a 2002 law on impact assessment, that are energy intensive, highly polluting or have previously violated national environmental laws); (b) aims to enhance environmental information sharing between the environmental authority and financial sector, and (c) imposes liability—administrative punishment and sanctions—on commercial entities for violations of the policy (Aizawa 2010).

¹⁹⁶ Statement of Suellen Lazarus, Senior Adviser, ABN AMRO Bank, House Committee on Finance Services, Hearing on “The Fight against Global Poverty and Inequality: The World Bank’s Approach to the Core Labor Standards and Employment Creation” (October 3, 2007).

procedures in accordance with the Recommendation that often exceed the requirements of the EPs (Watchman 2007).¹⁹⁷ In addition, by linking the EPs to the IFC's Performance Standards, the EPs have increased the acceptance and utilization of those standards as a universal standard, which according to one IFC staffer, would not have happened in the absence of the EPs.

On the other hand, if one of the ambitions of the EPFIs was to create a new global standard, China's apparent progress at home is countered by plenty of evidence of trends in the opposite direction involving its lending abroad, which poses severe challenges to the global sustainability agenda.¹⁹⁸ The question arises, however, whether this is a fair metric for the success or effectiveness of the EPs themselves, particularly considering that much of this is lending is by Chinese national banks, not private financial institutions. There is also reason to believe that this critique arises as much out of a concern for environmental and social

¹⁹⁷ As Watchman et al note, Coface, the French ECA, has developed sector-specific policies and environmental guidelines on thermal power plants, large dams, oil and gas projects and other activities and subjects. Moreover, the Japanese Bank for International Cooperation created its own Guidelines for Confirmation of Environmental and Social Considerations (the Guidelines), which were established in April 2002 and have been implemented from October 2003; see <http://www.jbic.go.jp/english/environ/guide/eguide/pdf/guide.pdf> (last visited December 25, 2010). The JBIC Guidelines, according to Watchman et al, "place[] a premium on stakeholder participation (e.g. local communities who will be affected by projects), requiring the project proponents to obtain stakeholders' participation from the project planning stage; also, the JBIC checklist for completion now includes social considerations pertaining to resettlement, indigenous people and women and JBIC is required to disclose publicly such items as the category classification of the project prior to loan approval." (Watchman 2007).

¹⁹⁸ See Adina Matisoff, *Credit where it's due*, CHINA DIALOGUE, July 27, 2010, at www.chinadialogue.net/article/show/single/en/3742-Credit-where-it-s-due-2 (last visited November 28, 2010) Matisoff notes that "[w]hile green finance is gaining traction domestically, however, there are no such policies governing the investments of Chinese commercial banks beyond the nation's borders," which has not mattered until now because they have not played a substantial role abroad, which has been led by Chinese policy banks arranging deals at the highest political levels, such as the China Export-Import (Exim) Bank's recent loan to the government of Ecuador US\$1.68 billion (11.38 billion yuan) to finance Sinohydro's construction of the Coco-Coda Sinclair hydropower dam, and China Development Bank's US\$30 billion (203 billion yuan) line of credit to China National Petroleum Corporation for its global expansion. But for smaller, less complex overseas investments where the government is less interested in getting involved, Chinese commercial banks such as Industrial and Commercial Bank of China (ICBC), China Construction Bank or Bank of China are stepping-in, particularly in financing outward mergers & acquisitions (M&A) of Chinese companies, following regulations introduced by the government in late 2008 allowing the commercial banks to help Chinese firms acquire companies abroad. Unfortunately, none of the three top banks mentioned have environmental and social risk policies in place to manage their overseas investments, which stands in sharp contrast to China Exim Bank's "Guidelines for Environmental and Social impact Assessments of the China Export Import Bank's (China Exim Bank) Loan Projects," which provides a basic synopsis of how environmental and social issues are taken into consideration by the institution and how concerns are addressed, emphasizing that host country laws must be followed, impact assessments must be conducted and that the bank has the right to investigate environmental concerns at any point during the lending cycle and call in loans on environmental grounds if need be.

Apparently, the law's influence has been felt. In 2008, China Exim Bank was exploring the prospect of financing the China National Machinery Export-Import Company to build the Belinga Iron Ore Mine in Gabon, a pet project of Gabon's late president, part off which was (unlawfully) in a national park that is home to "the most spectacular waterfalls in Central Africa... [that] have become the symbol of nature conservation in Gabon." When confronted with information about the impacts of its financing (in violation of Gabonese law), China Exim announced that it was freezing financing on the project until the results of environmental impact assessments could be verified.

sustainability as it does out of a sense of market competition: because Western governments insist on upholding certain standards in their lending to African projects and governments, they are continually on the losing end of the stick as China continues its campaign to buy-up as much of Africa's natural resources it can to fuel its tremendous economic growth (as of 2008, China was Africa's third-largest trading partner following the United States and Great Britain) (Taylor 2008).

Nevertheless, regardless of the impetus for the Western critique of China's African investment policies, it is questionable whether it is fair to blame the EPs for failing to alter a major geo-political economic power struggle that many of the world's governments have thus far not resolved amongst themselves. To even ask this question suggests there no longer is a rigid line between socially responsible behavior entailing the careful screening and mitigation of investment impacts, and grand policymaking on a geo-political scale. Arguably, in recognizing the disproportionate effect that banks' investment decisions have on geopolitical issues such as energy policy and demanding their decisions on such matters to be driven by a social conscience as opposed to mere profit-seeking we concede to them authority for policy decisions. The question is whether we should be expecting more thoughtful and socially-conscious behavior from private actors than that exhibited by governments? For example, look at climate change: are the bankers not somewhat justified in using the failure of the Copenhagen Summit as a reason that they themselves cannot put forward bold new approaches on climate change?¹⁹⁹

Impacts on Project Sponsors

Other journalistic accounts provide evidence of other changes, primarily for project sponsors: "An interesting by-product of the Equator initiative is that it seems to support corporations that are multi-nationals at the expense of the smaller companies. Reshaping projects so they can attract funding from Equator banks—which now represent the clear majority of the market—is a costly business" (Gaskin 2007). One banker noted Comments ANZ's Tonkin: 'There's no doubt that the Principles make it more difficult for smaller companies to develop projects. The environmental and social assessment measures have moved from being a cost to being a significant cost, which smaller companies will not find it easy to afford.' (Gaskin 2007). A leading environmental consultant has also observed changes in the "borrower community," where it is asserted to "matter most": Reed Huppman observed at a mining conference in South Africa in February 2007 that every presentation from a borrower to investors and banks included two or three slides referencing the EP, human rights policies, and the imperative to engage with and create long-term value for local communities. Mr. Huppman characterized this as "profound change," emphasizing that it was originating with the borrowers who manage the projects and "make the difference on the ground" (Gaskin 2007). The profound

¹⁹⁹ See Letter from Banktrack to Banks after February 2010 meeting in Zurich, pointing to banks' detailing why they could not move forward, namely, "the failure of 'Copenhagen' in setting a robust climate framework," among other things. See http://www.banktrack.org/download/letter_to_equator_banks_on_follow_up_zuerich/100211_follow_up_letter_zuerich_to_epfi_s.pdf (last visited December 18, 2010).

sense of change is emphasized by an academic article written on changes in global mining reclamation standards:

From a reclamation and closure perspective, the requirement for EPFIs to impose contractual requirements on borrowers to implement an action plan (which implements a wide range of environmental and social objectives) and a decommissioning plan is unprecedented, and clearly indicates that mining companies that do not comply will find that their funding options are severely constrained. The adoption of the Equator Principles by so many of the world's banks is a major step in institutionalizing this reclamation and closure-related requirement as international law (Otto 2009).

Other significant players, such as Gordon Peeling, President and CEO of the Mining Association of Canada (where many mining companies choose to list on stock exchanges²⁰⁰) have joined this assessment: “It has certainly been a positive development for the Canadian mining industry. It puts everyone on a level playing field in terms of how companies can best conduct their business across a wide range of environmental and social performance standards. It allows the mining industry to understand what the expectations are on project development so as to ensure best results.”²⁰¹ Future empirical work could confirm—from the perspective of project sponsors—what the EP regime's impact has been on their business practices, but this extensive research is beyond the scope of the current project.

Summary

This chapter's analysis of the various modalities in which the Equator Principles can be evaluated shows there to be many sides to the question of “effectiveness” or “impact” of regimes of private global governance. In particular, there is considerable evidence of individual institutional commitment in implementing the EPs and a healthy amount of willingness by various participants to contribute to the regime's governance and perpetuation, enabling it to enhance its function as a utility for social learning and a generator of focal points and standards of behavior. Although outcome effectiveness is harder to document and is subject to certain reservations regarding the subjectivity of defining and measuring project “success” or “failure,” the overall evidence suggests that the EPs have made a dramatic impact on the field of project finance, affecting the organizational structures, policies and practices of both participating institutions and becoming the benchmark standard for the project finance sector. The following chapter addresses yet two more ways to consider the “effectiveness” of global private regulation – the four competencies identified by Abbott and Snidal and the question of “political legitimacy” theorized by Bernstein, Cashore et al.

²⁰⁰ In fact, 55% of the world's public mining companies are listed on the Toronto Stock Exchange.

²⁰¹ Natasha Cappon, *Equator Principles: Promoting Greater Responsibility in Project Financing*, ExportWise (Export Development Canada) (Spring 2008), at http://www.edc.ca/english/publications_14554.htm (last visited November 27, 2010).

CHAPTER 9: THE FOUR COMPETENCIES (INDEPENDENCE, REPRESENTATIVENESS, EXPERTISE, AND OPERATIONAL CAPACITY) OF THE GOVERNANCE TRIANGLE AND THE QUESTION OF “POLITICAL LEGITIMACY”

The Governance Triangle

Another method for assessing regime effectiveness has been proposed by (Abbott 2009), who suggest that regulatory processes occur in roughly five-stages (although they do not always occur in an orderly fashion): *Agenda-setting*, *Negotiation*, *Implementation*, *Monitoring*, and *Enforcement* (a process they short-hand as “ANIME”). Truly effective regulatory schemes, they argue, must address all five stages. Echoing Cashore and Bernstein, they note that while

terms such as Monitoring and Enforcement evoke the ‘logic of consequences,’ the ANIME process can also accommodate the “logic of appropriateness.” In schemes built on consequences, for example, Monitoring might be designed to detect cheating and Enforcement to impose material costs. In schemes built on appropriateness, in contrast, Monitoring might aim to communicate the commitment and concern of managers and stakeholders, promoting socialization and an appropriate corporate culture, while Enforcement might invoke community approval or disapproval, enmeshing the firm in a normative conversation with customers, investors, and other interested groups. Clearly the two approaches can be mutually reinforcing (63-64).

Throughout these stages, actors (States, firms and NGOs) involved with governance regimes to varying degrees can exhibit four competencies: independence, representativeness, expertise, and operational capacity. Abbott and Snidal consider all of these competencies—which vary in their importance depending on the stage of the ANIME process—to be necessary, though not sufficient for a regime to be effective (63). The authors then assess the competencies of the primary “actor groups” (states in both the domestic and international context, firms and NGOs) throughout the various ANIME stages. They note that collective actors might possess different competencies than those of their members (for example, they note that “industry associations may be relatively independent of particular firms”).

Firms—and by extension—industry associations, are unique in their capacity to manage the *implementation stage* directly by drawing upon their operational capacity, which includes robust resources, internal authority and access, and managerial systems. Firms are also experts on themselves, i.e., their own business operations, which is extremely useful for the *standards-setting*, *implementation* and *monitoring* stages (67). Significantly, firms also suffer from a lack of independence, the value of which is heightened particularly during the monitoring stage. In addition, Abbott and Snidal observe that firms are “relatively weak on normative expertise and commitment, although some have accumulated both through CSR activities” (Abbott 2009). Moreover, firms typically are not representative beyond their shareholders and other economic stakeholders. In sum, they conclude, “firms are unlikely to produce regulatory standards and

programs that serve common interests, and may lack legitimacy and credibility in the eyes of the public—and certainly those of activists—even when they are sincere about self-regulation.”

But according to Abbott and Snidal, no individual actor in transnational settings—even advanced democracies—has the competencies required for effective regulation at *all stages* of the regulatory process. While different actors may develop additional competencies over time through hiring experts, employees or consultants, certain capacities are beyond both firms’ and NGOs’ reaches; for example, firms cannot be truly independent, but they can improve the perception and fact of their independence by hiring separate monitoring departments or enlisting external monitors (70). Given these limitations, Abbott and Snidal conclude that “single-actor schemes, whose competencies are primarily derived from their sponsors, are implausible as transnational regulators” (70). Accordingly, they also argue that the “most promising strategy may be collaboration,” i.e., “assembling the needed competencies by bringing together actors of different types” (46).

Interestingly, Abbott and Snidal actually place the Equator Principles not in one of the single-actor zones of their “governance triangle” (Zones 1-3), but in Zone 4, where actors from two groups share governance responsibility, with the third playing no more than a minor role. Thus, the EPs are joined in Zone 4 by what Abbott and Snidal term “state-firm alliances,” including the UN Global Compact (the UN Secretariat, along with other international organizations collaborate with firms, with minimal input from NGOs). Such schemes are contrasted with those in Zone 7, in the middle of the governance triangle, which include schemes that, by necessity of their legal mandates or formal rules, require the participation or representation of all three actor groups (e.g., the International Labor Organization, the constitution of which requires the participation of national delegations including fixed proportions of government representatives and workers’ and employers’ associations).

The placement of the EPs in Zone 4 reflects the authors’ understanding that they were developed in close coordination with the IFC and base their standards on the Performance Standards. Indeed, Abbott and Snidal argue that among the schemes adopted by international organizations—including the OECD, the World Health Organization and IFC—that only the IFC has sufficient leverage over its interlocutors to enforce its own standards (but here they most likely are inadvertently glossing over the interactions between the IFC and its Financial Intermediaries on its own B loans and its leverage over EPFIs on non-IFC loans). It is such ineffectiveness, Abbott and Snidal, emphasize, that is a “fundamental reason” for the rise of the multiple-actor schemes.

At the same time, they observe that even when states do not regulate directly, they can nonetheless play substantial roles indirectly by shaping the bargaining among different actor groups that leads to the formation and shaping of transnational governance regimes. A primary example of such indirect influence is in standard-setting by states and international organizations: standards “shape the expectations and normative understandings that guide other actors engaged in [regulatory standard setting]. They create levers by which NGOs hold firms accountable and focal points that simplify bargaining over the content of standards and reduce its

cost” (75). Indeed, Abbott and Snidal suggest that states and international organizations can play an “entrepreneurial role[]” in “enhancing the competencies and bargaining power of other actors and modifying the situational factors” relevant to the bargaining between actors (83). In particular, despite the efforts by NGO-and-firm-based schemes to innovate and create their own standards, they often root these standards in state-generated norms or eventually return to international norms as benchmarks, primarily because of the legitimacy conferred by norms developed through state or inter-state processes because these actors almost certainly represent a broader range of interest and preferences than do the narrow representativeness of either NGOs or firms (85). The use of legitimate public standards helps to shift the balance of power between firms and NGOs, making it harder for firms to resist NGO demands.

This is clearly what has occurred with respect to the relationships between the IFC and the EPs, although in complex ways. Because of the link between the two sets of norms, the EPs carry almost as much legitimacy as the Performance Standards; however, because the effectiveness and adequacy of the Performance Standards continue to be negotiated between the IFC and its various stakeholders, some of the substantive (as opposed to procedural) criticisms of the EPs actually derive from the inadequacy of the PS, and moreover, going forward there is not likely to be change in the PS without significant EPFI input and buy-in. An IFC staff person noted that the EPFIs’ input into the ongoing review of the PS was very much wanted and would be listened to, but ultimately, the review process remained an independent IFC-driven one, with the results dictated by the IFC with advice from external stakeholders. Furthermore, any changes to the PS will almost certainly have to be accepted and incorporated writ large by the EPFIs now that they have relied on the PS for their normative content for over seven years; indeed, according to Banktrack, the banks apparently have used the ongoing PS review as a justification for inaction on certain issues. From this perspective, the first few EPFIs certainly achieved one of their purported goals in forming the EPs, namely, to have a seat at the table when discussion of standards occur in the project finance sector.

Significantly, Abbott and Snidal’s description of the bargaining between actors predicts that where bargaining power between actors is relatively equal, we would expect to see collaborative schemes balancing NGO goals for higher and more effective standards with firm preferences for avoiding negative attention from NGOs. NGOs have particular leverage in situations involving consumer branded sectors, with prominent firms and with industries under close public scrutiny due to recent legitimacy crises, or when firms see opportunities to develop niche markets grounded in socially responsible behavior, making them eager to enlist the help of NGOs to enhance the credibility of their efforts (81).

The emergence of the EPs fit this idealized bargaining situation: prominent firms were involved and there had been (NGO-created) scandals over major projects in the early 2000s; simultaneously, the largest and most active banks sought to establish a level-playing field and a global standard for the industry. While this is not a separate niche market, per se, as the edges of EP-application are not well-defined, the rationale is the same: the banks hoped to create a “virtuous-cycle” where they would get more and more business based on their environmentally and socially progressive business practices, or put otherwise, they acted to preempt anticipated

loss of clientele who would not want to comply with the enhanced requirements of doing projects with levels of governance and risk management that these banks would require.

And yet, the EPs are not *officially* a multi-actor scheme – why so? Abbott and Snidal point out that in situations where firms are not subject to strong consumer scrutiny, they will prefer to go-it-alone through self-regulation or even inaction, knowing that NGOs lack the power to make them do otherwise, and additionally, because consumers might find it difficult to distinguish effective from ineffective schemes. As a result, “the most likely outcome in many areas . . . will be modest firm self-regulation combined with noisy but often ineffective NGO critics and schemes” (81).

Ironically, at certain points in the development of the EPs, NGOs expressed concerns about the EPFIs’ attitude toward accountability, which they perceived to be complacent. Some NGOs also seemed perturbed that the banks apparently expected the NGO community to take on the accountability role in the absence of the EPFIs doing so themselves. One banker had noted publicly that the EPFIs were “already regulated by the fact that they operate in the glare of NGO scrutiny,” a view echoed by the IFC’s Director of Environmental and Social Development (O’Sullivan 2009). One NGO—Platform—resented these statements:

[in the Financial Times Sustainability Supplement, the Director of Environment and Social Development at IFC was] talking about IFC stuff, not about the Equator Principles [directly], and there was this online debate, where Johan [BankTrack coordinator] asked a question [. . .] And she said “well now it’s up to you, the NGOs to keep the pressure on, to make sure things are implemented.” And actually I don’t want it to be up to me, I want the banks to hold themselves accountable and I’ll go do something else, they shouldn’t really rely on us. Because ultimately then we’re being free consultants and [. . .] that’s not our job (*Id.*).

Whether the NGO community likes it or not, though, they have assumed the role of policemen and in the process, have created a kind of uneasy alliance—a quasi hybrid governance scheme, demonstrating the wisdom of Abbott and Snidal’s insight that to achieve effective governance, the best strategy might be collaboration and “assembling” the various competencies of different actors. The IFC provides the third-leg of this scheme as its Performance Standards are the normative foundation for the EPs and it was their technical advice that was crucial to the EPs getting off the ground.

Thus, looking more closely at the four competencies described by Abbott and Snidal, we see that if we broadly construe the activities of governance related to project finance in the private sector, the EPs do have most of the competencies covered, particularly if its supporting governance actors—the NGOs and the IFC—are included as part of the “governance” structure, or triangle. Though both NGOs’ and banks’ representativeness would ordinarily be subject to

some criticism (Ottaway 2001),²⁰² this is offset somewhat by the inclusion of the IFC—a multilateral institution with over 140 Member States—and its significant influence on both standard-setting and ongoing assistance in technical advisory services and outreach (although true representativeness, one that would include the views of impacted populations, is far from actualized). The banks provide sufficient operational capacity individually and are continually ramping-up their collective capacity and resources, and while the independence of the EP Association from its individual members remains an open question, this, along with the issues of monitoring and enforcement, are being counter-balanced by persistent NGO monitoring, engagement and activism (and, on project-specific issues, independence is increased by EP 7’s requirement that on Category A and B projects the banks must hire an external independent consultant). It must be emphasized, however, that the NGOs’ ability to perform this function—which some suggest they do only reluctantly—is impeded by the EPFIs’ unwillingness thus far to do more extensive project-level disclosure.

When viewed in isolation, the EPs can be characterized as fitting Abbott and Snidal’s positive model predicting that single-actor governance schemes will provide only modest self-regulation; the newly-formed EP Association has some of the competencies described as necessary by Abbott and Snidal (expertise, operational capacity, and some representativeness), while primarily lacking demonstrated independence. Arguably, however, this is to take too myopic a view of the overall governance triangle operating with respect to the project finance sector. When the combined effects of the IFC and NGOs are included, a different picture emerges, with the various actor groups collectively providing all four competencies.

Have the EPs Achieved Political Legitimacy?

An important element of effectiveness not yet explored is the concept of political legitimacy – the necessity of governing actors to have their rules obeyed. Other than autocratic regimes who procure authority by force, it is thought that most normative systems cannot effectively impose order without legitimacy; it is a characteristic of the law or the rules that allow them to be obeyed. A positive theory of political legitimacy for particular types of private authority—“non-State market driven” (NSMD) governance—has been put forward by Bernstein and Cashore (Bernstein 2007). They distinguish NSMD governance from other forms of private authority in several ways, and it could be argued that the EPs do not fit squarely within their paradigm. I submit, however, that there is enough in common between the EPs and the idealized NSMD systems these authors describe to make it a relevant paradigm for discussion here.

²⁰² Abbott and Snidal note that NGOs do not necessarily represent the public or common interests as much as their own private interests and sometimes in contradictory ways, and even when they do have overlapping interests or claim to represent those of others (i.e., globally Northern NGOs representing disenfranchised groups in the global South), this is not without concerns, either about accountability or paternalism; moreover, they note NGOs’ are institutions with organizational prerogatives of survival and thus, fundraising, which can come into tension with their missions, and more broadly, as organizations they can develop pathologies. In addition, some NGOs, like unions, have direct material interests in the issues in which they engage themselves (Abbott and Snidal, 2009).

In distinguishing NSMD governance, Bernstein and Cashore list five characteristics of NSMD governance systems that make them different from other forms of private authority:: First, these regimes do not derive their policy-making authority from sovereign states (though some may receive support from state actors, their ultimate governing authority is not derived from states nor are NSMD systems accountable to states. Second, NSMD authority emanates from supply chains, from extractors/producers through to end users who make choices about the kind of certification or compliance they want to see for products and service they use. Third, NSMD governance systems “aim to *reconfigure* markets” attempting to fix global problems that firms have little incentive to address on their own, which distinguishes NSMD from other kinds of private authority such as environmental management systems or other attempts at standardization of business practices because these other kinds of regimes offer incentives for profit-maximizing firms and thus such systems are “win-win” situations in which there are clear drivers (profit-seeking) motivating firm behavior. Put otherwise, NSMD systems seek to “socially embed globalizing markets” by creating “governing authority directly in the global marketplace” (Auld 2009). Fourth, NSMD systems have means of monitoring compliance and enforcing costs for non-compliance. Finally, these regimes are example of “dynamic governance” wherein actors “purposely steer themselves toward collective goals and values and in which adaptation, inclusion, and learning occur over time and across a wide range of stakeholders” (Bernstein 2007). This distinguishes them from other regimes (e.g., eco-labeling initiatives) that focus on a “static measure of environmental quality” that firms seeking to join the initiative must attain to receive certification. According to Cashore and Bernstein, managers of NSMD systems justify their dynamic governance model on the grounds that it makes these systems more “democratic, open, and transparent than many of the business-dominated public policy networks they seek to bypass, as well as most corporate self-regulation and many social responsibility initiatives” (Bernstein 2007). The authors note that NSMD systems have arisen to address issues such as depletion of fisheries; environmental consequences from forestry, food production, tourism, and mining; rural and community poverty; and inhumane working conditions, covering one-fifth of globally traded products (Bernstein 2007).

Although there are a few characteristics of the NSMD ideal type for which the EPs make a poor fit, the NSMD paradigm arguably offers a “good enough” fit and therefore a useful theoretical tool with which to analyze the EPs’ political legitimacy. It must also be kept in mind that the NSMD paradigm is an ideal type, a positive theoretical contribution that might not describe the full range of closely-related governance phenomena. One superficial but not terribly significant difference is between the archetypal NSMD evolutionary story’s three phases and the way the EPs originated. For example, the EPs were not initiated by NGOs but by banks, albeit with some input and consultation from NGOs. Whereas typically NGOs initiate an NSMD scheme and sometimes firms counter-act with an initiative of their own, in this case because the EPs were industry-led to begin with, we have not seen the emergence of any competing systems. This is likely due to the fact that, as explained by Abbot and Snidal, NGOs often (as in this context) do not have “go-it-alone-power,” and accordingly, are not in the position to initiate their own NSMD alternative; they are stuck with either endorsing and helping to shape the evolution of the EPs, or condemning the EPs (Abbott 2009).

Another clear distinction is that the EPs are largely a “win-win” situation. As one financial analyst observed:

self-governance is likely to work in the end simply because the [Equator] Principles marry altruism with self-interest. The temptation to be avoided is to think the Principles are just something banks do to make themselves feel good and therefore may be avoided if there is a bottom line justification. Moral arguments aside, the Principles help protect the bottom line by providing a proper mechanism for assessing environmental and social risk” (Gaskin 2007).

Another banker added, “[t]he cost of a project going wrong far exceeds the cost of complying with the Principles,” although none of the banks have actually quantified the costs of compliance (Gaskin 2007).

Although Cashore and Bernstein portray win-win situations as insignificant governance achievements, this perhaps overlooks the challenges to “mere” coordination in different sectors, particularly in sectors where coordination means aligning the practices of disparate actors—from government agencies to commercial banks to transnational corporations—on highly controversial public issues such as infrastructure finance; indeed, if “mere” coordination of business or broader governmental or public interests were so simple to achieve, we would live in a very different world. Finally, a significant distinguishing characteristic of NSMD schemes is verification of compliance (Auld 2009), which remains one of the key governance features—if not *the* governance feature—over which the NGOs and the EPFIs remain in intense disagreement.

Other than these distinctions, however, there are not many structural qualities of the EPs that keep them from being considered alongside other NSMD systems—particularly in their earlier stages of development. This brings us, then, to the main question: what phase of the NSMD evolutionary paradigm have the EPs reached—have they achieved “full fledged” or some modicum of political legitimacy?

According to the Bernstein and Cashore’s paradigm of evolutionary growth, NSMD systems proceed through three stages of development on their way to “political legitimacy”: (1) “initiation,” (2) “building widespread support,” (3) “political legitimacy.” According to this paradigm, these systems are unlikely to “govern effectively if they depend solely on firms’ strategic interests for compliance,” because like governments, which rely on their legitimacy to reinforce their coercive power, NSMD systems need legitimacy to justify their own policy developments and coercive acts; unlike states or international organizations, which by definition either possess legitimate authority or derive it by consent, NSMD systems “must actively achieve ‘political legitimacy’,” for which the authors have a very specific conception in mind:

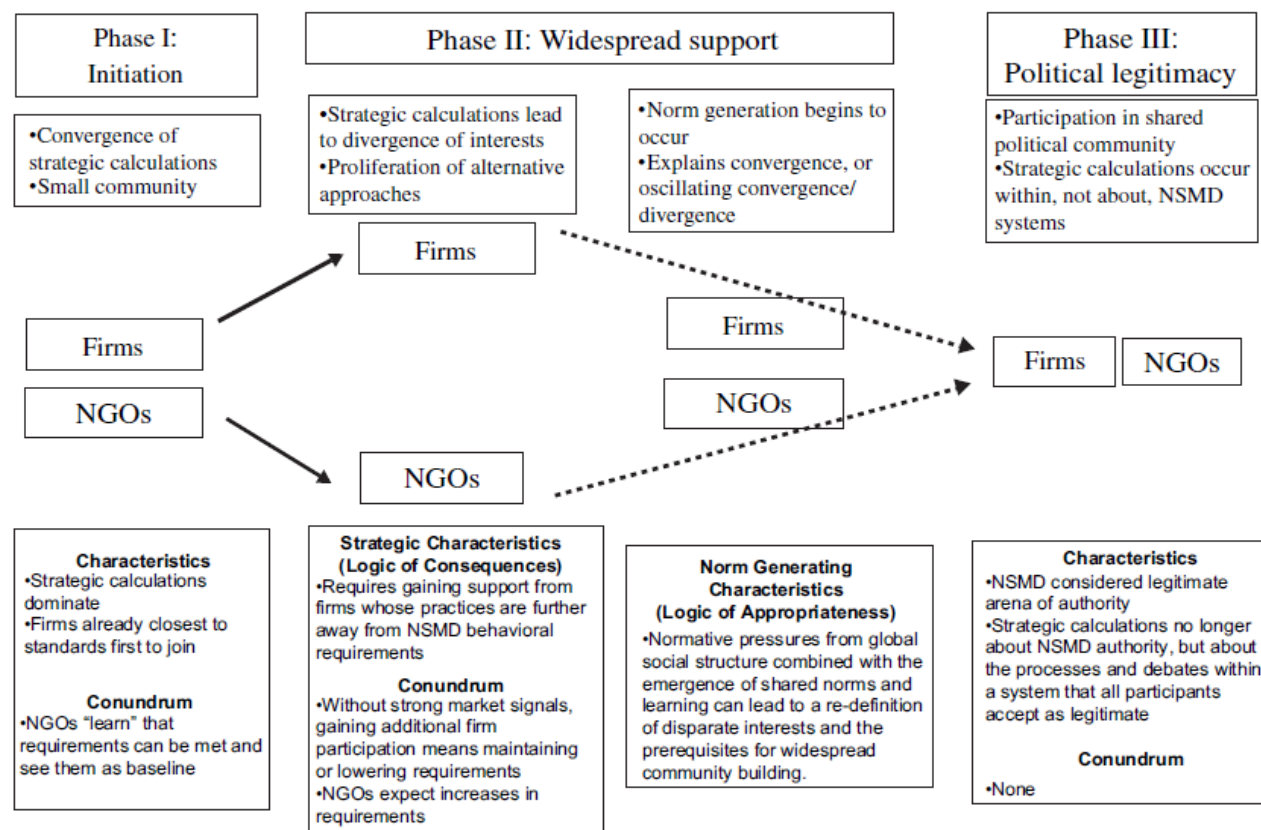
Whereas the concept of legitimacy generally refers to viewing the actions of an entity as “desirable, proper, or appropriate,” our analytical framework focuses specifically on political legitimacy because it concerns the acceptance of a governance relationship, where commands ought to be obeyed. It reflects “a more general support for a regime [or governance institution], which makes subjects willing to substitute the regime’s decisions for their own evaluation of a

situation.” Political legitimacy requires institutionalized authority (whether concentrated or diffuse) with power resources to exercise rule as well as shared norms among the community. Norms of legitimacy provide justifications and a shared understanding of what an acceptable or appropriate institution should look like and bounds what it can and should do. (Bernstein 2007).

Elaborating further, Cashore and Bernstein observe that their conception of political legitimacy combines elements from complementary literatures in political science, organizational sociology and management studies identifying different logics of action, including the “logic of appropriateness” proposed by March and Olsen as a counter to purely utilitarian “logic of consequences.” According to March and Olsen, a logic of appropriateness is built upon visions of civic identity and a framework of rule-based action. Embedded in this notion are ideas about the obligations of citizenship and office, the commitment to fulfill an identity without regard to its consequences for personal or group preferences or interests” (1996: 254).

In close parallel, sociologist Mark Suchman reviewing sociological institutionalism, distinguishes between “moral,” “cognitive” and “pragmatic” legitimacy. Moral legitimacy is an assessment by actors that an organization or institution’s behavior is “right” or “wrong” for society. Cognitive legitimacy is attained by institutions that have become so engrained in social structures that they assume a taken-for-granted status such that actors cannot think of things being any other way. In contrast to these two types, pragmatic legitimacy rests on the “self-interested calculations of an organization’s most immediate audiences,” and often involves “direct exchanges between organization and audience,” though it can also involve “broader political, economic, or social interdependencies, in which organizational action nonetheless visibly affects the audience’s well-being” (Suchman 1995). According to Suchman, “at the simplest level, pragmatic legitimacy boils down to a sort of exchange legitimacy—support for an organizational policy based on that policy’s expected value to a particular set of constituents,” although “cultural notions of appropriateness may color whether these exchanges are considered prerequisites or bribes, at the limit exchange legitimacy shades into a somewhat generalized and culturalized variant of more conventional, materialistic power-dependence relations (Suchman 1995). According to Cashore and Bernstein, political legitimacy almost always has some elements of both [cognitive and pragmatic legitimacy], but fits neither ideal type; rather, it almost always involves discursive validation based on implicit or explicit justifications. As they explain, what is “good” or “appropriate” is often what need to be worked out within politically legitimate arenas recognized by a wide-ranging and diverse community (Bernstein 2007).

The non-state market driven governance evolutionary model



Source: (Bernstein 2007).

In a subsequent re-working of their paradigm, the authors project five scenarios or fates for NSMD systems, including four alternatives to “fully fledged political legitimacy”: (1) “fully fledged political legitimacy” – all stakeholders within a sector recognize their membership in a political community that grants an NSMD system the authority to govern; (2) “niche or small-market-focused system” – the system is “important for norm generation but is unable to address widespread, globally important problems”; (3) “weak system” – the system gains widespread support, but exercises only a weak form of authority, “unable to unwilling to address the enduring social and environmental problems for which it was originally created”; (4) “Hybrid” – government and private authority come to mix and produce new forms of hybrid authority, which would “occur when governments required that some, but not all, parts of the supply chain adhere to the rules”; (5) “Bringing the State back in” – through increased public awareness and competition among various systems, governments have been motivated to regulate, in which scenario, the NSMD system played an important role in “facilitating learning across different stakeholders, but is ultimately viewed as being unable to progress further, and government moves in with a newly invigorated sense of mission” (Bernstein 2007).

This brings us, then, to the main question: what phase of the NSMD evolutionary paradigm have the EPs reached? As the history of the EPs’ development demonstrates (see

Chapters 4 and 5), there has been a long-standing relationship between the EPFIs and two of the other primary other stakeholders or “actor groups” (Abbott 2009) in their sector: the NGO community and the IFC.

The other significant actors include project sponsors and governments²⁰³ and while they will be consulted by the EP Association during its Strategic Review, it is unlikely that these comments will be publicized.²⁰⁴ Anecdotal evidence from interviews, industry periodicals, conferences programs, public presentations and other “artifacts” of industry knowledge (Riles) suggests that the major players—e.g., the International Hydropower Association and the mining industry—have fully-embraced the Equator Principles as part of their institutional and operational environment. However, despite this implicit grant of legitimacy, the real test of the EPs’ legitimacy will come from its harshest critics—the NGOs.

An in-depth assessment of on NGO-bank relations over the course of the EPs’ developmental period (2000-2006) considers the NGOs to be the banks’ “relevant public” as well as the catalyst for the EPs’ development. It concludes that “initially, despite reservations, campaigning NGOs conferred a nominal level of legitimacy on the financial institutions’ project finance activities through a shift from a strategy of hard line advocacy to one of engagement,” but that this attained legitimacy “unraveled” because of a “perceived lack of accountability at an institutional, organisational and individual project level” (O’Sullivan 2009). It concludes that the Equator Principles are a “primarily symbolic as opposed to substantive managerial vehicle aimed at legitimising project finance activities” (*Id.* at 556). This unraveling began in the February 2004 when several institutions were implicated in the funding of the BTC oil pipeline and the Sakhalin II pipelines, which NGOs considered a failure in accountability, it was compounded further after the February 2005 Zurich meetings at which it became clear to some NGOs that the EPFIs were resisting being held jointly accountable. The legitimacy crisis continued to grow worse in the 2005-2006 period when NGOs became increasingly disappointed in the level of disclosure by the adopting institutions and grew concerned about “free riders” out-numbering the

²⁰³ According to the IFC, during Phase I Consultation, the IFC met over 500 stakeholders “from a wide range of backgrounds and regions, including multilateral banks, bilateral banks, commercial financial institutions including the Steering Committee of Equator Principles Financial Institutions (EPFIs), trade unions, select UN agencies, Indigenous Peoples, conservation organizations, business associations, individual companies, the NGO and CSO community, World Bank Group colleagues and the External Advisory Group.” See IFC, “Summary of Stakeholder Dialogue During Phase I Consultation,” available at <http://www.ifc.org/ifcext/policyreview.nsf/Content/SummaryStakeholderDialog> (last visited November 20, 2010). Based on this description and others similar to it from the IFC, however, it is difficult to determine which specific actors participated and to what extent. The IFC has published a summary of the results and comments it received during the first phase of its consultation, but this summary does not attribute comments to their sources. See IFC Policy and Performance Standards on Social and Environmental Sustainability and Policy on Disclosure of Information Review and Update “Progress Report on Phase I of Consultation” (January 11, 2010), available at [http://www.ifc.org/ifcext/policyreview.nsf/AttachmentsByTitle/PhaseI_Progress_Report1-11-10.pdf/\\$FILE/PhaseI_Progress_Report1-11-10.pdf](http://www.ifc.org/ifcext/policyreview.nsf/AttachmentsByTitle/PhaseI_Progress_Report1-11-10.pdf/$FILE/PhaseI_Progress_Report1-11-10.pdf).

²⁰⁴ According to the EP Strategic Review website, “the Association will elicit targeted feedback from EPFIs, financial sector peers, clients and industry bodies, and civil society” See The Equator Principles Association Launches Strategic Review, available at <http://www.ep-strategic-review.com> (last visited November 20, 2010).

numbers of serious implementers. Finally the NGOs reached a level of disillusionment when the revision of the EPs and creation of the “EPIIs” in 2006 (following the IFC’s revision of its Performance Standards) did not satisfy the NGOs demands for disclosure or accountability mechanisms (*Id.* at 570-74).

But the EPs continued to grow, attracting new members, and notoriety throughout the financial sector as the new “global standard” – exactly what the initial EPFIs wanted to achieve. Consistent with Cashore and Bernstein’s paradigm, the Equator Principles formed an official governance body, the Equator Principles Association, in July 2010, which came with formalized Rules that included more legalized membership requirements and even some soft “teeth”: a delisting procedure for banks that do not report as required by EP 10. At the launch of the new Rules, Shawn Miller, Chair of the EPFI Steering Committee and Citi’s Environmental and Social Risk Management (ESRM) Director stated that the new governance framework would ensure for “effective decision making procedures,” make the regime “more efficient” and that members would be held accountable to them.²⁰⁵ Indeed, my survey showed that there is substantial belief in the potential for enhancing the sharpness of the regime’s sword: forty-two percent of respondents stated that they believed an “external monitoring” or “central enforcement” mechanism could develop within the EP regime.

However, only a few months before the launch of the new EP Association and its rules, the long-standing relations between the EPFIs and their primary NGO stakeholder community—the Banktrack network of NGOs—perhaps reached its lowest point ever. Following an annual consultation meeting in February 2010 in Zurich, Banktrack sent the EPFIs an open letter announcing its dissatisfaction with the progress the banks had made. The letter stated the NGOs’ conclusion that the large annual meetings in which they had participated in the past were not productive fora for engagement and had become “routine formalities, a venue for NGOs to continue raising the same points and for banks to repeat the reasons why they cannot act.” Consequently, the letter announced that the Banktrack NGOs decided to no longer attend the group meetings until they “see an adequate response from the EPFI Steering Committee,” though the NGOs remained open to discussing “concrete and substantive proposals and plans,” perhaps in smaller working groups with specific objectives. In the meantime, the Banktrack network announced its intention to increase its on-the-ground monitoring activities and assistance to communities dealing with EPFIs and project sponsors, with the expectation that “by further strengthening the role of civil society stakeholders” they can “help improve the effectiveness of the Principles in delivering to communities and the environment.”²⁰⁶ In response, Shawn Miller acknowledged the “long history of engagement and dialogue” between the EPFIs and Banktrack and noted that the “door is always open and we are happy to continue engaging with you on issues of mutual interest, such as the IFC Performance Standard Review (PSR) process,” which,

²⁰⁵ See *New Governance Rules Introduced for the Equator Principles* (July 1, 2010), available at <http://www.equator-principles.com/documents/EPGovernanceRulesAnnounce1July2010.pdf> (last visited December 18, 2010).

²⁰⁶ Banktrack Letter to EPFIs (February 2010), at http://www.banktrack.org/download/letter_to_equator_banks_on_follow_up_zuerich/100211_follow_up_letter_zuerich_to_epfi_s.pdf (last visited December 18, 2010).

he indicated, would be the main priority through most of 2010 and that it was in their mutual interest to continue engaging on the Performance Standards as they evolved. He also noted that the EPFIs strongly believe that the EPs “continue to make a positive difference on-the ground at the project level, within our own financial institutions, and within the finance sector generally,” that they had “formed the basis of many of our institution’s broader risk management policies,” and moreover, that they continued to be a “positive agent of change,” and to be “one of the finance sector’s most successful and effective market standards.”²⁰⁷

My research suggests that, despite the NGOs’ critiques, the EPs have evolved beyond the status of a “weak system” within Cashore and Bernstein’s framework, but nevertheless remain paused at the precipice of becoming a system with “fully fledged political legitimacy.” They have been globally recognized as *the* benchmark for ESRM practice in the project finance sector by the multilateral international organizations (IFC), government agencies (ECAs and DFIs), and industry associations, and while the NGOs remain dissatisfied with numerous aspects of the regime, they have not proposed an alternative system nor could they create one on their own initiative. Moreover, some of the most strident bases for their critique—e.g., their concern with the concept of “consultation” of affected communities as formulated in the EPs (contrasted with the principle of “free, prior and informed consent” articulated in international treaties and judicial decisions)—demands a level of sustainable practices that would go beyond current practice under the IFC’s Performance Standards or that has been solidified as part of customary international law. As the EPFIs noted in their comments to the PS Review:

We believe that the FPI [free, prior informed] Consultation framework continues to work well: it underscores the need for robust stakeholder engagement with affected communities in the absence of fear, intimidation or coercion, and full affected community access to environmental and social assessment documentation through robust disclosure of information at the project level. The further requirement of Broad Community Support (BCS), in addition to informed participation and the Good Faith Negotiation (GFN) requirement for Indigenous Peoples (IPs), is a good performance standard for those situations with sensitive IP issues. We also have a strong preference to include BCS with proper definition and guidance in PS 7 instead of in the IFC’s Sustainability Policy.

The EPs agree fully that I[indigenous] P[eople]s have social identities and characteristics that require special attention and focus, and impacts on them need to be carefully assessed, managed and monitored, and their rights respected. While we fully appreciate that the debate surrounding consent is challenging, “consent” is a concept that appears not to be fully and consistently defined. Indeed, there appears to be a lack of common agreement on how “consent” can be achieved in real-life project contexts. The IFC has not, as yet, given the EPFIs

²⁰⁷See Letter from Shawn Miller, Citi to Banktrack NGOs, March 29, 2010, *available at* http://www.banktrack.org/download/letter_to_banktrack_as_a_response_to_bt_letter_of_february_11_2010/100329_response_ep_banks_to_bt_letter.pdf (last visited November 28, 2010).

clear performance criteria on how to achieve and maintain consent over a project's life cycle, and such uncertainty could generate undue risk (*Id.* at 3).

Other areas of critique—e.g., climate change policy—demand a level of policy-making heretofore unseen by national governments or international organizations. Indeed, in the EP Associations' submitted comments to the IFC PS review, they express disappointment with how far the draft revised PS go and note that the IFC's own governance structure (as a multilateral institution with over 140 Member States) might impede its ability to go further:

As we have highlighted to the IFC before, climate change is one of the EPFIs' greatest priorities. In order for the IFC to maintain its standard setting role, the EPFIs recommend that the IFC is more assertive and innovative with regards to climate change than is currently proposed in its revised drafts. While this may be difficult within the IFC's governance structure, we feel that collectively we can do more to signal to the market that Equator Principles (EP)-compliant transactions meet best available technology (BAT), including BAT for climate mitigation. This will provide a stronger foundation as international agreements evolve and provide more specificity in the coming years. For example, BAT analysis could signal that subcritical technology (for coal-fired power) is not a generally preferred direct financing option in most cases (as some of your multilateral development bank peers currently reflect in their policies).²⁰⁸

Thus, both with respect to consultation of local communities and climate change policy, future progress by the EPFIs may be contingent on further evolution in practice—or standard-setting—by governments and international organizations. In turn, as noted, the ongoing review of the Performance Standards will also rely heavily on the input of the EPFIs. Accordingly, despite the NGOs' latest strategic maneuver to somewhat delegitimize the EP Association, the bottom line is that the discussion surrounding the EPs is no longer whether they are an accepted set of standards, but how far they can be improved upon. Thus it would seem that they have achieved a modicum of “political legitimacy,” albeit not “fully fledged” political legitimacy.

Summary

Despite the significant contributions made to governance by the banks participating in the EPs, effective governance in most areas of transnational policy ultimately will require the coordinated efforts of several types of actors, most prominently private actors, governments and civil society. Though the efforts exerted by these various actors—the EPFIs, the project sponsors, the IFC, governments and NGOs—is seldom coordinated or in concert, they nonetheless combine to offer the four competencies—independence, representativeness, expertise, and operational capacity—through the various stages of the private regulatory process (*Agenda-setting, Negotiation, Implementation, Monitoring, and Enforcement*). Further, in

²⁰⁸ See EPFI Steering Committee's Letter Submission to the IFC Regarding the Phase II Consultation of IFC Performance Standards Review and Update (August 27, 2010), at http://www.equator-principles.com/documents/EPFI_Letter_to_IFC_Jul2010.pdf (last visited November 28, 2010).

evaluating whether the EPs have achieved “political legitimacy,” it seems they are certainly on the cusp of attaining it: despite the persisting complaints by the NGO community, the EPs certainly have evolved beyond a “weak system” that has no effect; rather, they have been accepted as a governance standard and all of the discussion is now about how to refine them and make them work better.

CONCLUSION: THE REALITY AND POTENTIAL OF PRIVATE GLOBAL REGULATION

Does Self-Regulation Work on the Global Stage?

The primary theoretical question that directed this research is whether self-regulatory institutions lacking strong centralized enforcement mechanisms can nonetheless provide effective regulation. The principal mechanism by which it is hypothesized that effective regulation could be achieved under such conditions is the power of reputational concerns or legitimacy-seeking by individual actors and potentially a group of similarly situated actors across and industry. This concern with reputation and legitimacy is the same impulse identified by the literature as the major driver behind the initial formation of voluntary regimes, which usually arise in response to either or both information asymmetries or threats of common sanctions (Toffel 2009), although other motivations have been identified as well, such as pre-emption of future “command and control” regulation or increased input into the shape of such future regulation (Khanna 2001; Khanna, Koss et al. 2007). In part, then, this study sought to confirm and possibly extend our understanding of the role played by reputation in driving compliance with voluntary regimes, focusing on the way reputation works *among* a group of actors and particularly on how these actors’ subjectively experience reputational dynamics.

The second concern of the study flows from the first: understanding under what conditions global private regulation can be effective and trying to measure the different ways a voluntary regime’s effectiveness can be measured. Building on previous work in economics (Olson 1965; Hardin 1968; Grief 1997), existing studies of self-regulation and voluntary regimes demonstrate that in the absence of some form of “sword,” e.g., a monitoring or enforcement mechanism, whether third-party monitoring, public disclosure of audit information or sanctioning mechanisms, firms will not likely achieve high levels of compliance with voluntary regulation (A. A. King & M. J. Lenox 2000; M. Potoski & A. Prakash 2005b; A. Prakash & M. Potoski 2007). This view argues that absent sanctions or strong monitoring or at the very least costs of membership that could send meaningful signals about participants levels of compliance, any voluntary regime would suffer adverse selection and would effectively fail. That is, non-serious, “laggards” looking to “free ride” off the collective reputation the regime was trying to foster would bloat the ranks of the regime, thus ruining the clarity of the signal sent by individual actors by their decision to participate in the regime, and in the process, any legitimacy the regime might have built. This is, in short, Hardin’s “tragedy of the commons,” where the “commons” consist of the self-regulatory institution, its rules and legitimacy.

There are is a separate strain of research, however, following in the tradition of neoinstitutionalists (DiMaggio 1983; Suchman 1995), which thinks that sanctions are not needed for compliance because the institutional structure of self-regulation can control behavior through more informal coercive, normative and mimetic processes (Rees 1994; Gunningham 1995; Nash 1997). Scholars in this tradition believe that coercion can be achieved through norm diffusion that can changes actors’ preferences and values over time (Gunningham 1995; Hoffman 1999). More recently, scholars have suggested that by focusing exclusively on the *outcomes* of voluntary regimes (e.g., reduction in toxic emissions among adopting plants or companies), much of the research has potentially missed a long-term view of self-regulation’s promise: its power to initiate socialization *processes* that facilitate learning and dissemination of best

practices, thereby planting the seeds for *long-term* improvement (Lyon and Maxwell 2007; Darnall 2008).

This substantial literature on “effectiveness,” with only a few exceptions has focused on *domestic* initiatives, chiefly those dealing with pollution sponsored by the U.S. Environmental Protection Agency and similar State-sponsored voluntary programs (Koehler 2007; Rivera 2008). But the literature on *transnational* private regulation remains partial and incomplete (Vogel 2007).

On the Question of Reputation

With respect to the question of reputation, I tried to answer David Vogel’s call to get inside the “black box” of corporate actors (Vogel 2007). I tried to confirm through more rigorous testing across a wider variety of institutions what previous studies had suggested through anecdotal and circumstantial evidence about adopting institutions’ motivations in forming and joining the EP regime. The neoinstitutionalism literature and my pilot qualitative interviews with bankers and environmental and social risk management personnel at several EPFIs pointed me toward the power of reputational concerns—the search for institutional and collective “legitimacy”—as drivers not only of regime formation but also of compliance. But rather than assume the operation of reputation as a driver of behavior, I took the somewhat unconventional approach of actually asking the institutions themselves about their subjective understandings of how reputation worked on an individual level, across the voluntary regime and the broader industry. I was curious about the relative power of the various stakeholders who collectively endow the banks (and their clients) with the “social license to operate.” Moreover, I sought evidence for the assumptions about the formation of self-regulation institutions from the collective action literature: to what extent did the banks believe reputations were shared between them? In addition, I was curious if the NGOs’ strategy of targeting consumer business lines as a means of putting pressure on project finance lending was grounded in an observable link between banks’ reputations across their various business lines. Finally, pushing beyond previous research, I looked beyond the reputational dynamics leading to the formation of a regime or its adoption, to consider how reputational dynamics can change over time.

What I found on the whole did not surprise me and largely confirmed the neoinstitutionalist paradigm and the literature on self-regulation in domestic contexts. It did, however, also add some interesting nuance I could not have predicted and that I did not see borne out in previous research. My research confirmed neoinstitutionalism insight that we should see relationships between various bank criteria signifying greater reputational exposure (size, governance level of country of origin, scope of lending activity—including number of projects reviewed, financed, and number of “risky” projects financed) and an increase in normative isomorphic pressures, i.e., subjective experience of pressure from various stakeholders, including the experience of being targeted by public advocacy campaigns. Thus, my data confirms again the neoinstitutionalist insight that the larger, more “visible” firms will invite greater external stakeholder pressures.

More specifically, my research confirmed that, from the banks’ perspective, transnational NGOs and NGOs in banks’ home countries had exerted the most pressure on them either to

adopt the EPs or to implement them. If reputational concerns and legitimacy-seeking do in fact motivate initial adoption of voluntary regimes, it stands to reason—and anecdotal evidence confirms—that NGOs will not be satisfied with the mere adoption of a voluntary regime by institutions, but will demand *action* consistent with the adoption decision. This also was borne out in my research: fifty-eight percent of the respondents (14 banks) reported an *increase in contact or pressure following adoption* of the EPs, while only twenty-nine percent (7 banks) reported that the level of pressure remained the same and only 1 bank reported that the pressure abated. There were no significant relationships, however, between the reputational risk variables and whether there had been an increase in contact or pressure.

It was also interesting to learn that nearly seventy percent of all institutions thought that public campaigns by NGOs could *theoretically* pose greater reputational harm beyond an institution's project finance practice, and over forty percent specifically worried that such campaigns could have a chilling effect on retail and consumer business. This result was curious given that the vast majority of respondents (seventy-five percent) did *not believe* that "individual consumers are aware of a bank's ESRM reputation." Indeed, over fifty-four percent of respondents confessed that they "could not quantify the exact harm that might accrue," but nonetheless "wish[ed] to avoid such campaigns at all costs." This somewhat irrational doomsday-like fear might be explained by the very vivid linking of retail business lines with corporate and investment business lines by the RAN campaign against Citigroup in the years leading up to the formation of the EPs, and speaks further to the power of reputation as a primal element of business calculations that cannot be contained neatly in cost-benefit analysis.

Another very interesting, although not entirely surprising result is that most of the banks (sixty percent) were concerned that public advocacy campaigns would have a negative effect on the reputation held by an institution among its peer institutions, i.e., *other banks*. This makes sense because project finance is a very "social" lending enterprise, with each institution needing to maintain its credibility among its peers so that when it brings a deal to the international markets to "sell down" its share of the risk, other institutions trust that the deal has been arranged well and that risks have been properly accounted for.

In addition to bank concerns about their individual reputations, I was also curious about the reputational dynamics across one industry. An assumption of the self-regulation literature is that actors form governance institutions to protect collective reputations; but do the actors themselves actually see things this way? I was further curious to learn what the interplay was between individual and group reputations and between the reputation of the EPs as a governance regime in relation to the rest of the financial sector (or at least those banks actively engaged in project finance lending).

In general, the banks largely felt that they could have individual reputations while also sharing a collective reputation (52% of those who either agreed or strongly agreed with the proposition of having individual reputations also agreed that banks share a collective reputation; 47.8% of those who agreed or strongly agreed on individual reputation disagree or disagreed strongly with the possibility of having a collective reputation). Interestingly, there was an even higher percentage (87%) of those who agreed or strongly agreed on banks having individual reputations who felt that EPFIs shared a distinct reputation, whereas only 13% of those who

agreed or strongly agreed on the existence of an individual reputation disagreed or disagreed strongly on the notion of EPFIs sharing a distinct reputation.

A closer look at the data shows that early adopters were very strongly associated with the view that banks have individual reputations, which makes sense given their own decisions to adopt the EPs early to gain as much reputational benefit and market distinction as possible. In addition, consistent with this finding, the banks with greater degrees of reputational exposure were associated very strongly with a belief in individual reputations. Quizzically, the view that all EPFIs hold a reputation in common was inversely associated (negatively related) with many of these same reputational risk variables, although not as strongly as some of these variables were associated with the belief in individual reputations. The views on the collective nature of reputation across the entire industry were more parsimonious: the banks were split evenly on the question of whether *all* banks across the industry share in a common reputation.

It is also worth noting the surveys findings on changes in pressure from stakeholders over time, specifically pre- and post-adoption. The data shows that following adoption, there was a modest increase in the numbers of banks reporting that they had been targeted by public advocacy campaigns (from 50% of banks being targeted prior to adoption to 67.7% of banks being targeted after adoption). This offers some support for the notion that the pressure on the banks individually and collectively is increasing over time, and in fact, it can be said to be additive; that is, when Citigroup faced its first campaign in 2000, the NGOs were then only breaking ground by seeking to implement their vision for bank sustainability. Campaigns mounted ten years later have a decade of normative evolution and broken barriers to change to support their arguments; there is a new “normal” now adding weight to their claims.

Significantly, the findings on the increased pressure following adoption of the EPs and the common view that EPFIs shared a common reputation may point to another useful aspect of a voluntary regimes that has been under-appreciated in prior research: in creating a formalized collective structure, private actors give external stakeholders a single “complaint box” or wider target to which they can address their dissatisfaction. This is no small contribution given the limited resources of NGOs; with the greater institutionalization of a voluntary regime NGOs can with increased legitimacy hold all participants collectively responsible, or at least cast blame collectively. There is another side of this coin as well. By coming together under the banner of a joint governance association (albeit while many still assert their independence), the banks have formally acknowledged their shared fates. In doing so, they have also recognized their increased their capacity for cooperation and advancement of mutually beneficial goals, thereby increasing their leverage over the global policy-making and standard-setting that affects them, such as the evolution of the IFC’s Performance Standards and the role of the financial sector in addressing climate change and other global policy issues. It remains to be seen whether they will use this newfound leverage and power for a progressive or regressive agenda.

Measuring Private Regulation Effectiveness

With respect to the second question, I seized upon the “process”-centric trend that has broadened our perspective on what “effectiveness” means in the context of self-regulatory and

voluntary regimes. In addition to the access concerns due to the topic of the research, a focus on processes was also prudent because the purpose of the sustainable development norms fostered by the EPs is to create an *approach* to project assessment. The point is to institute processes of review, which will not yield concrete results as much as achieve *non-results* (if done successfully, that is). Thus, in contrast to pollution abatement or reduction of carbon dioxide levels, successful implementation of the EPs will not necessarily provide measureable results: if a bank does not demand compliance or lets certain of the borrower's obligations slide, this will *only* become a problem if the issue ignored or glossed over becomes a much bigger problem later on, which is far from a certainty and is contingent on many actors and factors beyond the bank's control.

Moreover, many problems develop during the construction phase, putting borrower's environmental management plans to the test. Should things go awry, this may or may not reflect any laxity in the quality of the bank's due diligence in *reviewing* the project, but rather, reinforces the inherent complexity of large infrastructure projects and the difficulties in constructing them without complications (Aizawa, 2007). Indeed, a focus on outcomes also demands definitions of what successful projects look like, and similarly, what constitutes project failure or a "problem project." But defining project failure raises another set of complicated empirical questions arising out of the inherently subjective exercise that is environmental and social risk assessment. All of this being said, the purpose of the EPs is also to create a sense of accountability for actions on the ground; if despite enhanced due diligence by the lenders, the borrowers are still non-compliant or unresponsive to developing problems, the banks bear ultimate responsibility for allowing the money to flow to the project. Thus, a focus on outcomes could still be informative of the EPs' effectiveness – it just seemed a daunting task to take this particular measurement.

The study focused instead on another useful indicator of implementation and one which it seemed could provide some actual data: institutional change following adoption of the EPs. As Potoski and Prakash's scholarship has shown, it is essential to any voluntary regime's success and legitimacy that membership exact *real costs* from members so that the decision to join the regime remains a meaningful signal that conveys useful information to external stakeholders about the commitments of the regime's members (Potoski and Prakash 2005; Potoski and Prakash 2005). Another meta-analysis of both first party and third-party audited voluntary programs observed that the most important conditions for effective strictly voluntary programs are (i) specific performance-based standards; (ii) periodic third-party audits of individual companies; and (iii) rewards that publicly recognize the performance obtained by each participant following third-party verification (Darnall 2008).

Given this theoretical background, the study focused on individual organizational change and capacity building as potential measures of real costs expended following adoption of the EPs. Beyond individual institutional commitment as measured by organizational changes, the study also looked into other metrics of the regime's overall effectiveness, such as (i) the utility of the EPs as a mechanism for social learning; (ii) the impact of the EPs beyond the adopting institutions; and (iii) the extent to which they and related actors offer the needed combination of governance "competencies" suggested by Abbott and Snidal, which include independence, representativeness, expertise, and operational capacity (Abbott 2009).

Taking Stock of the Real Costs of Compliance: Measuring Voluntary Regime Effectiveness Through the Lens of Individual Implementation

What can be said with a fair amount of certainty is that a representative sample of banks who have adopted the EPs have undergone significant organizational changes with regard to environmental and social risk management since adopting the EPs.

A significant indicia of change and individual commitment to implementing the EPs is the creation of designated ESRM personnel or departments: this indicates that banks are “willing to not only state a formal policy of commitment to compliance but are also actually devoting resources to hiring people with the skills and job description to help the organization actively manage compliance” (Parker 2009). Prior to the EPs’ creation, there were virtually no rigorous ESRM systems in place, and those systems that were in place were perhaps rudimentary compared to what is in place now. Indeed, while 41 percent of the banks surveyed were aware of ESRM issues and would discuss them with potential borrowers, only 20 percent (5 banks) benchmarked their ESRM review to existing World Bank standards, and even fewer (only 12 percent (3 banks) had systematized due diligence procedures and designated personnel to implement them. However, following adoption or in preparation for adopting, 75 percent (21 banks) reported having made some changes of varying degrees to their ESRM.²⁰⁹ The most common evolution in practices (45.8 percent, 11 banks) involved standardizing procedures in a more formal process that linked project review to the EPs and IFC benchmarks and incorporated these standards in detailed loan covenants. An additional twenty-five percent (the six banks mentioned above) reported going “beyond Equator” by applying ESRM review to non-project finance transactions as well.

Although institutions structure their ESRM and position it relative to their overall credit approval processes in different ways, it appears that most banks have endowed their ESRM personnel and review procedures with a significant stake in the outcome of credit decisions: 45 percent of respondents indicated that ESRM personnel can strongly recommend against pursuing a project further already at the marketing stage, which recommendation, they report, is generally accepted, and 50 percent of the banks represented that ESRM approval is required before a project is presented to the credit committee for final approval. It is also worth noting that a majority (sixty percent) of the banks have their ESRM personnel function outside of the project finance teams’ bonus structures, which suggests at least superficially that they are not incentivized to compromise on their own independent judgment with respect to particular projects, though of course they might feel other internal office and career pressures to not stand in the way of projects that others are ready to finance.

When focusing on tougher funding decisions, most credit committees strive for consensus, and if that cannot be achieved, many banks also have created quasi-appellate levels of

²⁰⁹ The other 25 percent (6 banks) reported that they had not made “significant changes,” but these responses were from the same banks who reported they were already benchmarking their ESRM to World Bank standards *prior* to adopting the EPs.

review going to the very tops of their management structures for decisions on particularly challenging and risky credit decisions. The creation of these heightened review mechanisms suggests that banks take very seriously potential reputational risks arising out of complicated, often politically sensitive transactions. This does not mean, of course, that bank management will always side on the cautious end of the spectrum with respect to environmental and social risks, which often are judgment calls (by independent consultants) both with respect to their eventuality and scope of impact “on the ground” as well as to their potential ramifications for bank reputation. While the technical calculation of environmental and social impacts should be the same for each bank (as they are based on the independent expert’s analysis), the reputational risk analysis might vary depending on the bank, its connection to the host country, the relative level of resulting civil society pressure, the particular environmental or social issue implicated, and of course, that particular institution’s appetite for risk.

Another important aspect of ESRM review is the depth of due diligence, particularly during project construction. Here the banks showed that they had some work to do. Typically, consultants do periodic site visits, which are more frequent at the start of construction and operation (quarterly, perhaps) but drop in frequency once the project reaches construction completion and begins operation (to an annual or bi-annual basis). These visits generate reports that are then circulated to all lenders in the syndicate. If a problem arises, the agent bank is supposed to inform all of the other banks, who must then intercede with the borrower to get the project back into compliance.

I had assumed that the banks would want to carefully monitor implementation, and it is the case that many do: a large percentage of banks (70 percent) reported doing their own site visits, which some of my interview subjects suggested typically occur when certain construction completion goals are reached since the further drawing-down of loan funds is often contingent on meeting certain construction deadlines. Only a relatively small-number of banks (12.5%, three banks), however, offered evidence of setting-up complaint mechanisms or secondary lines of communication that would serve to compensate for any breakdowns in information-flow and complaint procedures offered by project borrowers. I assumed that this would be a reasonable check on the overall compliance of a project—which Equator Principle 6 puts at the feet of the banks themselves. However, it might be operationally too complicated to achieve in practice, or this is an area where the banks are simply not willing to expend further resources. While one banker suggested that attention to ESRM issues might decline somewhat after financial close, he clarified that this slack is then picked-up by the “agent” bank, which is charged with monitoring compliance by the borrower with the loan covenants, which incorporate the EP requirements, such as an environmental action plan.

When one combines the roles played by the borrower, the independent consultant, the agent bank, and the rest of the banks within the syndicate, as well as the NGOs, what results is a complex web of governance. Whether this governance translates adequately into actual accountability remains an open empirical question.

Finally, a major implementation-related issue of significant concern to the NGO community is EPFI disclosure. Indeed, the value of transparency in the realm of corporate social

responsibility generally is paramount: as Banktrack suggests, greater transparency can empower affected communities with the knowledge they need to better understand projects, and by extension, to protest against development they view as detrimental. Nevertheless, my interview research helped contextualize the reporting requirement further. Notably, several interviewees explained that the data on projects – particular the numbers of projects rejected – is not necessarily as revealing as might be hoped because, as several banks' CSR reports make clear (see, e.g., Citibank and Barclays), projects can be rejected on any number of grounds, not just environmental or social-risk-related. My data shows that the banks were split 50-50 on whether they had ever rejected a project *primarily* on ESRM issues. Indeed, credit approval committees often reject projects because project sponsors' backgrounds not only raise questions about their capacity for environmental and social risk management, but also about their credit histories and general business practices.

The survey also found that the level of detail in disclosures varied by bank, but that nearly 40 percent of the banks' disclosure statements were in-line with EP Guidance Note on Disclosure. In addition, 70 percent of the institutions reported using external auditing firms to verify the disclosures in their CSR reports. It needs to be reiterated that the content of the information disclosed in the banks' reporting is not valuable in and of itself (compared to disclosure of project-level information well in advance of financial closure), but it is costly in the sense that it requires resources to produce this reporting. Even greater resources are expended in hiring external auditors to certify the disclosures. Thus, under signaling theory's insight, the outlay of non-trivial costs increases the likelihood that the information related to those costs is accurate. To reiterate, what we do *not* have here is evidence that banks made certain funding decisions related to particular categorizations of projects; what we do have here, and which arguably is significant, is evidence that they engaged in the process of categorization, which is the first—and essential—step in environmental and social risk management.

Collectively, this data on individual firm implementation and organizational change suggests that the adopting institutions have made significant changes. As discussed in the methodology section, the limitations of this research make it difficult to prove definitely that these changes were caused directly by the banks' decisions to adopt the the EPs or that these institutional changes are really making a difference on the ground. Nevertheless, other aspects of regime effectiveness buttress the conclusion that the EPs have made a significant impact.

Other Measures of Regime Effectiveness

As noted, recent research into voluntary regulation has emphasized its capacity to engender a social interactive process among its participants, which can yield long-term benefits that a short-term outcomes-based evaluation might overlook. In particular, a regime of private regulation can serve as a mechanism for social learning. To measure the effectiveness of this element of the EPs, I tried to gather data to answer the question of whether the regime has centralized and coordinated the resources of would-be competitors and whether it has effectively disseminated knowledge and norms that might otherwise find barriers to widespread dissemination?

Beyond the mere sharing of knowledge and expertise, a further marker of regime growth and potential effectiveness is the development of more formalized governance structures: have competitors become increasingly intertwined in an ever more formalized and quasi-legalized governance structure and whether, out of recognition of their shared fate, participants in the industry or regime have sought to help maintain this governance structure rather than let it wither through neglect or opposition? The converse of the “real costs” theory discussed above is that if a regime is created as mere greenwash, the participating actors would wish to expend as little energy and resources as possible maintaining it.

Building on these intuitions, my research tried to quantify the various “regime-building” activities in which EPFIS participated. First, the survey tried to get a measure of individual EPFIs’ contributions to the regime, what could be described as expressions of their “civic duty” to help build and maintain the governance structure or community of which they were a part. Of the respondents, 37 percent (9 banks) reported that they had served on the Steering Committee and 54 percent (13 banks) reported that they had served as members of one of the thematic working groups (seven of these were also Steering Committee members). Thirteen banks (54 percent) also reached out to other institutions, either to a non-adopting institution to encourage them to adopt, or to an adopting institution to provide capacity development. In addition, several banks noted their participation in both the IFC’s Learning Community event, which takes place annually in its headquarters and the EPFIs Annual Meetings, which are scheduled for the same week of the IFC event, as well as participation in conference calls and other organizational and planning activities.

Another way of gauging the extent to which the EP regime has facilitated social learning is to measure the levels of contact and discussion between banks before adoption and after adoption. Though project finance lending is necessarily a very social enterprise—very few projects can be developed without accessing international credit markets and very few banks wish to take on all of the credit risk that financing large projects entails—there are competitive advantages to being a bank that has the expertise necessary to serve as a lead arranger of large deals or to act in an advisory role, both activities that garner fees beyond that which a mere participant in a syndicate would earn, and thus, it is in individual institutions’ strategic interests to keep such expertise to themselves so that they are always viewed as a necessary participant to most deals. On the one hand, this would suggest that banks would not be in a hurry to disseminate expertise and capacity to conduct extensive ESRM due diligence; on the other hand, to the extent that the strategy of leading banks in creating the EPs has been to “set a level playing field,” a primary goal would be dissemination of norms and practices supportive of the Equator Principles becoming the gold standard in the industry.

To the extent that this latter imperative has trumped more individualistic strategic goals, we should see increased contact and dissemination of knowledge between EPFIs. The survey measured the level of contact that institutions had with their peers regarding ESRM issues both before and after implementing the EPs. Before adopting, 16 percent (4 banks) reported “no contact” with their peers; 50 percent (12 banks) reported “infrequent, informal one-on-one discussions” with their peers, and 33 percent (8 banks) reported “Regular contact through formal meetings.” The data shows that after adopting, there was a clear increase in the number of banks

reporting more regular and formalized contact with their peers: only 1 bank reported having “no contact” after adoption, whereas 17 percent (4 banks) reported “infrequent, informal one-on-one discussions” and 78 percent (18 banks) reported “regular contact through formal meetings.” There is also evidence that individual institutions assisted in capacity development of other institutions considering adoption: 20 percent (5 banks) of respondents had received help from other institutions in capacity development in preparation for adopting the EPs. In addition, another 8 banks received help from the IFC, although it is unclear whether this was assistance targeted to the institution alone or more passive capacity learning achieved through attendance at the IFC’s Community of Learning event, which is open to all (Wright 2007).

An interesting question emerges from these responses: it might be suggested that the extensive involvement of the IFC is the real root cause of extensive spread of the EPs and related norms—after all, the IFC was integral in founding the EPs and the EPs refer back to the IFC’s own Performance Standards. It is a difficult counter-factual to entertain, but one wonders what the state of ESRM practices in commercial banks would be if the EPs never developed and the IFC was continuing its engagement of the private sector financial institutions as it did before the EPs were created. It is interesting to note that before the EPs reached a critical mass (approximately 2006, after the release of EPII and the adoption by forty banks), the IFC had only done outreach on an ad hoc basis by engaging the financial intermediaries it interacted with on B loans to projects. In 2007, however, the IFC hosted its first Community of Learning event, which approximately 80-100 banks have attended every year since. Other initiatives targeting the financial sector, primarily the United Nations Environment Program’s Financial Initiative, have operated since 1992, but has never been the same level of sustained activity, interaction and cooperation *between* large banks as that experienced since the launch of the EPs.

Arguably an important step toward fostering a community of social interactive processes to facilitate norm diffusion is the creation of a self-sustaining architecture for such activities, such as governance structures. The more formal a mechanism that is established, the greater potential for growth. Overall, the research suggests that the EPFIs have become part of an increasingly congealed collective working together to maintain the regime they have established, and in the process overcoming, in part, the natural tendencies of competitors.

Voluntary regime impact can also be measured for its effects on a given industry or “field” (Bourdieu 1983; Powell 1983; Meyer 1991; Fligstein 1996; Fligstein 2005) of economic activity: has the regime’s existence led to learning and socialization *beyond* the regime’s participants, leading to knowledge transfer and an overall dissemination of norms beyond participating institutions that would otherwise not have occurred; has it changed the “rules of the game,” altering field dynamics between its constituent actors. Arguably, impact should be measured not based solely on changes experienced by similar actors who are nonetheless outside of the regime (i.e., non-adopting banks), but also other kinds of actors who are also engaged to varying degrees in the field. In this case, these other actors would include various kinds of financial institutions engaged in project finance (development finance institutions, both bilateral and multilateral, export credit agencies, private equity funds, etc), project sponsors, project finance lawyers, environmental and social risk consultants, and perhaps even NGOs involved in monitoring project finance.

This inquiry is also difficult because of the lack of information available on the practices of non-participating peer institutions, but I attempted to get a glimpse of this through my inquiry into activities undertaken by EPFIs to engage others in the sector. Over fifty-four percent of respondents (13 banks) had been active in “outreach to a non-adopting institution to encourage them to adopt the EPs,” and twenty percent of respondents (five banks) had done “outreach to a non-adopting institution to provide capacity development.” This would suggest that the EP regime’s benefits were not limited to adopting institutions. Indeed, there is a Working Group committed to outreach that has several members divided into regional foci. The EPFIs have also sponsored conferences to expand adoption in geographic sectors not known for heightened attention to sustainability, including India, Russia, China and the Middle East.²¹⁰ In fact, according to (Aizawa 2010), the EPs, while conducting their own outreach efforts, simultaneously “coordinate closely” with the IFC on outreach activities in the emerging markets. Although it was not deduced from my data, there is also evidence of the EPs’ impact, extending even beyond the private sector. A prime example is the alignment of many of the world’s leading export credit agencies’ (of Australia, Canada, Denmark, Norway) policies with the EPs, as well as those of a few development finance institutions, including FMO, the Netherlands development finance institution. In addition, by linking the EPs to the IFC’s Performance Standards, the EPs have increased the acceptance and utilization of those standards as a universal benchmark, which according to one IFC staffer, would not have happened in the absence of the EPs. Simultaneously, the EP banks have made themselves a crucial actor in any future discussion of changes to the Performance Standards.

In sum, it can be said that EPs have started to fill the “governance gap” related to foreign investment and infrastructure development in particular. This gap-filling happens to serve the banks’ strategic and economic interest of improved risk management over highly technical, politically sensitive infrastructure projects, but it also has effectively standardized across an entire industry a level of rigor in the assessment of grave environmental and social risks that was simply not found before the Equator Principles were launched in 2003. Significantly, this standardization has not been limited geographically, by sector, or by the type of financial institution funding projects. The EPs have been adopted as guidance for the infrastructure finance activity of financial institutions in dozens of countries in North America, Latin America, Europe and Africa, and is recognized as “best practice” equally by private commercial banks, multilateral development banks, export credit agencies and development finance institutions the world over. Less than a decade ago, the vast majority of these institutions – particularly in the private sector – had very little in terms of policy or procedures related to the environmental and social risks of large projects.

But my research and other investigations into the EPs also show that like any human institution—and governance institutions in particular—the Equator Principles are not perfect. It is difficult to ignore the persisting criticism of the EPs maintained by their primary

²¹⁰ A superficial look by a Malaysian commentator noted that in April 2010, a “quick review of ten established Islamic banks in various countries” shows that only one in ten mentioned sustainability in their annual reports. See Nik Sharihazal Sulaiman, *Sustainability and Equator Principles in Islamic Banking*, The Edge – Malaysia, April 19, 2019, at p. 72.

stakeholders—NGOs—who fault the regime and its individual participants for not living up to the promise the EPs once offered. Their primary complaints lie in the level of transparency presently offered by EPFIs on the regime level, the individual institutional level, and with respect to specific projects. Thus, despite the significant contributions made to governance by these private actors, effective governance in this area, like many areas of transnational policy, ultimately will require the coordinated efforts of several types of actors, most prominently private actors, governments and civil society. It can be said, then, that despite the persisting complaints by the NGO community, the EPs certainly have evolved beyond a “weak system” of private governance that has no effect; rather, they have been accepted as a governance standard even by their critics, and all of the discussion now focuses on how to refine them and make them work even better.

The Promise and Potential Pitfalls of Private Global Regulation: Some Normative Considerations

It is important to keep in mind that the benefits of this collaboration go beyond the mere generation of focal points of behavior among competitors. Indeed, the creation of a voluntary regime where none previously existed is the birth of a new political actor: a community of institutions that can now act and be acted upon in ways not possible before they came together. No matter how fiercely independent and free of centralized authority the banks wish to remain, the reality is that by joining together as the EP Association they have created a much larger target for the NGOs to hit, and now, they all will share as equally in whatever glory or shame they might bring upon themselves.

But this increasingly formalized shared fate also means that the banks have potentially magnified their already influential position in global economic activity. The EP Association carries tremendous potential for driving new global policy on the most important issues of the global commons, such as climate change, the role of nuclear energy in society, and striking the appropriate balance between economic growth, industrialization and sustainability. This potential will be realized only if the banks collectively choose to go beyond mere individual *risk-management* and adopt a collective attitude of *shared responsibility* and *stewardship* of these issues.

One obstacle to such coordination suggested above is competition law. Beyond the legal framework, however, is a broader constraint, namely, the framework of the client relationship and the broader market in which it is embedded. As one environmental and social risk management staff person noted, in her view the EPs are extremely useful and successful because they embed risk analysis within project review and embed project sponsor requirements deeply within loan documentation. However, in her view, there is more that can be done beyond such mere “box-ticking”: banks can engage their clients on an annual basis to strategize with them about their overall approach to sustainability and their capacity to implement their strategic vision in order that these issues come to be viewed on the same level as their clients’ “financial

health.”²¹¹ This would suggest that the banks could have considerable control over the type of projects their clients are developing. Similarly, the client relationship could be a source of leverage for larger policy issues such as climate change:

It depends on what we want to do about climate. If we are serious about climate, it could make a change, but for the time being it’s not exactly the case. If we say that the banking community wants to go further than what ... than Copenhagen, or, I mean, there’s no chance of that ... but wants to be serious about how to deal with climate change, and we want to get a specific standard that will apply in emerging countries but also maybe in developed countries, then maybe the Equator Principles could be a tool for that.²¹²

Can banks drive change or are the clients in the driving seat? One of the difficulties, as this ESRM specialist noted, is that sometimes banks do not feel that they have the leverage they would like over their clients’ project plans, since they are, after all, they are *the client*, who might be a repeat player and whose business they wish to retain in the future. Moreover, the banks are often involved only very late in the project planning process, once the client has been developing it for several years. When a bank enters so late in the game, few banks feel themselves in a position to alter radically their clients’ long-term agendas, at least on a one-on-one basis. Arguably, however, the banks could individually or collectively, choose to view the situation differently, by taking a long-term approach to the broader problem before them:

It depends on the type of service you want to provide to your clients . . . but, we are banks ... it comes back to what I was saying about the client relationship: that’s really, I think, where we should change things. If it’s only a way to protect our reputation, and I know that that’s really the way it’s been marketed for a long time, which is good because it’s true that it’s also important, if it’s only that, we will always stop [short of] making a real difference in what will be financed in the end. . . . If we want to be more ambitious, then let’s develop specific credit lines for energy efficiency, or what will probably banks do in the future; but if you look at the Equator Principles as purely a way to protect ourselves from reputation risk, then we make things change on the ground, but not so much as if we really engaged with our clients to see what are their needs, how we can help them develop an environmentally-friendly finance (*Id.*)

The scope of the opportunity for sweeping social change that could be initiated by the financial sector is well-illustrated by the takeover by the British government of the Royal Bank of Scotland, one of the largest and most active transnational banks.²¹³ A report by a former

²¹¹ Interview ESRM 3 (recording on file with author).

²¹² Interview ESRM 3 (recording on file with author).

²¹³ The UK government became the majority shareholder of RBS in November 2008 by acquiring a 58% share, a stake it increased to 70.3% of the ordinary shares in April 2009 through the conversion of preference shares,

PricewaterhouseCoopers consultant (commissioned by the NGOs Platform and the World Development Movement) argues that transforming RBS into a Green Investment Bank could kick-start the “green energy revolution” in the UK, bringing 50,000 new “green jobs” a year, increased energy efficiency, a reduction in the UK’s carbon emissions, and an improvement in its international competitiveness—all without increasing the budget deficit (Leaton 2010).

Elsewhere in the UK, the Co-operative Bank is demonstrating that banks *can* choose the socially responsible path in their lending decisions. Co-operative claims that in 2009 it turned down close to 100 million British pounds of business because twenty of the business opportunities it evaluated breached the bank’s policies on human rights, sixteen companies breached its environmental policies and four companies breached its animal welfare policies.²¹⁴ Co-operative Bank, it should be noted, is not an EPFI, most likely because it does not engage in much project finance lending.

Similarly, it seems that if the will power is there, enough brute financial force can always power a late-in-the-game intervention where earlier progressive planning was absent. A perfect illustration is the case of Texas Utilities (TXU), what environmental and social risk consultant Leo Johnston has called the “world’s first leveraged environmental buy-out.” TXU had planned construction of a series of eleven high-sulfur coal-fired power plants without capture technology that would produce an estimated seventy-eight million tons of CO² annually (equivalent at the time to about 80% of Britain’s emissions reduction target under the Kyoto Protocol). The deal had all the necessary momentum: it was being fast-tracked by the governor as a strategy to reduce brownouts and had financing from Citi, Morgan Stanley and Merrill Lynch. It nevertheless ran into stiff opposition from NGOs that included a ten-day hunger strike outside the governor’s mansion, which was followed by a letter-writing campaign led by the Rainforest Action Network. Merrill Lynch nevertheless stuck with the deal, prompting RAN to stage a “die-in”—a simulation of multiple coal-induced deaths in the lobby of one of its office buildings.

Thus, despite being a legally sanctioned transaction backed by the highest authority in the state that utilized the globally standard technology in coal plants (although not the absolute *best available* technology) in order to respond to a state-wide problem, stalemate blocked the project from moving forward. That’s when the private equity funds of Citi, Goldman Sachs, Morgan Stanley and Lehman Brothers backed two companies, KKR and Texas Pacific, stepped-into the picture. Over the course of all-night meetings, TXU’s management was convinced that they had an “environmentally distressed asset” and that the only way forward was for the company to close eight of the eleven plants and to upgrade the technology on the remaining three to the best practice.²¹⁵

As unprecedented as this “leveraged environmental buyout” was, in the years since the launch of the EPs, private sector financiers have gone far beyond such one-off interventions. In

and increased further to 84.4% in November 2009 when it subscribed to non-voting B shares to provide the bank further capital (Leaton 2010) p. 18.

²¹⁴ *Co-op turns down 100m of ‘unethical’ business*, May 31, 2010, available at http://menmedia.co.uk/manchestereveningnews/news/business/s/1241547_coop_turns_down_100m_of_unethical_business (last visited December 12, 2010).

²¹⁵ Leo Johnson, *Financiers hold the key to the future*, FINANCIAL TIMES, June 7, 2007, at 6.

fact, there have been signs that the financial sector is assuming a considerably more active role in directing the global governance of their own activities, and by extension, much of the global economy. For example, leading into renewed climate negotiations in Cancun in late 2010, 259 investors from Asia, Africa, Australia, Europe Latin America and North America with collective assets under management totaling over \$15 trillion²¹⁶ called for governments to take action on climate change. These investors were not necessarily united by their passion for the environment, but more likely by their realization of the financial risks related to climate change, which they claimed could amount to GDP losses of up to 20 percent by 2050, as well as the economic benefits of shifting to low-carbon and resource-efficient economies.²¹⁷ According to Ole Beier Sørensen, Chairman of the Institutional Investor Group on Climate Change and chief of Research and Strategy at the Danish pension fund ATP (with EUR 56 billion in assets) past experience in the renewable energy sector suggests that private sector investment in climate solutions has been driven, “almost without exception” by structured government policies that can “bolster investor confidence” and drive investments in renewable energy (*Id.*).

In addition to grand policy interventions, new private governance initiatives have launched in the financial sector. For example, the Principles for Responsible Investment were created in 2005 by the instigation of Kofi Annan, then-United Nations Secretary-General.²¹⁸ Not unlike the Equator Principles (but far less detailed than the EPs), the PRI provide guidance to investors in how to integrate issues of environmental and social governance into their investment policies. As of October 2010 over 800 investment institutions from 45 countries have become signatories,²¹⁹ including the members of the Private Equity Growth Capital Council,²²⁰ a “lobby group for major private equity firms,”²²¹ which announced that it would sign on to the UN PRI in February 2009.²²² What is remarkable about such developments is that private equity firms are barely regulated in major domestic jurisdictions such as the United States,²²³ and yet, they are

²¹⁶ This is equivalent to more than one-quarter of global market capitalization.

²¹⁷ United Nations Environment Programme Financial Initiative, *Press release: Largest ever investor group representing over \$15 trillion calls for determined policy action on climate change* (Geneva/Nairobi, November 16, 2010).

²¹⁸ See United Nations Principles for Responsible Investment, <http://www.unpri.org/about/> (last visited December 21, 2010).

²¹⁹ A full list of current signatories can be found at www.unpri.org/signatories.

²²⁰ See *About the Private Equity Growth Capital Council*, at <http://www.pegcc.org/about/> (last visited December 21, 2010). The Council’s membership includes some of the world’s best known private equity firms, including KPS Capital Partners; Levine Leichtman Capital Partners; Madison Dearborn Partners; MidOcean Partners; New Mountain Capital; Permira; Providence Equity Partners; The Riverside Company; Silver Lake; Sterling Partners; Sun Capital Partners; TA Associates; Thomas H. Lee Partners; TPG Capital (formerly Texas Pacific Group); Vector Capital; and Welsh, Carson, Anderson & Stowe.

²²¹ Sourcewatch, *Private Equity Council*, at http://www.sourcewatch.org/index.php?title=Private_Equity_Council (last visited December 21, 2010).

²²² See *Press Release: Private Equity Council members adopt guidelines for responsible investment*, at <http://209.236.74.220/press-releases/2009/02/10/private-equity-council-members-adopt-guidelines-for-responsible-investment/> (last visited December 21, 2010).

²²³ Under the 1940 Investment Advisors Act, hedge funds and private equity funds meet the definition of “investment advisor,” but generally qualify for the “private adviser” exemption from having to register with the SEC under § 203(b)(3) of the Act (this exemption is open to any adviser that has fewer than 15 clients and does not

now participating—at least superficially—in transnational private governance. Indeed, while the UN PRI are not as detailed in the performance standards and demands they make upon signatories as the EPs are, the UN PRI have already distinguished themselves by their preparedness to call-out “laggards”—albeit those lagging in a separate but closely-related governance regime: the UN Global Compact. In January of 2008, in fact, a coalition of 38 investors worth over US \$ 3 trillion wrote letters to the CEOs of 130 major listed companies that are signatories of the UN Global Compact. In their letters the investors praised twenty-five Global Compact signatories for meeting their obligations under the Compact to produce an annual “Communication on Progress,” but simultaneously identified over 100 other companies as “laggards,” who were mainly based in emerging markets, and demanding them to comply with their obligations.²²⁴ One of the collaborating institutions remarked:

There is now a critical mass of institutional investors who believe management of corporate responsibility or ESG issues is highly relevant to the long-term financial success of their investments. And the UN Global Compact’s system of reporting, which demands the production of a “Communication on Progress” (COP), provides an important way for the investment community to analy[z]e a company’s performance on those ESG issues. . . .

The UN Global Compact system provides investors with a universe of “good COPs” and “bad COPs.” Companies that produce a “good COP” send a powerful message to a valuable audience of institutional investors. Those who have failed to submit a report will trigger alarm bells among investors who want real details about a company’s business practices on ESG issues.²²⁵

This intervention by the investors illustrates the dynamism and possibility for cross-fertilization of these new regimes of global self-regulation. Indeed, although the Global Compact is managed by the United Nations, it is the market share of its private sector, voluntary participants that gives

generally hold itself out to the public as an investment adviser; hedge funds organized as limited partnerships have traditionally been themselves viewed by the SEC as the “client” in §203(b)(3), rather than to the investors constituting its limited partners). After the implosion of the US \$125 billion Long Term Capital Management of Connecticut in 1998, the SEC adopted the “Hedge Fund Rule” in 2004, which effectively reinterpreted the definition of “client” under the Advisers Act so that general partners of hedge funds had to “pierce the veil” of their fund to reach its beneficial owners to determine how many clients they advise. However, in 2006, the D.C. Circuit Court of Appeal vacated the “Hedge Fund Rule” as “arbitrary,” leaving the exemption in place. Subsequently, Senator Jack Reed (D-RI), introduced the Private Fund Transparency Act of 2009 (S. 1276), in June 2009, which aimed to amend the Advisers Act to require investment advisers to private funds who manage assets in excess of \$30 million to register with the SEC. The Obama administration proposed parallel legislation in July 2009. See Geoffrey Parnass, *Regulation of Private Funds: Senator Reed and the Congressional Hearings*, Private Equity Law Review, July 24, 2009, at <http://www.privateequitylawreview.com/2009/07/articles/for-private-equity-sponsors/regulation-of-private-funds-senator-reed-and-the-congressional-hearings/>. As of this writing, Senator Reed’s bill was read twice and referred to the Committee on Banking, Housing, and Urban Affairs.

²²⁴ Hugh Wheelan, *UN PRI cuts its teeth with first public investor campaign*, *Responsible Investor*, January 29, 2008, at http://www.responsible-investor.com/home/article/un_pri/P0/ (last visited December 21, 2010).

²²⁵ UN PRI, Media Release: *Corporate Responsibility: Investors Give New Twist to Good Cop/Bad Cop Routine*, at http://www.unpri.org/files/PRI_GCphII_final.pdf (last visited December 21, 2010).

these initiatives their potential power in shaping the global policies of both governments and corporations.

As noted, we should not mistake long-term risk management driven by the profit motive for altruism. The call for action by investors to governments in Cancun was not a product of enlightened capitalism, but of risk-avoidance; investors now appreciate the potential financial impacts of climate change and wish that governments would make it easier on corporations and others to pursue alternative energy strategies in the forms of tax-incentives and other benefits. This is not internalizing social costs as “triple bottom line” business models and corporate social responsibility dictate, but asking governments to subsidize research and development, and consequently, share the financial risk inherent in developing new technologies. It is likely only a matter of time before governments and corporations find some mutually agreeable price points, paving the way for true innovation of the global economy.

These observations about the increasing frequency with which certain private actors are flexing their regulatory muscles provide an excellent entrée into a realm that has been largely glossed over thus far, namely, the normative questions implicated by the very operation of the Equator Principles.

Even if banks truly can over time influence their clients’ preferences and business strategies, is such a development desirable from a public policy perspective with respect to specific projects in particular countries or on broader issues, like climate change? In other words, do we want bankers as policymakers? What chains of accountability will keep them in-check and how can they claim to make political decisions with more legitimacy than governmental actors? Would not a key component of such authority by necessity entail full disclosure of decision-making processes, something the banks, as of yet, are not willing to do on a project-level basis?

For example, how can bank personnel legitimately—that is, with democratic accountability—rely on their or their clients’ processes (or assessment of such processes) for attaining broad community support through informed consultation, as required by Equator Principle 5? This is supposed to apply in weak-governance zones, where the assumption is that such processes did not occur as part of the permitting process. But what about circumstances wherein such strategic planning was mandated and carried out by national law and is later checked by judicial review; are banks supposed to supplement their assessment for the robustness of the decision-making process for that of national regulators?

Disagreeing with the assessments of a government sponsor or partner may not be like direct review of those decisions, but they do suggest a critique of them. The exercise of such quasi-administrative law review functions has been challenged on legitimacy grounds in other contexts related to foreign investment. Some have questioned the legitimacy of a system that allows investment treaty arbitral bodies to review regulatory actions taken by national regulators with respect to environmental, health or other laws adopted to promote the public welfare (Van Harten 2006). What standards of review should govern such decision-making and what factors must be considered? Who, in the end, is supposed to be the judge of the quality and desirability of large-scale infrastructure projects or the quality of the due process [if any] by which the decisions to build them were made? Are independent environmental and social risk consultants

deploying the art and science of impact assessment to become ostensibly quasi-administrative law judges – unelected by, and thus unaccountable to, anyone but those who pay their fees? Who also should be the judge of the internal regulatory processes leading to the planning, approval and permitting of such projects, particularly in low-income economies? If an emerging market economy such as Brazil with a democratically-elected government prefers to build hydroelectric dams in the Amazon to fuel its 60% anticipated increase in energy needs, who is to tell it otherwise? And what are the implications for human development when large projects seen as crucial to infrastructure improvement and therefore economic development are held-up in court battles—domestic or international—as has happened so frequently in the United States—or happened in eighteenth century France, for that matter (Kagan 2001)?

These questions strike at the core normative implications resulting from the growth and evolution of regimes like the Equator Principles and the complicated problems this poses for sovereign autonomy, both over natural resources and over political decisions that implicate political rights and the separation of powers. Ultimately, the answers to these questions may be political ones that need to be resolved in the context of particular projects in particular countries, hashed-out between federal, state and local governments or in the context of debates within international organizations with active participation from a wide-range of stakeholders. But it should be clear that we need to do more thinking about what it would mean for sovereignty if there were to truly effective—and powerful—regimes of private governance.

Whatever form such regimes take, they are almost certain not to operate in a vacuum. Just as governments have failed to overcome collective action problems to regulate the environment or other aspects of the global commons, the banks, despite the potentially persuasive power of their market share, are not likely to go-it-alone, nor should that be a desired end. For better or worse, the future governance of these global gaps in regulation will by necessity entail a process of triangulated governance between banks, their clients, NGOs, international organizations and governments (Abbott 2009). If the past is any precedent, most of the battles will be fought in the court of public opinion as the NGOs demand increasing levels of accountability and the banks seek to protect both their individual reputations, and that of the EP regime as well. Somewhere in that process, some semblance of “governance” might be achieved.

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APPENDIX A: SUMMARY STATISTICS AND STATISTICAL TESTS

Table X.X Descriptive Statistics

Panel A: measures of reputational exposure – summary statistics

Variable	Mean	SD	Min	Max
(1) Id	1.83	0.92	1	4
(2) Oecd	0.67	0.48	0	1
(3) Size	0.87	0.34	0	1
(4) Projrev	2.25	0.34	1	3
(5) Projfin	2.17	0.87	1	3
(6) Projrisk	1.88	NA	1	3
(7) Advisor	1.83	0.92	1	3
(8) preESRM	3.00	0.93	1	4

Panel B: experience with external stakeholders – summary statistics

Presstransngo	2	1.10	0	3
Pressngoorig	2	0.98	0	3
Pressngohost	1.58	0.93	0	3
Pressregorig	0.88	0.95	0	3
Pressreghost	1.08	0.93	0	3
Pressintorg	1.08	0.88	0	3
Pressshare	1.13	0.99	0	3
Presssri	1.04	0.91	0	3
Pressmedia	1.38	0.82	0	3
Pressngopre	0.75	0.44	0	1
Pressngoincrease	0.58	0.50	0	1
Targetpreadopt	0.5	0.51	0	1
Targetpostadopt	0.67	0.48	0	1
Targeted	0.71	0.48	0	1
Epfiinfluence	1.43	NA	1	3
Ifcinfluence	1.71	0.86	1	4
Competeinfluence	2.82	NA	1	4
Targetinfluence	1.96	NA	1	4
Reginfluence	1.43	NA	1	3

Panel C: measures of implementation – summary statistics

Variable	Mean	SD	Min	Max
Changes	.75	0.44	0	1
postESRM	2	0.78	1	3
ESRMhire	1.88	0.68	1	3
Train	.96	0.20	0	1
ESRMrole	2.5	0.72	1	3
Secondsteps	2.3	0.62	1	3
Report	2.8	1.13	1	4
Reportplus	2.08	0.58	1	3
Audit	2.13	0.54	1	3
Leadership	2.04	0.54	0	3
Outreach	.54	0.51	0	1
rejectESRM	.54	0.51	0	1

Panel D: reputation and other variables (views on reputation and regime-building) – summary statistics

Variable	Mean	SD	Min	Max
Year	0.38	0.49	0	1
Precontact	2.17	0.70	1	3
Postcontact	2.74	NA	1	3
Repspillover	.46	0.51	0	1
Repspilloverpotential	.59	NA	0	1
Repawareconsumer	.29	0.46	0	1
Repawareclients	.86	NA	0	1
Repawarengobanks	.38	0.50	0	1
Repindivid	.96	0.20	0	1
Repallbanks	.54	0.51	0	1
Repepfi	.86	0.38	0	1
Monitoringenforcement	.43	NA	0	1

Table X.X – Statistical tests

Panel A: Fisher's exact test (p value) – Reputational exposure and stakeholder pressures

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
(1) size	-															
(2) oecd	1.00	-														
(3) projrev	0.02	0.14	-													
(4) projfin	0.03	0.02	0.00	-												
(5) projrisk	0.32	0.003	0.04	0.01	-											
(6) advisor	0.25	0.27	0.00	0.00	0.00	-										
(7) presstransngo	0.04	0.24	0.51	0.14	0.16	0.15	-									
(8) pressngoorig	0.005	0.62	0.04	0.01	0.33	0.21	0.002	-								
(9) pressngohost	0.06	0.29	0.11	0.28	0.08	0.14	0.01	0.0003	-							
(10) pressregorig	0.33	0.67	0.33	0.43	1.00	0.16	0.76	0.445	0.146	-						
(11) pressregghost	0.04	1.00	0.15	0.48	0.46	0.41	0.45	0.055	0.044	0.000001	-					
(12) pressmedia	0.13	0.90	0.26	0.31	0.41	0.13	0.01	0.108	0.014	0.343	0.045	-				
(13) pressshare	0.81	0.71	0.95	0.56	0.02	0.46	0.46	0.289	0.389	0.348	0.038	0.309	-			
(14) presssri	0.17	1.00	0.09	0.09	0.23	0.01	0.17	0.031	0.00001	0.003	0.001	0.013	0.011	-		
(15) pressintorg	0.35	0.56	0.51	0.14	0.34	0.12	0.56	0.122	0.001	0.021	0.004	0.122	0.001	0.000001	-	
(16) targetpreadopt	1.00	0.03	0.28	0.45	0.04	0.10	0.14	0.034	0.046	1.000	0.761	0.857	0.873	0.256	0.581	-
(17) targeted	0.25	0.00	0.01	0.06	0.01	0.19	0.03	0.040	0.02	0.85	0.15	0.90	0.41	0.17	0.56	0.001

Size = Global/Regional or National; Oecd = Non-OECD/Low-Income OECD or High-Income OECD; Projrev = number of projects reviewed annually on average (over last ten years), by banks' own estimation; Projfin = number of projects financed annually on average (over last ten years), by banks' own estimation; Projrisk = number of "high-risk" projects reviewed annually on average (over last ten years), by banks' own estimation; Advisor = number of times served as an advisor to a deal in the last ten years, by banks' own estimation; Presstransngo = relative level of pressure/contact experienced from transnational NGOs (ranging from no contact/pressure to

For further detail, please refer to Codebook Excel spreadsheet (attached separately)

intense contact/pressure); Pressngoorig = NGOs in country of origin pressure/contact; Pressngohost = NGOs in host countries pressure/contact; Pressregorig = regulator in country of origin pressure/contact; Pressregghost = regulator in host countries pressure/contact; Pressmedia = media pressure/contact; Pressshare = shareholder pressure/contact; Presssri = social responsible investment fund pressure/contact; Pressintorg = international organization pressure/contact; Targetpreadopt = whether targeted by public advocacy campaign prior to adopting Equator Principles; Targeted = targeted at any point.

Panel B: Gamma test for reputational exposure and stakeholder pressures

Reputational Exposure Variable	Stakeholder Pressure Variable	Gamma score (descending order of association)	P-value (level of significance)
Size	pressregorig	1	0
Size	pressreghost	1	0
Size	presssri	1	0
Size	pressngoorig	0.97	1.07E-120
Size	pressngohost	0.93	1.89E-33
Size	presstransngo	0.85	0.000000007
Projrisk	pressshare	0.74	0.000001
Size	pressshare	0.73	0.001
Projfin	pressngoorig	0.73	0.000001
Projrisk	pressngoorig	0.63	0.002
Oecd	pressngopre	0.61	0.005
Projfin	pressmedia	0.59	0.0003
Projrisk	presssri	0.58	0.005
Projrisk	pressmedia	0.55	0.01
Projfin	presstransngo	0.53	0.01
Projrev	presssri	0.51	0.01
Projrisk	pressngopre	0.51	0.02
Projrisk	presstransngo	0.50	0.01
Size	pressmedia	0.50	0.01
Projfin	presssri	0.48	0.02
Oecd	presstransngo	0.47	0.04
Projrev	pressngopre	0.46	0.02
Projrisk	pressngohost	0.46	0.03

Projrev	presstransngo	0.45	0.02
Projrev	pressngoorig	0.43	0.03
Projfin	pressngohost	0.39	0.04
Projrev	Pressmedia	0.33	0.059

Panel C: Fisher test for reputational exposure and understanding of shared reputation

Reputational Exposure Variable - Reputation Held By <i>All Banks</i>	P-value (level of significance)
Advisor	0.43
Oecd	0.39
Pressngopre	0.58
Projfin	0.87
Projrev	0.65
Projrisk	0.83
Size	1
Targeted	1
Targetpreadopt	1
Year	0.21
EPFI Share a Distinct Reputation	p-value
Advisor	0.25
Oecd	1
Pressngopre	0.33
Projfin	0.23
Projrev	0.78
Projrisk	0.01
Size	1
Targeted	1
Targetpreadopt	0.59
Year	1
Reputation Held <i>Individually</i>	p-value
Advisor	1

Oecd	1
Pressngopre	1
Projfin	0.54
Projrev	0.5
Projrisk	1
Size	0.13
Targeted	1
Targetpreadopt	1
Year	0.38

Panel D: Gamma test for reputational exposure and understanding of shared reputation

Reputational Risk Variable	Understanding of shared reputation	Gamma score	P-value (level of significance)
Year	Repindivid	-1.0	0.0
oecd	Repindivid	-1.0	0.0
pressngopre	Repindivid	-1.0	0.0
size	Repepfi	-1.0	0.0
projrisk	Repepfi	-0.75	0.0
advisor	Repepfi	-0.67	0.02
projrev	Repepfi	-0.63	0.02
Year	Repallbanks	-0.6	0.014
advisor	Repallbanks	-0.43	0.06
pressngopre	Repepfi	-0.41	0.19
projrev	Repallbanks	-0.39	0.09
projfin	repepfi	-0.33	0.15
size	repallbanks	-0.29	0.31
oecd	repepfi	-0.24	0.34
pressngopre	repallbanks	-0.15	0.32
projfin	repallbanks	0.12	0.36
projrisk	repallbanks	0.20	0.30
Year	Repepfi	0.33	0.26
oecd	repallbanks	0.47	0.08
advisor	repindivid	1.0	0.0
projfin	repindivid	1.0	0.0
projrev	repindivid	1.0	0.0
projrisk	repindivid	1.0	0.0
size	repindivid	1.0	0.0

Panel E: Fisher test for reputational exposure and implementation

Variable	audit	changes	ESRMhire	postESRM	esrmrole	leadership	Outreach	rejectesrm	report	reportplus	secondsteps	Train
Advisor	0.24	1.00	0.97	0.88	0.25	0.14	0.30	0.12	0.39	0.40	0.51	1.00
Oecd	1.00	0.07	0.05	0.04	0.24	0.85	1.00	0.68	0.01	0.01	0.56	1.00
Pressngopre	0.82	1	1	0.85	0.31	0.29	0.38	0.17	0.39	0.28	0.63	1
Projrev	0.78	0.16	0.49	0.39	0.67	1.00	0.44	0.32	0.04	0.37	0.59	0.50
Projfin	0.57	0.20	0.61	0.26	0.69	0.85	1.00	0.58	0.14	0.22	0.61	0.25
Projrisk	0.10	0.52	0.78	0.08	0.69	0.19	0.21	0.02	0.42	0.05	0.45	1.00
Size	1.00	0.55	1.00	0.75	1.00	1.00	0.58	0.22	1.00	1.00	1.00	1.00
Targeted	1.00	0.06	1.00	0.42	0.24	0.26	1.00	0.03	0.78	0.55	0.84	1.00
targetpreadopt	0.46	0.16	1.00	0.05	0.08	0.15	1.00	0.41	1.00	0.46	1.00	1.00
Year	0.23	1.00	0.62	1	0.42	0.69	0.21	0.42	0.02	0.08	0.70	1.00

Panel F: Gamma test for reputational exposure and implementation

Reputational Exposure Variable	Implementation Variable	Gamma score (in ascending order of association)	P-value (level of significance)
Year	outreach	-0.60	0.01
Projrisk	secondsteps	-0.49	0.04
Projfin	Secondsteps	-0.49	0.03
Projrisk	ESRMhire	-0.48	0.05
Oecd	secondsteps	-0.44	0.08
Advisor	secondsteps	-0.44	0.04
Projrev	secondsteps	-0.34	0.09
Projfin	ESRMhire	-0.29	0.14
Year	leadership	-0.29	0.16
Size	leadership	-0.18	0.32

Advisor	ESRMhire	-0.15	0.30
Size	report	-0.09	0.41
Projfin	leadership	-0.06	0.41
Projrev	ESRMhire	-0.05	0.41
Size	secondsteps	-0.03	0.48
Oecd	outreach	0.13	0.38
Advisor	report	0.16	0.26
Projrev	leadership	0.17	0.26
Projrev	report	0.23	0.16
Projrev	reportplus	0.24	0.24
Oecd	leadership	0.26	0.19
Advisor	reportplus	0.29	0.16
Size	ESRMhire	0.31	0.22
Year	secondsteps	0.33	0.16
Projfin	rejectesrm	0.34	0.12
Projrisk	report	0.36	0.07
Advisor	leadership	0.38	0.03
pressngopre	rejectesrm	0.42	0.07
Projrev	outreach	0.45	0.05
Projfin	report	0.46	0.02
Projrisk	outreach	0.47	0.06
Advisor	outreach	0.48	0.04
Projrev	rejectesrm	0.51	0.02
Projfin	reportplus	0.52	0.05
Advisor	rejectesrm	0.57	0.01
Projrisk	reportplus	0.61	0.004

Projrisk	leadership	0.70	0.0001
Projrisk	rejectesrm	0.80	0.0000002
Oecd	report	0.84	0.0000000000001
Oecd	reportplus	1.00	0.0