The Equator Principles: The Private Financial Sector’s Attempt at Environmental Responsibility

ABSTRACT

The Equator Principles are a set of voluntary environmental guidelines created to manage environmental degradation that results from large-scale developmental projects in the Third World. On June 4, 2003, ten private financial institutions adopted these guidelines, and by the end of 2006 this number had grown to forty. Moreover, in June 2006 the Principles were revised, raising the level of scrutiny for companies that adhere to these guidelines.

At first blush, the adoption of the Equator Principles by private financial institutions appears to be a substantial step toward implementing environmental standards in developing countries that lack adequate regulations. However, three years after their inception, debate as to whether the Principles are actually spurring environmental change remains. This Note analyzes whether the Equator Principles are having a positive impact and achieving their stated goals related to the local environment in developing countries. This Note concludes that, despite a great deal of uncertainty regarding their real impact, the Equator Principles clearly have improved the situation by placing the private sector in a proactive environmental role and strengthening the public’s ability to hold the financial sector accountable for its actions.
I. INTRODUCTION

Hydroelectric dams, power plants, and other large-scale developmental projects can substantially improve local economies; however, these projects frequently come at a great cost to the environment. In most cases, governments of the developing world have failed to establish environmental regulations to prevent the degradation of the local environment from these large-scale projects. This lack of governmental regulation has allowed private institutions to set their own bar for the environmental standards in the developing world. Initially, project standards set by these private institutions were minimal and resulted in large environmental degradation. However, as private funding for these projects


2. “Developing country” refers to “[a] country that is not as economically or politically advanced as the main industrial powers. Developing countries are located mostly in Africa, Asia, Eastern Europe, the Middle East, and Latin and South America.” BLACK’S LAW DICTIONARY 482 (8th ed. 2004).

3. See Lawrence & Thomas, supra note 1, at 21-22.

4. Id. at 22.
increased, public criticism intensified, and private financial institutions were targeted for their role in contributing to the environmental degradation.\

As a result of the increased public backlash, ten private financial institutions adopted a set of environmental guidelines known as the Equator Principles on June 4, 2003.6 These private institutions, known collectively as the Equator Principles Financial Institutions (EPFIs), created the Equator Principles to “manag[e] social and environmental issues related to the financing of projects.”7 By their third anniversary, the Equator Principles had been adopted by forty financial institutions including banks, export credit agencies, and development finance institutions.8 These financial institutions control approximately 80% of all project lending world-wide.9 Although the ability of the EPFIs to enforce these Principles is limited to the contractual relationship of a specific project, their influence over the industry grows as more banks adopt the Equator Principles.10 In turn, this creates the possibility for the Principles to become the international standard for all large-scale developmental projects.11

It is tempting to think of the Equator Principles as a substantial step toward enhancing environmental regulations in countries without adequate standards. However, three years after the inception of the Equator Principles, public criticism of them remains.

5. Id.
7. Id.
11. Id.
In July 2006, the EPFIIs launched the Equator Principles II\textsuperscript{12} (EPII) to address many of these criticisms.\textsuperscript{13} Currently, thirty-three of the forty original EPFIIs have adopted the EPII.\textsuperscript{14} Because the EPII are new to the marketplace, little information exists regarding their impact. However, an analysis of the revisions to the Equator Principles and how these changes were made is important to understanding the effect of the Principles on the private sector.

This Note analyzes whether the Equator Principles have positively impacted the environment in the developing world and achieved their stated goals of managing social and environmental risk. Part II of this Note outlines the requirements of the Equator Principles. Part III discusses the events leading up to the formation of the Principles. Part IV sets forth the common criticism of the Principles. In Part V, this Note considers the incentives private financial institutions have for adopting and adhering to the Equator Principles. Part VI then presents a case study, analyzing the effects of the Equator Principles on Sakhalin II, an integrated oil and gas development project in Russia. In order to determine the impact and future of the Principles on bank activities, Part VII examines each of the following: (1) whether an EPFI can be held liable for violating the Equator Principles, (2) the impact of the Equator Principles on the banking industry and the environment, and (3) the amendments to the Equator Principles and reasons for theses changes. Finally, Part VIII concludes by arguing that despite a great deal of uncertainty surrounding the Equator Principles, they have improved environmental performance by placing the private sector in a proactive environmental role and by increasing the public’s ability to hold the financial sector accountable for its actions.

II. THE EQUATOR PRINCIPLES

The stated purpose of the Equator Principles is to “ensure that the projects [the EPFIIs finance are developed in a manner that is socially responsible and reflect sound environmental management practices.”\textsuperscript{15} The Principles apply to all financial projects with a total


\textsuperscript{13} Demetri Sevastopulo, Revisions Raise Social Hurdles Changes To The Equator Principles: Banks That Sign Up To The New And Tighter Guidelines Will Be Gaining Flexibility, FIN. TIMES REP., June 12, 2006, at 1.


\textsuperscript{15} Equator Principles, supra note 12, pmbl.
capital cost of at least $50 million. These projects are initially categorized for their level of environmental and social risks based on internal guidelines that are derived from screening criteria used by the International Finance Corporation (IFC), the private sector arm of the World Bank. Specifically, the project's risks are assessed depending on the "type, location, sensitivity, and scale of the project and the nature and magnitude of its potential environmental and social impacts."  

Based on the level of environmental and social risk, each project is placed into either Category A, Category B, or Category C, correlating with high, medium, and low levels of risk. Category A projects are "likely to have significant adverse environmental impacts that are sensitive, diverse or unprecedented." The risks to the natural habitat or cultural heritage sites of Category A projects are potentially irreversible and may extend beyond the project site. Category B projects pose potentially adverse environmental impacts on human populations or on important areas, such as grasslands, forests, wetlands, and natural habitats. In contrast to the potential impacts of Category A projects, the potentially adverse impacts of Category B projects are site specific, often can be mitigated, and rarely are irreversible. Finally, Category C projects are likely to have minimal or no adverse impact on the environment.  

Both Category A and B projects require the company proposing the project to compile an Environmental Assessment (EA). Although an EA for Category B projects contains the same essential elements as those required for Category A projects, Category B analyses typically are narrower in scope. Projects that fall into Category C do not require an EA.  

The EA must include an examination of both the negative and positive potential environmental impacts. The company is also

16. Id. ¶ 9.  
18. Equator Principles, supra note 12, Exhibit I.  
19. Missbach, supra note 17.  
20. Equator Principles, supra note 12, Exhibit I.  
21. Id.  
22. Id.  
23. Id.  
24. Id.  
25. Id. ¶ 2.  
26. Id., Exhibit I.  
27. Id.  
28. Id.
required to compare the potential impacts with feasible alternatives, including a scenario where the project is not implemented at all.29

Finally, the EA includes recommendations for potential minimization, prevention, mitigation, or compensation measures.30

The EA must also address the project’s compliance with the laws of the host country.31 The EA will indicate the minimum applicable standards under the Pollution Prevention and Abatement Guidelines of the World Bank and the IFC.32 If the host country is a low or middle income country,33 the EA must take into account the applicable IFC Safeguard Policies.34 Finally, the EA should be consistent with the categorization procedures, as well as address the key environmental and social issues identified in the categorization process.35

Based on the conclusions of the EA, the borrower or a third-party expert for all Category A projects and certain Category B projects must develop an Environmental Management Plan (EMP).36 The EMP addresses any “mitigation, action plans, monitoring, management of risk and schedules” for the project.37 The borrower then covenants to: (1) obey the EMP throughout the project’s construction and operation, (2) regularly report the borrower’s compliance with the EMP, and (3) decommission the facility in accordance with an agreed upon Decommissioning Plan as needed.38

The Equator Principles also require a borrower or third-party expert for all Category A projects and certain Category B projects to consult with potentially impacted groups.39 Accordingly, the EA must be translated into the language of the host country for public comment.40 Typically the potentially impacted groups are comprised of the indigenous population and local non-governmental organizations (NGOs).41 Both the EA and the EMP must address the comments made by these parties.42

29. Id.
30. Id.
31. Id., 3.
32. Id.
33. Id. Low and middle income countries are defined by the standards used by the World Bank and are listed on the World Bank Indicator Database: www.worldbank.org/datab/countryclass/classgroups.htm. Id.
34. Id.
35. Id., 2.
36. Id., 4.
37. Id.
38. Id., 6.
39. Id., 5.
40. Id.
41. See id.
42. Id.
The EPFIs are responsible for determining whether the borrower is in compliance with the Equator Principles.43 If necessary, the banks are able to appoint an independent expert to provide additional review and reporting services.44 If a borrower is found to be in violation of the Equator Principles, the lender can seek a proposed solution from the borrower to bring the project into compliance.45 However, adoption of the Equator Principles is voluntary, and the internal policies banks establish are independent of the IFC and the World Bank.46 Therefore, adoption of the Equator Principles does "not create any rights in, or liability to, any person, public or private."47

III. SETTING THE STAGE FOR PRIVATE ACTION

A. Introduction

Traditionally, private entities are viewed as reactionary to governmental regulations.48 However, this reactionary stance is evolving, and private institutions are beginning to take an increasingly proactive role by self-regulating.49 The Equator Principles represent this proactive stance in the area of environmental regulation and are a major change in the private sector’s traditional role.50

EPFIs adopt the Principles by pledging to provide direct funding only to those projects that comply with their requirements.51 The decision to adhere to the Equator Principles is voluntary, and EPFIs do not sign a formal agreement.52 Generally, an EPFI adheres to the Principles by including additional environmental requirements in its

43. Id., pmbl.
44. Id. ¶ 7.
45. Id. ¶ 8.
46. Id. ¶ 9.
47. Id.
49. Id.
50. See id. ("The private governance scholarship has focused on two principle areas: (1) the privatization of public services . . . ; and (2) the extent to which government agencies contract with private actors to establish or enforce regulatory standards.").
51. Equator Principles, supra note 12, pmbl.
loan provisions, as well as by establishing internal screening and monitoring procedures.\(^{53}\)

These provisions, which generally exceed the environmental regulatory requirements of developing countries, fall into a category of agreements known as private second-order regulatory agreements.\(^{54}\) This term demonstrates that these agreements are between private parties, rather than governmental organizations.\(^{55}\) These agreements are second-order because “they are entered into in response to the existence or absence of first-order government regulatory requirements.”\(^{56}\) With this background in mind, it is important to examine the potential causes that spurred these private, profit-driven institutions to incorporate the Equator Principles into their loan provisions.

**B. Potential Causes**

Currently, there is no worldwide first-order environmental regulatory scheme. Generally, international first-order agreements occur through treaties, which are only binding on the signatories, if at all.\(^{57}\) Developed countries prevent large-scale environmental degradation in their own countries by passing legislation and monitoring industry activities to ensure compliance.\(^{58}\) These methods allow governments of the developed world to set the bar for their own environmental standards.\(^{59}\) In sharp contrast, the governments of the developing world frequently do not have environmental regulations in place or fail to enforce their established regulatory scheme.\(^{60}\) The lack of environmental regulations in the developing world, and a failure to establish a worldwide agreement, has allowed corporations building large-scale developmental projects in the developing world to set their own bar for environmental standards. Since establishing and enforcing environmental standards increase the costs of the project and affect profits, little incentive exists for these corporations to impose strict environmental standards. As a

\(^{53}\) Id.

\(^{54}\) Vandenbergh, supra note 48, at 2031.

\(^{55}\) Id.

\(^{56}\) Id.


\(^{59}\) Id.

\(^{60}\) Lawrence & Thomas, supra note 1, at 21-22.
result, projects in the developing world frequently have resulted in large-scale environmental degradation.

Previously, developmental organizations such as the World Bank and the International Monetary Fund (IMF) were able to regulate industry activities in the developing world.\textsuperscript{61} The mission of these organizations is to reduce poverty and improve standards of living in developing nations.\textsuperscript{62} To compensate for a country’s absence of environmental standards, developmental organizations would incorporate environmental and social guidelines into the loan agreements of the projects they financed.\textsuperscript{63} Over time, the growing dependency on the World Bank and the IMF to fund these projects caused their guidelines to become the prevailing environmental and social standards for international project finance in the developing world.\textsuperscript{64}

Recently, funding for large-scale developmental projects has shifted from international developmental organizations to private financial institutions.\textsuperscript{65} These private institutions are not subject to the World Bank’s environmental guidelines for the projects they independently finance.\textsuperscript{66} Initially, private banks incorporated little to no environmental standards into their loan agreements.\textsuperscript{67} This disparity in the environmental standards of the World Bank’s loan agreements and those of private financial institutions allowed projects that failed to meet the requisite environmental standards of the World Bank to seek and gain financing through the private sector.\textsuperscript{68} As a result, despite the World Bank’s influence, the environmental standards for projects in countries with poor environmental regulations are once again largely dependent upon private, profit-driven organizations.\textsuperscript{69}

This dependency on private financial institutions has resulted in the construction of projects with devastating environmental impacts.\textsuperscript{70} A notable example is the funding of the Three Gorges

\textsuperscript{62} Id.
\textsuperscript{63} Lawrence & Thomas, supra note 1, at 22.
\textsuperscript{64} Id.
\textsuperscript{65} See Rachel Kyte, Principles in Question, THE BANKER, Mar. 7, 2005, at 60 (discussing how private banks provided lending for various projects when various international organizations refused to do so).
\textsuperscript{66} Lawrence & Thomas, supra note 1, at 22.
\textsuperscript{67} See id. (explaining that private banks have little incentive to incorporate environmental standards).
\textsuperscript{68} Kyte, supra note 65, at 60.
\textsuperscript{69} Lawrence & Thomas, supra note 1, at 22.
\textsuperscript{70} Id.
Dam in China. The critics of the project speculated that the construction of the dam would result in the accumulation of large cesspools of sewage and chemical waste, threaten rare plant and animal life, and deplete the stock of aquatic life. In 1999, after the World Bank declined to invest in the project based on “environment and social grounds,” several private financial institutions emerged to provide funding for the dam. Private institutions’ financing of the project despite the World Bank’s refusal resulted in a “public uproar.”

The decision to fund the Three Gorges Dam despite the negative environmental and social consequences thrust private financial institutions into the public spotlight. NGOs increased their scrutiny of these lending institutions. This shifted the focus of NGOs’ scrutiny from the companies directly involved in the construction of the projects to the private institutions providing the financial backing. Public scrutiny of bank activity can be extremely detrimental to a bank’s reputation, leading to a devaluation of a bank’s brand and potentially a decrease in the stock price. To avoid the negative publicity, private banks began to incorporate into their financial agreements environmental standards that go above and beyond the standards of the country where the project is being constructed.

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73. Snyder & Muir, supra note 71, at 36. See also Kyte, supra note 65, at 60 (“[W]hen the US Export Import Bank and the World Bank both refused to finance China’s controversial Three Gorges Dam, private banks, unhampered by public scrutiny, stepped in and filled the gap.”).
74. Snyder & Muir, supra note 71, at 36.
75. Id.
76. Kyte, supra note 65, at 60.
78. See generally David Monsma & John Buckley, Non-Financial Corporate Performance: The Material Edges of Social and Environmental Disclosure, 11 U. BAL. J. ENVTL. L. 151, 179-180 (2004) (stating that opinions about a corporation have a great impact on the value of the corporation’s brand, which can lead to a decrease in brand equity, a reduction in the price of the stock, and lower shareholder returns).
79. Kyte, supra note 65, at 60.
IV. CRITICISMS OF THE EQUATOR PRINCIPLES

The same NGOs that initially pressured private financial institutions to adopt the Equator Principles also have been some of the banks harshest critics.\textsuperscript{80} Specifically, the Equator Principles have been attacked for their limited scope, their potential risk of segmentation, their lack of transparency and accountability,\textsuperscript{81} and their failure to proscribe procedural requirements.\textsuperscript{82} Although the EPII attempt to correct these problems, the revised Principles are not retroactive and have not been adopted by all the EPFIs. Because the original Equator Principles still govern many ongoing financial projects, it is important to examine these critiques to determine whether loopholes undercut the Equator Principles' ability to ensure environmental responsibility. Moreover, an examination of the current critiques will help future analysts determine whether the EPII correctly resolve these problems.

The Equator Principles set forth a number of limitations that narrow the scope of their application. For example, the Equator Principles only affect direct financing.\textsuperscript{83} Project financing, although not defined within the Equator Principles, is generally recognized as a transaction where "a loan is made by one or more banks to finance a project, but without recourse to persons or entities other than the project assets."\textsuperscript{84} However, banks frequently provide financing in other important ways. For example, a bank frequently will act as a "financial advisor, underwriter, arranger or lead manager" on a project.\textsuperscript{85} Accordingly, EPFIs can support a project that dramatically alters the environment and is outside the parameters of the Equator Principles if the funding is not derived from direct financing.\textsuperscript{86}

Moreover, the scope of the Equator Principles is further limited to projects with a cost of at least $50 million.\textsuperscript{87} This monetary threshold exempts approximately 3% of project lending.\textsuperscript{88} Since the threshold is cost-based, it is independent of the project's

\textsuperscript{80} Missbach, supra note 17.
\textsuperscript{82} Lawrence & Thomas, supra note 1, at 22.
\textsuperscript{83} Equator Principles, supra note 12, pmb, (stating that EPFIs will only provide direct loans to projects that adhere to the Principles).
\textsuperscript{84} Lawrence & Thomas, supra note 1, at 21.
\textsuperscript{85} Missbach, supra note 17.
\textsuperscript{86} Id. Forestry projects are among the most commonly cited examples of banks indirectly funding environmentally damaging projects. Id.
\textsuperscript{87} Equator Principles, supra note 12, ¶ 9.
\textsuperscript{88} See Banking on Responsibility, supra note 81, at 11.
environmental impact. Consequently, a project with low overall costs but substantial environmental risks will fall outside of the purview of the Equator Principles. Thus, the narrow scope of the Equator Principles permits EPFIs to have a substantial role in funding projects that negatively impact the environment without violating the Principles.

The Equator Principles also allow industry to avoid conducting a thorough environmental impact statement through segmentation. Segmentation, or piecemealing, occurs when a party separates a number of related actions into individual actions. Generally, a private company will segment a project into phases or into individual but simultaneously implemented actions. By piecemealing the project in this fashion, a party can misrepresent the overall environmental impact of the project. For example, a party that prepares individual EAs masks the project's overall environmental impact and avoids considering the cumulative environmental impacts of the related actions. This misrepresentation could allow a Category A project to be categorized improperly as a Category B or C project. Moreover, piecemealing permits the party to include the reasonable alternatives for only the individual segments. Thus, a party avoids considering the alternatives for the cumulative project, thereby making the EA less comprehensive. Finally, if a project is segmented through phases, the investment in the initial phases, which may have minimal environmental impact, could compel the funding of subsequent phases, even if these later phases negatively impact the environment. Therefore, segmentation can lead to an EPFI inadvertently funding a project that has severe environmental impacts.

The problem of segmentation is of particular concern because it has proven difficult to resolve adequately, even for governments in the developed world. For example, segmentation has caused frequent litigation over the National Environmental Policy Act (NEPA) in the United States. Similar to the Equator Principles, the NEPA requires U.S. federal agencies to prepare an environmental impact

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89. Id. at 11.
91. Id.
92. Id.
93. Id.
95. See id. at 624 ("Increasingly common is the claim that the scope of an impact statement is inappropriate—that the federal action under consideration has been artificially truncated into segments which cannot be meaningfully evaluated in isolation from one another.").
statement (EIS) for all "proposals for legislation and other Federal actions significantly affecting the quality of the human environment." In practice, problems arise in the United States when federal agencies have to "determine[] whether to prepare one impact statement to evaluate a broad multi-year program, a series of statements to evaluate individual components . . . or the broader program statement as the component statement." Although the United States is able to address improper segmentation through the promulgation of agency rules and judicial oversight, the Equator Principles do not provide EPFIs with similar means to resolve the issue. Therefore, EPFIs must create adequate implementation policies in order to ensure that the project is fully and properly presented to a bank.

The Equator Principles also have been publicly criticized for their lack of transparency and accountability to third parties. Since the Equator Principles are voluntary guidelines that govern private project financing, there is an inherent lack of publicly disclosed information. Additionally, based on the confidentiality of these financial agreements, banks typically do not disclose information regarding specific projects that have been turned down for their failure to meet the Equator Principles' standards. Moreover, the Equator Principles specifically disavow liability to any "person, public or private." Accordingly, it is the bank's responsibility to perform a due diligence inquiry into whether a borrower adheres to the Equator Principles and to enforce compliance. This lack of transparency and accountability make it difficult for the public to determine the effectiveness of the Equator Principles, including whether they are being correctly implemented, and to hold banks accountable for violations of the Principles.

The Equator Principles also have been criticized for their failure to provide banks with specific procedures on how to perform due diligence investigations of a project's environmental and social risks. Currently, the Equator Principles only mandate that the

97. See Wiggins, supra note 94, at 625.
98. Id. at 626-28.
100. Equator Principles, supra note 12.
101. Missbach, supra note 17.
103. CHAN-FISHEL, supra note 6, at 8-10.
borrower meet its requirements to the EPFI's satisfaction.\textsuperscript{104} Without a clearly specified and articulated standard or test, there is no definitive way to determine whether an EPFI's decision to fund a project complies with the Principles.\textsuperscript{105} Accordingly, NGOs and EPFIs frequently disagree on whether the requirements of the Equator Principles have been met prior to funding.\textsuperscript{106} This has created intense public criticism of EPFIs that agree to fund projects over the objections of NGOs.\textsuperscript{107}

Furthermore, the Equator Principles' failure to articulate a clear standard, coupled with the aforementioned accountability problem, could result in a free rider problem.\textsuperscript{108} The Equator Principles currently provide no recourse against a bank that adopts the Principles in name only and fails to impose any environmental standards. If this practice becomes a trend in the banking community, it would weaken the importance of the pledge by other financial institutions to adopt the Equator Principles. One of the major reasons that banks adopt the Equator Principles is to enhance their public image.\textsuperscript{109} Therefore, the free rider problem poses a substantial threat to the survival of the Principles. Critics accordingly argue that a specific standard of review should be established to deter the free rider problem and to allow a uniform way of determining whether a project has met the requirements of the Equator Principles.\textsuperscript{110}

As previously stated, the EPFIs launched revised Equator Principles, EPII, to resolve many of these criticisms. Specifically, these revisions address the need for a broader scope, increased external reporting, more accountability, and greater transparency. However, because EPII are such a recent development, it is still unclear whether these revisions properly address the current problems with the Equator Principles.

\textsuperscript{104} Lawrence & Thomas, supra note 1, at 22.

\textsuperscript{105} Id.

\textsuperscript{106} See BankTrack, Principal Objections: Analysis of the Sakhalin II Oil and Gas Project's Compliance with the Equator Principles (2005) [hereinafter BankTrack] (arguing the Sakhalin project did not comply with the Equator Principles).


\textsuperscript{108} See Chan-Fishel, supra note 6, at 20.


\textsuperscript{110} See Chan-Fishel, supra note 6, at 21.
V. INCENTIVES FOR ADHERING TO THE EQUATOR PRINCIPLES

The success of the Equator Principles is largely dependent upon the commitment of the EPFIIs to adhere to their requirements. By incorporating environmental provisions in loan agreements, the EPFIIs increase a project's transaction cost. This increase directly impacts the profits of the company constructing the project and thereby affects its ability to repay the loan. At first blush, it appears that adopting the Equator Principles would be detrimental to a private institution's goal of increasing shareholder profit. Since the Equator Principles appear to be detrimental to a bank's interest, it is important to identify the incentives that encourage banks to adopt the Equator Principles. Identifying these motivators will help ascertain how stringently the banks will implement the Principles, as well as determine whether banks will be able to adhere to the Principles and still survive amongst their competitors.

EPFIIs have indicated that increased risk management is among the most significant reasons for adopting the Equator Principles.\textsuperscript{111} Banks have a large incentive to manage the risks of their investments carefully to ensure repayment of the loan. A project that creates environmental degradation exposes the borrower to liability. Depending on the country, the borrower could incur substantial fines for violating local environmental laws and court fees for defending against these lawsuits.\textsuperscript{112} In addition to these traditional costs, the borrower's environmental degradation could result in damage to the reputation of its brand.\textsuperscript{113} Moreover, these costs in turn could affect the borrower's ability to repay the loan. The realization by the private financial sector that environmental degradation can have a significant negative impact on profits is becoming recognized globally in the financial sector.\textsuperscript{114} By adopting the Equator Principles, the banks pledge to establish internal policies for project approval and


\textsuperscript{112} Vandenberghe, supra note 48, at 2052; see Michael M. Phillips & Mitchell Pacelle, Banks Accept "Equator Principles," WALL ST. J., June 4, 2003, at A2 (stating that leaders in multinational private financial institutions recognize the risk of having the local government or people "interfere with . . . or even take [a project] away" if it significantly harms the environment).

\textsuperscript{113} Snyder & Muir, supra note 71, at 36.

\textsuperscript{114} See Karen Krebsbach, The Green Revolution: Are Banks Sacrificing Profits for Activists' Principles?, US BANKER, Dec. 2005, available at http://www.usbanker.com/article.html?id=20051201QN4K913T. A 2005 PricewaterhouseCooper survey of CEOs from 43 countries showed that 87% held the belief that "environmental sustainability is important to a company's profits," which is an 8% increase from 2004 and an 18% increase from 2003. \textit{Id.}
continued monitoring. Through these means, EPFIs improve their ability to ensure that a project is a more secure investment and consequently a safer loan. The EPFIs therefore can gain a competitive advantage through strict adherence to the Principles. For example, as a result of adopting the Equator Principles in June 2003, Citigroup claims that it has benefited through an enhancement of risk management policies. According to its website, Citigroup financed three unnamed Category A oil and gas projects in 2004. In accordance with the Equator Principles, the borrower created an EA. These assessments were commented on by the local community and underwent an independent expert review. In addition, the borrower prepared an EMP that was included in the loan documentation. Citigroup contends that these processes increased the company’s knowledge regarding the foreseeable environmental risk of these projects. Moreover, the inclusion of the EMP in the loan agreement allowed Citibank to continue to monitor compliance. Therefore, compliance with the Equator Principles has the potential to bring about an enhanced position in the marketplace by protecting the future of an EPFI’s investments.

The second advantage of the Equator Principles is that they increase the uniformity of the environmental requirements needed to acquire funding from private financial institutions. Prior to the Equator Principles, private lending institutions frequently would include some level of environmental standards in their loan agreements. However, these standards often varied significantly from bank to bank. Borrowers unconcerned with the environmental impact of their project could reduce their transaction costs by shopping the project around until they found a lender with the lowest environmental protocols. The Equator Principles help prevent this activity by creating greater uniformity in the environmental

115. See Phillips & Pacelle, supra note 112.
116. See id.
117. See generally Monsma & Buckley, supra note 78, at 165-66 (arguing that companies that have improved environmental performance “can sometimes gain [a] competitive advantage, albeit at the margins, through cost avoidance and enhanced brand reputation”).
119. Id.
120. Id.
121. Id.
122. Id.
standards of the banks.\textsuperscript{124} For example, each EPFI requires an initial screening process to categorize the project as a Category A, B, or C project.\textsuperscript{125} Moreover, the uniformity and commonality of the Equator Principles also make it increasingly difficult for companies to pit one bank against the other to negotiate down environmental standards.\textsuperscript{126} Finally, the uniformity also provides EPFIs and borrowers with greater certainty regarding the environmental and social risk that must be addressed in order to receive funding.\textsuperscript{127} In turn, this commonality will reduce transaction costs and allow for a faster turnaround in determining whether the project is environmentally compliant.\textsuperscript{128} With approximately 80\% of all project lending in 2003 controlled by EPFIs, it is increasingly difficult for banks to claim that adopting the Equator Principles puts them at a competitive disadvantage.\textsuperscript{129} Therefore, the uniformity of the Equator Principles makes it easier for projects to proceed, benefiting both the lender and the borrower.

Finally, adherence to the Principles helps protect the reputation of the EPFIs. Through both protests and grassroots campaigning, NGOs have shifted the focus of their campaigns from the companies performing the work on the project to the companies funding them.\textsuperscript{130} In addition, a general shift in consumer consciousness has caused a heightened level of scrutiny to ensure a company is acting responsibly.\textsuperscript{131} As private lending institutions increase their funding for financial projects in the developing world, these institutions are becoming the targets of NGOs with greater frequency.\textsuperscript{132} To continue to invest in these projects while avoiding negative media coverage, it


\textsuperscript{125} Id.


\textsuperscript{128} See id.

\textsuperscript{129} Demetri Sevastopulos, Banks in Drive for Project Principles, FIN. TIMES (London), Apr. 9, 2003, at 30.

\textsuperscript{130} See Krebsbach, supra note 114. For example, in April 2005 protestors from Rainforest Action Network protested outside JPMorgan Chase's New York and Chicago offices in opposition of the company's funding of a mining project in Peru and logging in Indonesia, and in October 2005 the Global Finance Campaign protested Wells Fargo's current environmental practices, which they believed to be "outdated." Id.

\textsuperscript{131} See Monsma & Buckley, supra note 78, at 173 ("Publicly traded businesses are now under an unprecedented level of scrutiny from investors, government, and the media to prove their dedication to scrupulous corporate governance and to demonstrate a higher degree of corporate responsibility.").

\textsuperscript{132} See Phillips & Pacelle, supra note 112.
is essential that banks meet the public’s expectations, which often exceed the local laws of the country. The standards used by the IFC, which are integrated into the Equator Principles, are widely accepted as providing an effective means to ensure that the projects being funded are environmentally and socially sound. Thus, by accepting and enforcing the Equator Principles, the EPFIs can more easily respond to public criticism.

In addition to NGOs, socially responsible investment groups pressure private financial organizations to become more environmentally conscious. Socially responsible investing is “an investment process that considers the social and environmental consequences of investments, both positive and negative, within the context of rigorous financial analysis.” The managers of these funds routinely factor in the methods companies use to “disclose their social and environmental impacts, risks, and performance and whether they use reporting standards or adhere to codes of conduct.” The investment firm then offers mutual funds or investment products in companies that are determined to be socially responsible based on the screening process. In 2005, approximately $2.3 trillion was invested in investment products that utilized socially responsible investing. This value equates to approximately one out of every ten professionally managed dollars in the United States. Accordingly, by adopting and ensuring compliance with the Equator Principles, EPFIs can maintain an environmentally conscious image, which may prevent losing investments from these socially responsible investment groups. Moreover, a company that may have acquired a reputation as being environmentally irresponsible may be able to enhance its corporate image by adopting the Equator Principles. However, the impact of the Equator Principles on the brand image will be short-lived if the adopting bank fails to adhere to the Principle’s requirements. Therefore, an EPFI must establish and

134. Id. at 264.
135. Snyder & Muir, supra note 71, at 36.
136. See SOCIAL INVESTMENT FORUM, 2005 REPORT ON SOCIALY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES: 10-YEAR REVIEW 2 (2006) [hereinafter 2005 REPORT] ("[O]ne or more of the three core strategies that define socially responsible investing [are]: screening, shareholder advocacy, and community investing.").
137. Id. at 5.
138. Id.
139. See id. at 1.
140. See id.
141. Andrew Bails & David Wighton, Gray Whales Hold the Key to Fate of Voluntary Guidelines, FIN. TIMES (London), Nov. 28, 2005, at 2.
142. See Monsma & Buckley, supra note 78, at 165.
maintain credible and transparent policies that ensure compliance with the Principles.\textsuperscript{143} In this way, the Equator Principles can increase the revenue flow of the private financial institutions by acquiring and keeping investment from socially responsible investment groups.

VI. SAKHALIN II: A TEST CASE

Three years after the inception of the Equator Principles, their success is still uncertain. NGOs continue to critique the EPFIs' commitment to the Principles and their funding of large-scale projects. In particular, Credit Suisse First Bank, an EPFI, has received a great deal of criticism for its role as an advisor to the consortium of businesses involved in the funding of the Sakhalin II project.\textsuperscript{144} As a result of the project's size and Credit Suisse's prominent role, many NGOs consider Sakhalin II to be the "test case" in establishing the level of commitment of the EPFIs to adhering to the Equator Principles.\textsuperscript{145}

The Sakhalin II project is led by Royal Dutch Shell, which proclaims that the project "represents the largest single foreign direct investment project in Russia,"\textsuperscript{146} and the "most advanced of the offshore projects on the Sakhalin shelf."\textsuperscript{147} The Sakhalin Islands are located on Russia's eastern coast, and the goal of the project is to develop two fields located to the east of the island.\textsuperscript{148} It is estimated that the development of these fields will reap over one billion barrels of crude oil and 500 billion cubic meters of natural gas.\textsuperscript{149}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{143} Id.
\item \textsuperscript{144} Press Release, Rainforest Action Network, Global Coalition on Environmental and Human Rights to CSFB: "Oil is Over, Fund the Future," (June 30, 2005), http://ran.org/media_center/news_article?uid=1527 [hereinafter Global Coalition].
\item \textsuperscript{145} Id.
\item \textsuperscript{147} See Sakhalin Oil and Gas Conferences Moves From . . . ., http://www.sakhalinenergy.com/en/default.asp?p=channel&c=3&n=46 (last visited Dec. 22, 2006).
\item \textsuperscript{148} Aver Kvaerner, Sakhalin – Concrete Advance in Russia, http://www.akerkvaerner.com/Internet/MediaCentre/Featurestories/OilandGas/Sakhalin.htm (last visited Dec. 22, 2006).
\item \textsuperscript{149} The Shell Group, Sakhalin II, http://www.shell.com (follow "Exploration and Production" hyperlink under "Shell for Businesses" heading; then follow "Major ongoing projects" hyperlink; then follow "Sakhalin II" hyperlink) (last visited Dec. 22, 2006).
\end{itemize}
\end{footnotesize}
The project is staged in two phases. Phase 1 was completed in 1999 and is currently in seasonal production due to the ice build-up during the winter months.\textsuperscript{150} This phase consisted of the construction of an offshore production platform, where oil is transported by shuttle tankers to an onshore facility.\textsuperscript{151} Phase 2 of the project will consist of more offshore production platforms, onshore facilities, and pipelines that will link the platforms constructed during Phases 1 and 2 with the shore.\textsuperscript{152} The completion of Phase 2 will permit year-round oil production.\textsuperscript{153} The Sakhalin II project is estimated to cost over $11 billion and is claimed to be “the largest single integrated oil and gas project ever undertaken.”\textsuperscript{154}

The environmental impact of the Sakhalin II project is highly controversial. NGOs believe the Sakhalin II project will significantly threaten the endangered western gray whale population, damage the wild salmon population, and pollute the fisheries of the Aniva Bay.\textsuperscript{155} Furthermore, there is a concern that a tanker accident or ruptured pipeline will cause a large oil spill, which could permanently damage the ecological system.\textsuperscript{156} On the other hand, Shell maintains that it is “commit[ed] to delivering a world-class oil and gas project that will be safe, environmentally sound, and will maximize the benefits to all those involved.”\textsuperscript{157} These two contrasting views have resulted in global debate over whether Phase 2 of the Sakhalin II project should proceed.

Because EPFIs are involved in funding the project, the Sakhalin II project should adhere to the Equator Principles in order to receive funding. However, there has been intense criticism over the project’s failure to meet the guidelines of the Equator Principles.\textsuperscript{158} In accordance with the Equator Principles, Shell created an EA for the

\textsuperscript{153} Id.
\textsuperscript{154} BANKTRACK, supra note 106, at 6.
\textsuperscript{155} Id.
\textsuperscript{156} Id.
\textsuperscript{157} Ian Craig, CEO, Sakhalin Energy, Address at the 10th Sakhalin Oil and Energy Gas Conference (Sept. 27, 2006), http://www.sakhalinenergy.com/en/default.asp?p=channel&c=1&n=130.
\textsuperscript{158} BANKTRACK, supra note 106, at 4-5.
Sakhalin II project. However, NGOs have criticized Shell’s assessment. The NGOs claim, among other things, that the EA fails to include key environmental impacts, specific information regarding endangered species, mitigation measures, and an evaluation of the conflicts with local environmental laws. Moreover, the EA lacks clarity regarding the environmental protection status of the region. Additionally, some of the data conflicts with reports issued by experts in the field. Furthermore, Shell has yet to perform a comment period seeking the participation of the local population or publish an EMP. If these failings are accurate and left uncorrected, they will cause the project to violate the Equator Principles. Accordingly, NGOs have intensely criticized the EPFIs and are calling for a withdrawal of all support of the project.

Whether the Sakhalin II project should or does proceed, the Equator Principles have had a significant effect on the public’s response to the environmental concerns of building large-scale projects. First, the controversy over the project’s environmental impact and assessment has caused several EPFIs to refrain from financing the project. Additionally, the EA provides NGOs with an opportunity to comment publicly regarding the specific inadequacies of the assessment, referencing key provisions of the Equator Principles. This public criticism has led some socially responsible investing groups to sell their shares of Shell. Therefore, the Equator Principles have created a shift in the marketplace, giving the public more leverage for influencing private actors to make environmentally and socially conscious decisions.

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160. BANKTRACK, supra note 106, at 144.
161. Id.
162. Id.
163. See Global Coalition, supra note 144.
164. Id. (“Eight international civil society groups placed a full page ad in the Financial Times today urging Credit Suisse First Boston (CSFB) to uphold its sustainability commitments and sever its relationship as financial advisor to the controversial Sakhalin II project.”).
165. See id.
166. See BANKTRACK, supra note 106, at 11-15.
167. See Global Coalition, supra note 144.
VII. THE FUTURE OF THE EQUATOR PRINCIPLES

A. Liability

One issue that has not been tested in court is whether an EPFI can be sued in either U.S. or foreign courts for violation of the Equator Principles. If a suit could be brought against an EPFI for violating the Equator Principles, it could have significant ramifications. First, the potential liability would provide NGOs with a heavy hammer for alleged violations of the Equator Principles. Consequently, this threat would increase the incentives for the EPFIs to strictly screen and monitor projects to avoid violations of the Principles. Also, liability based on the Equator Principles would create a large disincentive for future banks to adopt the Principles. Finally, the liability likely would cause banks that have already adopted the Equator Principles to abandon the Principles in order to avoid future lawsuits. Although determining whether a suit brought against an EPFI for violating the Equator Principles would survive in court is beyond the scope of this Note, the following analysis discusses potential claims that are likely to be brought against the EPFIs.

The Alien Tort Statute (ATS) is one possible avenue to bring a claim against the EPFIs in a U.S. District Court. The ATS provides federal subject matter jurisdiction for “any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States.” In 2004, the Supreme Court in Sosa v. Alvarez-Machain narrowly interpreted sources of customary international law to include only that which is universally recognized, specific, and followed out of a sense of legal obligation. Prior to Sosa, the ATS had been used to gain federal subject matter jurisdiction over corporations for aiding and abetting violations of international laws. However, lower courts are not unified as to whether the Supreme Court’s holding in Sosa left room for aiding and abetting

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169. Id.
170. Id.
172. Id.
174. See Pell & Horsch, supra note 168.
175. See Bodner v. Banque Paribas, 114 F. Supp. 2d 117, 134 (E.D.N.Y. 2000) (finding that plaintiffs stated a cognizable claim under international law against defendant banks for aiding and abetting in violations of international law); see also Pell & Horsch, supra note 168.
liability under the ATS. For example, in In re South African Apartheid Litigation, the plaintiff sued several multinational corporations alleging they were violating international law for, among other things, providing resources to the South African government during the apartheid regime. The District Court for the Southern District of New York stated that the ATS "does not provide for aider and abettor liability . . ." However, in In Re Agent Orange Product Liability Litigation, the District Court for the Eastern District of New York held that "historical evidence . . . supported aiding and abetting under the terms of the ATS." Thus, it is uncertain whether post-Sosa courts will allow claims for aiding and abetting violations of international law to continue to be brought under the ATS.

Even assuming that the court permits aiding and abetting, the party still has to establish that there was a violation of international law. Generally, only causes of actions alleging severe human rights abuses, such as genocide or human rights abuses, survive a motion to dismiss for failure to state a claim for which relief can be granted. Although there is a clear interdependency of environmental degradation and human rights, violations of environmental laws have yet to rise to the level of a violation of international customary law under the Sosa standard. For example, in Flores v. Southern Peru Cooper Corp., claims were brought against the Southern Peru Cooper Corporation alleging that the pollution resulting from the company's mining operation was a violation of customary international law. The plaintiff specifically alleged that these activities infringed upon the plaintiff's right to life, health, and sustainable development. The court held that the plaintiff failed to provide sufficient evidence to prove that "local environmental

177. Id. at 545-46.
178. Id. at 550. But see Daniel Diskin, Note, The Historical and Modern Foundations for Aiding and Abetting Liability Under the Alien Tort Statute, 47 Ariz. L. Rev. 805, 828-29 (2005) (arguing that despite recent “roadblocks,” aiding and abetting would have been recognized in the eighteenth century and therefore the ATS provides for this cause of action).
179. In re Agent Orange Prod. Liab. Litig., 373 F. Supp. 2d 7 (E.D.N.Y. 2005); see also Diskin, supra note 178, at 828; Pell & Horsch, supra note 168.
180. Diskin, supra note 178, at 815-16.
181. See Kinley & Tadaki, supra note 10, at 983.
182. Id. ("The disagreement and debate over whether there is, or should be, a free-standing right to a healthy environment persists within the canon of human rights law."). See Pell & Horsch, supra note 160 ("In rejecting claims premised on international environmental law, Flores emphasized that legitimate sources of international law should be interpreted narrowly to include 'formal lawmaker and official actions of States,' such as treaties ratified by a majority of states and to which those states have consistently adhered.").
183. Flores v. S. Peru Cooper Corp., 414 F.3d 233, 236-37 (2d Cir. 2003).
184. Id. at 237.
pollution violates customary international law." In both Sosa and Flores, the court narrowly interpreted the sources of international customary law. If this trend continues, "the Equator Principles should not be considered established international law that might be actionable under the [ATS]." Accordingly, it is unlikely that the EPFIs will be exposed to liability for aiding and abetting under the ATS.

In addition to the ATS, the U.S. Securities and Exchange Commission (SEC) provides another means by which banks potentially can be held liable for violations of the Equator Principles. The SEC regulates the disclosures of publicly traded U.S. corporations to prevent false statements to investors. Specifically, a plaintiff can state a claim against a corporation under Section 10(b) and Rule 10b-5 by pleading the following:

1. the defendant made a materially false or misleading statement or omitted to state a material fact necessary to make a statement not misleading; (2) with scienter; (3) in connection with the purchase or sale of securities; (4) upon which the plaintiff relied; and (5) the plaintiff's reliance was the proximate cause of its injury.

In order to satisfy the rule's requirements, courts consistently require the statement to be about information that is "important to a reasonable investor in making his or her investment decisions" and made with the intent to deceive or manipulate. Moreover, the statement must be false and contain a material fact. Although materiality is a subjective standard and case specific, some courts have found this requirement to be fulfilled by misstatements of environmental objectives. Accordingly, it is conceivable that a bank that adopted the Equator Principles in order deceive socially responsible investors (and was successful in doing so) could be brought into court.

185. Id. at 265-66.
186. See Pell & Horsch, supra note 168.
187. Id.
188. See Monsma & Buckley, supra note 78, at 183.
189. Id.
192. See Monsma & Buckley, supra note 78, at 183.
193. Id. at 183-84.
194. Id. at 184.
195. Id. at 183-86. The Second Circuit Court of Appeals decision in United Paperworker Int'l Union v. Int'l Paper Co. theoretically indicates that the failure to make information regarding negative environmental performance available to shareholders would be a material omission if the company otherwise made statements indicating a commitment to enhanced environmental policies. See id.; see also United Paperworker Int'l Union v. Int'l Paper Co., 985 F.2d 1190 (2d Cir. 1993).
Even assuming these requirements have been met, the courts have not set a clear standard regarding the requirement of detrimental reliance or injury. Therefore, it is unclear whether a socially responsible investor could prove detrimental reliance or injury if a bank fails to meet its own environmental objectives.\textsuperscript{196} However, the shift in the marketplace is leading to growing numbers of socially responsible investors that rely equally or, in some cases, more heavily upon a company’s environmental policies than its profits when making investment decisions.\textsuperscript{197} Based on this trend, it is becoming increasingly likely that a socially responsible investor will meet the detrimental reliance and injury requirements of the SEC rules if a bank consciously fails to meet the objectives of the Equator Principles.\textsuperscript{198}

Other potential claims against EPFTIs that could be filed in the United States for violating the Equator Principles generally would fall into the realm of fraud or false advertising.\textsuperscript{199} Recently, the \textit{Kasky v. Nike} decision suggested that companies will be held accountable for failing to reach the objectives of voluntary environmental policies, such as those stated in the Equator Principles.\textsuperscript{200} In \textit{Kasky}, Nike publicly stated that its employees work in healthy and safe conditions and are paid a living wage in response to allegations of human rights violations and “for the purpose of maintaining and increasing its sales and profits.”\textsuperscript{201} The plaintiffs asserted that Nike’s statements were false statements of fact and therefore constituted false advertising.\textsuperscript{202} Nike, on the other hand, asserted that the First Amendment right to free speech protected the statements.\textsuperscript{203} Overturning the California Court of Appeals, the California Supreme Court held that Nike’s statements were commercial speech and therefore not fully protected by the First Amendment.\textsuperscript{204} Accordingly, the state laws prohibiting false and misleading statements applied to Nike’s statements regarding its employment practices.\textsuperscript{205}

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\textsuperscript{196} See Monsma & Buckley, supra note 78, at 184.  \\
\textsuperscript{197} See 2005 REPORT, supra note 136, at 2 (“Social investment managers often overlay a qualitative analysis of corporate policies, practices, and impacts onto the traditional quantitative analysis of profit potential.”).  \\
\textsuperscript{198} See Monsma & Buckley, supra note 78, at 189 (“Having committed itself in a particular company policy, code or practice, it is not unrealistic to say, as legal matter or otherwise, that the marketplace had come to rely on what the company had stated.”).  \\
\textsuperscript{199} Snyder & Muir, supra note 71, at 70.  \\
\textsuperscript{200} See Monsma & Buckley, supra note 78, at 192.  \\
\textsuperscript{201} Kasky v. Nike, Inc., 27 Cal. 4th 939, 947 (2002).  \\
\textsuperscript{202} Id. at 945.  \\
\textsuperscript{203} Id. at 946.  \\
\textsuperscript{204} Id. at 969-70.  \\
\textsuperscript{205} Id. at 946.
\end{flushright}
Nike petitioned the U.S. Supreme Court for review of the California court's decision. The Supreme Court denied the writ of certiorari as improvidently granted, sidestepping the constitutional question.\textsuperscript{206} After the Supreme Court's denial of the writ, the case was allowed to proceed in California state court to determine whether Nike's statement indeed violated California's false advertising laws.\textsuperscript{207} However, Nike settled the case out of court. Therefore, the question of whether Nike was liable for public statements concerning the treatment of foreign workers remains unanswered.\textsuperscript{208}

Although \textit{Kasky} leaves a lot of unanswered questions,\textsuperscript{209} it does indicate a trend toward holding companies responsible for statements regarding their environmental commitment.\textsuperscript{210} Therefore, if an EPFI fails to establish policies and procedures to ensure environmentally and socially responsible investing, such a failure may expose the bank to liability to socially responsible investors.\textsuperscript{211} However, to be entitled to monetary damages, the pleadings requirements for fraud or false advertising present a high bar for plaintiffs. Generally, plaintiffs must first establish actual damages as well as a causal link between the EPFI's misrepresentations and the investor's loss of money.\textsuperscript{212} Even if an EPFI funded a project that damaged the environment, it would be difficult for socially responsible investment groups to prove damages if that investment earned a profit. Thus, despite the recent decision in \textit{Kasky}, it remains to be seen whether a socially responsible investment group will be able to prevail in court and receive relief against an EPFI for violations of the Equator Principles.

\textsuperscript{206} See Nike, Inc. v. Kasky (per curiam) \textit{cert. denied}, 539 U.S. 654, 655 (2003); see also Monsma & Buckley, \textit{supra} note 78, at 195.

\textsuperscript{207} \textit{Id.}

\textsuperscript{208} See Monsma & Buckley, \textit{supra} note 78, at 195.

\textsuperscript{209} See \textit{id}. at 198 (arguing that by sidestepping the constitutional issue, the Supreme Court failed to clearly indicate whether companies are entitled to First Amendment constitutional protection for their environment and socially responsible public statements).

\textsuperscript{210} \textit{Id.} at 198-99 (stating that the California court's treatment of the case arguably raises the need for veracity in a company's commitment of corporate social responsibility to the level required for statements regarding financial commitments).

\textsuperscript{211} \textit{Id.} at 38, 70 ("Under such circumstances, it would not be hard to imagine an influential interest group like the Sierra Club putting together a class-action lawsuit on behalf of its membership.").

\textsuperscript{212} United Indus. Corp. v. Clorox Co., 140 F.3d 1175, 1180 (8th Cir. 1998).
i. Methodology Behind the Changes

The EPFIs revised the Equator Principles and launched the EPII in June 2006. These revisions were necessary to ensure consistency with the February 2006 IFC updates, whereby the IFC replaced its Safeguard Policies with new Performance Standards.213 Because the Equator Principles are based on these Safeguard Policies, a revision was needed to reflect the changes. However, the EPII revisions go beyond merely ensuring consistency with the Safeguard Policies and include changes to the scope and substantive requirements of the Equator Principles. Examination of these revisions and how they were made is important in analyzing the overall impact of the Equator Principles.

The revision process is significant because it demonstrates increased communication between the private sector and NGOs. During this process, the EPFIs maintained an ongoing communication with clients in various sectors and industries, NGOs, and environmental practitioners.214 Based on client feedback, the EPFIs incorporated suggested changes into a proposed EPII and released this version for public comment. The EPFIs then received comment from NGOs and other official agencies.215 Some of these comments were ultimately implemented in the final EPII. The EPFIs also addressed why other comments were not incorporated into the EPII.216 Accordingly, the EPFIs not only maintained an open dialogue with the public, but they also used the public’s comments to improve the final version of the EPII.

This revision process demonstrates a unique interplay between the EPFIs and NGOs. Instead of the traditional method of the NGOs using public criticism to motivate change in the private sector, the private and public sectors in this circumstance had a more open line of communication.217 In turn, this collaboration led to higher environmental and social standards. Although the ultimate goal is improved environmental conditions, the ongoing communication

214. Id. ¶ 17.
215. Id.
216. Id.
between the private sector and the public represents a marked improvement in the marketplace.

ii. Changes to the Equator Principles

The EPII implement several changes that attempt to address the public's critiques of the original Equator Principles. These changes broaden the scope of the Equator Principles, increase the number of responsibilities for the borrowers and EPFIs, and require more covenants between the borrower and the EPFI.

First, the EPII broaden the scope of the Equator Principles by decreasing the monetary threshold requirement. The Principles now are applicable to new projects with a total capital cost in excess of $10 million.218 In addition, although not retroactive, the EPII apply to any expansion or upgrade of an existing facility that creates a significant environmental or social impact.219 The EPII further increase the scope of the Principles by making them applicable when EPFIs undertake financial advisory activities.220 Thus, when an EPFI acts as a financial advisor, it must: (1) make the client aware of the Principles, (2) inform the client of the potential benefit of applying the Principles to the proposed project, and (3) request that client adhere to the Principles when seeking financing. By lowering the threshold cost and expanding their application to advisory activities, the EPII address many of the criticisms regarding the Equator Principles' limited scope.

In addition to the changes in the Principles' scope, the EPII also incorporate substantive changes. First, the borrower must conduct a Social and Environmental Assessment (SEA) for every Category A and B project.221 Moreover, the EPII require the borrower to ensure that the projects adhere to the then-applicable Performance Standards222 and industry-specific environmental, health, and safety guidelines (EHS Guidelines)223 used by the IFC.224 These new

218. See Equator Principles, supra note 12, at "Scope."
219. Id.
220. Id.
221. Id. at Statement of Principles, ¶ 2.
standards incorporate more regulations regarding labor standards than the previous Safeguard Policies. The revisions also require borrowers to prepare an Action Plan (AP). An AP describes "the actions needed to implement mitigation measures, corrective actions and monitoring measures necessary to manage the impacts and risks identified in the [SEA]." Thus, the EPII require borrowers to go beyond merely addressing environmental concerns and also consider the social risks of projects.

In addition, the EPII create a grievance mechanism for Category A and certain Category B projects. Pursuant to this provision, the borrower is obligated to include a grievance mechanism in its management system. This mechanism will allow the borrower to hear individual and group concerns regarding the project’s social and environmental performance. The borrower, in turn, addresses these grievances in a “culturally appropriate manner.” Through this process, the EPFIs should be able to create an ongoing dialogue between the borrower and local community to help reduce the social and environmental impact.

The EPII also address the accountability critiques in several ways. First, the EPII increase the number of covenants between the EPFIs and the borrowers. Specifically, the EPII require the borrower to covenant to comply with the host country’s social and environmental laws as well as the AP. The borrower must also covenant to decommission the facilities in accordance with a decommission plan.

In addition to these covenants, the EPII also include independent review requirements. For example, the borrower must employ an independent social or environmental expert to examine the SEA, AP, and other documentation to ensure compliance with the EPII and assist with the EPFIs due diligence requirements. The borrower is also required to retain an independent expert to verify monitoring information to ensure proper monitoring and reporting over the life of the loan. Thus, independent reviews make borrowers and EPFIs aware of, and accordingly more accountable for, violations of the Equator Principles.

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225. *Id.* at 3.
226. *Id.*
228. *Id.*
229. *Id.*, Principle 8.
230. *Id.*
231. *Id.*
232. *Id.*
Finally, the EPII address transparency concerns. Specifically, the borrower must provide annual reports that demonstrate its compliance with the AP. The EPFIs are also required to report publicly, at least annually, about their “Equator Principles implementation processes and experience, taking into account appropriate confidentiality considerations.” At a minimum, these reports must include: “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.” Although these reports are limited to information that will not violate the borrowers’ confidentiality, these disclosures should increase the EPFIs’ level of transparency regarding their implementation of the Equator Principles.

Currently, thirty-three of the forty original institutions to adopt the original Equator Principles have adopted the EPII. Because EPFIs have only recently adopted the EPII, little information exists regarding their effect on the marketplace. However, the EPII are an important evolution to private environmental action. Therefore, future study is warranted to examine whether all of the EPFIs adopt the EPII, whether the adopting institutions are adhering to the higher standards, and if so, whether the EPII are correcting the problems generated by the original Equator Principles.

C. The Impact of the Equator Principles

Three years after their initial inception, there are differing and contested perspectives on the overall impact of the Equator Principles. Many in the banking industry strongly praise the Equator Principles as representing a major shift in the banking industry, whereby the private sector has taken a leading role in ensuring environmentally and socially sound corporate action. Generally, NGOs agree that the Equator Principles are a step in the right direction. Examining the impact of the Equator Principles

235. Id.
236. Id., n.6.
237. E-mail from Leonie Schreve, Secretariat Equator Principles, ING Group, to Andrew Hardenbrook, student, Vanderbilt University Law School (Sept. 7, 2006, 02:04 CST) (on file with author).
thus far on the environment and industry will help shed light on whether the Principles are in fact reducing environmental degradation and influencing corporation decision-making.

The actual environmental impact of the Equator Principles is difficult to measure. The EPFIs assert that the Equator Principles continually shape their funding decisions for project finance.\textsuperscript{240} However, verifying these claims is problematic for several reasons. First, due to the lack of transparency inherent in the Equator Principles and the banking industry, it is difficult to examine whether or not banks are denying projects they determine to be environmentally harmful.\textsuperscript{241} This same flaw also makes it difficult to determine whether banks have required companies to amend project proposals in order to comply with the Equator Principles. Therefore, NGOs tend to focus on the projects that the EPFIs have funded, which are more visible and publicized than the projects the EPFIs have refused to finance.\textsuperscript{242} This consequently has led to intense public criticism when the Equator Principles have failed and relatively little media coverage when they have succeeded. Therefore, examining only the projects that have been approved by the EPFIs since their adoption of the Principles is not the best way to ascertain whether the Principles are a success.

Another way to determine whether the Equator Principles impact banking decisions is to examine the policies and procedures that these financial institutions have implemented to meet the requirements of the Equator Principles. First, a bank must create an overall environmental management system to ensure proper implementation of the Equator Principles.\textsuperscript{243} In 2005, of the thirty-nine EPFIs that had adopted the Equator Principles, four had not established internal environmental management systems.\textsuperscript{244} Although the remaining institutions have set forth some kind of internal environmental management systems, the quality and comprehensiveness of these systems vary greatly depending on the financial institution.\textsuperscript{245} Some banks have "clear environmental

\textsuperscript{240} See CHAN-FISHEL, supra note 6, at 13.

\textsuperscript{241} Id. ("It is not evident how the Principles have influenced financing decisions, shaped the overall portfolios of signatories, or how they have been interpreted and applied in any given project.").

\textsuperscript{242} Id. at 15 (referencing the EPFIs' funding of the Baku-Tbilisi-Ceyhan pipeline and the Sakhalin II oil project).

\textsuperscript{243} Id. at 11.

\textsuperscript{244} Id. at 11.

\textsuperscript{245} Id. (stating that KBC focuses on reducing its direct environmental footprint, BBVA is still creating its system, and Calyon uses an unstructured approach).
governance structures and longstanding environmental policies,” while others are “satisfied with an unstructured approach towards environmental risk management.” 246 Since one of the advantages of the Equator Principles is to provide a level playing field among the banks, this lack of uniformity among the EPFI’s environmental management systems jeopardizes the success of the Equator Principles.

Second, it is important for banks to install appropriate monitoring and auditing systems. 247 Similar to the environmental management system, the level of implementation of these systems varies among the institutions. 248 At one end of the spectrum, several banks have implemented high levels of monitoring, requiring their environmental management systems to be externally audited. 249 At the other end, some of the EPFIIs have committed very few resources to ensure compliance with their environmental plans, merely publicly reporting the funding on their finance transactions. 250 Since it is crucial for a bank to ensure that the written policies are being put into practice, the failure of some of the EPFIIs to implement adequate monitoring is a distressing signal which suggests that the adoption of the Equator Principles for these banks was nothing more than propaganda.

Third, since EPFIIs are unfamiliar with many of the environmental procedures, it is critical to train new and existing personnel to ensure compliance with the Equator Principles. 251 Generally, the EPFIIs—with the assistance of the IFC—have implemented fairly extensive training programs. 252 However, few banks are engaging outside consultants for consultation on specific projects or creating new positions for employees whose sole function would be to implement and ensure compliance with the Equator Principles. 253

Finally, it is necessary to examine whether there have been any changes in loan covenants between the EPFI and the borrower. 254 This is perhaps the most important indication of an EPFI’s commitment to the Equator Principles, because it gives banks legal redress if the corporation fails to fully comply with the Equator Principles. Although the EPII mandate an increase in the number of

246. Id.
247. Id.
248. See id. at 11-12.
249. Id. at 12.
250. Id.
251. Id.
252. Id. (“Many banks have developed training programs that appear to be quite extensive in terms of their reach.”).
253. Id.
254. Id.
covenant requirements between the bank and borrower, little information exists regarding the fulfillment of this obligation beyond what the bank makes publicly available. In Citibank's Citizenship Report, the company stated that Category A transactions include covenants requiring a full environmental management plan.\footnote{Id.; see also CORPORATE CITIZENSHIP REPORT 2004, supra note 118, at 33.} Moreover, HSBC amended its standard loan agreement to include a covenant requiring borrowers to complete a full environmental management plan.\footnote{Id.} Although these two companies’ actions demonstrate that the Equator Principles are having some impact on loan agreements, without more information it is difficult to determine whether the Equator Principles are changing the language of loan agreements on a broader scale.

In addition to the changes in individual banking practices, the Equator Principles are altering the banking industry in general. As more banks adopt the Equator Principles, there is increased “peer and consumer pressure” for other large financial institutions to adopt the Principles.\footnote{Smith & Plit, supra note 127.} For example, several banks often combine resources to fund large financial projects. In these situations, banks in the syndicate with lower standards could compromise the standards for assessing and monitoring the environmental and social risks.\footnote{Bo Glasgow, A Point of Principle, GLOBAL FINANCE MAG., July 2003, available at http://www.equator-Principles.com/gfm1.shtml.} Therefore, EPFIs have a large incentive to ensure that other banks in the syndicate who have not adopted the Equator Principles nevertheless adhere to the same required level of environmental scrutiny.\footnote{Id.} Moreover, smaller local banks in developing nations frequently are involved in the funding of projects in their local communities and are also subject to the same pressure by the EPFIs to adhere to the Principles.\footnote{Smith & Plit, supra note 127; see also Ravindran, supra note 52 (arguing that Indian financial institutions should adopt the Equator Principles to enhance their environmental initiative).} This influence has the added benefit of creating a conduit to transfer the knowledge of international financial institutions to local ones, helping them identify and monitor environmental concerns in the future.\footnote{Smith & Plit, supra note 127.} Thus, as the Equator Principles gain in popularity, it will become increasingly difficult not to adopt the Principles or other equivalent environmental guidelines.

There also have been several unforeseen advantages to the Equator Principles. First, as a result of the enhanced risk management policies stemming from the adoption of the Equator Principles, many banks are making a commitment above and beyond
the guidelines. For example, Wells Fargo is considering extending
the Principles to its corporate lending and private equity-investment
businesses. HSBC is now weighing the introduction of principles
similar to the Equator Principles to govern its corporate
underwriting, which traditionally would fall outside the scope of
the Equator Principles. And JP Morgan Chase has established “No Go
Zones” whereby it refuses to fund commercial logging projects that
pose a risk of environmental degradation. Second, the Equator
Principles are having an influential upstream impact. Instead of
tpanies being deterred from lending through an EPFI because of
their increased protocols, “companies are asking how to become
compliant [with the Principles] so their projects will be eligible.”
These positive signs give hope to the supporters of the Equator
Principles.

However, there are unforeseen negative impacts resulting from
the adoption of the Equator Principles as well. For example, the
Equator Principles have unified the EPFIs, thus creating a new
lobbying group. Since the Equator Principles are directly related to
the IFC and the World Bank, the EPFIs have a vested interest in the
activities of these institutions. For example, in 2004 the World
Bank commissioned an independent study to examine the World
Bank’s natural resources portfolio. The results of this study,
entitled the Extractive Industries Review, recommended that the
World Bank “withdraw from lending to coal immediately and to oil by
2008.” After these recommendations were released, the EPFIs
submitted a letter to the President of World Bank, urging the World
Bank to reject the recommendations of the Extractive Industries
Review. Some view this action as a positive step, i.e., gaining
increased participation from the private sector regarding
environmental concerns. In contrast, many NGOs view this letter

262. See Krebsbach, supra note 114.
263. Id.
264. Snyder & Muir, supra note 71, at 38.
265. Id.
267. Id.
269. See Twelve Banks, supra note 268 (The banks believe that the “[Extractive Industries Review] has not given sufficient consideration to the fact that the extractive industries are essential to global economic growth and poverty reduction, and that for some countries the extractive industries represent a very important means of creating revenue for governmental programs.”); see also Sevastopulo, supra note 266, at 1.
270. See Sevastopulo, supra note 266, at 1.
as private banks “lobbying against proposals that would make emerging market investments better benefit the poor.”271 Whether the new unified lobbying group will result in more economically efficient and environmentally sound policies remains to be seen.

VIII. CONCLUSION

This Note addressed the events leading up to the adoption of the Equator Principles, the impact of these Principles, and the future of the Principles. These Principles were created and adopted to establish an international environmental standard and increase public scrutiny of the financial sector. After three years, NGOs continue to criticize the Principles for their failings. However, the Principles have improved the marketplace, where the private sector takes an active role in implementing environmental standards ahead of government action. Moreover, although little information is known about the actual affect of the Principles on the local environment, the Principles have substantially impacted the banking industry. A growing emphasis is now placed on risk management and the creation of a uniform standard of environmental compliance, which avoids banks being pitted against each other in a race to the bottom. Furthermore, the adoption of the Equator Principles represents a bank’s commitment to implementing policies and incorporating private second-order agreements into its loan transactions that are designed to ensure that the projects it funds in the developing world are environmentally responsible.

Even though banks probably will escape legal liability for violations of the Principles, they will be held accountable in the court of public opinion. By creating a uniform standard for environmental agreements, the Equator Principles have developed a uniform public expectation. If EPPIs fail to meet this expectation, the failure will result in intense public criticism leading to real-world consequences, such as an injured brand reputation and decreased investment from socially responsible investment groups. Moreover, the EPII offer new hope by incorporating changes that respond to criticisms of the original Equator Principles. The revision process itself reflects a shift in the marketplace: increased communication between the private sector and NGOs. Even though the overall effect of the Equator Principles remains controversial, it is clear that their impact thus far has heightened the public’s ability to influence private action and has created a new role for the private sector to be proactive in setting

271. Id. (quoting Michelle Chan-Fishel, a representative from Friends of the Earth).
environmental standards, which has led to significant gains in the public's ability to protect the environment.

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