

Financing Useless Projects

The debts of Castor Project

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Infrastructure as a motor for growth?

Credit from the financial sector is essential for the functioning of the current form of the economy (based on the accumulation of capital), and without it, the economy soon begins to slow. This is essentially what has happened to the world economy since the crisis of 2007. Whereas before financial institutions were awash with cheap credit, now the well has dried up meaning that business' access to credit has diminished and with it a slowing of the economy. Especially affected are small and medium enterprises (SMEs) – which do not have access to other 'solutions' such as the emission of bonds or the refinancing of existing debts.

The irresponsible activities of major banks and the regulators at regional, state and international level that led to the crisis generated mistrust between the banks and as a result, a freezing of the financial markets. The banks ceased lending to each other and to the population as the elevated risk of money not being returned curtailed their incentives to lend. This paralysis of the financial markets led to states and regulators injecting money into the banks in the form of large bailouts funded by tax payers in both the USA and in EU countries. These bailouts led to banks being subjected to new controls on the amount of capital

required to be kept in banks' reserves at any one time. These new regulations agreed as part of the Basel III Accord are expected to have a significant impact on the lending abilities of banks, further reducing liquidity in the market and business' access to credit [1].

At the same time, infrastructure renewal is considered in Europe to be of fundamental importance to the success of any economy. At present, the EU is prioritising more investment in its infrastructure to achieve its stated aims as part of its 20-20-20 [2] package which is supposed to lead to a low-carbon economy by 2050 [3].

Thus, in a time of economic crisis in which budgetary cuts have frozen public investment in infrastructure, the EU sets out to update its infrastructure and remedy the lack of new public investment through new financial mechanisms that cut distances between private investors, financial institutions and the EU. In practice, to obtain private finance whilst offering public guarantees. However, projects that have been the subject of this mechanism, such as the underground gas storage facility Castor off the Spanish Mediterranean coast near Vinarós (Castelló) and Alcanar (Tarragona), make us question a variety of issues: Is this infrastructure that the population needs? Is the EU really pursuing a reduction in emissions and the decarbonisation of the economy? Why is large infrastructure perceived as a motor for growth?

The Project Bond Initiative

The Project Bond Initiative was developed to address the lack of available finance [4]. Heralded in his 2010 State of the Union speech, EC President J.M. Barroso proposed the Project Bond Initiative as a way to “*explore new sources of financing for major European infrastructure projects*” and proposing the establishment of EU project bonds together with the European Investment Bank (EIB) [5]. At its centre the initiative “*aims to provide partial credit enhancement to attract capital market investors*” [6] that otherwise would not be so inclined to invest. This mechanism allows the division of the debt generated by the investment into a subordinated

debt tranche and a senior debt tranche. This senior debt tranche increases the attractiveness of the project by increasing its rating on the bonds market [7], given that when the EIB buys subordinated debt (less secure by virtue of being the subordinated compared to senior, which would have priority in being recouped in case of non-payment), it attracts institutional investors such as insurance companies and pension funds to buy into the senior debt tranche which is more secure. Typically, infrastructure project promoters (normally public private partnerships - PPPs) would receive credit enhancements from the EIB with the support of the EC. The subordinated debt tranche can take the form of a contingent credit line (should it be required) through the life of the project, or through the form of a direct loan from the EIB at the outset of the project, known as the Project Bond Credit Enhancement (PBCE).

The EIB claims that PBCE is an “*innovative way to unlock private investment in infrastructure and a key element in helping to boost growth and jobs*” [8] and that this new financial mechanism is the key to future infrastructure renewal within the EU. In practice, The Project Bond Initiative entails the use of public funds (from European tax-payers) to assume part of the risk faced by investors from the capital markets, encouraging them to invest in large-scale infrastructure projects.

In the first pilot project (Castor Project) we can see how private finance is attracted, but also, when the project runs into difficulties how it is the European tax-payer (and the Spanish tax-payer at state level) that finally assumes the risk [9]. Moreover, those who have put forward these infrastructure projects under this type of finance mechanism have come under fire at the first opportunity during the implementation of the first mega-project, Castor. In spite of the 500 earthquakes in the zone of Castor Project, the public support against the project [10] and the fact the Project Bond Initiative is in the pilot phase, the EIB will not consider re-examining this financial mechanism.

It is a scene much reminiscent of bank bailouts or energy oligopoly coverage: that the public sector is left to pay the bill when the market is unable to manage risk. In the face of continual budget cuts in all the EU, does it make sense for our taxes to

be put towards these failed mega-operations such as Project Castor and others financed using Project Bonds (of which benefit large companies through contracts with abusive clauses) and whose social benefit remains arguable?

The debts of Castor Project

The initial idea behind Project Castor can trace its roots back to 1996 [11] and the company in charge of the project at the moment is ESCAL UGS. Its shares are in the hands of Florentino Pérez's company, ACS (66.7% – of which 33.3% were expected to be sold to Enagás when the project was initiated) and Castor Limited Partnership (33.3% – with the majority of its shares in the hands of the Canadian company Dundee Energy). Castor Project rose to fame after the earthquakes which happened in the zone in September 2013. This makes us ask ourselves if the great quantities of public money spent, in this case at both Spanish and European level, are destined to finance a model of development that actually benefits the population.

- Unnecessary Project: the demand for gas has drastically decreased since 2008 (even when it grew it did so well below what was expected) [12]. The project does not spring forth from public need, but from the promoting company. In fact, even the National Energy Commission recognises that the gas storage infrastructures have been strengthened excessively due to the bad predictions and constitute a big part of the current gas deficit [13].
- Illegitimate and antidemocratic process: the “public consultation” to which ESCAL UGS was obliged to carry out, consisted in the mere presentation of the information of the Project, available as statements translated into Spanish during a short period of 30 days [14].
- Locked energy model: Castor Project continues the perpetuation of an energy model based on fossil fuels which contravenes the EU strategy outlined in '20-20-20', given that it will be tied to gas installations [15]. The amortisation of Castor, after the tripling of its investment, has changed from 10 to 20 years, the minimum time during which we will be continually obliged to consume gas [16].
- “Culture of the fast-buck:” The Project responds to the interests of big capital and

goes ahead even when the risks and social and environmental costs are evident and demonstrated conclusively. The earthquakes reported reached an intensity of 4.2 on the Richter scale, and the insecurity of the population will continue until the definite paralysis of the installations.

- **Elite debts:** on an economic level Castor Project is extremely costly. According to reports from the Spanish Ministry of Industry, Energy and Tourism, J.M. Soria 10th October 2013, ESCAL UGS had spent €1,273bn on investments for the project (of which was needed an emission of bands which the EIB participated in), €186m for the gas cushion and €234m for financial costs [17]. In short a sum of €1.693bn as the total cost of the project, which at the onset was estimated at €500m, less than a third of the total cost.

Hidden aspects of the project

With the paralysis of the installations (up to the time of writing this text) and with no current plans to resume work due to seismic risks confirmed by the National Institute of Geography (Instituto Geográfico Nacional, IGN) [18] the compensation that the state may have to pay to ESCAL UGS has been speculated upon. This compensation, according to article 14 of the concession [19], would reach the residual value of the project (the value of the assets at the end of their working lives) if fraud or negligence by ESCAL UGS is proved, or by the net countable value (the total value of the recognised investment), if it were by cause of expiry.

If it could be demonstrated that there has been negligence on part of the company (for example, if it can be shown the assessment of the seismic risk was inexistent or insufficient) the government should pay the residual value to ESCAL UGS, which is normally inferior to the net value, but it seems in this case that Castor could recuperate the residual value and the net value, given that the warehouse did not begin working (and therefore its installations would not have lost value with the passing of time). Both quantities coincide.

It has also been argued that if the state dismantled the installations, the residual value would be zero,

and therefore, it would “only” have to pay for the dismantling [20]. But the future of the project is currently uncertain. The auditing firm which was placed in charge by the Spanish government, a Norwegian firm called DNV, whose figures have been leaked to the media [21], estimate that €1.461bn of the €1.693 that ESCAL UGS declares (it has still not been made public but coincides with the cost declared minus the financial costs). It seems that, for better or for worse, the government does not want to come out in a bad light from the series of events and is looking for a way to justify the negligence of the operator of the installations, ESCAL UGS. However, we have seen previously that this in no way means that the tax payer will avoid footing the bill. In any case, the responsibility of the state in having validated the technical studies made by ESCAL UGS through the Spanish Institute of Geology and Mining (Instituto Geológico y Minero de España, IGME) from 27th January 2007 should be also be clarified, (at present this document remains confidential).

At the end of 2013 it was also announced that the Ministry of Industry had hired three international experts to analyse the project to see if it were free of seismic risks [22]. Despite the IGN report already being public which clearly shows a cause-effect relation between the injection of gas and the earthquakes, the Government declared that it would not take a decision until all other studies are available. The Platform for the Defense of the Terres del Sénia, who opposed the project and who have been undertaking actions against it since 2007, have argued that due to the complexity of these types of studies, it could be seen as part of a strategy to delay the taking of the final decision meaning passing the responsibility onto the next government.

It is also necessary to point out that at state level the project has been through a number of authorisations since 1996 – some being conceded by the POSE government and others by the PP government.

But, who was in charge of the studies relating to the potential environmental risks? In the case of Castor Project, the environmental impact study which was undertaken by the Spanish Government

and the EIB trusted so much in the project that no such seismic risk study was undertaken. Of the risks studied, no impact was categorised as severe or critical [23]. URS, the company in charge of the study, had previously been behind other studies which have resulted in environmental and social conflicts [24]. It could be argued that these types of projects are often controversial [25]. Nevertheless, is it not sufficient for the doubts to result in not going ahead with such projects? Shouldn't projects of this kind have to openly and systematically demonstrate that they pose no risk to the population, and that the population should be involved in the process at all stages and be in agreement? In this project the concerns of the population were not taken into account relating to an underwater gas storage facility, and with it the ecological and financial risks which have the potential to be assumed by the surroundings. These impacts convert the project into a massively costly one (in terms of economy, social and environmental costs) from a collective point of view.

To make matter worse, there exist serious doubts whether the Spanish Government as well as the EIB knew of the potential risks of gas leaks and seismic activity that appeared in previous studies before the issue of bonds and the beginning of the injection cushion gas [26]. We are reminded that the EIB bought €300m of the total €1.434bn (bought for a period of 21.5 years amortization, at 5.7% interest) of the bonds as an anchor investor in July 2013, as well as portioning a credit line of the €200m to ensure that the sale went ahead. Therefore, if the BEI bought part of the bonds, did it do so unaware of the previous studies which outlined the potential risks?

In response to a complaint letter sent by 14 organisations within the Spanish state to the EIB and the European Commission, the EIB argued that *“the current situation facing Castor Project is not related to the way in which it was financed; therefore the circumstances do not affect the support given”* [27]. However, the form in which the project was financed does affect the current situation of the project given that, if not for the emission of the bonds, the project would not have gone ahead. The 7 year debt which ESCAL UGS contracted with 19 banks was actually refinanced by the issuance of

bonds (in which Caixa Bank, Bankia, Banco Santander and Banco Popular took part). Without this, it would have been a debt difficult to repay. The functioning of mechanism that permits the emission of bonds is the one which influences whether investors decide to purchase bonds or not (due to the fact that the EIB purchases bonds their rating on the market increased).

However, after the earthquakes, the value of the Castor bonds (issued with the consent and under the structure of the EIB's Project Bond Initiative), has fallen substantially [28]. The EIB refuses to respond to this fact, arguing that it cannot comment on the current value of the bonds.

An illegitimate debt?

There exist serious doubts regarding the quality of the assessment that the EIB used to approve Castor as one of the pilot projects of the Project Bond Initiative. It seems that projects using this type of finance will mean that nation states are wholly responsible for any technical studies, and that the EIB does not assume any type of extra assessment linked so social, environmental or financial concerns. The environmental impact studies which the promoter companies present are the fragile pillar which is deemed sufficient by the EIB and the nation states where the projects will finally be undertaken.

To determine if a debt is illegitimate, the behaviour of the creditor (the EIB) and other key actors should be taken into account, in particular the Spanish state. They have permitted and financed a pointless project for the population without having taken into account neither the possible failure nor the social and environmental consequences. The circumstances surrounding the project should be audited correctly and the relationship between the actors properly set out. This aspect has already attracted accusations surrounding the concessions and authorisations at the level of the Spanish state that could be considered as special favours [29].

The situation of the debtor should also be taken into consideration (taking into account the clause of the concession which passes the buck from ESCAL UGS to the Spanish state) and the effects of paying this debt would have. Specifically, if we consider the €1.461bn which the auditors have

validated, it would represent one sixth of the health budget for the Catalan Government for 2014 (€8.2bn) [30]. If we compare it with the health budgets for the other autonomous communities of Spain, the debt generated from Castor is equivalent to one quarter of the total budget for Valencia in 2012 and the total for Extremadura in the same year [31]. The situation is even worse if we consider that the modification to Article 135 of the Constitution in 2011 prioritises the payment of the debt before that of any other expense (e.g. that of public services). Thus, the debt from Castor passes into the hands of the State and as a public debt, its repayment is a priority before any other expenditure – coming in a time when public spending is imperative.

In the same vein, the destination of the funds should also be taken into account, and as had already been mentioned, the project is increasingly being felt as unnecessary and one which opts for an impossible energetic model, in which the Spanish government together with the EIB have ignored the real needs of the population. In this case, private interests have been placed in front in an attempt to make the project viable, and even after the strong impulse it received and the use of public funds, the project has ultimately become harmful and more so has failed spectacularly in the eyes of the population and public opinion.

In our understanding the debt which will pass to the Spanish state owing to this project does not comply to the various needs of the population, and because of this, it constitutes as a new case of illegitimate debt and should not be paid. Therefore, reparations from all the actors which benefited from this project should be sought according to their responsibilities and profits.

Acknowledgements:

Our thanks to David Llistar, for his exhaustive comments and valuable advice, and to Plataforma Ciudadana en Defensa de les Terres del Sénia, for all the information shared.

¹ KPMG (2011) *Basel III: Issues and Complications*, <http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/basell-III-issues-implications.pdf>

² Concretely for 2020, the objective is to reduce emissions in 20%, to increase energy from renewable resources in 20%, and improve energy efficiency in 20%. See: <http://ec.europa.eu/clima/policies/package/> y http://europa.eu/legislation_summaries/energy/europe_an_energy_policy/en0024_es.htm

³ UE (2011) *Hoja de ruta hacia una economía hipocarbónica competitiva en 2050*, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0112:FIN:ES:PDF>

⁴ BEI (2012) *Project Bonds Guide*, http://www.eib.org/attachments/documents/project_bonds_guide_en.pdf

⁵ J.M. Barroso (2010) *Discourse “State of the Union”*, http://europa.eu/rapid/press-release_SPEECH-10-411_en.htm

⁶ BEI (2012) *The Europe 2020 Project Bond Initiative - Innovative infrastructure financing*, <http://eib.europa.eu/products/project-bonds/index.htm>

⁷ BEI (2012) *Project Bonds Guide*, http://www.eib.org/attachments/documents/project_bonds_guide_en.pdf

⁸ EUROPE PRESS RELEASES (2013) European Investment Bank welcomes first successful use of project bond credit enhancement and provides EUR 500m for Castor energy storage project in Spain, http://europa.eu/rapid/press-release_BEI-13-117_en.htm

⁹ Re:Common (2013) *Large infrastructure to overcome the crises?*, <http://www.counter-balance.org/counterbalance-eib.org/wp-content/uploads/2013/06/Infrastructure-briefingOK.pdf>

¹⁰ There have been motions of censure against Castor Project in the Catalan and Valencian Parliaments. See: <http://www.europapress.es/catalunya/noticia-parlament-pide-cierre-definitivo-castor-si-no-puede-garantizar-fin-seismos-20131121172238.html>

<http://www.publico.es/477056/les-corts-valencianes-del-pp-piden-a-soria-el-cierre-definitivo-de-castor>

¹¹ Industry Minister Josep Piqué gave in 1996 the first hydrocarbon exploration permit of Castor Project. For the prospection of the area an authorisation was mandatory: to investigate presence or absence of hydrocarbon and the characteristics of the deposit. There was only one petition, from of España Canadá Resources (company who passed on the torch to ESCAL UGS). See: Real Decreto 2056/1996

12 Comisión Nacional de Energía (2012) *Measures to ensure economic and financial sustainability of the Gas System*, pages 4-5.

http://www.cne.es/cne/doc/publicaciones/20120309_P I_DEFICIT_GAS.pdf

13 Comisión Nacional de Energía (2012) *Measures to ensure economic and financial sustainability of the Gas System*, pages 7-9 and 14

http://www.cne.es/cne/doc/publicaciones/20120309_P II_DEFICIT_GAS.pdf

14 Gobierno de España (2009) *BOE 17989/2009. EIA of Castor Project*, page 94818

<http://www.boe.es/boe/dias/2009/11/11/pdfs/BOE-A-2009-17989.pdf>

15 UE (2009) *European Energy Programme for Recovery*, http://europa.eu/legislation_summaries/energy/europe_an_energy_policy/en0012_en.htm

16 Castor had a guaranteed recovery of the investment made (with payments that the gas system assures) though the gas bills, with a profitability of 7.5% in 10 years. Nevertheless, the amortization period was changed from 10 to 20 years by recommendation of the National Energy Commission.

17 Gobierno de España. Congreso de los Diputados (10th October 2013) *Diario de Sesiones*, page 4.

http://www.congreso.es/public_oficiales/L10/CONG/DS/CO/DSCD-10-CO-435.PDF

18 Instituto Geográfico Nacional (17th December 2013) *Informe sobre la actividad sísmica en el Golfo de Valencia*,

http://www.ara.cat/societat/Informe-lactivitat-sismica-magatzem-Castor-ARAFIL20140512_0001.pdf

19 Gobierno de España (2008) *Real Decreto 855/2008*, Article 14.

<http://www.boe.es/boe/dias/2008/06/05/pdfs/A26051-26052.pdf>

20 Cinco días (18th October 2013) Castor won't receive compensation in case of fraud by the promoter if it is dismantled,

http://cincodias.com/cincodias/2013/10/17/empresas/1382029792_805284.html

21 El Economista (20th February 2014) Auditing firm DNV values Castor in 1,461 billion and affirms it is secure,

<http://www.eleconomista.es/energia/noticias/5560324/02/14/La-auditora-DNV-valora-el-Castor-en-1461-millones-y-afirma-que-es-seguro.html>

22 El Mundo (23th January 2014) Three international experts will decide Castor's future

<http://www.elmundo.es/ciencia/2014/01/26/52e3eb0222601d89018b4576.html>

23 URS (May 2008) *Estudio de Impacto Ambiental. Documento de Síntesis. Almacén Subterráneo de Gas*

Natural Castor, page 27

http://www.eib.org/attachments/pipeline/20060184_nts_en.pdf

24 Observatorio de Conflictos Mineros de América Latina (s.f.) URS Corporation S.A.

http://basedatos.conflictosmineros.net/ocmal_db/?page=empresa&id=900

25 NIMBY cases ("not in my back yard") are mentioned to argue that population normally opposes to projects that are perceived as dangerous for its potential risks near people's homes.

26 In 2005 Observatori del Ebre/CSIC/URL published a report by Arantza Ugalde that mentioned seismic risks. It is not public and CSIC is not allowed to comment it:

http://sociedad.elpais.com/sociedad/2013/10/07/actualidad/1381181311_736995.html

In 2006 UB published a study by Hector Perea Manera regarding the faults in the area and its dangers:

<http://diposit.ub.edu/dspace/handle/2445/34907>.

The prospect of the bonds issued in Luxemburg in already mentioned the risks (page 27):

http://www.castorugs.com/cm4all/iproc.php/files/otra%20informacion/Project%20Castor%20Prospectus_CL%20low%20res.pdf?cdp=a

After the earthquakes, the geologist Miguel de las Doblás also studied the matter for Ecologistas en Acción:

<http://www.ecologistasenaccion.org/article27345.html>

27 AraInfo (30th October 2013) Ecologist organizations ask the European Commission to answer questions about Castor Project,

<http://arainfo.org/2013/10/organizaciones-ecologistas-piden-explicaciones-sobre-el-proyecto-castor-a-la-comision-europea/>

28 Fitch Ratings placed Castor bonds on rating watch negative, and a few days later they fell 98,6%. See:

http://www.alacrastore.com/research/fitch-ratings-fitch-places-castor-gas-storage-bonds-on-rating-watch-negative-803779_pr_frame

http://www.elconfidencial.com/mercados/2013-10-15/los-bonos-del-proyecto-castor-cotizan-ya-por-debajo-del-precio-al-que-se-emitieron_41789/

29 A denounce to IGME was presented in November 2013. See:

http://ccaa.elpais.com/ccaa/2013/11/12/andalucia/1384260182_369212.html

30 Generalitat de Catalunya (2014) *Pressupostos 2014. Dades bàsiques*

http://www15.gencat.net/ecofin_wpres14/pdf/DBA_L_CAT.pdf

31 20 minutos (2012) *Presupuestos en Sanidad por Comunidades Autónomas*

<http://www.20minutos.es/graficos/presupuestos-en-sanidad-por-comunidades-autonomas-10/0/>