



INVESTIGATION REPORT

CAO Compliance

August 21, 2017

**CAO Investigation of IFC Environmental and Social Performance in relation to:
Latin Renewables Infrastructure Fund, Latin America Region, as related to Hidroeléctrica
Santa Rita complaint**

Office of the Compliance Advisor Ombudsman (CAO)
for the
International Finance Corporation (IFC) and
Multilateral Investment Guarantee Agency (MIGA)
Members of the World Bank Group

Executive Summary

In October 2014, CAO received a complaint from community members residing near the Santa Rita project (“the project”), a 23-megawatt hydro-electric power plant on the Río Icbolay in Alta Verapaz, Guatemala. The project is managed by a local development company, Hidroeléctrica Santa Rita (“HSR”). IFC has a stake in the project through a 2012 equity investment it made in a financial intermediary, the Latin Renewables Infrastructure Fund (“the Fund”). Construction of the project commenced in 2013 but was quickly aborted due to project related conflict. To date construction has not recommenced.

The complainants raise concerns regarding a range of environmental and social issues related to the project. They allege that the project did not meet IFC’s consultation requirements for free, prior, and informed consent. They are concerned that HSR has not addressed their concerns regarding the project’s design and has not considered its potential for adverse impacts on local water sources. They fear that the project will compromise their ability to generate income and to sustain their livelihoods. Further, they assert that their opposition to the project has been met with violence, repression, and criminalization of community leaders.

As detailed in this investigation report, CAO has made several non-compliance findings in relation to IFC’s review and supervision of its investment in the Fund and the Santa Rita project.

IFC’s Role in Project Review and Supervision

When investing in a financial intermediary (FI) such as the Latin Renewables Infrastructure Fund, IFC reviews the capacity of the FI to assess and manage the environmental and social (E&S) risks in its investment portfolio. To manage E&S risks, IFC requires the FI to develop and implement an Environmental and Social Management System (ESMS). IFC’s role is to ensure that the FI implements the ESMS to IFC standards. For FIs that plan to invest in projects that have higher E&S risks, this includes applying IFC’s Performance Standards.

Findings of the CAO with Respect to IFC Performance

IFC was aware that its investment in the Latin Renewables Infrastructure Fund involved a high degree of E&S risk. The Fund intended to make investments in hydro and wind power projects in Central America and elsewhere in Latin America and the Caribbean. During its pre-investment review, IFC acknowledged that such projects could have negative impacts on local communities, including Indigenous Peoples. IFC also acknowledged the Fund lacked experience in the management of E&S risk. To help avoid and mitigate these risks, IFC agreed to support the Fund to develop a best-in-class ESMS. IFC also undertook to closely monitor the Fund’s compliance with IFC E&S requirements. As part of this commitment, IFC and the Fund agreed that IFC staff would have the right to review the Fund’s E&S due diligence for its first three projects.

CAO finds that IFC appropriately categorized this investment as high risk and required the Fund to implement the Performance Standards. However, CAO also finds that IFC’s pre-investment review was not commensurate to risk. IFC did not have an adequate understanding the contextual risks associated with its investment in the Fund and gave insufficient consideration to the challenges that the Fund would face in implementing IFC’s recently updated Indigenous Peoples requirements. Further, CAO finds that IFC’s approach to the review of the Fund’s E&S due diligence for the first three proposed projects was flawed because it did not provide IFC staff with sufficient time or information to determine whether the Fund was applying IFC’s standards to its projects. In making this finding, CAO notes that IFC’s standards for E&S review of private equity investments as applicable to this investment went beyond market guidance for private sector investors in similar funds.

The Santa Rita project was the Fund's first investment. The project involved the construction of a hydroelectric power plant with a 17.5-meter dam, a 33-hectare reservoir and a 15-kilometer power transmission line in an area where indigenous peoples lived. The Santa Rita project was acknowledged as having potential adverse environmental and social impacts.

IFC reviewed the Fund's environmental and social due diligence (ESDD) for the Santa Rita project in August 2012—noting gaps in its analysis of risks and impacts, and recommending additional mitigation measures. However, CAO finds that IFC's review overlooked weaknesses in the ESDD as relevant to the issues raised in the complaint. Key shortcomings in the ESDD that IFC did not identify included: (a) gaps in the environmental assessment information presented, including that it related to an earlier – and significantly smaller – version of the project; (b) the lack of a social impact assessment; (c) inadequate analysis of the project's expected impacts on biodiversity, land use, drinking water, livelihoods, and cultural heritage; and (d) the lack of an assessment of whether the dam met World Bank design and safety standards.

Important, given that the complainants are indigenous peoples, CAO finds that IFC's review of the ESDD for the Santa Rita project was not sufficient to ensure that the Fund had correctly assessed the application of Performance Standard 7 to the project, in particular the requirement for Free Prior Informed Consent (FPIC) for projects impacting land and natural resources under traditional ownership or customary use.

CAO also finds that IFC did not give due consideration to the division of community sentiment around the project. As outlined in CAO's assessment report there were supporters and opponents of the project in the communities near the project site. This situation was well documented prior to IFC's investment in the Fund. Project documentation indicated community support for the project. At the same time, local protests against the project were reported as starting in 2010. Local opposition was reported publicly on several occasions between February and October 2012, following the commencement of dredging of the river. As initial construction works for the project commenced, opposition intensified. In July 2013, project opponents damaged project machinery and a road block was established by some community members opposing the project at the nearby village of Monte Olivo. In August 2013, two children and a former worker at the project were killed at an incident in Monte Olivo. The circumstances surrounding this incident remain unclear, with the client noting that the former worker who allegedly killed the children was drunk and acting on his own accord, while the complainants allege that he was acting on behalf of HSR. A client commissioned third-party review of the incident supports the former version of events.

Following an agreement between some community representatives and HSR to recommence construction of the project, in August 2014, police temporarily removed a road block erected by project opponents. In October 2014, representatives of indigenous community members opposing the project met with IFC and subsequently filed a complaint with CAO.

Nearly four years after IFC's disbursement to the Fund, the road block in Monte Olivo remains in place. The complainants maintain that the project has led to internal division within their communities, resulting in ongoing negative impacts. The Fund has advised CAO that it no longer plans to develop the project.

In this context, CAO finds that IFC did not sufficiently engage with the Fund to address the rising tensions, violent incidents, and serious allegations of E&S impacts raised by local community members and their representatives. CAO also finds that the prevalence of community opposition

was sufficient for IFC to require a reevaluation of the applicability of its Indigenous Peoples standards to the project.

More broadly, CAO's findings raise questions as to the effectiveness of IFC's control over compliance when it comes to the application of its E&S standards to high risk FI investments. As observed in this case, IFC's approach to ESDD review did not provide assurance that the Fund was applying IFC's E&S requirements to its investments. Further, in a context where IFC was aware of a range of allegations regarding the project's E&S impacts, CAO finds that IFC's approach to supervision of the Fund provided insufficient information to determine whether the Fund was properly applying IFC's E&S standards to its investments.

Next Steps

CAO will keep this compliance investigation open and monitor the situation until actions taken by IFC assure CAO that IFC is addressing its noncompliance findings.

Table of Contents

Executive Summary	2
Acronyms	6
Overview of the CAO Compliance Process	7
1. Background.....	8
1.1 Santa Rita Hydroelectric Power Plant.....	8
1.2 IFC Exposure to the Santa Rita Project.....	9
1.3 The Complaint and CAO Assessment	10
1.4 Scope of CAO Investigation	11
1.5 Methodology for CAO Investigation	11
1.6 IFC's Approach to Financial Intermediary Investments.....	12
1.7 Project Timeline.....	13
2. Analysis and Findings.....	14
2.1 IFC's Pre-Investment Review and Development of Risk Mitigation Measures.....	14
2.2 IFC Supervision	19
3. Conclusions	40
Annex A: Map of Project Area	42
Annex B: IFC E&S risk mitigation provisions agreed with the Fund	43
Annex C: Summary of Key Findings	44

Acronyms

AEPR	Annual Environment Performance Report
AMC	Asset Management Company (IFC subsidiary)
CAO	Office of the Compliance Advisor Ombudsman
COCODE	Consejos Comunitarios de Desarrollo
CEDER	Centro para el Desarrollo Rural
COD	conditions of disbursement
CUC	Comité de Unidad Campesina
DFI	Development Finance Institutions
E&S	environmental and social
EIA	Environmental Impact Assessment
ESAP	Environmental and Social Action Plan
ESDD	Environmental and Social Due Diligence
ESMS	Environmental and Social Management System
ESRR	Environmental and Social Risk Rating
ESRP	Environmental and Social Review Procedure
FPIC	Free, prior and informed consent (PS requirement)
GIIP	Good international industry practice
HSR	Hidroeléctrica Santa Rita
ICP	Informed Consultation and Participation (PS requirement)
IFC	International Finance Corporation
IPs	Indigenous Peoples
IRM	Investment Review Meeting
IWGIA	International Work Group for Indigenous Affairs
LRIF	Latin Renewables Infrastructure Fund
MARN	Ministry of Environment and Natural Resources (Guatemala)
MIGA	Multilateral Investment Guarantee Agency
MW	Megawatt
NGO	Nongovernmental organization
OSH	Occupational safety and health
PS	IFC Performance Standards (2012)
PS1	IFC Performance Standard 1: Social and Environmental Assessment
PS4	IFC Performance Standard 4: Community Health, Safety, and Security
PS5	IFC Performance Standard 5: Land Acquisition and Involuntary Resettlement
PS7	IFC Performance Standard 7: Indigenous Peoples
REAL	Real Infrastructure Capital Partners
SHA	Shareholders Agreement
SSV	IFC Site Supervision Visit
TOR	Terms of Reference
UN CDM	United Nations Clean Development Mechanism

Overview of the CAO Compliance Process

CAO's approach to its environmental and social (E&S) compliance function is set out in its Operational Guidelines (March 2013).

When CAO receives an eligible complaint, the complaint first undergoes an assessment to determine how CAO should respond. If the CAO compliance function is triggered, CAO will conduct an appraisal of IFC's/MIGA's involvement in the project, and determine if an investigation is warranted. The CAO compliance function can also be triggered by the World Bank Group President, the CAO Vice President, or senior management of IFC/MIGA.

CAO compliance investigations focus on IFC/MIGA, and how IFC/MIGA assured itself of the E&S performance of an IFC/MIGA project. The purpose of a CAO compliance investigation is to ensure compliance with policies, standards, guidelines, procedures, and conditions for IFC/MIGA involvement, and thereby improve E&S performance.

In the context of a CAO compliance investigation, at issue is whether:

- The actual E&S outcomes of a project are consistent with or contrary to the desired effect of the IFC/MIGA policy provisions; or,
- A failure by IFC/MIGA to address E&S issues as part of the appraisal or supervision resulted in outcomes that are contrary to the desired effect of the policy provisions.

In many cases, in documenting and verifying the performance of the project and implementation of measures to meet relevant requirements, it is necessary to review the actions of the IFC/MIGA client and verify outcomes in the field.

CAO has no authority with respect to judicial processes. CAO is neither a court of appeal nor a legal enforcement mechanism, nor is CAO a substitute for international court systems or court systems in the countries where IFC/MIGA operates.

Upon finalizing a compliance investigation, IFC/MIGA is given 20 working days to prepare a public response. The compliance investigation report, together with any response from IFC/MIGA, is then sent to the World Bank Group President for clearance. It is then made public on the CAO website.

In cases where IFC/MIGA is found to be out of compliance, CAO keeps the investigation open and monitors the situation until actions taken by IFC/MIGA assure CAO that IFC/MIGA is addressing the noncompliance. CAO will then close the compliance investigation.

1. Background

1.1 Santa Rita Hydroelectric Power Plant

Santa Rita Hydroelectric Power Plant (“the project”) is a proposed 23.6 megawatt (MW) hydropower plant on the Río Icbolay in Alta Verapaz, Guatemala. The project is managed by a local development company, Hidroeléctrica Santa Rita, S.A (HSR).

The project is situated 40 kilometers outside Coban, Alta Verapaz, in an area where the population is predominantly indigenous Q’eqchi’. The area in question is remote and poor.¹

The project involves the construction of 551 meter (m) open canal to channel water from the dam site to two electric turbines. The project involves the construction of a 17.5m high and 64m wide dam with a reservoir extending to 33 hectares. The dam is designed to provide temporary storage water in the reservoir to supplement relatively low seasonal river flow during the dry season. The project also includes the construction of a 15-kilometer-high voltage powerline to connect the hydroelectric power plant to the national electricity grid.²

The Environmental Impact Assessment (EIA) for the project was finalized in early 2009 and approved by the Guatemalan Ministry of Environment and Natural Resources (MARN) in May 2009. The 2009 EIA was based on a design for a 18-20 megawatt (MW) hydro power plant with a smaller dam and reservoir. The MARN approval was revised in August 2010 to allow for a larger, 23.6MW, hydro power plant and dam.³

While the EIA did not include a definition of the affected area or affected communities, subsequent community consultation by HSR defined the affected area to include the project property and four nearby communities along the access road to the project site. Thereafter, the project area was expanded to include a total of 17 communities with a total population of 7,000 people.

Project construction commenced in February 2013. In July 2013, project equipment was damaged and a road block was established on the access road at Monte Olivo by opponents of the project. Following this incident, construction at the project was suspended⁴ and at the time of writing construction had not resumed. Subsequent violent incidents related to or occurring near the project site are noted in IFC’s project documentation, media reports and raised by the complainants. IFC’s client has advised CAO that it has no longer plans to develop the project.

A map of the project area is provided in Annex A.

¹ Incidence of poverty in Alta Verapaz is 83 percent, with incidence of extreme poverty at 53 percent, making it the poorest department in the nation. Among Guatemala’s indigenous groups, the Q’eqchi’ have the highest poverty rate, with over three quarters of the population living in poverty or extreme poverty. INE (2016), ENCOVI, 2014, Cuadros Principales Resultados. <https://goo.gl/vU2FtT>; Sanchez et al (2015). Guatemala: Closing Gaps to Generate More Inclusive Growth. Systematic Country Diagnostic. IRDB/World Bank. p.30. <https://goo.gl/yzDaOa>.

² United Nations Clean Development Mechanism (UN CDM): Santa Rita Hydroelectric Plant (2014). Available at <https://goo.gl/QWVBHK>.

³ Letter from HSR to the UN CDM (May 2014). Available at <https://goo.gl/aZWz6d>.

⁴ Letter from HSR to the UN CDM (May 2014). Available at <https://goo.gl/aZWz6d>.

1.2 IFC Exposure to the Santa Rita Project

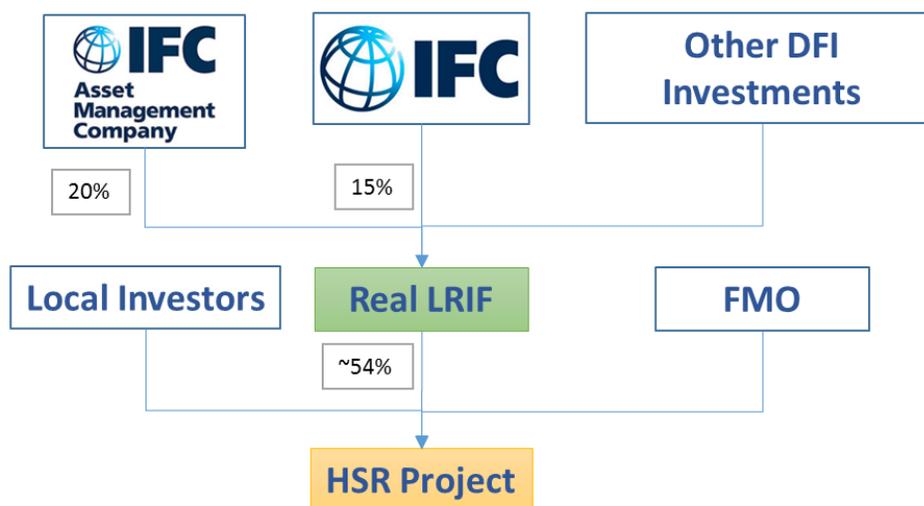
IFC is financially exposed to the project through an equity investment in the Latin Renewables Infrastructure Fund (LRIF, the “Fund” or the “client”), a fund established and managed by Real Infrastructure Capital Partners (REAL). REAL was newly established in 2010 as a New York based fund managed by four partners with extensive experience in the renewable energy sector.⁵

In June 2012, IFC committed to a US\$15 million equity investment in the LRIF, a 10-year closed-end private equity fund. The Fund’s goal was to invest in 8-12 infrastructure projects in the renewable power and energy efficiency sectors in Latin America and the Caribbean.⁶ In 2014, IFC’s Asset Management Company (AMC) made a US\$20 million equity investment in the Fund.⁷ At this point, REAL announced that it had reached final closing for the Fund with commitments of US\$100 million.⁸ IFC’s and AMC’s equity investments represented 15 and 20 percent of Real LRIF, respectively.

The expected development impact of IFC’s investment in the Fund included: (i) a reduction in greenhouse gases through the Fund’s investments in renewable sector; (ii) job creation in local communities; and (iii) strengthening the financial and governance perspective of the projects the Fund invests in thus demonstrating the business case for renewable energy and clean technology investments.⁹

In late 2012, the Fund acquired a controlling equity stake in the Santa Rita Hydroelectric Power Plant, its first project. Subsequently, the Netherlands Development Finance Company (FMO) also made an equity investment in the project.¹⁰

Figure 1 - IFC’s exposure to the Project



⁵ IFC Disclosure, Summary of Investment Information (SII) - <http://goo.gl/N2zrY8>.

⁶ SII – IFC Disclosure.

⁷ IFC AMC Portfolio - <http://goo.gl/u1GFLJ>.

⁸ Real LRIF, January 2014, Press Release - <http://goo.gl/Ow47nr>.

⁹ SII – IFC Disclosure.

¹⁰ CAO Assessment Report of IFC’s investment in Real LRIF - <http://goo.gl/BMcN6c>; and, FMO Disclosure - <https://goo.gl/mkfilMy>.

1.3 The Complaint and CAO Assessment

In October 2014, CAO received a complaint submitted by *Colectivo Madre Selva* and the *Consejo de Pueblos de Tezulutlan*, two Guatemalan organizations, on behalf of several community members residing downstream and upstream from the project. The complaint raises concerns regarding a range of environmental and social issues related to IFC's due diligence, project information disclosure and consultation, potential impacts to local water sources, displacement, indigenous people, and security concerns. In particular, the complainants assert that the project does not meet IFC requirements for free, prior, and informed consent (FPIC) and that it has disturbed the peace and social cohesion of their communities. Further, the complainants assert that their opposition to the project has been met with violence, repression, and criminalization of community leaders.¹¹

The complainants raise particular concerns regarding violent incidents in August 2013 and April 2014 that resulted in deaths of two men and two children in Monte Olivo. They accuse the project operators and a landowner who sold part of his land to the project of playing a significant role in these incidents.¹²

The complainants also allege that the project did not comply with IFC PS2: Labor and Working Conditions. Specifically, the complainants allege that 40-60 workers at the hydro power plant burned machinery in July 2013 as a demonstration of their discontent over the lack of pay for three months. As the complainants do not assert to represent workers at the hydro power plant, this issue is not within the scope of the CAO investigation.¹³

As documented in CAO's initial assessment of the complaint, the client's view is that the project would have minimal adverse environmental impacts, whereas it had the potential for significant community benefits. Adverse impacts were expected to be temporary and limited mostly to the construction phase. The client asserted that the majority of the affected communities supported the project, and that community division and violence was generated by national and international non-governmental organizations (NGO) from outside the area that have a political agenda to block hydroelectric projects. The client asserted that they were not involved in the violent incident at Monte Olivo in August 2013. Further, the client asserted that they have made several attempts to hold meetings with opposing groups to share information and discuss their concerns but that these invitations have not been accepted.¹⁴

CAO's assessment report also documents the views of community representatives supporting the project. They state that they support the project because it will have limited adverse impacts on the river while bringing benefits to their communities. They state that community divisions have been fueled by external organizations that mislead and use a small minority of community members to organize opposition to the project. They state that the opposition groups use coercive or violent actions against those who favor the project, blocking roads or access to resources, impeding them from selling their crops, issuing death threats, and harassing them. While noting that initial consultation around the project did not generate trust, they are positive about the talks that LRIF/HSR facilitated starting in 2013.¹⁵

¹¹ Complaint to CAO.

¹² CAO Assessment Report of IFC's investment in Real LRIF - <http://goo.gl/BMcN6c>

¹³ Complaint to CAO.

¹⁴ CAO Assessment Report of IFC's investment in Real LRIF - <http://goo.gl/BMcN6c>

¹⁵ *Ibid.*

Following CAO's assessment, the complainants decided not to pursue a CAO-facilitated dispute resolution process, and accordingly, in June 2015 the complaint was transferred to CAO's compliance function.

1.4 Scope of CAO Investigation

CAO's compliance appraisal was finalized in July 2015, with a decision that this case merited further inquiry. As a result, this compliance investigation was initiated. The scope of this investigation is defined in Terms of Reference (TOR) issued by CAO in October 2015. As set out in the TOR, the focus of this CAO compliance investigation is on IFC, and how IFC assured itself of the E&S performance of its investment at appraisal and during supervision. CAO does not make findings in relation to the performance of the client.

The following specific questions are noted in the TOR:

1. whether IFC's pre-investment [E&S] review of its client was commensurate to risk;
2. whether IFC's approach to the management of E&S risks in relation to this investment met relevant requirements; and,
3. whether IFC's supervision of the Fund in relation to the Santa Rita project, both at the ESDD phase [IFC's E&S due diligence of the project] and thereafter, met relevant requirements.

The TOR also asks CAO to consider whether IFC's Policy and Performance Standards on Environmental and Social Sustainability and Policy on Disclosure of Information as applied to this project provided an adequate level of protection.

1.5 Methodology for CAO Investigation

The CAO investigation team (CAO staff and two external panelists) reviewed IFC's and client provided documentation in relation to IFC's investment in the Fund and the subsequent investment by the Fund in the Santa Rita project. The CAO investigation team travelled to Guatemala City and project area in February 2016 to meet with the complainants, the client, community members who support the project and other stakeholders.

CAO's external panel included an anthropologist and a specialist in environmental and social impact assessment. In addition, CAO commissioned a review of the project EIA by an environmental expert with extensive experience in hydropower development.

Following the field visit to the project area, the CAO investigation team met with IFC staff, the client and other stakeholders in Washington DC and via teleconference.

The investigation has considered IFC's performance in relation to the requirements of its 2012 Policy on Environmental and Social Sustainability ("the Sustainability Policy"), Performance Standards (PS), and Access to Information Policy, together referred to as the Sustainability Framework.

In considering the adequacy of IFC's E&S performance in relation to this investment, CAO has been conscious not to expect performance at a level that requires the benefit of hindsight. Rather

the question is whether there is evidence that IFC applied relevant requirements considering sources of information available at the time.

As CAO's compliance mandate is focused on IFC's E&S performance, it should be emphasized that this report does not make findings in relation to the client, adverse or otherwise. Similarly, CAO makes no findings in relation to the conflicting factual claims of the groups supporting and opposing the project.

1.6 IFC's Approach to Financial Intermediary Investments

With the objective of supporting sustainable capital market and financial sector development, IFC has developed a significant program of indirect investment through financial intermediaries (FIs). IFC's investment in the Fund was an FI investment. Through these investments "IFC helps strengthen domestic capital and financial markets that support economic development at a scale of activity that is smaller than would be possible through direct FI investments."¹⁶ IFC's FI portfolio has grown significantly in recent years, accounting for US\$5 billion of new long-term commitments in FY16 – 45 percent of IFC's new commitments.¹⁷

As with any IFC investment, IFC commits to carry out its activities with the intent to "do no harm" to people and the environment.¹⁸ IFC also commits to ensuring that "the costs of economic development do not fall disproportionately on those who are poor or vulnerable, that the environment is not degraded in the process, and that renewable natural resources are managed sustainably."¹⁹

IFC's approach to E&S risk management is emphasized as supporting the capacity of FI clients to assess and manage the E&S risk of their investments.²⁰ "This is achieved in part through the development and implementation of an Environmental and Social Management System (ESMS), and by enhancing FIs' in-house capacity for the day-to-day management of portfolio risks, including environmental and social risk."²¹ From an environmental and social perspective this approach potentially leverages IFC's standards across a much larger portfolio of projects and investors than would be the case in relation to its direct investments.²² Additional requirements for IFC in reviewing and monitoring an FI investment are detail in relevant sections below.

¹⁶ IFC Sustainability Policy (2012), para 32.

¹⁷ IFC Annual Report 2016, page 34.

¹⁸ IFC Sustainability Policy (2012), para. 9.

¹⁹ IFC Sustainability Policy (2012), para 9.

²⁰ IFC Sustainability Policy (2012), para 33.

²¹ IFC Sustainability Policy (2012), para 33.

²² IFC Sustainability Policy (2012), para 32.

1.7 Project Timeline

Date	Events related to HSR	IFC Actions
2009		
May	Environmental Impact Assessment (EIA) for the project approved by Government	
2010		
Feb	Between February 2009 and 2010, consultations held in the project area	
July	Some local communities' express opposition to the project	
2011		
June	Project consultation held in Coban as part of the UN Clean Development Mechanism (UNCDM) process	
Dec		IFC initiates its pre-investment Appraisal of the Fund
2012		
April	Media report of protests near the project after the commencement of initial works. Government forces dispatched to the project area. A national organization led a protest march to Guatemala City opposing the project and other hydropower developments.	
May		IFC approves an investment in the Fund.
June		Prior to IFC's Commitment, IFC reviews and comments on the Fund's ESMS.
July		IFC completes First Disbursement to the Fund.
Aug	The Fund conducts an E&S due diligence (ESDD) visit to the project area. Community consultation held in Coban.	IFC reviews the Fund's ESDD for the HSR investment. IFC provides comments and recommendations to the Fund.
Oct		IFC processes disbursement to the Fund for the project.
Dec	Independent Consultant Report on the project finalized. This review provided a more critical perspective on the project's approach to the management of E&S risk compared to the Fund's ESDD or IFC's ESDD review.	
2013		
Feb	Construction activity commences at the project. Statement by national organization alleging project impacts.	IFC processes disbursement to the Fund for the project.
May		IFC processes disbursement to the Fund for the project.
July	Project equipment damaged and opponents of the project establish a road block at Monte Olivo. Project construction suspended.	
Aug		The Fund informed IFC of the death of two children and one former HSR contractor near the project.
Oct		Fund provides IFC with a report into the three August 2013 deaths near the project.
Dec		IFC completes review of the Fund's AEPR. Provides an ESRR 3: Partly Unsatisfactory.
2014		
Jan		IFC's AMC makes an investment in the Fund.
April	Opponent of the project allegedly killed by landowner.	
May		IFC processes disbursement to the Fund for the project.
June	The project is registered by UNCDM.	
July	Community Agreement signed in Guatemala City.	
Aug	National police remove road block. This action leads to clashes between project opponents and the police.	
Oct		CAO receives a complaint in relation to the project.
Dec		IFC processes disbursement to the Fund for the project.

2. Analysis and Findings

2.1 IFC's Pre-Investment Review and Development of Risk Mitigation Measures

Before investing in an FI, IFC reviews the E&S risk and impacts of a proposed investment and agrees with the FI on measures to mitigate these risks in accordance with IFC's E&S requirements. For this compliance investigation, a key question is whether IFC's pre-investment review of the client was commensurate to risk and whether IFC's approach to the management of E&S risks in relation to this investment met relevant requirements.

Summary of Findings:

IFC appropriately categorized the investment as F11 (high E&S risk) and required the Fund to ensure that projects it supported were operated in accordance with the Performance Standards.

IFC's E&S review of its investment in the Fund was not commensurate to risk.

Given the high E&S risk profile of the Fund's prospective investments and the client's limited capacity, the framework which IFC negotiated for review of the Fund's projects limited the ability of the E&S specialist "to determine whether the client's ESMS implementation [was] robust" as required by ESRP 7.2.10.

Pre-Investment Requirements

IFC's 2012 Sustainability Framework details a series of IFC and client requirements to ensure that IFC's investments are implemented in a sustainable manner. The framework is comprised of IFC's Sustainability Policy and IFC's Access to Information Policy; which detail requirements upon IFC, and IFC's Performance Standards; which detail client E&S responsibilities. Environmental and Social Review Procedures (ESRP) set out the process through which IFC staff review and supervise investments to ensure they are meeting IFC's E&S requirements.

To manage E&S risk, IFC requires its FI clients to develop and implement an E&S Management System (ESMS). Through its ESMS, an FI is responsible for reviewing and monitoring the individual sub-projects that the FI supports. FIs are required to ensure that the higher (E&S) risk business activities they support operate in accordance with the requirements of the IFC Performance Standards.²³ IFC's role is "to ensure, through its due diligence, monitoring, and supervision efforts, that the business activities it finances are implemented in accordance with the requirements of the Performance Standards."²⁴

The table below presents a summary of IFC policy requirements and guidance for its pre-investment review of an FI investment.²⁵

²³ IFC Sustainability Policy (2012) – para 35. This is applicable where IFC finance supports the higher E&S risk business activities of the FI.

²⁴ IFC Sustainability Policy (2012) – para 7.

²⁵ Table prepared on the basis of IFC Sustainability Policy and Access to Information requirements, and IFC ESRPs.

IFC 2012 Sustainability Policy and Access to Information Policy

Purpose

Ensure that IFC does not finance projects that cannot be expected to meet its E&S requirements within a reasonable period of time (para. 22)

2012 Sustainability Policy requirements

- IFC review of an FI's existing portfolio and prospective business activities (para. 34)
- Considers whether the FI could be exposed to E&S risks as a result of its investments (para. 34)
- IFC reviews the implementation capacity of the FI, including its ESMS, to manage E&S risk in accordance with IFC's requirements (para. 34-35)
- Provide an E&S categorization for the investment; FI1 (high risk), FI2 (medium risk) or FI3 (low risk) (para. 40)
- Determine the applicable IFC requirements based on the E&S risk. FI required to develop and operate an ESMS commensurate with the E&S risk in its portfolio and prospective business activities. If the FI intends to support higher risk projects, FI required to apply PSs (para. 35)
- IFC reviews clients' identification of third party risks (including role of government agencies) to ensure outcomes are consistent with the PS (para. 23)

2012 Access to Information Policy requirements

- IFC discloses a Summary of Investment information (SII) for FI investments detailing the: i) E&S risks; ii) E&S risk categorization; iii) summary of the FI's ESMS; and, iv) as relevant, an ESAP for the FI to implement (para. 31)

IFC Environmental and Social Review Procedures

Purpose

ESRPs detail steps for IFC staff to implement IFC policy requirements

Requirements (ESRP7, June 2011)

- Determine the E&S risk based on review of client portfolio and sector information (para. 2.14)
- Based on this review, determine the applicable IFC requirements (para. 2.14)
- Review and identify gaps in the client's ESMS to implement IFC's requirements, considering the client's; (para. 2.18)
 - E&S policies and procedures;
 - Organizational structure and staffing;
 - Skills and competencies in E&S areas;
 - Training and awareness of investment, legal, and credit officers on the organization's E&S requirements and its ESMS;
 - Performance monitoring procedure;
 - Reporting of results to management; and,
 - Track record to date of ESMS implementation
- For investments involving higher risks and where gaps in the ESMS are identified, these are required to be closed before or as a condition of IFC's disbursement (para. 2.19)
- PE funds, IFC may reserve the right to review the client's E&S due diligence for a proposed investment to ensure the ESMS implementation is robust (para. 2.10)

Additional optional measures

- For complex or uncommon issue, or for issues that common to a number of projects, IFC may convene Peer Review Meeting to review IFC's pre-investment review (para. 2.21)
- Conduct a site visit to the FI or its existing projects (para. 2.17)

IFC Pre-Investment Review

IFC's due diligence for its investment in the Fund commenced in late 2011. As part of its due diligence, IFC staff held several calls with REAL management and visited their offices in New York City. IFC staff explained IFC's E&S requirements, disclosure policy and assessed the client's approach to E&S risk management.

Identification of E&S risk

IFC noted that the Fund intended to make investments in hydro power projects between 5 and 30 MW and wind power projects between 20 and 60 MW (with potential for some over 100 MW) in Central America, and potentially elsewhere in Latin America and the Caribbean. Accordingly, IFC assigned the investment an E&S category of FI1: high-risk.²⁶ IFC recognized that many of the

²⁶ SII – IFC Disclosure.

Fund's investments "could potentially have negative impacts on local communities, indigenous peoples, and biodiversity, and other risks such as, but not limited to, occupational health and safety, resettlement, and cultural heritage."²⁷ IFC's documentation recorded that in two of the Fund's priority countries, Panama and Guatemala, IFC had investments in hydro projects where concerns had been raised regarding indigenous peoples.

IFC reviewed a pipeline of 32 projects that the Fund was considering as potential investments. This list included 10 hydro and 5 wind power projects, all in Central America, which the Fund reported to be high priorities. IFC noted that all projects in the Fund's pipeline could potentially trigger all Performance Standards. IFC investment staff met with a number of the project developers to better understand the projects' status and the potential role for the Fund if it made an investment. IFC did not undertake a similar approach to understand the potential E&S risks and capacity of project developers to manage those risks as part of its pre-investment E&S review.

REAL was established in 2010. While REAL's partners' experience in the renewable sector was acknowledged, IFC noted that they lacked E&S risk management experience.

In considering the investment, IFC management noted that E&S issues could be the greatest obstacle to approval. To mitigate E&S risk, IFC management recommended that IFC E&S staff maintain the right to review the Fund's E&S due diligence for each proposed investment and that IFC E&S staff would have sufficient time to undertake this review. Further, management requested IFC's right to suspend disbursements if a project breached its E&S requirements, allowing for a reasonable period of time for the client to seek resolution for any breach.

Risk mitigation

Recognizing that there were significant E&S risks attached to its investment, IFC agreed with the client on the following mitigation measures which were consistent with IFC's approach in other private equity investments at the time.

Disclosed E&S Action Plan (ESAP) measures for the Fund to complete:

- Nominate an E&S Officer prior to April 30, 2012;
- Establish an ESMS including guidelines for its implementation prior to June 30, 2012; and,
- Implement Staff E&S Training prior to July 30, 2012.²⁸

Additional measures agreed with the Fund:

- IFC's right to review and comment on the Fund's first three investments and all high-risk investments;
- Fund to provide IFC with an annual E&S performance report;
- IFC's right to visit a project site to verify compliance with E&S requirements once the Fund has made its investment in the project;
- Where the Fund becomes aware that a project is in breach of the E&S requirements, the Fund is required to inform and consult with IFC on the development of corrective measures;

²⁷ SII – IFC Disclosure.

²⁸ SII – IFC Disclosure. IFC and the Fund agreed to provide for nomination of an E&S Officer and establishment of an ESMS including guidelines for implementation as a condition of IFC's commitment. Implementation of Staff Training was incorporated into the legal agreement for implementation 12 months post IFC's commitment.

- IFC right to refuse participation in a proposed Fund investment in a project; and,
- IFC right to suspend disbursements without penalty where the Fund has made investments in material violation of E&S requirements.

In addition to the Fund appointing a staff member as the E&S Officer, IFC required the Fund to retain an Environmental Advisor to support: (i) implementation of its ESMS, and (ii) the Fund's E&S due diligence on potential projects. This was required as the Fund did not have an ESMS and lacked sufficient E&S risk management experience.²⁹ See Annex B for a more detailed presentation of E&S provisions agreed between IFC and the Fund.

Approval and Commitment

In presenting the project to the IFC Board for approval, IFC noted that the Fund's objective was to make investments in small renewable energy projects that had potentially high E&S risks and impacts. To mitigate this risk, IFC stated that it would support the Fund in developing a best-in-class ESMS as well as closely monitoring the Fund's compliance with its E&S requirements.

The IFC Board approved the project on May 22, 2012 and IFC committed to the investment on June 22, 2012. Prior to IFC's commitment, the client informed IFC that it had designated an E&S Officer responsible for implementing the Fund's ESMS. IFC staff also reviewed and commented on the Fund's new ESMS policy and procedures. The Fund incorporated IFC's comments into the ESMS prior to IFC's commitment. At this point IFC noted that the client had completed all actions required as per the disclosed ESAP.³⁰

Discussion and Findings

Identification of E&S risk

IFC's investment in the Fund was its first category FI1 (high E&S risk) investment made under the 2012 Sustainability Framework.

In assessing the Fund's proposed business activities, IFC recognized that the development of renewable energy projects in Central America and other countries in Latin America had the potential for high E&S risk. Considering sector and regional exposure, IFC further recognized that the Fund's projects could be exposed to a series of impacts covered by the Performance Standards, including impacts related to indigenous peoples, biodiversity, occupational health and safety, resettlement, and cultural heritage. ***Thus, CAO finds that IFC appropriately categorized the investment as FI1 and required the Fund to ensure that projects the Fund supported were operated in accordance with the Performance Standards.***

In assessing the Fund's capacity to implement IFC's E&S requirements, IFC recognized that the Fund was newly established and, thus, did not have an ESMS. Further, IFC acknowledged that the Fund's partners lacked E&S risk management experience. As a mitigation measure, IFC required the Fund to hire a specialist E&S Advisor to support the Fund in developing an ESMS and conducting E&S due diligence for the Fund's initial investments. IFC reviewed qualifications of the E&S Advisor and noted the individual's extensive experience both in relation to E&S assessment of renewable and conventional energy projects and in working on E&S risk management with private equity funds. However, it is not apparent that IFC reviewed terms of

²⁹ PS1 (2012) requires that a client have "Personnel within the client's organization with direct responsibility for the project's environmental and social performance will have the knowledge, skills, and experience necessary to perform their work, including current knowledge of the host country's regulatory requirements and the applicable requirements of Performance Standards 1 through 8."

³⁰ SII – IFC Disclosure.

reference for the role, or assessed whether a single individual would have the range of skills required for the task as required by PS1. In this context, it is notable that in 2014 the Fund decided that it would be preferable to have a firm, rather than an individual E&S advisor, conducting the ESDD process.

IFC's pre-investment review did not present an analysis of country, contextual, or other third party E&S risk factors in the Fund's target markets (Sustainability Policy para. 23). These types of risks were highly relevant given the markets that the Fund was targeting which included countries with weak institutional capacity and challenges around violence, conflict and engagement with indigenous peoples, including in relation to renewable energy projects.³¹ By way of contrast, IFC's produced an investment climate review for each of the Fund's target countries. Absent analysis of contextual and third party risk, IFC was not in a position to ensure that the mitigation measures proposed were commensurate to the client's business needs (Sustainability Policy para. 35).

IFC's pre-investment review noted changes in requirements between its Sustainability Framework 2006 and the (then new) 2012 Framework. Specifically, IFC noted reputational risk associated with the 2012 requirement to disclose projects the Fund was supporting. IFC's pre-investment review documentation does not discuss other changes to its E&S requirements. Of particular relevance, given the presence of significant indigenous populations in Central America and known conflicts over the development of renewable energy projects areas with significant indigenous populations, would have been a discussion of the challenges in implementing the new and more stringent Free Prior Informed Consent (FPIC) standard for projects affecting land and natural resources used by indigenous people under PS7 (2012).³²

In these circumstances, CAO finds that IFC's E&S review of its investment in the Fund was not commensurate to risk. Factors that made this investment particularly challenging from an E&S perspective included: (i) the Fund's planned investments in projects with significant potential E&S impacts; (ii) the Fund's target countries – which included countries with known crime, violence, and governance issues; (iii) the Fund's lack of E&S systems or capacity; and, (iv) the potential that the client would need to implement IFC's (then new) FPIC requirement for projects impacting indigenous people.

Opportunities for an enhanced appraisal were present. In particular, it was open to IFC E&S staff to request a Peer Review Meeting as provided for in its procedures.³³ The Peer Review Meeting is designed to provide a forum for internal discussion as to the adequacy of IFC's E&S review in relation to challenging projects. As the Fund had shared a list of potential pipeline projects with IFC, IFC also had the opportunity to carry out an additional analysis of the E&S risks associated with the Fund's prospective business activities and the challenges they would face in meeting the requirements of the Performance Standards. By way of contrast, IFC investment review

³¹ USAID (2010) Promoting Sustainable Energy Integration in Central America <https://goo.gl/MeP8wB>. 2012 Economist Intelligence Unit country reports for Guatemala and Panama and US State Department Human Rights Reviews (2011) for Costa Rica, Guatemala, Honduras, Nicaragua and Panama note various indigenous communities' protests in relation to infrastructure projects. United States State Department Annual Human Rights Reviews (2011) raise concern in regard to violence, conflict and engagement with indigenous peoples in a number of Central American countries. For further details, see <https://goo.gl/YeDriP>.

³² According to the International Work Group for Indigenous Affairs (IWGIA), there are over 8 million people who identify as Indigenous in Central America. For further details, see <https://goo.gl/UAAANrU>

³³As per ESRP 7 (v.4, 2.21), IFC E&S staff can request the E&S manager to convene a peer review meeting to discuss E&S aspects of the proposed investment where: i) there are project issues that are common to a number of projects and that need a common approach for quality assurance; or ii) there is a complex project E&S issue that is uncommon or has not been encountered before.

considered the potential financial exposure to each of the Fund's prospective business activities and discussed some of the prospective projects with the project developer.

Risk mitigation

While IFC's review identified relevant categories of E&S risk that the Fund would be exposed to, it did not document an engagement with the severity of these risks. Absent a more detailed articulation of the E&S risks associated with the investment, IFC developed a series of general mitigation measures that were in accordance with IFC practice for private equity fund investments at the time.

The Fund was required to implement two mitigation measures prior to IFC's commitment: (i) nominate an E&S Officer; and, (ii) establish an ESMS including guidelines for implementation.

The Fund nominated an E&S Officer and provided IFC with a document outlining its ESMS. IFC reviewed the ESMS and, in response to IFC's comments, the Fund revised its ESMS prior to commitment. Relevant to the issues raised in the complaint, however, CAO notes that the ESMS was based on a process whereby gaps in a Fund's E&S assessment were identified and addressed as part of the pre-investment ESAP for a project. As a result, the ESMS lacked guidance along the lines of the IFC Sustainability Policy (paras. 22 and 23) on when the Fund should not proceed with financing.

IFC and the Fund also agreed on a framework for IFC to review the Fund's ESDD for its first three investments and all high-risk projects thereafter. This framework provided IFC ten business days to complete its review of the Fund's ESDD and make recommendations. IFC also had the ability to opt-out of a particular investment on E&S grounds.

The objective of IFC's review was to provide IFC with a basis to assure itself that the Fund's ESMS implementation was robust (ESRP 7.2.10). This framework for review, however, was limited by the short time frame provided for IFC's review and restrictions in IFC's ability to access to primary sources of information about the project.

Thus despite implementing a number of risk mitigation measures, **CAO finds that the framework which IFC negotiated for review of the Fund's projects limited the ability of the E&S specialist to "determine whether the client's ESMS implementation [was] robust"** as required by ESRP 7.2.10.

In reaching this conclusion, CAO considered: (i) the high E&S risk profile of the Fund's prospective investments, (ii) the fact that this was a startup Fund with no existing E&S capacity or systems; (iii) the lack of guidance in the Fund's ESMS on when it appropriate to refrain from supporting a proposed business activity and (iv) limitations in the agreed framework for IFC's review of the Fund's ESDD for new projects.

2.2 IFC Supervision

This section considers firstly, the adequacy of IFC's initial review of the Fund's ESDD for the HSR project; and secondly, IFC's supervision of the Fund as issues were reported related to the project.

Supervision Requirements

IFC's supervision phase commences at first disbursement and continues until the investment is closed. In order to determine the effectiveness of an FI's ESMS, IFC periodically reviews the process and results of an FI's ESDD. IFC's supervision may include a visit to the FI and/or to "recipients of FI loans/investments, particularly high risk sub-projects..." The frequency and focus

of IFC's supervision visits is "commensurate with the identified risks."³⁴ The table below presents a summary of IFC policy requirements and procedures for supervising an FI investment.

IFC 2012 Sustainability Policy and Access to Information Policy	IFC Environmental and Social Review Procedures
<p>Purpose To determine the effectiveness of an FI's ESMS, IFC will periodically review the process and the results of the environmental and social due diligence conducted by the FI for its investments. (Sustainability Policy, para. 45)</p> <p>IFC monitors an FI client's performance with a view to assuring itself that there is sufficient evidence: (i) the client's ESMS is operating as envisaged at the time of IFC's pre-investment review; and, (ii) the client is applying IFC's E&S requirements to sub-projects (ESRP 9, para. 2.6)</p>	
<p>2012 Sustainability Policy requirements</p> <ul style="list-style-type: none"> → To determine the effectiveness of an FI's ESMS, IFC will periodically review the process and results of an FI's ESDD (para. 45) → IFC's supervision may include a visit to the FI or a project of the FI (para. 45) → IFC works with the FI to address shortcomings in their ESMS (para. 45) 	<p>Requirements (ESRP9, June 2011)</p> <ul style="list-style-type: none"> → Review conditions of disbursement (para. 2.2) → Review the FI's annual E&S reporting (AEPR) (para. 2.6) → Based on these reviews, an E&S risk rating (ESRR) on a four point scale is provided from 1:Excellent, 2: Satisfactory, 3: Partly Unsatisfactory, and 4: Unsatisfactory (para. 2.6) → If gaps are identified, IFC should provide timely and clear explanation to the FI on actions needed to address performance gaps or other issues of concern (para. 2.6) → Determine the need for a supervision visit to the FI or an FI's project in order to further review the FI's compliance with IFC's E&S requirements (para. 2.7)
<p>2012 Access to Information Policy requirements</p> <ul style="list-style-type: none"> → For PE funds, IFC periodically discloses the name, location and sectors of high-risk projects the fund invests in, subject to regulatory constraints and market sensitivities (para. 25, FN 16) 	<p>Additional measures</p> <ul style="list-style-type: none"> → For FIs where there are potential significant E&S risks associated with their financing activities or where IFC is more directly exposed to the E&S risks of their financing activities (e.g., private equity fund operations), IFC reserves the right to review the FI's first few projects to ensure that the FI's implementation of its ESMS "is robust." In these cases, IFC reviews the FI's ESDD according to the timeframe specified in the legal agreement (para 7.2.10 & 9.2.3) → ESRP5 provides procedures on how IFC should respond to a CAO complaint, notification of a serious incident at a project or media coverage and/or NGO interest in a project. Notable, in response to a serious incident, IFC should schedule a site visit, request the client to prepare a root cause analysis and an action plan with a schedule for full implementation. IFC monitors to ensure the action plan fully responsive to remedial needs, committed to by management and fully funded (ESRP5).

³⁴ IFC Sustainability Policy (2012) – para 45.

IFC ESDD Review of HSR Project

The supervision phase of this investment commenced when IFC made its first disbursement to the Fund in July 2012.³⁵ In August 2012, IFC reviewed the Fund's ESDD for its first proposed investment; the HSR project. The purpose of the ESDD review was to ensure that the Fund was properly applying IFC's Performance Standards and relevant World Bank Group Environmental, Health and Safety Guidelines to the project. This section presents an overview of the process and considers the adequacy of IFC's review considering the specific concerns raised by the complainants.

Summary of Findings:

IFC failed to identify shortcomings in the project's E&S assessment compared to good international industry practice and the requirements of the Performance Standards, in particular:

- IFC did not assure itself that the Fund had adequately assessed potential impacts on water and dam safety risk associated with the project particularly given the change in the size of the plant and the dam.
- IFC did not take adequate steps to assure itself that the project met IFC's requirements for consultation and disclosure.
- IFC's review was not sufficient to ensure that the Fund had correctly assessed the application of Performance Standard 7 to the project, in particular the requirement for Free Prior Informed Consent for projects impacting land and natural resources under traditional ownership or customary use.
- IFC did not assure itself that the Fund had adequately assessed potential economic displacement as a result of the project.

IFC's ESDD review was not sufficient to ensure that the Fund had correctly applied its E&S requirements to the project.

Overview of IFC's ESDD Review

IFC's role in reviewing the Fund's ESDDs for prospective investments was a key mitigation measure as agreed between IFC and the Fund. Fifteen (15) business days prior to the Fund's internal approval of a proposed investment, the Fund was required to provide IFC with its ESDD report and any E&S Action Plan (ESAP) for the proposed investment. IFC had 10 business days to review and make recommendations to the Fund in respect of the proposed investment. Where IFC made recommendations, the Fund agreed to address these by updating the ESAP for the project.

The Fund prepared an ESDD report for its investment in HSR between July and August 2012. In preparing the ESDD report, staff of the Fund conducted a two-day visit to the project area. This included a visit to the project site, a meeting with the project developer, a meeting with Centro para el Desarrollo Rural (CEDER)³⁶ and a meeting with *Consejos Comunitarios de Desarrollo*

³⁵ IFC completed its first disbursement to the Fund on July 30, 2012. As IFC had cleared all conditions of the ESAP at commitment, the only E&S condition of disbursement was a representation from the Fund that no amendments had been made to its ESMS since IFC's commitment. IFC received this representation. The purpose of this disbursement was to support the Fund's administrative expenses.

³⁶ CEDER is a nongovernmental organization that was contracted by the project to conduct community consultation and outreach activities in the project area.

(COCODES)³⁷ representatives from communities in the project area who gathered in the city of Coban – 40km from the project site.

Following the site visit, the Fund informed IFC that it was considering an investment in HSR. The Fund reported that the project was in final design stage with construction expected to commence in November 2012.

The Fund assigned the project an E&S Category B meaning that it had limited potential adverse E&S risks and impacts that were few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures.³⁸ The categorization decision was based on an assessment that the project would have only temporary impacts during construction. The Fund reported expected positive benefits of the project including the provision of electricity infrastructure, improvements of access roads and a small number of jobs for local individuals. The Fund noted that the project would provide the infrastructure to enable villages to access power, but it could not act as the power distributor as this needed to be negotiated between the state distributor and each village.³⁹

In August 2012, the Fund provided IFC with its ESDD report for review.⁴⁰ The Fund also provided IFC with underlying E&S assessment documentation for the project. This included a project Environmental Impact Assessment (EIA, 2009), a community relations plan (2011) and an environmental and social mitigation plan (2011). Notably, this documentation did not include a social impact assessment or equivalent. IFC reviewed the Fund's ESDD and provided comments, to which the Fund responded. Thereafter, IFC recommended that the Fund include additional mitigation measures in the project ESAP. IFC's recommendations included requirements to enhance E&S management, monitoring plans, assessment of vector-borne diseases and develop a stakeholder engagement plan and grievance mechanism.

In October 2012, IFC completed a disbursement to the Fund for its investment in HSR project.

In December 2012, an independent consultant commissioned by the Fund and FMO, completed an E&S review of the project (hereafter the Consultant's E&S Review). The consultant reviewed project documentation and visited the project site in mid-August 2012. The consultant recommended classifying the project as Category B under IFC's framework and Category B+ under FMO's framework, considering: (i) the limited experience of the developer, (ii) the general climate for hydro project developments in Guatemala, and (iii) weaknesses in the environmental and social assessment process.⁴¹

The Consultant's E&S Review provided a more critical perspective on the project than either the Fund's ESDD report or IFC's ESDD review, concluding that: (i) the EIA for the project had a number of important gaps in terms of its analysis of project impacts on biodiversity, drinking water,

³⁷ COCODES are a representative body of community leaders who are appointed by the local mayor with the goal of representing the community and providing input into development planning. Other representative bodies for Q'eqchi' community members include *Comité de Ancianos* (Committee of Elders), other local organizations such as the women's committee, local sections of trade unions or peasant movements (e.g. *Comité de Unidad Campesina* – CUC and *Coordinadora Nacional Indígena y Campesina* – CONIC).

³⁸ The client uses IFC's E&S categorization criteria. See IFC Sustainability Policy 2012, para. 40.

³⁹ Alta Verpaz has 35 percent electricity coverage, the lowest in Guatemala. See Government of Guatemala (2013), *Política Energética 2013-2027*, available at <https://goo.gl/phWhdV>.

⁴⁰ IFC received the following primary documentation; i) EIA (2009), ii) Study of Land Use (2008); iii) Forest Management Plan; iv) E&S Action Plan (2011). The EIA was prepared on the basis of an 18-20MW power plant with a 10m high dam. The project as proposed was for a 24.6MW power plant with a 17.5m dam.

⁴¹ Additional detail on FMO E&S categorization standard available in FMO's Sustainability Policy, available at <https://goo.gl/Avg7VK>.

livelihoods, and cultural heritage; (ii) project E&S staff capacity was very limited; and, (iii) there were gaps in the consultation process.

As a result, the consultant recommended a series of action plan items. These actions were reflected in a time bound ESAP that was significantly more detailed than that provided in the Fund's ESDD report reviewed by and agreed with IFC. Of relevance to the issues raised in the complaint, the consultant's ESAP recommended further assessment of project impacts on livelihood, including community access to drinking water and agricultural uses of the project property. The consultant also recommended further analysis of indigenous peoples' customary use of land and natural resources in the project area to ensure compliance with PS7. Each of these additional assessments were included in the project's ESAP and required prior to agreement on debt financing of the project.

Subsequently, FMO decided to categorize the project as Category A indicating that it had potential significant adverse environmental or social risks and/or impacts that are diverse, irreversible or unprecedented.⁴²

More detailed analysis of IFC's ESDD review in the context of the issues raised by the complaint is provided below.

Potential for Project Impacts on River Use

The complainants raise concerns related to the project's impact on the river, which they state, both up and downstream communities depend on for drinking, bathing, washing, irrigation, fishing, transportation and recreational use.⁴³ In particular, the complainants raise concerns about availability of water to downstream communities.

Project Design and Environmental Flow

The project's design includes the construction of a 17.5m high and 64m wide dam and a 551m long canal. As designed, the dam would create a temporary reservoir and divert the river to the canal - thus providing a flow of water to generator the hydro power plants turbines.

While most of the river is diverted towards the canal, a portion of the river will continue to flow down its natural route. This residual flow is referred to as the Environmental Flow. A minimum environmental flow "refers to the quality, quantity, and timing of water flows required to maintain the components, functions, processes, and resilience of aquatic ecosystems that provide goods and services to people."⁴⁴

IFC Requirements

Performance Standard 1 requires a process of E&S assessment that is consistent with good international industry practice.⁴⁵ The process "will consider all relevant environmental and social

⁴² FMO (no date) Santa Rita Investment Consortium <https://goo.gl/eNVhf0>.

⁴³ Complaint to CAO, October 27, 2014

⁴⁴ Hirji, R. & Davis, R (2009) *Environmental Flows in Water Resources Policies, Plans, and Projects*. Published by the World Bank at <https://goo.gl/d2lgDJ>.

⁴⁵ PS1, para 7.

risks and impacts of the project, including the issues identified in Performance Standards 2 through 8, and those who are likely to be affected by such risks and impacts.”⁴⁶

Performance Standard 4 and 6 require that adverse impacts on ecosystem services, including the diminution or degradation of natural resources such as freshwater, be avoided.⁴⁷ Where impacts are unavoidable, the client is required to: (i) conduct a systemic review to identify priority ecosystem services and (ii) minimize the impacts and implement mitigation measures that aim to maintain the value and functionality of priority ecosystem services for Affected Communities.⁴⁸

Neither the Performance Standards nor the World Bank EHS Guidelines provide an explicit minimum percentage standard for a river’s environmental flow.

Discussion and findings

The Fund noted potential impacts on water quality during construction due to contamination of soil and other waste products. The Fund noted that these impacts would be monitored and measures developed to reduce impacts on water quality. The Fund also asserted that two independent reports confirmed that the design provided for the preservation of an appropriate environmental flow downstream. IFC did not recommend additional specific measures with regard to the potential impact of the project on access to water.

Subsequently, the Fund’s Consultant’s E&S Review noted that the project had an environmental flow approved by MARN but that further assessment was required to determine if this was adequate from E&S perspective. The Fund’s Consultant’s E&S Review noted that neither the EIA nor other project assessment documentation contained any information on the use of the river by local communities. Based on information provided by CEDER, the consultant noted that the river is used by all surrounding communities as a primary source of drinking water, but not for fishing or irrigation. The consultant also noted that there had been no detailed assessment of how changes in the river’s flow, development of a reservoir and restrictions on access to water may affect local usage of the river. As a result, the project’s ESAP was updated to require an additional assessment of the environmental flow requirement for the project based on longer-term hydrological data and result of additional biological monitoring.

Additional shortcomings in IFC’s ESDD review included the following.

First, IFC did not assure itself that the project impact assessment was up-to-date and based on appropriately detailed baseline data. The EIA for the project was finalized in 2009 on the basis designs for an 18-20MW hydroelectric power plant with a 10-meter dam.⁴⁹ However, in 2010 the project was revised to 23.6MW hydroelectric power plant with a 17.5-meter dam.⁵⁰ The Fund presented IFC with the revised project, however, provided IFC E&S assessment documentation for the original project design. The EIA for the project presented (i) insufficient description of the

⁴⁶ *Ibid.*

⁴⁷ PS6 (para. 2) defines ecosystem services as “the benefits that people, including businesses, derive from ecosystems. Ecosystem services are organized into four types: (i) provisioning services, which are the products people obtain from ecosystems [e.g. Freshwater]; (ii) regulating services, which are the benefits people obtain from the regulation of ecosystem processes; (iii) cultural services, which are the nonmaterial benefits people obtain from ecosystems; and (iv) supporting services, which are the natural processes that maintain the other services.”

⁴⁸ PS4 4, para 8 and PS6, para 24 and 25.

⁴⁹ The EIA notes the size of the hydroelectric power plant to be 18MW and 20MW at various points in the document.

⁵⁰ Letter from HSR to the UN CDM (May 2014). Available at <https://goo.gl/aZWz6d>

project, (ii) insufficient definition the project's area of influence,⁵¹ (iii) insufficient baseline analysis, and (iv) lacked an adequate social assessment of potential project impacts on communities.

Second, IFC did not assure itself that an assessment of community use of and dependence upon the river had been completed. Neither the Fund's ESDD review or the underlying project E&S assessment documentation included this type of analysis.

Third, the methodology used in preparing the environmental flow assessment was inconsistent with good international industry practice⁵² and was prepared on the basis of inconsistent monthly river flow data.⁵³

Consequently, absent an assessment of communities' use of the river, it was not possible to derive a minimum environmental flow requirement which ensured that the value and functionality of ecosystem services for Affected Communities were maintained.

Finding: IFC's ESDD review failed to identify shortcomings in the project E&S assessment compared to good international industry practice.

Dam Safety

The complainants allege that the EIA does not adequately assess the structural integrity of the proposed dam.

IFC Requirements

PS4 requires the client to "design, construct, operate, and decommission the structural elements or components of the project in accordance with GIIP [good international industry practice], taking into consideration safety risks to third parties or Affected Communities." Further, PS4 requires that "when structural elements or components, such as dams, tailings dams, or ash ponds are situated in high-risk locations, and their failure or malfunction may threaten the safety of communities, the client will engage one or more external experts with relevant and recognized experience in similar projects, separate from those responsible for the design and construction, to conduct a review as early as possible in project development and throughout the stages of project design, construction, operation, and decommissioning."⁵⁴ A risk assessment by an external expert is required for high-risk structural elements, such as dams located upstream from communities.⁵⁵

As reference for good international industry practice (GIIP), the World Bank considers dams over 15 meters in height to be large, and requires a higher level of review.⁵⁶ Relevantly, this includes a requirement to hire an independent expert to review the project throughout its life cycle.

⁵¹ Notably, the EIA did not indicate the size of the expected reservoir for the original 18-20MW project envisaged and no subsequent analysis of the impact of the larger reservoir was reviewed by IFC.

⁵² This was noted by the Fund's Consultant and a consultant hired by CAO to review the environmental flow assessment documentation.

⁵³ For example, the environmental flow assessment does not outline how the minimum flow was established and water flow data is inconsistent with other project assessments.

⁵⁴ PS4, para 6.

⁵⁵ PS4, Guidance Note 9.

⁵⁶ World Bank Operational Policy 4.37, Safety of Dams, October 2001. This is based on the definition of 'large dam' provided by the International Commission on Large Dams, see <https://goo.gl/3A6kEA>.

Discussion and Findings

The Fund reported that dam safety was reviewed by two independent consultants. Upon IFC's request, the Fund confirmed that the dam's design met safety standards without elaborating on what specific requirements were considered. In relation to project risks to communities, IFC recommended, as part of the ESAP, that an Emergency Preparedness and Response program be developed.

The EIA for the project was finalized in 2009 on the basis designs for an 18-20MW hydroelectric power plant with a 10-meter dam.⁵⁷ However, in 2010 the project was revised to 23.567MW hydroelectric power plant with a 17.5-meter dam.⁵⁸ The Fund presented IFC with the larger project, but the E&S assessment documentation for the smaller project design. There is no evidence that IFC requested E&S assessment documentation related to the revised project. Accordingly, IFC was not in a position to assure itself that the project's structural elements were designed and would be constructed, operated and decommissioned in accordance with GIIP taking into consideration safety risks for Affected Communities.

Under the World Bank operational guidelines, the proposed dam for this project would be considered a large dam, and, thus a requirement for the project to be reviewed by an independent expert throughout the project cycle would be applicable. The Performance Standards require external reviews of dam safety when malfunction may threaten the safety of communities. In this context, for the project to not require independent review through its life cycle, an analysis supporting limited risk to the safety of communities due to a failure of a project element or component was required. This type of analysis was not possible as the project lacked an adequate assessment of communities use of the river.

Finding: IFC did not assure itself that the Fund had adequately assessed dam safety risk associated with the project, particularly given the change in the size of the plant and the dam.

Project consultation

The complainants raise concerns about the project consultation process. They allege that the original consultation process was not transparent and that divisive tactics were used to win the favor of community leaders. They note that 14 local communities rejected the project in July 2010 and communicated this to the government, the project developer and CEDER.⁵⁹

In February 2012, the project developer commenced the dredging of the river. This led to protests by local communities. As reported in March 2012, a peasant movement supported by a national organization, CUC, marched 200km to Guatemala City to protest the project and a Guatemalan military detachment was sent to the project area for one month.⁶⁰ The complainants report additional acts of opposition to the project in August and October 2012.⁶¹

⁵⁷ The EIA states the size of the hydroelectric power plant would be either 18MW or 20MW at different points in the document.

⁵⁸ Letter from HSR to the UN CDM (May 2014). Available at <https://goo.gl/aZWz6d>

⁵⁹ Complaint to CAO, October 27, 2014 and CAO compliance field visit, February 2016.

⁶⁰ Noticias (March 19, 2012) Campesinos inician marcha de varios días para hacer llegar sus demandas al gobierno. Available at <http://goo.gl/J7z9Wl>

⁶¹ Letter from Consejo de Pueblos de Tezulutlán Manuel Tot to UN CDM, March 14, 2014. Available at <http://goo.gl/WHAKUT>.

Albedrio.org (April 2012) *Ante la amenaza de la construcción de la hidroeléctrica Sta. Rita en Río Dolores y la instalación de un destacamento militar en la localidad*, available at <https://goo.gl/RnVaPb>

IFC Requirements

PS1 requires clients to “provide Affected Communities with access to relevant information on: (i) the purpose, nature, and scale of the project; (ii) the duration of proposed project activities; (iii) any risks to and potential impacts on such communities and relevant mitigation measures; (iv) the envisaged stakeholder engagement process; and (v) the grievance mechanism” (para. 29).

PS1 requires clients to “undertake a process of consultation in a manner that provides the Affected Communities with opportunities to express their views on project risks, impacts and mitigation measures, and allows the client to consider and respond to them” (para. 30). PS1 outline a series of steps to ensure effective consultation. Specifically:

Effective consultation is a two-way process that should: (i) begin early in the process of identification of environmental and social risks and impacts and continue on an ongoing basis as risks and impacts arise; (ii) be **based on the prior disclosure and dissemination of relevant, transparent, objective, meaningful and easily accessible information which is in a culturally appropriate local language(s) and format and is understandable to Affected Communities**; (iii) focus inclusive engagement on those directly affected as opposed to those not directly affected; (iv) **be free of external manipulation, interference, coercion, or intimidation**; (v) enable meaningful participation, where applicable; and (vi) be documented. The client will tailor its consultation process to the language preferences of the Affected Communities, their decision-making process, and the needs of disadvantaged or vulnerable groups. **If clients have already engaged in such a process, they will provide adequate documented evidence of such engagement** (para. 30, emphasis added).

“For projects with potentially significant adverse impacts on Affected Communities”, PS1 requires clients to ensure that there is Informed Consultation and Participation (ICP). This consultation process involves more “in-depth exchange of views and information” and the client’s incorporation of the views of Affected Communities in the decision making process on matters that will affect them. To meet the ICP standard, the client is also required to “document the process, in particular the measures taken to avoid or minimize risks to and adverse impacts on the Affected Communities, and will inform those affected about how their concerns have been considered” (para. 31).

The ICP standard also applies to any project that affects Indigenous Peoples. In such cases, the client is required to address any adverse impacts of the project on Indigenous Peoples through the development of a time bound action plan with the ICP of the Affected Communities of Indigenous Peoples.⁶²

Discussion and Findings

As noted in the Fund’s ESDD report, CEDER had been conducting consultation and outreach on behalf of the project with two affected communities and 15 other communities in the project area for two years. The ESDD report noted that the project had only two Affected Communities, San Isidro and Monte Olivo (see map in Annex A), that would be impacted due to movement of material, machinery and personnel to project site. Further, the Fund noted that CEDER had interviewed every family in the affected villages and that CEDER representatives had maintained a constant presence on the ground. Accordingly, the Fund asserted that consultation met IFC requirements for informed consultation and participation (ICP). The Fund reported previous protests in opposition to the project. As reported, these protests were organized by a national

⁶² PS7, para. 9

NGO who would bus in protesters from other areas. The Fund reported that these protests had been unsuccessful in raising local opposition against the project.⁶³

In its review, IFC noted that the Fund should ensure that it documented the consultation process in sufficient detail. IFC recommended the Fund develop a Stakeholder Engagement Plan to ensure implementation of the social actions and impacts in the affected communities, including a grievance mechanism. No gaps in consultation were identified.

The consultant's E&S Review noted basic information about the project had been disclosed to communities, but that this did not include design changes, details on the size of the reservoir, or potential fluctuations in the river flow. Based on information from CEDER, the consultant noted that the project appeared to have broad public support in neighboring communities. However, the consultant also noted that protests in April 2012 placed the project under more scrutiny and raised the standard of care required for its successful implementation. In this context, the consultant noted that he was not provided the time or resources to interview local community members or opposition groups. The consultant also noted that it may not have been appropriate to undertake local consultations given recent tensions over the project.

CAO finds weaknesses in IFC's review of project consultation against the PS1 requirements for ICP. The Fund's assessment was made on the basis of a review of project consultation documentation and an off-site meeting with community leaders organized by CEDER. IFC's review did not: (i) raise concerns with the methodology used by the Fund to assess project consultation;⁶⁴ (ii) adequately examine the consultation process through a review of documentation evidencing such an engagement (PS1, para. 30); or (iii) give due consideration to reports of public opposition to the project. Specifically, in relation to reports of public opposition to the project, IFC's review relied on the Fund's assessment of the issue without cross checking this against other sources of information.⁶⁵

Further, CAO finds that IFC overlooked shortcomings in the project E&S assessment documentation as relevant to community consultation. As noted above, i) the EIA provided to IFC considered a project of smaller size than the one the Fund proposed to develop; and ii) there were significant weaknesses in the project's EIA including insufficient description of the project area and insufficient assessment of potential social impacts on communities. Accordingly, IFC did not have a basis to assure itself that information disclosed to communities was relevant to the "purpose, nature, and scale of the project" and "objective, [and] meaningful" as these risks had not been adequately considered in prior assessments available to IFC.⁶⁶

In this context, CAO notes that the Independent Consultant's Review, completed subsequently to IFC's ESDD review raised concerns that, key changes in the design of the project (including the increase in the size of dam and reservoir) had not been adequately disclosed to communities.

⁶³ Prior to IFC's first disbursement to the Fund for the HSR project in October 2012, another investor in the Fund consulted with IFC in relation to media coverage from April 2012 of protests at the project (see <https://goo.gl/RnVaPb>). IFC's view was that these protests were organized by a national organization in Guatemala.

⁶⁴ The Fund's meeting with community representatives was organized by the project developer and held in the city of Coban – 40 kilometers from the project site. The purpose of the meeting was for the project developer to provide an update on project process – not specifically for the Fund to seek the views of community representatives.

⁶⁵ As noted above, information on the disputes was publically available at the time of IFC's ESDD review. This web post, representing the view of the complainants alleges that a military unit was dispatched to the project area in April 2012 in response to opposition to the project. Some community members alleged lack of consultation on the project and impacts on water due to initial construction work. See <https://goo.gl/RnVaPb>

⁶⁶ PS1 (2012), para 29 & 30.

Finding: IFC did not take adequate steps to assure itself that the project met IFC's requirements for consultation and disclosure.

Project Impact on Indigenous Peoples

The complainants are Indigenous People. They allege that if IFC Performance Standard 7 on Indigenous Peoples had been properly applied to the project, adverse social impacts on nearby communities could have been avoided and/or minimized.

As noted above, the complaint states that nearby villages use the river for a range of purposes. During CAO's site visit, the complainants and other local community members also advised CAO that the river on which the project is to be developed is sacred. Specifically, CAO was informed that the river is considered a living entity and that community members engage in ritual practices to maintain their bond with the river.

IFC Requirements

PS7 provides specific requirements for managing project impacts on Indigenous Peoples. Where there are indigenous communities within a project's area of influence, the client is required to assess any "economic, social, cultural, and environmental impacts on Indigenous Peoples," both "direct and indirect".⁶⁷

Where a project is expected to have adverse impacts on Indigenous People, PS7 requires that these impacts should be "avoided where possible" and where unavoidable that "the client will minimize, restore and/or compensate for these impacts in a culturally appropriate manner"⁶⁸

As noted above, IFC clients are required to ensure that any project affecting Indigenous Peoples meets the Informed Consultation and Participation (ICP) standard for community engagement.⁶⁹ However, a higher standard of Free, Prior and Informed Consent (FPIC) is required where there are "adverse impacts" on land and natural resources under traditional ownership or customary use or where a project may significantly impact on critical cultural heritage.⁷⁰ Where FPIC is applicable, the client will document "(i) the mutually accepted process between the client and Affected Communities of Indigenous Peoples (IPs), and (ii) evidence of agreement between the parties as the outcome of the negotiations." (PS7 para.12)

Discussion and Findings

The Fund's ESDD report for the project acknowledged that the communities within the project area are indigenous. The Fund's noted that two communities (San Isidro and Monte Olivo) could experience adverse impacts from the transportation of equipment and material to the project site during the construction phase, but that they are not close enough to experience adverse impacts from construction. The ESDD report further stated that there is no cultural heritage resources or areas of cultural significance impact by the project. As a result, the Fund's view was that FPIC was not applicable as the affected villages would not experience "significant adverse impacts"

⁶⁷ PS7 (2012), para. 8.

⁶⁸ PS7 (2012), para 9.

⁶⁹ PS7 (2012), para 9.

⁷⁰ As outlined in PS7 (para. 12), "FPIC builds on and expands the process of ICP described in Performance Standard 1 and will be established through good faith negotiation between the client and the Affected Communities of Indigenous Peoples...FPIC does not necessarily require unanimity and may be achieved even when individuals or groups within the community explicitly disagree."

from the project. IFC reviewed and did not object to the Fund's conclusion that the project did not require FPIC.

The Consultant E&S Review noted that FPIC did not appear to apply for this project. At the same time, however, the consultant noted that the project assessment of impacts on Indigenous Peoples was insufficient, in particular in relation to land and natural resources under customary use, and potential cultural heritage impacts. Accordingly, the consultant recommended additional assessment of such impacts prior to financing.

CAO finds that IFC's review of the Fund's application of PS7 to the project – in particular the FPIC requirement - was inadequate for the following reasons.

First, while it is acknowledged that there were Indigenous Peoples in the project area, IFC did not assure itself that there was an adequate assessment of the project's impacts on Indigenous Peoples. Neither, the Fund's ESDD review or the underlying project E&S assessment documentation included an assessment of the economic, social, cultural, and environmental impacts on Indigenous Peoples as required by PS7.⁷¹ Indeed, no social impact assessment was included in the E&S documentation. To the extent that information on social impact was provided, this was included in the EIA. However, the EIA presented minimal information on Indigenous Peoples' use of the river and surrounding lands whether for livelihoods or cultural purposes. The EIA draws conclusions that the project will have only positive social impacts without presentation of supporting evidence or analysis. The Consultant's E&S Review also identified the absence of an adequate social assessment, in particular in relation to potential project impacts on drinking water access, livelihood, and land acquisition. Further the consultant noted land tenure to be a major source of social conflict in the area.⁷² These gaps were not flagged in IFC's ESDD review.

Second, IFC did not ensure correct application of the FPIC requirement under PS7. According to PS7, FPIC is required for projects that have "adverse impacts" on lands or natural resources subject to traditional ownership or under customary use. The Fund's statement that FPIC did not apply as affected communities would not experience "significant adverse impacts" represented a narrowing of this requirement. As noted above, project E&S assessment documentation provided to IFC did not include an analysis of the project's impacts on the use of the river by local communities as a source of drinking water. This was particularly important given reports that preliminary construction work in early 2012 had led to sedimentation of the river. The Consultant's E&S Review also noted the lack of a study of potential livelihood impacts arising from local communities' use of parts of the project property for agriculture. Further, CAO notes that the project included the acquisition of rights-of-way from the municipality and local communities for construction of the transmission line. No analysis of the impacts of the construction of the transmission line is included in the project E&S documentation. Considering the above, CAO finds that IFC did not require appropriate assessment of potential adverse impacts of the project on lands or natural resources subject to traditional ownership or under customary use by Indigenous Peoples (PS7, para. 13-14). In these circumstances, CAO finds that IFC had insufficient basis to conclude that the project could proceed without FPIC.

⁷¹ PS7 (2012), para. 8 & 9.

⁷² The propensity for violent land conflict in Guatemala is well documented beyond the consultant's report. Land claimed by indigenous groups is reported as being particularly prone to conflict including in cases where indigenous groups oppose development projects such as hydropower projects and Alta Verapaz is reported as having one of the highest incidences of land disputation in Guatemala. USAID (2005) *Guatemala: Land Conflict Assessment* <https://goo.gl/1Affeh>; IACHR (2015) *Situation of Human Rights in Guatemala*, <http://goo.gl/7MhyNG>

Third, as noted above, CAO was informed by the complainants and others within the local community, that the river on which the project was to be developed has cultural significance. The EIA notes that there are no sites of cultural significance on the project property. Documentation or evidence of field work to support this analysis is absent. Rather than a cultural heritage assessment, the Fund noted that the project would implement a procedure to manage chance find of sites of cultural significance. CAO notes that indigenous groups in Guatemala are known to attach cultural significance to rivers in some instances.⁷³ In this context, an appropriate E&S impact assessment required a cultural heritage assessment as provided for in PS7 and PS8.⁷⁴ IFC did not recommend that this type of assessment be prepared.

Finding: IFC's review was not sufficient to ensure that the Fund had correctly assessed the application of Performance Standard 7 to the project, in particular the requirement for Free Prior Informed Consent for projects impacting land and natural resources under traditional ownership or customary use.

Land acquisition and displacement

The complainants raise concerns that the project may lead to economic displacement for communities upstream and downstream from the dam. In particular, they argue that the lack of specific information on the flood zone upstream of the dam, or on the flow conditions in the zone downstream, fails to forecast economic displacement for several communities on the shore of the Río Dolores.⁷⁵

IFC Requirements

IFC's requirements on Land Acquisition and Involuntary Resettlement (PS5) apply to economic and physical displacement caused by "project-related land acquisition and/or restrictions on land use".⁷⁶ The application of these requirements is designed to be established during the environmental and social risks and impacts identification process.⁷⁷

PS5 "does not apply to resettlement resulting from voluntary land transactions" or "to impacts on livelihoods where the project is not changing the land use of the affected groups or communities".⁷⁸

Where a project is expected to result in economic displacement, PS5 requires that displaced persons who have legal tenure or recognizable rights to land be compensated with replacement property of greater or equal value, or provided cash compensation. Where economically displaced persons do not have legally recognizable claims to land they should be "compensated for lost assets other than land (such as crops, irrigation infrastructure and other improvements made to

⁷³ Q'eqchi' people are reported to believe that the *Tzuultaq'a* (a spirit) lives inside the mountains, more specifically in caves; however, other natural features such as ridges, springs and rivers are also recognized as manifestations of the *Tzuultaq'a*. See Grandia, L. (2012) *Enclosed: Conservation, Cattle, and Commerce Among the Q'eqchi' Maya Lowlanders*. p.75; and Wilson, R. (1999) *Maya Resurgence in Guatemala: Q'Eqchi' Experiences*, p. 144.

⁷⁴ PS7 (2012) para 16 & 17, PS8, Guidance Notes Annex B.

⁷⁵ Complaint to CAO.

⁷⁶ PS5 (2012), para 18.

⁷⁷ PS5 (2012), para 4.

⁷⁸ PS5 (2012), para 6.

the land), at full replacement cost.”⁷⁹ In addition, PS5 requires displaced persons to be provided with sufficient support to reestablish their livelihoods.⁸⁰

Discussion and findings

The Performance Standards require an assessment of project impact on land use, including where the people using the land are not the legal owners.

The Fund reported to IFC that PS5 was not applicable as the land for the project was acquired from a private landowner on a voluntary basis and that no economic displacement would occur as a result of the project.

The project’s EIA noted, however, that farmers have cleared significant areas of project land for the cultivation of subsistence crops. The Consultants E&S Review provided photographic evidence of the same while noting the project developer’s assertion that the project would not interfere with these existing uses.

Absent an appropriate social impact assessment for the project and a survey which considered project impacts on existing land use, it was not possible to correctly determine the applicability of PS5.

Further, the dam was redesign to provide for a larger reservoir after the completion of the EIA. An updated assessment of project impacts on land use was absent. As noted above, an assessment of the impact of the transmission line was similarly absent. A survey of the land related impacts of the transmission line would also have been required to determine the applicability of PS5.

Finding: IFC did not assure itself that the Fund had adequately assessed potential project impacts on economic displacement.

Summary – IFC ESDD Review of HSR Project

A range of potential E&S impacts are known to be associated with hydropower projects, including smaller run-of-river hydropower projects. The Performance Standards framework requires that these are identified and mitigated as part of the E&S assessment process. Areas of potential impact associated with hydropower projects as acknowledged in the industry include: i) changes in aquatic and terrestrial ecosystems as a result of creation of reservoirs, alternations in river flow and flood cycles; ii) greenhouse gas emission from newly created reservoirs; iii) physical and economic displacement of communities including indigenous people and loss of access to natural resource and cultural heritage; iv) use of existing water resource as related to fisheries, water supply and transportation; v) safety factors of the infrastructure and potential effects on downstream communities; and vi) cumulative effects on natural resources.⁸¹

IFC reviewed the Fund’s ESDD for the project in August 2012. Based on the review, IFC provided feedback to the Fund as envisaged in the investment agreement. IFC’s review led to the development of additional mitigation and monitoring measures to be included in the project ESAP.

⁷⁹ PS5 (2012) para 27.

⁸⁰ PS5 (2012) para 25.

⁸¹ See: OPIC *Environmental Guidance Renewable Energy – Hydro Projects* (2012), available at <https://goo.gl/DgwK79>. Further guidance provided in *The Report of the World Commission on Dams* (2000), available at <https://goo.gl/QNY16z>; UNEP *Dams and Development Report; Relevant Practice for Improved Decision Making* (2007), available at <https://goo.gl/UzHaLW>; and IFC *Hydroelectric Power: A guide for developers and Investors*, available at <https://goo.gl/5UTC9K>

However, IFC's review overlooked manifest shortcomings in the project's E&S assessment documentation compared to IFC requirements and good international industry practice. As discussed above, these included: (a) inadequate environmental and social baseline information, (b) assessment documentation that did not adequately define the project and was prepared on the basis of smaller project than that which was presented to IFC, and (c) a lack of analysis of project impacts on biodiversity, drinking water, livelihoods, and cultural heritage.

Gaps in the E&S assessment combined with a lack of E&S systems at the project level were serious enough to have raised questions about the project's readiness for construction within the three-month period that was envisaged at the time. Nonetheless, IFC endorsed the project recommending only that an additional vector-borne disease assessment would be required to meet PS requirements.

In this context, CAO finds ***IFC's ESDD review was not sufficient to ensure that the Fund had correctly applied its E&S requirements to the project.*** In the context of a new FI1 Fund, weaknesses in IFC's approach included: (i) the short timeframe which was agreed upon for IFC's ESDD review (ten days); (ii) IFC's lack of access to relevant sources of information about the project (e.g. access to project site, the project developer, affected communities, and other stakeholders); and, (iii) a lack of relevant technical expertise in the review process. To effectively review the application of E&S standards to this hydro power plant was a complex task which required time and resources beyond that which IFC dedicated to the process.

IFC Supervision post ESDD review

This section summarizes IFC's supervision of the Fund as related to the project. It outlines IFC's response to incidents in the project area and analyzes these in the context of IFC's supervision requirements.

Summary of Findings:

IFC's supervision did not provide sufficient evidence to conclude that the Fund was correctly applying IFC's E&S requirements to the project.

Given the ongoing conflict around the project, and persistent concerns about local impacts, additional supervision was required by IFC, in particular in relation to: (i) the adequacy of additional E&S assessments required by the project ESAP, (ii) the decision not to apply FPIC to the project; and, (iii) the client's security management plan.

Project construction: January – June 2013

In January 2013, the client informed IFC that it had taken a number of measures to mitigate potential disruption of the project due to social concerns. These included: (i) implementing a community outreach and communications program in preparation for contractor mobilization; and, (ii) agreeing to local development measures such as road improvement works, and hiring 75 people from the local community during construction.

In February 2013, IFC completed a second disbursement to the Fund for the project. The purpose of the investment was to support initial construction work.

Subsequent to IFC's disbursement, in February 2013, CUC and some members of the COCODES released a statement making a series of negative allegations against HSR. Specifically, they alleged that: (i) the project would adversely impact communities' access to water; (ii) project

consultation had focused on providing benefits to communities who supported the project which had resulted in division between communities; (iii) HSR had supported the mobilization of the national military to the project area in 2012; (iv) HSR had applied pressure to communities and their leaders to support the project, including attempts to criminalize community members; and, (v) arrest warrants had been issued against individuals who opposed the project.⁸²

In May 2013, IFC completed a third disbursement to the Fund for the project. Prior to this disbursement, the Fund provided IFC with a status update on the project. The Fund reported that most of the actions in the project's ESAP had been completed, that project construction had commenced and that an E&S officer was expected to join the project in June 2013. The Fund also reported that a local E&S consultancy firm had been hired to provide independent monitoring of project implementation. CAO notes that there is no evidence in IFC's documentation that IFC requested or reviewed any of the additional assessments required under the project's ESAP.

Social incidents July – December 2013

Between July and August 2013, a number of incidents were reported in relation to the project. As subsequently reported by the Fund, in mid-July a group of armed people entered the project site on two occasions and damaged construction machinery. Soon afterwards, people opposing the project blocked the road at Monte Olivo preventing access to the project site. At this point, construction of the project was suspended and the project hired additional personnel to manage community social issues instead of CEDER.⁸³

In mid-August, IFC completed a fourth disbursement to the Fund for the project. Following this disbursement, the Fund reported that: (i) the project had completed all ESAP conditions and other E&S requirements for financial close; (ii) early work in the project area had led to an increase in entrepreneurial activity among the local community; and, (iii) the project faced opposition from a small group of people from the village of Monte Olivo. Nonetheless, the Fund asserted to IFC that the vast majority of people in the area supported the project.

On August 23, 2013, two children and one adult were killed in the village of Monte Olivo. As reported in media articles at the time, the two children were allegedly killed by an individual who previously worked with the project. Subsequently, the suspected perpetrator was killed, allegedly by members of the local community.⁸⁴

In relation to this incident, the complainants have alleged that the individual who killed the children worked at the project and that HSR played a significant part in this incident.⁸⁵

The Fund informed IFC of this incident and subsequently provided IFC with an incident report. The incident report provided additional detail on the August 23 incident and detailed a series of actions the project had implemented since July 2013. IFC subsequently provided advice to the Fund to improve its security management plan.

In October 2013, the Fund provided IFC with a private investigation report into the August 23 incident prepared by an international consultancy firm. The report was prepared on the basis of interviews with a number of people with different accounts of the events. While the report noted

⁸² Denuncia Publica contra Hidro Santa Rita en Alta Verpaz (February 16, 2013). Available at <https://goo.gl/V4wOXu>

⁸³ HSR letter to UN CDM, May 20, 2014 and CAO compliance appraisal report.

⁸⁴ The incident was reported by Terra (August 27, 2013); <https://goo.gl/MrkWX9>, Prensa Libre (August 29, 2013); <https://goo.gl/Xypkfh> (subscription), Agence France-Presse (August 27, 2013) <https://goo.gl/3olRNA> (subscription), Inter-American Commission on Human Rights (August 24, 2013) <https://goo.gl/9OyEbu> .

⁸⁵ Complaint to CAO and CAO Assessment Report.

that there were a number of contradictory narratives, based on its analysis, the report found that the most credible version of events was that the alleged perpetrator of the August 23 incident had not been hired by the project to kill the two children, but rather that he did so while under the influence of alcohol.

On October 31, 2013, HSR suspended the project execution and declared Force Majeure to the Guatemalan Ministry of Energy and Mines (MEM).⁸⁶

A subsequent update from the Fund to IFC in November 2013 noted that the project sought to resume construction and was focusing its actions on (i) mitigating the situation from a public relations, legal and financial perspective, (ii) revising its approach to engagement with local communities, and (iii) seeking greater involvement of the national government.

In November and December 2013, the complainants allege that a local landowner, who sold property to the project, organized violence against some community members. The complainants allege that opponents of the project entered the land in order to block access road to the project. They allege that five people were shot at on November 8, 2013 and four people in the community of Nueve de Febrero were attacked by people with machetes on December 8, 2013.⁸⁷

IFC AEPR Review

IFC received the Fund's 2012 AEPR in March 2013 (due April, 2013). This report focused exclusively on HSR. In August 2013, after the Fund sought feedback on its report, IFC was requested and the Fund submitted a revised 2012 AEPR. IFC completed its review of the AEPR in December 2013.

In its review, IFC noted that it discussed the social incidents of July/August 2013 with a social specialist from another investor who shared the Fund's view that the opposition to the project was isolated to part of the Monte Olivo community. As reported by IFC, the social specialist from the other investor was also of the view that the project had documented evidence of appropriate consultation and stakeholder engagement.

IFC provided the investment an environmental and social risk rating of 3: Partly Unsatisfactory. IFC noted that the project would update its contractor management plan, transportation security plan and enhance security measures in a manner consistent with PS4.

In communicating a summary of its review to the Fund, IFC commended the Fund on its implementation of its ESMS and for taking measures to address the social incidents related to project. IFC advised the Fund to hire a social specialist to review future projects which involve impacts on communities.

⁸⁶ Letter from HSR to the UN CDM (May 2014). Available at <https://goo.gl/aZWz6d>

⁸⁷ Complaint to CAO. This allegation was also reported publicly, see <https://goo.gl/wjKv98>.

IFC AMC Investment

In January 2014, IFC's Asset Management Company (AMC) made a US\$20 million investment in Fund.⁸⁸ The investment was financed through AMC's Catalyst Fund.⁸⁹ As agreed with the AMC, IFC is responsible for E&S review and supervision of AMC investments.

HSR update – March 2014

In March 2014, IFC received a project status update from the Fund. The Fund reported opposition to the project was from a small minority of the local communities who had previously been supported by national NGOs. The protests against the project, the Fund reported, had not been due to any specific impact, rather the project had been targeted as part of a board-based strategy by national NGOs against hydroelectric developments. The Fund noted that opposition to the project had weakened due to: (i) a reduction in financial support to local opponents of the project from national NGOs; (ii) the issuance of “many arrest warrants” at the urging of HSR against individuals involved in damaging project equipment; and, (iii) HSR's engagement with community leaders in order to facilitate a community agreement.

Project opponent allegedly killed by landowner – April 2014

The complainants note that in April 2014 an opponent of the project, Victor Juc, was allegedly killed by the former owner of the land upon which the project was expected to be constructed.⁹⁰ This incident was subsequently reported in the international media.⁹¹

IFC subsequent disbursement – May 2014

In May 2014, IFC completed its fourth disbursement to the Fund for the project.

United Nations CDM registration – June 2014

In June 2014, the project was registered by the United Nations Clean Development Mechanism (UNCDM).⁹² The UNCDM allows emission-reduction projects in developing countries to earn certified emission reduction credits which can be traded and sold. To be registered by the UNCDM, the project must substantiate that it is an emission reduction project, present information on the project design, impacts, mitigation measures and its approach to stakeholder engagement. Further, prior to UNCDM registration, the project requires approval by the national authorities and information presented in the application is verified by a private third-party certifier.^{93, 94}

⁸⁸ For further details, see <https://goo.gl/pdMlUR>

⁸⁹ AMC Catalyst Fund is a US\$418 million capitalized fund in which IFC has directly invested US\$75 million. Its objective is to make co-investments alongside IFC in private equity funds focused on low carbon and climate friendly projects and companies globally across the emerging markets. For further details, see IFC Summary of Proposed Investment in Catalyst Fund, <https://goo.gl/cZ2lfq>

⁹⁰ For further details, see <https://goo.gl/mDuCs8>.

⁹¹ Guardian Newspaper, March 26 2015, 'Green' dam linked to killings of six indigenous people in Guatemala. Available at <https://goo.gl/L3rSGO>.

⁹² UN CDM (June 2016), Meeting Report 79. Available at <https://goo.gl/2UEZd4>

⁹³ Further information on the UN CDM is available at <https://goo.gl/HmO4es>

⁹⁴ More generally, the UN CDM has also attracted criticism from international civil society organizations for i) permitting national authorities to define their own sustainability criteria rather than a common standard, ii) lack of explicated consideration for potential human rights impacts and iii) absence of a grievance mechanism for project affected people. For further information, see Carbon Market Watch at <https://goo.gl/fcVvW1>

Community Agreement – July 2014

On July 30, 2014, HSR signed a cooperation agreement with 14 community leaders (COCODES), including a representative of Monte Olivo – the location of the road block to the project site. The agreement called for cooperation between the community and HSR over the life time of the project. As part of the agreement, HSR agreed to establish a foundation to implement economic and social development projects in the local communities. The agreement was signed in the National Palace in Guatemala City under the auspices of the President of Guatemala. Further, the community representatives present requested the intervention of the government to take action against opponents of the project blocking access at Monte Olivo.⁹⁵ They also alleged that the opponents of the project were operating the road block as an illegal toll to extort money from other community members.

The complainants have alleged that the community representatives present did not have the authority from their communities to sign the corporation agreement. Further, the complainants have alleged that the community representatives that signed the agreement were all appointed by the regional mayor one month prior to the signing. The complainants provided CAO with documentation which they allege support these claims.

Social incidents – August 2014

In mid-August 2014, the Fund reported to IFC that 700 police officers, accompanied by a Guatemalan government independent human rights lawyer, went to Monte Olivo to remove the road block and execute two eviction orders; one for the HSR project site and the other for a neighboring farm. The Fund reported that the lawyer sought to negotiate with the project opponents before violence broke out. The Fund noted that two police officers were injured and five individuals were subsequently arrested. The following day, the police returned to Monte Olivo where they were not met with resistance. The police proceeded to the project site where, as noted by the Fund to IFC, they demolished up to fifteen structures on a neighboring farm which had allegedly been used by squatters.

This incident was reported widely in the local and national media. It was reported that the police used tear gas to disburse protestors and community members. As reported, this led to a mass evacuation by local community members to the nearby hills where they remained overnight until the police departed.^{96, 97}

The complainants assert that this incident resulted in the violent eviction of 10 families in the community of Nueve de Febrero as well as acts of repression against the community of Monte Olivo.⁹⁸

World Bank Annual Meetings – October 2014

Representatives of Guatemalan and international NGOs supporting the complainants met with IFC staff in Washington D.C. in October 2014. The NGOs discussed their concerns related to the

⁹⁵ A recording of the public announcement of the agreement at the National Palace in Guatemala City is available at <https://goo.gl/2vjGvA> and <https://goo.gl/v3sck2>

⁹⁶ For additional details see: Prensa Libre video report <https://goo.gl/N4vTrj>; Telesur - <https://goo.gl/QZ5CV1>; IHS Global Insights Daily Analysis - <https://goo.gl/yNRTcy> (subscription required); and, Truthout <https://goo.gl/tyhkJx>

⁹⁷ It was also reported that three people were killed, however, the Fund clarified that this occurred at a different hydroelectric project unconnected to HSR. The deaths of three people were not raised by the complainants in the context of this incident.

⁹⁸ Complaint to CAO.

project with IFC and provided IFC with documentation related to the August 2014 incidents. They also provided statements asserting local community opposition to the project. At the same time, IFC received documentation from the Fund which evidenced community support for the project.

Subsequently, the complainants submitted a complaint to CAO.

Recent IFC Supervision

IFC received the Fund's 2013 AEPR in April 2014. In November 2014, IFC completed its review of the AEPR. IFC's review considered information presented in the 2013 AEPR and subsequent information presented in relation to the August 2014 incidents. As follow up actions, IFC noted that it would continue to monitor the situation at the project and follow up with the Fund on any new allegations. IFC provided the investment an environmental and social risk rating of 3: Partly Unsatisfactory.

In December 2014, June 2015, February 2016, June 2016, December 2016 and May 2017, IFC completed disbursements to the Fund to support operating expenses of HSR. As of December 2016, the Fund confirmed to IFC that the project remains suspended and employs a part time project manager and a part time community relations manager.

Between 2014-2016, IFC reviewed two additional ESDDs prepared by the Fund for proposed renewable energy investments. In these reviews, IFC identified gaps in the Fund's E&S assessments and requested the Fund to undertake additional assessments with the assistance of third party specialists. Further, IFC reviewed the Fund's AEPRs for 2014 and 2015. IFC maintained the ESRR rating of 3: Partly Unsatisfactory on the basis of the incidents at the HSR project.

Discussion and Findings – IFC's E&S Supervision of the Fund and HSR

The Fund's investment in HSR was its first. It was also the Fund's only investment that had commenced construction through 2014. As a result, during the period 2012 – 2014 the HSR project was the only source of information for IFC on the effectiveness of the Fund's application of its E&S requirements to its sub-projects.

Although the project was generating E&S concerns, IFC provided limited advice on the project to the Fund during supervision.

Following the August 2013 incident, IFC advised the client to update the project's security management plan in accordance with PS4. This is the only documented advice IFC provided to the Fund regarding the project. More generally, IFC advised the Fund to hire a social specialist to review future projects which potentially involved impacts upon communities.

On one occasion following the August 2013 incident, IFC noted speaking to a social specialist from another investor in the project. IFC received and reviewed a private investigation report on the August 2013 incident commissioned by the Fund. During the World Bank annual meetings in October 2014, IFC met in Washington DC with representative of some local communities and international NGOs to discuss the project. Apart from this, IFC relied on the Fund's reporting to assure itself that the Fund was applying its E&S standards to the project. Provisions in the legal agreement that would have allowed IFC to conduct a project site visit in accordance with ESRP 5 procedures, were not activated. While CAO notes the view of IFC staff that a visit was not possible in the context of the ongoing social tension in the area, there was no analysis of alternative opportunities to verify client reporting (e.g. third party verification and engagement with stakeholders off site in Guatemala). IFC did not assist the client in developing an action plan in

response to the social conflict as provided for in its legal agreement and IFC's procedures (ESRP 5, para 2.2).

A range of risk factors meant that ***IFC's approach to supervision did not provide sufficient evidence to conclude that the Fund was correctly applying IFC's E&S requirements to the project.*** These included: (i) persistent allegations of adverse E&S impacts from representatives of local indigenous communities; (ii) the establishment and maintenance of a road block barring access to the project site; and, (iii) broader country governance related risks.

In this context, CAO finds that additional measures were required, for IFC to have reasonable assurance that the Fund was correctly applying the Performance Standards to the project, specifically, a technical review of: (i) the additional assessments provided for in the ESAP, in particular, the livelihood assessment and environmental flow assessment; (ii) the allegations of adverse impact raised by the communities opposed to the project and the adequacy of the project E&S assessment in addressing these; (iii) the applicability of PS7 (including FPIC requirements) in light of specific demands that the project be subject to an FPIC process; and (iv) the project's security management plan including an assessment of the risks arising from the project's reliance on government security forces to remove the road block in August 2014.⁹⁹ Where gaps are identified at the project level, the client was required to develop corrective measures for implementation at the project, in consultation with IFC, however CAO finds no indication that IFC took measures to ensure that this occurred.¹⁰⁰

Nearly four years after the project was suspended, IFC has continued to make disbursements for the project. Due to shortcomings in IFC's supervision of the Fund, CAO notes that IFC lacked a basis to be assured that the Fund was properly applying the Performance Standards to the project, or was implementing an adequate corrective action plan to resolve outstanding issues at the point of each disbursement.

At a systemic level, CAO notes that IFC's processing of disbursements for the project was not conditional on the Fund providing specific information in relation to the project's implementation of IFC's E&S requirements, including ESAP implementation. Rather, the Fund was required to make only general representations in relation to its E&S performance. There were no project level conditions of disbursement in IFC's investment agreement with the Fund. As a result, despite E&S concerns at the project level, IFC E&S staff were not required to clear subsequent disbursements for the project. This represents a gap in IFC's E&S procedures for private equity funds.

Also of systemic importance, CAO notes that IFC's approach to verification of the application of its E&S requirements to the project focused on the ESDD review, and included little ongoing oversight during project implementation. Beyond the requirement to review the client's E&S reporting, and potentially conduct sub-project site visits, IFC's E&S procedures provide little guidance to staff on how to supervise a PE Fund's ESMS implementation at the sub-project level.

⁹⁹ See PS4 (paras. 12-14).

¹⁰⁰ As provided for in IFC's legal agreement. See Annex B.

3. Conclusions

The objective of IFC's investment in the Fund was to support projects in the renewable power and energy efficiency sectors of Latin America and the Caribbean. The expected development impact of this investment included reducing carbon emissions, promoting growth, creating jobs in local communities, and supporting the business case for renewable energy and clean technology projects. The HSR project was aligned with the expected development impact of IFC's investment in the Fund.

IFC recognized that the Fund was planning to invest in projects that involved significant E&S risks. IFC appropriately categorized the investment FI1 and required the Fund to apply IFC's Performance Standards to its investments. However, considering the proposed business activities of the Fund, its lack of E&S experience, CAO finds that IFC's pre-investment review and mitigation measures agreed with the Fund were insufficient to generate an expectation that its investments in the Fund would meet the requirements of the Performance Standards within a reasonable period of time. In making this finding, CAO notes that IFC's standards for E&S review of private equity investments as applicable to this investment went beyond market guidance for private sector investors in similar circumstances.

In relation to the HSR project specifically, CAO finds that IFC's ESDD review, overlooked key weaknesses in the project E&S assessment. Relevant to the issues raised in the complaint, this included: inadequate environmental and social baseline information, out of date assessment documentation, and a lack of analysis of project impacts on biodiversity, drinking water, livelihoods, and cultural heritage. Gaps in the E&S assessment combined with a lack of E&S systems at the project level were serious enough to have raised questions about the project's readiness for construction within the three-month period that was envisaged at the time. In this context, CAO finds that IFC's ESDD review was not sufficient to ensure that the Fund had correctly applied its E&S requirements to the project.

Underlying the shortcomings in IFC's performance at the ESDD review phase was a risk mitigation framework which was not fit for purpose. Key structural weaknesses in the ESDD review process included: (i) the short timeframe which was agreed upon for IFC to complete its ESDD review (ten days); (ii) IFC's lack of access to important sources of information about the project (e.g. access to project site, the project developer, affected communities and other stakeholders); and, (iii) a lack of relevant technical expertise in the review process. In this context, IFC was not in a position to assist the Fund in developing mitigation measures to support implementation of the project in accordance with the Performance Standards.

IFC's approach to supervision of this investment, specifically in relation to the HSR project, did not provide IFC with sufficient evidence to conclude that the Fund was correctly applying IFC's E&S requirements to the project. Given the ongoing conflict around the project, and persistent concerns about local impacts, additional supervision was required by IFC, in particular in relation to: (i) the adequacy of additional E&S assessments required by the project ESAP; (ii) the decision not to apply FPIC to the project; and, (iii) the client's security management plan.

CAO notes IFC's view that a more active involvement by IFC during supervision of a private equity funded project risks transforming IFC's position from that of a limited partner to that of a general partner,¹⁰¹ resulting in additional financial risk to IFC. This concern, however, must be weighed

¹⁰¹ Limited partners provide financial backing to the partnership but have little role in management and no personal liability in excess of the amount of their original commitment. General partners are active in the day to day management of the private equity fund and do not have limited liability.

against IFC's E&S policies which require IFC to refrain from financing projects that cannot be expected to meet the requirements of the Performance Standards over a reasonable period of time.¹⁰²

Nearly four years after IFC's disbursement to the Fund, a road block to the project site maintained by community members opposing the project remains in place. The complainants maintain that the project has led to internal division within their communities which have ongoing impacts. The Fund has advised CAO that it has no longer plans to develop the project.

CAO will monitor IFC's response to the non-compliance findings made in this investigation.

¹⁰² Sustainability Policy (2012), para 22.

Annex A: Map of Project Area



Annex B: IFC E&S risk mitigation provisions agreed with the Fund

General E&S Risk Management Approach	
ESMS	
a.	Establish an ESMS to ensure that projects the Fund invests in operate in accordance with the Performance Standards and applicable national laws (“E&S requirements”).
b.	Commit only to investments where (i) any identified E&S risk has been resolved in accordance with the E&S requirements; or (ii) a corrective action plan is agreed and represented in the investment documentation to resolve identified adverse impacts within a reasonable timeline.
Capacity	
c.	Nominate an ESMS Officer reasonably acceptable to IFC with responsibility for implementing the ESMS. Retain the services of an external Environmental Advisor.
d.	Establish the position of ESMS manager with a requirement for that individual to complete a training program on the E&S requirements within 12 months of IFC’s commitment.
IFC ESDD Review	
e.	For the Fund’s first 3 investments and for all Category A investments ¹⁰³ ,
i.	Provide IFC with a Fund prepared E&S due diligence report and proposed corrective action plan for a proposed investment in a project at least 15 days prior to the Fund’s internal consideration.
ii.	IFC can provide the Fund with E&S recommendations in relation to proposed investment within 10 days of receipt of the above information.
iii.	E&S recommendations are considered by all of the Fund’s investors. A final corrective action plan will be prepared which the Fund investors can review and comment on.
Reporting Requirements	
f.	If the Fund becomes aware of additional E&S risk associated with an existing project, it will confirm to IFC that it has sufficient capacity to assess and manage the E&S risk going forward.
g.	Submit an annual E&S performance report to IFC. Where this report is not satisfactory to IFC, IFC has the right to commission its own report at a cost to the Fund.
h.	Notify IFC within 3 days of becoming aware of any serious E&S incidents.
i.	Inform IFC when a project is in breach of its E&S requirements and develop, in consultation with IFC, corrective measures for implementation at the project. Where a project does not implement corrective measures, use all reasonable efforts to either (i) assert and enforce the project to comply with the corrective measures or (ii) dispose of the investment on commercially reasonable terms.
Additional IFC Rights	
j.	IFC is not required to participate in a proposed investment in a project where to do so would violate IFC’s internal policy or constitutive documents. ¹⁰⁴
k.	Provide IFC access to visit the project site of any of the Fund’s investments.
l.	IFC is permitted to cease making capital contributions without penalty where the Fund has made investments in material violation of the E&S requirements.

¹⁰³ Define from IFC Sustainability Framework.

¹⁰⁴ Subsequently agreed in October 2012.

Annex C: Summary of Key Findings

IFC Requirements for Pre-Investment Review and Supervision	CAO Finding
IFC's Pre-Investment Review and Risk Mitigation Measures	
<p>IFC will classify the investment FI-1: when an FI's existing or proposed portfolio includes, or is expected to include, substantial financial exposure to business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented (SP, para. 40).</p> <p>FIs with portfolio and/or prospective business activities that present moderate to high environmental or social risks (i.e., Category FI-1 and FI-2) will require higher risk business activities they support to apply relevant requirements of the Performance Standards (SP, para. 35).</p>	<p>IFC appropriately categorized the investment as FI1 (high E&S risk) and required the Fund to ensure that projects it supported were operated in accordance with the Performance Standards.</p>
<p>IFC reviews the existing portfolio and prospective business activities of its FI clients to identify activities where the FIs and IFC could be exposed to risks as a result of their investments, and defines requirements for managing these risks. (SP, para. 34)</p> <p>IFC reviews client's identification of third party risks to determine whether such risks are manageable and if so under what circumstances to ensure outcomes are consistent with the PS. (SP, para. 23)</p> <p>IFC collects portfolio data for analysis. (ESRP, 7.2.14)</p> <p>IFC evaluates the client's ESMS and considers any actions that the client would need to undertake to address gaps in its ESMS (including ESMS implementation capacity) to ensure compliance with the Performance Standards. (ESRP, 7.2.18/19)</p> <p>Personnel within the client's organization with direct responsibility for E&S performance will have the knowledge, skills, and experience necessary to perform their work, including current knowledge of the host country's regulatory requirements and the applicable requirements of Performance Standards 1 through 8. (PS1, para 18)</p>	<p>IFC's E&S review of its investment in the Fund was not commensurate to risk.</p>
<p>IFC reviews the client's ESMS, considering its adequacy to implement IFC's E&S requirements. (ESRP, 7.2.18)</p> <p>Gaps in the ESMS of FIs that are engaged in projects with either potentially significant E&S risks must be closed to ensure compliance with the IFC's E&S requirements as a condition of IFC disbursement at latest (ESRP, 7.2.18);</p> <p>For PE Funds, IFC may reserve the right to review the client's E&S due diligence for a proposed investment to ensure the ESMS implementation is robust (ESRP 7 2.10)</p>	<p>Given the high E&S risk profile of the Fund's prospective investments and the client's limited capacity, the framework which IFC negotiated for review of the Fund's projects limited the ability of the E&S specialist "to determine whether the client's ESMS implementation [was] robust" as required by ESRP 7.2.10.</p>

IFC ESDD Review of HSR Project	
<p><i>In order to assure itself that the client's ESMS implementation is robust (ESRP 7.2.10), IFC reviews the client's ESDD to assure itself that it adequately evaluated project E&S risks in accordance with IFC's Performance Standard requirements. Where IFC identified gaps, IFC was could make recommendations to the client. IFC had 10 days to complete this task.</i></p>	
<p>PS1 requires a process of E&S assessment that is consistent with good international industry practice (para 4)</p> <p>PS4 & 6 requires that adverse impacts on ecosystem services, including the diminution or degradation of natural resources such as freshwater, be avoided. Where impacts are unavoidable, the client is required to: (i) conduct an assessment of priority ecosystem services and (ii) minimize the impacts and implement mitigation measures that aim to maintain the value and functionality of priority ecosystem services for Affected Communities (PS4 4, para 8 and PS6, para 24 and 25)</p>	<p>IFC failed to identify shortcomings in the project's E&S assessment compared to good international industry practice and the requirements of the Performance Standards, in particular:</p>
<p>PS4 requires the client to “design, construct, operate, and decommission the structural elements or components of the project in accordance with GIIP [good international industry practice], taking into consideration safety risks to third parties or Affected Communities.” For structural elements or components situated in high-risk locations, and their failure or malfunction may threaten the safety of communities, the client will engage one or more external experts to oversee the project throughout the project cycle. (para. 6)</p> <p>As reference for good international industry practice (GIIP), the World Bank considers dams over 15 meters in height to be large, and requires a higher level of review. Relevantly, this includes a requirement to hire an independent expert to review the project throughout its life cycle. (World Bank Operational Policy 4.37, Safety of Dams, October 2001)</p>	<p>IFC did not assure itself that the Fund had adequately assessed potential impacts on water and dam safety risk associated with the project particularly given the change in the size of the plant and the dam.</p>

IFC ESDD Review of HSR Project	
<p>PS1 requires</p> <ul style="list-style-type: none"> • Affected Communities provided with access to relevant information on the purpose, nature, and scale of the project (para. 29). • a consultation process which provide Affected Communities with opportunities to express their views on project risks, impacts and mitigation measures, and allows the client to consider and respond to them (para 30). Effective consultation should be "based on the prior disclosure and dissemination of relevant, transparent, objective, meaningful and easily accessible information which is in a culturally appropriate local language(s) and format and is understandable to Affected Communities" and "be free of external manipulation, interference, coercion, or intimidation"... If clients have already engaged in such a process, they will provide adequate documented evidence of such engagement (para. 30). • "For projects with potentially significant adverse impacts on Affected Communities", PS1 requires clients to ensure that there is Informed Consultation and Participation (ICP). This consultation process involves more "in-depth exchange of views and information" and the client's incorporation of the views of Affected Communities in the decision making process on matters that will affect them. To meet the ICP standard, the client is also required to "document the process, in particular the measures taken to avoid or minimize risks to and adverse impacts on the Affected Communities, and will inform those affected about how their concerns have been considered" (para. 31). 	<p>IFC did not take adequate steps to assure itself that the project met IFC's requirements for consultation and disclosure.</p>
<p>PS7 requires</p> <ul style="list-style-type: none"> • Where there are indigenous communities within a project's area of influence the client is required to assess any "economic, social, cultural, and environmental impacts on Indigenous Peoples," both "direct and indirect". Adverse impacts are to be "avoided where possible" and where unavoidable that "the client will minimize, restore and/or compensate for these impacts in a culturally appropriate manner (para. 9). • Where there are adverse impacts on land and natural resources under traditional ownership or customary use or where a project may significantly impact on critical cultural heritage, the higher standard of Free, Prior and Informed Consent (FPIC) is required to be met (para 13-17). 	<p>IFC's review was not sufficient to ensure that the Fund had correctly assessed the application of Performance Standard 7 to the project, in particular the requirement for Free Prior Informed Consent for projects impacting land and natural resources under traditional ownership or customary use.</p>

IFC ESDD Review of HSR Project	
<p>PS5 requires</p> <ul style="list-style-type: none"> • The application of PS5 to be considered during the E&S risks and impact identification stage (para. 4). • Where a project is expected to result in economic displacement, PS5 requires that displaced persons who have legal tenure or recognizable rights to land be compensated with replacement property of greater or equal value, or provided cash compensation. Where economically displaced persons do not have legally recognizable claims to land they should be “compensated for lost assets other than land (such as crops, irrigation infrastructure and other improvements made to the land), at full replacement cost.” In addition, PS5 requires displaced persons to be provided with sufficient support to reestablish their livelihoods (para 25 & 27) 	<p>IFC did not assure itself that the Fund had adequately assessed potential economic displacement as a result of the project.</p>
<p>The FI prepares its ESDD based on the IFC Performance Standard requirements. (SP, para 33 & para 35) IFC reviews the FI’s ESDD to ensure that the FI’s implementation of its ESMS is robust. (ESRP 7.2.10 & 9.2.3)</p>	<p>IFC’s ESDD review was not sufficient to ensure that the Fund had correctly applied its E&S requirements to the project</p>
IFC Supervision post ESDD review	
<p>IFC assures itself that there is sufficient evidence (i) the client’s ESMS is operating as envisaged at the time of IFC’s pre-investment review; and, (ii) the client is applying IFC’s E&S requirements to sub-projects (ESRP 9, 2.6) Receive the client’s AEPR and determine whether the information is provided is adequate. (ESRP 9, 2.6) Review AEPR and provide timely and clear explanation on actions needed to address performance gaps or other issues of concern (ESRP 9, 2.6) Determine the need for a supervision visit to the FI or an FI’s project in order to further review the FI’s compliance with IFC’s E&S requirements. (ESRP 9, para 7) In response to a serious incident, IFC should schedule a visit, request the prepare a root cause analysis and an action plan for full implementation. IFC monitors to ensure the action plan fully responsive to remedial needs. (ESRP 5)</p>	<p>IFC’s supervision did not provide sufficient evidence to conclude that the Fund was correctly applying IFC’s E&S requirements to the project.</p> <p>Given the ongoing conflict around the project, and persistent concerns about local impacts, additional supervision was required by IFC, in particular in relation to: (i) the adequacy of additional E&S assessments required by the project ESAP, (ii) the decision not to apply FPIC to the project; and, (iii) the client’s security management plan.</p>