



Assessment Report LOOFAH S.A. PR MICI001/2010



**OFFICE of the
PROJECT OMBUDSPERSON**

April 2011

Assessment Report

This report has been prepared pursuant to Articles 42 to 45 of the Policy establishing the ICIM, and aims to present the work done during the assessment phase, following the determination of the case's eligibility.



Executive Summary

Project: SP/SF-04-35-PR and ATN/SF-8984-PR, “Development of the Vegetable Sponge Products Industry”

Country: Paraguay

Request: Ms. Brigitte Fuzellier, representing the company Loofah S.A., filed a complaint with the Inter-American Development Bank’s Independent Investigation Mechanism (IIM), the ICIM’s precursor, in connection with loan contract SP/SF-04-35-PR and technical-cooperation operation ATN/SF-8984-PR, “Development of the Vegetable Sponge Products Industry,” alleging damages to her company due to the suspension of US\$107,502.77 in disbursements from the aforementioned technical-cooperation operation. The request was referred to the Independent Consultation and Investigation Mechanism (ICIM), once it became effective. The ICIM declared the case eligible for the Consultation Phase on 16 December 2010.

Assessment group: Isabel Lavadenz (Ombudsperson) and Fátima Andrada (Legal Operations Analyst).

Stakeholders: Brigitte Fuzellier: Requester, President of Loofah S.A.; Jerome Fuzellier: General Manager of Loofah S.A.; Carlos Ortiz: Country Office Technical Specialist; Alejandro Escobar: MIF Technical Specialist.

Eligibility determination: The request was declared eligible on 16 December 2010.

Conclusions: The parties to this case have expressed an inclination to reach an agreement. They have signed a debt restructuring agreement enabling the requester to clear its arrears under the loan contract. The requester and the Bank have also agreed that Loofah S.A. will submit the necessary documentation to the Bank to substantiate a request for all or part of the pending disbursements under the technical-cooperation operation, for the categories specified in it through 2009. The Bank will then review this documentation to determine the feasibility of disbursing the corresponding amount (if the expenditures match the categories established in the technical-cooperation operation). The process under way is a positive one, with the parties at the stage of dialogue and preliminary agreement.

The ICIM’s role and next steps: The ICIM has succeeded in getting the parties to clarify, individually and jointly, their respective interests and positions, and to engage in a process of informed dialogue, reaching a preliminary agreement on the points noted above. This was possible because of the predisposition and active participation of the project team and the Country Office. The next steps include submittal and review of the documentation from the company, so the agreement can be finalized and the case before the ICIM closed.

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1. BACKGROUND

1.1. The project

On 8 February 2005, the Inter-American Development Bank (IDB) and Loofah S.A. signed loan contract SP/SF-04-35-PR and technical-cooperation agreement ATN/SF-8984-PR for “Development of the Vegetable Sponge Products Industry” (“the Project”), under the Social Entrepreneurship Program, whose main objective was to diversify the incomes of Paraguayan campesino and indigenous farmers and to create jobs for low-income families in urban and periurban areas by consolidating the vegetable sponge products industry.¹

The specific objectives of the Project were to: (a) strengthen the marketing and export chain for vegetable sponge products; (b) facilitate access to working capital for the entire vegetable sponge product marketing process; (c) boost field production capacity for loofahs² and improve farm management; (d) encourage the organization of campesino and indigenous small farmers involved in loofah production; and (e) create sustainable jobs in urban areas where the manufacturing of finished products is based.

The involvement of a nongovernmental organization (NGO) was considered a suitable option for the technical-cooperation operation, to facilitate project execution. Accordingly, at the suggestion of Loofah S.A., the agreement establishes that the service contract to be signed by Loofah S.A. would be performed through the NGOs, Organización Internacional Pro-Inversión Comercio y Medio Ambiente [International Pro-commercial Investment and Environment Organization] (OIPIC) and Madre Tierra [“Mother Earth”], as they were the only local organizations with the technical capacity to carry out the technical assistance activities in the area of vegetable sponge cultivation and production. This assistance consisted of providing training to campesino and indigenous groups, with 30% covered by the Bank’s contribution, and the remainder by the local contribution.

The Project therefore entailed strengthening the vegetable sponge products industry by enhancing the company’s ability to make high-quality products as well as to generate income and jobs for small-scale vegetable sponge growers, campesinos, indigenous communities, and low-income families, by providing them with relevant training.

¹ The Project was originally under the Sustainable Development Department/Micro, Small, and Medium Enterprise Division (SDS/MSM). After the Bank’s realignment in 2007, the Social Entrepreneurship Program (SEP) was transferred from SDS/MSM to the Multilateral Investment Fund (MIF).

² Loofahs are a type of vegetable sponge with healing and relaxing properties.

Once the Project was under way, the full amount of reimbursable financing was disbursed via two transfers—US\$150,000 on 13 April 2005 and US\$100,000 on 18 November 2005.

On 8 August 2006, Loofah S.A. fell into arrears on its obligations with the Bank.

On 8 April 2008, the Bank notified the company that it had canceled the unused technical-cooperation funds (US\$107,502.77) on 31 March 2008, because the program had not met the established objectives and due to nonfulfillment of the Bank's fiduciary requirements. Thus, the technical-cooperation operation with Loofah S.A. was canceled.³

The situation described above subsequently led to the request filed by Loofah S.A. with the Bank's Independent Investigation Mechanism (IIM).

1.2. The request

On 10 February 2009, Ms. Brigitte Fuzellier, as president of Loofah S.A. ("Loofah" or "the Requester") filed a request ("the Request") with the IDB's Independent Investigation Mechanism ("IIM" or "previous mechanism") in connection with the loan contract and technical-cooperation agreement, alleging economic and financial damages caused by the cancelation of the technical-cooperation funds. The operational policies related to the purpose of the complaint, and subject to the previous mechanism are OP-302 ("Project Preparation, Evaluation and Approval" of December 1994), which sets forth that project targets must be attainable; OP-752 ("Rural Development" of December 1994), under which the selection of rural development projects must include a viability study considering national economic and development policies; and OP-304 ("Operations Administration" of December 1994), which sets forth the Bank's obligation to advise borrowers and beneficiaries on how to resolve problems arising during project execution.

In her complaint, Ms. Fuzellier holds that the Bank erred in the Project's design stage when it required the company to make administrative and financial changes based on unrealistic projections. She claims that the IDB required an increase in the number of vegetable sponge suppliers previously used throughout the company's existence (from about 100 families to 1,500 families).

The Requester also argues that the Bank was negligent in performing its supervisory duties in the Project's execution stage, as the company had a shortfall of US\$50,000 in 2005 (due to

³ The Bank decided to suspend the technical-cooperation funds after a process that involved: first, a request to Loofah S.A. for supporting documentation for expenditures, then, a "suspension of funds," and, finally, a "cancelation of balances" unused by the end of the project execution period. The Bank's decision was made based on nonfulfillment of technical and financial requirements.

events not attributable to Loofah S.A.) that went undetected by the Bank's reviews. She also states that the IDB failed to respond promptly to the company's communication attempts. Specifically, the Requester alleges that on several occasions the Bank either failed to reply to correspondence or did so with considerable delay, causing substantial material damage, and lastly, that the company had been required to enter into exclusivity arrangements with customers, as recommended by the IDB's advisors.

The Requester also mentions in the Request that Loofah S.A. executives lost money because of nonpayment of accrued expenses to OIPIC (the NGO partner in the Project) for training services. The result, according to the Requester, was direct, material economic damage to the company. Loofah S.A. claims to have lost approximately US\$200,000 in 2006 owing to a surplus of vegetable sponges that could not be sold on the market. It alleges that the IDB required training to be provided to more than 10,000 people, even though sufficient demand did not yet exist to justify producing a larger amount of vegetable sponges. Also mentioned in the complaint is that Loofah S.A. was unable to take part in international trade fairs because it lacked the funds that were supposed to have been disbursed as part of the technical-cooperation operation.



1.3. Role of the ICIM

The Policy establishing the ICIM provides that after eligibility is determined and a case is registered, an assessment phase is begun with the following purposes:

- a) To clarify the issues and concerns raised by the Request;
- b) To identify and gather information and viewpoints from stakeholders;
- c) To inquire as to the views and incentives of all stakeholders and map stakeholders;
- d) To help determine whether a resolution to the issues raised can be reached; and
- e) To determine the best process for resolving the conflict.

The assessment will be completed within 120 calendar days of the date the Request was determined eligible. It may involve a desk review, a site visit, discussions with the Requester, Management, or others, and any process conducive to determining the substance of the Request and identifying possible alternatives put forward by the parties.

Based on the results of the assessment, the policy requires the Ombudsperson to determine whether constructive dialogue and a consensus-based solution are possible. In the case at hand, the assessment process has culminated in this report.

1.4. Sequence of events

The table below shows the timing of the most significant events relating to the Project and the case filed with the Mechanism.

DATE	DOCUMENT	EVENT
8 February 2005	SP/SF-04-35-PR and ATN/SF-8984-PR	Signing of loan contract and technical-cooperation agreement
7 April 2005	ATN/SF-8984-PR	First disbursement (US\$63,000) of technical-cooperation funds
13 April 2005	SP/SF-04-35-PR	First loan disbursement (US\$150,000)
18 November 2005	SP/SF-04-35-PR	Second loan disbursement (US\$100,000)
9 February 2006	ATN/SF-8984-PR	Second disbursement (US\$39,497.23) of technical-cooperation funds
6 July 2007	CPR/C/2007/2280	Financial assessment
7 December 2007	CPR/C/2007/3992	Process of suspending technical-cooperation disbursements initiated
31 March 2008		Funds suspended
8 April 2008	CPR/C/2008/837	Loofah S.A. notified of suspension
10 February 2009		Request filed with the IIM
2009/2010	Negotiations between the MIF and Loofah S.A. to restructure the debt	
11 September 2010		Case transferred to the ICIM
11 December 2010		Debt restructuring agreement
16 December 2010	Eligibility Memorandum	Case before the ICIM declared eligible
24 February 2011		Information-sharing meeting
7 March 2011		Visit to the Loofah S.A. factory

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2. THE ASSESSMENT

2.1. Stakeholders

In this particular case, the assessment followed the primary/secondary stakeholder methodology because it was best suited to the type of claim and case. It bears mentioning, however, that when the Bank was realigned in 2007, the Sustainable Development Department/Micro Enterprise Division (SDS/MSM) was dissolved, and its programs, including the Social Entrepreneurship Program (SEP), were transferred to the Multilateral Investment Fund (MIF). For this reason, the Loofah S.A. case was processed with participation by MIF representatives. These stakeholders have extensive knowledge not only of the case, but also of technical considerations relevant to the design of the Project and the technical-cooperation operation, which facilitated negotiations with the Requester.

Primary stakeholders

Primary stakeholders are those who will be affected by the decisions and recommendations resulting from the ICIM proceeding, or who have a large share of the decision-making power. In this case, they are:

- Ms. Brigitte Fuzellier: The company's Director
- Mr. Jerome Fuzellier: The company's General Manager
- Mr. Carlos Ortiz: Technical Specialist at the Country Office in Paraguay

Secondary stakeholders

Secondary stakeholders in the proceeding brought before the ICIM are persons not directly affected by the decisions to be made, but whose involvement in the process is necessary in order to provide guidance to the parties on issues relevant to the Request. In this case, the secondary stakeholder is:

- Mr. Alejandro Escobar: MIF Technical Specialist



2.2 Assessment methodology

The methodological steps followed in the process were:

- a) Discussions with both Country Office and MIF technical specialists, with an ongoing exchange of information via e-mail, as well as by telephone and video-conference, as needed over the course of the assessment;
- b) Interviews, discussions, and preparation sessions with the Requester, as well as bilateral exchanges with the Country Office;
- c) A working meeting for information-sharing among all parties involved, via video-conference;
- d) A visit to the Loofah S.A. factory; and
- e) Compilation and analysis of the documentation received.

2.3 Information-sharing meeting

As part of the assessment process, several meetings were held with the claimants and the project team, in country and at Headquarters, the main meeting having been held by video conference with all the parties on 24 February 2011. The objective of this meeting was to exchange information and explore possible solutions from the standpoints of the Requester and the Bank.⁴

As a result of the information-sharing meeting, the following points of agreement and next steps were identified:

- a) *Be flexible in order to reach consensus.* It was agreed that all the parties—the Requester, the MIF, and the Bank’s Country Office—would endeavor to satisfactorily settle the claim presented by Loofah S.A. within the Bank’s operating and fiduciary framework.

⁴ The meeting agenda was as follows:

- Welcome and objectives of the dialogue
- Presentation by Loofah S.A. on its claim
- Response from the IDB team
- Presentation of alternative solutions proposed by Loofah S.A.
- Response from the IDB team
- Facilitated dialogue and identification of consensus points (ICIM team)
- Determination of next steps and timeframes
- Wrap-up

- b) *Have realistic expectations.* It was made clear to the Requester that this ICIM proceeding would include no discussion of compensation for any damages, expansion of the credit line, or the granting of new technical-cooperation funding. The ICIM does not have that authority, and those issues fall outside its mandate and procedures. It was also explained that none of the IDB's operational policies provide for the possibility of direct compensation to borrowing clients for alleged damages incurred during the design, development, or execution of a project.
- c) *Shared responsibilities.* The parties are aware that financial and administrative issues arose that precluded continuing the normal course of the technical-cooperation operation. The company and the Bank discussed the various factors that prevented technical-cooperation disbursements from being continued at the time, as well as the reasons for the suspension of disbursements, and the impacts that this suspension might have had on the company. The IDB said its decisions were justified by the problems highlighted by the various audits and the fact that the company had already had financial and administrative problems in 2005, among other factors.
- d) *Decision to prioritize the areas affected most by the suspension.* The company provisionally identified the areas of marketing and sales, relations with farmers, and the lack of liquidity for continuing its international trade activities as those affected most by the suspension of technical-cooperation disbursements.
- e) *Next steps:* (i) Presentation by the company of supporting documentation for expenditures from 2005 to 2009; (ii) Verification by the Bank of the fiduciary soundness of those expenditures. These steps are to be taken in March 2011.

Lastly, it was explained to the Requester that these discussions or any resulting agreement in no way implied an obligation on the part of the IDB (or the Mechanism) to disburse the remainder of the funds under the closed technical-cooperation operation. That could happen only to the extent that (a) the cancellation of the balance of technical-cooperation funds could be reversed in accordance with Bank procedures; (b) Loofah S.A. provided the documentation to justify the pending disbursements for which it was requesting payment; and (c) that supporting documentation was accepted by the Country Office Financial Specialist and by the Project Manager, pursuant to the Bank's current fiduciary standards.

2.4 Visit to the Loofah S.A. factory

On 7 March 2011, representing the ICIM, Fátima Andrada, Esq.—an ICIM consultant—visited the Loofah S.A. factory in the city of San Lorenzo, Paraguay (approximately 10 kilometers from Asuncion, the capital).

The purpose of the visit was to become familiar with the factory and its infrastructure, and to speak with the Requester. The ICIM representative met with Ms. Brigitte Fuzellier, Mr. Jerome Fuzellier, and administrative staff.

The Loofah S.A. factory has been operating in Paraguay for 12 years. The country's warm climate is ideal for cultivating and producing vegetable sponges (loofahs). The company executives commented that loofah products are now on the list of the country's continuous exports, with various high-quality, hand-made products exported to Europe and the United States.

Loofah S.A. specializes in sales to the wholesale market, as its primary market, particularly for international sales. Over the years, the company has signed sales contracts with representatives in the United States, Canada, and Europe, and has posted sales of more than US\$2 million, with an increase of US\$1.4 million over the last three years. According to Paraguay's export schedules, vegetable sponges brought US\$139,433 in profits in 2009, and US\$631,745 in 2010 (353.1% more than the prior year).⁵

2.4.1 Infrastructure

The factory is a simple structure. It is a house consisting of several rooms, each one devoted to processing of the product for both export and domestic consumption. The fruit has to be cleaned, cut, and dried. Each stage is carried out in a different area. There is also storage for the finished product awaiting export. The production process is largely manual, and the workers are trained and managed by the Director.



2.4.2 Raw materials, products, and social impact

The primary raw material for all the company's products is the vegetable sponge. The business relationship with the campesinos is direct, with no intermediation costs, thereby ensuring an

⁵ Information furnished by Loofah on 23 March 2011, available at www.abc.com.py/0/vnc/galeria.vnc?id=239113.

optimum price per sponge. For the company, this provides the certainty needed to plan production costs.

Other materials, such as wood, cotton, cord, etc. can be supplied by local businesses, thus ensuring a commitment to domestic and regional production, and contributing to the development of other industries, in addition to a commitment to the country.

The raw material is purchased from farmers located in several parts of the country (Altos, Itá, Ayolas, Itaipú). Training is an ongoing activity, and today, according to the Requester, there are thousands of individuals who have received training on soil management and growing and harvesting the vegetable sponges that provide the raw material for manufacturing loofah products.



The factory has a small loofah plantation to show to customers and people interested in loofah products.

The factory has created several products, including BIOMOC—highly successful in the local market—which is used to ward off mosquitoes during dengue fever epidemics, as well as other products: LoofahDeco, Loofah-Pet, and Loofah-Bath and Shower.

During the visit, the training provided to many farmers and indigenous communities on how

to grow and harvest the fruit was cited as one of the company's successes, increasing these communities' income and, as a result, improving their quality of life.

Growing vegetable sponges enables campesinos to earn extra income without having to sacrifice a large portion of their land, since these sponges can be grown together with other crops, such as beans. Sponge production also gives campesinos the opportunity to learn about organic farming, which reduces soil contamination and improves health factors as well as productivity.

In the city, workers (mainly women) learn to sew the sponges, providing another source of household income.

2.5 The role of the ICIM

Before declaring the case eligible, the Ombudsperson, using the powers vested in her by the Policy establishing the ICIM, gave Management and the Requester the opportunity to wrap up their negotiations to restructure the debt on the loan. A restructuring agreement was signed on

11 December 2010.⁶ The Requester has made an initial payment, and is now no longer in arrears to the Bank.⁷

The Request filed with the Mechanism opened a new channel for dialogue between the parties that focused their efforts on the goal of seeking a prompt solution to the conflict. Overcoming previous communication problems, the ICIM facilitated a very timely exchange of information and convergence of views. The claim ended up being limited to exploring the feasibility of obtaining the undisbursed portions the technical-cooperation funding.

3. NEXT STEPS

The parties have reached a preliminary agreement that includes the following:

- Loofah S.A.: will submit to the Bank, with a copy to the ICIM, supporting documentation for expenditures incurred for the technical-cooperation operation. The expenditures must fall under the categories established for that operation and be consistent with the Bank's fiduciary framework.
- The Bank: will review the documentation submitted by Loofah S.A. and will verify that it is consistent with the operation's categories and meets the IDB's respective fiduciary requirements.
- The ICIM: will facilitate any other virtual exchange of information between the parties and will hold the final dialogue meeting, after completion of the previous steps, at which the terms of a definitive agreement will be determined.

4. CONCLUSIONS

During this assessment, as a result of the information-sharing meeting, it was confirmed that there is potential for reaching a definitive agreement that will enable this case to be closed. This phase has been critical in reestablishing constructive dialogue, and has confirmed the willingness of the claimants, the project team, and the Country Office to make progress toward a definitive resolution of this case.

One of the shortcomings found in the relationship between the Bank and the Requester during the time leading up to the submission of the case to the ICIM was the lack of communication and dialogue. The two parties had differences regarding audit results that were not fully explained in a timely fashion. Lastly, the assessment phase was successful because of the collaboration between the parties and their openness to seeking equitable solutions, rather

⁶ Amending SEP Loofah S.A. contract SP/SF-04-35-PR.

⁷ A payment of US\$9,965 was made on 18 January. The second payment is scheduled for May 2011.

than simply serving their own interests. They have shown flexibility in seeking an agreement that is beneficial and reasonable for both parties, consistent with the IDB's rules and regulations.

