



APPRAISAL REPORT

CAO Appraisal for Compliance
Investigation of IFC

CAO Compliance

CAO Compliance Ref: C-I-R9-Y12-F167

May 15, 2013

**Anglo American Quellaveco SA
Peru**

Case of

Asociación Civil Labor, Junta de Usuarios de Riego del Distrito de Moquegua, Comité de Frente de
Defensa de los Intereses de Distrito de Torata

Summary

In November 2011, CAO received a complaint from *Asociación Civil Labor*, a local environmental NGO in Peru, raising concerns about the Quellaveco Project's actual and anticipated impacts on local people and the environment.

The Quellaveco mining concession is located in Peru in the department of Moquegua. It is an undeveloped porphyry copper deposit. In April 1993, the IFC Board approved a 20 per cent equity investment in the Company. During the 1990s and 2000s IFC participated in a number of rights issues. In February 2012 IFC sold all of its shares in the Company to a wholly-owned subsidiary of Mitsubishi Corporation.

The issues raised in the complaint relate to:

- (a) water scarcity, the degradation of water quality, and increased competition over water resources in an arid area;
- (b) pollution, including disposal of mine tailings and consequent environmental and health risks;
- (c) land claims on the project sites; and
- (d) adequacy of community engagement, including lack of consultation on the initial and modified Environmental Impact Assessment.

CAO has conducted a Compliance Appraisal in accordance with its Operational Guidelines. In relation to engagement at the pre-commitment and commitment stage, CAO finds that although there were relevant Environmental and Social (E&S) procedures and guidelines in existence which were said to apply to the Project, no steps were taken by IFC to ensure the Company's formal commitment to comply with such procedures and guidelines.

In relation to supervision, CAO finds that efforts were made to supervise Quellaveco's compliance with IFC E&S standards as they evolved, representing good practice. However, the lack of clarity around the client's obligations made it difficult to deal with E&S issues (for example those around land acquisition) which emerged during supervision. CAO also finds that Project documentation that went to the Board during the course of supervision did not appear to fully reflect concerns about the project's E&S performance.

Based on the Compliance Appraisal process, CAO finds that a review of certain aspects of this Project which relate to its nature as an early equity mining investment might better inform the application of policies (or other Compliance Investigation criteria) to future projects. CAO therefore decides to conduct a Compliance Investigation into this Project, having regard to the matters raised in the complaint, with a focus on the following questions:

- Are IFC's policies and procedures regarding environmental and social categorization of projects, as applied to its investment in Quellaveco, effective to reflect the magnitude of project risks and impacts?
- Are IFC's policies and procedures in relation to rights issues, as applied to its investment in Quellaveco, consistent with IFC's commitment to ensure that the business activities it finances are implemented in accordance with relevant environmental and social standards?
- Do IFC's policies and procedures regarding divestment from projects, as applied to its investment in Quellaveco, ensure appropriate consideration of environmental and social aspects prior to exiting?

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About the CAO

The CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of IFC and MIGA.

The CAO (Office of the Compliance Advisor/Ombudsman) is an independent post that reports directly to the president of the World Bank Group. The CAO reviews complaints from communities affected by development projects undertaken by the two private sector lending arms of the World Bank Group: the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

For more information about the CAO, please visit www.cao-ombudsman.org

1. Overview of the CAO Compliance Appraisal process

When CAO receives a complaint about an IFC or MIGA project, the complaint is referred to CAO's dispute resolution arm, CAO Ombudsman, which works to respond quickly and effectively to complaints through facilitated settlements, if appropriate. If CAO Ombudsman concludes that the parties are not willing or able to reach a facilitated solution, the case is transferred to CAO Compliance for Appraisal and potential Compliance Investigation.

The focus of CAO Compliance is on IFC and MIGA, not their client. This applies to all IFC's business activities including the real sector, financial markets, and advisory. CAO assesses how IFC/MIGA assured itself/themselves of the performance of its business activity or advice, as well as whether the outcomes of the business activity or advice are consistent with the intent of the relevant policy provisions. In many cases, however, in assessing the performance of the project and IFC's/MIGA's implementation of measures to meet the relevant requirements, it will be necessary for CAO to review the actions of the client and verify outcomes in the field.

In order to decide whether a Compliance Investigation is warranted, CAO Compliance first conducts a Compliance Appraisal. The purpose of the appraisal process is to ensure that Compliance Investigations are initiated only for those projects that raise substantial concerns regarding environmental and/or social outcomes, and/or issues of systemic importance to IFC/MIGA.

To guide the appraisal process, the CAO applies several basic criteria. These criteria test the value of undertaking a Compliance Investigation, as CAO seeks to determine whether:

- There is evidence of potentially significant adverse environmental and/or social outcome(s) now, or in the future.
- There are indications that a policy or other appraisal criteria may not have been adhered to or properly applied by IFC/MIGA.
- There is evidence that indicates that IFC's/MIGA's provisions, whether or not complied with, have failed to provide an adequate level of protection.

In conducting the Appraisal, CAO will hold discussions with the IFC/MIGA team working with the specific project and other stakeholders to understand which criteria IFC/MIGA used to assure itself/themselves of the performance of the project, how IFC/MIGA assured itself/themselves of compliance with these criteria, how IFC/MIGA assured itself/themselves that these provisions provided an adequate level of protection, and, generally, whether a Compliance Investigation is the appropriate response. After a Compliance Appraisal has been completed, the CAO can close the case or initiate a Compliance Investigation of IFC or MIGA.

Once CAO concludes an Appraisal, it will advise IFC/MIGA, the President, and the Board in writing. If an Appraisal results from a case transferred from CAO's Dispute Resolution role, the complainant will also be advised in writing. A summary of all appraisal results will be made public. If CAO decides to initiate a Compliance Investigation as a result of the Compliance Appraisal, CAO will draw up Terms of Reference for the Compliance Investigation in accordance with CAO's Operational Guidelines.

2. Background

Investment

The Quellaveco mining concession is located in Peru in the department of Moquegua. It is an undeveloped porphyry copper deposit. It was privatized and acquired by Empresa Minera de Mantos Blancos SA (Mantos Blancos) in February 1993. At the time, the majority of Mantos Blancos' share capital was held by Anglo American Corporation of South America. Mantos Blancos established Minera Quellaveco SA (the Company) as a substantially wholly-owned subsidiary and assigned the Quellaveco mining concession to the Company.

In April 1993, the IFC Board approved an equity investment in the Company to fund a 20 per cent share of acquisition costs and a two-phase feasibility pilot program for a technology assessment to confirm process feasibility and commercial viability. During the 1990s and 2000s, IFC participated in a number of rights issues with the result that by 2012 it had an 18.1 per cent stake in the Company. Details of these rights issues are discussed below. In February 2012 the IFC sold all of its shares in the Company to a wholly-owned subsidiary of Mitsubishi Corporation. The remaining shares are held by Anglo American Quellaveco SA, now a wholly-owned subsidiary of Anglo American plc.

Quellaveco's copper reserve is approximately 10 million tonnes (content metal basis) with an estimated mine life of 28 years. The initial production is expected to be approximately 225,000 tonnes per annum. The company aims to commence production in 2016 with the proposal to construct the mine to be considered by Anglo's board in the course of 2013.

Complaint

In November 2011, CAO received a complaint from *Asociación Civil Labor*, a local environmental NGO in Peru, raising concerns about the Project's actual and anticipated impacts on local people and the environment (the substance of these concerns is detailed further below under 'Scope'). On CAO's request for documentation verifying the participation of project-affected groups, *Junta de Usuarios de Riego del Distrito de Moquegua* and *Frente Unificado de Defensa de los Intereses del Distrito de Torata* sent letters to CAO in March 2012. CAO concluded that the complaint was eligible. Given that the complaint was filed before IFC divested from the project, CAO proceeded to an assessment following established practice and in accordance with its Operational Guidelines.

Ombudsman Assessment Report

The Ombudsman Assessment Report was published in July 2012.¹ As neither the Complainants nor the Company wished to engage in a dispute resolution process facilitated by CAO, this complaint was referred to CAO Compliance for appraisal of IFC's E&S performance.

3. Scope of the Appraisal for a Compliance Investigation of IFC

In cases referred by CAO Ombudsman, the scope of the Appraisal is defined by issues raised in the complaint and identified during the CAO assessment phase. Based on the letters of

¹ http://www.cao-ombudsman.org/cases/case_detail.aspx?id=185.

complaint and the CAO Ombudsman Assessment Report,² the issues raised can be summarized as concerns regarding:

- (a) water scarcity, the degradation of water quality, and increased competition over water resources in an arid area;
- (b) pollution, including disposal of mine tailings and consequent environmental and health risks;
- (c) land claims on the project sites; and
- (d) adequacy of community engagement, including lack of consultation on the initial and modified Environmental Impact Assessment.

CAO notes that some issues raised by the complainants (including those regarding the impact on water and possible pollution) relate to the prospective design, development and operation of the mine rather than to specific actions taken during the feasibility stage. However, these issues remain relevant at the feasibility stage of the mine to the extent that they were or ought to have been addressed in the Environmental Impact Assessment prepared by the Company as part of this Project.

From the perspective of the CAO compliance mandate, the general question raised is whether IFC exercised due diligence in its review and supervision of environmental and social (E&S) aspects of the project, particularly as they relate to the issues listed above.

4. CAO Findings

IFC guidelines and standards

IFC made its initial investment in the Company in April 1993 and divested in February 2012. Given that IFC's investment in the Company spanned almost 20 years, it is worth briefly outlining developments in IFC's E&S policies, procedures and standards over that time.

The IFC Board approved its first formal Procedure for Environmental Review of IFC Projects in March 1990, requiring compliance with the standards set out in relevant World Bank Policies and Guidelines. This Procedure was revised in December 1992 and again in October 1993.

In September 1998, IFC approved a version of the Procedure which required compliance with IFC Environmental and Social Safeguard Policies, based closely on the World Bank Safeguards.

In April 2006, following fundamental restructuring and revision, IFC approved its Policy on Social and Environmental Sustainability which required client compliance with a new set of Performance Standards. According to IFC's website, this Framework applies to investments that undergo IFC's initial credit review process from April 30, 2006 to December 31, 2011. The IFC Board Decision approving the Policy and Performance Standards, however, endorses the President's recommendation that these be 'effective as of 30 April 2006', without qualification.

Finally, in January 2012, IFC approved a new 'Sustainability Framework', incorporating an updated Policy on Environmental and Social Sustainability, and Performance Standards on Environmental and Social Sustainability. According to IFC's website, this Framework is said to apply to all investment and advisory projects that undergo IFC's initial credit review process

² http://www.cao-ombudsman.org/cases/case_detail.aspx?id=185.

after January 1, 2012. As in 2006, however, the IFC Board Decision is that the new Policy and Performance Standards on Environmental and Social Sustainability be adopted effective January 2012, without qualification.³

Pre-Commitment

At the pre-commitment stage, IFC reviews the E&S risks and impacts of a proposed investment and categorizes the project on this basis. The question for CAO is whether the Project was processed according to IFC policies and procedures in effect at the time. A further issue is whether relevant E&S obligations were incorporated into the investment agreement.

The IFC Board document relating to the initial investment in the Company was finalized in March 1993. The Board endorsed an equity investment of US\$6.22m with provision for further capital raising by way of share issues. The Board document stated that the project would 'comply with all applicable World Bank environmental and occupational health and safety guidelines'. Specifically, during the second phase of the feasibility project, it stated that the Company would carry out an environmental assessment on the mine development. A number of World Bank Guidelines are likely to have been relevant to the Project.⁴

E&S categorization of IFC projects is intended to provide an accurate reflection of the magnitude of risks and impacts of a project and to signal those risks to stakeholders. E&S categorization has implications for disclosure, Board engagement, and supervision. The IFC Board document relating to the initial investment in 1993 identified the Project as Category B (meaning a project that 'may result in specific environmental impacts and require adherence to certain predetermined performance standards, guidelines or design criteria to mitigate impacts'). The Board document noted that future mine development would be a Category A project.

The December 1992 Procedure for Environmental Review required that an 'environmental analysis' be undertaken for Category B projects. Prior to the Initial Project Review, the Environment Unit would be required to prepare an environmental information memorandum, including typical standards for a project of this type against which the project would be reviewed. 'Environmental Review' of the project, consisting of a desk review of environmental information in the case of Category B projects, was to be undertaken 'to determine if the project is in compliance with appropriate World Bank policies and guidelines, host country requirements and/or internationally accepted standards'. CAO has not been able to identify an Environmental Review of the project undertaken prior to IFC investment.

The Shareholders and Subscription Agreements relating to the initial investment are dated 1 June 1993 (thus made under the IFC's 1992 procedure). These documents make no reference to environmental or social requirements.

³ The paper annexing the updated Policy and Performance Standards on Environmental and Social Sustainability that went to the Board recommended that the Board approve the policy content effective January 1, 2012. The Minutes of the Meeting of the Board of Directors of IFC, May 12, 2011 state that the policy content of the Corporation's updated Policy and Performance Standards on Environmental and Social Sustainability be adopted as set out in Annex B of the Report, effective January 12, 2012.

⁴ Including: Operational Directive 4.20: Indigenous Peoples (September 1991); Operational Directive 4.30: Involuntary Resettlement (June 1990); Environmental Guidelines: Mining and Milling – Open Pit (Source: Draft – Environmental Guidelines, 1992).

CAO finds that there were relevant E&S procedures and guidelines in existence during the pre-commitment and commitment stages of the project. These were acknowledged in the documentation that went to the IFC Board in relation to the initial investment, which confirms that IFC considered compliance with the guidelines to be a necessary element of the Project. However, CAO finds no indication that Company made any formal commitment to comply with relevant E&S guidelines. The reasons for this are unclear.

Supervision

The IFC has articulated an approach to the supervision of E&S risks in its projects since at least 1992. According to the Internal Procedure for Environmental Review (1992):

IFC monitors the environmental performance of projects in its Investment Portfolio. ... In the case of non-compliance, the Environment Unit discusses an appropriate course of action with the Regional or Specialist Department and the Technical and Environment Department.

The articulation of IFC's approach to E&S supervision evolved significantly during the period of this investment and as such, CAO would expect to see a development of the approach to supervision over time. E&S supervision of this Project can be tracked through Board documentation prepared for IFC approval of rights issues as well as dedicated IFC Environment and Social Development Department (CES) supervision reports. A table setting out IFC's participation in rights issues is annexed to this Appraisal.

In March 1996, Board approval for participation in a rights issue was granted, increasing IFC's investment by US\$5.3m. The additional capital was to fund a revised and enlarged Phase II of the feasibility work. The IFC Board documentation stated that the environmental impacts of the revised feasibility program were 'expected to be substantially less than those originally reviewed and cleared by IFC in 1993, therefore the project remains in compliance with World Bank guidelines'. It also stated that IFC would provide early guidance on the completion of a full Environmental Impact Assessment (EIA) in Phase II of the feasibility study. The documentation identified the purpose of Phase II as a bankable feasibility study to be ready by December 1997 with the possibility of full production by 2001.

From the documentation reviewed by CAO, it is clear that IFC took an active role in supervising the Company's E&S activities from 1996 through to 2000. In 1996, IFC CES provided guidance and input for a full environmental assessment to be undertaken by consultants. Reviewing a preliminary EIA provided in late 1997, CES identified a number of concerns relating to water, Indigenous peoples, public consultation and archeological sites. In early 1998, IFC expressed the view that further work on the EIA was required. A Back to Office (BTO) report following a site visit by IFC CES in August 1998 notes the need for a thorough EIA, consistent with IFC policy. The Company appeared to be receptive and responsive to these comments. IFC ensured that the Company was provided with copies of relevant IFC procedures and policies.

IFC CES undertook another site visit in November/December 1999. Following this visit, and the receipt of a further draft of the EIA, IFC CES provided a comprehensive summary of environmental issues and supplementary requirements to be included the EIA, along with an Action Plan. In March 2000, IFC CES provided advice on land acquisition issues, noting that there had been significant conflict with local communities at the time of land purchases for the Project in 1994, resulting in legal action that in 2000 was pending in the Peruvian Supreme Court.

In August 2000 the Company submitted the EIA to Peruvian authorities and received significant comments back. Consultations on the EIA with affected communities revealed community dissatisfaction with the water feasibility study, particularly the proposal to rely on subterranean water from the Chilota watershed in the Tambo valley. On this basis, the Company decided to update and modify the EIA, a process which does not appear to have been completed until 2010.

Between 2004 and 2007, IFC decided not to participate in cash call contributions and consequently its interest in the Company was diluted.

In September 2006, a specialist from the IFC Environment and Social Development Department (CES) met with a representative of the Company. The report of this meeting indicated that the Company had signed land purchase agreements with a number of landholders on the Project site; that there was widespread community concern about the mine's impact on water availability; that communities wanted to be more informed; and that the area of influence as well as potential cumulative impacts was greater than expected.

In October 2006, IFC CES met with members of the project team in Lima to discuss the project. IFC CES gave presentations on the 2006 Performance Standards and how they applied to mining projects. At this time, IFC assigned an Environmental and Social Risk Rating (ESRR). The ESRR identified the project as a Category A investment (this would appear to be inconsistent with the original Board documentation which indicates that the project was Category B). It assigned a rating of 5 (falling within the 'A1-good' band), though the basis for this finding is not elaborated in a BTO report or similar which CAO has had the opportunity to review.

In November 2007, IFC CES prepared an Environmental and Social Review Document (ESRD) for a proposed rights issue combined with a BTO review of the existing equity investment. The report referred to the rights issue as Category A (this would appear to be inconsistent with the original Board documentation which indicates that the project was Category B). The report identified the 1993 World Bank Guidelines as applicable to the initial investment and the 2006 Performance Standards (1 to 8) as applicable to the rights issue.

The 2007 ESRD assessed compliance against each of the 2006 Performance Standards. It identified significant gaps. Some E&S plans were found to be non-existent (such as a Social Engagement Plan and a Stakeholder Engagement Process) while others were not aligned with the Performance Standards (such as the Resettlement Action Plan (RAP)). The ESRD noted community concerns about the amount of dust the mine development may create. It commented that the project team's optimistic views on community support for the mine were not supported by the Company's Social Baseline Study. The ESRD also noted that while stepping up efforts to build relationships with a range of communities within the Project's broader area of influence, the Company was holding back on releasing relevant E&S documentation to the public pending finalization of the land acquisitions needed for the project's dams.

Positively, the 2007 ESRD noted that the new water feasibility study was intended to respond to community concerns regarding use of underground water resources. Also on the question of water, the ESRD noted that the Company recognized that the mine had the potential to negatively impact the communities located downstream from the dam sites as far away as the

ocean, and that mitigation plans would be needed to address these impacts on the water supply.

The issues raised in the 2007 ESRD reflect a number of the issues raised in the complaint including air pollution, lack of community support and impact on water access and quality. CAO has not been able to locate an ESRR following the 2007 supervision visit. From the materials available to CAO at appraisal it is not apparent that the findings from the ESRD were translated into an Environmental and Social Action Plan (ESAP) or other agreed corrective action plan.

In July 2008, the IFC Board approved participation in a further rights issue, increasing IFC's investment by US\$12m (although this amount was not disbursed until 2010). The 2008 Board document stated that IFC's investment would support a project where project design, operations and management and mineral processing would be carried out in line with IFC's environmental and social standards. The Board document assessed that IFC's involvement at this early stage and through mine development and operation would help to build the right foundation for Quellaveco to deal with the environmental and social issues that would arise during later phases of the project. It noted that the Company had specifically sought IFC assistance in relation to participatory water monitoring. This document also confirmed that IFC's environmental specialists had been engaged in advising Quellaveco concerning preparation of environmental and social documentation in accordance with IFC guidelines.

The 2008 Board document further confirmed that the Company was in the process of securing land rights in the area where water would be supplied, stating that the water supply scheme was likely to result in the physical and economic displacement of a number of families and that the Company had begun work on a social program to deal with this. It contemplated approval of development of the mine by Anglo American's board during the third quarter of 2008, with construction expected to take three years for a production start-up in early 2011.

In May 2010, the Board approved participation in a further rights issue, increasing IFC's investment by an additional US\$18m. The new funds would be used to finance pre-development expenses, including finalization of an Environmental and Social Impact Assessment (ESIA) meeting the IFC Performance Standards. Reference was made to a Financial Year 2008 ESRR rating of 1 (satisfactory).

The May 2010 Board document describes the original 1993 investment as having been required to meet the World Bank Environmental standards then applicable (this would appear to be incorrect, given there were no obligations in the legal agreements). The 2010 Board document notes that during 2007 an IFC social specialist conducted a site visit to assess compliance with the 2006 Performance Standards, concluding that the exploration activities were fully compliant with the Performance Standards and applicable guidelines and that the Company was committed to operating to world class standards including the IFC Performance Standards as it moved towards development. At this stage, construction was anticipated to take three years, with production starting in 2014.

In November 2010, IFC CES prepared a detailed BTO report from a site visit. The BTO noted that the original equity investment had no reporting requirements and assessed compliance with the 2006 Performance Standards. It again identified material E&S gaps. The report expressed concern about the lack of an Environmental and Social Management System appropriate for construction (which at that stage was expected to begin in early 2011). The BTO also recommended a gap analysis of the EIA to fully assess compliance with IFC E&S requirements.

Recognizing that the Company was not obligated to develop and operate the Project to current IFC standards, the report noted (parent company) Anglo American's commitment to operating to the highest international standards, including IFC Performance Standards. However, concern was raised about high staff turnover and a lack of project level capacity to implement to these E&S standards. In this context the link between the project and Anglo's corporate E&S standards was found to be weakened.

In relation to stakeholder consultations, the 2010 BTO report recognized improvements since CES' previous site visit in 2007. The Company is reported to have conducted extensive stakeholder engagement of the affected communities and towns, to have held the required public consultations on the modified EIAs, and to have opened a public information office in the downstream town of Moquegua.

The 2010 BTO report discussed the design criteria for the tailings dam, the pit lake and the project's approach to waste rock disposal at some length. Given significant potential for contamination of ground water and impact on downstream water users, the BTO recommended additional technical reviews in relation to each of these with any mitigation measures to be fully incorporated into the design documents. The report also noted that the modified EIA referred to a commitment to consider Performance Standard 5 on Land Acquisition and Involuntary Resettlement, but also that project staff did not seem to be aware of this commitment. Finally, the report identified an urgent need for a comprehensive framework for land acquisition, resettlement and leasing to IFC standards as well as a RAP and an audit (issues that were raised in, but appear not to have been satisfactorily resolved since, the 2007 ESRD). As in relation to the 2007 ESRD, from the materials available at appraisal, it is not apparent to CAO that the issues identified in the 2010 BTO were translated into an ESAP or other agreed corrective action plan.

In January 2011, the IFC assigned an Environmental and Social Risk Rating (ESSR) to the project of B3-Partly Unsatisfactory. This is reflected in IFC Credit Review Reports from 2011. Also in early 2011, a CES specialist recommended that 'based on the current project status (with construction starting very soon) and the existing E&S risks, we should look at re-categorizing this project as an A'.

No further E&S supervision of the project is documented.

Between 1993 and 2012, IFC subscribed to a number of rights issues which did not go to the Board on the basis that the additional amounts invested did not meet the threshold required for Board consideration (in later years, US\$10m). This included participation in four capital calls during 2011, amounting to a total further investment of over US\$15m.

In February 2012 IFC sold all of its shares in the Company to a wholly-owned subsidiary of Mitsubishi Corporation.

Application of E&S Standards

Regarding supervision, CAO finds the central issue to be a lack of clarity regarding the application of E&S standards to the Project. The 2006 Policy on Social and Environmental Sustainability and the 2012 Policy on Environmental and Social Sustainability suggest that supervision of projects should include reference to the current Performance Standards even

when the client is bound only by earlier standards.⁵ This approach is reflected in the 2006 ESRP which states that a direct investment should be supervised considering '[t]he client's performance against the requirements of the investment agreement in particular and the IFC [Policy and Performance Standards] in general'. It is also consistent with the current version of the ESRP which requires E&S staff to consider both the safeguards and the performance standards in relation to pre-Performance Standard projects (ESRP 6.2.3).

In the absence of formal E&S obligations, IFC CES made efforts to supervise the Company's compliance with IFC standards as they evolved. In CAO's view, this represents good practice and is consistent with the trend in the development of IFC's policies and procedures. However, the lack of clarity around the client's obligations made it difficult to deal with E&S issues (for example those around land acquisition) which emerged during project supervision.

A second issue emerging from the above discussion relates to submissions to the IFC Board in relation to E&S issues around the project. The substantive IFC CES supervision reports from 2007 and 2010 identified gaps in relation to the Project's performance measured against the 2006 Performance Standards and prior safeguards. Many of these gaps correspond to the substance of the current complaint, covering issues such as water rights, pollution and land acquisition. The CES reports also express concern about the Company's capacity to implement the project in accordance with the 2006 Performance Standards. These concerns were not reflected in the Board documentation for the 2008 or 2010 rights issues. In addition, the Board documentation for the rights issues failed to note the lack of substantive E&S obligations in relation to this Project. In this context CAO has questions as to whether IFC accurately informed the Board in relation to E&S issues around the Project.

E&S Review and Rights Issues

A further issue in supervision relates to the way in which IFC considered E&S risk prior to approving additional investments in the Company in the form of rights issues.

IFC E&S guidelines in relation to rights issues have developed over time. Under the 1998 Procedure for Environmental and Social Review of Projects, rights issues were considered Category C on the basis that they were likely to have minimal or no adverse environmental impacts. As such, beyond screening, no further environmental assessment was required. The 2006 ESRP was silent on rights issues. The 2007 ESRP provided that

For projects where IFC's proposed financing is for Rights Issues where the subscription price for additional shares in each transaction exceeds ten million dollars (\$10,000,000), no review or public disclosure documents (SPI, ESRS) are necessary per IFC's Operational Procedures XI.2. [2.2.2(d)]

It is unclear what the rationale was for a threshold of ten million dollars. The current 2011 ESRP provides that

⁵ For example, the 2006 Policy on Social and Environmental Sustainability states that 'IFC seeks to ensure that the projects it finances are operated in a manner consistent with the requirements of the Performance Standards'. This is repeated and developed in the 2012 Policy on Environmental and Social Sustainability, which states that 'IFC seeks 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'.

For projects where IFC's proposed financing is for Rights Issues ... no review or public disclosure documents (Summary of Proposed Investment and Environment and Social Review Summary or Environmental and Social Clearance Memoranda) are necessary. The project E&S Category should remain the same as the original investment E&S Category ...[2.5.3]

As described above, between 1993 and 2012, IFC participated in a number of significant rights issues offered by the Company. The nature of the Project changed significantly over this period of time, from feasibility work in 1993 through to work preparatory to design and development, including land acquisition and resettlement, by 2007. IFC E&S standards also developed significantly over this period of time, as outlined above.

Credit Review Reports prepared by IFC in 2008 and 2009 indicated that disbursement of additional funds approved by IFC in the 2008 rights issue would be subject to a number of conditions in the form of an amendment to the Shareholders Agreement, including the Company's written commitment to IFC's Performance Standards. However, the additional funds approved in the 2008 and 2010 rights issues were disbursed in May 2010, without any commitment by the Company to IFC E&S standards. In correspondence with CAO IFC staff indicated that this was proposed to Anglo as part of a set of changes to the Shareholders Agreement but that over time the commercial circumstances shifted and IFC decided not pursue the changes in the agreement as it seemed unlikely that they would find a common position given the lengthy negotiation that led to no results.

Although IFC appears to have complied with relevant provisions on rights issues, and took some steps to encourage the Company to commit formally to IFC E&S standards, CAO has questions as to whether the provisions on rights issues support IFC's commitment to ensure that the business activities it finances are implemented in accordance with relevant environmental and social standards, particularly in cases where the nature of the project and/or IFC standards have evolved significantly since the initial investment.

5. CAO Decision

The decision about whether CAO should initiate a Compliance Investigation requires the weighing of a number of factors including the likely social and environmental impact of a project, a preliminary Appraisal of IFC's E&S performance, as well as a more general assessment of whether there is an argument for the value of a Compliance Investigation for project-related or systemic reasons.

At the outset, IFC categorized this Project as one which may result in specific environmental impacts and required adherence to performance standards, guidelines or design criteria to mitigate impacts. As the project progressed, IFC engaged with the Company around issues including access to water, pollution, ongoing land acquisition and resettlement, and the Project's impact on Indigenous peoples. In this context, the Complainants raise serious concerns about actual and anticipated E&S impacts of the Project.

In appraising IFC's E&S performance, CAO recognizes that this investment was initiated at a time when IFC E&S requirements were new and relatively underdeveloped. In addition, because the Project was designed to produce a series of feasibility studies, it was assumed that the E&S impact of the project was to be minimal. Nevertheless CAO finds that the lack of E&S requirements in the original investment agreement meant that there was a significant gap in terms of the Company's E&S obligations, even as required under the 1992 procedure. This

made E&S supervision difficult. The subsequent development of E&S policies and procedures, however, means that such an oversight would be unlikely to reoccur at IFC today.

Notwithstanding the lack of formal E&S requirements, CAO finds that IFC supervised the Project with reference to IFC's evolving E&S standards and policies. During supervision, attention was paid to E&S impacts arising in the context of land acquisition and resettlement, and the adequacy of public consultation. Significant attention was also paid to anticipated E&S impacts, including issues around water quality and access, pollution, cultural property and the impact on Indigenous peoples. This represented good practice. While the Complainants' concerns had not been fully addressed as at the time of IFC's divestment, CAO finds that IFC's engagement with the Company around E&S issues was generally appropriate to the stage of development of the Project. CAO notes that the Company was broadly receptive to IFC advice on E&S issues. However, CAO also notes that important E&S issues identified by IFC in 2007 and 2010 appear not to have been translated into agreed corrective action plans. Doing this would have been of particular relevance in relation to resettlement activities (which IFC noted were proceeding in advance of the development of appropriate plans and procedures), but also in relation to issues of stakeholder engagement and the more technical elements of project design that are discussed in the 2007 and 2010 CES reviews of the project.

More generally, this investment illustrates challenges inherent in applying IFC's E&S requirements to potentially high risk projects at an early (eg feasibility, pre-development) stage. IFC views its role in early or exploration stage equity mining as 'long term',⁶ stating that '[i]deally, IFC looks to be involved throughout the project cycle, providing further equity and debt as the mine goes into development'.⁷ IFC does not get involved in purely speculative projects, but aims to take 'a well informed bet that the property will be developed'.⁸ One benefit IFC offers early equity clients is assistance managing E&S risk.⁹ As a general proposition, CAO endorses IFC's view that partnering with clients at an early stage of a mining project can add significant value in terms of environmental and social risk management.

However, the current IFC Interpretation Note on Environmental and Social Categorization indicates that an IFC investment in exploratory or investigative work would typically be categorized as B. The Interpretation Note also suggests that material change in a client's business will not affect the E&S category assigned to the original investment. CAO has questions as to whether the current IFC guidance for the categorization of early equity mining projects is consistent with IFC's general approach to early equity mining projects and consistent with statements in the 2012 Policy.

The 2012 Policy states that '[w]here ... IFC invests in a pre development phase of a business activity, IFC will determine the category based on risks inherent to the particular sector and the context of the business activity's setting'. This would suggest a need to look beyond the immediate impacts of a feasibility stage project in the context of categorization. It would also suggest scope to reconsider the categorization of an early equity mining project if supervision

⁶ *Global Mining Overview*, available at: <http://www1.ifc.org/wps/wcm/connect/434c0a0049a5f8cda3d0e3a8c6a8312a/IFC+Mining+Overview.pdf?MOD=AJPERES>

⁷ *IFC Mining Background Note*, available at: [http://ifcnet.ifc.org/intranet/infrastructure.nsf/AttachmentsByTitle/IFC+Mining+%E2%80%93+Background+Note/\\$FILE/IFC+Mining+2010+-+Background+Note.docx](http://ifcnet.ifc.org/intranet/infrastructure.nsf/AttachmentsByTitle/IFC+Mining+%E2%80%93+Background+Note/$FILE/IFC+Mining+2010+-+Background+Note.docx)

⁸ *Ibid.*

⁹ See *Global Mining Overview* (above).

suggests the project has moved beyond feasibility and into activities with ‘potential significant adverse environmental or social risks’. This does not appear to align with the guidance referred to above.

In this case, there appears to have been much confusion regarding categorization of the Project. Documents reviewed by CAO refer to the Project at different points in time as Category A, B and C, although there does not appear to have been any formal process of re-categorization.

This investment also raises questions about current procedures related to rights issues. In particular, CAO notes that participation in rights issues may offer an opportunity to review a client’s E&S obligations and potentially leverage additional contributions to ensure that E&S performance keeps pace with the evolving risk profile of a project. Based on CAO’s review of this Project, it would appear that some efforts were made to introduce E&S obligations into the Shareholder’s Agreement, but that ultimately these efforts were not sustained.

Finally, this investment demonstrates the importance of reviewing and considering the adequacy of a client’s E&S compliance in the context of IFC’s exit from a project. CAO notes that the 2006 Policy states that IFC will ‘[e]ncourage the client to continue to meet the Performance Standards after IFC’s exit from the project’ (there does not appear to be an equivalent provision in the 2012 Policy). In relation to early equity investments, where IFC divests prior to completion of a project, a lack of structured attention to E&S performance prior to exiting may mean that major downstream impacts are inadequately mitigated. In a worst case scenario this could give rise to a situation where a project that IFC supports at the feasibility stage later causes significant social and/or environmental harm. The question of how IFC should respond to this type of risk does not appear to be well-captured in the Sustainability Framework or associated procedures.

Considering the above findings in relation to IFC’s E&S performance, the fact that this investment was approved under the long-superseded 1992 Procedure, and the fact that IFC has no ongoing involvement with the Project, CAO finds that a Compliance Investigation in relation to the full range of issues raised in the complaint is not merited. However, CAO finds that a review of certain aspects of this Project which relate to its nature as an early equity mining investment might better inform the application of policies (or other Compliance Investigation criteria) to future projects.

On the balance of considerations, CAO decides to conduct a Compliance Investigation into this Project, having regard to the matters raised in the Complaint, with a focus on the following questions:

- Are IFC’s policies and procedures regarding environmental and social categorization of projects, as applied to its investment in Quellaveco, effective to reflect the magnitude of project risks and impacts?
- Are IFC’s policies and procedures in relation to rights issues, as applied to its investment in Quellaveco, consistent with IFC’s commitment to ensure that the business activities it finances are implemented in accordance with relevant environmental and social standards?
- Do IFC’s policies and procedures regarding divestment from projects, as applied to its investment in Quellaveco, ensure appropriate consideration of environmental and social aspects prior to exiting?

Annex – IFC investment in Quellaveco copper project [*figures subject to confirmation*]

| Project | Type | Approval | Date approved | Amount approved | Disbursement |
|---|----------------|-----------|---------------------------|-----------------|--|
| 3823 | Initial equity | Board | March 1993 | US\$6.22m | Fully disbursed by July 1993 |
| 7441 | Rights issue | Board | March 1996 | US\$5.3m | Fully disbursed by October 1996 |
| 10170 | Rights issue | Delegated | February 2000 | US\$600,000 | Fully disbursed by December 2003 |
| 10837 | Rights issue | Delegated | January 2001 | US\$750,000 | US\$721,486 disbursed by December 2003 |
| IFC did not participate in rights issues from May 2003. In March 2007 IFC decided to meet previous cash calls to which IFC had not subscribed in order to maintain its stake in the Company. IFC also decided to participate in future rights issues. | | | | | |
| 26130 | Rights issue | Board | July 2008 | US\$12m | Fully disbursed by May 2010 |
| 29691 | Rights issue | Board | May 2010 | US\$18m | US\$15.8m disbursed May 2010 |
| 30734 | Rights issue | Delegated | March 2011 | US\$5m | Fully disbursed by May 2011 |
| 31119 | Rights issue | Delegated | July 2011 | US\$2.1 | Fully disbursed by July 2011 |
| 31341 | Rights issue | Delegated | September 2011 | US\$6m | Fully disbursed by September 2011 |
| 31872 | Rights issue | Delegated | [<i>Date not known</i>] | US\$3.8m | US\$3.7m disbursed [<i>date not known</i>] |