



May 16, 2016
Office of the Compliance Advisor Ombudsman (CAO)

COMPLIANCE APPRAISAL: SUMMARY OF RESULTS

Enso Albania (IFC Project #30979)
Albania

On September 28, 2011, IFC approved an early stage equity investment of up to EUR 6 million in Enso Hydro Energji sh.p.k., an Albanian holding company established by Enso Hydro GmbH (referred to jointly as “Enso” or “the client”). Enso Hydro GmbH is an Austrian company specializing in investments in small-scale and medium-scale hydropower projects. This compliance appraisal relates to a 8.9MW run-of-the-river hydropower project on the Lëngarica River that has been developed by the client (the “project”).

On June 22, 2015, CAO received a complaint submitted by the Organic Agriculture Association. The complainants contend that the project lies inside the boundaries of Bredhi Hotovës National Park. The complaint alleges violations of IFC’s environmental and social (E&S) standards, including: failure to respect national legislation; failure to protect and conserve natural and critical habitats; inadequate community involvement; and adverse impacts on tourism based livelihoods.

The purpose of a compliance appraisal 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.

This project is acknowledged as being located within a national park. It is also acknowledged as being located in an area with high biodiversity values and rich habitats. Further, an IUCN Red List (Critically Endangered) species, *Anguilla anguilla* (European eel) has been identified in the project area.

Natural habitats, critical habitats and protected areas receive specific protections under Performance Standard 6 (Biodiversity Conservation and Sustainable Natural Resource Management). In this context, CAO notes IFC’s view that the project does not impact critical habitats and is not located within an area that is legally designated for the purpose of protection or conservation of biodiversity. CAO also notes IFC’s view that the project has been designed to minimize adverse impacts on biodiversity and local sites of importance from a scenic and cultural heritage perspective.

Nevertheless, CAO finds that the complaint raises substantial issues related to IFC’s appraisal and supervision of the environmental and social impacts of the project. These include questions as to:

- a. Whether IFC’s pre-investment E&S review of the project, in particular its potential impact on biodiversity and ecosystem services was commensurate to risk;
- b. Whether IFC ensured proper application of Performance Standard 6 to the project, in particular given the project’s location in a national park and the presence of rare and/or endangered species in the area; and

- c. Whether IFC ensured proper application of its consultation and disclosure requirements to the project.

Resolution of the above issues requires detailed consideration with involvement of relevant technical expertise. As a result, CAO has determined that a compliance investigation is warranted. Terms of reference of compliance investigation will be issued in accordance with CAO's Operational Guidelines.

About CAO

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.

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

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

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I. Overview of the Compliance Appraisal Process

When CAO receives a complaint about an IFC or MIGA project, the complaint is referred for assessment. If CAO concludes that the parties are not willing or able to reach a facilitated solution, the case is transferred to the CAO compliance function for appraisal and potential investigation.

A compliance appraisal also can be triggered by the CAO vice president, IFC/MIGA management, or the president of the World Bank Group.

The focus of the CAO compliance function 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 first conducts a compliance appraisal. The purpose of the compliance 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 compliance appraisal process, 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 engage 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, CAO can close the case or initiate a compliance investigation of IFC or MIGA.

Once CAO concludes a compliance appraisal, it will advise IFC/MIGA, the World Bank Group President, and the Board in writing. If a compliance appraisal results from a case transferred from CAO's dispute resolution, 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.

II. Background

Investment

On September 28, 2011, IFC approved an early stage equity investment of up to EUR 6 million in Enso Hydro Energji sh.p.k., an Albanian holding company established by Enso Hydro GmbH (referred to jointly as “Enso” or “the client”). IFC’s investment was for equity of up to EUR 6 million, representing up to twenty percent of the client’s outstanding share capital. The investment was to provide support for the construction of the Lëngarica and Mati hydropower projects, as well as future envisaged projects. An investment agreement was signed between the client and IFC on February 3, 2012 and IFC invested on March 11, 2013. The investment is classified as Category B, meaning that IFC judged it to have limited potential E&S risks and impacts.

The Lëngarica hydropower project is an 8.9MW run-of-the-river type hydropower project built by a controlled subsidiary of the client.

The project is constructed at the lower part of the Lëngarica river basin, a tributary of the Vjosa River, in Përmet district, Gjirokaster prefecture, Albania. The project consists of a regulator, a 4km tunnel, a forebay, a 3.7 km penstock, a powerhouse, and a 6.5km transmission line to the Përmet substation. The project was awarded a build-operate-transfer (BOT) concession of 35 years by the Albanian Ministry of Economy, Trade, and Energy in 2008. In June 2011, Enso submitted an application for an environmental permit, which was refused in October 2011. Enso then received the permit in January 2012, after submission of additional information. The Lëngarica project has been operational since November 2015.

Complaint

On 22 June 2015, CAO received a complaint submitted by the Organic Agriculture Association on behalf of project affected people. CAO determined that the complaint was eligible on July 15, 2015. Following an attempt at dispute resolution the complaint was transferred to the CAO compliance function for appraisal in February 2016.

According to the complainants, the project is located inside a national park that is designated as a protected area, and falls under national legislation that prohibits high-impact activities in those areas. They therefore see the construction of the project as non-compliant with Albanian law and are concerned about the precedent this may set for future projects in protected areas. They have questions about the permits obtained by Enso Albania, and about the social and environmental impact studies, which were financed by the company.

The complainants perceive the Lëngarica river basin, where the project is located, as a unique area, rich in biodiversity which supports several communities, their culture, and livelihood activities. The complainants believe their eco-tourism livelihood activities will be adversely affected by the construction of the project. They are specifically concerned about the diversion of river waters which they contend will affect biodiversity, communities’ access to and use of water, as well as the natural landscape (the river itself, the thermal springs, Banja’s canyon and cave, the Petran Stone, and other natural monuments, which have cultural and touristic appeal). They state that the project will only allow 2.5 percent of the river’s flow to run naturally.

Although the company conducted meetings with communities, the complainants contend they did not adequately address local concerns or opposition to the project that was expressed by community members. The complainants also believe the project has brought little in the way of jobs, infrastructure improvements, or other local benefits.

Company perspective

As summarized in CAO's Assessment Report,¹ the company indicates that they have undertaken proper due diligence around the Lëngarica project. They state that the concession was granted before the area was designated as a national park and the protected area (core zone) of the park is approximately 9 km away from the project area. They contend that the project is designed to be small-scale and highly invisible, with 95 percent of the construction underground, and with limited environmental impacts. The company states that it has addressed issues raised by local stakeholders, such as impacts to the thermal springs, water access, and impacts to tourism by undertaking studies or putting works in place to address these issues, for example through a rehabilitation plan to restore the area, building a fish pass, and rehabilitation of cultural monuments. They report that the studies that have been carried out, from the Environmental Impact Assessment to an investigation by the Ministry of Environment, have concluded there are limited or no environmental impacts from the project.

In terms of national legislation, the company acknowledges that parts of the project indeed fall within a national park, but that the park has designated zones where certain activities are permitted, and they believe the project falls within such designated zones. They note that the project has a valid environmental license issued in January 2012.

With regard to community consultation, the company contends that they have held public meetings and information sessions, and have invited NGOs, affected people, and others to visit the project site and share their concerns. They report limited uptake of these opportunities. Their understanding is that there is local support for the project and the economic activity it has brought to the area.

¹ CAO Assessment Report, Enso Albania-01, November 2015 - <http://goo.gl/CiFd0g>

III. Analysis

IFC's investment in the client was made under its 2006 Policy on Social and Environmental Sustainability ("the Sustainability Policy") and Performance Standards (PS), together referred to as the Sustainability Framework. IFC's 2006 Policy on Disclosure of Information also applies.

This section considers IFC's E&S performance in relation to the above requirements. In light of the issues raised by the complainants, it focuses on:

- (a) IFC's pre-investment E&S review and whether this was commensurate to risk;
- (b) IFC's application of PS6 (Biodiversity Conservation and Sustainable Natural Resource Management) to the project;
- (c) IFC's consideration of the project's compliance with national law; and
- (d) IFC's application of its consultation and disclosure requirements to the project.

Pre-investment review

Prior to making an investment, IFC conducts an E&S review. IFC's pre-investment E&S review should be "appropriate to the nature and scale of the project, and commensurate with the level of social and environmental risks and impacts" (Sustainability Policy, para. 13). In conducting the E&S review IFC considers the E&S risks as assessed by the client and the "the commitment and capacity of the client" to manage these risks (*Ibid.*, para. 15). A key requirement of the Sustainability Policy is that "IFC does not finance new business activity that cannot be expected to meet the Performance Standards over a reasonable period of time" (para. 17).

As described in IFC's E&S Review Procedure (ESRP) the E&S review should result in an Environmental and Social Action Plan (ESAP) addressing all deficiencies and non-compliances discerned during the appraisal (ESRP3, para. 1.1).

IFC's E&S Review Summary (ESRS) for the project was disclosed in August 2011.² The ESRS was conducted on the basis of a review of "internal documents associated to the Sponsor's ESHS program," interviews with client staff and visits to the project site in Albania.

The ESRS focuses on the client's capacity to:

undertake adequate environmental and social impact assessments and manage the environmental, social, health and safety (ESHS) risks and impacts associated to the acquisition, engineering, construction and operation of hydropower projects and associated facilities (e.g. access road, transmission line), particularly those related to construction management, determination of ecological flow and biodiversity impact mitigation; and effectively consulting and engaging with project-affected communities.

This approach was taken because the client was expected to develop multiple hydropower projects, to which it would apply the Performance Standards.

The ESRS also notes the client's commitment to compliance with "Albanian and IFC Performance Standards on Social and Environmental Sustainability, and relevant IFC Environmental, Health and Safety (EHS) Guidelines."

In addition to analysis of the client's E&S management system, the ESRS includes a number of observations in relation to the Lëngarica project, which was to be the first project developed by the client following IFC's investment.

² IFC Environmental and Social Review Summary (ESRS), August 2011 - <http://goo.gl/z6ZHsj>

Relevant to the issues raised by the complainants, the ESRS states that the client has “reviewed the previous ESIA (Environmental and Social Impact Assessment) prepared prior to the client’s involvement, and updated the ESIA in line with good international industry practice.” Summarizing the updated ESIA, the ESRS notes that the Lëngarica river is “an area with high biodiversity value” and that approximately 8km of the Lëngarica will have a reduced flow due to the project. The guaranteed minimum flow is described as 20% of the minimum flow during dry periods (or 0.2 m³/s). IFC also notes a finding from the ESIA that “the residual water flow ... can protect different functions of the river, providing habitats for plants, wildlife and aquatic species.”

Relevant to the complainants’ concerns regarding the impact of the project on the area’s touristic appeal, the ESRS notes that the client is designing the project so as to minimize impact on the scenic value of the area including hot springs and ancient bridges.

An Environmental and Social Action Plan for the client was disclosed on the IFC website at the same time as the ESRS.³ In relation to the project, this included requirements that the client:

- implement Environmental Management and Environmental and Social Monitoring Plans;
- maintain a year round stabilized residual flow of 0.2m³/s;
- commission a report showing that impacts on hydrogeology (including impact on geothermal springs) are limited; and
- retain an independent biodiversity expert to design and manage the implementation of a robust biodiversity monitoring program.

Neither the ESRS or the ESAP mention the project’s location in a national park, nor the presence of specific endangered species in the area. The ESAP does, however, refer to the presence of “endemic species of the ‘red list’ in extinction danger.” This reference is drawn from the ESIA, which notes the presence of “rare and endangered species” in the area including floral species, amphibians and fish, notably *Anguilla anguilla* (European Eel) which is described as endangered according to the Albanian Red List.⁴

As explained to CAO by IFC, the team was not aware that the project was located in a national park at the time of the E&S review, as this was not identified in the 2011 ESIA, although the area in question was declared as part of the national park in 2008. In relation to the presence of *Anguilla anguilla*, IFC is of the view that while the presence of this species was reported, the ESIA did not support a conclusion that the project was located in a critical habitat. In this context, IFC notes conclusions from the ESIA that, due to the presence of the Benja Thermal Waters: “the ecologic status of the river segment impacted by the project is ‘poor’ close to thermal waters and ‘moderated’ at the lower flow close to Vjosa river.” IFC also notes that the agreed ESAP included a requirement to develop a biodiversity monitoring program to ensure that impacts on biodiversity were minimized.

Application of Performance Standard 6

Relevant to the application of Performance Standard 6 (Biodiversity Conservation and Sustainable Natural Resource Management), the complainants allege that the project: (a) has negative impacts on biodiversity in natural and critical habitats; (b) is located within and negatively

³ Enso Albania, Environmental and Social Action Plan, August 2011 - <http://goo.gl/M4YR0u>

⁴ *Anguilla anguilla* has been classified as ‘critically endangered’ in the IUCN Red List of Threatened Species since 2008: <http://www.iucnredlist.org/search> One of the major threats to European Eel populations, as described by IUCN is “barriers to upstream and downstream migration, which also includes mortality by hydropower turbines.”

impacts legally protected areas; and (c) has negative impacts on ecotourism activities such as kayaking and guided tours in the Lëngarica canyon and visits to the Benja thermal waters.

At the time of disclosure, IFC noted that PS6 would be applicable to the project. Relevant to the issues raised by the complainants, PS6 provides as follows:

In order to avoid and minimize adverse impacts to biodiversity in the project's area of influence, the client will assess the significance of project impacts on all levels of biodiversity as an integral part of the Social and Environmental Assessment process. The assessment will take into account the differing values attached to biodiversity by specific stakeholders, as well as identify impacts on ecosystem services.⁵

PS6 establishes differing requirements depending on the types of habitat a project is expected to impact. Natural habitats, critical habitats and protected areas receive specific protections under Performance Standard 6 (paras 7-11).

For natural habitats the requirement is that the project will not convert or degrade such habitat unless: (a) there are no technically and financially feasible alternatives; (b) the overall benefits of the project outweigh the costs (including those to the environment and biodiversity); and (c) any conversion or degradation is appropriately mitigated. Required mitigation measures are further described as being designed to achieve no net loss of biodiversity where feasible and may include restoration of habitats, offset of losses and compensation for direct users of biodiversity (paras. 7 & 8).

More stringent standards apply to projects that impact critical habitats and protected areas. In these circumstances PS6 prevents project activity unless: (a) there is no measurable adverse impact on critical aspects of the habitat; and (b) there is no reduction in the population of any recognized endangered species in the habitat (paras. 10 & 11).

In response to these requirements IFC takes the view that, based on the original ESIA and subsequent studies commissioned by the client, the project does not impact a critical habitat or an area that is legally designated for the purpose of protection or conservation of biodiversity as defined in PS6. While acknowledging that the project will change the natural dynamic of the river, IFC is of the view that a residual flow sufficient to protect the ecological functions of the river was identified in the ESIA and will be maintained. IFC also notes the establishment of a biodiversity monitoring program designed to ensure that biodiversity values in the stretch of river with reduced flow are not adversely impacted. Monitoring is described as supporting an adaptive response that would ensure the maintenance of biodiversity in the river should the project have a greater impact than expected or observed to date.

Of relevance to the project's impacts on tourism, the ESIA for the project (2011) concludes that water reduction in the canyon will decrease its touristic and landscape values. The client's Environmental and Social Action and Monitoring Plan (2013) identifies potential adverse impacts on ecotourism as possible and recommends that this be monitored. IFC's supervision documentation includes a Tourism Impact Assessment (2014) which concludes that the project will have a negative impact on some tourism activities (such as kayaking in the Lëngarica) but an overall cumulative positive impact on tourism development in the area. IFC notes that the nature of the project is such that it will have minimal visual impact on the landscape. IFC also notes the client's commitment to post construction rehabilitation and reforestation which should bring value from a recreation perspective and ensure the accessibility of the thermal springs. In addition, IFC notes several Corporate Social Responsibility activities that are being implemented by the client to

⁵ IFC Performance Standard 6, para. 4, April 2006

restore cultural monuments in the vicinity. Finally, IFC notes studies undertaken to ensure that the project does not impact thermal springs in the area, which are used for by tourists and locals.

Disclosure and Stakeholder Engagement

The complainants raise concerns regarding the adequacy of the client's disclosure of information in relation to the project. They also contend that client's approach to consultation was not meaningful.

Disclosure of E&S assessment documents and action plans, as well updates and progress on action plans are client requirements (PS1, paras. 20 & 26). In addition, IFC must disclose "electronic copies of [...] any relevant E&S impact assessment documents prepared by or on behalf of the client [...]" prior to IFC's disclosure of the project.⁶

As required by PS1, community engagement should be conducted on the basis of "[...] timely, relevant, understandable and accessible information" (para. 19). The process of consultation must provide "affected communities with opportunities to express their views on project risks, impacts, and mitigation measures [...]"⁷ Effective consultation, PS1 provides "[...] should be based on the prior disclosure of relevant and adequate information including draft documents and plans [...]" and should be "tailor[ed] [...]" to the language preferences of affected communities "⁸

CAO notes that neither IFC nor the Company have disclosed the ESIA on their websites. According to the ESRS, the ESIA was disclosed in Albania in August 2011 to two state institutions: the QKL (National Licensing Center) and the Ministry of the Environment, Forestry, and Water Management. The ESRS further states that the ESIA "is being disclosed by [the client] to affected communities." Post approval E&S documentation produced by the client is listed on the client's website,⁹ but not disclosed, with the exception of the Environmental and Social Action and Monitoring Plan (2013) which is disclosed in English.

In relation to the client's approach to stakeholder engagement, IFC notes that a consultation meeting was held as part of the preparation of the ESIA in 2011. IFC notes that a local information office has been established in Përmet and a community liaison officer appointed. IFC also notes public information events held by the client in the capital, Tirana in 2014 and 2015.

Compliance with national law

IFC requires that projects it supports comply with applicable national laws in addition to meeting the requirements of its performance standards (Performance Standards (2006) Introduction, para. 3).

The complainants allege that the project does not meet Albanian legal requirements. In particular they allege that its construction is contrary to the requirements of Albania's law on protected areas and the zoning framework for the Bredhi Hotovës National Park, within which it is located. In this context, the complainants note that in October 2011 the Albanian Ministry of Environment denied the client authorization for the project, based on its location within the National Park and a protected area of national monuments.

In response to this issue, IFC notes that the Ministry of Environment approved the project in January 2012 following submission of additional information by the client. IFC also notes that the National Park is divided into 4 zones and that the project is located outside the core zone, in areas

⁶ Policy on Disclosure of Information, para. 13, April 2006

⁷ IFC Performance Standard 1, para. 21, April 2006

⁸ IFC Performance Standard 1, para. 21, April 2006

⁹ <http://www.Enso.at/referenzen/projekte/detail/lengarica/>

zoned for: sustainable, traditional, and recreational use. IFC also points to a legal review commissioned by the client which concludes that the project is appropriately permitted.

Conclusion

This compliance appraisal considers a complaint regarding the environmental and social impacts of the Lëngarica hydroelectric project. Having considered the issues raised by the complainants and undertaken a review of available documentation, CAO has identified a number of concerns as to IFC's review and supervision of the project. First, CAO is unclear as to whether IFC's pre-investment review of the client's ESIA was commensurate to risk, particularly as relates to the project's potential impacts of biodiversity. Second, given its location within a national park, and the identification of rare and/or endangered species in the area, CAO is unclear as to whether IFC correctly applied aspects of PS6 which relate to specific types of habitat and protected areas to the project. Thirdly, it is not apparent from the available documentation that IFC correctly applied its disclosure and consultation requirements to the project.

Defining IFC's role in assessing project compliance with national law is a challenging one, given that national institutions have jurisdiction to make determinations regarding compliance with national law. In this instance, CAO notes that IFC's supervision of the project references: (a) a permit from the Albanian Ministry of Environment authorizing construction of the project; and (b) a legal review of the issue commissioned by the client. In the absence of alternative evidence, CAO concludes that IFC's supervision of the legal compliance issue was appropriate.

IV. CAO Decision

The decision as to whether CAO should initiate a compliance investigation requires a weighing of factors including the likely E&S impact of a project, a preliminary appraisal of IFC' performance against E&S requirements, as well as a more general assessment of the adequacy of IFC's E&S requirements in the context of the issues raised by a complaint.

This project is acknowledged as being located within a national park. It is also acknowledged as being located in an area with high biodiversity values and rich habitats. Further, an IUCN Red List (Critically Endangered) species, *Anguilla anguilla* has been identified in the project area.

Natural habitats, critical habitats and protected areas receive specific protections under Performance Standard 6 (Biodiversity Conservation and Sustainable Natural Resource Management). In this context, CAO notes IFC's view that the project does not impact critical habitats and is not located within an area that is legally designated for the purpose of protection or conservation of biodiversity. CAO also notes IFC's view that the project has been designed to minimize adverse impacts on biodiversity and local sites of importance from a scenic and cultural heritage perspective.

Nevertheless, CAO finds that the complaint raises substantial issues related to IFC's appraisal and supervision of the environmental and social impacts of the project. These include:

- a. Whether IFC's pre-investment E&S review of the project, in particular its potential impact on biodiversity and ecosystem services was commensurate to risk;
- b. Whether IFC ensured proper application of Performance Standard 6 to the project, in particular given the project's location in a national park and the presence of rare and/or endangered species in the area; and
- c. Whether IFC ensured proper application of its consultation and disclosure requirements to the project.

Resolution of the above issues requires detailed consideration with involvement of relevant technical expertise. As a result, CAO has determined that a compliance investigation is warranted. Terms of reference of compliance investigation will be issued in accordance with CAO's Operational Guidelines.