



April 27, 2015
Office of the Compliance Advisor Ombudsman (CAO)

COMPLIANCE APPRAISAL REPORT

*IFC Investment in Avenell Engineering Systems Ltd., Papua New Guinea
Project #32750*

Complaint 01

Summary

Avenell Engineering Systems Ltd. (“AES” or “the company”) was established in 1997 as an electrical engineering business in Papua New Guinea, specializing in power generation supply and assembly. The Company subsequently diversified its interests into plant and machinery hire, construction, port development and operations.

In June 2013, IFC committed a US\$4 million loan to the company to fund a capital expenditure program which includes the acquisition of plant and equipment for the construction and operation of a wharf and port facility.

A complaint was lodged with CAO in September 2014 by the Kuriu Clan of Roku village in Papua New Guinea, with support from a local consultant. The complainants’ main concern relates to what they identify as an illegal occupation of their customary land by AES, and in turn to IFC’s due diligence process, which they argue failed to appropriately identify them as the legitimate land owners.

The purpose of a CAO compliance appraisal is to determine whether an investigation of IFC’s environmental and social (E&S) performance is required in response to a complaint. In deciding whether to initiate an investigation, CAO weighs factors including the magnitude of the E&S concerns raised in a complaint, results of a preliminary review of IFC’s E&S performance in relation to these issues, and a more general assessment of whether a compliance investigation is the appropriate response in the circumstances.

In this case, CAO has concerns as to the adequacy of IFC’s E&S review prior to its investment in the company. Given that the complainants assert: (a) to be the customary owners of land acquired by the company, and (b) to have been involved in a long running dispute over the land in question, CAO has questions as to whether IFC properly considered the application of Performance Standard 7 (Indigenous Peoples) to this investment. However, CAO notes that the IFC loan was never disbursed and was ultimately canceled at the company’s request in December 2014.

In conclusion, considering that IFC is no longer involved in the project, and that no investment was made, CAO decides that an investigation of IFC’s performance is not an appropriate response to the issues raised in the complaint. As a result, in accordance with its Operational Guidelines, CAO has decided to close this case.

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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Acronyms

Acronym	Definition
AES	Avenell Engineering Systems, Ltd.
CAO	Office of the Compliance Advisor Ombudsman
E&S	Environmental and Social
ESAP	Environmental and Social Action Plan
ESMS	Environmental and Social Management System
ESRS	Environmental and Social Review Summary
ESRP	Environmental and Social Review Procedures
FPIC	Free, Prior, and Informed Consent
ICP	Informed Consultation and Participation
IFC	International Finance Corporation
MIGA	Multilateral Investment Guarantee Agency
PS	Performance Standard
SABL	Special Agricultural Business Lease
SPI	Summary of the Proposed Investment
SSV	Supervision Site Visit

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

Avenell Engineering Systems Ltd. (“AES” or “the company”) was established in 1997 as an electrical engineering business in East New Britain Province of Papua New Guinea, specializing in power generation supply and assembly. The Company subsequently diversified its interests into plant and machinery hire, construction, port development and operations.

In June 2013, IFC committed a US\$4 million loan to the company to fund a capital expenditure program which includes the acquisition of plant and equipment for the construction and operation of a wharf and port facility.¹ However, the IFC loan was never disbursed and was ultimately canceled at the company’s request in December 2014.

Complaint and CAO Assessment

A complaint was lodged with CAO in September 2014 by the Kuriu Clan of Roku village in Papua New Guinea, with support from a local consultant. The complainants’ main concern relates to what they identify as an illegal occupation of their customary land by the company, and in turn to IFC’s due diligence process, which they argue failed to appropriately identify them as the legitimate land owners. The complainants claim that their customary land has been converted to a Special Agricultural Business Lease (SABL) that was granted to illegitimate owners, whereas they should have been recognized as legitimate customary landowners, and subsequently should have received adequate compensation from the company for the use of their land.

At the time the complaint was lodged, the Kuriu Clan also sought legal recourse to reclaim their land. According to the complainants, legal proceeding commenced in 2010. They also state that the Central Province Lands Court ruled in favor of the Kuriu Clan, and that following the court decision, lawyers acting on behalf of the Kuriu Clan issued notices to the company ordering to cease paying royalties to the illegitimate owners on September 22, 2014. Hence, the complainants demand that their land be returned to them, and compensation be paid for damage already done.

Further to the issues raised in the original complaint, the CAO assessment report mentions concerns about potential impacts on soil erosion due to land clearing, destruction of local habitats, and damages to natural habitat.

For the purpose of this compliance appraisal, CAO considers that the focus of the complaint relates to the identification of the complainants as the proper customary owners of the land in question. As such, this is the focus of CAO’s compliance appraisal.

¹ IFC Investment in AES, Summary of Proposed Investment, May 2013, <http://goo.gl/ZRnpbA>

III. Analysis

This section outlines the IFC E&S policies and procedures as apply to the project. It then analyses IFC's performance against these standards during preparation and implementation of the project and in the context of the issues raised by the complainants.

IFC Policies and Procedures

IFC's investment in the company was made in the context of its 2012 Policy on Environmental and Social Sustainability ("the Sustainability Policy") and Performance Standards (PS), together referred to as the Sustainability Framework and effective as of January 1, 2012. Through the Sustainability Framework, "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" (para. 7).

IFC implements the commitments set out in the Sustainability Policy through its Environmental and Social Review Procedures (ESRP), which are updated periodically. The AES project was approved and supervised under ESRP version 5.0².

When financing a project, IFC first conducts an appraisal aimed at assessing the full business potential, risks, and opportunities associated with the investment. Once the project is approved and IFC has invested in a client, the investment is monitored throughout the project cycle to ensure compliance with the conditions in the loan agreement and IFC's applicable policies and standards. Considering that IFC's loan was canceled after commitment, this CAO compliance appraisal focuses on IFC's performance at appraisal and post-commitment stages as relevant to the issues raised by the complainants.

Pre-investment Environmental and Social Review

For the purpose of this compliance appraisal, a key question is whether IFC conducted an adequate pre-investment review of potential risks and impacts of the project as relates to the use of customary land belonging to Indigenous Peoples.

Requirements

As required by the Sustainability Policy, IFC's E&S review should include "(i) reviewing all available information, records and documentation related to the environmental and social risks and impacts of the business activity; (ii) conducting site inspections and interviews of client personnel and relevant stakeholders [...]; (iii) analyzing the business activity's environmental and social performance in relation to the requirements of the Performance Standards and provisions of the World Bank Group Environmental, Health and Safety Guidelines" (para. 28).

Relevant to the issues raised in the complaint, PS7 (Indigenous Peoples) provides that when a project is "likely to generate potential adverse impacts on Indigenous Peoples, IFC expects clients to engage in a process of Informed Consultation and Participation (ICP)" (para. 30). This process is to include Free, Prior, and Informed Consent (FPIC) "if the client proposes to locate a project on [...] lands [...] under the customary use of Indigenous Peoples, and adverse impacts can be expected" (para. 14).

² IFC Environmental and Social Review Procedures Manual, version 5.0, April 15, 2013

IFC's pre-investment review of the company

IFC prepared a Concept Note for the project in December 2012. IFC's E&S early review identified issues such as EHS organization and management, potential environmental impacts and disturbance of local communities during the construction phase, and hazardous waste storage and handling. It also noted that an early preliminary review would be required in order to clarify the unknowns related to the biodiversity value of the mangroves and marine communities, and associated impacts of the project. IFC's early review did not identify issues related to the use of customary land by Indigenous Peoples.

An ESIA and an Environmental Management Plan were prepared by the company during the course of IFC's appraisal of the project. CAO notes that the ESIA did not mention issues related to the use of customary land by Indigenous Peoples.

In May 2013, an E&S Review Summary (ESRS) was disclosed by IFC.³ According to the ESRS, "no economic or physical resettlement was involved in the purchase of the site; the lease was bought on a willing buyer willing seller basis. [...] There are no adverse impacts on indigenous peoples or over cultural property". The ESRS further underscores that "the Department of Conservation (DEC) consulted the land owner group and villagers during the permit application process [and] communications [...] has revolved around compensation for the land lease [...], provision of additional support on a mutually agreed basis, and discussion and resolution of any grievances". It is, however, unclear to CAO whether members of the Kuriu Clan were included in this consultation process, and whether they were identified as customary land users.

The proposed investment was submitted to the IFC Board in June 2013. The Board Paper identified land risk as a major issue in the context of Papua New Guinea. It underscores risks related to misusing SABLs to acquire customary land. However, the Board Paper noted that interviews of customary land owners did not indicate any misuse of the SABL scheme in this case. It further states that there were no potential adverse impacts on indigenous peoples or over cultural property.

The investment was approved by IFC Management and committed later in June 2013.

Conclusion

CAO has questions as to whether IFC's E&S due diligence in relation to land issues surrounding this project was commensurate to risk. CAO's concerns relate in particular to IFC's due diligence in the context of Papua New Guinea, where issues regarding customary land ownership are well known.

Actions following approval of the loan

A loan agreement was signed between IFC and the company on June 28, 2013. This agreement requires the company to comply with the ESAP and submit to IFC annual monitoring reports (AMR) on its activities. More generally, it requires the company to conduct its activities in accordance with the Performance Standards.

Following IFC's commitment, CAO notes that IFC engaged with the client in order to address a number of conditions of disbursement, none of which are relevant to the issues raised in the CAO complaint. Further, an IFC Advisory Services project was initiated to help the client establish an E&S Management System (ESMS).

³ IFC Investment in AES, Environmental and Social Review Summary, May 2013, <http://goo.gl/4icpy7>

IFC conducted a supervision site visit (SSV) in February 2014. The objective was to help the client move forward on outstanding E&S actions. CAO notes that the issues raised by the complainants are not mentioned in IFC documentation following this SSV.

In July 2014, the client gave notice to IFC that it wished to cancel the loan. IFC agreed with this request. The loan was formally canceled in December 2014, and the IFC Advisory Services project was subsequently terminated.

CAO notes that IFC did not identify issues related to land ownership until the complaint was lodged with CAO in September 2014. As the loan was already in the process of being canceled at this time, IFC did not take action in response to the issues raised by the complainants.

IV. Decision

The purpose of a CAO compliance appraisal is to determine whether an investigation of IFC's E&S performance is required in response to a complaint. In deciding whether to initiate an investigation, CAO weighs factors including the magnitude of the E&S concerns raised in a complaint, results of a preliminary review of IFC's E&S performance in relation to these issues, and a more general assessment of whether a compliance investigation is the appropriate response in the circumstances.

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In conclusion, considering that IFC is no longer involved in the project, and that no investment was made, CAO decides that an investigation of IFC's performance is not an appropriate response to the issues raised in the complaint. As a result, in accordance with its Operational Guidelines, CAO has decided to close this case.