COMPLIANCE MONITORING REPORT

IFC Investment in Quellaveco, Peru
Project #3823
Complaint 01

Monitoring of IFC’s Response to:
CAO Investigation of IFC’s Investment in Minera Quellaveco S.A., Peru

October 14, 2015
Office of the Compliance Advisor Ombudsman (CAO)
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
Introduction

The CAO compliance function oversees investigations of IFC/MIGA’s environmental and social (E&S) performance with a view to ensuring compliance with relevant requirements and improving the E&S performance of the institutions.

Following a CAO compliance investigation, CAO will monitor actions taken by IFC/MIGA until such actions assure CAO that its compliance findings are being addressed.

CAO’s monitoring considers IFC’s response to a compliance process at two levels:

- Firstly CAO considers actions taken or proposed by IFC that respond to CAO findings at the project level.
- Secondly, CAO considers actions taken or proposed by IFC that respond to CAO findings at the level of IFC/MIGA policies, procedures, practice or knowledge.

The first level of analysis is designed to ensure that project level concerns identified by CAO are addressed. The second level is designed to document progress in the IFC’s approach to the identification and management of E&S risk.

This report documents CAO’s monitoring of IFC’s response to its investigation of IFC’s investment in Minera Quellaveco S.A. (“the compliance investigation”) in the period August 2014 – August 2015.¹

Background

The compliance investigation relates to IFC’s investment in Minera Quellaveco S.A. (“the client”), a mining concession located in Peru in the Region of Moquegua. In April 1993, the IFC Board approved a US$ 6 million investment to acquire a 20 percent equity investment in the client. Between 1996 and 2011, IFC participated in a number of rights issues providing US$ 54 million in additional capital to the company to continue its development activities. In February 2012, IFC sold all of its shares in the Company to a fully-owned subsidiary of Mitsubishi Corporation.

The compliance process was triggered by a complaint received in November 2011 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 issues raised in the complaint can be summarized as concerns regarding water resources, pollution, land claims, and the adequacy of community engagement in relation to the preparation of an Environmental Impact Assessment (EIA).

The compliance investigation was released in August 2014. A summary of findings as presented in the August 2014 report is set out in the table below.

¹ The CAO investigation, IFC’s response to the investigation and related materials are available on the CAO website - [http://goo.gl/QCyelB](http://goo.gl/QCyelB)
**Summary of Key Findings**

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<th>General</th>
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<td>The absence of E&amp;S requirements in IFC’s Shareholders Agreement for Quellaveco meant that there was a significant gap in terms of the Company’s E&amp;S obligations. This made effective E&amp;S supervision difficult.</td>
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<td>Nevertheless, IFC supervised the Project with reference to IFC’s evolving E&amp;S standards and policies. This represented good practice.</td>
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<td>While the Complainants’ concerns had not been resolved as at the time of IFC’s divestment, CAO finds that IFC’s engagement with the Company around E&amp;S issues was generally appropriate to the stage of development of the Project.</td>
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<td>Key E&amp;S issues identified by IFC in project supervision were, however, not translated into corrective action plans. Agreeing on corrective action plans would have been of particular relevance in relation to: (a) resettlement activities (which IFC noted were proceeding in advance of the development of studies and plans required by IFC E&amp;S standards); (b) the impact of land acquisition on Indigenous people; (c) issues of stakeholder engagement; and (d) the more technical elements of project design and environmental impact assessment that are discussed in IFC’s 2007 and 2010 supervision documentation.</td>
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<td>Information presented by IFC to its Board regarding this Project was incomplete, particularly with relation to the E&amp;S standards which applied to the Project and its level of E&amp;S compliance.</td>
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<th>E&amp;S Categorization</th>
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<td>IFC’s Quellaveco investment would properly have been categorized A at the outset given: (a) the magnitude of the potential impacts of the proposed mine; (b) IFC’s view that it had a high likelihood of moving forward to development within a relatively short period of time; and (c) the potential E&amp;S risks and impacts of the Project in the pre-development phase, in particular potential impacts on Indigenous People.</td>
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<td>The decision as to whether an early equity mining project should be categorized as A or B needs to be determined on a case-by-case basis, taking into account the potential E&amp;S impacts of the Project (both immediate and long term), as well as its likelihood of development.</td>
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<th>E&amp;S Considerations around Participation in Rights Issues</th>
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<td>IFC complied with existing procedures for participating in rights issues in Quellaveco</td>
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<td>IFC’s procedures as applied in the processing of rights issues in Quellaveco are inconsistent with IFC’s commitment to having clients manage E&amp;S risks in accordance with the Performance Standards as set out in the Sustainability Policy (2006).</td>
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<td>IFC’s procedures regarding the processing of rights issues are inconsistent with para. 17 of the Sustainability Policy (2006), which implies a requirement to analyze any additional financing in terms of whether it involves “new business activity”, and if so to apply the Performance Standards to that investment.</td>
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<th>E&amp;S Considerations around Divestment</th>
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<td>IFC did not adequately consider whether the investment’s purpose has been “substantially fulfilled” in the context of its divestment decision. In circumstances where IFC’s additionality is framed in terms of E&amp;S issues (as was the case in relation to Quellaveco), this requires an analysis of E&amp;S achievements and future risks.</td>
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<td>IFC’s Operational Procedures on Equity Sales do not adequately support IFC’s commitments to E&amp;S sustainability in its investments.</td>
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<td>It would be consistent with both the Operational Procedures on Equity Sales and IFC’s broader commitments to E&amp;S sustainability for E&amp;S considerations to be structured into IFC’s decision making around divestment.</td>
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IFC’s Response to the Investigation

A management response from IFC was released together with the investigation in August 2014.2 At project level, IFC’s response notes that IFC has divested from Quellaveco after 19 years in which IFC supported the project’s exploration activities, feasibility studies, and environmental and social management initiatives. IFC underscores that during its involvement in the project, IFC’s E&S activities focused on: (a) the actual on the ground impacts of exploration and feasibility work; and (b) the potential impacts of the project if it were to, one day, be built. According to IFC, Quellaveco was compliant in its day-to-day activities.

IFC notes that it had no active investment in the project. IFC underscores that the project ownership has transitioned to two reputable sponsors, providing confidence to IFC that the project would be carried out with sound environmental and social management.

IFC’s response notes that CAO’s comments relating to broader IFC investment practices would be taken on board by IFC management as the institution continues to enhance its investment practices. IFC’s response acknowledges CAO’s findings regarding broader operational policies relating to, among others, early equity investments, environmental and social categorization, rights issuances, and divestment policies. Through its response, IFC committed to continuing the dialogue with CAO in this regard.

Conclusions from CAO Monitoring

Project level response

During the period covered by this monitoring report, IFC has not reported any action that addresses CAO’s project level findings.

These include findings in relation to:

- **Land acquisition activities**, which IFC noted were proceeding in advance of the development of studies and plans required by IFC E&S standards.
- The **impact of the project on Indigenous Peoples**, which according to IFC’s documentation were potentially affected during the pre-construction stage, particularly through economic displacement in advance of adequate consultation and planning.
- **Issues of stakeholder engagement**, in particular the absence of a Stakeholder Engagement Plan.
- The more technical elements of **project design and environmental impact assessment** that are discussed in IFC’s supervision documentation, including the risk of groundwater contamination, and the design of the tailings dam.

In explaining the decision not to take up the findings with its client, IFC notes that:

- (a) it disagrees with CAO’s project level findings;
- (b) no decision on further development of the project has yet been made;
- (c) the company undertook a number of activities related to stakeholder engagement and community development projects during the feasibility phase;
- (d) the company is committed to allocating significantly more attention and budget to these issues, should development of the project proceed;

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2 IFC’s Response to CAO Compliance Investigation Report in respect of IFC’s investment in Minera Quellaveco, Peru - [http://goo.gl/TetWDL](http://goo.gl/TetWDL)
(e) the company has been a responsible partner over the years and has worked with IFC to implement a wide range of E&S measures well beyond what the legal documents required; and

(f) IFC sold its equity in the project in 2012 and has concluded its engagement with this project.

While it is clear that IFC has no ongoing investment in the project, CAO’s view is that this does not prevent IFC from making good faith efforts to ensure that the project level findings in the CAO report are addressed. This is no less the case, considering that IFC has an ongoing commercial relationship with the project sponsor, Anglo American plc, through its equity stake in the Loma de Niquel project in Venezuela. In this context CAO notes the instance of CAO’s compliance audit of IFC’s investment in Lukoil, in response to which IFC did engage with its former client to address the findings of CAO’s audit, even though the client already had pre-paid its loan to IFC. In the case of Minera Quellaveco, IFC reported to CAO that it did not believe trying to re-engage with the project owners on these issues would be productive.

Response at the Level of IFC policies, procedures, practice or knowledge

During the period covered by this monitoring report, IFC reported several steps that are being taken to address CAO’s findings at the level of policy, procedures, practice or knowledge. These include findings in relation to:

- IFC’s approach to the categorization of early equity mining projects.
- IFC’s procedures for providing additional financing.
- IFC’s decision making process around divestment and E&S considerations.

Regarding these issues, IFC reports that it has ongoing internal conversations around categorization and re-categorization of projects. IFC further reports that it is currently working on an advanced draft procedure (“ESRP 13”) on “Managing Phased Development Projects”. IFC also notes that a proposed approach to dealing with rights issues and similar follow-on equity investments has been drafted. At the time of writing, both documents were under management consideration.

Although CAO acknowledges that the actions initiated by IFC regarding categorization and additional financing represent positive steps towards addressing the audit findings, CAO has not had an opportunity to review the initiatives proposed by IFC. It is thus premature to reach conclusions from monitoring at this stage. CAO further notes that IFC has not reported proposed actions in relation to CAO’s findings on divestment.

Conclusion

CAO will keep this case open for monitoring, and plans to issue a follow up monitoring report in relation to this investigation no later than August 2016.

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3 IFC. Summary of Project Information (Minera Loma de Niquel CA). http://goo.gl/iwQ5zS
4 See CAO Website [Kazakhstan / Lukoil Overseas-01/Berezovka]: http://goo.gl/wDkfMq