APPRAISAL REPORT

CAO Appraisal for Investigation of IFC

CAO Compliance

C-I-R7-Y13-F183
March 18, 2014

Albania Hydros Project (583387)
Albania

Case of
Albania Hydros Project

Summary

In 2011 IFC initiated an Advisory Services project to support the Government of Albania (GoA) to privatize four hydropower plants (HPPs).

The main objectives of the Project were to identify private sector investors to acquire, upgrade, efficiently operate and manage the four HPPs, and to maximize proceeds from privatization of the assets.

In January 2013, a complaint was filed with CAO by the Environmental Center for Development Education and Networking (EDEN), based in the Albanian capital, Tirana. The complaint raised concerns about the potential negative impact of privatizing the HPPs. Issues raised by the complaint and considered in this compliance appraisal include: IFC's due diligence and mandate with respect to the project and the extent of disclosure and consultation around the project.

Having considered available information on the potential adverse environmental and social impact of the project in light of the issues raised by the complainant and the application of relevant IFC policies, standards and procedures, CAO finds that this complaint does not warrant further investigation. As such, CAO has decided to close the case.

Office of the Compliance Advisor Ombudsman (CAO)
for the
International Finance Corporation (IFC)
Multilateral Investment Guarantee Agency (MIGA)
Members of the World Bank Group

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About the 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 lending 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

1. Overview of the CAO Compliance Appraisal process

When CAO receives an eligible 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 CAO compliance for Appraisal and potential compliance investigation.

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

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 services. 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 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.

In cases transferred to compliance after a CAO assessment, the scope of the appraisal is defined by issues raised in the complaint and identified during the CAO assessment phase.

To guide the compliance 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 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, the 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 President, and the Board in writing. If a compliance 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 and Concerns that led to the Appraisal

Korporata Elektroenergjitike Shiqiptare (KESH) is an Albanian state owned electricity company which operated the four hydro power plants (HPPs) (Ulza HPP, Shkopeti HPP, Bristrica I HPP, and Bristrica II HPP) which the Government of Albania (GoA) decided to privatize. Prior to the privatization of the HPPs, IFC had previously assisted GoA's Ministry of Economy, Trade, and Energy (METE) with the unbundling and privatization of the electricity-distribution activities of the KESH (IFC Project - #25624).

Ulez and Shkopet HPPs are situated on the Mat River in northern Albania and Bistrica I and II HPPs are situated on the Bistrica River in southwestern Albania (collectively referred to as Mat Cascade). The total capacity of these plants is approximately 76.7 megawatts, which represents approximately six percent of Albanian's overall annual electricity consumption.

IFC Advisory Services (AS) seeks to strengthen the development impact of IFC's investments, unlock investment by the private sector, and help businesses expand and create jobs. IFC Advisory Services has four business lines: Access to Finance; Investment Climate; Sustainable Business and Public-Private Partnerships.[1]

In 2011, the GoA decided to introduce private sector participation in the operation and maintenance of the HPPs. GoA engaged IFC (Public-Private Partnerships business line) in October 2011 as Lead Advisor to assist in the various phases of reviewing, structuring and implementing the privatization and modernization plan. According to IFC's Implementation Plan,[2] the two key objectives of the advisory project were to:

1. Help the GoA maximize privatization proceeds from the sale of the hydropower plants; and
2. Ensure that the plants are rehabilitated and efficiently operated by the new owner to improve Albanian generation system and ensure reliable energy supply in Albania.

The HPPs were separated into two companies (HEC Ulez Shkopet Sha and HEC Bistrica I/Bistrica II Sha) by the GoA. Under the Financial Advisory Services Agreement (FASA) signed with the GoA in October 2011, IFC's role was to provide advice to separately tender the two companies for privatization. Relevantly, as part of the Project, IFC commissioned an E&S due diligence study which was delivered in March 2012 and advised its client on the inclusion of E&S considerations in the tender documents. In January 2013, the GoA announced that Kürüm International (Kürüm) had won both tenders and contracts for the sale of the HPPs were signed in February 2013. Kürüm is the international arm of a privately owned Turkish iron and steel producer. In Albania, Kürüm has a large iron and steel production operation in Elbasan, approximately 35 kilometers (km) Southwest of the Albanian capital, Tirana.

On January 14, 2013, a complaint relating to IFC's Albania Hydros advisory services project (the Project) was filed by the Environmental Center for Development Education and Networking (EDEN). EDEN (the Complainant) raised concerns about the impacts of the privatization of the HPPs. In particular, negative impacts on the electricity market and the national budget were

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[1] IFC.org About Us – see http://goo.gl/ECqGp6 (accessed January 13, 2014).
[2] IFC Advisory Services Implementation Plan (Project # 583387) (November 2011).

claimed. The complaint was brought by EDEN on its own behalf. EDEN did not claim to represent any other project affected person or group. CAO deemed the complaint eligible in February 2013 on the basis that EDEN, as an Albanian civil society organization, had the potential to be negatively impacted if the concerns raised in the complaint were realized.

As part of CAO's assessment phase, in March 2013, a CAO team met with the Complainant, IFC's project team, the GoA and other stakeholders. During the assessment EDEN asserted that they did not believe their concerns were amenable to a collaborative dispute resolution process. As a result, CAO concluded its assessment and the complaint was transferred to CAO's Compliance function for Appraisal.

In September 2013, IFC approved a loan of up to $30 million from its own account to support: (i) the acquisition of the HPPs; and (ii) the estimated EUR 10 million rehabilitation investment of these power plants. At the time of writing this investment was listed as pending disbursement.[3]

3. Scope of the Appraisal for Investigation of IFC

As noted in Section 1 above, in cases transferred after CAO's assessment, the scope of the Appraisal is defined by issues raised in the complaint and identified during the CAO assessment phase.

Based on the letter of complaint and CAO's Assessment Report, the following issues are considered in this Compliance Appraisal:

a. project selection and IFC mandate (particularly IFC's decision to support GoA in the privatization of the HPPs);
b. the extent of disclosure and consultation around the decision to privatize the HPPs;

A number of other E&S concerns associated with the project are noted in the CAO Assessment Report. These were identified by CAO through engagement with stakeholders, and include:

c. historical land claims which remain unresolved;
d. potential job losses;
e. potential for the project to contribute to air pollution around the steel plant of the winning bidder (Kürüm International); and
f. the impact of the project on water users and communities living downstream of the projects.

Issues c. – f. above are not considered in detail as part of the Appraisal as they are not asserted to pose significant E&S risks to the Complainant. Similarly, this Compliance Appraisal focusses on IFC's Advisory Services project with the GoA rather than its subsequent investment in Kürüm as it is to the Advisory Services project that issues a. and b. above relate. In proceeding in this fashion CAO recalls that its mandate is defined as addressing "complaints from people affected by IFC/MIGA projects" (CAO Operational Guidelines (2013), para. 1.1).

[3] IFC, Summary of Project Information (Kürüm International). http://goo.gl/dcJBH5 (accessed March 12, 2014)

Given IFC's commitments in relation to Advisory Services projects, this Appraisal focuses on whether IFC acted in accordance with relevant policy requirements in its review and execution of the Project. More specifically it considers whether the scope of IFC's due diligence, was in accordance with relevant IFC policy provisions and whether IFC's advice was consistent with the requirements of the Performance Standards.

4. Discussion

4.1 IFC Project Pre-Implementation and Implementation: General Compliance Issues

Advisory Services Project Preparation and Implementation: IFC Policy and Procedures
IFC's Pre-implementation phase of the Albania Hydros project commenced under the 2006 Policy on Social and Environmental Sustainability ("Sustainability Policy (2006)") but the Project was implemented largely under the updated version of the Sustainability Policy which came into effect on January 1, 2012. This Compliance Appraisal thus refers primarily to the Sustainability Policy (2012). The key requirement from the Sustainability Policy (2012) in relation to Advisory Services projects is that where E&S risks are identified, IFC's advice with be "consistent with the Performance Standards" (para. 39). This is consistent with the approach taken by the consultants engaged by IFC to undertake E&S due diligence in relation to the project, who reference the 2012 Performance Standards in their report.

The Sustainability Policy (2012) also provides that "IFC weighs the costs and benefits of each proposed advisory activity for E&S risk… [and that] these are provided to IFC management when the project is presented for approval" (para. 38). No similar provision was present in the 2006 version of the Sustainability Policy, which was applicable when this project was approved. The 2006 Sustainability Policy does, however, include more general provisions, for example in the "Purpose of this Policy" section, which provides that IFC "seeks to ensure that the projects it finances are operated in a manner consistent with the requirements of the Performance Standards" (para. 5). Similarly, the under the heading of "IFC's Commitment" the 2006 Sustainability Policy provides that efforts to "carry out its investment operations and advisory services in a manner that "do no harm" to people and environment," are "central to IFC's development mission" (para. 8).[4]

IFC implements its commitments in the Sustainability Policy through its Environmental and Social Review Procedures (ESRP). These procedures outline how IFC staff evaluate the potential impacts of a proposed Advisory Service project and determine if the project could have potential E&S risks. IFC's due diligence for this project commenced under ESRP v.5 (September 2010). IFC was, however, not required to conduct specific E&S due diligence before the procedures were updated in June 2011 (ESRP v.6). CAO thus considers ESRP v.6 applicable for this project's due diligence and implementation. It should be noted that in relation to stand alone Advisory Services projects, such as this one, the ESRP only applies to projects that are categorized as high E&S risks by IFC Advisory Services staff (ESRP v.6, para 11.1.1).

ESRP v.6 provides that IFC "AS staff will review the proposed mandate and assign an E&S risk rating associated with the AS project" (para. 11.2.2). This is done by the Advisory Services Team Leader applying a screening tool. The screening tool applicable at the time the Albania Hydros

[4] Similar general commitments are also included in IFC's Sustainability Policy (2012).

project was processed indicates that all Public Private Partnership (PPP) projects should be considered medium or high risk, and that "most [PPP] projects are high E&S risk."[5]

In instances where the project is considered high risk, an "E&S Specialist"[6] is assigned to the team to "ensure that an appropriately qualified professional assists the AS Team Leader in project analysis and preparation of an E&S Memo" (ESRP v.6, para. 11.2.2). The E&S Memo is to contain "an analysis of the risks considering the requirements of IFC's Sustainability Framework, defining specific ameliorative measures required to close observed gaps and reduce identified risks to achieve consistency with the Sustainability Framework" (*Ibid.*) For low and medium risk projects, the ESRP does not require the involvement of an IFC E&S specialist. In such cases, AS project E&S risk is assessed and managed by AS technical staff in consultation with regional "Sustainability Champions."[7]

<u>IFC's Pre-Implementation and Implementation of the Albania Hydros Project</u>

IFC commenced the pre implementation phase of this project in late 2010. A Quality at Entry (QAE) meeting was held in December 2010. Minutes of the QAE meeting noted that an E&S Specialist had conducted a review of the project and that no major E&S issues were identified.[8] The HPPs are described as having been operating for over 30 years with no negative impact. The minutes, however, note the need to further review the HPPs' environmental flow requirements, irrigation needs and reservoir sediment composition. The minutes also identify retrenchment risks (depending on the transaction structure) and the need to assess any past land acquisition claims.

IFC's Early Review documentation (PDS Early Review) was complete in June 2011. The only E&S risk mentioned at this point relates to the need for "downsizing of the workforce."

A Financial Advisory Services Agreement (FASA) was signed between IFC and the client on October 17, 2011. The only reference to E&S issues in the FASA is in the description of the services which IFC will provide, which include review of environmental documentation to identify technical gaps and weaknesses to be addressed in subsequent project structuring, "identifying surplus staff" and "designing the best approach on how to deal with such staff in order to mitigate social consequences that may amount from privatization."[9]

Following execution of the FASA, IFC prepared an Advisory Services Implementation Plan. This was approved on November 17, 2011. As explained by IFC staff working on the project, the Advisory Service Implementation Plan represented the formal approval from IFC management to move forward to the implementation stage of the Project.

An IFC E&S Specialist was involved in the preparation of the Advisory Services Implementation Plan. At this point, the E&S Specialist – in consultation with the regional AS Sustainability

[5] E&S Risk Assessment for AS Projects, Screening Matrix by Business Line and Products (Revision February 2011).
[6] E&S Specialists are technical specialists employed by IFC's E&S department.
[7] Sustainability Champions are IFC AS technical staff who have been trained to provide advice on E&S issues in relation to low and medium risk AS projects.
[8] The E&S Specialist was also present at the QAE meeting.
[9] Financial Advisory Services Agreement between IFC and Government of Albania (October 17, 2011).

Champion – suggested that the project be categorized as medium (rather than low) E&S risk.[10] This advice was based on the issues which were flagged in the minutes of the QAE meeting noted above, namely: water flow management; potential for toxic sediment from earlier upstream mining activities; retrenchment and concerns about historical land claims. As a result, the E&S Specialist recommended to include in the technical due diligence for the Project "an E&S scoping study" flagging all relevant E&S issues, including past liabilities and future potential impacts. At this point, the E&S Specialist also noted that the project may need to be reclassified as E&S high risk once more data was available. The AS team leader accepted the recommendation to classify the project as medium E&S risk and undertook to expand the Terms of Reference (ToR) for the technical due diligence to include E&S issues.

IFC received a consultant E&S due diligence report in relation to the Project in March 2012. The E&S due diligence report is structured around the IFC Performance Standards (2012) and considers the application of Performance Standards 1, 2, 3, 5 and 6 to the project in particular. Issues noted in the E&S due diligence report include weaknesses in the HPPs Environmental and Social Management System; lack of baseline analysis as to the E&S impact of the HPPs; lack of records of consultation with affected communities; lack of Human Resources policies; lack of pollution prevention and control plans; lack of emergency preparedness and response plans; possible claims in relation to past land acquisition; and lack of environmental flow data or plans.[11]

In April 2012 IFC raised E&S issues in relation to E&S aspects of the Project with the GoA, emphasizing the importance of adopting an approach consistent with the Performance Standards in relation to the transaction. Particular concerns at this stage related to "reactions" to the privatization from current employees and those claiming land previously acquired by the HPPs. To address these concerns IFC advised that an improved stakeholder engagement process was needed.

In May 2012, in advance of a June 2012 supervision mission, the E&S Specialist completed an E&S Memorandum for the Project. The E&S Memorandum summarizes the findings of the E&S due diligence report and outlines challenges which the team was having negotiating the inclusion of adequate E&S provisions in the tendering documentation. As a result the E&S memorandum proposes that the Project be reclassified from medium to high E&S risk.

A back to office report dated July 2012 and prepared by the E&S Specialist summarizes the outcomes of the June 2012 supervision mission. A site visit to the HPPs is described as confirming the results of the E&S due diligence. As part of the mission, the E&S Specialist attended the bidders conference to ensure that potential bidders were informed on the social issues (workers concerns and land claims) related to the project. In addition the back to office report notes that the tender documents prepared by IFC include "E&S provisions to close gaps with the IFC Performance Standards and require compliance with IFC PS2 in matters of retrenchment" and that the E&S due diligence reports were included in the information circulated with the tender documents.

A Share Purchase Agreement (SPA) was signed between the Government of Albania and Kürüm International on February 11, 2013 for the purchase of the four HPPs. Under the agreement,

[10] IFC Advisory Services Implementation Plan (November 2011).
[11] Posch and Partners (March 2012) E&S Due Diligence: Mat River Cascade – HPP Ulza and HPP Shkopeti.

Kürüm International is required to operate the company in accordance with IFC's 2012 Performance Standards and World Bank Group Environmental, Health and Safety General Guidelines (WBG EHS) and Sector Guidelines, and in the case of collective dismissals of employees, to comply with IFC's Performance Standard 2. Kürüm International commits to develop and notify the GoA within 24 months of the implementation of an Environmental and Social Management System (ESMS) in accordance with PS1. Explicit criteria for the ESMS are defined in the SPA, specifically the ESMS shall incorporate; (i) a dam safety programs and emergency, preparedness and response system in line with Good International Industry Practice, (ii) a stakeholder engagement process, which is on-going and aims to establish and maintain a constructive relationship with key stakeholders, and (iii) monitoring programs of key E&S indicators in line with WGB EHS and Sector Guidelines. Kürüm International also commits to improve Occupational Health and Safety practices, improve dam safety, maintain or improve the current ecological status of the river where the business is operating and develop a watershed management program.[12]

The SPA includes further provisions to ensure implementation of the above commitments. Specifically, following a term of 24 months the GoA can request Kürüm International to conduct a Compliance Audit by an agreed ESMS Expert. The SPA also sets out financial penalties to be incurred by Kürüm International based on any failures identified in the Compliance Audit.

IFC completed implementation of this project in June 2013. At a post implementation meeting, IFC rated its Impact Achievement as Satisfactory. IFC noted that they expected improved environmental and social management at the hydropower plants and rehabilitation of the HPP Ulez to improve its energy efficiency. Further, IFC noted that post completion monitoring could take place three years after project completion with a focus on "whether the company performed in accordance with the privatization contracts" and "how much investment was mobilized for the refurbishment of the hydropower plants". IFC noted that if they financed Kürüm's investment in the privatized HPPs, they would have access to the necessary monitoring information or alternatively, the local IFC office could try to obtain the information from the Government of Albania.

Conclusion

As noted above the key requirement in relation to the implementation of IFC AS projects under the Sustainability Policy (2012) is that advice provided will be consistent with the Performance Standards. CAO's Appraisal in relation to the Complaint reveals no indication of non-compliance in this respect. On the contrary, CAO observes what it considers to be elements of good practice in relation to the management of E&S risks around the project, particularly the commissioning of an E&S due diligence report structured around the Performance Standards, as well as the incorporation of E&S information and reference to the Performance Standards in the tender documentation.

In relation to the pre-implementation phase of the Project, CAO notes that the E&S risk was likely under classified (as low) by the IFC AS team. CAO also notes that the Advisory Service Implementation Plan – which represented the formal approval document for the project internally –

[12] Share Purchase Agreement between GoA and Kürüm International, February 11, 2013. The Albania version of this agreement is published on the Government of Albania's Official Gazette http://www.qbz.gov.al/botime/fletore_zyrtare/2013/PDF-2013/24-2013.pdf (accessed February 24, 2014). The environmental and social conditions which CAO cites are in an annex to the agreement (not at this link).

was not prepared until after the FASA was signed with the client. CAO further notes that because the project was classified as low E&S risk at the time the FASA was signed, there was no requirement for the preparation of an E&S Memo in the pre-implementation phase of the project implementation. As a result, CAO is concerned that opportunities were missed for early engagement with the client on what was later recognized as a project with high E&S risk.

4.2 Specific Issues Raised by the Complainant

Project Selection and IFC Mandate

The Complainant contends that IFC acted in violation of its Articles of Agreement in providing advice to a public enterprise,[13] particularly in relation to the privatization of what are asserted to be "profitable public enterprises."[14]

The Complainant also contends that the sale of the hydro power schemes would contribute to the budget of the "current government right before the election campaign of June 2013" and that the "potential use of this sale for political purposes cannot be ignored."[15] On this basis it is argued that the Project represented a breach of IFC's prohibition against political activities.[16]

Further, the Complainant contends that IFC acted in violation of commitments in its Sustainability Policy to "fight poverty with passion" and carry out its investment and advisory activities in a manner that "do no harm" to people and the environment. In this context the Complainant identifies possible negative impacts on the national budget as well as potential electricity tariff increases as outcomes of the project.

IFC's November 2011 Advisory Services Plan articulates the rationale for the project, in terms of two objectives: (a) maximizing privatization proceeds, and (b) ensuring that the plants are rehabilitated and efficiently operated.[17] An analysis of risks is also provided in this document. These include possible E&S risk, particularly: environmental flow requirements; potential contamination of upstream areas from past mining, retrenchment of excess staff; and the existence of historical land claims.

Project documentation reviewed by CAO does not include any analysis of the pros and cons of the decision to privatize the HPPs from a social or poverty perspective. Nor does it include analysis of alternative projects. However, in an IFC submission to CAO, IFC notes that

> "the change of ownership of the HPPs was not expected to lead to a change in domestic energy supply and demand. Rather, their refurbishment is likely to increase the amount of energy produced. In addition, it needs to be noted that the

[13] Article 1 of the Articles of Agreement which states that IFC's purpose is to "further economic development by encouraging growth of productive private enterprises in member countries" is cited in this respect.
[14] EDEN, Letter of Complaint (January 14, 2013).
[15] *Ibid.*
[16] Article 9 of IFC's Articles of Agreement provides as follows: "The Corporation and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in this Agreement."
[17] IFC (2011) Advisory Services Plan.

winning bidder is already operating in Albania and consuming approximately the same electricity as produced by the hydros, and will now have greater price and supply stability. IFC does not expect the regulated electricity tariff to change as a result of the change in ownership of the HPPs".[18]

On the possibility of a negative impact on the government's revenue, IFC has asserted to CAO that at the time the project commenced the HPPs "were selling electricity at the regulated generation tariff, which did not cover their running costs" which resulted in an annual operating loss for the HPPs. Further, IFC note that the "proceeds from the privatization of the hydropower plants has the potential to reduce Albania's overall debt servicing obligations".[19]

As in previous cases, CAO notes that it does not make findings in relation to IFC's choice of projects unless there is a lack of compliance with relevant policies or requirements.

On the question of whether IFC should have considered alternative projects, CAO notes that the GoA requested IFC to provide advice on the privatization of the HPPs, the decision to privatize having already been taken by the government of the day. Various provisions of the IFC Sustainability Framework require the consideration of alternatives to E&S impacts,[20] however, a requirement to consider alternative projects, or the "no project" scenario, are absent from the framework.[21]

While there may be legitimate differences of opinion as to whether privatization of the HPPs represented good economic or social policy, IFC requirements do not, in CAO's view, prevent the provision of advice of the type given by IFC to the GoA in this case.

On the contrary, CAO notes that IFC's Articles of Agreement provide a basis for the provision of advisory services which is consistent with IFC's approach to this Project.[22]

While the Complainant raises issues with regard to: (a) the scope of IFC's pre-project social impact analysis; and (b) whether IFC deployed its advisory services in a manner which was sufficiently strategic and focused on development outcomes, in CAO's view these do not amount to E&S compliance issues in this instance.

In reaching this conclusion CAO notes that as of January 2012, the Sustainability Framework would have required an articulation of the "costs and benefits" of the Project from an E&S point of view and that this be provided to IFC management prior to approval (para. 38). This provision, it

[18] IFC submission to CAO on Albania Hydros (December 2013).
[19] *ibid*
[20] Where a project is likely to generate environmental and social impacts, PS1 required alternative analysis (para 11). PS3, 5, 6, 7 and 8 each require consideration for alternative project design as they related to specific environmental and social risks.
[21] cf. World Bank Operational Policy 4.01, which for Category A projects requires that an Environmental Assessment "examines the project's potential negative and positive environmental impacts, compares them with those of feasible alternatives (including the *"without project"* situation)…" (emphasis added).
[22] IFC Articles of Association (as amended through June 27, 2012), include in the description of the purpose of the IFC: "(ii) seek to bring together investment opportunities, domestic and foreign private capital, and experienced management; and (iii) seek to stimulate, and to help create conditions conducive to, the flow of private capital, domestic and foreign, into productive investment in member countries" (Art. 1).

appears, would require some of the broader social impact analysis which is absent from the IFC's documentation in this Project. At the time the Albania Hydros AS project received the final approval for implementation from IFC Management (in November 2011), however, no similar provision was present in the IFC Sustainability Policy.

Map of HPPs and Kurum's Steel Production Facility

Disclosure and consultation:

As documented in the CAO Assessment Report, the Complainant raised concerns that "people were not given an opportunity to raise concerns about the privatization of the HPPs as the public was not consulted prior to or during the privatization process." The Complainant also raised concerns regarding "lack of access to project documentation."

As the FASA for this project was executed in October 2011 the applicable IFC Disclosure Policy is that of 2006. According to that Policy, there is no requirement for IFC to disclose information in relation to specific AS projects. In relation to more recent projects, however, CAO notes that the Access to Information Policy (2012) would require a Summary of Advisory Services Project Information including E&S information where applicable (para. 44).

As outlined above, IFC's advice to its client was required to be consistent with the Performance Standards. In relation to consultation, PS1 provides for both "stakeholder engagement" and consultation with "Affected Communities." "Stakeholder engagement" is a broader process whereby IFC clients build the "strong, constructive and responsive relationships that are essential for the successful management of project's E&S impacts" (para. 25). "Affected Communities" on the other hand are defined more narrowly as "local communities directly affected by the project" (para. 1).

Within this framework it is clear that the Complainant – as an Albanian NGO not based in the locality of the project – would properly be considered a stakeholder rather than a member of an Affected Community (see map). As such it is the stakeholder engagement requirements of PS1 which are the focus of this discussion.

Relevantly PS1 describes stakeholder engagement as follows:

> The nature, frequency, and level of effort of stakeholder engagement may vary considerably and will be commensurate with the project's risks and adverse impacts, and the project's phase of development (para. 25).
>
> Clients should identify the range of stakeholders that may be interested in their actions and consider how external communications might facilitate a dialog with all stakeholders (para. 26).
>
> The client will develop and implement a Stakeholder Engagement Plan that is scaled to the project risks and impacts and development stage … (para. 27).
>
> Disclosure of relevant project information helps Affected Communities and other stakeholders understand the risks, impacts and opportunities of the project (para. 29).

As noted above, in April 2012 IFC made representations to the GoA specifically addressing concerns about consultation and engagement with local communities and employees. To ensure compliance with the requirements of PS1, IFC highlighted the importance of information disclosure, and establishing and maintaining a constructive relationship with stakeholders. IFC also highlighted the importance of communicating information on the privatization process to stakeholders and attached a copy of IFC's Stakeholder Engagement Handbook.[23] Internally, however, IFC noted that the client was reluctant to hold the necessary consultations and that due to poor stakeholder consultation this project would probably not meet PS compliance. Following IFC's internal conclusion that GoA was reluctant to engage in necessary stakeholder engagement processes, IFC reemphasized to the GoA the importance of proactive engagement in communications with all stakeholders that will be affected by the transaction.[24]

While there may be questions as to the extent of stakeholder engagement which would have been appropriate in relation to this project, it appears that the advice IFC provided to its client in this respect was consistent with the Performance Standards. IFC's lack of traction in relation to this advice, however, raises questions as to IFC's influence in relation to the E&S performance of its AS clients. In the context of a project that was acknowledged as having high E&S risk, it is notable that IFC articulated in a submission to CAO that it has limited leverage in public private partnership advisory service projects, specifically stating that "its clients have the option to accept or reject IFC's advice."[25]

5. 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.

On the question of the E&S impact of the Project, IFC identified high E&S risks in the course of implementation. It is, however, not apparent to CAO that this implies evidence of potentially significant adverse E&S impacts on the Complainant.

On questions of compliance with IFC's policies, procedures and standards, CAO notes that IFC had not completed its pre-implementation planning and approval process prior to executing the FASA with the client. As a result, CAO is concerned that opportunities were missed for early engagement with the client on what was later recognized as a project with high E&S risks. This sequencing of work also meant that opportunities may have been missed to incorporate additional E&S provisions in the FASA, which in turn may have increased IFC's leverage during implementation of the AS project.

Nevertheless, in relation to the issues raised by the Complainant, this CAO Compliance Appraisal reveals no indication that IFC's advice on the identification and management of potential E&S impacts, was other than consistent with the requirements of the Performance Standards (2012). In particular CAO notes the commissioning of an E&S due diligence report on the HPPs that was structured around the Performance Standards, as well as the incorporation of E&S information and

[23] IFC (2007),*Stakeholder Engagement – A Good Practice Handbook for Companies Doing Business in Emerging Markets.* The Handbook outlines a broad approach to engaging with stakeholders defined as "persons or groups who are directly or indirectly affected by a project as well as those who may have interests in a project and/or the ability to influence its outcome, either positively or negatively."
[24] IFC letter to Minister of Economy, Trade and Energy (20 June 2012).
[25] IFC submission to CAO on Albania Hydros (December 2013).

reference to the Performance Standards in the tender documentation. Further, CAO notes recommendations and tools provided to the GoA in relation to stakeholder engagement processes which referenced the requirements Performance Standard 1.

On the question of whether IFC's policies provide an adequate level of protection in relation to the E&S impacts that stem from its projects, CAO has a number of observations. These build on the findings of CAO's audit of IFC's Advisory Services Project with the Korporata Energjetike e Kosovës (KEK) in Kosovo,[26] and include concerns that:

a. underassessment of E&S risk in the pre-implementation stage of the Project may have led to late engagement with the client in relation to E&S issues and a failure to incorporate appropriate E&S provisions in the FASA;
b. IFC may not have adequate procedures in place for assessing a client's capacity and commitment to execute a project (in relation to which IFC is giving advice) in accordance with the Performance Standards; and
c. IFC may not have adequate procedures in place to ensure that advice is provided in relation to whether an eventual purchaser of privatized assets has the capacity and commitment to carry out its E&S commitments under the purchase agreement.

In making these observations, CAO acknowledges the work that IFC's AS unit is doing to develop its approach to the identification and management of E&S risk in its projects. Recent steps in this regard include the development of an early risk screening tool which guides AS staff to consider a range of factors including sector risk, project specific risk, host country regulatory risk and client capacity in conducting their initial AS project E&S risk categorization. Another development is the inclusion, in the IFC's standard FASA language, of "a clause stating that IFC will advise clients in a manner consistent with the Performance Standards" and that IFC "has the right to terminate the FASA … if IFC determines that it would not be able to continue advising the Client in connection with the Project in a manner that would be materially consistent with the Sustainability Policy."[27]

In relation to projects with significant potential E&S impacts, and where E&S impacts will not be realized until after IFC exits the project, however, CAO has questions as to the ability of the IFC AS business line to deliver against IFC's higher level commitments under the Sustainability Policy. In particular CAO refers here to IFC's commitment to "do no harm" principles and its commitment to "ensuring that the costs of economic development do not fall disproportionately on those who are poor and vulnerable [and] that the environment is not degraded in the process…" (Sustainability Policy (2012) para. 8). In highlighting these more general questions CAO notes that, in this case, IFC's financing of Kürüm (the purchaser of the HPPs) provides a basis for ongoing supervision of the project in accordance with the Sustainability Framework.

On the balance of considerations, CAO concludes that further investigation in relation this Complaint is not warranted. As such CAO will close this case at Appraisal.

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[26] CAO Audit of IFC Advisory Services Project with the Korporata Energjetike e Kosovës Kosovohttp://www.cao-ombudsman.org/documents/Audit_Report_C-I-R4-Y12-F158_KOSOVO.pdf (accessed March 12, 2014)
[27] IFC (2013) Response to CAO's Audit Report of IFC Advisory Services Project with KEK, Kosovo. http://goo.gl/d1faM3 (accessed February 24, 2014).