July 31, 2015
Office of the Compliance Advisor Ombudsman (CAO)

COMPLIANCE APPRAISAL: SUMMARY OF RESULTS

Real LRIF (IFC Project # 31458)
Guatemala

Complaint 01

Latin Renewables Infrastructure Fund, L.P. ("the Fund" or "the client") is a $100 million 10-year closed-end private equity fund set up to invest in infrastructure projects in the renewable power and energy sectors in Latin America and the Caribbean. The Fund is managed by Real Infrastructure Capital Partners, a New York-based fund manager established in 2010. In 2012, IFC committed to a $15 million equity investment in the Fund. In 2013, the Fund invested in the Santa Rita Hydroelectric Power Plant ("Santa Rita" or "the project"), a 23 MW run-of-the-river hydroelectric power plant located on the Icbolay River in Alta Verapaz, Guatemala.

In October 2014, CAO received a complaint from two Guatemalan organizations, on behalf of several community members living upstream and downstream of the project site. Complainants raise concerns regarding a range of environmental and social issues related to disclosure and consultation, security, indigenous people, displacement, and potential impacts on local water sources. In particular, the complainants assert that the project does not meet IFC requirements for free, prior and informed consent (FPIC) and that it has disturbed the peace and social cohesion of their communities. Further, the complainants assert that their opposition to the project has met with violence, repression and criminalization of community leaders.

The client has asserted that the project will have minimal adverse environmental impacts, whereas it has potential for significant community benefits. Adverse impacts are expected to be temporary and limited mostly to the construction phase. They assert that community diversion and violence have been generated and exacerbated by national and international non-governmental organizations (NGO) from outside the area and which have a political agenda to block hydroelectric projects in Guatemala. Further, the client asserts that they have made several attempts to hold meetings with opposing groups to share information and discuss their concerns but these invitations have never been accepted.

The purpose of a CAO compliance appraisal is to ensure that compliance investigations are initiated only in relation to projects that raise substantial concerns regarding E&S outcomes and/or issues of systemic importance to IFC. 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, the existence of questions as to the adequacy of IFC's requirements, and a more general assessment of whether a compliance investigation is the appropriate response in the circumstances.

In this case, the complainants raise a range of environmental and social issues in relation to the Santa Rita project. While CAO takes no position on the merits of the allegations set out in the complaint, CAO finds that they are substantial in nature.

In relation to IFC's E&S performance, CAO has identified questions as to: (a) whether IFC's pre-investment review was commensurate to risk; and (b) the adequacy of IFC's approach to the management of E&S risks in relation to this investment. CAO has also identified questions as to IFC's supervision of its investment in the Fund, in particular whether the advice that IFC provided the Fund in relation to the Santa Rita project, both at the ESDD phase and thereafter, met IFC's E&S requirements.

As a result, CAO will conduct a compliance investigation in response to this complaint. The scope of the investigation will be defined in terms of reference, which will be disclosed in accordance with the CAO 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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Acronyms

Acronym	Definition
AEPR	Annual Environmental Performance Report
CAO	Office of the Compliance Advisor Ombudsman (IFC and MIGA)
E&S	Environmental and Social
EHS	Environmental, Health and Safety
EIA	Environmental Impact Assessment
ESAP	Environmental and Social Action Plan
ESDD	Environmental and Social Due Diligence
ESMS	Environmental and Social Management System
ESRS	Environmental and Social Review Summary
ESRP	Environmental and Social Review Procedures
FI	Financial Intermediary
FMO	Netherlands Development Finance Company
FPIC	Free, Prior and Informed Consultation
IFC	International Finance Corporation
LRIF	Latin Renewables Infrastructure Fund, LP
MIGA	Multilateral Investment Guarantee Agency
PS	Performance Standards (IFC)
REAL	Real Infrastructure Capital Partners, LLC
SII	Summary of Investment Information

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

In June 2012, IFC committed to US$15 million equity investment in Latin Renewables Infrastructure Fund LP (the "Fund" or "the client"), a 10-year closed-end private equity fund managed by the recently established US-based Real Infrastructure Capital Partners (REAL). LRIF seeks to invest in 8-12 infrastructure projects in the renewable power and energy efficiency sectors of Latin America and the Caribbean.[1] In 2013, IFC Asset Management Company (AMC) made a $20 million equity investment in the Fund.[2] In January 2014, REAL announced that it had reached final closing for the Fund with commitments of US$100 million.[3]

IFC noted that the purpose of its investment was to assist the Fund in reaching final closing for its initial target of US$150 million, encourage the participation of other investors, provide the Fund with critical knowledge and support from its own experience in renewable and clean energy projects, and support the Fund in the implementation of E&S standards.[4]

In 2013, the LRIF made its first investment in the Santa Rita Hydroelectric Power Plant ("Santa Rita" or "the project"), a 23 megawatt (MW) run-of-the-river hydroelectric power plant on the Icbolay River in Alta Verapaz, Guatemala. The sub-project is managed by a local development company, Hidroelectrica Santa Rita, S.A. The Development Finance Institute of Holland (FMO) also holds a significant investment in the sub-project.[5]

CAO notes that financing for the project was expected to include debt. The project operators made arrangements for lines of credit from some regional banks that are IFC clients. Given, however, that these lines of credit have not been used, this compliance appraisal will focus on IFC's exposure to the project through the Fund.

Complaint and CAO Assessment

In October 2014, CAO received a complaint submitted by Colectivo Madre Selva and the Consejo de Pueblos de Tezulutlan, and two local organization, on behalf of communities residing downstream and upstream from the sub-project. The complaint raises concerns regarding a range of environmental and social issues related to IFC's due diligence, project information disclosure and consultation, potential impacts to local water sources, displacement, indigenous people, and security concerns. In particular, the complainants assert that the project does not meet IFC requirements for free, prior and informed consent (FPIC) and that it has disturbed the peace and social cohesion of their communities. Further, the complainants assert that their opposition to the project has met with violence, repression and criminalization of community leaders. The complainants also raise concerns regarding violent incidents that resulted in deaths of two men and two children in Monte Olivo, a village within the project's area of influence, and accuse the project operators and a landowner who sold part of his land to the project of playing a significant role in these incidents.[6]

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[1] IFC Disclosure, Summary of Investment Information - http://goo.gl/N2zrY8
[2] IFC AMC Portfolio - http://goo.gl/u1GFLJ
[3] Real LRIF, January 2014, Press Release - http://goo.gl/Ow47nr
[4] IFC Disclosure, Summary of Investment Information - http://goo.gl/N2zrY8
[5] CAO Assessment Report of IFC's investment in Real LRIF - http://goo.gl/BMcN6c; and FMO Disclosure - https://goo.gl/mkfIMy
[6] CAO Assessment Report of IFC's investment in Real LRIF - http://goo.gl/BMcN6c

As documented in CAO's initial assessment of the complaint, the client is of the view that the project will have minimal adverse environmental impacts, whereas it has potential for significant community benefits. Adverse impacts are expected to be temporary and limited mostly to the construction phase. They assert that the majority of the affected communities support the project, and that community division and violence have been generated by national and international non-governmental organizations (NGO) from outside the area that have a political agenda to block hydroelectric projects. The client asserts that they were not involved in the violent incident at Monte Olivo in August 2013. Further, the client asserts that they have made several attempts to hold meetings with opposing groups to share information and discuss their concerns but these invitations have not been accepted.[7]

Following CAO's assessment, the complainants decided not to pursue a CAO-facilitated dispute resolution process, and accordingly, the complaint was transferred to CAO Compliance for appraisal in June 2015.

III. Analysis

This compliance appraisal focuses on IFC's pre-investment review and supervision of its investment in the Fund and the identification and management of E&S risks related to the Fund's sub-projects.

<u>IFC Policy Framework</u>

IFC's investment in the client 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. Through the Sustainability Policy, "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). The Sustainability Policy also notes that "central to IFC's development mission are its efforts to carry out investment and advisory activities with the intent to 'do no harm' to people and the environment" (para. 9). IFC will invest in a project only when the activities it finances "are expected to meet the requirements of the Performance Standards within a reasonable period of time" (para 22).

Through its investments in Financial Intermediaries (FIs), "IFC supports the capacity development of the banking and financial sector to manage environmental and social risks. This is achieved in part through the development and implementation of an ESMS [Environmental and Social management System] and by enhancing FIs' in-house capacity" to manage E&S risk (para 33).

<u>IFC's Pre-Investment Due Diligence</u>

The key question for CAO at pre-commitment phase of the project cycle is whether IFC exercised due diligence in its review of the E&S risks of the investment. As a general principle, IFC is committed to a pre-investment E&S review that is "commensurate with the level of environmental and social risks and/or impacts".[8] Accordingly, questions arise in relation to the adequacy of: (a) IFC's review of the E&S potential risk attached to the business of its FI client, (b) IFC's approach

[7] *ibid*
[8] IFC Policy on Environmental and Social Sustainability, 2012, para. 6

to the assessment of the client's capacity to manage and mitigate these risks; and (c) the measures that IFC required the client to implement to ensure appropriate management of E&S risk.

Requirements

As per the requirements of the 2012 Sustainability Policy, at the appraisal stage, IFC "reviews the existing portfolio and prospective business activities of its FI clients to identify activities where the FIs and IFC could be exposed to risks as a result of their investments…" (para. 34). In addition, IFC reviews the implementation capacity of FIs and their ESMS, which should be "commensurate with the level of environmental and social risks in its portfolio, and prospective business activities" (paras 34 & 35).

Upon review and depending on the investment type, use of IFC financing and level of expected E&S risk in the FI's portfolio, IFC provides an E&S risk categorization to reflect the risks and impacts of the investment and determines the E&S requirements the FI client will be expected to implement (paras 35 & 40). Where an FI's portfolio or prospective business activities present moderate to high E&S risk, IFC will categorize the project as FI-1 and will require its client "to apply relevant requirements of the Performance Standards."[9]

Prior to approval, IFC discloses a Summary of Investment information (SII) for FI investments. Through this disclosure, IFC outlines its rationale for its determination of the E&S risk categorization, a description of the main E&S risks and impacts associated with IFC's investment and a summary of the FI's ESMS, and key measures identified to strengthen the client's ESMS as included in an E&S action plan (ESAP) with the FI.[10]

IFC's E&S Appraisal of the Fund

In reviewing this investment, IFC considered the proposed business activities of the fund, its track record in E&S risk management and its capacity to manage E&S risk of proposed investments. As this was a first time fund manager, however, IFC's review focused on the track record of the individuals managing the Fund (Fund partners) and its proposed capacity to manage E&S risk of the Fund's investments.

In its SII disclosure, IFC identified the main E&S risks and impacts of its client's target investments in renewable energy projects. These mostly consisted of hydropower projects in the 5 to 30 megawatt (MW) range and wind power projects in the 20 to 60 MW range. The geographical focus for the Fund's investments included Panama, Honduras, Nicaragua, Colombia, Costa Rica, Peru and other Latin America and Caribbean countries. While the client's target projects were not considered large by IFC standards, IFC did note they could potentially have negative impacts on local communities, indigenous peoples, cultural heritage, resettlement, biodiversity and Occupational Health and Safety (OHS).[11] More specifically, IFC's appraisal documentation noted the existence of social issues around hydropower development and indigenous peoples in Central America.

[9] IFC provides an FI with an E&S risk categorization of FI-1 "when an FI's existing or proposed portfolio includes, or is expected to include, substantial financial exposure to business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented." Policy on Environmental and Social Sustainability, 2012, para. 40.
[10] IFC Access to Information Policy, 2012, para 31.b
[11] IFC Disclosure, Summary of Investment Information - http://goo.gl/N2zrY8

Key E&S risk mitigation measures as disclosed by IFC were as follows:

> (i) Develop an E&S Management System (ESMS) and capacity to review all sub-projects per the E&S laws and regulations of the sub-project's country and the Performance Standards, to be in place by commitment; (ii) conduct an E&S due diligence (ESDD), with the help of qualified professionals, to identify the applicable E&S risks of each sub-project and require corrective actions as needed to ensure that these risks are managed according to the Performance Standards and applicable laws; (iii) implement a monitoring framework to supervise the E&S risks of all sub-projects and report to IFC. In addition, IFC will review the first three ESDDs and that of all Category A sub-projects (if any) prior to the Fund's investment to support the implementation of the ESMS.[12]

IFC classified its investment in the Fund as Category FI-1.

IFC's investment in the Fund was approved by the IFC Board in May 2012.

As a condition of IFC's commitment, IFC disclosed that the Fund would be required to "establish an ESMS including guidelines for its implementation."[13] The Fund submitted its ESMS to IFC in June 2012, prior to the signing of the investment agreement.

Conclusion

This investment provided a structure for IFC funding of projects through a newly created Fund. By categorizing its investment FI-1, IFC recognized that the Fund's proposed portfolio would include substantial financial exposure to business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented. A number of mitigation measures were agreed with a view to ensuring that E&S risks would be appropriately managed. Given that the Fund did not have a track record, however, and given the acknowledged risks attached to its proposed portfolio, questions arise as to: (a) whether IFC's pre-investment review was commensurate to risk; and (b) the adequacy of IFC's approach to the management of E&S risk in relation to this investment.

IFC's Supervision of the Investment and Review of the Santa Rita Project

Requirements

As per the requirements of the 2012 Sustainability Policy, "IFC requires FIs to carry out individual transaction appraisal and monitoring as well as overall portfolio management in accordance with the environmental and social risk profile of its activities and that of individual transactions" (para. 33). At the supervision phase, IFC reviews the E&S conditions of disbursements, reviews and provides feedback on an Annual Environmental Performance Report (AEPR) submitted by the client and depending on need may conduct a site supervision mission to the client or the sub-project.[14] Further, in monitoring an FI's implementation of its E&S requirements through the FI's ESMS, IFC will periodically review the environmental and social due diligence process conducted by the FI.[15]

Subject to regulatory constraints and market sensitivities, IFC is committed periodically disclose the name, location and sector of high-risk sub-projects supported by IFC private equity funds.[16]

[12] IFC Disclosure, Summary of Investment Information - http://goo.gl/N2zrY8
[13] *ibid*
[14] IFC ESRP 9, June 2011
[15] IFC Policy on Environmental and Social Sustainability, 2012, para. 45
[16] IFC Access to Information Policy, 2012, footnote 16

General Supervision of the Fund

IFC processed its first disbursement to the Fund on July 30, 2012.

Since disbursement, IFC has reviewed three AEPR reports submitted by the client. IFC supervision documentation notes that the client has developed a SEMS which incorporates the IFC's Performance Standards and provided evidence of adequate implementation, including training of staff and use of consultants for conducting ESDDs prior to investing.

Supervision of the Santa Rita Hydro Project

In August 2012, the Fund provided IFC with its ESDD report for the Santa Rita project in which the Fund was considering an investment.

The Fund's ESDD for the Santa Rita project was prepared by the Fund's E&S consultant on the basis of a review of documentation including: (a) a 2009 EIA for the project, and (b) social documentation prepared by an NGO engaged by the project to conduct stakeholder engagement activities. As part of the ESDD process, the Fund's E&S consultant and a Fund partner visited the Santa Rita site.

The responsible IFC E&S specialist provided comments on the Fund's ESDD and proposed an E&S Action Plan (ESAP) for the Santa Rita project.

IFC's supervision documentation notes that the Santa Rita project was provided with an E&S risk category of B, indicating that it involved potential limited adverse E&S risk and impacts that are few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures. CAO notes that FMO, which was also considering a direct investment in the project at the time, provided the project with an E&S risk category of A, indicating the project involved significant E&S impacts which are diverse, irreversible or unprecedented.[17]

As noted in the project documentation, IFC was aware of a number of protests against the project by indigenous groups commencing in April 2012.[18] According to IFC, in July 2013, community members from a village in the vicinity of the project allegedly accessed the project site and damaged project equipment. Following this incident, construction at the project was suspended and at the time of writing had yet to resume. Further violent incidents have also been noted in IFC's project documentation, media reports and as raised by the complainants. Specifically, three people were killed near the project site in August 2013 and a number of people were allegedly evicted from farms on or near the project site by police in August 2014; an event that reportedly resulted in further violence.[19]

As explained by IFC, the client has been proactive and open in relation to the difficulties faced by the project. IFC notes that it has advised the client to take an extremely cautious approach so as not to escalate the situation. IFC also notes that it has shared the Voluntary Principles on Security and Human Rights with the Fund, and advised the Fund in relation to these.

[17] FMO Project Disclosure - https://goo.gl/mkfIMy; and FMO ESG Policy - https://goo.gl/yzK19Q
[18] As reported publically in August 2012 - http://goo.gl/Cko97R
[19] IHS Global Insight, August 17, 2014 - http://goo.gl/QEQuMZ

Conclusion

CAO notes that IFC reviewed and commented on the Fund's ESDD for the Santa Rita project. CAO also notes that IFC was aware of and engaged with the Fund in relation to the violent incidents that are raised by the complainants. Without further investigation, however, CAO is not able to reach a conclusion as to the adequacy of IFC's review of the Fund's ESDD for the Santa Rita project, or its response to the issues regarding the application of IFC's Performance Standards that are raised by the complainants.

IV. CAO Decision

The purpose of a CAO compliance appraisal is to ensure that compliance investigations are initiated only in relation to projects that raise substantial concerns regarding E&S outcomes and/or issues of systemic importance to IFC. 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, the existence of questions as to the adequacy of IFC's requirements, and a more general assessment of whether a compliance investigation is the appropriate response in the circumstances.

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