APPRAISAL REPORT

CAO Appraisal for Audit of IFC

CAO Compliance

CAO Ref Code: C-I-R9-Y12-F161

13 August 2012

Corporación Dinant S.A. de C.V.

Honduras

Case of

Appraisal initiated by CAO Vice President

Summary

This appraisal relates to IFC's investment in Corporación Dinant, a vertically-integrated palm oil and food company in Honduras. In this instance a CAO's compliance appraisal was initiated by the CAO Vice President in response to a letter submitted to the President of the World Bank Group in November 2010 and conversations between CAO and local NGOs.

Key allegations in regards to the project were as follows:

- that IFC's client (Dinant) conducted, facilitated or supported forced evictions of farmers in the Aguan Valley;
- that violence against farmers on and around Dinant plantations in the Aguan Valley occurred due to inappropriate use of private and public security forces under Dinant's control or influence.
- that IFC failed to identify and/or respond appropriately to the situation of Dinant in the context of the declining political and security situation in Honduras, and specifically in the Aguan Valley, following the ouster of President Zelaya in June 2009.

Having held discussions with the IFC team and reviewed relevant documentation CAO concludes that IFC's social and environmental performance in relation to this investment merits further enquiry. Thus, in accordance with its Operational Guidelines, CAO will develop Terms of Reference for a compliance audit with regard to the following issues:

- whether IFC exercised due diligence in its review of the social risks attached to the Project;
- whether IFC responded adequately to the context of intensifying social and political conflict surrounding the Project post commitment; and
- whether IFC policies and procedures provide adequate guidance to staff on how to assess and manage social risks associated with projects in areas that are subject to conflict or conflict prone.

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About CAO

The 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.

The CAO (Office of the Compliance Advisor/Ombudsman) is an independent post that reports directly to the president of the World Bank Group. The 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 the CAO, please visit www.cao-ombudsman.org

1. Overview of the CAO Compliance Appraisal process

The CAO Operational Guidelines (OG) provide for the CAO compliance process to be triggered at the discretion of the CAO Vice President (OG 3.3.1).

In the context of a CAO compliance audit, at issue is whether:

- The actual social or environmental outcomes of a project are consistent with or contrary to the desired effect of the IFC/MIGA social and environmental policy provisions; or
- A failure by IFC/MIGA to address social or environmental issues as part of the appraisal or supervision resulted in outcomes that are contrary to the desired effect of the policy provisions.

A compliance audit is concerned with assessing the application of relevant policy provisions and related guidelines and procedures to determine whether IFC and MIGA are in compliance. The primary focus of compliance auditing is on IFC and MIGA, but the role of the sponsor may also be considered.

In order to decide whether a full audit is warranted, CAO Compliance first conducts a compliance appraisal.

To guide the appraisal process, the CAO applies several criteria. These are framed as a series of questions to test the value of undertaking a compliance audit.

- Is there evidence of significant adverse social and environmental outcome(s) as a result of the project now or in the future?
- Are there indications that a policy or other audit criteria has not been adhered to or properly applied?
- Is there evidence that indicates that IFC/MIGA's provisions, whether or not complied with, have failed to provide an adequate level of protection?
- Is there an argument for the value of an audit, either because a compliance audit is likely to support the realization of better social and environmental outcomes in the project under review, or because a compliance audit could yield information or findings that might better inform the application of policies (or other audit criteria) to future projects?

As part of the appraisal process CAO Compliance reviewed relevant documentation and held discussions with the IFC project team to understand the validity of the concerns, which criteria IFC used to assure itself/themselves of project performance, how IFC assured itself/themselves of compliance with these criteria, and generally whether an audit is the appropriate response. In addition to providing access to project documentation the IFC team provided detailed written responses to CAO's enquiries.

After a compliance appraisal has been completed, the CAO can choose one of two options: to close the case, or to initiate a compliance audit of IFC or MIGA.

The CAO will report and disclose the findings and decision of the CAO compliance appraisal in an appraisal report in order to inform the President of the World Bank Group, the Boards of the World Bank Group, senior management of IFC or MIGA, and the public in writing about its decision.

If the CAO decides to initiate a compliance audit as a result of the compliance appraisal, the CAO will draw up a Terms of Reference for the audit in accordance with CAO's Operational Guidelines.

2. Background

This Project provided Corporación Dinant, a vertically-integrated palm oil and food company in Honduras, with a corporate loan to enable it to develop young palm oil plantations, increase production capacity in its snacks and edible oils divisions, expand and upgrade its distribution network, and build a biogas facility to generate electricity for own and third-party consumption. The total project cost was estimated at $75 million, and IFC's proposed investment was a $30 million loan.

Dinant is headquartered in Tegucigalpa, Honduras. It owns palm oil plantations across the Aguan and Lean Valleys and operates two palm oil mills and an edible oil refinery near the cities of Tocoa and La Ceiba. The company also operates a port storage facility at Puerto Castilla; owns vegetable greenhouses and a food processing plant in the Comayagua Valley; and has a snacks plant in San Pedro Sula.

3. Scope of Appraisal

The scope of the appraisal of IFC's investment in Corporación Dinant was set out by the CAO Vice President. The issues raised do not reflect the position of CAO but are based on allegations made via a letter submitted to the President of the World Bank Group in November 2010, and conversations between CAO and local NGOs in March 2011.

Key allegations in regards to the project are as follows:

- that IFC's client (Dinant) conducted, facilitated or supported forced evictions of farmers in the Aguan Valley;
- that violence against farmers on and around Dinant plantations in the Aguan Valley occurred because of inappropriate use of private and public security forces under Dinant's control or influence.
- that IFC failed to identify early enough and/or respond appropriately to the situation of Dinant in the context of the declining political and security situation in Honduras, and specifically in the Aguan Valley, following the ouster of President Zelaya in June 2009.

From the perspective of CAO's mandate, the general question raised is whether IFC exercised due diligence in its review and supervision of environmental and social (E&S) aspects of the Project, in particular in relation to land issues and the use of security personnel, on and around the numerous plantations which comprise the project.

4. Discussion and Findings

The analysis that follows is organized chronologically following the IFC project cycle and the deterioration of the security situation in the Arguan Valley which occurred following the ouster of President Zelaya of Honduras in June 2009.

June – December 2008 (Pre-commitment)

In relation to the pre-commitment phase of the project cycle, the key questions are whether IFC correctly categorized the project and otherwise exercised due diligence in its review of and response to the client's assessment of E&S impacts (Policy on Social and Environmental Sustainability (PSES) (2006) paras. 11 & 18).

This project was assessed under the 2006 IFC Performance Standards and the environmental and social review was completed under the Category B provisions as defined in IFC's procedures meaning that the project was expected to have limited adverse social or environmental impacts that are few in number, generally site specific, largely reversible and readily addressed through mitigation measures.

IFC's early review of the project was completed in mid-2008 and identified potential E&S issues characteristic of oil palm operations which would need to be taken into account including land acquisition. In this case, however, the land issue is found to be less relevant as the project is not seen as involving the expansion of existing plantations and is "located over land that have (*sic.*) been long cleared…" (Project Data Sheet - Early Review, 2008, p.10).

The following summary of E&S issues is provided in the Summary of Project Information (SPI):

> Oil palm plantation development is occurring on existing, cleared agricultural land, and there is no destruction of or impact on critical habitat involved. Land acquisition is on a willing buyer-willing seller basis, and there is no involuntary displacement of any people. There are no indigenous peoples' ancestral lands in the area and the Pech community near the Company's Aguan operations is not expected to be adversely affected by the project. The company is working to actively upgrade its environmental protection capabilities, and will ensure that its operations meet international standards for the sector (SPI, 2008).

The Environmental and Social Review Summary (ESRS, 2008) indicates that the IFC's E&S review was completed on the basis of meetings with Dinant management and staff as well as representatives of local communities. The ESRS also refers to (but does not cite or disclose) a 1997 environmental impact assessment (EIA) conducted for a previous investment in Corporación Cressida (a company owned by the owner of Dinant) and an environmental and social assessment undertaken by a consultant for *Deutsche Investitions- und Entwicklungsgesellschaft* (DEG).[1] The ESRS makes no mention of land related disputes, conflict or grievances in or around the Dinant plantations in the Aguan Valley. The ESRS notes that Dinant has more than 300 security staff most of whom are armed.

Following IFC's E&S review, Dinant prepared an E&S Action Plan (ESAP) though this contains no required actions in relation to conflict around land or security issues (EASP, Oct. 2008).

IFC also documented an "integrity due diligence" enquiry relating to the ownership of Dinant. This focused on a land dispute involving the owner on the island of Zacate Grande. Citing opinion from local counsel, it is noted that "land tenure issues are of a legal nature" and that there are no legal claims in corresponding jurisdictions against the owner. On the positive side the owner is described as being recognized as a having "engaged with the community," being "recognized as a successful businessman" and having "received several international recognitions."

An IFC board document for the Project was finalized in December 2008. Again no specific mention is made of land conflict or security issues. The board document does, however, assert that "Dinant understands the importance of having good relationships with their neighboring communities and are proactive in this regard," and that "company management regularly visits with municipal officials, the Pech indigenous community and other local stakeholders" (p.10).

In reaching its findings, CAO notes that land conflict and related violence between peasant movements and agribusiness in the Aguan Valley are not new, but date to the 1990s, with roots in historical land reform and land acquisitions processes in Honduras. CAO also notes that there

[1] As explained by the IFC team to CAO, the documents referred to were: Wiley, Robert (1998) *An Environmental Review of lands and facilities belonging to Corporación Cressida of Honduras*; and GAI (2008) *Environmental & Social Assessment: Dinant Corporation* (Corporación Dinant S.A. de C.V.).

were contemporaneous reports of violence and conflict, as well as allegations relating to illegal activities on and/or around properties belonging to Dinant and its owner, in the public domain before IFC committed to the Project. In this context CAO finds that further enquiry is required to reach a conclusion as to whether IFC exercised due diligence in its E&S review. Given the history of grievance around land issues in the Aguan Valley it is also unclear to CAO whether the Project was correctly classified Category B. Finally, CAO is unclear whether IFC complied with its obligation to make available "relevant social and environmental impact assessment documents prepared by or on behalf of the client" as required by the Policy of Disclosure of Information (2006, para. 13).

December 2008 – November 2009 (Commitment and 1st Disbursement)

IFC's loan agreement with Dinant is dated 3 April 2009 and the first disbursement (USD 15 million) was executed on 5 November 2009. Conditions of disbursement in the loan agreement included warranties requiring Dinant to disclose: (a) any environmental and social risks of which they became aware subsequent to the date of the agreement, and (b) complaints related matters covered by the performance standards. It was also a condition of disbursement that there had occurred no 'Material Adverse Effect' on Dinant's operations.

In the weeks prior to his 28 June 2009 removal from power, President Zelaya's office oversaw an agreement to review the peasant movements' land claims in the Aguan Valley, including the establishment of a technical/legal commission to investigate the legality of various land holdings in the area. Though the major recent escalation of violence in the Aguan Valley occurred following a series of peasant occupations that commenced in December 2009, there are reports of violence against land activists and land related tensions in both the immediate pre- and post coup periods.[2]

IFC has documented discussions with Dinant during the period August to October 2009 relating to E&S conditions precedent to disbursement. These discussions resulted in agreements between the IFC and the client, but are reported as focusing on air dispersion studies and progress towards Round Table on Sustainable Palm Oil (RSPO) certification. When considering the disbursement, IFC reports concluding that the ouster of President Zelaya in June 2009 did not constitute a Material Adverse Effect as defined in the loan agreement so long as the political upheaval had no material impact on the client's business operations.[3]

CAO agrees that the fact of the removal of a head of state will not *per se* constitute a Material Adverse Effect on an IFC investment. CAO is not, however, clear whether IFC exercised due diligence in its assessment of specific events that occurred between April and November 2009 - in particular developments related to conflicts and claims on and/or around properties belonging to Dinant in the Aguan Valley.

December 2009 to date (Post-disbursement)

IFC's approach to the land and security issues around this investment becomes more proactive following Dinant's report to IFC in December 2009 that some of its plantations in the Aguan Valley had been invaded and in particular in response to the escalation of violence that occurred in the following months. At this point IFC documents discussions with Dinant management (March 2010). Subsequent to receiving correspondence from NGO 'Rights Action' in November 2010 senior IFC management responded by writing to (December 2010) and visiting Dinant (January 2011). Also in January 2011 IFC Executive Vice President, Lars Thunell wrote to President Lobo of Honduras expressing hope for a negotiated solution, and subsequently (in August 2011) discussed the issues at a face to face meeting with the President.

[2] Relevantly, these include the invasion of the Dinant 'Finca San Isidoro' in June 2009.
[3] IFC communication with CAO dated 28 June 2012.

In addition, at the technical level, IFC requested Dinant to engage the services of an independent international security specialist to conduct an audit of the Company's security operations and to evaluate current compliance with IFC's PS4 concerning Security Personnel Requirements. The security audit was completed in March 2011. Further, IFC E&S specialists conducted site supervision visits to Dinant in March 2011 and April 2012 with the result that an updated ESAP was drafted. This included actions related to: (a) the development of a grievance procedure to deal with 'specific concerns of communities'; (b) execution of a 'rapid community risk and impact assessment'' and (c) the development of a 'community engagement strategy commensurate to with identified risks'; (ESAP, Apr. 2012).

CAO acknowledges IFC's efforts to exercise influence in relation to Dinant's response to the deteriorating security situation that manifested in the period after the first disbursement. Nevertheless, CAO finds that further enquiry is required to reach a conclusion as to whether IFC's response was sufficient given the violent nature of the conflict that was playing out on the ground around the Dinant properties in the Aguan Valley.

In reaching these findings CAO notes both: (a) that a series of agreements have been signed involving peasant organizations, the government and plantation owners (including Dinant) which would see the redistribution of significant amount of land in the Aguan Valley (most recently in June 2012) and (b) reports of continued plantation invasions and associated violence in the Aguan Valley (most recently in July 2012).

5. CAO Decision

Having held discussions with the IFC team and reviewed relevant documentation, CAO concludes that IFC's social and environmental performance with regard to the Dinant investment merits further enquiry. Thus, in accordance with its Operational Guidelines, CAO will develop Terms of Reference for a compliance audit with regard to the following issues:

- whether IFC exercised due diligence in its review of the social risks attached to the Project;
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