



**December 19, 2018**  
*Office of the Compliance Advisor Ombudsman (CAO)*

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## **COMPLIANCE INVESTIGATION REPORT**

*IFC Investment in Corporación Interamericana para el Financiamiento de Infraestructura, S.A. (Project #26031)*

*Complaint 01*

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**CAO Investigation of IFC Environmental and Social Performance in relation to:  
Corporación Interamericana para el Financiamiento de Infraestructura, S.A.**

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

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## Executive Summary

In July 2015, CAO received a complaint from community members who live near the site of Canbalam I (“the project”), a proposed 4.9-megawatt hydroelectric power plant two kilometers outside the town of Santa Cruz Barillas in Huehuetenango, Guatemala. The project was to be developed by Hidro Santa Cruz, S.A. (HSC, “project developer”), a company established by two Spanish businesses to pursue their first project in Guatemala. HSC commenced assessment of the project in 2008. Project construction commenced in January 2012, however, it was suspended in late March 2012 after community protests. Construction did not recommence. The project developer abandoned the project in December 2016. IFC is exposed to the project through a 2008 equity and loan investment in a financial intermediary, Corporación Interamericana para el Financiamiento de Infraestructura (CIFI, “the client”). CIFI provided a loan to the project in December 2011.

The complainants are Indigenous Peoples and the project was located in a majority indigenous region of Guatemala. The complainants allege that the project did not meet IFC’s requirements for free, prior, and informed consultation (FPIC). They raise concerns regarding transparency of the land acquisition process and project-related economic displacement. They assert that there should have been a cumulative impact assessment to understand project-related environmental impacts, given that the developer was also proposing another hydropower project on the same river. They assert that project opponents were subject to violence, persecution, threats, and intimidation. In particular, they note a violent incident on May 1, 2012, where one community member was killed and two others injured. The complainants maintain that one of the perpetrators was a security guard hired by the project. HSC acknowledges that one of the two individuals charged with the murder had worked for the project’s security company but denies any involvement in the incident. Both of the accused were acquitted of murder in 2013, though one was reported to have been convicted of inflicting serious injury. This decision was appealed in 2014 and in January 2017, it was reported that there would be re-trial. The current state of the judicial proceedings is, however, unclear. The May 2012 incident led to a violent protest involving hundreds of local people following which the Government of Guatemala declared a state of siege in Santa Cruz Barillas and mobilized police and military to the area for almost three weeks.

This CAO compliance investigation considers IFC’s performance in reviewing and supervising CIFI’s performance against the requirements of its environmental and social (E&S) policies, procedures, and standards. It also considers the extent to which the complainants allegations of adverse impact can be verified.

When investing through a financial intermediary such as CIFI, IFC’s responsibility is to ensure that the client is implementing an appropriate Environmental and Social Management System (ESMS) and applying the IFC Performance Standards to the higher risk projects that it finances. Where there are shortcomings in the client’s ESMS, IFC’s role is to ensure that these are addressed. IFC is generally not involved in the appraisal and monitoring of individual projects that the client is financing.

In its pre-investment E&S review of the client’s ESMS in 2007, IFC recognized that CIFI financed medium to high E&S risks and required the client to apply IFC’s Performance Standards for new investments. However, IFC did not identify gaps in the CIFI’s ESMS implementation capacity, in particular: (a) its lack of a full-time E&S officer; (b) its limited capacity to oversee E&S due diligence of higher risk projects; and (c) its limited capacity to assure itself that agreed E&S risk mitigation measures were being implemented. IFC did not ensure that these gaps were resolved prior making to its final disbursement to CIFI in April 2010.

It is in this context that CIFI reviewed and committed to finance the Canbalam I project in 2010. Gaps in the preparation of the Canbalam I project against IFC Performance Standards requirements were overlooked by the client. These are directly relevant to the concerns raised by the complainants. While CIFI's E&S review documentation concluded that the project was in general alignment with the Performance Standards, it also noted the absence of an adequate social impact assessment or socio-economic baseline study. This type of information is required in order to assess the impact of a greenfield hydropower project such as Canbalam I in accordance with the Performance Standards. Absent a review of this type of information, it was not possible to reach sound conclusions on project compliance with Performance Standards (PS) requirements regarding consultation (under PS1 and PS7) or assessment of impacts on Indigenous Peoples (under PS7) prior to the commencement of construction. It is also relevant that the project E&S assessment documentation omitted an assessment of security risk (a requirement under PS4). Similarly absent was analysis of the project operator's organizational capacity (as required by PS1), an important factor given that this was HSC's first project. While the project was small in terms of size, the above issues were of particular relevance given that the project was being developed in a post-conflict indigenous community with a history of opposition to outside projects that predated CIFI's involvement. CIFI made its initial disbursement to the project, which supported initial construction activities, without these PS compliance issues having been addressed.

IFC's lack of oversight in ensuring the client was implementing an adequate ESMS—one that was sufficient to assess and monitor risks and impacts arising from investments in projects such as Canbalam I—contributed to a situation in which project activities were allowed to commence in advance of an adequate risk assessment and implementation of mitigation measures envisaged by the Performance Standards.

Following the violent incidents of May 2012, the client suspended disbursements to the project and notified IFC. Where IFC is notified of a serious incident at the project level, IFC has a duty to respond as per its own E&S procedures. This includes requirements to ensure that the root cause of the incident is assessed, and measures put in place to prevent reoccurrence.

In response to the incident, the client commissioned its E&S consultant to prepare a review of the project. Although not shared with IFC until April 2015, the E&S consultant delivered a Social Monitoring Report to the client in October 2012. The Social Monitoring Report represented an appropriate initial assessment in response to the conflict around the project. It concluded that the development of the project had generated significant negative impacts in the social context of the project area and was potentially non-compliant with Performance Standards requirements for consultation under PS1 and PS7, FPIC requirements under PS7, and requirements for use of security forces under PS4.

The client decided to suspend disbursements to the project pending resolution of the conflict. This was similarly appropriate.

IFC, however, did not engage with the client in relation to the project or the violent incident as required by its E&S procedures. In this context, gaps in the client's response to Performance Standards requirements were not addressed. These gaps included: (a) absence of risk assessment and mitigation measures related to the project's use of security forces as required by PS4; (b) absence of an investigation (by the project developer) of allegations against project security personnel as required by PS4; and (c) absence of expert assessment of project social impacts, including impacts on Indigenous Peoples as required by PS1 and PS7. On this basis, CAO finds that IFC did not comply with its procedures on responding to serious incidents, nor did it take measures needed to ensure that the client's response reflected Performance Standards requirements to address project impacts throughout the project cycle including at project closure.

Ultimately, in November 2015, CIFI terminated its loan to the project developer, and the project was abandoned in December 2016.

The 2006 Sustainability Policy which was in force at the time of investment provides that efforts to carry out its investment activities in a manner that “do no harm” to people or the environment are central to IFC’s development mission. The Policy also commits IFC to “ensuring that the costs of economic development do not fall disproportionately on those who are poor and vulnerable.” Where adverse project impacts do occur, the Policy and PS1 provide that IFC will work with its client to ensure that impacts are assessed, reduced, mitigated or compensated for, as appropriate.

The complainants maintain that the project has resulted in adverse social impacts on their communities. In particular, they claim that the project led to the escalation of project related conflict, resulted in the death of one community member, left two community members seriously injured, and led to the detainment of seventeen other community members. They assert that traditional access to land and natural resources remains limited due to the construction of a perimeter fence around the project site.

While the project was abandoned in December 2016, available evidence supports the complainants’ assertion that residual impacts remain. Though aware of these impacts during the period of financing, IFC did not engage with its client to ensure that residual impacts of the project were assessed, reduced, mitigated, or compensated for, as appropriate, including at project closure, as required by the Performance Standards and the Sustainability Policy.

CAO will keep this investigation open and monitor IFC’s response to the investigation findings.

## Acronyms

AEPR	Annual Environment Performance Report (synonymous with Social and Environmental Performance Report, SEPR)
CAO	Office of the Compliance Advisor Ombudsman
CIFI	Corporación Interamericana para el Financiamiento de Infraestructura, S.A.
CNEE	Guatemala National Electric Energy Commission
COCODE	Consejo Comunitario de Desarrollo
E&S	environmental and social
EHS	Environmental, Health, and Safety
EP	Equator Principles
ESAP	Environmental and Social Action Plan
ESDD	Environmental and Social Due Diligence
ESMS	Environmental and Social Management System (synonymous with Social and Environmental Management System, SEMS)
ESRR	Environmental and Social Risk Rating
ESRP	Environmental and Social Review Procedure
FI	financial intermediary
FPIC	free, prior and informed consultation (PS 2006 requirement)
FY	fiscal year
GN	Guidance Note
HSC	Hidro Santa Cruz, S.A.
IACHR	Inter-American Commission on Human Rights
IDB	Inter-American Development Bank
IEA	Initial Environmental Assessment
IFC	International Finance Corporation
IIC	Inter-American Investment Corporation
ILO	International Labour Organization
IP	Indigenous Peoples
LAC	Latin America and the Caribbean
MARN	Ministry of Environment and Natural Resources (Guatemala)
MEM	Ministry of Energy and Mines (Guatemala)
MIGA	Multilateral Investment Guarantee Agency
MW	megawatt
Norfund	Norwegian Investment Fund for Developing Countries
PDD	Project Design Document (UN CDM)
PS	IFC Performance Standards (2006)
PS1	IFC Performance Standard 1: Social and Environmental Assessment
PS4	IFC Performance Standard 4: Community Health, Safety, and Security
PS5	IFC Performance Standard 5: Land Acquisition and Involuntary Resettlement
PS7	IFC Performance Standard 7: Indigenous Peoples
SPI	Summary of Proposed Investment
TOR	Terms of Reference
UDEFEGUA	Unidad de Protección a Defensoras y Defensores de Derechos Humanos, Guatemala
UN CDM	United Nations Clean Development Mechanism

## Overview of the CAO Compliance Process

CAO's approach to its environmental and social (E&S) compliance function is set out in its Operational Guidelines (March 2013).

When CAO receives an eligible complaint, the complaint first undergoes an assessment to determine how CAO should respond based on the parties' preferences. If the CAO compliance function is triggered, CAO will conduct an appraisal of IFC's/MIGA's involvement in the project, and determine if an investigation is warranted. The CAO compliance function can also be triggered by the World Bank Group President, the CAO Vice President, or senior management of IFC/MIGA.

CAO compliance investigations focus on IFC/MIGA, and how IFC/MIGA assured itself of the E&S performance of an IFC/MIGA project. The purpose of a CAO compliance investigation is to ensure compliance with policies, standards, guidelines, procedures, and conditions for IFC/MIGA involvement, and thereby improve E&S performance.

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

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

In many cases, in documenting and verifying the performance of the project and implementation of measures to meet relevant requirements, it is necessary to review the actions of the IFC/MIGA client and verify outcomes in the field.

CAO has no authority with respect to judicial processes. CAO is neither a court of appeal nor a legal enforcement mechanism, nor is CAO a substitute for international court systems or court systems in the countries where IFC/MIGA operates.

Upon finalizing a compliance investigation, IFC/MIGA is given 20 working days to prepare a public response. The compliance investigation report, together with any response from IFC/MIGA, is then sent to the World Bank Group President for clearance. It is then made public on the CAO website.

In cases where IFC/MIGA is found to be out of compliance, CAO keeps the investigation open and monitors the situation until actions taken by IFC/MIGA assure CAO that IFC/MIGA is addressing the non-compliance. CAO will then close the compliance investigation.

# 1. Background

## 1.1 Hidro Santa Cruz Canbalam I Hydroelectric Power Plant

This compliance investigation relates to the development of a hydroelectric power plant near the town of Santa Cruz Barillas (referred locally and in this report as Barillas) in the department of Huehuetenango, Guatemala. The hydroelectric power plant Canbalam I (“the project”) was a proposed 4.96-megawatt (MW) run-of-river hydropower plant on the Q’anb’alam River, two kilometers from Santa Cruz Barillas.<sup>1</sup> It was managed by Hidro Santa Cruz, S. A. (HSC). HSC is owned by Ecoener and Desarrollo Hidroeléctrico Centroamericano (combined “the project developer”).<sup>2</sup> The project was approved by the national regulator in 2010. Project construction commenced in January 2012, however, it was suspended in late March 2012 following community protests. HSC abandoned the project in December 2016 due to unresolved social conflicts.<sup>3</sup>

The project proposed the construction of: (a) a 2.50-meter-high feeder dam on the Q’anb’alam River; (b) a powerhouse connected to the dam via a 1.3-kilometer long pipeline; (c) a 4.9-kilometer-long transmission line from the powerhouse through Barillas to the national grid; and (d) two roads, a 336-meter access road to the project site and a 2.1-kilometer road from the dam to the powerhouse.<sup>4</sup>

Envisaged project benefits included: (a) a reduction in greenhouse gas emissions; (b) improved electricity supply for residential and commercial uses in the project area; and (c) short-term construction jobs and long-term project operation jobs. The project was also expected to result in a reduction of waste and pollution on the river.<sup>5</sup> Adverse impacts of the project expected during construction included water, soil, air, vegetation, fauna, and habitats impacts. The project developer considered all these impacts to be of low magnitude.<sup>6</sup>

A second hydroelectric power plant, Canbalam II, was registered with the Ministry of Energy and Mines (MEM) in April 2012.<sup>7</sup> In March 2013, the National Electric Energy Commission (CNEE) approved the electrical studies for Canbalam II.<sup>8</sup> The size of Canbalam II has been cited as between 4.99 MW and 12 MW.<sup>9</sup> The registration of Canbalam II was cancelled in September 2014.<sup>10</sup>

The Initial Environmental Assessment for the project was finalized in February 2010, and the Ministry of Environment and Natural Resources (MARN) approved and awarded an environmental license in May 2010. In June 2010, the Ministry of Energy and Mines authorized the project. MARN approved Canbalam’s transmission line and substation in September 2010.

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<sup>1</sup> UN CDM Project Design Document (PDD) for Canbalam I, dated July 27, 2012, available at <https://goo.gl/bTIPgp>.

<sup>2</sup> “CIFI to help Hidro Santa Cruz raise project funds,” June 9, 2010, BN Americas. Available at <https://goo.gl/AWXyn9>.

<sup>3</sup> Hidro Santa Cruz press release, Dec. 22, 2016. Available at <https://goo.gl/B9kQNz>.

<sup>4</sup> UN CDM PDD; Ecoener presentation (June 2010), available at <https://goo.gl/l8VtEb>.

<sup>5</sup> UN CDM PDD.

<sup>6</sup> Ibid.

<sup>7</sup> Guatemala Ministry of Energy and Mines, List of registered hydroelectric projects. Available at <https://goo.gl/f2Z1Qz>

<sup>8</sup> Guatemala National Electric Energy Commission, Resolution No. CNEE-54-2013. Available at <https://goo.gl/sEsjS2>

<sup>9</sup> MEM documentations (dated between April-December 2012) noted Canbalam II to be 4.99 MW.

(<https://goo.gl/pQ6u5J>; <https://goo.gl/dRdogm>), while CNEE documentation described Canbalam II as 12 MW (CNEE-54-2013, March 2013). AyD Consultores’ Environmental Impact Evaluation Study in 2013 for Canbalam II noted its size to be 10.9 MW (<https://goo.gl/Kn79Lx>).

<sup>10</sup> Guatemala Ministry of Energy and Mines, List of registered hydroelectric projects. Available at <https://goo.gl/pQ6u5J>.



The project site was cleared and fenced off as early as May 2011.<sup>11</sup> Some machinery and storage units were brought onto the site by November 2011 and project construction commenced in January 2012.<sup>12</sup> Opposition to the project has been reported since July 2009 (see section 2.3). Protests in March 2012 resulted in the suspension of project construction. Opposition escalated on May 1, 2012 (“May 2012 incident”) when a local resident, Andrés Francisco Miguel, was killed. As alleged by the complainants, Andrés Francisco Miguel was killed by a worker from the security company hired by the project. Local media reports that one of the accused was named in government documentation as HSC’s head of security while the other was a sub-contractor to the project.<sup>13</sup>

HSC initially denied that the individuals detained in relation to the death were employees of HSC or that it had any responsibility, direct or indirect for the killing.<sup>14</sup> Subsequently, however, HSC noted that one of the individuals accused of the murder had worked for the security company that controlled and protected access to the project site.<sup>15</sup> HSC also noted that the circumstances in which the killing occurred were unclear, but that a judge’s ruling acquitted the accused party of the charges against him.<sup>16</sup>

While the accused in question were acquitted of murder, CAO notes that one of the accused was convicted in September 2013 of causing serious injury in relation to the incident.<sup>17</sup> CAO also notes reports that the decision to acquit the accused of murder was overturned on appeal in 2014 with a re-trial that was scheduled for January 2017.<sup>18</sup> CAO is unclear as to the current state of these judicial proceedings.

As reported, the May 2012 killing, led to a violent protest involving hundreds of local people following which the Government of Guatemala declared a state of siege in Barillas and mobilized police and military to the area for almost three weeks.<sup>19</sup> According to the complainants, persecution of community leaders opposing the project peaked during the state of siege, but arrests continued through 2015 and allegations of persecution continued as of February 2017. In December 2016, HSC published a press release, announcing it had surrendered the Canbalam

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<sup>11</sup> “Estado de sitio, Santa Cruz Barillas, informe de verificación,” June 2012, Convergencia por los Derechos Humanos, available at <https://goo.gl/Qeooiu>. “Líderes comunitarios hacen denuncia pública por la construcción de hidroeléctrica,” Oct. 3, 2011, available at: <https://goo.gl/RKFz9e>. “Comunidades manifiestan en contra de la minería y de la hidroeléctrica,” Nov. 16, 2011, available at <https://goo.gl/6bk5dl>.

<sup>12</sup> “Manifestantes destruyen parcialmente las instalaciones de Hidro Santa Cruz,” Nov. 18, 2011, available at: <https://goo.gl/FzAma6>.

<sup>13</sup> Plaza Publica, September 18, 2013, *Acoso y derribo a la justicia en Guatemala*. Available at <https://goo.gl/CqkXKa>

<sup>14</sup> See also Hidro Santa Cruz press release: “Comunicado oficial de Hidro Santa Cruz, S.A.,” May 26, 2012, available at <https://goo.gl/vqqM98>.

<sup>15</sup> CAO Assessment Report.

<sup>16</sup> Ibid.

<sup>17</sup> Plaza Publica, September 12, 2013. *Guardia es enviado cinco años a prisión, Prensa Libre*. Available at <https://goo.gl/rAs4yv>.

<sup>18</sup> Campana por la libertad de los presos políticos de Huehuetenango, Guatemala, 2015. PDF available at <https://goo.gl/xU4mdA>.

Van a juicio de nuevo dos encargados de la seguridad de hidroeléctrica española.” Jan. 22, 2017. Available at <https://goo.gl/jaKfa6>.

<sup>19</sup> For further details, see articles published on web-based news site related to Santa Cruz Barillas: <https://goo.gl/jVYUjD>, <https://goo.gl/rA7qzx>, <https://goo.gl/9OtJsh> and <https://goo.gl/K2qtGI>.

hydro project and was in the process of withdrawing from the country.<sup>20</sup> In March 2017, registration of the Canbalam I project was cancelled.<sup>21</sup>

## 1.2 IFC Exposure to the Hidro Santa Cruz Canbalam I Project

IFC made an equity and loan investments in Corporación Interamericana para el Financiamiento de Infraestructura, S.A. (CIFI, “the client”), a non-banking financial institution established in 2001 to provide financing to small and medium sized infrastructure projects (up to US\$100 million) across Latin America and the Caribbean.<sup>22</sup> CIFI, in turn, directly invested in the project.

In June 2008, IFC committed to a US\$10 million equity investment for a 15-percent stake in the client (IFC project number 26031).<sup>23</sup> IFC’s equity investment involved the purchase of shares from existing shareholders with the objective of consolidating the shareholding structure. Additionally, IFC made a US\$20 million loan investment and arranged a US\$48.5 million syndicated loan for the client.<sup>24</sup> In March 2014, IFC sold part of its shareholding to Bankia.<sup>25</sup> As of March 2017, IFC’s equity investment represented 7.94 percent of CIFI.<sup>26</sup>

The purpose of IFC’s investment was to support implementation of the client’s business plan which included expected asset growth, operational consolidation, and access to lower-cost, long-term funding from international capital markets. IFC expected to contribute to the implementation of the client’s business plan through the transfer of industry knowledge, structuring skills, and best international practices.<sup>27</sup> This included transfer of knowledge of best practices in E&S standards in the infrastructure and financial market sectors.

The expected development impact of IFC’s investment in the client included: (a) facilitating economic development through infrastructure investment; (b) increasing access to basic services; and (c) providing net positive tax payments to governments.<sup>28</sup>

In December 2011, CIFI and Norfund (Norwegian Investment Fund for Developing Countries) (combined “the lenders”) made debt and mezzanine finance investments of up to US\$10.6 million to support the development of the Canbalam project.<sup>29</sup> The lenders made an initial disbursement of US\$3.5 million in 2011. The remaining US\$7.1 million were never disbursed due to unresolved social conflicts around the project.<sup>30</sup>

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<sup>20</sup> Hidro Santa Cruz desiste de su proyecto Canbalam a raíz del rechazo significativo en Santa Cruz Barillas," Dec. 22, 2016, el Periódico. Available at <https://goo.gl/Ume6zc>.

<sup>21</sup> Guatemala Ministry of Energy and Mines, List of registered hydroelectric projects. Available at <https://goo.gl/pQ6u5J>.

<sup>22</sup> CIFI website: <http://www.cifi.com>.

<sup>23</sup> IFC Disclosure, Summary of Proposed Investment (SPI), project number 26031, available at <http://goo.gl/VQleNA>.

<sup>24</sup> IFC Disclosure, SPI; IFC press release, dated July 15, 2008, available at <https://goo.gl/hJ1XeL>. The client repaid the loans to IFC in 2014.

<sup>25</sup> CIFI Financial Statement, 2014, available at <https://goo.gl/GQq68e>.

<sup>26</sup> CIFI Financial Statement, March 2017, available at <https://goo.gl/B8NfJC>.

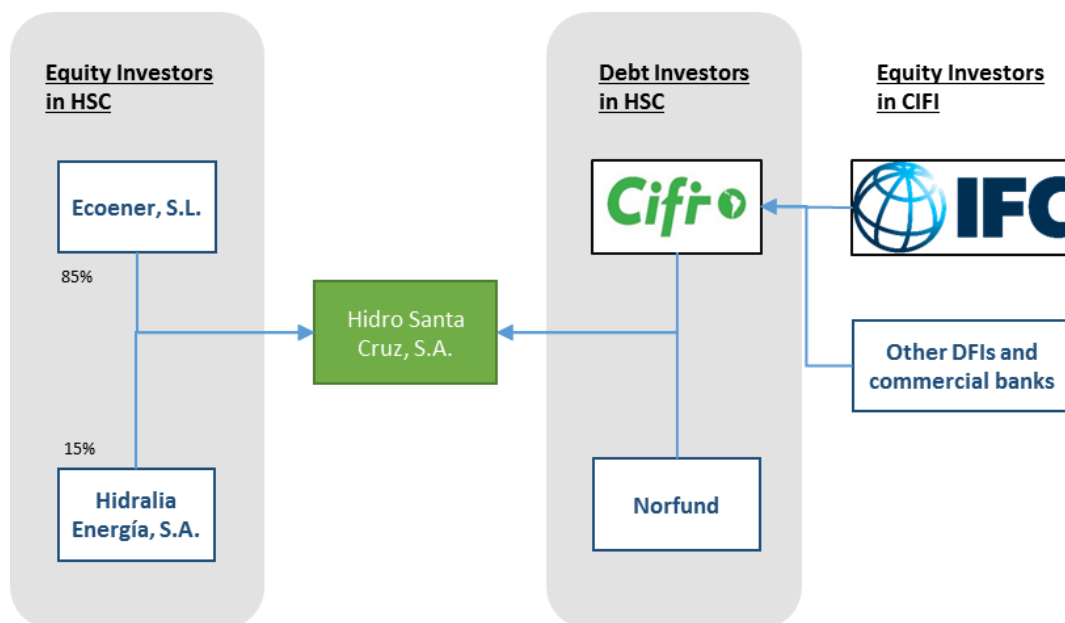
<sup>27</sup> IFC Disclosure, SPI.

<sup>28</sup> Ibid.

<sup>29</sup> CAO Assessment Report, available at <http://goo.gl/MR2NBB>. Norfund Report on Operations 2011, available at <https://goo.gl/AQE6sU>.

<sup>30</sup> CAO Assessment Report.

**Figure 1. IFC’s exposure to the Project**



### 1.3 The Complaint and CAO Assessment

In July 2015, a group of community representatives filed a complaint to CAO on behalf of themselves and other community members in the Municipality of Santa Cruz Barillas. The complainants raise concerns about several environmental and social (E&S) issues. These include: IFC’s due diligence in relation to the CIFI investment, the dissemination and disclosure of project information, lack of consultation, and potential impacts of the project on indigenous populations. The complaint also raises concerns regarding the potential for project-related displacement and impacts on local water resources. The complainants assert that when they decided to oppose the project, their community was subject to violence, persecution, threats, and intimidation. The complainants further allege that an employee of the security company hired by the project killed a local landowner and project opponent in May 2012 (“the May 2012 incident”) and injured two other community members. As a result, they state that violence erupted within the community and the national government declared a state of emergency. This, they assert, led to the mobilization of police and military and the detainment of seventeen community members, of whom nine were jailed for a period of nine months.<sup>31</sup> The complainants maintain to CAO that the unaddressed impacts of the project are (a) escalation of social conflict within the community; (b) death of one community member, injuries to two community members, and detainment of seventeen community members in relation to the protests that followed the killing; and, (c) limitations to access to land and natural resources due to the construction of a perimeter fence around the project site.

As set out in CAO’s May 2016 Assessment Report, the project developer asserts that this project poses limited environmental risks and has been granted the necessary environmental licenses. While the project developer acknowledges that initial consultation with communities was limited, following a series of consultations with the Municipality, community representatives, and

<sup>31</sup> Complaint to CAO, July 15, 2015, available at <https://goo.gl/GFy93s>.

community meetings, the project developer asserted that it was in a position to sign a cooperation agreement with community representatives in December 2011. This was not signed, the project developer claimed, due to a radical minority group resorting to violence and boycotting the agreement. As explained by the project developer, the community division and violence stem from politically motivated non-governmental organizations supported by European cooperation agencies. In relation to the alleged murder of a community member, the project developer acknowledges that one of the individuals accused of the murder had worked for the security company that controlled access to the project site, but denies any involvement in the incident.<sup>32</sup> The project developer notes that this man and the other accused were acquitted of the charges against them, though it was reported in January 2017 that there would be re-trial. The complainants have noted to CAO that the trial is currently stopped.<sup>33</sup>

CIFI's view, as summarized in CAO's Assessment Report, is that the E&S assessment it conducted prior to the approval and disbursement of the loan provided a satisfactory evaluation of the project. Further, the client noted that at the time the first disbursement was made, they did not have information about opposition to the project. As a result of the May 2012 incident, the lenders halted disbursement indefinitely pending resolution of the conflict. From CIFI's perspective, despite multiple efforts by the lenders to solve the problems, a satisfactory resolution was never reached. Therefore, CIFI reported that as of November 3, 2015, HSC and the lenders terminated their credit relationship. Since then, CIFI has no financial relationship with the project.

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

#### **1.4 Scope of CAO Investigation**

The scope of this investigation is defined in Terms of Reference (TOR) issued by CAO in January 2017.<sup>34</sup> As set out in the TOR, the focus of this CAO compliance investigation is on IFC, and whether IFC's investment in CIFI was appraised, structured, and supervised in accordance with applicable IFC policies, procedures, and standards.

Per the TOR, the following questions are the focus of the compliance investigation.

1. Was IFC's pre-investment E&S review of its client commensurate to risk?
2. Was IFC's approach to the management of E&S risks in relation to this investment adequate?
3. Was IFC's supervision of E&S risks related to the client adequate?
4. Was IFC's response and support to the client in relation to the issues at the Hidro Santa Cruz site adequate?

The TOR also asks CAO to consider whether IFC's Policy and Performance Standards on Environmental and Social Sustainability and Policy on Disclosure of Information as applied to this project provided an adequate level of protection.

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<sup>32</sup> CAO Assessment Report.

<sup>33</sup> The accused were acquitted in September 2013; however, following a successful appeal in February 2014, the trial was restarted in January 2017. For further details see Van a juicio de nuevo dos encargados de la seguridad de hidroeléctrica española." Jan. 22, 2017. Available at <https://goo.gl/jaKfa6>.

<sup>34</sup> CAO Investigation Terms of Reference, available at <https://goo.gl/wnQzpw>.

## **1.5 Methodology for CAO Investigation**

The CAO investigation team (CAO staff and one external panelist) reviewed IFC's and client-provided documentation in relation to IFC's investment in CIFI and the subsequent investment by CIFI in Canbalam I. The CAO investigation team travelled to Guatemala City and Panama City in February 2017 to meet with the complainants and their representatives, the client, and other stakeholders. Following the field visit, the CAO investigation team met with IFC staff and other stakeholders. This report considered IFC's supervision documentation prepared prior to CAO sending the report to IFC for Factual Review and Comment in July 2018.

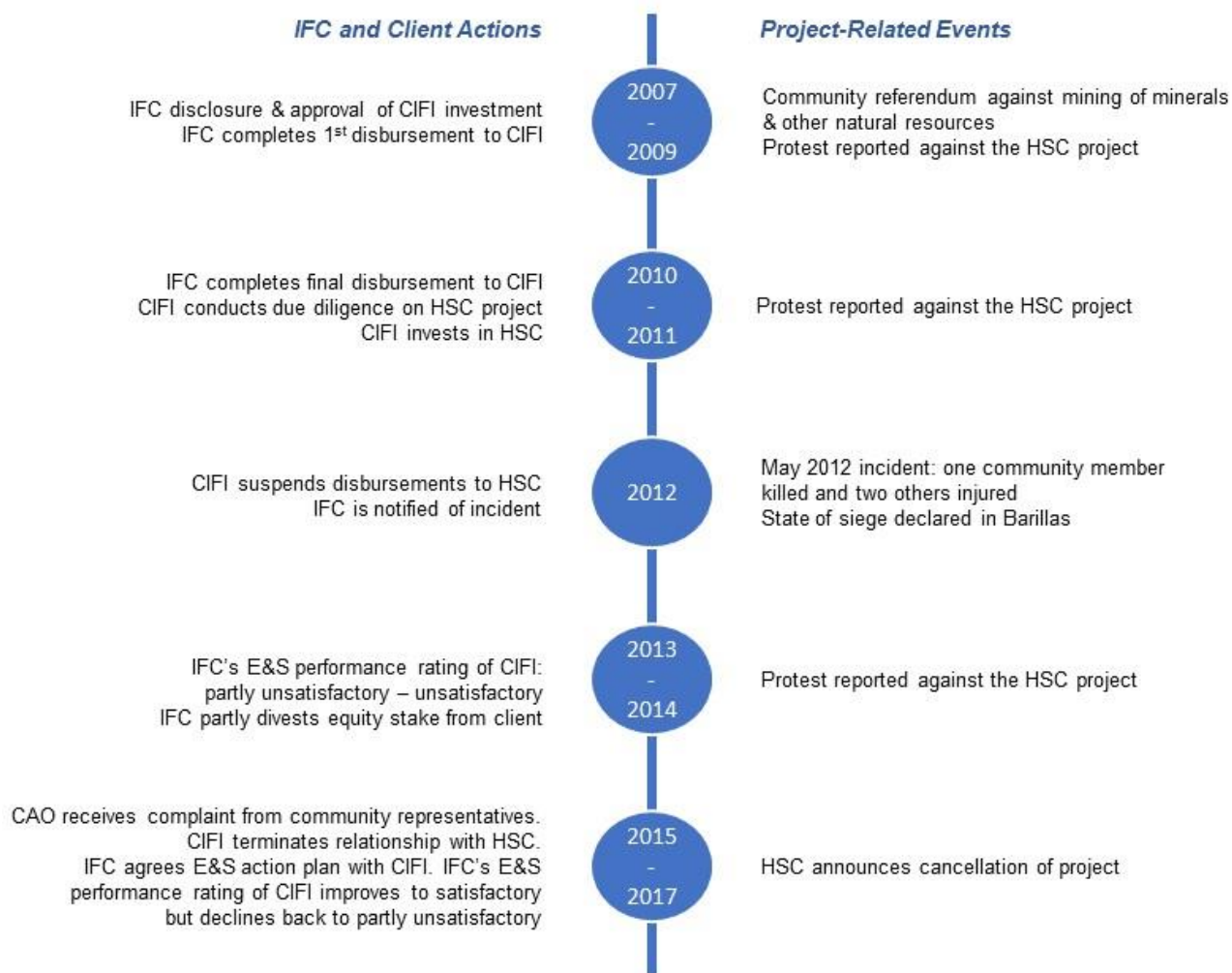
CAO's external panelist is an engineer with expertise in hydroelectric power plant assessments and a specialist in Environmental and Social Management Systems (ESMS) for Financial Intermediaries (FI).

The investigation has considered IFC's performance in relation to the requirements of its 2006 Policy on Environmental and Social Sustainability ("the Sustainability Policy"), the 2006 Performance Standards (PS), and 2006 Policy on Disclosure of Information ("Disclosure Policy"), together referred to as the Sustainability Framework.

In considering IFC's E&S performance in relation to this investment, CAO has been conscious not to expect performance at a level that requires the benefit of hindsight. Rather, the question is whether there is evidence that IFC applied relevant requirements considering sources of information available at the time.

CAO's compliance mandate is focused on IFC's E&S performance. In accordance with CAO's Operational Guidelines, this report documents investigation findings with respect to IFC's compliance with relevant requirements and adverse environmental and/or social outcomes, including the extent to which these are related to the project.

## 1.6 Key Events Timeline



A detailed timeline of the Hidro Santa Cruz project is available in section 2.3.2.

## 1.7 IFC's Policy Framework and Approach to Financial Intermediary Investments

IFC's 2006 Sustainability Framework details a series of IFC and client requirements to ensure that IFC's investments are implemented in a sustainable manner. The framework is comprised of IFC's Sustainability Policy and IFC's Disclosure and Information Policy, which set out requirements upon IFC. IFC's Performance Standards detail client E&S responsibilities. Environmental and Social Review Procedures (ESRP) set out the process through which IFC staff review and monitor investments to ensure they are meeting its E&S requirements.

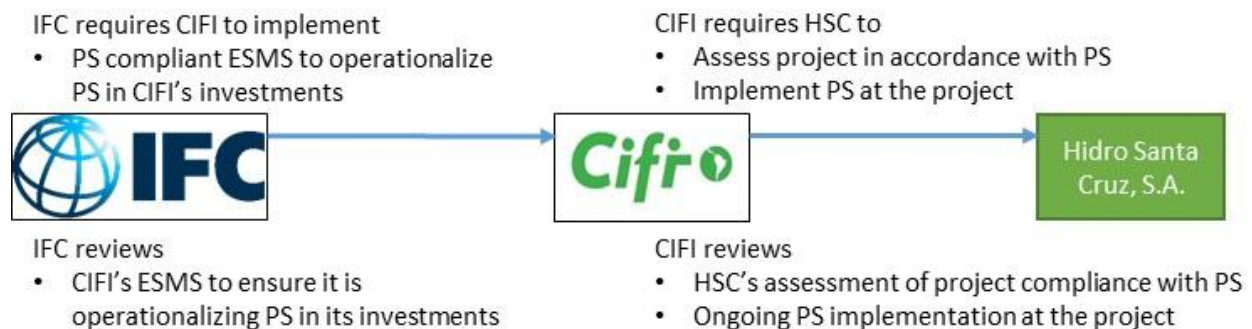
The Sustainability Policy establishes IFC's commitment that the "do no harm" principle is central to IFC's development mission. In its investment operations, IFC affirms that negative impacts should be avoided where possible, "or if avoidance is not possible, to reduce, mitigate, or

compensate for the impacts, as appropriate.”<sup>35</sup> In particular, IFC notes that it “is committed to ensuring that the costs of economic development do not fall disproportionately on those who are poor or vulnerable, that the environment is not degraded in the process, and that natural resources are managed efficiently and sustainably.”<sup>36</sup>

While managing E&S risk in accordance with the Performance Standards is a client responsibility, IFC “seeks to ensure that the projects it finances are operated in a manner consistent with the requirements of the Performance Standards.”<sup>37</sup>

With regards to financial intermediary (FI) investments, IFC’s key requirement is for an FI client to have an E&S management system (ESMS) that is sufficient to ensure application of IFC standards at the level of the client’s investments.<sup>38</sup> When an FI finances activities that involve significant E&S risk, the requirement is that the recipient of funds implements IFC’s Performance Standards.<sup>39</sup> IFC’s role is to assess the performance of the FI’s ESMS given these requirements.

**Figure 2. Pass-through of IFC requirements**



IFC has developed a significant program of indirect investments through FIs with the objective to: “strengthen domestic capital markets that support economic development at a scale of enterprise that is smaller than would be possible through direct IFC investments.”<sup>40</sup> IFC’s FI portfolio has grown significantly in recent years, accounting for US\$6.2 billion of new long-term commitments in FY17 and 52 percent of IFC’s new commitments.<sup>41</sup>

<sup>35</sup> IFC Sustainability Policy (2006), para. 4.

<sup>36</sup> Ibid., para. 8.

<sup>37</sup> Ibid., para. 5.

<sup>38</sup> Ibid., para. 29.

<sup>39</sup> Ibid., paras. 27–28.

<sup>40</sup> Ibid., para. 27.

<sup>41</sup> IFC Annual Report 2017, p. 58.

## 1.8 Contextual Background

The population of Santa Cruz Barillas is predominately (86 percent) indigenous, many of whom live in poverty or extreme poverty. Q'anjob'al communities are the majority indigenous people in Huehuetenango.<sup>42</sup>

The department of Huehuetenango experienced significant violence during the Guatemalan civil war (1960–1996). More than 10,000 people were killed in Huehuetenango.<sup>43</sup> A majority (83 percent) of these people were from indigenous communities.<sup>44</sup>

Since the peace accords were signed in 1996, Guatemala has made progress in consolidating democratic institutions. The country has, however, experienced difficulties in responding to economic and social challenges, including crime and violence. According to the World Bank, Guatemala is one of the poorest and most unequal countries in Latin America and the Caribbean region with low social indicators compared to countries of similar income levels. The World Bank has also noted that Guatemala faces significant governance challenges.<sup>45</sup>

Guatemala has the most inequitable and concentrated distribution of land ownership in Central America, and this has been cited as a cause of the civil war.<sup>46</sup> According to the Inter-American Commission on Human Rights (IACHR):

The situation of indigenous property rights in Guatemala is marked by the failure to recognize historic rights to the land; the lack of legal certainty and guarantees such as titling, delimitation, and demarcation; the failure to resolve long-standing legal actions relating to the land; inconclusive and inefficient adjudication procedures that have resulted in debts for the communities; involuntary losses of lands due to causes associated with the armed conflict; evictions and forced displacements associated with development projects; and the impact on the enjoyment of their rights due to the creation of protected natural areas.<sup>47</sup>

IACHR further notes that the “main obstacle to respecting and ensuring indigenous property rights in Guatemala is the failure to recognize historical use and occupation as the basis of Indigenous Peoples’ and communities’ collective rights to the land, territory, and natural resources.” This has resulted in a very high level of land disputes among communities, creating “situations of considerable unrest among Indigenous Peoples and communities, owners of landed estates, and peasant farmers.” Huehuetenango is observed to have one of the highest incidences of land disputes in Guatemala.<sup>48</sup>

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<sup>42</sup> 85 percent of Indigenous Peoples in Huehuetenango live in poverty or extreme poverty. For further details, see: UNDP. 2011. *Cifras para el desarrollo humano, Huehuetenango*. Available at <https://goo.gl/msg9LG>.

<sup>43</sup> Tejada Bouscayrol, M. 2010. *Historia social del norte de Huehuetenango*. Centro de Estudios y Documentación de la Frontera (CEDFOG), p.180.

<sup>44</sup> Commission for Historical Clarification. 1999. *Guatemala: Memory of Silence. Report of the Commission for Historical Clarification (CEH), Conclusions and Recommendations*. Available at <http://goo.gl/GWWDfQ>.

<sup>45</sup> World Bank Group. 2012. I. Available at: <http://goo.gl/e1CaL0>. Sanchez, S.M., K. Scott, and J.H. Lopez. 2015. *Guatemala: Closing Gaps to Generate More Inclusive Growth*. Systematic Country Diagnostic, World Bank. Available at: <https://goo.gl/mnacPP>.

<sup>46</sup> USAID. 2010. *Guatemala Land Tenure Profile*. Available at <http://goo.gl/s7dyKs>.

<sup>47</sup> IACHR. 2015. *Situation of Human Rights in Guatemala*, p. 189. Available at <http://goo.gl/7MhyNG>.

<sup>48</sup> *Ibid.*, pp. 191-193.



## 2. Analysis and Findings

### 2.1 IFC's Pre-Investment Review and Risk Mitigation Measures

Before investing in an FI, IFC reviews the E&S risks and impacts of the proposed investment and agrees with the FI on measures to mitigate these risks in accordance with IFC's E&S requirements. This section considers IFC's pre-investment E&S review of the CIFI investment and IFC's approach to the management of E&S risks in relation to the investment.

#### Summary of Findings

IFC appropriately categorized the investment as FI and required the client to apply IFC's Performance Standards to its investments.

IFC's pre-investment E&S review was not commensurate to risk. Specifically, CAO identified shortcomings in IFC's assessment of: (a) the client's track record of ESMS implementation; and (b) the client's capacity to implement its ESMS to IFC standards.

CAO finds that IFC's pre-investment E&S review did not lead to the development of an action plan to address gaps in the client's ESMS, a requirement of IFC's ESRPs. As a result, IFC did not have assurance that the client's ESMS implementation was sufficient to ensure that higher risk investments it planned to finance, such as Canbalam I, would meet the requirements of the Performance Standards.

#### 2.1.1 Pre-Investment Requirements

Central to its pre-investment review of FI investments, IFC is required to review "the business of its FI clients to identify activities where the FI could be exposed to social and environmental risk as a result of its investments."<sup>49</sup> Based on the magnitude of impacts understood, IFC categorizes the investment as Category A, B, C or FI.<sup>50</sup>

An IFC FI client is responsible for reviewing and monitoring E&S risks associated with the businesses that it finances, through its ESMS.<sup>51</sup> Where an FI has an existing ESMS, IFC reviews its capacity and implementation track record to identify gaps against IFC's requirements. For FIs supporting activities which present significant E&S risks, IFC requires the FI to have an ESMS which incorporates IFC's Performance Standards.<sup>52</sup> The objective of this process is to ensure that the FI client will be in a position to apply IFC's E&S standards to the higher risk business activities that it is financing.

The table below presents a summary of IFC policy and procedural requirements for its pre-investment review of an FI investment.<sup>53</sup>

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<sup>49</sup> IFC Sustainability Policy (2006), para. 28.

<sup>50</sup> See IFC Sustainability Policy (2006), para. 18 for further details.

<sup>51</sup> Social and Environmental Management System (SEMS) is used prior to 2012 but is synonymous with ESMS, which is used in this report. See Annex A for key aspects of an ESMS.

<sup>52</sup> IFC Sustainability Policy (2006), para. 28.

<sup>53</sup> Table prepared on the basis of IFC Sustainability Policy (2006), Disclosure of Information Policy (2006) requirements, and IFC ESRPs, as updated from time to time.

IFC 2006 Sustainability Policy and Disclosure Policy	IFC Environmental and Social Review Procedures (ESRP)
<p><b>Purpose</b></p> <p>Ensure that IFC does not finance new business activity that cannot be expected to meet the PS over a reasonable period of time (para. 17)</p>	<p><b>Purpose</b></p> <p>Specify the E&amp;S review process for IFC staff to implement IFC policy requirements</p>
<p><b>2006 Sustainability Policy requirements</b></p> <p>→ IFC reviews the business of its FI clients to identify activities where the FI could be exposed to social and environmental risk as a result of its investments (para. 28)</p> <p>→ IFC's requirements for the FI client will be proportional to the level of potential risk:</p> <ul style="list-style-type: none"> <li>- FIs with business activities that have minimal or no adverse social or environmental risks will be considered Category C projects and need not apply any specific requirements;</li> <li>- All other FIs will apply the Exclusion List;</li> <li>- In addition to the Exclusion List, FIs providing long-term corporate finance or project finance will require the recipient of such finance to: <ul style="list-style-type: none"> <li>(i) follow national laws where the activity financed presents limited social or environmental risks; and</li> <li>(ii) apply the Performance Standards where the activity financed presents significant social or environmental risks (para. 28)</li> </ul> </li> </ul> <p>→ The FI will be required to establish and maintain an ESMS to ensure that its investments meet IFC's requirements (para. 29)</p>	<p><b>Requirements (ESRP, July 2007)</b></p> <p>→ Determine the significance of business activities that have potential E&amp;S impact by reviewing the portfolio and sectoral information. (para. 7.2.12)</p> <p>→ Determine the applicable performance requirements, specifically, and as proportional to the level of potential risk: IFC's Exclusion List, applicable national E&amp;S laws and regulations, and IFC's Performance Standards (para. 7.2.12)</p> <p>→ Review the client's ESMS, considering its adequacy to implement the applicable performance requirements. Consider the following aspects of the ESMS as relevant:</p> <ul style="list-style-type: none"> <li>a. E&amp;S policies and procedures;</li> <li>b. The current organizational structure and staffing;</li> <li>c. Skills and competencies in E&amp;S areas;</li> <li>d. Training and awareness of the client's investment, legal, and credit officers on the organization's EHS requirements and the ESMS;</li> <li>e. Reporting of results to management;</li> <li>f. Track record to date in ESMS implementation; and</li> <li>g. Performance monitoring procedure (para. 7.2.16)</li> </ul> <p>→ Identify any ESMS enhancements the client would need to undertake to address gaps in these areas, and incorporate this in the ESMS Plan to be included in the legal agreements (para. 7.2.17)</p>
<p><b>2006 Disclosure Policy requirements</b></p> <p>→ IFC discloses a Summary of Proposed Investment (SPI) for FI investments including a brief summary of any key enhancements to be made to the FI's SEMS (para. 14)</p>	

### 2.1.2 IFC Pre-Investment Review (2007–2008)

IFC's pre-investment review of its investment in CIFI commenced in mid-2007. As part of its due diligence, IFC staff reviewed the client's ESMS and visited the client at their offices in Virginia, USA.

At the time of IFC's due diligence, the client had 27 active investments across the Latin America and Caribbean (LAC) region.<sup>54</sup> These investments supported various infrastructure sectors including energy production, infrastructure-related service, and transportation. CIFI categorized

<sup>54</sup> As of September 30, 2007. Additional details available at <https://goo.gl/KPTWGj>.

the E&S risk of these investments as: Category A (1); Category B (25); and Category C (1).<sup>55</sup> The client had different roles in these investments, from acting as lead arranger on some to purchasing debt on secondary markets in others.<sup>56</sup>

### **CIFI's ESMS (2007)**

In 2005, CIFI adopted an ESMS to review, categorize, and supervise prospective and approved projects. As part of its ESMS, CIFI applied the policies and procedures of the Inter-American Investment Corporation (IIC). On April 6, 2007, CIFI adopted the Equator Principles which reflected IFC's 2006 Performance Standards and applicable World Bank Group Environmental, Health, and Safety (EHS) Guidelines.<sup>57</sup>

Similar to IFC, CIFI categorized project E&S risk, assigning a project a Category A, B, or C. Unlike IFC, CIFI also considered its leverage and direct exposure to a project when categorizing E&S risk.<sup>58</sup>

In 2005, CIFI hired a financial analyst to support general monitoring of its investments, including E&S performance.<sup>59</sup>

As part of its pre-investment E&S review, IFC considered the client's ESMS and provided written comments. IFC required the client to incorporate the Performance Standards into its ESMS. IFC identified differences between the client's approach to E&S categorization and that of IFC (see box above). In response, IFC required the client to include guidance on project categorization in its ESMS. In general, however, IFC determined that CIFI's ESMS was comprehensive and satisfactory. CIFI amended its ESMS procedures in January 2008 to reflect IFC's comments.

IFC's pre-investment due diligence also included a portfolio-level review of CIFI's investments and E&S documentation available on CIFI's intranet. Based on this review, IFC noted differences between IFC and CIFI E&S assessments of jointly funded projects. IFC did not document a review of the adequacy of CIFI's E&S assessments or its monitoring of its portfolio. IFC did not conduct a review of the client's capacity to implement its ESMS. At the time, CAO notes that the client did not have a dedicated E&S officer. Rather, investment staff had responsibility for implementing the ESMS.

By way of comparison, IFC's financial due diligence included a documented review of each of the client's investments, considering: (a) country diversification and political risk; (b) sector diversification and investment maturity profile; and (c) investment performance and portfolio quality. IFC also considered the quality of the client's credit risk assessments and staff capacity.

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<sup>55</sup> At IFC's appraisal, CIFI was participating in two investments which IFC was involved. While CIFI had categorized both investments as Category B, IFC had categorized one of these investments (construction and operation of the Caucedo Port, Dominican Republic) as Category A, see <https://goo.gl/1sU1I2>.

<sup>56</sup> An arranger of debt coordinates other financial institutions in organizing a syndicated loan. The arranger is involved in every aspect of the transaction and has access to all necessary documentation to complete the transaction. When purchasing debt on a secondary market, access to relevant E&S documentation is frequently limited as there is no direct relationship between the financier and the project being financed.

<sup>57</sup> See Annex A for a summary of CIFI's ESMS at the time of IFC's appraisal.

<sup>58</sup> CIFI Annual Environmental Report 2007, available at <https://goo.gl/rTBKnU>.

<sup>59</sup> CIFI Annual Environmental Report 2005, available at <https://goo.gl/oQhAhc>.

In presenting the investment to management in December 2007, IFC described its role as supporting a unique FI in the LAC region by transferring of industry knowledge and ensuring that good practice E&S standards were applied to the client's projects. The investment was approved by IFC management in December 2007.<sup>60</sup>

The investment was approved by the IFC Board in May 2008 and IFC committed to it in June 2008. As part of the legal arrangements, the client was required to implement an ESMS which was adequate to identify, assess, and manage the E&S risk of investments in accordance with IFC's Exclusion List, applicable E&S national law, and IFC's Performance Standards. Further, the client was required to provide IFC with an annual E&S performance report (see Annex B).

### 2.1.3 Discussion and Findings

The client was established in 2001 with the objective of supporting the development of infrastructure projects in the LAC region. In 2005, the client first established an ESMS and in April 2007, the client adopted the Equator Principles which required the application of IFC's Performance Standards to project finance investments. At the time of IFC's due diligence, the client's portfolio consisted of both high and medium E&S risk investments.

In accordance with its Sustainability Policy, IFC classified the investment as FI. IFC's review of the client's ESMS procedure identified gaps which were communicated to the client for resolution prior to IFC's disbursement. In accordance with the Sustainability Policy, IFC required the client to amend its ESMS to reflect IFC's Performance Standards rather than the Equator Principles. **CAO finds that IFC appropriately categorized the investment as FI and required the client to implement IFC's Performance Standards.** IFC required the client to apply the PS to all operations it financed. This is an example of IFC going beyond its the Sustainability Policy (para. 28) requirement at the time, which was that the FI apply the PS to activities which present "significant environmental or social risks."

CAO notes that the client's business (spanning from arranger of debt to secondary market purchase of debt) presented challenges to implement IFC's E&S requirements. For example, in instances where the client is not the lead arranger on an investment, the client explained that its access to E&S information and its ability to influence performance at the project level may be limited. Lack of access to this type of information also raises questions as to the client's ability to assess and monitor project E&S risk in accordance with IFC's requirements. Such issues were not considered by IFC in its E&S review.

IFC noted differences in E&S categorization between common IFC-CIFI investments at the time, and thus advised the client to include additional guidance on categorization in its ESMS.

IFC's E&S review did not include a documented assessment of the client's ESMS implementation track record. While IFC noted that the client filed E&S assessment and monitoring documentation, IFC did not document a review of client track record of assessing and monitoring E&S risk.<sup>61</sup> As IFC was aware that the client had committed in April 2007 to implement the Performance Standards through its adoption of the Equator Principles, there was an opportunity to assess the client's implementation of these standards at the project level. However, IFC did not do this. By

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<sup>60</sup> IFC Disclosure, Summary of Proposed Investment (SPI), project number 26031, available at <http://goo.gl/VQIeNA>.

<sup>61</sup> As per IFC per-investment E&S review procedures: ESRP 7.2.16.

way of contrast, IFC investment review considered the country, sector, and maturity risk of the client's portfolio, and included a detailed financial review of each client portfolio investment.

IFC did not document an assessment of the client's capacity to implement its ESMS. Client investment staff were responsible for implementing the ESMS. In the context where the client had 26 medium to high E&S risk investments, IFC did not consider whether: (a) the client had sufficient staff capacity to implement its ESMS; or (b) giving investment staff responsibility for ESMS oversight risk presented a conflict of interest.

The client's 2007 Annual Environmental Performance Report (AEPR 2007) is indicative of the state of the client's ESMS implementation at the time of IFC's E&S review. This third-party assessment of the client's approach to E&S risk management covers the period January–December 2007 and was received by IFC in July 2008, shortly after approval of the investment. The AEPR 2007 notes that the client generally complied with its ESMS, but that day-to-day implementation of the ESMS could be improved. The report notes that justification for categorization of projects and results of E&S due diligence were not documented. Accordingly, the author of the AEPR 2007 was unable to assess the client's E&S due diligence process in detail. The report notes that client had experienced challenges in implementing the Equator Principles, especially for transactions where it had limited influence over loan covenants and annual reporting. Further, the AEPR 2007 recommended that the client hire a full-time E&S officer and amend its organizational structure to provide for independent internal E&S review of projects. IFC did not develop analysis or recommendations of this type in the course of its E&S review.

In summary, **CAO finds that IFC's pre-investment E&S review was not commensurate to risk.** CAO makes this finding based on shortcomings in IFC's assessment of: (a) the client's track record of ESMS implementation; and (b) its capacity to implement its ESMS to IFC standards, as outlined above. While IFC reviewed and commented on the client's ESMS procedures, an assessment of the client's ESMS implementation capacity considering the range of issues required in the ESRP was not conducted.<sup>62</sup> Accordingly, IFC was not in a position to identify ESMS enhancements necessary to meet IFC requirements.<sup>63</sup> **In this context, CAO finds that IFC's pre-investment E&S review did not lead to the development of an action plan to address gaps in the client's ESMS, a requirement of IFC's ESRPs. As a result, IFC did not have assurance that the client's ESMS implementation was sufficient to ensure that higher risk investments it planned to finance, such as Canbalam I, would meet the requirements of the Performance Standards.**

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<sup>62</sup> ESRP (2007), para. 7.2.16.

<sup>63</sup> *Ibid.*, para. 7.2.17.

## 2.2 General Supervision

IFC's supervision of its investment in CIFI commenced with first disbursement in August 2008. This section presents a summary of IFC's supervision of the client from 2008 to present and considers the adequacy of IFC's supervision of the client's ESMS implementation generally. The subsequent section considers IFC supervision of the client as related to Canbalam I specifically.

### Summary of Findings

IFC did not meet the requirements of the Sustainability Policy (para. 26) for project supervision, particularly requirements to identify and correct client non-compliance with its E&S requirements.

Nine years after making its investment, IFC has yet to assure itself that the client is "operating the ESMS as envisaged at the time of appraisal" or its client has "applied the applicable performance requirements to its sub-projects."

IFC has taken insufficient action to support its client in establishing compliance with IFC's requirements. Thus, throughout the period of supervision, IFC has been at risk of exposure to projects with E&S impacts that are not being managed in accordance with the Performance Standards.

### 2.2.1 Supervision Requirements

The supervision phase of the IFC investment cycle commences at first disbursement and continues until the investment is closed. The Sustainability Policy requires that IFC monitor FI clients' performance on the basis of their ESMS.<sup>64</sup>

IFC's legal agreement with CIFI required the preparation of an Annual Environmental Performance Report (AEPR) within 120 days of the end of each fiscal year. IFC's internal objective is to complete a review of the AEPR within 30 days of receipt of the report.

Upon completion of a supervision activity, IFC provides an E&S Risk Rating (ESRR) of the client's performance on a four-point scale: F1-Excellent, F2-Satisfactory, F3-Partly Unsatisfactory, and F4-Unsatisfactory. A rating of 3 or 4 indicates the client is not in compliance with IFC's E&S requirements. The table below presents a summary of IFC policy requirements and procedures for supervising an FI investment.<sup>65</sup>

Outside of this annual report, where the client becomes aware of an E&S incident which could have a material adverse impact on the operations of a project, the client is required to inform IFC.<sup>66</sup>

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<sup>64</sup> IFC Sustainability Policy (2006), para. 29.

<sup>65</sup> Table prepared on the basis of IFC Sustainability Policy (2006) and IFC ESRPs.

<sup>66</sup> ESRP (August 2009), 9.2.13 and IFC's legal agreement (see Annex B).

## IFC 2006 Sustainability Policy

## IFC Environmental and Social Review Procedures (ESRP)

### Purpose

IFC monitors an FI client's E&S performance to assure itself that there is sufficient evidence: (a) the client's ESMS is operating as envisaged at the time of appraisal; and (b) the client has applied the applicable performance requirements to their sub-projects (ESRP 2009, para. 9.2.6).

### 2006 Sustainability Policy requirements

→ IFC will monitor the FI's performance based on its ESMS (para. 29)  
→ If the client fails to comply with its E&S commitments, IFC works with the client to bring it back into compliance to the extent feasible, and if the client fails to reestablish compliance, exercise remedies when appropriate (para. 26)

### Requirements (ESRP, Aug 2009)<sup>67</sup>

→ Review conditions of disbursement (para. 9.2.2)  
→ When clearance for a disbursement is sought, information is obtained and reviewed as required to evidence that E&S conditions of disbursement have been met. Where a condition has not been met, an E&S waiver can be provided.  
→ Review the FI's annual E&S reporting (AEPR),<sup>68</sup> including:  
a. Client's performance against applicable requirements;  
b. Status of the client's ESMS Plan and timeline;  
c. Achievement reaching performance indicators  
d. Previous AEPRs and IFC E&S ratings  
e. Key gaps relating to the client's performance and ESMS;  
f. Key steps the client may need to take to improve performance; and  
g. Follow up with the client (para. 9.2.6).  
→ Based on AEPR review, generate an E&S Risk Rating (ESRR) (para. 9.2.6).  
→ If there are gaps in the client's performance or other issues of concern, the Portfolio Officer shall be alerted for timely follow up. The E&S specialist should provide timely and clear explanations to the client on the actions needed to address these performance gaps or other issues of concern (9.2.6).  
→ Where considered necessary to further review the client's performance and verify its compliance with the application requirements, communicate directly with FI client or carry out a field visit to the FI and/or a sub-project (para. 9.2.7).

## 2.2.2 IFC Supervision

### *Disbursements*

In June 2008, IFC legally committed to the investment in CIFI. In July 2008, prior to first disbursement, IFC received the client's 2007 AEPR as prepared by a third-party consultant.<sup>69</sup> The report concluded that the client generally complied with its ESMS, but that implementation could be improved. The report noted challenges faced by the client in applying the Equator Principles to: (a) existing projects under implementation; and (b) transactions where the client was not the arranger. Further, the AEPR noted that the client's ability to obtain sufficient E&S information was

<sup>67</sup> ESRP (version August 2009) have been the applicable procedures for supervising the project from August 2009 until July 2014. ESRP (version July 2007) was applicable at the time of IFC's first disbursement. There were no material changes between ESRP version 2007 and version August 2009 as related to disbursement. Available at <https://goo.gl/KSKv86> (2007) and <https://goo.gl/WSxL3p> (2009).

<sup>68</sup> The term AEPR is used more frequently day-to-day by IFC and its FI clients and is synonymous with Social and Environmental Performance Report (SEPR), the term used in IFC's ESRPs for the annual E&S Performance Report provided by an FI client.

<sup>69</sup> The client's AEPRs were prepared by a third-party firm until June 2016. They were prepared based on a review of the client's ESMS and project documentation for the fiscal year. Thereafter, the client has prepared its own AEPR. The client discloses a summary of its AEPR on its website. Available at <https://goo.gl/aPSSYb>.

limited in certain transactions (e.g. bond financing and corporate financing). The report, which IFC had received and thus was on notice of, recommended that the client: (a) systematically outsource E&S due diligence for higher risk sectors; (b) document E&S categorization and results of E&S due diligence; (c) amend its organizational structure to provide for independent internal E&S review of proposed investments; (d) hire a full-time E&S specialist; and (e) provide an E&S questionnaire to sub-clients earlier in the due diligence process.

IFC completed its first disbursement to the client on August 20, 2008, and completed its equity subscription on August 29, 2008. At this point, the client represented that there were no material E&S risks with respect to its operations other than those identified in its AEPR. IFC recorded that the client had met the one E&S condition of first disbursement (amending its ESMS procedures to incorporate IFC's comments). The condition was reviewed and cleared by IFC E&S staff. IFC made three further disbursements between September and December 2008.

In December 2009, IFC completed its first supervision review of the client's E&S performance, based on the client's 2008 AEPR.<sup>70</sup> The AEPR stated that the client's ESMS appeared to be fully integrated into the investment cycle and noted positive measures implemented by the client in its organizational structure to separate ESMS oversight from the investment department. At the same time, the 2008 AEPR report, prepared by the client's E&S consultant, documented similar gaps to the 2007 report. Relevantly, where the client had limited involvement in arranging project finance, the AEPR report noted that the client had limited ability to impose conditions, influence project management and access relevant E&S information, and thus, had difficulty in applying its ESMS. Separate from issues raised by the client's E&S consultant, IFC raised concern with the client's E&S risk categorization, noting instances where a project was provided a lower E&S risk category than expected by its stage of development and/or sector. IFC assigned an ESRR of F3-Partly Unsatisfactory.

In December 2009, IFC E&S staff requested that the client be advised to: (a) assess and supervise project compliance to IFC's PS and EHS Guidelines requirements; (b) obtain sufficient E&S information and assure itself that project mitigation measures were implemented; (c) hire a full-time E&S officer; (d) retain E&S due diligence and categorization documentation; (e) revise its E&S questionnaire provided to sub-clients; (f) outsource E&S due diligence (ESDD) of Category B projects in higher risk sectors; (g) update the ESMS procedure to reflect current organization structure; and (h) include additional E&S risk categorization guidance in its ESMS.

In February 2010, the client requested a subsequent loan disbursement. IFC's documentation reveals that prior to disbursement, IFC E&S staff noted that there had been no engagement with the client on the E&S issues identified in December 2009 and pending disbursements provided IFC with the best period of leverage to correct non-compliance. IFC's documentation indicates that three days later IFC processed the loan disbursement with a note that the E&S specialist had cleared the disbursement. IFC E&S staff next met the client in March 2010. At this point, IFC requested the client to: (a) revise its E&S questionnaire; (b) update its ESMS to reflect current organization structure; and (c) include additional E&S risk categorization guidance in its ESMS. These actions were requested by IFC as it determined that CIFI could complete them prior to final loan disbursement. IFC's documentation indicates that following the meeting IFC provided the client a list of third party consultants for it to consider in conducting client due diligence and supervision. IFC noted that it would follow up over time on other identified gaps.

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<sup>70</sup> IFC has consistently received the client's AEPR by July of the subsequent reporting year, which is over the 120 days stipulated in the legal agreement. For example, IFC received the 2008 AEPR in July 2009.



In April 2010, IFC staff briefly reviewed documentation in relation to five of the client's projects. IFC noted that the documentation was generally satisfactory, and in some instances, it went beyond what IFC normally expects to review from an FI.

After this review, IFC completed its final loan disbursement to the client. IFC's documentation recorded that E&S issues were discussed with the client and that actions taken by the client were satisfactory. However, evidence of resolution of key gaps identified in December 2009 is not retained in IFC's documentation. Particularly, the client had not hired a full time E&S officer as recommended by IFC, meaning that responsibility for oversight of the client's E&S review of projects remained in the hands of staff without specialist E&S expertise.

#### *IFC Supervision: 2010–2014*

The client's 2009 AEPR reaffirmed that CIFI's ESMS was integrated into the investment cycle with responsibilities for implementation separated from the investment department. As with earlier AEPRs, IFC was aware that the 2009 AEPR flagged challenges the client had in applying its E&S requirements to projects where it was not the arranger. IFC's AEPR review, completed in November 2010, noted that the client's E&S performance had improved significantly and upgraded its ESRR score to F2-Satisfactory. The 2009 AEPR review was brief and noted general improvements across relevant parameters. IFC noted that the client had addressed recommendations previously provided by IFC and the third-party consultant. However, IFC also noted gaps in sub-project-level information and compliance.

In April 2012, IFC completed its review of the client's 2010 AEPR. IFC recorded a decline in the client's performance and provided an ESRR score of F3-Partly Unsatisfactory. Positively, IFC noted that the client: (a) declined to proceed with some proposed projects due to E&S issues; (b) divested from one project due to E&S non-compliance; and (c) had applied its ESMS to each project. At the same time, IFC raised concerns that the client: (a) invested in a number of projects without requiring E&S reporting; (b) disbursed to several projects where the E&S assessment of the project was incomplete and/or E&S requirements had not been fulfilled prior to disbursement; (c) classified one project Category B, while IFC categorized it as Category A; and (d) had taken insufficient action in response to very significant E&S non-compliances with some of its projects. IFC also raised concerns regarding the recommendation made by the client's E&S consultant, that the client apply the PS to project finance transactions and high-risk projects, rather than across all investments. IFC noted that accepting this recommendation would violate IFC's legal agreement with the client. Subsequently, IFC followed up with the client in relation to 15 projects where E&S compliance concerns were noted.

In June 2012, IFC received notification from the client of a violent incident in relation to Canbalam I. The client advised IFC that on May 1, 2012, a protest in Barillas turned violent resulting in one community member being killed and two others injured. Following this incident, the client advised that protesters briefly took over a military outpost which resulted in the national government declaring a state of siege for 20 days. The client informed that it had suspended disbursements to HSC and had requested its consultant to prepare an updated E&S report on the project. See section 2.3 for further details of the project and specific issues raised by the complainants.

In March 2013, IFC completed its review of the client's 2011 AEPR. In its review, IFC noted a deterioration in the client's E&S performance and provided an ESRR score of F4-Unsatisfactory. IFC noted that feedback provided to the client following IFC's 2010 AEPR Review had not been implemented. IFC reviewed the adequacy of the client's reporting on each of its projects and noted the view of the client's third-party consultant that E&S performance was less than satisfactory in a majority of the client's projects.

IFC met with the client in May 2013 to discuss its E&S performance. Following this meeting, the client provided IFC with additional E&S documentation and ESDD documentation for one of its investments (not HSC). There is no record of IFC reviewing or providing feedback to the client on this investment. Concurrently, IFC management visited the client's office to discuss its E&S performance and noted that the client was receptive to improving its performance. Following these site visits, in July 2013 IFC upgraded its assessment of its client's E&S performance and provided an ESRR score of F3-Partly Unsatisfactory.

In January and September 2014, IFC completed reviews of the client's 2012 and 2013 AEPRs. In both instances, IFC provided an ESRR score of F3-Partly Unsatisfactory.

The 2013 AEPR reported E&S risk management improvements. Specifically, the client reported that it was applying IFC's 2012 Performance Standards to new investments. This represented an advance beyond its legal obligations to IFC which referenced the 2006 Performance Standards. The client noted that it had changed its business strategy to focus on direct project origination.<sup>71</sup> The client expected this change to increase its leverage to apply E&S requirements to investments. Further, the client reported that it had fully integrated its ESMS into its investment cycle and assigned an E&S manager and two E&S specialists to support implementation.

IFC's 2013 AEPR review recorded that the client had adequate capacity including qualified staff to implement the ESMS, as well as adequate E&S policies and procedures. However, IFC raised concern that nine client investments did not provide E&S reporting to the client and 25 investments had potentially significant E&S issues. While IFC's documentation records that IFC received one client-prepared ESDD, there is no evidence that IFC provided feedback to the client on the adequacy of the ESDD. IFC noted that the client should inform IFC regarding: (a) action taken to obtain missing E&S information; and (b) action taken to improve compliance.

#### *IFC Supervision: 2015–Present*

In April 2015, at the client's request, IFC formulated an E&S action plan to improve its performance. In November 2015, IFC and the client agreed an E&S action plan which provided for the client to a) update its Exclusion List; (b) clarify that a full ESDD would be prepared for all investments; (c) refrain from making investments in medium to high E&S risk projects that did not require full compliance with IFC's Performance Standards; (d) enhance E&S reporting to IFC; (e) consult with IFC where a client investment involves a high level of reputational risk; (f) use external consultants for all Category A ESDD; and (g) provide IFC with ESDD documentation of its next three investment for review and approval.

The client submitted two examples of ESDD documents it had prepared. IFC requested additional information on the status of action plans for these two projects. There is no evidence that IFC provided comments or recommendations to the client on its ESDDs.

In March 2016, IFC completed its review of the client's 2014 AEPR. The client reported that ESMS updates developed in 2013 were fully implemented in 2014. The client stated that it had: improved project documentation; increased the size of its E&S team; improved its project tracking and reporting procedures; incorporated more detailed covenants into its legal agreements; completed training on IFC Performance Standards; and contracted consultants to support project ESDD.<sup>72</sup>

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<sup>71</sup> CIFI 2013 Annual Environmental and Social Performance Report. Available at <https://goo.gl/nTKpkB>.

<sup>72</sup> CIFI 2014 Annual Environmental and Social Performance Report. Available at <https://goo.gl/UeYPmN>.

In its review of the client's 2014 AEPR and in interactions with the client regarding the E&S action plan (November 2015), IFC noted that the client's due diligence and its reporting to IFC provided evidence of improvement in management commitment, capacity, and communication, resulting in improved E&S risk management. In this context, IFC upgraded its ESRR to F2-Satisfactory.

IFC's review of the client's 2015 AEPR recorded a deterioration in the client's E&S performance. IFC raised concerns regarding two new investments the client had made. In one case, IFC noted that no ESDD was prepared, and in the other case, IFC noted the existence of serious E&S concerns. IFC also raised concerns with client E&S staff turnover and a deterioration in the client's E&S investment monitoring. IFC provided an ESRR score of F3-Partly Unsatisfactory.

IFC's review of the client's 2016 AEPR recorded limited improvement in the client's E&S performance in comparison to 2015. The 2016 AEPR was the first report prepared by the client itself, rather than a third-party consultant. IFC noted that the client: (a) took limited action to follow up on gaps IFC had previously noted; (b) made new short-term investments where the scope of E&S requirements to be applied was either unclear or insufficient; and (c) demonstrated limited improvement in E&S investment monitoring. IFC provided an ESRR score of F3-Partly Unsatisfactory.

### **2.2.3 Discussion and Findings**

Two key requirements for IFC during supervision of an FI investment are to ascertain whether: (a) there is sufficient evidence that the client is operating the ESMS as envisaged at the time of appraisal; and (b) there is sufficient evidence that the client has applied the applicable performance requirements to their investments.<sup>73</sup> Where the client is financing projects with significant E&S risks, the applicable performance requirements include IFC's Performance Standards. Where there are gaps in the client's ESMS implementation, IFC is required to work with the client to bring it back into compliance, and if the client fails to reestablish compliance, to exercise remedies when appropriate (Sustainability Policy, para. 26).

IFC's supervision framework for this investment included annual client reporting, the right to conduct site supervision visits to the client's premises, and client E&S incident reporting.<sup>74</sup> While not a requirement of IFC's investment, the client contracted an E&S consultant to review its ESMS implementation annually. The client submitted these third-party reports to IFC as its AEPRs.<sup>75</sup>

From August 2008 through April 2010, IFC made a series of disbursements to the client despite indications of non-compliance with IFC's E&S requirements. In July 2008, one month prior to first disbursement, IFC received the client's 2007 AEPR. The AEPR noted gaps in the client's ESMS implementation. As relevant to the client's role in reviewing and supervising a sub-project such as HSC, the 2007 AEPR noted gaps in the client's: (a) documentation of E&S risk categorization and results of due diligence; (b) organizational structure; and (c) staff capacity. There is no documented review of this information by IFC, and IFC did not take any action to address reported gaps in the client's ESMS implementation prior to completing its first disbursement in August 2008, a key point of leverage as noted by IFC E&S staff at the time. IFC completed two further disbursements to the client in September and December 2008. No E&S issues were noted by IFC

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<sup>73</sup> IFC ESRP (August 2009), para. 9.2.6.

<sup>74</sup> IFC did not reserve the right to conduct a site visit to the client's project sites. While not a compliance requirement, CAO notes that IFC included the right to conduct sub-project visits in other FI investments made at the time.

<sup>75</sup> This approach ordinarily would provide an additional independent assessment of the client's performance, separate to IFC's review. In this instance, however, the consultant tasked with reviewing the client's ESMS also conducted multiple ESDD reviews of the client's sub-projects generating a potential conflict of interest.

prior to completing these disbursements. It was not until December 2009 that IFC's supervision identified gaps in the client's ESMS implementation as reported in the client's 2007 and 2008 AEPRs. While these gaps were known internally to IFC, they were not raised with the client until after a subsequent disbursement in March 2010. IFC discussed the ESMS gaps with the client and briefly reviewed a client documentation in relation to five projects prior to IFC's final disbursement in April 2010. In clearing this final disbursement, IFC noted actions taken by the client to address identified gaps in its ESMS. However, a number of the issues raised in the client's 2008 AEPR report were noted again in subsequent client reporting, indicating that they may not, in fact, have been addressed at the time of final disbursement. Therefore, over the period in which its investment was disbursed, **CAO finds that IFC did not meet the requirements of the Sustainability Policy (para. 26) for project supervision, particularly requirements to identify and correct non-compliance with IFC's E&S requirements.**

Until recently, IFC's approach to supervising its client E&S performance has been to note gaps identified by the client's E&S consultant and to seek assurance that these would be addressed. Specifically, IFC has recorded concerns regarding client: (a) ability to access sufficient E&S information and apply the Performance Standards to certain investment types (e.g. secondary market transactions and bond transactions); (b) investments with insufficient assessment or application of mitigation measures; (c) staff organization and capacity; and (d) approach to E&S investment monitoring. There is limited evidence, however, that IFC sought to work with its client to address these issues. While IFC provided feedback to the client on its AEPR and met on several occasions to discuss its E&S performance, these interactions did not result in the development of an agreed corrective action plan. While a corrective action plan was agreed in late 2015, IFC has not assured itself that this was fully implemented and subsequent supervision has confirmed that the client's ESMS remains less than satisfactory.

***Nine years after making its investment, IFC has yet to assure itself that the client is "operating the ESMS as envisaged at the time of appraisal" or that its client has "applied the applicable performance requirements to their sub-projects" (ESRP 9.2.6). Further, CAO finds that IFC has taken insufficient action in a timely manner to support its client in establishing compliance with IFC's requirements (Sustainability Policy, para. 26).***

## 2.3 Adequacy of IFC's Response and Support to the Client in Relation to Canbalam I

This section presents a summary of IFC's supervision of its investment in CIFI with a focus on the issues at the Hidro Santa Cruz project site. It outlines key project events and IFC's response to the conflict around the project before reaching findings as to whether IFC discharged its supervision duty in relation to the issues raised by the complainants.

Issues raised by the complainants can be grouped as follows: (a) consultation and disclosure; (b) approach to security; (c) transparency in land acquisition; and (d) cumulative impact. A summary of these issues and relevant IFC Performance Standards requirements is presented in Annex C.

### Summary of Findings

CAO finds that IFC did not take measures provided for in the ESRP to ensure that the client was properly applying the Performance Standards to the project, following the violent incidents of May 2012.

IFC did not monitor client activity to ensure that the action plan between the client and HSC was fully responsive to remedial needs, committed to by management, and fully funded. Though aware of project impacts during the period of financing, IFC did not engage with its client to ensure that residual impacts of the project were assessed, reduced, mitigated, or compensated for, as appropriate, including at project closure, as required by the Performance Standards and the Sustainability Policy. In these circumstances, contrary to the intent of IFC's Sustainability Policy, documented adverse impacts have been left to fall on the community.

At a systemic level, IFC's policies and procedures do not provide an adequate level of protection in response to serious E&S incidents at the project level in FI investments.

### 2.3.1 Supervision Requirements

As part of its investment in the project, the client required the project developer to implement the IFC Performance Standards. As noted in section 1.7 above, the client's role was to assess and supervise the project to ensure it operated in accordance with the Performance Standards. This included a client requirement to ensure there was an adequate assessment of risks and impacts for key stages of the project cycle, including preconstruction, construction, operations, and decommissioning or closure.<sup>76</sup> IFC's role was to supervise its client to ensure that: (a) its ESMS was operating as envisaged at the time of IFC appraisal; and (b) it applied IFC's E&S requirements to their projects.

IFC was not required to review or supervise individual client investments in the normal course of business. However, when notified of a serious incident, including incidents involving fatalities, IFC procedures required a response. This included requirements to: (a) request that the client provide detailed information on the incident; (b) request that the client investigate the root causes of the incident; and (c) prepare a contractually binding ESAP designed to prevent reoccurrence.<sup>77</sup> In

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<sup>76</sup> IFC PS1, para.6.

<sup>77</sup> IFC ESRP 5.2.2 (version July 2010).

such circumstances, IFC is expected to monitor the client to ensure that the root cause analysis and remedial measures proposed by the client are adequate and that the response is fully funded.<sup>78</sup> IFC is also expected to schedule a site supervision visit to facilitate collection and analysis of information in response to serious incidents where further information is required. More generally, the ESRPs provide for IFC to carry out site supervision visits to verify an FI client's compliance with IFC E&S requirements, where issues regarding the client's E&S performance are identified.<sup>79</sup>

IFC's legal agreement with the client reflected these requirements, providing for the client to inform IFC within three days of the client becoming aware of any E&S incident or accident at the project level which could reasonably be expected to have an adverse impact on the implementation of IFC's Performance Standards. Specifically, the client was required to provide IFC with a summary of the incident and measures taken or planned to address the incident and prevent future similar incidents. The client was also required to keep IFC informed of ongoing implementation of such measures, and provide IFC with access to its premises, staff, and records upon request.

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<sup>78</sup> Ibid.

<sup>79</sup> IFC ESRP 9.2.7.

## 2.3.2 Project Timeline

Date	Project-related events
<b>2007</b>	
June	Community referendum votes 46,481 to 9 against mining and to defend natural resources.
<b>2009</b>	
Feb.	Confrontation between HSC and community members mediated by Asamblea Departamental de Huehuetenango. Subsequently, HSC filed a lawsuit against 7 community leaders.
July	Communities protest against Canbalam hydro project
<b>2010</b>	
Jan.	Stakeholder meetings held in Barillas as part of UN Clean Development Mechanism (UN CDM) process
May	Government approves Initial Environmental Assessment (IEA) and grants environmental license for Canbalam I
June	Communities present complaint against the project to Guatemalan Human Rights Ombudsman citing land invasions. HSC hires CIFI as financial advisor for Canbalam hydro project.
Sept.	Government grants environmental license for transmission line and substation for Canbalam I
Nov.	CIFI consultant completes ESDD of project
<b>2011</b>	
Apr.	Municipal Council denies license for construction of Canbalam I by HSC
July	Demonstration in Barillas against exploitation of natural resources, 4th anniversary of 2007 community referendum
Oct.	Cooperation Agreement between Municipality and HSC made public but unclear if signed
Oct-Nov	Series of protests reported against the project
Dec.	CIFI invests in HSC (Canbalam I)
<b>2012</b>	
Mar-Apr	Consultant report concludes that the project is in general alignment with applicable E&S standards. HSC workers and police officers detained by communities, machinery burned. Government registers Canbalam II, a 4-12MW hydro power plant to be developed by HSC.
May	Following the killing of Andrés Pedro Miguel on May 1, some community members held a violent protest against the project which resulted in the national government declaring a state of siege. 19 community members are detained.
June	IFC receives notification from CIFI regarding May incident and consequent suspension of disbursement
July	CIFI provides IFC with a summary of May incidents as part of its AEPR 2011. 400 community members participate in <i>mesa de trabajo</i> .
Aug-Sept	Multi-stakeholder meetings including community representatives and HSC
Oct.	CIFI receives Social Risk Monitoring Report for Canbalam I project prepared by consultant; report concludes that the project is at risk of non-compliance of PS1, PS4, and PS7. CIFI sends letter to HSC with conditions for further disbursements based on Social Risk Monitoring Report findings. Canbalam I registered as UN CDM project.
Nov.	Several community leaders released
Dec.	A proposed agreement between the Municipality and HSC is not finalized due to community opposition
<b>2013</b>	
Jan-May	9 community leaders released; 30 community representatives requested government suspend the project
Feb.	Act signed between community members and municipal council requesting suspension of HSC. Protest at Barillas municipal palace against HSC. HSC facility damaged
Mar.	IFC advises CIFI to use a different consultant to prepare updated Social Monitoring Report
April	Protest near HSC site including road blockage
Sept.	HSC equipment and police substation burned, police respond by using tear gas. Barillas community leaders arrested. Military soldier shot and killed; leads to increased presence of police and military
Oct.	Guatemalan Human Rights Ombudsman meets with community leaders and local authorities regarding incidents
Nov.	7 electricity company workers detained by community members for presumed HSC connection but released
<b>2014</b>	
Sept.	Canbalam II canceled by government
<b>2015</b>	
Feb-June	4 Barillas community leaders detained
April	IFC received 2012 Social Monitoring Report from CIFI
July	CAO receives complaint from community representatives
Nov.	CIFI and Norfund end credit relationship with HSC
<b>2016</b>	
Jan-July	7 Barillas leaders released from prison
Dec.	HSC announces cancellation of project
<b>2017</b>	
Mar.	Canbalam I canceled with MEM

### 2.3.3 Overview of Client Engagement in the Project: Review and Supervision

#### *Client Review of Canbalam I (2010–2012)*

HSC commenced project assessment in 2008. A series of community and stakeholder consultations were conducted between January and October 2010. Between April and August 2010, the project received national regulatory approval from the ministries of environment and energy.<sup>80</sup>

In June 2010, HSC hired the client to structure and finance the development of the project.<sup>81</sup> In August 2010, a summary of the project's E&S assessment, as prepared by HSC, was published on the United Nations Clean Development Mechanism website.<sup>82,83</sup> The summary notes that HSC had submitted an Environmental Impact Evaluation to the Guatemalan Department of Environment and Natural Resources. This type of evaluation is more general than an Environmental Impact Assessment.<sup>84</sup> Based on the Environmental Impact Evaluation, HSC asserted that there were no communities inhabiting the project site that could be negatively affected by the project. HSC stated that the river had been used by local inhabitants to dispose of rubbish and sewage, and as a result, it was not used for fishing, water consumption, or irrigation. HSC asserted that the project would have benefits to the local community. Specifically, HSC affirmed that the project would create infrastructure, provide employment opportunities, encourage the development of other projects, reduce greenhouse gas emissions, and improve water quality. HSC noted that possible negative impacts from the project included water and air pollution during construction, prevention of some migration of minor wildlife species and loss of landscape aesthetic value. However, impacts were considered to be of low magnitude and not significant. HSC noted that it held a consultation meeting with local stakeholders in January 2010 where the project was explained. HSC asserted that all present supported the project.<sup>85</sup>

As subsequently reported by the client to IFC, in November 2010, an E&S consultancy firm hired by the client ("the client's E&S consultant") prepared an E&S due diligence (ESDD) report for the project ("the client's ESDD"). The ESDD report was based on a review of project documentation, a site visit, and meetings with stakeholders in the project area. The project was classified as Category B. The report noted that the construction phase was scheduled to start in January 2011 with operation commencing in the second quarter of 2011. The consultant concluded that the project was in general alignment with relevant IFC Performance Standards but identified gaps in project documentation and internal planning. These, however, were considered unlikely to cause material issues during implementation.

Regarding the project social baseline analysis, the consultant noted that an inadequate consideration of community demography, economy, livelihoods and governance structures. This baseline information was considered important by the consultant to analyze Indigenous People

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<sup>80</sup> UN CDM Project Validation Report: Canbalam I, available at <https://goo.gl/zzepYB>.

<sup>81</sup> CIFI news announcement, June 2010. Available at <http://goo.gl/nUQKHv> and <http://goo.gl/bgFhfd>.

<sup>82</sup> Further information on the UN CDM is available at <https://goo.gl/HmO4es>.

<sup>83</sup> UN CDM Project Design Document: Canbalam I, version 1 (June 11, 2010), available at <https://goo.gl/u6iwYN>.

<sup>84</sup> As outlined in MARN's Environmental Evaluation, Control, and Monitoring Regulation (Acuerdo gubernativo número 431-2007, available at <https://goo.gl/q1mBT2>), Category B and C projects are required to submit an Initial Environmental Evaluation (Evaluación ambiental inicial), while Category A projects require an Environmental Impact Evaluation Study (Estudio de evaluación del impacto ambiental), which consists of an in-depth analysis of potential environmental risks and impacts, as well as prevention and mitigation recommendations.

<sup>85</sup> UN CDM PDD: Canbalam I, version 1 (June 11, 2010), available at <https://goo.gl/u6iwYN>.



issues. Further, the consultant noted project documentation needed to fully describe any potential socio-economic impacts, including community health and safety impacts.

The client's E&S consultant made a series of recommendations in order that the project fully comply with the Performance Standards. As reported to IFC, HSC agreed to address the consultant's recommendations to: (a) prepare an expanded socio-economic baseline and impact assessment to better understand potential impacts on project-affected people, including Indigenous Peoples; (b) develop further explanation of the ecological flow; (c) prepare a final land acquisition evaluation and report; (d) develop an Action Plan and ESMS; and (e) prepare an Integrated Community Relations Plan and Communication/Grievance Procedure. While the client's E&S consultant reported that required actions were completed by HSC prior to financial close in December 2011, no review of these actions was documented.

In October 2011, local media reported that some COCODE<sup>86</sup> representatives had complained to the municipal mayor citing intimidation after HSC deployed armed security to the project area. In November 2011, it was reported that there was a demonstration against the project.<sup>87</sup>

In December 2011, the client and Norfund (collectively "the Lenders") agreed to provide HSC a loan facility of up to US\$10.6 million to develop the project and completed a first disbursement for US\$3.5 million.<sup>88</sup> As a condition of investment, HSC agreed to operate the project in accordance with IFC's Performance Standards. In January 2012, project construction commenced.

In February 2012, the client's E&S consultant conducted a monitoring visit to the project site. The consultant concluded that the project was in general alignment with the applicable E&S requirements, but recommended improvements in the project's social management strategy, communication with Indigenous Peoples, and community relations staff capacity.

Between March and April 2012, additional acts of opposition to the project were reported. In particular, on March 9, 2012, it was reported that community members opposing the project obstructed the road to the project site, detained 25 project employees and 3 police officers, and damaged project machinery.<sup>89</sup> Project construction ceased in late March 2012. In April 2012, an explosion was reportedly heard and there were allegations of a land mine having been placed on

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<sup>86</sup> The *Órganos de Coordinación de los Consejos Comunitarios de Desarrollo Urbano y Rural* (Coordinating Body of the Urban and Rural Community Development Council, or COCODE) are chaired by the Community Mayor and consist of up to 12 representatives elected by the General Assembly, that is, the community residents. Their function is to coordinate and oversee community development projects and programs as well as to ensure good use of resources for the projects and programs; *Consejo de Ancianos* (Council of Maya Elders) are selected through differing methods by communities and provide spiritual guidance, mediation, and advice on community issues. For further details, see "Consejos comunitarios, sistemas de consejos de desarrollo, Secretaría de Planificación y Programación de la Presidencia, Guatemala," available at: <https://goo.gl/EcA5Yf>.

<sup>87</sup> "Líderes comunitarios hacen denuncia pública por la construcción de hidroeléctrica," Oct. 3, 2011, available at: <https://goo.gl/RKFz9e>; "Manifestantes destruyen parcialmente las instalaciones de Hidro Santa Cruz," Nov. 18, 2011, available at: <https://goo.gl/FzAma6>; and "Vecinos de Huehue protestan contra minería e hidroeléctricas," Nov. 16, 2011, available at: <https://goo.gl/jxvKQI>.

<sup>88</sup> CAO Assessment Report, p.12.

<sup>89</sup> "Vecinos retienen a 28 personas y maquinaria para hidroeléctrica," March 9, 2012, available at: <https://goo.gl/989eNT>.

the project property, leading to a demonstration of 4000 community members against the project.<sup>90</sup>

In April 2012, HSC registered a second hydroelectric power plant (Canbalam II) with the Ministry of Energy and Mines (MEM). The site for Canbalam II was downstream of Canbalam I.<sup>91</sup> The proposed size of Canbalam II has varied between 4.99 MW and 12 MW.<sup>92</sup>

### *May 2012 Incidents*

On May 1, 2012, an annual day of festivities for the patron saint of Barillas, a series of incidents took place culminating in the President of Guatemala declaring a state of siege (*estado de sitio*) in the area. As reported by the Office of the United Nations High Commissioner for Human Rights in 2013:

[Declaration of a state of siege] followed the 1 May killing of peasant Andrés Pedro Miguel, allegedly by a private security guard. In response, some members of the community damaged a hotel and other buildings, allegedly detained a judicial official and forcibly entered the military barracks. The decree establishing the state of siege lacked a clear justification and analysis of necessity, exceptionality and proportionality. The Government withdrew the measure after 18 days.

On 2 May, during the state of siege, nine arbitrary and/or illegal detentions were carried out without a court order by private individuals who claimed to be victims of the events the day before. Those detained were accused of participating in the disturbances. They were not able to present their initial statement before a competent judge until over two weeks after their detention. Eight were indicted on 19 September and remain in detention, while one was released.<sup>93,94</sup>

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<sup>90</sup> Denuncia 370-2012, dated April 16, 2012, presented by the Municipal Mayor of Santa Cruz Barillas before the Juez de Paz of Barillas. "Estado de sitio, Santa Cruz Barillas, informe de verificación," June 2012, Convergencia por los Derechos Humanos.

<sup>91</sup> Guatemala Ministry of Energy and Mines, List of registered hydroelectric projects. Available at <https://goo.gl/f2Z1Qz>. In March 2013, the National Electric Energy Commission (CNEE) approved the electrical studies for Canbalam II. The registration was cancelled in September 2014. For further details, see <https://goo.gl/sEsiS2> and <https://goo.gl/pQ6u5J>.

<sup>92</sup> MEM documentations (dated between April–December 2012) noted Canbalam II to be 4.99 MW (<https://goo.gl/pQ6u5J>; <https://goo.gl/dRdoqm>), while CNEE documentation described Canbalam II as 12 MW (CNEE-54-2013, March 2013). AyD Consultores' Environmental Impact Evaluation Study in 2013 for Canbalam II noted its size to be 10.9 MW (<https://goo.gl/Kn79Lx>).

<sup>93</sup> The UN High Commissioner for Human Rights reports nine illegal detentions (criminal case MP-92-2012) (2013 Annual Report Addendum, available at <https://goo.gl/4YU3Tn>). Five were detained without arrest warrants and three were detained for the burning of company machinery (criminal case MP-65-2012) (Guatemala: Derechos humanos e hidroeléctricas, 2017, presented to CIDH by a group of local, national, and international NGOs, available at <https://goo.gl/fEPWky>).

<sup>94</sup> The declaration of a state of siege brought a significant presence of military and national police in Barillas; reports range in figures from 500 to 900 combined deployment of police and military. During the 18 days that the state of siege was in effect, it was reported that the military and police carried out numerous house searches and raids, at times with no warrants, questioning the residents including children, which were accompanied by the use of excessive force, material confiscation, threats, and insults. See Guatemala: Derechos humanos e hidroeléctricas (2017), and Hegoa Instituto de Estudios sobre Desarrollo y Cooperación Internacional & Universidad del País Vasco (2012) La presencia de Hidro Santa Cruz en Barillas: Una historia de imposición y violencia; available at: <https://goo.gl/7qKji0>.

Two individuals were arrested in May 2012 in relation to the killing of Andrés Pedro Miguel and the attack on two other community members. Local media reports that one of the accused was named in government documentation as HSC's head of security while the other was a sub-contractor to the project.<sup>95</sup> The project developer confirmed that one individual arrested had worked for the security company that controlled and protected access to the project site, while denying any involvement in the attack.<sup>96</sup> It was reported that the accused were acquitted of murder in September 2013, however the accused who worked as part of the company's security team was convicted of causing serious injury.<sup>97</sup> Following a successful appeal of the murder acquittals in February 2014, it was reported in January 2017 that the trial was due to restart.<sup>98</sup> The complainants have noted to CAO that the trial is currently on hold and awaiting a date to recommence. CAO is unclear as to the current state of these judicial proceedings.

On May 10, 2012, the lenders suspended disbursements to the project.

The client notified IFC of these incidents in June 2012. At this point, the client provided IFC a summary of: (a) the project; (b) the E&S due diligence as prepared by its E&S consultant; (c) the project's ESAP; and (d) the May 2012 incidents. The client notified IFC that it had informed HSC of its decision to suspend further disbursements due to the volatile situation. The client also informed IFC that it would require the consultant to update its E&S assessment of the project before it could continue to fund the project. Notwithstanding this advice, HSC informed the client of its intention to restart construction activities in June 2012.

### *Social Monitoring Report*

In October 2012, the client received a Social Monitoring Report from its E&S consultant. The report noted that, since February 2012, the social context in Barillas and the public perception of the project had deteriorated. Further, it noted that misconceptions among local communities regarding the project combined with insufficient and inadequate communication between HSC, local communities, and other stakeholders had led to growing opposition to the project. The report stated that these issues were compounded by regional and national political issues such as indigenous rights, the use of military in response to project-level incidents, and the role of international private investment in rural indigenous areas of Guatemala. The report concluded that the development of the project had generated significant negative impacts in the social context of the project area.

The Social Monitoring Report assessed a series of allegations related to the project. These included: (a) not ensuring FPIC of affected communities; (b) not respecting the results of

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<sup>95</sup> Plaza Publica, September 18, 2013, *Acoso y derribo a la justicia en Guatemala*. Available at <https://goo.gl/CqkXKa>  
El Periódico. May 31, 2012. Sección: Nación. p.8. <https://goo.gl/QHyt7c>.

<sup>96</sup> CAO Assessment Report.

<sup>97</sup> Santa Cruz Barillas, September 11, 2013, Tribunal condena a un implicado en muerte de campesino en Barillas. Available at <https://goo.gl/z6CJW8>.

Plaza Publica, September 13, 2013, *La muerte inconclusa de Andres Pedro Miguel*. Available at <https://goo.gl/cYYZEQ>.

<sup>98</sup> "Van a juicio de nuevo dos encargados de la seguridad de hidroeléctrica española." Jan. 22, 2017. Available at <https://goo.gl/jaKfa6>.

Campana por la libertad de los presos politicos de Huehuetenango, Guatemala, p.11. Available at <https://goo.gl/PZr1bq>.

community consultations; (c) not implementing ILO 169;<sup>99</sup> (d) inadequate land acquisition process; (e) use of customary and/or sacred land by the project; (f) improper use of public and private security forces; (g) alleged involvement of former security staff in violent crime; and (h) relationships between HSC staff, representatives of the Ministerio Público (public prosecutor's office of Guatemala) and suspects involved in the May 2012 incident. The client's E&S consultant concluded that allegations related to customary land use and the land acquisition process were not substantiated by available evidence. The consultant concluded that the remaining allegations were substantiated or partially substantiated by available evidence.

While the Social Monitoring Report did not focus on determining compliance with IFC's Performance Standards, the findings of the report indicated that the project was at risk of non-compliance with PS1, PS4, and PS7 requirements. Specifically, the report raised concerns that:

- Community consultation and the then proposed benefits agreement may not be free of manipulation and parties may not be fully informed (PS1);
- Project consultation was not consistently conducted in Indigenous Peoples' language (PS1 and PS7);
- Project-level grievance mechanism was significantly constrained (PS1 and PS7); and
- Actions related to public security on May 1, 2012, and subsequent community detentions were being investigated for their legality and potential human rights infringements, and that HSC staff and assets may be implicated in these activities (PS4).

The report recommended that the lenders postpone further investment in the project and that HSC refrain from further development of the project until there was clarification and/or conclusion of pending legal cases related to the incidents of March 9 and May 1, 2012. The report also recommended that the lenders: (a) require HSC to plan for and demonstrate positive, ongoing communication with local communities; (b) wait for verification on renewal of broad community support; and (c) establish a benefit sharing agreement between the project and the Municipality of Santa Cruz Barillas. The report further recommended that a proposed Collaboration and Cooperation Agreement between HSC and the Municipality not proceed as it: (a) attached direct financial benefits to the Municipality for the provision of permits for the transmission line; (b) obligated the Municipality to restrict/constrain any and all protests against the project; and (c) would likely be heavily criticized if it were made public.

The lenders advised HSC that disbursements would continue to be suspended until the consultant's recommendations were implemented.

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<sup>99</sup> International Labour Organization (ILO) convention 169 sets out a series of rights for Indigenous Peoples. The convention is implemented by the national government, and relevantly, it provides Indigenous Peoples "the right to decide their own priorities for the process of development as it affects their lives, beliefs, institutions and spiritual well-being and the lands they occupy or otherwise use, and to exercise control, to the extent possible, over their own economic, social and cultural development.... Governments shall ensure that, whenever appropriate, studies are carried out, in co-operation with the peoples concerned, to assess the social, spiritual, cultural and environmental impact on them of planned development activities.... Governments shall take measures, in co-operation with the peoples concerned, to protect and preserve the environment of the territories they inhabit" (Article 7). Guatemala ratified the convention in 1996.

### *Proposed Cooperation Agreement*

In December 2012, the municipality of Santa Cruz Barillas and HSC reached a cooperation agreement. The agreement provided for an annual payment by HSC to the municipality of 1.5 million Guatemalan quetzals with an additional 2 million quetzals payable upon conclusion of the construction of Canbalam I and starting of work on Canbalam II. The economic contribution was to be used for community development projects, which would be identified and prioritized by members of the COCODEs.<sup>100</sup>

As reported, during the signing ceremony, more than 400 community members surrounded the community hall where 80 national police and 35 soldiers were present. Opponents of the project interrupted the ceremony which led to altercations with people who supported the project. The ceremony was suspended without the agreement being signed.<sup>101</sup>

### *Summary of Investment and Project-Related Events (2013–2017)*

Multiple forums of dialogue between the national government, local government, community representatives, and HSC developers were convened in attempts to resolve the conflict. These efforts, however, did not lead to agreement. During this period, there were reports of further community protests against the project. As reported, in 2013, protests included the following:

- February: HSC site damaged<sup>102</sup>
- April: Road blocked near HSC site<sup>103</sup>
- September: HSC equipment and police substation damaged. Police respond with tear gas. One soldier killed. Increased presence of police and military in the area.<sup>104</sup>

As explained by the client, despite multiple efforts by the lenders to solve problems, a satisfactory resolution was never reached. Accordingly, the lenders terminated their relationship with HSC in November 2015.

In December 2016, HSC announced that it was abandoning the project. The project's license was cancelled by the government in March 2017.

### **2.3.4 IFC Engagement with the Client in Relation to HSC**

#### *Notification of the May 2012 incidents*

The client's first communication with IFC in relation to E&S aspects of the project was a June 2012 letter notifying IFC of the social unrest surrounding the project. In this letter, the client provided a summary of the project and the due diligence prepared by its E&S consultant.

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<sup>100</sup> Document by the Municipal Council presented in response to the protest that stopped the signing of the agreement, dated Dec. 16, 2012. Available at <https://goo.gl/XSLJ5H>.

<sup>101</sup> "Pobladores impiden firma de acuerdo entre municipalidad e hidroeléctrica," Dec. 14, 2012, available at <https://goo.gl/mTcafx>.

<sup>102</sup> Santa Cruz Barillas, Feb. 18, 2013, *Desconocidos disparan y causan daños en hidroeléctrica*, available at <https://goo.gl/Lc4Hwt>.

<sup>103</sup> Santa Cruz Barillas, April 9, 2013, *Continúa la manifestación pacífica en Poza Verde*, available at <https://goo.gl/LMk6Se>.

<sup>104</sup> For further details in relation to these incidents, see reports at GuatePrensa (<https://goo.gl/8nvnJg> and <https://goo.gl/4gS1n1>) and Santa Cruz Barillas (<https://goo.gl/4fzYrM> and <https://goo.gl/iCHMYX>).

The letter referred to escalating acts of vandalism and protests against the project starting in November 2011. The letter summarized the May 1 incident and affirmed that no HSC employees were involved in the violence. Further, the letter noted that HSC had stopped construction of the project, removed personnel from the site, and reinitiated consultation with surrounding communities. The letter also noted that the Lenders had suspended further disbursements to the project pending a resolution of the issues with the communities. Finally, it noted that the Lenders had requested their E&S consultant to update its E&S due diligence on the project prior to any decision on further funding. There is no record of IFC following up with the client in relation to the incident report.

As advised by IFC staff, the Lenders' October 2012 Social Monitoring Report (discussed in section 2.3.3 above) was shared with IFC in April 2015.

### *Annual Monitoring Reports*

In July 2012, IFC received further information about the project in the form of the client's AEPR for 2011. The 2011 AEPR (prepared by the client's E&S consultant) outlines the results of the E&S review of the project (also prepared by the client's E&S consultant) describing it as "complete and thorough." It describes identified gaps in the project E&S assessment which HSC agreed to address. The 2011 AEPR also provides an overview of the conflict surrounding the project noting that it was "unforeseen" and that it could not have been captured during due diligence.

The client's AEPRs for 2012, 2013, and 2014 provide updates on the project describing attempts by HSC to seek a resolution to the conflict. They note that construction of the project had not recommenced and that disbursements remained suspended. The client's AEPR for 2015 notes that the project was closed with HSC having prepaid its loans to CIFI.

IFC's only recorded engagement with CIFI in relation to the issues at HSC was in March 2013. At this point, in the course of providing feedback on the client's 2011 AEPR, IFC raised concerns regarding quality of the E&S review of the project as conducted by the client's E&S consultant. In response, the client informed IFC that it had already evaluated the use of its E&S consultant and had decided to continue to work with them as the project's social distress was unforeseen at the time the consultant conducted its E&S due diligence.

### **2.3.5 Discussion and Findings**

The Sustainability Framework envisages that projects such as HSC will comply with the Performance Standards, when funded by an IFC FI client. In such cases, IFC's duty is to ensure that the FI is operating an ESMS at the required level and applying the Performance Standards to its investments. As set out in sections 2.1 and 2.2 above, CAO finds that IFC's review and supervision of its investment in CIFI were not sufficient to provide assurance that CIFI was consistently applying the Performance Standards to its investments.

IFC did not have a role in CIFI's E&S review and commitment to the Hidro Santa Cruz project in 2010–2011. However, at the time, IFC was aware of weaknesses in CIFI's ESMS implementation capacity, in particular: (a) its lack of a full-time E&S officer; (b) its limited capacity to oversee E&S due diligence of higher risk projects; and (c) its limited capacity to assure itself that agreed E&S risk mitigation measures were being implemented.

In this context, evident gaps in the client's ESDD for the Hidro Santa Cruz project were overlooked. While the client's ESDD report found that the project was in general alignment with the Performance Standards it also noted the absence of an adequate social impact assessment or socio-economic baseline study. This type of information is required in order to assess the

impact of a greenfield hydropower project such as Hidro Santa Cruz in accordance with the Performance Standards. Absent this information, it is not possible to determine the project's compliance with the Performance Standards requirements regarding consultation (under PS1 and PS7) or assessment of impacts on Indigenous Peoples and need for FPIC (under PS7). Further, neither project documentation or the client's ESDD addressed the project's approach to security (as required by PS4). Similarly absent was analysis of the project developer's organizational capacity (as required by PS1), an important factor given that this was HSC's first project and its owners' first project in Guatemala. While the project was a smaller one in terms of size, the above issues were of particular importance given that the project was being developed in a post-conflict indigenous community with a history of opposition to outside projects that predated CIFI's involvement. Relevantly, the project developer subsequently acknowledged that project had not initially understood properly how things functioned in the area.<sup>105</sup>

Once the client informed IFC in June 2012 of the violent incidents of May 2012, IFC had a duty to respond (as per ESRP 5). As outlined above, this included requirements to ensure that an analysis of the root causes of the incident had been conducted. In addition to its general supervision requirements, IFC also had a duty to ensure that appropriate plans were in place to prevent reoccurrence. This is important in this instance as the client's October 2012 Social Monitoring Report concluded that the project had generated significant negative impact in the social context of the project area and was potentially non-compliant with Performance Standards requirements for consultation (under PS1 and PS7), application of FPIC (under PS7), and use of security forces (under PS4).

IFC's only documented engagement with the client regarding the May 2012 incidents was in March 2013 when IFC advised the client to engage a different E&S consultant (not the one that had conducted the initial ESDD) to review the project. At this point IFC was not aware that the client's original E&S consultant had already completed the Social Monitoring Report. Accordingly, **CAO finds that IFC did not take measures provided for in the ESRP to ensure that the client was properly applying the Performance Standards to the project, following the violent incidents of May 2012.**

CAO makes this finding considering that IFC did not take measures provided for in its procedures to ensure the client was properly applying the Performance Standards including: (a) schedule a site visit to the client, in a timely manner, or the project site to further analyze the situation (ESRP 5.2.2/9.2.7); (b) document a review of the client-commissioned Social Monitoring Report, and thereafter provide feedback to the client to support compliance (ESRP 5.2.2); (c) conduct a review of the client's ESMS implementation in relation to the project to identify potential gaps (ESRP 9.2.6); (d) ensure that the client had in place a binding remedial action plan to address any identified gaps in Performance Standards implementation (ESRP 5.2.2); or (e) ensure it remained informed of ongoing implementation of remedial actions as provided for in its legal agreement (see Annex B).

Although not shared with IFC until April 2015, the client's October 2012 Social Monitoring Report represented an appropriate initial assessment in response to the conflict around the project. The client's decision to suspend disbursements to the project pending resolution of the conflict was similarly appropriate. However, IFC's lack of engagement with the client in relation to the conflict around the project meant that apparent gaps in the client's response were not addressed. Relevant to the issues raised by the complainants, these included requirements to:

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<sup>105</sup> Alianza Solidaridad 2015, *La lucha por la dignidad del pueblo indígena de Santa Cruz de Barillas*, available on YouTube at <https://goo.gl/6Zb6Ep>.

- Assess and mitigate risk associated with reliance on security forces, both private and public moving forward (PS4, paras. 13-14);
- Investigate credible allegations against security personnel (including clarification of the relationship between HSC and the individuals charged with the murder of Andrés Pedro Miguel) (PS4, para. 15); and
- Ensure that any re-commencement of construction was preceded by expert assessment of project impacts on land and natural resources including cultural resources of Indigenous Peoples (PS1, para. 7; PS7, para. 11).

***Accordingly, CAO finds that IFC did not monitor client activity to ensure that the action plan between the client and HSC was fully responsive to remedial needs (ESRP 5.2.2). Nor did IFC take measures needed to ensure that the client's response reflected Performance Standards requirements to address project impacts throughout the project cycle including at project closure (PS1 para. 6).***

The complainants maintain that the project has resulted in adverse social impacts on their communities. In particular, they claim that the project led to the escalation of project related conflict, resulted in the death of one community member, left two community members seriously injured, and led to the detainment of seventeen other community members. They assert that traditional access to land and natural resources remains limited due to the construction of a perimeter fence around the project site.

While the project was abandoned in December 2016, available evidence supports the complainants' assertion that residual impacts remain. ***Though aware of project impacts during the period of financing, IFC did not engage with its client to ensure that residual impacts of the project were assessed, reduced, mitigated, or compensated for, as appropriate, including at project closure, as required by the Performance Standards and the Sustainability Policy.***



### 3. Conclusion

CIFI, a non-banking financial institution, was established in 2001 with the objective of providing specialized project and corporate finance, and advisory services to infrastructure projects in the LAC region. In 2008 IFC approved an investment in the client with the objective to support client investment growth, operational consolidation, and access to lower-cost, long-term funding from international capital markets. As part of the investment, IFC committed to ensure that best practices in E&S standards were applied in the client's projects and to assist the client in updating its ESMS.

#### *IFC Pre-Investment E&S Review*

The purpose of IFC's pre-investment E&S review for an FI is to: (a) assess the E&S risk; (b) detail appropriate E&S requirements for the client to implement; and (c) ensure the client has an adequate ESMS to apply the E&S requirements to its projects.

In its pre-investment E&S review, IFC appropriately categorized the investment as FI and required the client to apply IFC's Performance Standards to all projects the client financed. This is an example of IFC going beyond its Sustainability Policy (para. 28) requirement at the time, which was that the FI apply the PS to activities which present "significant environmental or social risks."

However, IFC's pre-investment E&S review was not commensurate to risk. While the client voluntarily committed to apply IFC's Performance Standards to its projects since April 2007, IFC did not review the client's track record of implementation. Further, IFC did not consider whether the client had sufficient capacity to implement its ESMS. A contemporaneous report by the client's E&S consultant noted client challenges to implement IFC's Performance Standards and made recommendations to improve organizational structure and staff capacity. As IFC did not identify these issues in its pre-investment E&S review, IFC did not address gaps in the client's ESMS prior to proceeding with the investment. As a result, IFC did not have assurance that the client's ESMS implementation was sufficient to ensure that higher risk investments such as Canbalam I would meet the requirements of the Performance Standards.

#### *IFC General Supervision*

The purpose of IFC's supervision for an FI investment is to assure itself that the client is operating an adequate ESMS and is applying IFC's E&S requirements to its projects.

IFC did not meet the requirements of the Sustainability Policy (para. 26) for project supervision, particularly requirements to identify and correct non-compliance with IFC's E&S requirements. From August to December 2008, IFC made a series of disbursements to the client despite indications of non-compliance with IFC's E&S requirements. When IFC identified these issues in December 2009, IFC did not take steps to address these gaps prior to a disbursement in March 2010. IFC subsequently met with the client in advance of IFC's final disbursement in April 2010 and noted that the client had addressed gaps in its ESMS. However, similar concerns regarding the client's ESMS implementation were noted again in subsequent IFC supervision, indicating they may not have been addressed prior to IFC's final disbursement.

General concerns regarding the client's ESMS persisted during supervision. IFC has recorded concerns regarding client: (a) ability to access sufficient E&S information and apply the Performance Standards to certain investment types (e.g. secondary market transactions and bond transactions); (b) investments with insufficient assessment or application of mitigation measures; (c) staff organization and capacity; and (d) approach to E&S investment monitoring.

While IFC has noted these concerns to the client, IFC did not agree a corrective action plan to address them until November 2015, when the client requested that a corrective action plan be developed.

While the client has increased its E&S staff capacity and realigned its business strategy to make investments which provide it with additional leverage to apply IFC's Performance Standards, subsequent IFC supervision has confirmed that the client's ESMS remains less than satisfactory. Accordingly, nine years after making its investment, IFC has yet to assure itself that the client is "operating the ESMS as envisaged at the time of appraisal" or its client has "applied the applicable performance requirements to their sub-projects" (ESRP 9.2.6). Further, CAO finds that IFC has taken insufficient action in a timely manner to support its client in establishing compliance with IFC's requirements (Sustainability Policy, para. 26).

### *IFC's Response and Support to the Client in Relation to the Canbalam I*

The Hidro Santa Cruz project proposed the construction of a small hydroelectric power plant on the Q'anb'alam River near the town of Santa Cruz Barillas, Guatemala. The complainants acknowledged that it should not pose a significant environmental risk. In their 2015 complaint to CAO, they raised concerns regarding project: (a) consultation in accordance with FPIC; (b) potential impacts on land and natural resources; (c) approach to security and violent incidents they associate with the project; and (d) potential impacts on the environment due to additional proposed hydroelectric power plants.

CIFI's ESDD of the project in 2010 concluded that the project was in general alignment with the Performance Standards. However, it also noted the absence of a social impact assessment or socio-economic baseline study. This type of information is required in order to assess the impact of a greenfield hydropower project such as Hidro Santa Cruz in accordance with the Performance Standards. Absent this information, it is not possible to determine the project's alignment with the Performance Standards requirements regarding consultation (under PS1 and PS7) or assessment of impacts on Indigenous Peoples (under PS7). Further, neither project documentation or the client's ESDD commented on the project's approach to security (as required by PS4). While the project was a smaller one in terms of size, the above issues were of particular importance given that the project was being developed in a post-conflict indigenous community with a history of opposition to projects that predated CIFI's involvement. IFC's lack of oversight in ensuring the client was implementing an adequate ESMS—one that was sufficient to assess and monitor risks and impacts arising from investments in projects such as Canbalam I—contributed to a situation in which project activities were allowed to commence in advance of an adequate risk assessment and implementation of mitigation measures envisaged by the Performance Standards.

IFC did not have a role in CIFI's E&S review and commitment to the Hidro Santa Cruz project in 2010 and 2011. However, once aware of serious E&S allegation in relation to the project, IFC had a duty to respond.

Following the violent incidents related to the project of May 2012, IFC did not take measures provided for in its procedures to ensure the client was properly applying the Performance Standards. Specifically, IFC did not: (a) schedule a site visit to the client or the project; (b) document a review of the client-commissioned Social Monitoring Report; (c) review the client's ESMS implementation in relation to the project; (d) ensure the client had in place an adequate remedial action plan for the project; and (e) remain informed of ongoing implementation of project-level remedial actions.

The 2006 Sustainability Policy provides that efforts to carry out its investment activities in a manner that “do no harm” to people or the environment are central to IFC’s development mission. The Policy also commits IFC to “ensuring that the costs of economic development do not fall disproportionately on those who are poor and vulnerable.” Where adverse project impacts do occur, the Policy and PS1 provide that IFC will work with its client to ensure that impacts are assessed, reduced, mitigated or compensated for, as appropriate.

The complainants maintain that the project has resulted in adverse social impacts on their communities. In particular, they claim that the project led to the escalation of project related conflict, resulted in the death of one community member, left two community members seriously injured, and led to the detainment of seventeen other community members. They assert that traditional access to land and natural resources remains limited due to the construction of a perimeter fence around the project site. The client’s October 2012 Social Monitoring Report concluded that the project had generated significant negative impacts in the social context of the project area. Though aware of these impacts during the period of financing, IFC did not engage with its client to ensure that residual impacts of the project were assessed, reduced, mitigated, or compensated for, as appropriate, including at project closure, as required by the Performance Standards and the Sustainability Policy.

Underlying CAO’s findings are systemic gaps in IFC’s procedures and guidance to staff and FI clients on how to appropriately prepare for and respond to serious E&S incidents at the project level. PS1 requires clients to develop an Emergency Preparedness and Response system as part of its ESMS to respond to accidental and emergency situations associated with a project in a manner appropriate to prevent and mitigate any harm to people and/or the environment. Neither IFC’s ESRPs at the time of the CIFI investment nor the current version provide guidance to IFC staff on assessing an FI’s Emergency Preparedness and Response system. IFC’s current position is that this provision is only applied by the FI in relation to its own premises and not in relation to its investments.<sup>106</sup> Guidance for FIs on preparing to manage unanticipated negative E&S impacts in its investments, alleged or otherwise, is absent.

In responding to a serious E&S project impact, IFC’s procedures at the time of the May 2012 incident required staff to: (a) visit the project site; (b) request the client to investigate the root causes of the incident; (c) prepare an ESAP with short- and long-term actions; (d) bind the client to full compliance with the action plan; and (e) monitor client activity to ensure the action plan is responsive to remedial needs and is implemented. These procedures do not differentiate between IFC’s role in an FI investment and a direct investment, where IFC has a direct relationship with the project, and potentially, additional leverage. CAO notes that the current version of these procedures no longer require the client, in all instances, to: (a) prepare a root cause analysis; (b) prepare a remedial ESAP; and (c) contractually agree with IFC an ESAP. Guidance to IFC staff on how to support its FI clients in response to a serious project-level incident is also absent. In this regard, **CAO finds that IFC’s policies and procedures do not provide an adequate level of protection.**

CAO will monitor IFC’s response to the non-compliance findings made in this investigation.

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<sup>106</sup> IFC Interpretation Note on Financial Intermediaries (2012, updated 2017).

## Annex A: ESMS summary

### *General Framework*<sup>107</sup>

An ESMS is a framework that integrates E&S risk management into an FI client's business processes. An ESMS outlines a set of actions and procedures for a client to manage E&S risks by conducting E&S due diligence prior to making an investment and adequate supervision of investments thereafter. For IFC FIs, an ESMS ensures that an FI client's activities are in compliance with IFC's E&S requirements.

An ESMS details:

- 1) **An environmental and social policy** approved by senior management and committing the client to manage E&S risks across its operations;
- 2) **Procedures to screen projects**, assign environmental risk category, and conduct due diligence to evaluate environmental and social risks. Depending on the E&S risk, due diligence may consist of a desk review, a site-visit or a full-scale review conducted by a technical qualified consultant. Where gaps are identified from the desk review, the client prepares an Action Plan outline specific mitigation measure and actions necessary for the project to comply with relevant IFC requirements;
- 3) **Monitoring and record keeping**. E&S performance of projects is monitored by the client on a periodic basis to ensure compliance with IFC's requirements. Where relevant, the client may use inspections and audits to verify compliance and for projects with significant impacts, the client retains qualified and experienced external experts to verify monitoring information. The client maintains a record of supporting E&S documentation;
- 4) **ESMS review and continuous improvement**. Provisions to review the scope and application of the ESMS;
- 5) **External reporting**. Provisions to report to IFC: (a) annually on the client's E&S performance; (b) high-risk projects prior to investment; and (c) major accidents and incidents as they occur. Furthermore, if the client anticipates ongoing risks to or adverse impacts on affected communities, the client should establish a grievance mechanism which is readily accessible to affected communities and about which affected communities are informed;
- 6) **Staff roles and responsibilities**. Specifically, the responsibility of the ESMS officer to oversee implementation of the ESMS and responsibility of other FI staff involved in the due diligence and supervision of projects (e.g. E&S specialist, loan/investment officer, legal counsel); and
- 7) **Budget, training, and Senior Management approval**. Specifically, senior management approval of necessary resource allocation to implement ESMS.

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<sup>107</sup> For further details, see IFC Performance Standard 1 and IFC's First for Sustainability, available at <https://goo.gl/2YywpP>.

### *CIFI's ESMS at the Time of IFC's Appraisal*

At its establishment in 2001, CIFI adopted some of the E&S practices of its then shareholders, in particular IIC's criteria for E&S review.<sup>108</sup> Implementation of this approach was reviewed by the environmental consulting firm Environmental Resources Management (ERM). In 2005, CIFI implemented an ESMS to review, categorize and supervise prospective and approved loans. Under this ESMS, CIFI continued to apply IIC's policies and procedures. In 2007, CIFI adopted the Equator Principles thus committing to finance projects in accordance with IFC's Performance Standards.<sup>109</sup>

At the time of IFC's appraisal, CIFI's ESMS provided for:

- Screening against IIC/IDB exclusion criteria;
- **Risk categorized** similar to IFC's E&S risk screening criteria. In addition, CIFI took into account its role in the financial structure of the proposed investment (e.g. lead debt arranger, syndicated FI, asset purchase) to weigh this against the E&S risk categorization to determine the reputational risk of the transaction;
- **Due diligence and monitoring** of projects commensurate to levels of impact.
  - For due diligence: (a) high-risk projects required a thorough E&S due diligence which could be outsourced to a consultant/firm; (b) medium-risk projects were assessed by CIFI staff responsible for credit review or outsourced; and (c) low-risk projects were assessed by CIFI staff.
  - Following due diligence, specific time-bounded corrective actions were designed and included in the loan agreement.
  - Monitoring of E&S performance was the responsibility of CIFI's portfolio officers.
- Structuring a project in a manner that met environmental requirements; and
- **Corrective action**, where necessary.

In addition, CIFI staff responsible for E&S risk management were required to attend an annual IIC/IDB training course.

At the time of IFC's appraisal, the CEO had ultimate responsibility for implementing the ESMS with an Investment Officer responsible for E&S risk categorization and portfolio management. In 2009, CIFI created an E&S Coordinator and Risk Officer independent of the transaction team with responsibility to lead internal E&S due diligence and evaluation of projects.

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<sup>108</sup> This section is based on a summary of CIFI's ESMS detailed in IDB's *CIFI Financing Facility*, available at <https://goo.gl/9wXZlx>.

<sup>109</sup> CIFI Annual Environmental Report 2007, available at <https://goo.gl/fGpVBd>.

## Annex B: IFC E&S risk mitigation provisions agreed with the client, June 2008

<b>General E&amp;S Risk Management Approach</b>	
<b>ESMS</b>	
a.	Use all reasonable efforts to ensure continuing operation of ESMS to identify, assess, and manage E&S performance of its operations and any operations financed by the client in compliance with E&S requirements. E&S requirements defined as: (a) IFC's Exclusion List; (b) applicable E&S national law; (c) IFC Performance Standards; and (d) other requirements established by the ESMS.
<b>Capacity</b>	
b.	Where a new ESMS officer is appointed, ensure that officer shall be reasonably acceptable to IFC. The ESMS Officer shall: (a) be a full-time employee; (b) report directly to the client's general manager; (c) have managerial oversight of the ESMS; and (d) demonstrate qualifications and training to handle the applicable duties.
c.	Establish the position of ESMS manager with a requirement for that individual to complete a training program on the E&S requirements within 12 months of IFC's commitment.
<b>Reporting Requirements</b>	
d.	Submit an annual E&S performance report to IFC within 120 days after the end of each fiscal year. This report should note any material social, labor, health and safety security or environmental incident, accidents or circumstances related to the client or any of its key subsidiaries. The report should describe in reasonable detail: (a) implementation and operation of the ESMS; and (b) E&S performance of the client's project investments.
e.	Notify IFC within 3 days of becoming aware of any serious E&S incidents. Notify IFC of the details of the incident and measures taken, or plans to be taken, to address issues. Keep IFC informed of the on-going implementation of those measures.
f.	If the client becomes aware that a proposed investment is classified Category A, promptly notify IFC and provide IFC with information concerning such matter as IFC may reasonably request.
g.	If the client becomes aware that any project it supports is not operating in accordance with E&S requirements, the client shall promptly: (a) agree with the project, or require the project to undertake corrective measures to remedy such inconsistency or breach; and (b) if the project does not implement corrective measures, use reasonable efforts to dispose of the project investment on commercially reasonable terms.

## Annex C: Project-level observations

<b>Project Consultation and Information Disclosure</b>
<p><b>Issues raised by the complainants</b></p> <ul style="list-style-type: none"><li>• Project lacked an adequate: (a) assessment of social impacts; (b) disclosure of information; and (c) consultation process (Free, Prior and Informed Consultation<sup>110</sup>) with the affected communities</li><li>• Concern that the community consultation (<i>consulta comunitaria de buena fe</i>) carried out in Barillas in June 2007, in addition to numerous community meetings in which community members expressed their opposition to projects such as the Canbalam project were not taken into consideration by the project developer</li><li>• Concern with project's approach to sharing benefits with communities. The Municipality and the project developer had reached an agreement in December 2012, but it was rejected by COCODE representatives.</li><li>• Claim that the Q'anb'alam River and its waterfalls—the natural drop of the waterfalls was to be used by the hydro project—have cultural and spiritual significance for the Indigenous Peoples in the area.</li></ul>
<p><b>Performance Standards requirements</b></p> <ul style="list-style-type: none"><li>• Disclose to affected communities information about the project's purpose, nature and scale, duration of proposed activities, and any risks to and potential impacts on such communities (PS1, para. 20)</li><li>• Undertake a process of consultation in a manner that provides the affected communities with opportunities to express their views on project risks, impacts, and mitigation measures, and allows the project developer to consider and respond to them (PS1, para. 21)</li><li>• When Indigenous Peoples may be adversely impacted, the consultation process will ensure FPIC and facilitate informed participation on matters that affect IPs directly, such as proposed mitigation measures, the sharing of development benefits and opportunities, and implementation issues. The process should be culturally appropriate and an accessible grievance mechanism should be established (PS7, para. 9).</li><li>• Where a project is expected to have adverse impacts on traditional or customary lands or natural resources on these lands, the project is required to retain external experts to assist in assessing IPs customary use of land and resources, including spiritual. Any potential adverse impacts on IPs use must be documented and addressed within the context of their belief systems (PS7, para.11 and PS7, GN23).</li></ul>
<p><b>CAO observations</b></p> <ul style="list-style-type: none"><li>• In June 2007, a referendum in Barillas opposing mining of minerals and other natural resources was passed 46,481 against to 9 votes supporting such projects.</li><li>• Assessment documentation identified the project area as majority Indigenous Peoples.</li><li>• The client's ESDD noted that there were no foreseen adverse impacts to IPs traditional or customary land use, water use, cultural resources or livelihoods. However, an expanded socio-economic baseline and impact assessment was recommended. It was concluded that the consultation process demonstrated broad understanding and general support for the project, and thus, PS compliant.</li><li>• Assessment documentation recorded that the project would limit the river's flow over 1.2-kilometer stretch in 150 days of the year. The client's consultant noted that the effect on the water quality and river level during this period is not well documented in the project environmental assessment documentation. The consultant recommended an updated ecological flow assessment but also determined that the project would have no adverse impacts on IPs.</li><li>• Following the May 2012 incident, the Social Monitoring Report (Oct 2012) raised concern with the project's compliance with PS1 and PS7 requirements on disclosure, consultation, a process demonstrating community support and free of manipulation in negotiating a benefit sharing agreement, and on a grievance mechanism.</li><li>• Following notification of the security incident, no evidence that IFC sought to assure itself that its client was applying relevant PS1 and PS7 requirements. There is no evidence that IFC assured</li></ul>

<sup>110</sup> PS7 (2006) defines FPIC as Free, Prior, and Informed Consultation. In the 2012 version of IFC PS, FPIC is defined as Free, Prior, and Informed Consent.

itself that an adequate assessment by qualified and experienced external experts of IPs' use and relationship to the river was conducted (PS7, para 11.)

## **Allegations Related to Project Impacts on Land and Natural Resources**

### **Issues raised by the complainants**

- Allegation that the land acquisition process lacked transparency and was not fully voluntary.
- Allegations of economic displacement because land acquired was used by community members to plant subsistence crops.
- The families who rented the land to grow crops are poor and do not own sufficient land themselves. They are a particularly vulnerable group, in addition to being Indigenous People.
- Concern about future development of the lands acquired for the project after project developer announced plans to leave the country. Access to lands remain restricted by a fence.
- Concern about current status of acquired lands, since the project developer has cancelled the project.

### **Performance Standards requirements**

- Identify individuals or communities who will be affected as part of the E&S assessment of the project (PS1, para. 4), including economic displacement
- Where displacement is involuntary, disclose all relevant information, consult with and facilitate informed participation of affected persons and communities in decision-making processes related to resettlement (PS5, para. 9). All land transactions should be documented (PS5, para. 12).
- Promptly compensate economically displaced persons for loss of assets or access to assets at full replacement cost and provide transitional support to economically displaced persons if land acquisition causes loss of income or livelihood (PS5, para. 20)
- Vulnerable groups, include people who live below the poverty line, may require special measures in terms of consultation and development assistance to allow such groups to participate in meaningful resettlement planning and benefit from development opportunities (GN5, para. 16)
- Retain qualified and experienced external experts to assist in conducting an impact assessment of traditional or customary use of land and natural resources by IPs, including cultural and spiritual use (PS7, paras.12-13). Any potential adverse impacts on IPs use must be documented and addressed within the context of their unique knowledge and belief systems (GN7, para. 23).

### **CAO observations**

- Project was to be developed in a region with one of the highest incidence of land disputes in Guatemala and a prior history of violence during the civil war
- Project assessment documentation recorded that there were no physical structures on the land and two individuals would experience economic displacement. This was handled through informal agreements. The client's E&S consultant recommended that the land acquisition process be documented and an expanded socio-economic assessment be conducted on potential IP impacts. However, based on available information, the consultant advised that the project was aligned with PS5 and PS7 requirements.
- The Social Monitoring Report (October 2012) asserted that allegations of improper customary land use and coercive land acquisition practices by the project operator were not substantiated by available evidence. Limited discussion or evidence is presented in the report to support the determination that allegations of improper customary land use were not substantiated. It is also unclear if an expanded socio-economic baseline study and impact assessment was prepared for the project.
- IFC provided CAO with copies of land purchase agreements between the project developer and landowners dated September and October 2010
- Following notification of the security incident and reports on public allegations of project impact on land, there is no evidence that IFC sought to assure itself that the project assessment of impacts on land and approach to implement the land acquisition process complied with PS5 and PS7 requirements. Land purchase agreements provided by IFC to CAO dated September and October 2010 demonstrate that land was purchased but not that PS5 and PS7 requirements were met.



## **Allegations Related to Project's Approach to Security**

### **Issues raised by the complainants**

- Persecution and criminalization of leaders who have protested the project; threats, intimidations, and abuse of community members
- Concern with project's use of a private security force
- Allegation that a member of the client's project security force killed one community member and injured two others on May 1, 2012
- During state of siege that followed this incident, 17 community members were detained and nine sent to jail for 9 months. As of March 2017, arrest warrants are still in effect
- Allegation of a close relationship between police/military and project developer
- Threats and persecution continue as of March 2017 despite the public announcement in December 2016 of the closing and exiting of project developer

### **Performance Standards requirements**

- Assess risks to those within and outside the project site in making security arrangements. Force cannot be sanctioned except when used for preventive and defensive purposes in proportion to the nature and extent of the threat. A grievance mechanism should be provided for community concerns (PS4, para. 13).
- Where government personnel are deployed to provide security, project developer assesses risks and communicates its intent to the government that its security personnel act in accordance with principles of proportionality and good international practice (PS4, para. 14)
- Credible allegations of unlawful or abusive acts of security personnel should be investigated and action taken to prevent recurrence (PS4, para. 15)
- Adverse project impacts should be assessed, reduced, mitigated or compensated for as appropriate (PS1, objectives).

### **CAO Observations**

- Project was to be developed in a region with one of the highest incidence of land disputes in Guatemala and a prior history of violence during the civil war
- Neither the UN CDM project summary nor the client's ESDD comment on the project's approach to security
- CAO has not seen evidence that public reports in November 2011 of community concerns related to project's use of armed security were considered and addressed prior to the client's investment in December 2011.
- Following security incidents in March and May 2012, the Social Monitoring Report (October 2012) raised concern with the project's compliance with PS4 requirements on use of security
- Following notification of the security incident, no evidence that IFC sought to assure its client was applying relevant PS1 or PS4 requirements as relate to the investigation of security incidents, the assessment and mitigation of security risk, or the provision of compensation for adverse impacts arising from the client's use of security personnel, should they be determined to have occurred.

<b>Allegations Related to Project’s Environmental Impacts</b>
<p><b>Issues raised by the complainants</b></p> <ul style="list-style-type: none"> <li>• Acknowledge no significant environmental risk is posed by Canbalam I as it is a small-scale hydropower plant</li> <li>• Concerns about possible cumulative impact of proposed project, Canbalam II<sup>111</sup>, and lack of cumulative impact assessment</li> </ul>
<p><b>Performance Standards requirements</b></p> <ul style="list-style-type: none"> <li>• Analyze project risks and impacts in the context of the area of influence, including areas potentially impacted by cumulative impacts from further planned developments as well as areas potentially affected by impacts from unplanned but predictable developments caused by the project that may occur later or at a different location (PS1, para. 5)</li> <li>• Analyze risks and impacts for key stages of the project cycle, including pre-construction, construction, operations, and decommissioning or closure (PS1, para. 6) <ul style="list-style-type: none"> <li>• The project developer will identify and reflect the necessary corrective and preventive actions in the amended management program (PS1, para. 24). As part of on-going maintenance of its Management System, the client should update the management program from time to time, so that it can adequately address the change in the social or environmental risks arising from any change in the client’s business or circumstances (PS1 Guidance Notes, Para G63).</li> </ul> </li> </ul>
<p><b>CAO Observations</b></p> <ul style="list-style-type: none"> <li>• The project has been referred to a Canbalam I in project documentation as of January 2010. Canbalam I was approved by the national regulator in August 2010.</li> <li>• The Canbalam II project was noted in public marketing campaigns since December 2011.<sup>112</sup> The project developer sought approval for Canbalam II in April 2012.</li> <li>• No evidence that the project developer assessed cumulative risks presented by Canbalam II, and as appropriate, amended its management program.</li> <li>• Both projects now cancelled.</li> </ul>

<sup>111</sup> In April 2012, five months after CIFI financed the Canbalam I, Canbalam II—a proposed 12MW hydroelectric power plant on the same river as Canbalam I—was promoted by the project developer and registered by the Ministry of Energy and Mines (MEM). The registration was cancelled in September 2014.

<sup>112</sup> Hidro Santa Cruz YouTube clip. Published December 28, 2011. Available at <https://goo.gl/QUup2f>.

## Annex D: CAO compliance findings

CAO FINDING	CAO MONITORING FRAMEWORK <i>Findings to be Monitored (See Note)</i>	
IFC's Pre-Investment Review and Risk Mitigation Measures	Sub-Project Response	Project Level Response
IFC appropriately categorized the investment as FI and required the client to apply IFC's Performance Standards to its investments.		
IFC's pre-investment E&S review was not commensurate to risk. Specifically, CAO identified shortcomings in IFC's assessment of: (a) the client's track record of ESMS implementation; and (b) the client's capacity to implement its ESMS to IFC standards.		
CAO finds that IFC's pre-investment E&S review did not lead to the development of an action plan to address gaps in the client's ESMS, a requirement of IFC's ESRPs. As a result, IFC did not have assurance that the client's ESMS implementation was sufficient to ensure that higher risk investments it planned to finance, such as Canbalam I, would meet the requirements of the Performance Standards		
IFC Supervision	Sub-Project Response	Project Level Response
IFC did not meet the requirements of the Sustainability Policy (para. 26) for project supervision, particularly requirements to identify and correct client non-compliance with its E&S requirements.		
Nine years after making its investment, IFC has yet to assure itself that the client is "operating the ESMS as envisaged at the time of appraisal" or its client has "applied the applicable performance requirements to its sub-projects."		<b>MONITORING</b>
IFC has taken insufficient action to support its client in establishing compliance with IFC's requirements. Thus, throughout the period of supervision, IFC has been at risk of exposure to projects with E&S impacts that are not being managed in accordance with the Performance Standards.		<b>MONITORING</b>

IFC Response to Sub-Project Incident	Sub-Project Response	Project Level Response
CAO finds that IFC did not take measures provided for in the ESRP to ensure that the client was properly applying the Performance Standards to the project.		
IFC did not monitor client activity to ensure that the action plan between the client and HSC was fully responsive to remedial needs, committed to by management, and fully funded.		
Though aware of project impacts during the period of financing, IFC did not engage with its client to ensure that residual impacts of the project were assessed, reduced, mitigated, or compensated for, as appropriate, including at project closure, as required by the Performance Standards and the Sustainability Policy. In these circumstances, contrary to the intent of IFC's Sustainability Policy, adverse impacts have been left to fall on the community.	<b>MONITORING</b>	<b>MONITORING</b>
At a systemic level, IFC's policies and procedures do not provide an adequate level of protection in response to serious E&S incidents at the project level in FI investments.		
<b>IFC Systemic Level Response (See Note)</b>		
<b>MONITORING</b>		
<p><b>Note:</b> This table details CAO's compliance findings and indicates where CAO will monitor IFC's response. In some instances it may not be possible for IFC commit to project / sub-project actions in response to findings. For example, where CAO has found IFC to be non-compliant in regard to past events (e.g. a shortcoming in IFC's pre-investment due diligence), no action will bring IFC back into compliance. While some CAO findings do not anticipate a project/sub-project level response, where relevant, CAO will monitor IFC's response with regard to systemic improvements.</p>		