



April 20, 2015

Office of the Compliance Advisor Ombudsman (CAO)

COMPLIANCE APPRAISAL REPORT

Appraisal of IFC investment in Terminal de Contenedores Quetzal S.A. (IFC Project #32763)

Summary

In March 2014, CAO received a complaint from the Sindicato de Trabajadores Organizados de Empresa Portuaria Quetzal (STOPQ) (“the complainants”), a union of workers at Empresa Portuaria Quetzal (EPQ), the state company that owns and administers Puerto Quetzal, a major port in Guatemala.

Terminal de Contenedores Quetzal (TCQ / “the client”) is the Guatemalan branch of Grup Maritim Terminal de Contenedores Barcelona (GMTCB). In July 2012, the IFC client signed a 25-year usufruct agreement¹ with EPQ allowing it to construct and operate a new container terminal within Puerto Quetzal. IFC has provided approximately \$45 million in debt and equity to TCQ to finance the construction of the new terminal.

According to CAO’s Operational Guidelines, the purpose of a compliance appraisal is to ensure that compliance investigations are initiated only for those projects that raise substantial concerns about environmental and/or social (E&S) outcomes, and/or issues of systemic importance to IFC/MIGA.

The complainants allege that the agreement between EPQ and TCQ, and the decision to construct the container terminal: (a) violate national law, (b) were approved without consulting appropriate sectors of civil society, and (c) were based on an unduly processed Environmental Impact Assessment (EIA). The complainants also contend that their members’ economic well-being and that of the communities in the vicinity of the port zone will be negatively affected by the development.

In relation to the complainants’ concerns regarding the project’s compliance with national law, CAO notes that IFC conducted due diligence and received advice from local counsel on key legal compliance issues raised by the complainants. This represented good practice.

In relation of IFC’s environmental and social due diligence, CAO notes that IFC reviewed the client’s assessment documentation, including the EIA, reaching the view that the project was unlikely to have significant social or environmental impacts. Nevertheless, IFC identified gaps in the client’s social impact assessment as well as its approach to stakeholder engagement. As a result, requirements to: (a) complete a supplementary socioeconomic assessment, and (b)

¹ A usufruct agreement is a legal right accorded to a person or party that confers the temporary right to use and derive income or benefit from someone else's property. Usufruct is usually conferred for a limited time period.

strengthen the client's stakeholder engagement plan, were included in the Environmental and Social Action Plan (ESAP). However, it appears that the complainants' key concerns – as they relate to the broader implications of the project on government finances and employment at other enterprises such as EPQ – were not considered by IFC in a structured manner, as these fell outside IFC's understanding of the social impacts of the project.

In relation to the issues raised by the complainants, CAO has not identified substantial concerns regarding the E&S outcomes of IFC's investment or issues of systemic importance to IFC such that a compliance investigation would be the appropriate response. As a result, CAO has decided to close this case. In reaching this conclusion, CAO notes that IFC's interpretation of the requirement to consider the social impacts of the project did not extend to analyzing potential adverse impacts of the project on: (a) employment at other enterprises such as EPQ, or (b) government revenue. It is unclear to CAO whether this interpretation was justified in the circumstances. Absent evidence of significant adverse outcomes, however, CAO concludes that this question alone does not merit a compliance investigation.

About CAO

CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of IFC and MIGA.

CAO (Office of the Compliance Advisor Ombudsman) is an independent post that reports directly to the President of the World Bank Group. CAO reviews complaints from communities affected by development projects undertaken by the two private sector arms of the World Bank Group, the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

For more information about CAO, please visit www.cao-ombudsman.org

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Acronyms

CAO	Compliance Advisor Ombudsman
COCODES	Consejos Comunitarios de Desarrollo
COD	Conditions of Disbursement
COMUDES	Consejos Municipales de Desarrollo
E&S	Environmental and Social
EHSS	Environmental, Health, Safety and Social
EHSS	Environmental, Health and Safety
EIA	Environmental Impact Assessment
EPQ	Empresa Portuaria Quetzal
ESAP	Environmental and Social Action Plan
ESIA	Environmental and Social Impact Assessment
ESMS	Environmental and Social Management System
ESRP	Environmental and Social Review Procedures
ESRR	Environmental and Social Review Rating
ESRS	Environmental and Social Review Summary
GMTCB	Grup Maritim Terminal de Contenedores Barcelona
IFC	International Finance Corporation
LESS	Lead Environmental and Social Specialist
MIGA	Multilateral Investment Guarantee Agency
PS(s)	Performance Standard(s)
SAV	Site Appraisal Visit
STOPQ	Sindicato de Trabajadores Organizadoes de Empresa Portuaria Quetzal
TCQ	Terminal de Contenedores Quetzal

I. Overview of the Compliance Appraisal Process

When CAO receives a complaint about an IFC or MIGA project, the complaint is referred for assessment. If CAO concludes that the parties are not willing or able to reach a facilitated solution, the case is transferred to the CAO compliance function for appraisal and potential investigation.

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

The focus of the CAO compliance function is on IFC and MIGA, not their client. This applies to all IFC's business activities, including the real sector, financial markets, and advisory. CAO assesses how IFC/MIGA assured itself/themselves of the performance of its business activity or advice, as well as whether the outcomes of the business activity or advice are consistent with the intent of the relevant policy provisions. In many cases, however, in assessing the performance of the project and IFC's/MIGA's implementation of measures to meet the relevant requirements, it will be necessary for CAO to review the actions of the client and verify outcomes in the field.

In order to decide whether a compliance investigation is warranted, CAO first conducts a compliance appraisal. The purpose of the compliance appraisal process is to ensure that compliance investigations are initiated only for those projects that raise substantial concerns regarding environmental and/or social outcomes, and/or issues of systemic importance to IFC/MIGA.

To guide the compliance appraisal process, CAO applies several basic criteria. These criteria test the value of undertaking a compliance investigation, as CAO seeks to determine whether:

- There is evidence of potentially significant adverse environmental and/or social outcome(s) now, or in the future.
- There are indications that a policy or other appraisal criteria may not have been adhered to or properly applied by IFC/MIGA.
- There is evidence that indicates that IFC's/MIGA's provisions, whether complied with or not, have failed to provide an adequate level of protection.

In conducting the appraisal, CAO will engage with the IFC/MIGA team working with the specific project and other stakeholders to understand which criteria IFC/MIGA used to assure itself/themselves of the performance of the project, how IFC/MIGA assured itself/themselves of compliance with these criteria, how IFC/MIGA assured itself/themselves that these provisions provided an adequate level of protection, and, generally, whether a compliance investigation is the appropriate response. After a compliance appraisal has been completed, CAO can close the case or initiate a compliance investigation of IFC or MIGA.

Once CAO concludes a compliance appraisal, it will advise IFC/MIGA, the World Bank Group President, and the Board in writing. If a compliance appraisal results from a case transferred from CAO's dispute resolution, the complainant will also be advised in writing. A summary of all appraisal results will be made public. If CAO decides to initiate a compliance investigation as a result of the compliance appraisal, CAO will draw up terms of reference for the compliance investigation in accordance with CAO's Operational Guidelines.

II. Background

Investment

Puerto Quetzal is one of the main ports in Guatemala. It is located on the Pacific Coast and is administered by EPQ. After signing a 25-year usufruct agreement with EPQ to operate and construct a new dedicated container terminal within Puerto Quetzal, TCQ requested IFC financing to build the container facility.

TCQ hired a local company to complete the Environmental Impact Assessment (EIA) of the planned project. The EIA was completed in July 2013 and was approved by the local environmental authorities in September of the same year. EPQ's workers union, STOPQ, claimed that it was not properly engaged in the process that led to the approval of the EIA, and asked the environmental authority to review its comments. The environmental authority considered questions submitted by STOPQ and approved the EIA in March 2014. The content of the EIA did not change. STOPQ appealed the decision filing for administrative review by the Ministry of Environment. Following the Ministry's confirmation of the EIA process, STOPQ filed for judicial review. The outcome of the judicial process had not been determined at the time this report was written.

IFC's appraisal of the investment commenced in 2013, when the IFC team conducted a Site Appraisal Visit (SAV). IFC's investment team conducted a second visit in February 2014, together with other development finance institutions. IFC presented the proposed project to its Board of Directors on March 27, 2014. The Board approved a proposed investment of a \$35 million loan and a \$9.7 million equity investment. IFC committed to the project on April 30, 2014, and made its first disbursement in August 2014.²

In September 2014, IFC's environmental and social (E&S) team traveled to the project site to conduct a site supervision visit to gather information on the development of the terminal and the client's progress in implementing the actions included in an agreed Environmental and Social Action Plan (ESAP). IFC was, however, unable to visit the project site, as municipal authorities had sealed the entrance to the port, apparently due to an issue related to construction permitting.

Complaint

On March 17, 2014, CAO received a complaint from STOPQ, a union of port workers employed by EPQ. The complainants contend that the agreement between EPQ and TCQ and the decision to construct the container terminal violate national law, were approved without consulting appropriate sectors of civil society, and were based on an unduly processed EIA. The complainants also contend that their members' economic well-being and that of the communities in the vicinity of the port zone will be negatively affected by the development.

During its initial assessment of the complaint,³ CAO gathered further information on E&S concerns raised by the complainants, including:

² IFC, "Summary of Investment Information" (February 21, 2014).

[http://ifcextapps.ifc.org/ifcext/spiwebsite1.nsf/\(SearchView\)?SearchView&Query=\(FIELD+DocType+Summary+of+Proposed+Investment\)+AND+\(FIELD+ProjectId+=+32763\)](http://ifcextapps.ifc.org/ifcext/spiwebsite1.nsf/(SearchView)?SearchView&Query=(FIELD+DocType+Summary+of+Proposed+Investment)+AND+(FIELD+ProjectId+=+32763))

³ CAO, "Assessment Report," (September 10, 2014). http://www.cao-ombudsman.org/cases/case_detail.aspx?id=219

- *Violations of national law:* Complainants allege the usufruct agreement, and particularly the process through which the EIA was approved, violates the Guatemalan Constitution, as well as other relevant national laws. Complainants also claim that certain construction activities were carried out without permits.
- *Violation of the collective agreement:* Complainants state that the granting of the usufruct agreement violates their collective agreement with EPQ.
- *Lack of consultation:* Complainants contend that relevant components of civil society — specifically, the municipal community councils and the development community councils (COMUDES and COCODES) — were not consulted when the proposed usufruct agreement was being considered and approved.
- *Loss of benefits:* Complainants are concerned about the fate of a current subsidy (a percentage of profits is distributed to the workforce and the government) that benefits workers of EPQ and local communities. The complainants believe the subsidy will be jeopardized by the new project and that losses will have social and economic impacts on workers, their families, and communities that depend on them.
- *Environmental impacts:* Complainants allege the project will have adverse impacts on seawater, as well as freshwater, land stability, and mangrove ecology and biodiversity in the area.

In addition to the above-mentioned issues, the complainants raise a number of broader governance issues that go beyond CAO's E&S mandate, and as such are not addressed in this appraisal report. As issues around social impact, the adequacy of the client's stakeholder engagement process and the project's compliance with national law were the focus of the complaint; they are also the focus of this appraisal.

III. Analysis

This section outlines the IFC E&S policies and procedures that apply to the project. It then analyzes IFC's performance against these standards during preparation and implementation of the project and in the context of the issues raised by the complainants.

IFC Policies and Procedures

IFC's investment in the client was made in the context of its 2012 Policy on Environmental and Social Sustainability ("the Sustainability Policy") and Performance Standards (PS), together referred to as the Sustainability Framework. Through the Sustainability Framework, "IFC seeks to ensure, through its due diligence, monitoring, and supervision efforts, that the business activities it finances are implemented in accordance with the requirements of the Performance Standards" (para. 7).

IFC implements the commitments set out in the Sustainability Policy through its Environmental and Social Review Procedures (ESRP), which are updated periodically.

Before making an investment the Sustainability Policy (para. 26) provides that IFC will undertake a process of E&S due diligence in a manner that is “commensurate with the nature, scale, and stage of the business activity and with [its] level of E&S risks and impacts.” As a result, IFC “weighs the costs and benefits of the proposed business activity” and presents these to its Board for approval. The E&S due diligence is designed to allow IFC to finance only “investment activities that are expected to meet the requirements of the Performance Standards” (para. 22). To ensure the business activity meets the Performance Standards, IFC and the client agree on an Environmental and Social Action Plan (ESAP) which includes any necessary conditions of IFC’s investment (para. 28).

Once the project is approved and IFC has invested in a client, the investment is monitored throughout the project cycle to ensure compliance with the conditions in the loan agreement and IFC’s applicable policies and standards.

IFC’s Assessment of the Project’s Compliance with National Law

Policy Requirements and IFC’s Due Diligence

The complainants claim there are several elements of the project that do not comply with national legislation: namely, the approval and terms of the usufruct agreement; terms of the contract between EPQ and the client; and stakeholder consultation at the time of the approval of the EIA. The complainants also contend that there were violations of the collective bargaining agreement between EPQ and workers unions during the approval of the usufruct agreement and concerns.

According to the 2012 Sustainability Framework, “in addition to meeting the requirements under the Performance Standards, clients must comply with applicable national law, including those laws implementing host country obligations under international law.”⁴

Defining IFC’s pre investment role in assessing project compliance with national law is a challenging one, given that national institutions have jurisdiction to make determinations regarding compliance with national law. As noted above, the Sustainability Policy provides that IFC’s E&S due diligence should be commensurate to risk. This principle of review commensurate to risk should also be seen as applying to E&S risks that emerge from legal compliance. Thus, the question that arises here is whether there are indications that IFC’s due diligence was other than commensurate to risk in relation to issues of the project’s compliance with national law.

In this respect, CAO notes that before approval of the project, IFC carried out legal due diligence on the agreements for the financing of the project, the EIA approval process, and the usufruct agreement. IFC was aware that the legality of the usufruct agreement was contested and reported that this could have repercussions for the development of the project. However, IFC also noted that the validity of the usufruct agreement had been confirmed through various legal proceedings and that potential opposition in the future could be mitigated by strengthening relations between TCQ, EPQ, and the affected communities.

Further, IFC requested an opinion from its local counsel, and considered this together with information provided by the company’s counsel, as well as EPQ’s representative responsible for

⁴ IFC, “Performance Standards on Environmental and Social Sustainability,” Overview, para 5 (January 1, 2012).

the approval of the usufruct agreement. In February 2014, IFC also held meetings with senior representatives of the Government of Guatemala to discuss legal aspects of the project.

In March 2014, when IFC presented the project to the Board, IFC was aware that challenges to the legality of the project and its EIA were ongoing. However, IFC's analysis did not identify any legal noncompliance. IFC's analysis also noted the claim that EPQ may have violated its collective bargaining agreement with STOPQ, concluding that if upheld, this could result in fines for EPQ, but not the annulment of the usufruct agreement held by its client.

In August 2014, on the basis of legal advice and representations made by the company regarding the project, the usufruct agreement and the status of the EIA, IFC concluded that there were no legal compliance issues that would prevent disbursement.

Conclusion

CAO notes that IFC conducted due diligence and received advice from local counsel in relation to key legal compliance issues raised by the complainants. This represented good practice.

IFC's Assessment of the Project's Social and Environmental Risks

Stakeholder Engagement and Consultation

In relation to stakeholder engagement and consultation, the complainants claim they were unable to contact anyone at TCQ to express their concerns and raise issues regarding the project. They are particularly concerned that the project will weaken EPQ's financial position and profitability and that it will put in jeopardy an important source of livelihood and economic activity for communities in the area. In particular, the complainants are unclear about the number and the nature of jobs that the client expects to create and the impacts on fishermen in the area.

During its December 2013 site appraisal visit, IFC traveled to the project site to meet with stakeholders, to assess potential E&S risks and impacts related to the project, and to identify any gaps in the E&S analyses conducted by the client. IFC held meetings with local staff of the client, environmental specialists, EPQ staff, and representatives from communities surrounding Puerto Quetzal. Following the site visit, IFC reported that disclosure of information regarding the project met Guatemalan requirements. However, IFC also noted that stakeholders were not adequately engaged during the approval process for the EIA, which was led by EPQ. This was reported by IFC as a gap in disclosure and consultation as required by PS1 (paras. 25ff). As a result, IFC and the client agreed that the client would develop a stakeholder engagement plan that incorporated a stakeholder identification and mapping exercise along with other components. This was included in the ESAP for the project.⁵

Assessment of Social and Environmental Risks

The complainants allege that the project will generate adverse socioeconomic outcomes. These include redundancies at EPQ, reduced benefits for EPQ workers, loss of jobs for local businesses, and negative impacts on fishermen's livelihoods. Moreover, the complainants allege that the project will reduce benefits for EPQ and the country overall. The complainants also raise more general concerns regarding the environmental impacts of the project.

⁵ IFC. TCQ – Environmental and Social Action Plan. <http://goo.gl/bLhH4F>

IFC's understanding of the client's duty to assess project impacts is set out in PS1. PS1 (para. 8) provides that the client will consider a project's E&S impacts in the context of its "area of influence." The area of influence is defined as including both the area physically affected by the project as well as any impacts from "unplanned but predictable developments caused by the project that may occur later or at a different location."

As part of its review of the potential social impacts of the project, IFC E&S staff met with the client, EPQ, and community representatives near Puerto Quetzal. Community members included representatives from fishing cooperatives, tourism and sporting organizations, youth, and women's associations. IFC noted unions concerns that the new container terminal would lead to a loss of jobs at EPQ.

Through its review of the client's assessment documentation, including the EIA, IFC reached the view that the project was unlikely to have significant social or environmental impacts. In reaching this conclusion IFC noted that the project footprint is located within a heavily industrialized existing port and that incremental E&S impacts beyond those of the existing port would be limited. In this context IFC noted that the project did not require the acquisition of new land and that the biodiversity value of the area to be used for the terminal was low.⁶

Nevertheless, IFC's pre-investment review found gaps in the client's approach to social impact assessment. As a result it was agreed and included in the ESAP that the client would conduct a review of potential socioeconomic impacts on local communities, including fishermen, by March 2015. More specifically, IFC noted that the client would "review and confirm that the construction of the terminal will have no adverse socio-economic impacts on local communities, including fishermen. It was further noted that the review would "cover aspects such as the potential for increased shipping and trucking traffic associated with terminal construction and operations, and any adverse social impacts this may have on local people, for example, any incremental disruption to fishing activities or access to fishing grounds."⁷

While acknowledging that a full social impact assessment as required by PS1 was not available at the time the project was approved, IFC moved forward on the understanding that the nature of the project (the development within an existing port facility) would likely have only limited incremental social impacts. In reaching this conclusion, it is notable that IFC defined the scope of the supplementary social impact focusing on direct impacts arising from increased shipping and trucking activities and not the broader implications of the project on government finances or employment at other enterprises such as EPQ, which may be negatively affected by the opening of a new container facility. At the time of writing this report, the supplemental social impact assessment was not available for review.

Conclusion

In the course of its pre-investment due diligence, IFC reviewed the client's assessment documentation, including the EIA, reaching the view that the project was unlikely to have significant social or environmental impacts. Nevertheless, IFC identified gaps in the client's social impact assessment as well as its approach to stakeholder engagement. As a result, requirements to: (a) complete a supplementary socioeconomic assessment, and (b) strengthen the client's stakeholder engagement plan, were included in the ESAP. However, it appears that the complainants' key concerns — as relate to the broader implications of the project on

⁶ IFC, "Environmental and Social Review Summary" (February 20, 2014). [http://ifcextapps.ifc.org/ifcext/spiwebsite1.nsf/\(SearchView\)?SearchView&Query=\(FIELD+DocType+==+Environmental+Documents\)+AND+\(FIELD+ProjectId+==+32763\)](http://ifcextapps.ifc.org/ifcext/spiwebsite1.nsf/(SearchView)?SearchView&Query=(FIELD+DocType+==+Environmental+Documents)+AND+(FIELD+ProjectId+==+32763))

⁷ *Ibid.*

government finances and employment at other enterprises such as EPQ — were not considered in any structured manner, as these fell outside IFC's understanding of the social impacts of the project.

IV. Decision

The purpose of a CAO compliance appraisal is to determine whether an investigation of IFC's E&S performance is required in response to a complaint. In deciding whether to initiate an investigation, CAO weighs factors including the magnitude of the E&S concerns raised in a complaint, results of a preliminary review of IFC's E&S performance in relation to these issues, and a more general assessment of whether a compliance investigation is the appropriate response in the circumstances.

The complainant in this case is a union of port workers employed by EPQ, a publicly owned port that has contracted the IFC client to construct and operate a new container facility at the same port. The focus of the complaint is on concerns regarding the social impact of the project, the adequacy of the client's stakeholder engagement process, and the project's compliance with national law.

In relation to these issues, CAO has not identified substantial concerns regarding the E&S outcomes of IFC's investment or issues of systemic importance to IFC such that a compliance investigation becomes the appropriate response. As a result, CAO has decided to close this case. In reaching this conclusion, CAO notes that IFC's interpretation of the requirement to consider the social impacts of the project did not extend to analyzing potential adverse impacts of the project on: (a) employment at other enterprises such as EPQ, or (b) government revenue. It is unclear to CAO whether this interpretation was justified in the circumstances. Absent evidence of potentially significant adverse outcomes, however, CAO concludes that this question alone does not merit a compliance investigation.