



**CAO Audit of IFC's and MIGA's Due Diligence
for two Pulp Mills in Uruguay**

Final Report

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**Office of the Compliance Advisor/Ombudsman
International Finance Corporation
Multilateral Investment Guarantee Agency**



Acronyms

ADP	Air Dried Pulp
BAT	Best Available Technology
BTO	Back To Office report
CAO	Compliance Advisor/Ombudsman
CARU	Comision Administradora del Rio Uruguay
CES	Environment and Social Development Department of IFC
CIS	Cumulative Impact Study
CMB	Celulosas de M'Bopicua project
DINAMA	Dirección Nacional de Medio Ambiente
EA	Environmental Assessment
EAP	Environmental Action Plan
ECF	Elemental Chlorine Free
EIA	Environmental Impact Assessment
ESAP	Environmental and Social Action Plan
ESIM	Environmental and Social Information Memorandum
ESRP	Environmental and Social Review Procedures
EU	European Union
FOSA	Compañía Forestal Oriental SA
FSC	Forestry Stewardship Council
IFC	International Finance Corporation
IPPC (EU)	Integrated Pollution Prevention and Control
MIGA	Multilateral Investment Guarantee Agency
NGO	Non Governmental Organization
OP	Operation Procedures
PCDP	Public Consultation and Disclosure Plan
PDS-ER	Project Data Sheet - Early Review
ESRP	Environmental and Social Review of Projects
PPAH	Pollution Prevention and Abatement Handbook
PRM	Peer Review Meeting
TCF	Total Chlorine Free
TLM	Terminal Logistica M' Bopicua
US-EPA	United States – Environmental Protection Agency
WBG	World Bank Group



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Executive Summary

This audit report relates to two projects on the River Uruguay, which forms the natural border between Uruguay and Argentina. Both projects are in Uruguay. One project is being developed by Grupo Empresarial ENCE of Spain (the Celulosas de M'Bopicua project, or CMB project), and the second is being developed by Oy Metsa Botnia of Finland (the Orion project). IFC is considering investing in both projects; MIGA is considering providing political risk insurance to the Orion project only. The audit was initiated in response to a request from the CAO's Ombudsman function, following the completion of a Preliminary Assessment Report on a complaint submitted to the CAO in September 2005. The CAO recommended that an audit of IFC's and MIGA's appraisal procedures be undertaken, up to the point of disclosure of the EAs. The objective of the audit was to provide greater clarity in relation to the application of social and environmental appraisal procedures by both IFC and MIGA.

Having taken the decision to commission an additional study of the cumulative impacts in July 2005, IFC essentially signaled that there had been a short-coming in its earlier due diligence. However, IFC gave no public clarity about the extent to which the Cumulative Impact Study (CIS) might influence project decision-making, by neither acknowledging that there had been a short-coming in its earlier due diligence, nor by making a clear commitment to consultation on the CIS, nor a clear commitment to restart the disclosure period.

CAO does not discuss the efficacy of IFC's decision to commission a CIS in July 2005, and within the scope of this audit only seeks to identify possible explanations for the divergence of opinion between IFC and MIGA concerning the need for a CIS.

In regard to how IFC have applied their policies and procedures, CAO finds that—

- IFC's due diligence to satisfy itself that the EAs were complete in all material respects prior to disclosure was inadequate and not in compliance with the organization's Disclosure Policy, resulting in disclosure of EAs that were not complete.
- In addition to the inadequacy of the due diligence pertinent to this specific EA, CAO concludes that IFC's ESRPs more generally are not currently supportive of compliance with IFC's Disclosure Policy requirements. In other words, although the procedures are followed, they are not rigorous or robust enough to sufficiently support an outcome that is in compliance with the Disclosure Policy. For example, CES is not currently obliged to record the basis for determining that an EA is complete in all material respects. Similarly, the procedures provide insufficient guidance to staff in the event that they discover a requirement for the client to undertake additional EA work after public disclosure has taken place.

In regard to how MIGA have applied their policies and procedures, CAO finds that—

- MIGA's process of due diligence on the Orion project was in compliance with the organization's policies and procedures that required the documents disclosed to be sufficiently complete for public disclosure



CAO makes the following observations:

- The absence of explicit procedures for deciding how to handle circumstances in which a need for additional information is identified after public disclosure has begun, results in the process being unnecessarily unpredictable for staff, stakeholders and project sponsors.
- IFC and MIGA initially collaborated effectively with respect to the Orion project, however, when IFC identified a need for, and took the decision to commission, an additional study of cumulative impacts, the collaboration was less evident.
- Orion EA documentation was not publicly available through the InfoShop Web site several weeks after MIGA announced that it was officially disclosed.

Based on this audit:

- CAO recommends that IFC systematically document its appraisal of the adequacy of clients' social and environmental processes and documentation prior to public disclosure of EA documents, so that IFC in detail outlines the findings of its environmental and social due diligence.
- CAO recommends that procedures be implemented in both organizations that clearly define the process to be followed where short-comings are identified in the client's social or environmental documentation or processes after disclosure.
- CAO recommends that where IFC and MIGA are involved in the same project there should be clearly defined procedures for collaboration, including the sharing of information and the documentation of the rationale for key decisions.
- CAO recommends that IFC and MIGA implement procedures to verify that the documentation posted on the external Web sites is accessible, correct, and consistent during the entire disclosure period.



1 Introduction

The Compliance Advisor/Ombudsman (CAO) is an independent post that reports directly to the President of the World Bank Group. Established in 1999, the CAO has three distinct roles that promote dispute resolution and external accountability for IFC and MIGA:

- The Ombudsman role: Responding to Complaints by persons who are affected by projects and attempting to resolve the issues raised, using a flexible problem-solving approach.
- The Compliance role: Overseeing audits of IFC's and MIGA's social and environmental performance, particularly in relation to sensitive projects, to ensure compliance with policies, guidelines, procedures, and systems.
- The Advisory role: Providing a source of independent advice to the President and the management of IFC and MIGA, in relation to broader environmental and social policies, guidelines, procedures, strategic issues, trends, and systemic issues.

A compliance audit is concerned with independently assessing the application to a project of policies, guidelines and procedures, to determine whether IFC and MIGA are in compliance. Several principles underpin the compliance audit function. These principles are designed to ensure that the Compliance role remains focused on enhancing social and environmental outcomes, while ensuring that the Safeguard Policies, related guidelines, and procedures are interpreted correctly.

If auditing identifies noncompliance, the emphasis will be on promoting constructive solutions and avoiding recurrences, rather than punitive measures aimed at individual staff.

A compliance audit is a systematic, documented verification process of objectively obtaining and evaluating evidence to determine whether environmental and social activities, conditions, management systems, or related information are in compliance with the audit criteria.

1.1 Background and concern that gave rise to the audit

This audit report relates to two projects in Uruguay, close to the border with Argentina. One project is being developed by Grupo Empresarial ENCE of Spain (the Celulosas de M'Bopicua project, or CMB project), and the second is being developed by Oy Metsa Botnia of Finland (the Orion project). IFC is considering investing in both projects; MIGA is considering providing political risk insurance to the Orion project only.

The audit was initiated in response to a request from the CAO's Ombudsman function, following the completion of a Preliminary Assessment Report on a complaint submitted to the CAO in September 2005. CAO recommended that an audit of IFC and MIGA's appraisal procedures be undertaken, up to the point of public disclosure of the EAs for both projects.



1.2 The objectives and scope of the audit

The objective of the audit was to provide greater clarity in relation to the application of social and environmental appraisal procedures by both IFC and MIGA. Listed below are the three specific objectives:

- Review IFC's and MIGA's due diligence of the projects to satisfy themselves that the EAs were complete prior to disclosure¹
- Review if the practice followed when additional information after public disclosure of the EA is required or comes to light, is, in fact, consistent with applicable policies or procedures
- Understand how the application and interpretation of IFC and MIGA Environmental and Social Review Procedures can result in differing outcomes between the two institutions, with particular emphasis on the issue of cumulative impacts.

The scope did not include any assessment of whether there was a need for an additional study of cumulative impacts. Therefore the audit was not concerned with the efficacy of the decision by IFC to commission a Cumulative Impact Study in July 2005.

¹ IFC and MIGA have slightly different criteria for disclosure. See Chapters 3.1 and 4.1.



2 Context to the Audit of IFC's and MIGA's Due Diligence

2.1 The Orion and CMB projects

2.1.1 Project Description

The proposed Celulosas de M'Bopicuá (CMB) project is a greenfield eucalyptus kraft pulp mill, which will use Elemental Chlorine Free (ECF) technology. The site for the CMB mill is in the Rio Negro district in Uruguay, 12 km from Fray Bentos. The proposed facility will produce annually 500,000 tons of air-dried pulp (ADP), the primary raw material for the production of paper and paper-related products. The total cost of the project is expected to be US\$660 million.

The proposed Orion project is also a greenfield eucalyptus kraft pulp mill, which will use Elemental Chlorine Free (ECF) technology. The site for the mill is in Fray Bentos, Uruguay. This mill will also produce the primary raw material for the production of paper and paper-related products with a capacity of 1 million tons of air-dried pulp (ADP) a year. The total cost of the project is US\$1.2 billion.

2.1.2 Timing of IFC and MIGA involvement

The preliminary application by Botnia to MIGA for the Orion project, took place April 14, 2004. MIGA received the definitive application from Botnia on October 19, 2004, and MIGA's environmental team began the environmental and social due diligence in mid-December and made a site visit in January 2005, which resulted in a clearance memorandum dated January 24, 2005, and a disclosure of the EA on February 9, 2005.

IFC prepared its Project Data Sheet – Early Review on August 10, 2004, for the Orion project, after which IFC entered a period during which it was not actively involved until February 2005. IFC's environmental team was on a site visit in March 2005, and IFC disclosed the EA on April 20, 2005.

For the CMB project, IFC prepared a Project Data Sheet – Early Review on December 15, 2004, and disclosed the EA on July 29, 2005.

2.1.3 The national EA review and permitting process

Both the CMB project and the Orion project had completed the process for review and disclosure of the environmental impact assessment by the competent authority in Uruguay, DINAMA (Dirección Nacional de Medio Ambiente), and had received an Autorización Ambiental Previa (Environmental Permit)² prior to IFC's disclosure of the EA and related documents. MIGA's disclosure of the EA and related documents for the Orion project occurred near the end of the process as the Uruguayan authority were drafting the Environmental Permit for disclosure in February 2005.

The permits allow specified construction works to start within 24 months following notification of the order and for operations to start within 48 months of the beginning of construction.

² In the form of Orders issued by the Ministry of Housing, Territorial, and Environmental Affairs



The process followed by DINAMA is an internal review of the EA submitted by the sponsor, which may include formal requests for supplementary information or analysis, followed by a 120-day EA public disclosure period and one or more public hearings organized and publicized by the project sponsor as specified by DINAMA. Following the public hearing, DINAMA may request that the sponsor conduct further work. When DINAMA is satisfied that the issues raised during the public disclosure of the EA and the public hearings have been properly taken account of in its examination of the sponsor's application for an Environmental Permit, the Environmental Permit is drafted and made public. The permit may include conditions that the sponsor must satisfy throughout the period covered by the permit or at specific times, e.g. before construction starts. There is a 14-day period within which objections concerning the Environmental Permit may be lodged. Following this 14-day period, DINAMA may determine, or an objector request, that a further public hearing is needed. Once DINAMA is satisfied that any objections have been addressed, the Environmental Permit comes into effect.

The CMB project

In the case of the CMB project, the EA was submitted to DINAMA on January 8, 2003, and following review by DINAMA was publicly disclosed locally on May 26, 2003. The public hearing on the EA was held in Fray Bentos on July 21, 2003. The Environmental Permit was issued on October 9, 2003, and was valid for 24 months in which to begin construction and for 48 months from the start of construction to begin operations.

The permit for the CMB project included conditions such as the development of environmental management plans prior to construction and operation, monitoring and monitoring plan requirements, specifications for pollution control and other technical aspects, emission limits, requirements to present a solid waste disposal project for approval by DINAMA prior to construction, and participation in an Environmental Monitoring Commission lead by DINAMA. The Environmental Permit was revised in April 2004, with an amended table of air emission limits.

In July 2005, a supplement to the EA was produced in response to a request from IFC (see Chapter 3.2.2).

The Orion project

In the case of the Orion project, the EA was submitted to DINAMA on March 31, 2004. DINAMA's review up to December 2004, involved six requests for supplementary information and analysis covering a range of topics, including assessment of the cumulative impacts of the Botnia and CMB projects in relation to water, air, and odor. A seventh request was made on December 20, 2004, and the response to this was dated January 17, 2005.

On December 6, 2004, DINAMA instructed Botnia to announce the beginning of the public disclosure period with a public hearing to be held in Fray Bentos on December 21, 2004. Botnia printed and distributed 3,000 copies of the EA summary and opened a public consultation office in Fray Bentos for the week of December 13, 2004. Botnia announced the consultation in local newspapers and on radio and TV stations in the Fray Bentos area, including adjacent towns and across the river in the city of Gualeguaychu, Argentina.



The permit was released for public disclosure on February 14, 2005. During the 14-day notification period, one appeal was lodged by Guayubira,³ which reserved its right to specify the appeal at a later date.

The Orion Environmental Permit dated February 15⁴, 2005 sets out the EA submission and review process, lists the main issues raised at the public hearing on the EA, notes that the issues raised during the public notices and the hearing in connection with the permit were properly taken into account in DINAMA's examination of the application, and sets out 34 conditions applied to the permit. These conditions include information and access to be provided to DINAMA, additional plans and studies to be completed at various stages, project-specific emission limits, monitoring and monitoring plan requirements, participation of Botnia in an environmental performance committee to include local government and community representatives, proposals for a revised location of the on-site landfill, acquisition and management of a conservation area, and construction of a cycle way.

2.2 Framework within which MIGA's and IFC's due diligence takes place and audit criteria

As the focus of this audit concerned the adequacy of due diligence, the framework within which due diligence takes place for both IFC and MIGA was important to understand. IFC's due diligence is primarily guided by—

- IFC's procedure for Environmental and Social Review of Projects (**ESRPs**) (1998);
- IFC's OP 4.01 Policy on Environmental Assessment (**EA**) (1998);
- IFC's Policy on Disclosure of Information.

In addition, IFC has safeguard policies addressing specific issues such as Involuntary Resettlement, Natural Habitats, Indigenous Peoples, Cultural Property, and Forestry. These are not directly relevant to the scope of this audit⁵. The sector-specific guidelines within the Pollution Prevention and Abatement Handbook (1999, *final version*) are applicable to IFC, in common with the other institutions of the World Bank Group. This includes a guideline on Pulp and Paper mills. IFC has also produced an Environmental, Health and Safety Guideline for Port and Harbor facilities (July 1998).

The framework within which MIGA's due diligence takes place is similar to IFC, and includes—

- MIGA's Environmental and Social Review Procedures (**ESRPs**) (2002);
- MIGA's Policy on Environmental Assessment (**EA**) (1999);

³ An Uruguay-based environmental NGO focusing on conservation and the socioeconomic and environmental impacts of forest developments. See www.quayubira.org

⁴ The permit was disclosed on February 14, 2005, the date on the accessible document reads February 15, 2005

⁵ This is not to suggest that individual safeguard policies are (or are not) applicable to either the CMB or Orion projects. The focus of CAO in the audit, however, was on key provisions of the EA Policies, ESRPs, and Disclosure Policies of IFC and MIGA.



- MIGA's Disclosure Policy (1999).

MIGA has interim issues-specific safeguard policies that are broadly similar to those of the IFC. These are not directly relevant to the scope of this audit. The sector-specific guidelines within the Pollution Prevention and Abatement Handbook (1999, *final version*) are also applicable to MIGA.

This framework represents the key audit criteria.

In making a determination of the adequacy of IFC's and MIGA's due diligence, the following overall issues were explicitly considered by the CAO:

- Documentation of decision-making processes and document trails to verify conclusions reached.
- The application of relevant procedures, and the extent to which these procedures are supportive of compliance with policies, and
- Consistency between intent spelled out in overall policies and applied procedures.

CAO specifically focused on these overall issues within the following areas:

- Engagement with Botnia and ENCE on the scope and content of the EA, applicable policies and guidelines, and on any deficiencies in the EA that needed to be addressed.
- The determination of the project's area of influence; the consideration of ancillary aspects or associated facilities; analysis of feasible alternatives, including the 'without project' situation; consideration of cumulative impacts; and verification of adequacy of consultation and local disclosures in support of meaningful consultation.

At this stage, CAO has not conducted an in-depth independent assessment of the adequacy of the EAs and ancillary materials for the projects but, instead, has focused on internal processes according to the audit Terms of Reference.

The specific policy and procedural provisions of IFC and MIGA in relation to the audit criteria are outlined in Chapter 3.2 for IFC and Chapter 4.2 for MIGA.



3 IFC

3.1 Key aspects of IFC's due diligence of relevance to the audit

3.1.1 Key provisions of IFC's ESRPs and EA Policy

IFC's procedure for Environmental and Social Review of Projects (ESRPs) of 1998⁶ discusses applicable environmental and social policies, outlines applicable environmental and other guidelines, describes IFC's project cycle, and details the procedures that IFC staff must follow to ensure that projects meet IFC's commitment to environmentally sustainable and socially responsible projects. The ESRPs include the following stages that are applicable up to the point of public disclosure of a project:

- **Environmental screening:** Once a project has proceeded to the early review stage and is being considered for financing, project screening is undertaken by the Environment and Social Development Department (CES) to decide on the nature and extent of the environmental assessment needed for the project and to categorize the project (as A, B, or C):
- **Environmental and social information requirements and review:** CES must have sufficient information on the environmental and social aspects of a project for staff to review the environmental assessment (and any other available information) to determine its adequacy and identify additional information required. This may involve a site visit.
- **Public consultation:** For category A projects, the sponsor is required to conduct meaningful consultations and to submit a Public Consultation and Disclosure Plan to IFC.
- **Disclosure of EA:** Once CES is satisfied that the EA is complete in all material respects, it discloses the EA (and any supplements or addenda) to the public (see section 3.1.2).
- **Environmental and social clearance:** On determining that a project “will comply with the applicable IFC policies and meet the applicable guidelines,” CES prepares a formal Environmental and Social Clearance Memorandum for the investment department, which clears the project for consideration by the Board⁷.

In its policy on EA, IFC defines a **project's area of influence** as “*The area likely to be affected by the project, including all its ancillary aspects, such as power transmission corridors, pipelines, canals, tunnels, relocation and access roads, borrow and disposal areas, and construction camps, as well as unplanned developments induced by the project (e.g., spontaneous settlement, logging, or shifting agriculture along access roads). The area of influence may include, for example, (i) the watershed within which the project is located; (ii) any affected estuary and coastal zone; (iii) off-site areas required for resettlement or compensatory tracts; (iv) the airshed (e.g., where airborne pollution such as smoke or dust may enter or leave the area of influence); (v) migratory routes of humans, wildlife, or fish, particularly where they relate to public health, economic activities, or environmental conservation; and (vi) areas used for livelihood activities (hunting, fishing, grazing, gathering, agriculture, etc.) or religious or ceremonial purposes of a customary nature.*”

⁶ IFC's ESRPs may be viewed in full at www.ifc.org

⁷ IFC has advised that specialists prepare the Environmental and Social Clearance Memorandum only prior to a project's presentation to Board.



IFC has defined **associated facilities** as facilities that are essential to the construction or operation of an IFC-financed project but are not themselves financed by IFC⁸.

IFC's EA Policy sets out **consultation requirements** that address the frequency of consultation and ensure that consultations are meaningful: *"For Category A projects, the project sponsor consults these groups at least twice: (a) shortly after environmental screening and before the terms of reference for the EA are finalized, and (b) once a draft EA report is prepared."* The policy also requires: *"For meaningful consultations, between the project sponsor and project-affected groups and local NGOs on all Category A and as appropriate for Category B projects, the project sponsor provides relevant material in a timely manner prior to consultation and in a form and language that are understandable and accessible to the groups being consulted"*.

With respect to consultation, IFC's ESRPs require the following: *"For meaningful consultations, the project sponsor provides relevant information in a timely manner and in a form and language that are understandable and accessible to the groups being consulted.... To be meaningful, consultation should be carried out in a culturally appropriate manner, with information in local languages distributed in advance."* (paragraph 37) For category A projects, clients must prepare a **Public Consultation and Disclosure plan (PCDP)**. *"A PCDP defines a technically sound and culturally appropriate approach to meaningful consultation and disclosure. The plan describes local requirements for consultation and disclosure, identifies key stakeholder groups, provides a strategy and timetable for sharing information and consulting with each of these groups, describes resources and responsibilities for implementing the PCDP and details reporting/documentation of the consultation and disclosure activities."* (ESRPs, page 39) In those cases when the EA has been completed prior to the IFC involvement, CES reviews the sponsor's public consultation and disclosure activities for adequacy. If necessary, a supplemental PCDP may be required.

The requirement for **analysis of alternatives** in IFC's EA policy is to *"Systematically compare feasible alternatives to the proposed project site, technology, design, and operation – including, the "without project" situation".* (Annex B (f)) IFC's ESRPs require that sponsor: *"Systematically compares feasible alternatives to the proposed project site, technology, design, and operation—including the "without project" scenario—in terms of their potential environmental and social impacts; the feasibility of mitigating these impacts; their capital and recurrent costs; their suitability under local conditions; and their institutional, training, and monitoring requirements. For each of the alternatives, quantifies the environmental and social impacts to the extent possible, and attaches economic values where feasible. States the basis for selecting the particular project design proposed and justifies recommended emission levels and approaches to pollution prevention and abatement."* (Guidance Note B (f))

For **cumulative impacts**, IFC requires that, as appropriate, clients consider *"Cumulative impacts of existing projects, the proposed project, and anticipated future projects. The assessment of cumulative impacts would take into account projects or potential developments that are realistically*

⁸ This is the definition included in IFC's 2002 Handbook for Preparing a Resettlement Action Plan and appears to be the only publicly available IFC explanation of an associated facility. CES uses a working definition internally, which considers **associated facilities** as facilities that are not funded as part of the project (although separate funding may be provided by the client or others) and whose viability and existence depends exclusively on the project and whose goods and services are essential in the successful operation of the project.



defined at the time the EA is undertaken, when they would directly impact on the project area.” (Annex C, 1)

3.1.2 Disclosure requirements of IFC with respect to EA

For the purposes of the audit, it is important to make a distinction between local disclosures in support of consultation, and the pre-Board disclosure requirements of the institution. This section concerns the latter. Disclosure in support of meaningful consultation is addressed in 3.1.1.

IFC’s **disclosure requirements** are specified in the 1998 Policy on Disclosure of Information. For Category A projects, *“IFC staff must be satisfied that the EA report is complete in all material respects before releasing it to the InfoShop” (1998 Disclosure Policy)*. Once IFC has made this determination and obtained permission for its release from the sponsor, IFC releases the EA report (and any supplements and addenda) to the public in-country and through the World Bank’s InfoShop as early as possible but no later than 60 days prior to the proposed Board date. EA reports are also required to contain details of public consultations made during EA preparation and an Environmental Action Plan (EAP) containing the environmental and social measures designed to manage, mitigate, and monitor impacts.

IFC’s ESRPs reflect similar requirements and stipulate that the following be disclosed: *“all supplements and addenda to the EA report and the responses to the public consultation process” (ESRPs, paragraph 43)*.

3.1.3 Provisions for dealing with significant new information post EA disclosure

Neither IFC’s policies nor procedures formally provide for situations in which significant new information comes to light following the formal disclosure of the EA in the InfoShop. The view of the IFC project team is that this event should be dealt with on a case-by-case basis.

3.2 CAO Analysis of IFC Key Audit Aspects

CAO’s analysis of the questions raised in the scope of the audit is focused on—

- An assessment of IFC’s due diligence to satisfy itself that the Orion and CMB project EAs were consistent with IFC’s respective policies, procedures and guidelines (Section 3.2); and
- An assessment of the handling of new or emerging information during the pre-Board disclosure period that may challenge the adequacy of the EAs as disclosed. In this case, information came to light that challenged the acceptability of the assessment of cumulative impacts for the Orion and CMB projects (Section 5.2).

3.2.1 Adequacy of IFC’s EA due diligence and disclosure for the Orion project

3.2.1.1 How did IFC assure itself that the Orion EA was complete in all material respects?

IFC’s Disclosure Policy requires that *“the EA report is complete in all material respects before releasing it to the InfoShop.”*



In February 2005, after discussions between IFC and the Orion sponsor resumed, a mandate letter was signed. On February 28, 2005, CES began project appraisal. This included a review of EA documentation and of the Back-to-Office Report (BTO) from MIGA's appraisal visit to the project in January 2005. On March 14, 2005, a list of issues for discussion with the sponsor during a subsequent appraisal visit was prepared. In advance of the site visit, the sponsor provided preliminary feedback or responses to many of the issues raised.

The appraisal visit by a Senior Environmental Specialist took place in late March and early April 2005 and included visits to FOSA's nursery, the project site at Fray Bentos, the Ontur Terminal at Nueva Palmira, and discussions with the sponsor. The BTO of the appraisal visit and a related Post Mission Project Briefing Sheet (both dated April 2, 2005) outline the findings of the visit. These documents also allude to a discussion of the issues sent to the sponsor on March 14, 2005, requesting additional information.

Given that the EA and related public consultations were substantially complete at the time IFC became involved in the project in 2005, a decision was taken within CES not to require a Public Consultation and Disclosure Plan. IFC has also orally advised that it considered the consultations undertaken by the sponsor to be adequate. There is no documentation of the background analysis for these decisions within the project files.

Subsequently, there were discussions within IFC concerning whether or not the Ontur Terminal at Nueva Palmira was an associated facility. The sponsor was advised on April 13, 2005, that the terminal was an associated facility. However, the IFC peer review of the project on April 15, 2005, determined that the terminal was not an associated facility.⁹ A number of other minor clarifications were sought from the sponsor in an exchange of e-mails prior to the sponsor's providing clearance for the EA documentation to be disclosed. In the clearance letter, which requires the sponsor to confirm receipt of a number of IFC policies and guidelines, the sponsor indicates that it looked forward to discussing the implications in due course. IFC did provide copies of the relevant policies and guidelines to the sponsor during the appraisal visit.

3.2.1.2 How did IFC address EA related disclosure on the Orion project?

IFC did not document the basis for deciding that the EA was complete in all material respects, and is not explicitly required to do so under its ESRP or Disclosure Policy. IFC has advised that the posting of the Category A Disclosure Sheet on the InfoShop is, in and of itself, confirmation that IFC considers the EA complete in all respects. On April 20, 2005, IFC obtained permission for the release of a set of 20 project documents from the sponsor. The provisional Board date had been set for June 23, 2005, indicating that the pre-Board 60-day disclosure requirement was initiated.

The Environmental Impact Assessment (EIA) summary (Category A Disclosure Sheet), which accompanies the documents disclosed, provides some context to the project and the environmental and social issues that IFC required the sponsor to address. It is implicitly supportive of the adequacy of the EA and explicitly states that *"IFC has reviewed this documentation and considers that it is of adequate quality to be released to the public."* However, it further states that IFC *"does not endorse the content."* In the summary project description and presentation of environmental and social issues, no specific qualitative statements are made on the adequacy of

⁹ It would have been built without the project; the sponsor is a minority shareholder (40%); and the sponsor could potentially use an alternative port in which it has no ownership.



the materials presented. IFC is not explicitly required to do so under its current ESRP or Disclosure Policy.

The IFC disclosure Web pages present a number of documents. The attached PDF files are cluttered, and in two cases the project file names included in the document lists differ from the file names of the PDF attachments. The version of the EA that IFC posted was a different version of the EA to that version which MIGA had posted. The version MIGA posted was the most recent, and Chapter 6 of that version included an integrated discussion of cumulative impacts that had previously only been addressed within an annex. The version IFC posted had a less detailed discussion of cumulative impacts in Chapter 6 of the main EA.

3.2.1.3 How did IFC handle the emergence of significant new information?

During the pre-Board disclosure period, IFC asserted that new information came to light challenging the adequacy of the EA as disclosed and, in particular, the assessment of cumulative impacts for the Orion and CMB projects. Minutes from a May 4, 2005, meeting on Orion state that more analysis on the cumulative impacts may be needed. Until beginning of June, 2005, IFC had kept a “Chinese wall” between the CMB and the Orion project teams to avoid all possibilities for exchange of sensitive business information. This “Chinese wall” was removed for social and environmental information in beginning of June, 2005. IFC advised that on June 7, 2005, it became apparent that data on cumulative impacts in the Orion EA was based on obsolete technical data, due to design changes in the CMB project. IFC also advised it had become aware of concerns that communities in Argentina perceived the pulp mills as threatening to their quality of life. Notes from a meeting on July 25, 2005, state that IFC found the additional study on cumulative impacts necessary for several specific reasons not directly related to retrieving additional social and environmental information.

Neither IFC’s policies nor procedures formally provided for a situation when the organization assessed that new significant information had emerged, and CES was of the opinion that this aspect should be dealt with on a case-by-case basis.

In July 2005, the Orion EA had been disclosed for a period exceeding the minimum 60 days, and thus could formally be presented to the Board at any time. Documentation¹⁰ verifies that IFC was of the opinion that the Cumulative Impact Study (CIS) initiated in July 2005, and its findings, would not trigger a new 60-day disclosure period. On December 6, 2005, IFC verbally advised the CAO that the disclosure of the CIS would restart a new 60-day period. CAO has been advised that this decision was made on November 29, 2005, during planning of the disclosure process for the CIS.

3.2.2 Adequacy of IFC’s EA due diligence and disclosure for the CMB project

3.2.2.1 How did IFC assure itself that the CMB EA was complete in all material respects?

ENCE prepared an EA for the Celulosas de M’Bopicua (CMB) project in 2002. After holding an officially sponsored public hearing in Fray Bentos (Uruguay) in July 2003, the project obtained the DINAMA Environmental Permit in October 2003. At the request of IFC, ENCE produced a

¹⁰ Notes from IFC meetings on June 24 and July 25, 2005



supplementary EA (108 pages) on July 15, 2005. The CMB document package was disclosed on July 29¹¹, 2005.

The IFC team provided ENCE with specific guidance (including policies and safeguards, a note on cumulative assessment, consultation and disclosure procedures, etc.) and agreed on a table of contents for the supplementary EA. The team reviewed a draft of the supplementary EA and sent detailed comments (7 pages) to ENCE on June 19, 2005, outlining inadequacies of the supplementary EA, including the suggestion that it could not be disclosed in its present state. The comments were also specific in regard to the evaluation of cumulative impacts, especially social and economic impacts, including impacts on tourism on the Argentine side of the Uruguay River. IFC has advised that CES specialists visited CMB in July 2005 to review the outstanding issues in the EA.

The environmental related documents (supplementary EA, ESAP, PCDP, and Project Disclosure Sheet among others) were released to the public (InfoShop) on July 29, 2005 (see footnote 11).

The disclosed version of the EA includes specific reference to CMB's compliance with IFC safeguard policies and World Bank Guidelines, in addition to compliance with EU and US-EPA standards on emissions and IPPC (EU) criteria for most appropriate technology. It also includes a PCDP, Mitigation and Monitoring Plan and Contingency and Emergency Plan, among others.

IFC did not document the basis for deciding that the disclosed EA addressed the issues raised on June 19, 2005, and that the EA now satisfied IFC requirements. IFC is not explicitly required to do so under its ESRP or Disclosure Policy. The Category A Project Disclosure Sheet is dated July 29, 2005.

Most of the public consultation on the CMB project took place prior to presentation of the EA to DINAMA in 2003. The sponsor (ENCE) through its subsidiary EUFORES has been involved in the forestry sector in the Fray Bentos region for many years and through its subsidiary TLM (Terminal Logística M'Bopicua) in the industrial and transportation sector since 1998. IFC specifically requested that ENCE prepare a PCDP (based on IFC public consultation and disclosure policy), which is included in the disclosure package of July 29, 2005. The PCDP presented in July 2005 provided information of ENCE's continuous engagement with local stakeholders and ongoing support of community development activities through, among other things, environmental education, cultural preservation, and sport sponsorships. The IFC team also involved ENCE in the preparation of the CIS and its strategy for disclosure and consultation.

3.2.2.2 How did IFC address EA related disclosure on the CMB project?

On July 29, 2005, the IFC team prepared a disclosure sheet detailing which documents (and which language and dated version) should be disclosed. The documents were disclosed the same day. The disclosure package contains the information available as of July 2005 in a way that is accessible and informative in both Spanish and English. The PCDP (28 pages) also contains details on means and timing for continuous engagement with the community and the affected population.

¹¹ During the period from July 2005 to January 2006, the IFC web page stated that the CMB information was disclosed on July 21, 2005. IFC has advised that this was a mistake, that the information was disclosed on July 29, and IFC have now changed the date stated as disclosure date on their web page to July 29



3.2.2.3 How did IFC handle the emergence of significant new information?

IFC started its due diligence for CMB after the 60-day public disclosure period on the Orion project had started. By that time, the Orion project had generated concerns on both sides of the Uruguay River, especially regarding cumulative impacts; socioeconomic impacts; and indirect effects on tourism, employment, and quality of life.

Minutes from a May 19, 2005, meeting on CMB state that IFC will make clear that CMB must assess cumulative impacts.

Prior to start of the 60-day public disclosure period on CMB, the IFC team requested that ENCE produce a supplement to the EA, including an ESAP, PCDP, and an analysis of cumulative aspects of the wood supply for the new mill. The May Peer Review Meeting also committed the IFC team to require ENCE to take a more proactive approach in regard to communications with affected communities.

The IFC review of the EA, the specification of the need for an update and review of the supplement draft appears adequate and is fully documented up to the point of review and feedback to CMB on the draft supplementary EA. IFC advised that this included several visits by IFC staff to CMB in order to ensure that the supplemental EA met IFC standards. No documentation has been identified by CAO confirming that the supplementary EA was revised to meet IFC concerns. IFC is not explicitly required to do so under its current ESRP or Disclosure Policy.

Early in the due diligence process and as soon as IFC decided that a CIS was required, IFC's team working on CMB due diligence involved ENCE, in part to respond to concerns that the 2002 EA and the 2005 supplement still only superficially addressed cumulative and indirect impacts and the impacts on the Argentine (Gualeyguachu) side of the river. The request to ENCE to involve the community and accept its concerns shows that significant issues were recognized and requests made to the project sponsor to deal with those issues.



4 MIGA

4.1 Key aspects of MIGA's due diligence of relevance to the audit

4.1.1 Key provisions of MIGA's ESRPs and EA Policy

MIGA's Environmental and Social Review Procedures (ESRPs) of 2002¹² are designed to obtain relevant information necessary for the review of projects in a timely manner to enable the required environmental and social clearance to be obtained prior to issuing coverage to an applicant (*paragraph 4, MIGA ESRPs*). The ESRPs include the following stages that are applicable up to the point of public disclosure:

- **Environmental screening:** On receipt of a Definitive Application to provide political risk insurance, a preliminary environmental screening is undertaken to identify key issues and categorize the project (as A, B, or C);
- **Environmental and social information requirements and review:** MIGA staff review the environmental assessment and any other available information to determine its adequacy and identify additional information required, which may involve a site visit;
- **Environmental and social clearance:** On determining that a project “*will comply with applicable MIGA policies and meet the applicable guidelines*”, the environmental officer prepares a formal Environmental Clearance Memorandum; and
- **Disclosure of EA and supplementary materials:** MIGA staff ensure that the requirements to disclose information on Category A projects are followed (see 4.1.2).

In its policy on EA, MIGA defines a **project's area of influence** as “*The area likely to be affected by the project, including all its ancillary aspects, such as power transmission corridors, pipelines, canals, tunnels, relocation and access roads, borrow and disposal areas, and construction camps, as well as unplanned developments induced by the project (e.g., spontaneous settlement, logging, or shifting agriculture along access roads). The area of influence may include, for example, (i) the watershed within which the project is located, including the affected estuary and coastal zone; (ii) off-site areas required for resettlement or compensatory tracts; (iii) the airshed (e.g., where airborne pollution such as smoke or dust may enter or leave the area of influence); (iv) migratory routes of humans, wildlife, or fish, particularly where they relate to public health, economic activities, or environmental conservation; and (v) areas used for livelihood activities (hunting, fishing, grazing, gathering, agriculture, etc.) or religious or ceremonial purposes of a customary nature.*”

MIGA defines **associated facilities** as those facilities that are essential to the construction or operation of a MIGA-insured investment and that are dependent on the MIGA-insured investment for their existence or success but are undertakings of a third party (i.e., not investments made by the MIGA Guarantee Holder).

For **consultation** on Category A projects, MIGA's EA Policy indicates that “*MIGA will require the project sponsor to consult, or to have consulted, project-affected groups and local nongovernmental organizations about the project's environmental impacts, and to take their views*

¹² MIGA's ESRPs may be viewed in full at www.miga.org.



into account.” The policy also states that for meaningful consultations to have taken place between the project sponsor and project-affected groups and local nongovernmental organizations, *“the project sponsor provides relevant material in a timely manner in a form and language that are understandable and accessible to the groups being consulted.”*

With respect to consultation, MIGA’s ESRPs require the following: *“For meaningful consultations, the project sponsor provides, or has provided, relevant information in a timely manner and in a form and language that are understandable and accessible to the groups being consulted....The project sponsor should consult before the terms of reference for the environmental assessment are finalized, and once a draft environmental assessment report has been prepared.”* (Paragraph 8)

The requirement for **analysis of alternatives** in MIGA’s EA Guidance is that clients document: *“alternatives that were considered in project site selection, technology selection, and project design.”*

For **cumulative impacts**, MIGA requires that: *“In certain cases, cumulative impacts may need to be assessed. Such cases could arise when the project includes plans for significant future expansion or has the potential to interact with other proposed development activities or other environmental phenomenon such that the resulting impact on the environment is much greater than would be if each project occurred alone. As a general guidance, preparers of the EA should determine to the extent practical whether there are other development projects being considered for the project area that are likely to be implemented in the foreseeable future and which are likely to have impacts that will substantively interact with those of the sponsor’s proposed project.”* (MIGA’s 1998 EA Guidance for Sponsors)

4.1.2 Disclosure requirements of MIGA with respect of EA

For the purposes of the audit, it is important to make a distinction between local disclosures in support of consultation and the pre-Board disclosure requirements of the institution. This section concerns the latter. Disclosure in support of meaningful consultation is addressed in 4.1.1.

MIGA’s **disclosure requirements** are outlined in its 1999 Disclosure Policy. This commits to making *“the sponsor’s Environmental Impact Assessment report (EIA) available through the World Bank’s InfoShop a minimum of 60 days prior to Board consideration”* (paragraph 8, MIGA Disclosure Policy) for Category A projects. Further clarification is provided in MIGA’s ESRPs, which commit to *“release the sponsor’s environmental impact assessment report to the Bank’s InfoShop in Washington DC at least 60 days before the Board date. Notice of the release of the sponsor’s environmental impact assessment report for Category A projects will be posted on the Internet through MIGA’s home page. Environmental information on the project should not be released until (1) MIGA’s Environment Office has reviewed the environmental information and determined that the information is sufficiently complete and appropriate for public disclosure, and (2) the applicant has notified MIGA in writing that it authorizes the release of the information.”* (paragraph 44, MIGA ESRPs)

MIGA requires that the following be disclosed: *“The Environmental Impact Assessment”* and *“a non-technical environmental assessment summary should be disseminated in the local language to local stakeholders.”*



4.1.3 Provisions for dealing with significant new information post EA disclosure

Neither MIGA's policies nor procedures formally provide for situations when significant new information comes to light following the formal disclosure of the EA in the InfoShop. In the opinion of the MIGA project team, this event should be dealt with on a case-by-case basis.

4.2 CAO Analysis of MIGA Key Audit Aspects

CAO's analysis of the questions raised in the scope of the audit is focused on—

- An assessment of MIGA's due diligence to satisfy itself that the Orion EA was consistent with MIGA's respective policies, procedures and guidelines (Section 4.2);
- An assessment of the handling of new or emerging information during the pre-Board disclosure period that may challenge the adequacy of the EAs as disclosed. (Section 5.2).

4.2.1 Adequacy of MIGA's EA due diligence and disclosure for the Orion project

4.2.1.1 How did MIGA assure itself that the Orion EA was sufficiently complete and appropriate for public disclosure?

MIGA's environmental due diligence on Orion, prior to disclosure on MIGA's Web site and in the World Bank InfoShop on February 9, 2005, comprised a review of the EA (including the series of supplements provided in response to DINAMA and including materials available in Spanish only), a review of the socioeconomic study completed for Orion in June 2004, and consultation with World Bank Group colleagues to identify any relevant issues or results from the Forest Products Transport Project for which a World Bank loan to the Government of Uruguay was agreed in 1997. Further, MIGA's environmental officer followed up on a number of issues with Botnia on receipt of an initial set of EA materials and prior to the site visit. These issues included local social infrastructure and consultation (see below). The site visit in January 2004 included visits to the proposed pulp mill site and a selection of plantations and meetings with the project sponsors, regulatory authority, and consultants conducting local consultation.

The Back to Office Report (BTO) systematically reviewed the potential applicability of MIGA issue-specific environmental policies to the Orion project and set out the reasons why only the Physical Cultural Resources Policy applied. The BTO reported that Spanish investors had purchased land at M'bopicua upstream of the proposed Orion site and had received permission to build a pulp mill of about half the capacity of the Orion project. Subsequent to the site visit, e-mails between MIGA and Orion followed up on details about stakeholder consultations.

MIGA determined that the MIGA policy for Projects on International Waterways did not apply because no significant impact was expected on navigation or water quality, quantity, or use in the Uruguay River and reported that both Argentinean and Uruguayan representatives of CARU¹³ were participants in various workshops during the EA preparation.

¹³ Comisión Administradora del Río Uruguay.



The results of this assurance process were documented in MIGA's clearance memorandum dated January 24, 2005. The Clearance Memorandum stated that the additional (nonstandard) environmental conditions should be incorporated into the contract requiring compliance with MIGA's environmental guideline for pulp and paper mills, an annual environmental monitoring report and provision of technical advice and extension services to independent plantation growers.

MIGA's due diligence, as documented in the clearance memorandum, differentiated the project's area of influence by type of impact and, in some cases, acknowledged that this included areas in Argentina. For example, in relation to the local economy, the area of influence was identified as an approximate 60km radius around the project; for wood supply as within the radius of 200km, with the bulk of the supply expected to come from within a 60km radius; and for effluent discharges as changes were highly localized, in the immediate vicinity of the outfall.

In the clearance memorandum, MIGA defines the project and its associated facilities as the pulp mill including its power supply, pollution control equipment and plant, on-site landfill, wharf facilities, and wood supply. MIGA did not consider potential development of a terminal at Ontur port as an associated facility to be included in the Orion environmental due diligence because this was not deemed to be dependent on the Orion project. The Ontur port expansion was identified as a project that the government intended to carry out whether or not the pulp project went ahead.

MIGA reported in the clearance memorandum that alternative locations for the pulp mill had been considered, as were alternatives for the wharf facility, and that the technology selection included the best available technology as defined by the European Union in a 2002 directive. The socioeconomic study systematically considered project and non-project alternatives in the regional analysis (defined as including the Argentine province of Entre Rios), and macro-economic impact analysis.¹⁴

The World Bank Pollution Prevention and Abatement Handbook (1999, final version) stated that only ECF processes were acceptable, and that TCF was the preferred technology for pulp bleaching. MIGA's assessment, communicated verbally to CAO¹⁵, was that the ECF technology selected by the project complies with PPAH insofar as use of TCF is not required by the handbook. In the environmental due diligence documentation that MIGA reported on and referenced, studies showed that emissions from ECF are not appreciably different from TCF, and showed that ECF is internationally recognized as the Best Available Technology (BAT).

MIGA's interaction with Botnia included requesting further information on the processes of local consultation leading to the results reported in the EA and socioeconomic study, a meeting during the field visit with the consultants responsible for local consultation, and scrutiny of meeting records.

¹⁴ The Socio Economic Study notes (Executive Summary, p.7) that the study of regional socioeconomic impacts on Entre Rios was limited by data availability and recommends that "a deeper assessment of the socioeconomic impact and the overall impact to the economy of Entre Rios would merit more work, considering the resource potential of the region once the project moves ahead. The mill will increase demand for Argentinean wood supplies and construction service providers and will provide working opportunities for people living nearby."

¹⁵ This argument is also documented in MIGA's internal paper in connection with a draft response to NGOs dated 25 July 2005, "Summary of Cumulative Impacts Review."



4.2.2.2 How did MIGA address EA related disclosure on Orion?

MIGA's disclosure policy requires that the EA be "sufficiently complete and appropriate for public disclosure." MIGA advised CAO that its approach is to seek to get EAs disclosed early, even in draft form, recognizing that documents may subsequently be modified. Following Environmental Clearance and approval by the applicant, the MIGA Environment Office arranges for the transmission of appropriate documents to the World Bank InfoShop¹⁶ and the posting of appropriate notices and information on MIGA's Internet home page.

Initially, MIGA proposed to the Orion project sponsors that the following documents would be disclosed, subject to a satisfactory outcome of the site visit in January:

- The EA dated March 2004;
- The six EA supplements prepared up to December 2004 in response to requirements by DINAMA;
- The Non-Technical Summary dated December 2004; and
- The Executive Summary of the Socioeconomic Study dated June 2004.

The documents were written in a mix of Spanish and English.

However, on January 10, 2005, MIGA received updated versions of Chapters 5 and 6 of the Orion EA, incorporating all the additional information and analyses requested by DINAMA during the period July–November 2004. Permission to disclose was given by Botnia on January 25, but processing delays within MIGA prevented delivery to the InfoShop until the second week of February. Announcement of availability of the EA was posted on MIGA's external Web site on February 6, 2005.

This 618-page EA in a mix of English and Spanish and incorporating supplements was not available online through the InfoShop until mid March.¹⁷

¹⁶ A number of practical difficulties were encountered in achieving disclosure at the InfoShop. The disclosure documents were provided by Botnia on a CD. The contents were downloaded successfully onto MIGA's Web site but not by the InfoShop. On March 2, 2005, MIGA provided the InfoShop with a hard copy of the EA as found on the CD. These problems continued into March 2005. On March 17, 2005, Botnia informed MIGA that it had published all EA information except EA annexes on its Spanish-language Web page in response to criticism from some local NGOs following the MIGA disclosure.

¹⁷ This 618-page EA was on the Web site at the time of the CAO audit.

5 IFC and MIGA

5.1 Similarities and main differences between IFC and MIGA processes

MIGA's EA Policy (1999) and ESRPs (2002) were developed after that IFC produced its equivalent policy and procedures in 1998. In drafting its policy and procedural provisions, MIGA aimed for consonance between the policies and procedures of both institutions. The intent was to allow for differences that reflected the differing business models and project cycles of both institutions but to ensure that the basic intents of the policies and procedural requirements were retained. This explains the many similarities between IFC's and MIGA's policies and processes.

The following differences between the two institutional frameworks have been identified:

- With respect to consultation, IFC's and MIGA's provisions are broadly similar. IFC requires a PCDP, unless the EA has been completed prior to the IFC involvement and CES considers the sponsor's public consultation and disclosure activities to have been adequate. MIGA has no requirement for a PCDP but can retrospectively assess adequacy of consultation and disclosure.
- IFC's 'standard' for adequacy of EA prior to disclosure is *"complete in all material respects"*, whereas MIGA's is that the EA should be *"sufficiently complete and appropriate for public disclosure."*
- MIGA requires that the EA be disclosed and a non technical EA summary be available in a local language. IFC requires that the EA be disclosed, along with *"all supplements and addenda to the EA report and the responses to the public consultation process."*
- MIGA's disclosure requirements stipulate that when MIGA participates in the same project as the IFC, MIGA will not duplicate the release of information already undertaken by its counterpart organization (*paragraph 44, MIGA ESRPs*). IFC has no equivalent provision.
- IFC's and MIGA's requirements for alternatives analysis are similar in summary form, but IFC provides a fuller explanation of the specific aspects that might be addressed.
- MIGA's EA Policy and ESRPs make no reference to cumulative impacts. However, the EA Guidance that MIGA provides to clients has similar commitments to IFC's ESRPs, and includes a fuller explanation of how cumulative aspects might be addressed.
- IFC's International Waterway Policy (OP 7.50) requires notification by IFC to all parties involved when IFC is considering financing a project on an international waterway. MIGA's policy only requires notification to potentially impacted riparian states when significant impacts are predicted on those riparian states.

5.2 Understanding due diligence outcomes on cumulative impacts

An objective of this audit is to understand how the application and interpretation of IFC's and MIGA's Environmental and Social Review Procedures and Safeguard Policies can result in differing outcomes between the two institutions.



5.2.1 How did IFC address the question of cumulative impacts?

Orion Project

On March 14, 2005, in preparation for its appraisal visit to the Orion project, IFC raised the issue of cumulative impacts with the sponsor. The sponsor responded (March 15, 2005) that the cumulative impacts of both the Orion and CMB project mills had been assessed in the EA for the Orion project and that more details were provided in the seven additional analyses to the EA prepared between September 2004 and January 2005. The sponsor also stated that the air quality indices would not be affected by the project and that the proposed treatment of Fray Bentos' wastewater by Orion would bring about a net improvement in water quality. There is no subsequent discussion reported within IFC's files on the Orion project on cumulative impacts of the Orion and CMB projects prior to disclosure April 20. Minutes of the Investment Review Meeting held May 4 state that more analysis may be needed on the cumulative impact of the project. As stated in Chapter 3.2.1.3, IFC advised that on June 7, 2005, it became apparent that data on cumulative impacts in the Orion EA was based on obsolete technical data, due to design changes in the CMB project. IFC also advised that they had become aware of concerns that communities in Argentina perceived the pulp mills as threatening to their quality of life.

CMB project

The record of the IFC peer review meeting on CMB shows that in May 2005, IFC determined that the CMB EA dated 2002 needed to be supplemented to fulfill IFC's requirements for a Category A project. To avoid potential misunderstandings between government conditions for the project and IFC's, the IFC project team met with DINAMA to explain IFC's approach.

The scope and format of the supplemental EA outlined in May 2005 did not include cumulative impacts of the two plants.¹⁸ In IFC's response June 20, 2005, to CMB on the draft supplementary EA, IFC noted its belief "that a cumulative impact study is needed" and that the information from the supplementary EA on CMB would facilitate this assessment. IFC also noted that the cumulative impact study would cover both Orion and CMB for which a separate TOR (terms of reference) would be drawn up.

5.2.2 How did MIGA address the question of cumulative impacts?

MIGA's review of the Orion environmental impact assessment included review of the information on the cumulative impacts of the two plants that is included in the EA documentation. MIGA did not identify cumulative impacts as a specific or problematic issue to be addressed during its environmental due diligence for the Orion project. The existence of the CMB chipping plant and wharf and the potential CMB pulp project, were identified during the January 2005 field visit and reported on in the BTO. Because the Orion project came after the CMB project in the DINAMA EA review and permitting process, DINAMA required Botnia to consider the existence of the proposed CMB plant in its impact assessment and assess cumulative impacts of the two projects.

On learning that IFC had identified the potential need for a separate cumulative impact study in June/July 2005, MIGA undertook a detailed internal document setting out its analysis of the

¹⁸ From Peer Review Briefing Note: The scope is on (1) reference to WBG emission standards; (2) hazardous materials management and emergency response; (3) alternatives analysis for location and technology; (4) enhanced ESAP; (5) wood sourcing, impacts, and ESAP and PCDP. It is stated explicitly that that the data for (5) is only available from FSC certification and socioeconomic studies already completed and that for the supplement as a whole, "relevant material appears to be available."



cumulative impacts of the two pulp mill projects (completed on July 25, 2005). This identified the five key issues regarding the cumulative impacts of the Orion and CMB pulp mill projects as—

- Capacity and commitment to environmental protection;
- Air emissions and air quality;
- Effluents and water quality;
- Plantation operations and land use; and
- Direct and indirect socioeconomic effects.

The document sets out MIGA's evaluation of cumulative impacts in respect of these points, drawing on documents made available as part of the permitting process for both projects and in publicly available reports that MIGA considered relevant.

CAO understands that this document on cumulative impacts was not shared with IFC in July 2005, because by the time it was completed, IFC had announced that a cumulative impact study would be undertaken. MIGA subsequently provided IFC with the document on October 20, 2005, in the context of discussions on the draft CIS.

5.2.3 Why did IFC's and MIGA's due diligence result in differing outcomes?

There was a difference of opinion between IFC and MIGA regarding the adequacy of the assessment of cumulative impacts in the Orion Project EA. Both IFC and MIGA concluded that the assessment of cumulative impacts was adequate at the point of disclosure of the EAs. Subsequently, IFC revised this opinion, whereas MIGA remained satisfied that the assessment of cumulative impacts was adequate. CAO does not challenge the efficacy of either position.

Given the level of consistency between IFC's and MIGA's policies and procedures for category A projects, CAO does not consider that differences between the two institutions' policies or procedural frameworks would explain these differences in opinion.

Therefore other factors outside the specific requirements of the environmental and social due diligence processes must have affected the decision by IFC to initiate a more in-depth study of cumulative impacts.

There are possibly several inter-linked reasons that may explain the differing approaches by IFC and MIGA:

Differing data sets

Internal documents indicate that during the environmental due diligence on the Orion project, IFC and MIGA were using differing data sets. MIGA was using the complete and final Spanish- and English- language EA. The documents reviewed by the auditors suggest that IFC was using documents that had not been amended to include the supplementary information, including that on cumulative impacts¹⁹, which was added to the EA between September 2004 and January 2005²⁰.

¹⁹ This was evident from internal documentation reviewed, and implied in the IFC Status Note on the project dated October 17, 2005, and confirmed in an intra-institutional correspondence.



Professional judgment and differing responses to perceived risks

Both institutions recognize the role of professional judgment in environmental and social due diligence. It is possible that differences in professional judgment contributed to different conclusions concerning the need for additional work on cumulative impacts. However, there is no evidence of any systematic effort by the two institutions to review or determine reasons that drove them to different professional judgments.

IFC took the view that additional work on cumulative impacts would also contribute to address the concerns raised by communities in June 2005. MIGA considered the original work on cumulative impacts in the Orion EA to have been adequate. This may partially have been a case of differing perceptions of institutional risk between IFC and MIGA.

In retrospect, the limited intra-institutional coordination between IFC and MIGA at that time meant that these factors that might have influenced the differing outcomes were not reconciled. While pre-EA disclosure coordination and cooperation was evident, this intra-institutional coordination was much less evident on the issue of cumulative impacts.

²⁰ IFC have asserted, and CAO accepts, that the documents disclosed by the two institutions are broadly equivalent. However, it is evident from an intra-institutional correspondence between IFC and MIGA that IFC's due diligence was partly based on an incomplete appreciation of the extent of cumulative impacts analysis undertaken for the Orion project, prior to the point of disclosure of the EA in April 2005.



6 Findings and Recommendations

CAO does not discuss the efficacy of IFC's decision to commission a Cumulative Impact Study (CIS) in July 2005, and within the scope of this audit only seeks to identify possible explanations for the divergence of opinion between IFC and MIGA concerning the need for a CIS.

Having taken the decision to commission an additional study of the cumulative impacts in July 2005, IFC essentially signaled that there had been a short-coming in its earlier due diligence. However, IFC gave no public clarity about the extent to which the CIS might influence project decision-making, by neither acknowledging that there had been a short-coming in its earlier due diligence, nor by making a clear commitment to consultation on the CIS, nor a clear commitment to restart the disclosure period.

6.1 Findings

In regard to how IFC and MIGA have applied their policies and procedures, CAO finds that—

IFC's due diligence to satisfy itself that the EAs were complete in all material respects prior to disclosure was inadequate and not in compliance with the organization's Disclosure Policy, resulting in disclosure of EAs that were not complete as:

- Up to (and after) disclosure on Orion in April 2005, IFC was working from incomplete versions of the EA.
- Given that subsequent to disclosure of the Orion EA in April, IFC determined that the EA inadequately addressed cumulative impacts (and that earlier consultations might therefore be inadequate), IFC should have clearly signaled this to stakeholders by committing to consider further consultation on the CIS and to commit to re-starting the pre-Board disclosure period when the EA was complete.
- There was an inherent contradiction in disclosing the CMB EA, and thereby signaling that it was complete in all material respects, without qualifying the basis for its disclosure and the link to the forthcoming CIS, given that the IFC-commissioned CIS had already been committed to.

In addition to the inadequacy of the due diligence pertinent to this specific EA, CAO concludes that IFC's ESRPs more generally are not currently supportive of compliance with IFC's Disclosure Policy requirements. In other words, although the procedures are followed, they are not rigorous or robust enough to sufficiently support an outcome that is in compliance with the Disclosure Policy. For example, CES is not currently obliged to record the basis for determining that an EA is complete in all material respects. Similarly, the procedures provide insufficient guidance to staff in the event that they discover a requirement for the client to undertake additional EA work after public disclosure has taken place.

- For the Orion project, there was no documentation that systematically showed how and why the decision was made that the EA was complete in all material respects and therefore



ready for disclosure. There was no documentation recording the basis on which the decision was made that no PCDP was required for this project.

- For the CMB project, there was no documentation that systematically showed how the inadequacies identified in the project EA were addressed to IFC's satisfaction, prior to disclosure.

MIGA's process of due diligence on the Orion project was in compliance with the organization's policies and procedures that required the documents disclosed to be sufficiently complete for public disclosure

- The complete set of EA documentation was reviewed.
- The decision to disclose is fully documented in a clearance memorandum that systematically reports on the project in the context of MIGA's environmental policies and procedures.
- All issues raised during MIGA's appraisal were resolved to the satisfaction of the MIGA staff involved prior to disclosure.

MIGA did not consider that there was a need for an additional study on cumulative impacts, and therefore saw no need to reconsider its decision that the EA was sufficiently complete.

CAO makes the following observations:

- The absence of explicit procedures for deciding how to handle circumstances in which a need for additional information is identified after public disclosure has begun, results in the process being unnecessarily unpredictable for stakeholders and project sponsors.
- IFC and MIGA initially collaborated effectively with respect to the Orion project, however, when IFC identified a need for, and took the decision to commission, an additional study of cumulative impacts, the collaboration was less evident.
- EA documentation was not publicly available through the InfoShop Web site several weeks after it was officially disclosed.

6.2 Recommendations

Based on this audit:

- CAO recommends that IFC systematically document its appraisal of the adequacy of clients' social and environmental processes and documentation prior to public disclosure of EA documents, so that IFC in detail outlines the findings of its environmental and social due diligence.
- CAO recommends that procedures be implemented in both organizations that clearly define the process to be followed where short-comings are identified in the client's social or environmental documentation or processes after disclosure.



- CAO recommends that where IFC and MIGA are involved in the same project there should be clearly defined procedures for collaboration, including the sharing of information and the documentation of the rationale for key decisions.
- CAO recommends that IFC and MIGA implement procedures to verify that the documentation posted on the external Web sites is accessible, correct, and consistent during the entire disclosure period.



Annex 1: Request for Audit

(Extract from CAO Preliminary Assessment Report “Complaint Regarding IFC’s Proposed Investment in Celulosas de M’Bopicuá and Orion Projects, Uruguay, November 2005”)

4.1 Recommendations

4. The CAO believes that greater clarity in relation to the application of social and environmental appraisal procedures by both IFC and MIGA will be helpful in assisting the dispute resolution process. Accordingly, the CAO will undertake a compliance audit of the adequacy of IFC’s procedures to the point of public disclosures. This audit will also address the question of IFC/MIGA application of policy to the same client on the same project. This audit will be commissioned immediately and should be completed within a month. CAO will work with the parties to ensure that the findings of this audit are well understood and that it is helpful in addressing concerns.



**Compliance Audit of IFC and MIGA's Due Diligence
for two Pulp and Paper Projects²¹ in Uruguay
Terms of Reference**

1. Introduction

The Compliance Advisor/Ombudsman (CAO) is an independent post that reports directly to the President of the World Bank Group. Established in 1999, the CAO has three distinct roles which together promote dispute resolution and external accountability for IFC and MIGA:

- **The Ombudsman role:** Responding to Complaints by persons who are affected by projects and attempting to resolve the issues raised, using a flexible problem-solving approach.
- **The Compliance role:** Overseeing audits of IFC's and MIGA's social and environmental performance, particularly in relation to sensitive projects, to ensure compliance with policies, guidelines, procedures, and systems.
- **The Advisory role:** Providing a source of independent advice to the President and the management of IFC and MIGA, in relation to broader environmental and social policies, guidelines, procedures, strategic issues, trends and systemic issues.

This Terms of Reference (TOR) is for two consultants to participate in a compliance audit of IFC and MIGA's due diligence for two large pulp and paper projects in Uruguay, close to the border with Argentina. One project is being developed by Grupo Empresarial ENCE of Spain (the Celulosas de M'Bopicua project), and the second is being developed by Oy Metsa Botnia of Finland (the Orion project). The audit was initiated in response to a request from the CAO, following the completion of a Preliminary Assessment Report²² on a complaint submitted to the CAO in September 2005. The Preliminary Assessment Report recognized that the resolution of the dispute between the complainants and the project promoters (supported by IFC and MIGA) would benefit from greater clarity in relation to the application of social and environmental appraisal procedures by both IFC and MIGA. Accordingly, it recommended that an audit of IFC and MIGA's appraisal procedures be undertaken, up to the point of public disclosure by both institutions.

Brief background to the projects and IFC/MIGA's involvement

ENCE is a multinational company originating in Spain. ENCE has been operating in Uruguay for more than 15 years in a number of locations. The ENCE operation at M'Bopicua began as a woodchip and port facility. In October of 2003, the installation of the pulp mill was authorized by the Uruguayan government.

²¹ IFC is considering investing in both projects, whereas MIGA is proposing to provide a guarantee for only one of the projects, the Orion project.

²² See www.cao-ombudsman for the full text of this Preliminary Assessment Report.



The proposed **Celulosas de M'Boticua (CMB) project** is a greenfield eucalyptus kraft pulp mill, which will use Elemental Chlorine Free (ECF) technology. The site for the CMB mill is in the Rio Negro district in Uruguay, 12 km north of Fray Bentos. The proposed ENCE facility will produce 500,000 tons of air-dried pulp (ADP) a year, the primary raw material for the production of paper and paper-related products. The total cost of the project is expected to be US\$660 million, with a possible US\$200 million investment from IFC, through both type "A" and "B" loans.

Botnia is a Finnish multinational corporation. Botnia was founded in 1973 and has five pulp mills in Scandinavia, making it Europe's second largest pulp producer. It has no prior experience in Uruguay. Botnia's proposed **Orion project** is also a greenfield eucalyptus kraft pulp mill, which will use Elemental Chlorine Free (ECF) technology. The site for the mill is in Fray Bentos, Uruguay. This mill will also produce the primary raw material for the production of paper and paper related products with a capacity of 1,000,000 tons of ADP a year⁴. The total cost of the project is US\$1.2 billion with a possible IFC investment of US\$200 million through both type "A" and "B" loans. MIGA may provide political risk insurance for up to \$1.2 billion.

2. Objective and scope of the audit

The objective of the audit is to provide greater clarity in relation to the application of social and environmental appraisal procedures by both IFC and MIGA. The overall scope is as follows:

- ***To review IFC and MIGA's due diligence of the CMB and Orion projects to satisfy themselves that the EA's were complete in all material respects prior to disclosure***

IFC's Disclosure Policy states that "IFC staff must be satisfied that the EA report is complete in all material respects before releasing it to the InfoShop, the sponsor may be required to provide supplements and addenda to the EA report before the disclosure period commences." MIGA's Disclosure Environmental and Social Review Procedures state that "Environmental information on the project should not be released until: (1) MIGA's Environment Office has reviewed the environmental information and determined that the information is sufficiently complete and appropriate for public disclosure, and (2) the applicant has notified MIGA in writing that it authorizes the release of the information."

- ***To review if the actual practice of requiring additional information after public disclosure of the EA are consistent with applicable policies***

The audit will consider the implications for affected communities, for IFC's clients, and for IFC's own internal processes of requiring supplementary information, such as in the form of a Cumulative Impact Study after the EAs had been disclosed, and review if this actual procedure are consistent with, in particular, the Disclosure Policies. Additional issues to be addressed under this aspect of the audit would include: what implications this has for consultation with affected communities, as required by IFC's Environmental Assessment Policy (OP4.01) or Policy on Disclosure of Information; what are the client responsibilities, vis a vis any supplementary information required by the IFC; and what are the implications in terms of the required period (60 days) of disclosure and timing of potential Board consideration of the projects.



- **To understand how the application and interpretation of IFC and MIGA Environmental and Social review Procedures can result in such differing outcomes between the two sister institutions**

In particular, this aspect of the audit will explore how IFC can determine that a Cumulative Impact Study is required, albeit belatedly, whereas MIGA consider that no such supplementary study is required.

The audit will be based on an in-depth desk review of IFC and MIGA's appraisal processes for each project, related documents, management systems, procedural controls, and any other information that may be material to the audit. Given that the focus is exclusively on IFC and MIGA's deliberative processes, there will be no requirement to visit the project sites. For the same reason, the requirements of the CAO's Operational Guidelines with respect to sharing audit TORs or draft audit reports with IFC and MIGA clients will also not apply.

3. Approach to the audit and tasks

The approach to the audit will be as described in the CAO Operational Guidelines. The specific tasks will include *inter alia* the following:

1. Participate in initial meeting with the project teams. The purpose of these meetings will be to:

- Introduce the audit team members to the project teams and establish lines of communication with the project team members;
- Review the audit objectives and scope with the project teams;
- Review the audit criteria, which in this instance will include (but not be limited to) IFC/MIGA's Environmental & Social Review Procedures, and relevant provisions of the EA and Disclosure Policies²³;
- Ensure that the audit team benefits from the direct experience of the project teams and to provide a basis for constructive cooperation;
- Identify sources of audit evidence, against which compliance with the audit criteria will be determined. These would likely include key documents produced internally at various stages in the project cycle, but may also include reports or other documents submitted by ENCE or Botnia, or other information from the project files.

Subsequent to the meeting with the project team, more detailed follow-up conversations may be required with project team members (or consultants who have worked on the project).

²³ At a minimum, the audit criteria will include the relevant provisions of:
IFC' Policy on Disclosure of Information (September 1998)
IFC Procedure for Environmental and Social Review of Projects (December 1998)
IFC Operational Policy OP 4.01, Environmental Assessment (October 1998)
MIGA Disclosure Policy (undated)
MIGA Environmental and Social Review Procedures (undated)
MIGA Environmental Assessment Policy (undated)



- 2. Undertake detailed review of audit evidence** gathered through the initial meeting, subsequent interviews, and relevant documents. On the basis of this review, the objectives and scope of the audit (including related audit criteria) should be reviewed with the CAO, and revised if appropriate. The initial review should also make a distinction between verifiable information and information that can not readily be verified, and identify its potential significance i.e. might it be material to determining compliance or not. It is not anticipated that a site visit will be required.
- 3. Review the audit evidence** to determine whether there are non-compliances with the audit criteria. Where apparent non-compliances are identified, the immediate and underlying causes should be fully explored. This will involve consideration of the formal and informal organizational and management policies and practices within IFC and MIGA that may have contributed to the non-compliance.
- 4. Conduct a closing meeting** with IFC and MIGA to verbally discuss the initial audit findings. This should be confined to factual matters as opposed to a discussion of conclusions or recommendations, and will provide an initial opportunity for IFC or MIGA to raise concerns if CAO has misunderstood any of the information gathered during the course of the audit.
- 5. Prepare a report for submission to the President.** This will detail the findings of the audit team. A draft report should be completed no more than 10 working days after completion of the desk review, and will be subject to a process of fact checking by IFC and MIGA. Given that the focus is almost exclusively on IFC and MIGA as opposed to their clients, the CAO may depart from its standard procedural requirement to consult with IFC and MIGA's clients; the final decision will be at the discretion of the CAO. The audit team may revise the draft report in light of responses, if factual inaccuracies are identified. A final report will be submitted to the President for approval.

4. Timing, fees and anticipated costs

The work will begin in the week commencing November 28, 2005, and the investigative part should last no more than 2 weeks. A draft report should be made available to the CAO by December 16, 2005. The consultants should each allow for up to 15 days for work on the audit. Individual consultants and their daily rates will be subject to approval by the World Bank Groups Consultants Appointment Unit. A detailed resume for each team member should be submitted in order to expedite the hiring process.