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Panama's Pando and Monte Lirio Dams: Proactive Engagement in Environmental Human Rights Through Project Due Diligence Leads to Improved Risk Management and Cost Controls

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PANAMA'S PANDO AND MONTE LIRIO DAMS: PROACTIVE ENGAGEMENT IN ENVIRONMENTAL HUMAN RIGHTS THROUGH PROJECT DUE DILIGENCE LEADS TO IMPROVED RISK MANAGEMENT AND COST CONTROLS

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INTRODUCTION

The Pando-Monte Lirio Hydroelectric Power Project (Pando Project) is located along the Chiriqui Viejo River (CVR) in Western Panama. It consists of two hydroelectric dams that are part of nineteen hydroelectric installations planned and partially constructed along the CVR in Western Panama.[1] The Pando Project reflects the Inter-American Development Bank's (IDB's) commitment to investments in "clean energy" in Central America.[2] The project is an important contribution to Central America's energy needs, but has caused a number of residents and citizen organizations in the CVR region to raise issues regarding the impact the project will have on the CVR and their livelihoods and way of life.[3]

The IDB approved a loan for the Pando Project on December 9, 2009[4] in the amount of $40 million,[5] and the International Finance Corporation (IFC) approved a series of loans on February 4, 2010 for a total loan risk of $40 million.[6] According to the IFC's Compliance Ad-

1. WERNER KIENE ET AL., COMPLIANCE REVIEW TEAM OF THE INDEP. CONSULTATION AND INVESTIGATION MECHANISM, COMPLIANCE REVIEW REPORT, THE PANDO-MONTE LIRIO HYDROELECTRIC POWER PROJECT, COMPLIANCE REVIEW PANEL TEAM 10 (Sept. 28, 2012), *available at* http://www.iadb.org/en/mici/complaint-detail,1804.html?ID=PN-MICI001-2010.
2. *Id.* at 18.
3. *Id.* at 12.
4. OFFICE OF COMPLIANCE ADVISOR/OMBUDSMAN AND INDEP. CONSULTATION AND INVESTIGATION MECHANISM, CONCLUSION REPORT CAO OMBUDSMAN PROCESS/ICIM CONSULTATION PHASE 1 (April 2011) [hereinafter CONCLUSION REPORT], *available at* http://www.cao-ombudsman.org/cases/document-links/links-156.aspx.
5. KIENE ET AL., *supra* note 1, at 14.
6. OFFICE OF THE COMPLIANCE ADVISOR/OMBUDSMAN, APPRAISAL REPORT: PANDO AND MONTE LIRIO HYDROPOWER, CHIRIQUI VIEJO RIVER, PANAMA 5 (2012) [hereinafter APPRAISAL REPORT], *available at* http://www.cao-ombudsman.org/cases/document-links/links-156.aspx.

visor Ombudsman Appraisal Report, the investment decision to fund the Pando Project was made despite the undefined potential cumulative impact of the development on the entire CVR.[7] The local community questioned the validity of the environmental impact assessments related to the Pando Project and maintained a deep distrust of environmental impact assessments conducted on projects in the CVR.[8]

The IDB's approval process involved intense debate regarding the approval decision.[9] Ultimately, the IDB management recommended engagement in the Pando Project to follow the lead of the other co-financiers.[10] The IDB made the decision to fund on the merits of the rationale that the existing financiers were going forward with the financing despite the issues and the IDB should remain engaged to continue progressing towards long-term compliance with the bank's environmental and social policies.[11] At the loan document signing, the IDB conditioned the first loan disbursement on a key environmental study.[12] The environmental study failed to meet lender requirements at disbursement, yet the IDB released the first disbursement as planned.[13] The poorly planned project has been the source of growing conflict.[14]

The World Bank Group's (WBG's) traditional mandate is to advance human rights through poverty reduction by assisting developing countries to enhance their infrastructure and economic resources.[15] Operating within this WBG framework, the IDB and IFC implement the mandate for advancing human rights by combating poverty in developing countries.

The new Human Rights and Environment (HRE) paradigm adds innovative human rights concerns; concerns that are at times at

7. *Id.* at 1.

8. OFFICE OF COMPLIANCE ADVISOR/OMBUDSMAN, OMBUDSMAN ASSESSMENT REPORT: COMPLAINT REGARDING THE ELECTRON INVESTMENT S.A. PANDO – MONTE LIRIO HYDROELECTRIC PROJECT (#27975) 8 (July 2010) *available at* http://www.cao-ombudsman.org/cases/document-links/links-156.aspx.

9. KIENE ET AL., *supra* note 1, at 14, 18.

10. *Id.* at 18.

11. *Id.*

12. *Id.* at 19.

13. PRESS RELEASE, ACCOUNTABILITY COUNSEL AND BANK INFORMATION CENTER, INTER-AMERICAN DEVELOPMENT BANK AUDIT SHOWS PROJECT THREATENS PANAMANIAN RIVER (Oct. 23, 2012), *available at* http://www.bicusa.org/idb-pando-monte/.

14. *Id.*

15. KIM HERBERTSON ET AL., A ROADMAP FOR INTEGRATING HUMAN RIGHTS INTO THE WORLD BANK GROUP iv. (World Resources Institute, 2010), *available at* http://www.wri.org/publication/roadmap-integrating-human-rights-world-bank-group.

odds with the traditional role of the WBG members to combat poverty in developing but impoverished communities throughout the world. In an age of increasing sensitivity to burgeoning corporate citizenship, the goal to protect human rights affords the WBG opportunities to create substantive beneficial outcomes to millions of people through proactive engagement of stakeholders incorporated into WBG lending policies.

Despite the WBG's progress towards addressing HRE issues, the efficacy of its role is limited because WBG organizations lack regulatory authority. As Alan Miller, Principal Climate Change Specialist in the Climate Business Department at the IFC, recently commented, the IFC is really only a bank and its scope of influence limits it ability to act as a regulatory agency.[16] Miller noted that the WBG's lending role allows for some influence, but it lacks the necessary authority to act fully in a regulatory capacity.[17] It is against this backdrop that WBG entities, such as IFC and IDB, may embrace the opportunity to further integrate HRE standards into their banking operations.

Ultimately, economic viability is contingent on tenuous margins, making WBG investments riskier than private lender investments. Borrowers, lenders, governments, NGOs, and other stakeholders must therefore be cognizant of HRE issues that increasingly put projects at risk. Increasingly, these risks hamper the advancement of the more traditional human rights objectives of the WBG. Nevertheless, stricter adherence to WBG HRE policies will lead to improved risk management and cost control.

A review of the Pando Project's shortcomings in due diligence illustrates the need for stricter integration of procedures and evaluation practices in designing and conducting substantive due diligence. The members of the WBG, along with other multi-national banks and the complete array of unique stakeholders, benefit from synergistic engagement by avoiding risks that arise from late-emerging HRE issues. All stakeholders must strive to balance the tenuous financial dimension of economic development projects with the important HRE concerns raised by stakeholders in developing countries.

Proactive engagement begins with implementing procedural standards aimed at engaging all stakeholders. Prior to approving project funding, all stakeholders, with the WBG institutions leading the

16. Remarks of Alan Miller, Principal Climate Change Specialist in the Climate Business Department of the International Finance Corporation, Panel on International Finance, Human Rights, and the Environment, Fourth Annual Environmental Law and Justice Symposium, Florida A&M University College of Law (Nov. 8, 2013).

17. *Id.*

way, must engage in a dialogue aimed at managing risks and costs, addressing HRE concerns, and proactively working towards synergistic solutions. By valuing good corporate citizenship and the need for cost certainty, the developer must be thoughtful and deliberate in properly addressing HRE issues.

Development projects face increasing risks of delay and rapidly escalating costs due to the haphazard attention to proactive due diligence, particularly relating to HRE issues. A proactive and engaged initial due diligence process leads to earlier solutions to issues, which leads to reduced risk and lower project costs. The adherence to IFC Performance Standards or the Equator Principles guides the initial due diligence and benefits lenders and developers in managing risk and costs.

Part I of this paper reviews the evolution of the Pando Project and the IDB's and the IFC's funding of the Pando Project in Panama. Part II reviews the role of the WBG, IDB, and IFC in funding economic development, including the evolution of the WBG's traditional role and its emerging integration of HRE into its lending practices through the IFC's Performance Standards and the subsequent development of the Equator Principles III. Part III reviews the Pando Project's failure to fully engage all stakeholders early in the due diligence process. Part IV proposes that proactive, synergistic engagement in integrating HRE leads to improved risk management and cost control. Promoting proactive engagement of HRE principles in Multilateral Development Banks' (MDBs') lending practices leads to improved economic development projects and HRE protections through lower project costs, increased cost certainty, and reduced financial and political risk.

I. The Pando-Monte Lirio Hydroelectric Power Project, Chiriqui River, Panama

A. *Overview of the Pando-Monte Lirio Hydroelectric Power Project*

The Pando Project and other IDB-financed dams on the river impact approximately 21% of the total length of the 128-kilometer river.[18] The developer is Electron Investment S.A.[19] Electron Investment S.A. is a joint venture between a Spanish company and a Panamanian private foundation started by a prominent Panamanian businessman and politician.[20] The IDB approved a loan for the Pando

18. Kiene et al., *supra* note 1, at 12.
19. Conclusion Report, *supra* note 4, at 1.
20. Ombudsman Assessment Report, *supra* note 8, at 6.

Project on December 9, 2009,[21] in the amount of $40 million,[22] and the IFC approved a series of loans on February 4, 2010,[23] consisting of two loans and an IFC swap for a total loan risk of $40 million.[24] The total initial cost of the project was estimated to be $291.7 million.[25] The companies collectively contributed $109 million in equity to the project.[26] The additional funding was derived from $153 million in senior debt and $30 million in subordinated debt.[27] Both the IDB and the IFC approved loans for the Pando Project as part of a funding consortium of approximately $180 million.[28]

The IFC made the investment decision to fund the Pando Project prior to ascertaining the potential cumulative impact of the development of the entire CVR.[29] The appraisal report noted the IFC was aware of emerging concerns but the IFC maintained it better served its purpose by continuing to engage in projects to address issues long term.[30] The IFC's position was that by remaining engaged, the lender remains influential in ensuring a resolution of the issues surrounding the project."[31] Further, the appraisal report concluded the IFC should not strictly adhere to its policies because the audit found it would yield limited information.[32]

IDB's approval process was more contentious. Nevertheless, with other co-financiers moving forward with the decision to finance the Pando Project, the IDB management ultimately recommended following the lead of the other co-financiers.[33] The IDB had to fund the project rather than insisting on more due diligence and compliance with lender requirements prior to loan approval.[34]

In 2002-2003, preliminary environmental impact assessment reports were prepared for the Pando and Monte Lirio plants.[35]

21. CONCLUSION REPORT, *supra* note 4, at 1.
22. KIENE ET AL., *supra* note 1, at 14.
23. CONCLUSION REPORT, *supra* note 4, at 1.
24. APPRAISAL REPORT, *supra* note 6, at 5.
25. *Id.*
26. OMBUDSMAN ASSESSMENT REPORT, *supra* note 8, at 6.
27. KIENE ET AL., *supra* note 1, at 12.
28. Accountability Counsel and Bank Information Center, *supra* note 13.
29. APPRAISAL REPORT, *supra* note 6, at 1.
30. *Id.* at 10.
31. *Id.*
32. *Id.* at 11.
33. KIENE ET AL., *supra* note 1, at 12.
34. *Id.* at 12.
35. INT'L FIN. CORP., KEY ISSUES & MITIGATION, PANDO MONTE LIRIO: ENVIRONMENTAL & SOCIAL REVIEW SUMMARY, http://ifcext.ifc.org/ifcext/spiwebsite1.nsf/1ca07340e47a35cd85256efb00700cee/2B66650654EF01A7852576BA000E32C0 (last visited Oct. 7, 2013). *See*

Autoridad Nacional del Ambiente (ANAM), the local environmental authority, granted Environmental Licenses in July of 2004.[36] These environmental impact assessments, completed early in the development stage, initially identified the key environmental and social impacts of the Pando Project along with mitigation measures and plans.[37] An improved environmental impact assessment became available in November of 2009.[38] The 2009 environmental impact assessment was completed by Sustainable Development Advisors and IT Power in September of 2009.[39] Hatch, an independent engineering firm, conducted an independent assessment of the 2009 environmental impact assessment, recommending additional baseline studies prior to construction due to inadequate studies conducted during the environmental impact assessment process.[40] Hatch recommended the studies include socioeconomic studies and the identification of downstream river users, the identification of aquatic species and habitats, as well as terrestrial and avian communities, followed by the development of mitigation plans to minimize any potential impacts.[41] The Lenders are coordinating a cumulative impact assessment to include all ongoing and planned hydropower projects along the CVR.[42] The IFC's Compliance Advisor Ombudsman Appraisal Report in 2012 concluded that the IFC policy provisions had been adhered to despite the emerging concerns.[43]

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also Inter-American Development Bank, ENVIRONMENTAL AND SOCIAL MANAGEMENT REPORT (ESMR), 6 (Nov. 20, 2009), *available at* http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=35003657. The original Category III EIA reports for the Project were prepared in 2002. Separate reports were prepared for the Pando project and the Monte Lirio project. In December 2002, ANAM requested additional information on ecological flow, impacts on river users, and implementation schedule of mitigation measures. The requested information was provided by Electron Investment S.A. in March 2003, and ANAM approved the two EIAs report in March 2004. *Id.*

36. *Id.*

37. *Id.*

38. APPRAISAL REPORT, *supra* note 6, at 7.

39. IT Power and Sustainable Development Advisors, PRELIMINARY STUDY TO GENERATE THE EVALUATION FRAMEWORK OF POTENTIAL CUMULATIVE IMPACTS ASSOCIATED WITH THE CURRENTLY CONCESSION HYDROPOWER DEVELOPMENT IN THE CHIRIQUI VIEJO RIVER BASIN – PANAMA, http://ifcext.ifc.org/ifcext/spiwebsite1.nsf/0/2B66650654EF01A7852576BA000E32C0/$File/7.%20Executive_Summary_of_CIA_2.pdf (last visited Jan. 1, 2014).

40. Hatch, INDEPENDENT ENGINEER'S EVALUATION OF THE 32-MW PANDO AND 52-MW MONTE LIRIO GREENFIELD FACILITIES, http://www.hatch.ca/environmental_services_group/EAM/Projects/pando.htm (last visited Jan. 1, 2014).

41. *Id.*

42. *Id.*

43. *See* discussion *infra* Part I.B.

B. Review of the Complaints Filed by the NGO Alliance

On January 26, 2010, the IFC's Compliance Advisor Ombudsman received a complaint letter from Environmental Alliance for Integral Development–United for Panama (AAPRODIUPA), an alliance of 16 organizations, alleging that the planned Pando Project violated a number of IFC standards.[44] As a result of the policy violations, the complaint letter claimed a number of social and environmental concerns, including lack of participative consultation processes with communities, cumulative environmental impact reports, flooding concerns downstream, endangerment of fish and other species, and limited access to water.[45] The Pando Project raises issues regarding the impact of the project on the CVR and the livelihoods and way of life of the local and downstream citizens.[46] The AAPRODIUPA claims 80 percent of Panama's agricultural output comes from the Chiriqui Viejo River watershed.[47] Because agriculture is the primary source of livelihood for many downstream residents, soil and water are their most important resources and their livelihood depends on soil and water to sustain their agricultural livelihood.[48]

The primary issues raised by AAPRODIUPA relate to the quality of the documents and studies available at the time IFC decided to invest in the Pando Project.[49] A related issue was the lack of consultation regarding the documents and studies.[50] On March 12, 2010, the IDB's Independent Consultation and Investigation Mechanism received a similar complaint.[51]

In July of 2010, IFC's Compliance Advisor Ombudsman completed an assessment, and the parties agreed to participate in a dialogue process facilitated by IFC's Compliance Advisor Ombudsman and IDB's Independent Consultation and Investigation Mechanism to attempt to reach a mutually agreeable solution to the issues raised by AAPRODIUPA.[52] A variety of meetings were held among the various stakeholders and, after five months, no agreement was reached.[53] IFC's Compliance Advisor Ombudsman and IDB's Independent Con-

44. CONCLUSION REPORT, *supra* note 4, at 1.
45. *Id.*
46. KIENE ET AL., *supra* note 1, at 12.
47. *Id.* at 15.
48. APPRAISAL REPORT, *supra* note 6, at 5.
49. *Id.* at 1.
50. *Id.*
51. KIENE ET AL., *supra* note 1, at 10.
52. CONCLUSION REPORT, *supra* note 4, at 1.
53. *Id.*

sultation and Investigation Mechanism had entered into an agreement on February 15, 2011, to conduct a joint consultation process.[54] In February of 2011, the IFC's Compliance Advisor Ombudsman deemed the complaints eligible for assessment, but found not all stakeholders were interested in participating in a dialogue process.[55]

Electron Investment S.A. decided in March 2011 that it was no longer in its interest to continue to participate in the process.[56] The complaint was then transferred to IFC's Compliance Advisor Ombudsman compliance division for appraisal in April of 2011.[57] Electron Investment S.A. withdrew its participation despite the lenders' requirement to verify compliance with a series of conditions prior to the first loan disbursement.[58] Due to Electron Investment S.A.'s decision to opt out of the review process, IFC's Compliance Advisor Ombudsman and IDB's Independent Consultation and Investigation Mechanism terminated the joint consultation process.[59] The complaints were then transferred to IFC's Compliance Advisor Ombudsman's compliance function for an appraisal report and to IDB's Independent Consultation and Investigation Mechanism's Compliance Review Panel for Eligibility Analysis.[60] Following this split, the IFC's Compliance Advisor Ombudsman's and the IDB's Independent Consultation and Investigation Mechanism proceed on different paths.

On February 8, 2012, the IFC's Compliance Advisor Ombudsman issued an appraisal report in response to the January 26, 2010 letter from AAPRODIUPA outlining alleged violations of IFC policies.[61] The IFC's Compliance Advisor Ombudsman appraisal report concluded the case failed to merit an audit of IFC's due diligence related to the Pando Project.[62] The IFC's Compliance Advisor Ombudsman will close this case and take no further action.[63] IFC's Compliance Advisor Ombudsman's determined that a compliance audit would yield limited additional information on the Pando Project.[64] On February 21, 2012, the AAPRODIUPA raised objections and concerns related to the IFC's Compliance Advisor Ombudsman compliance ap-

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54. KIENE ET AL., *supra* note 1, at 15.
55. APPRAISAL REPORT, *supra* note 6, at 6.
56. CONCLUSION REPORT, *supra* note 4, at 1.
57. APPRAISAL REPORT, *supra* note 6, at 6.
58. CONCLUSION REPORT, *supra* note 4, at 2.
59. KIENE ET AL., *supra* note 1, at 15.
60. CONCLUSION REPORT, *supra* note 4, at 1-2.
61. *See* APPRAISAL REPORT, *supra* note 6.
62. *Id.* at 11.
63. *Id.*
64. *Id.* at 1.

praisal report of IFC's involvement.[65] IFC's Compliance Advisor Ombudsman's March 30, 2012, letter in response to AAPRODIUPA's objection letter reiterated IFC's Compliance Advisor Ombudsman's position that the case did not merit an audit of IFC's due diligence.[66]

In March 2011, the IDB's Independent Consultation and Investigation Mechanism issued a Compliance Review Report on the IDB loan funding the Pando Project.[67] In contrast to the approach by the IFC's Compliance Advisor Ombudsman, the IDB's Independent Consultation and Investigation Mechanism conducted a full investigation and publicly released a Compliance Review Report in September/October 2012.[68] The audit confirmed that IDB approved the loan despite knowledge that significant issues were raised by stakeholders.[69] Among the complaints raised by the AAPRODIUPA, this paper will be limited to reviewing the procedural issues raised with respect to proactive engagement in due diligence.[70]

The IDB's Independent Consultation and Investigation Mechanism Project Ombudsman is tasked in the Consultation phase of the Compliance Review to mediate among relevant stakeholders as part of a problem-solving approach.[71] The Compliance Review focuses on whether the IDB's processes meet relevant policy requirements.[72] IBD's Operational Policies require the Bank to ensure that its financial resources are only made available in a way consistent with the Bank's principles and policies and that they continue to be consistent once assigned and disbursed.[73] The Compliance Review Panel concluded that the claims stem from the handling of design issues on the overall impact on the total CRV and the impact of the altered ecological flow.[74]

The Compliance Review Panel did not investigate the borrower, local institutions, and other organizations involved in the project.[75] The efficacy of the report is limited by the panel's mandate to report

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65. Letter from Meg Taylor, Compliance Advisor/Ombudsman to Ms. Damris Sanchez, AAPRODIUPA (March 30, 2012) (on file with author), *available at* http://www.accountabilitycounsel.org/communities/current-cases/pando-and-monte-lirio-dams-panama/.

66. *Id.*

67. *See* KIENE ET AL., *supra* note 1.

68. Accountability Counsel, *Current Cases: Pando and Monte Lirio Dams*, http://www.accountabilitycounsel.org/communities/current-cases/pando-and-monte-lirio-dams-panama/ (last visited July. 16, 2014).

69. *Id.*

70. *See infra* Part III.A.

71. KIENE ET AL., *supra* note 1, at 12.

72. *Id.*

73. *Id.* at 13.

74. *Id.* at 14.

75. *Id.* at 16.

IDB's compliance.[76] It is not within the scope of the panel's mandate to assess the merits of the decision to acquiesce to corporate expediency or to assess the decisions of the IFC and the other financiers.[77] Nonetheless, it is illustrative of a procedural breakdown when the project approved by the IDB board in December of 2009 was conditioned on the completion of an ecological flow study prior to the signing of the loan documents.[78]

IFC's Compliance Advisor Ombudsman acknowledges the IFC is well aware of the challenges of funding development projects and assesses the challenges as part of the decision to fund and further influence outcomes.[79] The IFC makes a compelling case that funding challenging projects and maintaining influence on the outcomes serves its purpose. If IFC backed out of loans with challenges, the IFC would significantly lower its lending influence and its ability to fulfill its mandate. At the signing of the loan agreement, the panel decided to sign the loan documents only if a flow study would be completed as a condition precedent to the first loan disbursement.[80] While a study was produced prior to the first loan disbursement, the study was flawed and found unacceptable by the IDB's Environmental and Social Safeguards Unit (ESG).[81] Despite this conclusion, IDB continued with the first disbursement.[82]

The procedural history of the Pando Project loan process by IDB and IFC illustrates how lender due diligence continues to fall short of the proactive integration of HRE considerations into the WBG lending process. The path taken by Electron Investment S.A., IFCs and IDB highlights the difficulties associated with designing and conducting project evaluations consistent with HRE concerns of all stakeholders. It also highlights an apparent lack of will to address concerns proactively and in an engaged manner.

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76. *Id.* at 18.
77. *Id.*
78. *Id.* at 19.
79. APPRAISAL REPORT, *supra* note 6, at 10.
80. KIENE ET AL., *supra* note 1, at 19.
81. *Id.*
82. *Id.*

II. Multilateral Development Banks: The Current Integration of Environmental Human Rights and Environmental Issues into Funding Economic Development

Part II provides historical context regarding the development of the WBG, the IFC, and the IDB. It then discusses the nature and development of the IFC's Performance Standards. Part II concludes with a discussion of the recently updated Equator Principles III and the role of the Equator Principles III in advancing the concept of proactive engagement in due diligence to improve risk management and cost control.

A. *Historical Review of the World Bank Group, the Inter-American Development Bank, and the International Finance Corporation*

In 1944, as a result of the Bretton Woods Conference, the World Bank (WB) was formed to assist in the rebuilding of war torn countries impacted by World War II.[83] With the signing of the Marshall Plan in 1944, the WB's purpose shifted to financing economic development projects in emerging markets, combating poverty, and advancing human rights throughout the developing world's population.[84] The WB and its affiliated banking institutions have a rich history of funding economic development projects in developing countries throughout the globe.

The WBG is comprised of a variety of entities lending money for development projects, providing loan guarantees, and providing dispute resolution procedures to resolve concerns stemming from lending projects.[85] The introduction of HRE adds another dimension of human right concerns to the WBG's original mandate, coinciding with the human rights priorities that guided the WBG from its inception to assist in combating poverty. The United Nations (UN) and numerous human rights organizations are working to clarify roles and responsibilities, help guide the implementation and to resolve concerns such as whether human rights are universal, whether human rights reflect cultural biases, how to resolve such cultural biases, and how to manage

83. The World Bank, *World Bank History*, The World Bank: Working for a World Free of Poverty, http://go.worldbank.org/W3SF2UKO71 (last visited July 16, 2014) [hereinafter The World Bank].

84. Rolf H. Weber & Douglas W. Arner, *Toward a New Design for International Financial Regulation*, 29 U. Pa. J. Int'l L. 391, 398-399 (2007).

85. *See* The World Bank, *supra* note 83.

conflicting human rights when resources are scare and alternatives are costly or unavailable.[86]

Reducing poverty through economic development has traditionally been the driving purpose behind the WBG's funding activities.[87] The new HRE paradigm introduces additional human rights concerns—concerns that are at times at odds with the traditional role of the WBG.

The World Bank is directed by 188 member countries,[88] and the International Finance Corporation is directed by 184 member countries[89] with diverse traditions. This structure developed a culture of quantifying investments at a national level, aspiring to respect boundaries between the WBG role and the role of each country's government.[90] It is within this politically diverse web of competing interests that the challenge of integrating HRE into existing WBG projects and procedures exists. This integration not only requires shifting paradigms and policy modifications by the WBG, but it also requires the same shifting for member governments, developing country governments, NGOs, private and public development companies, benefiting communities, and affected communities.

While there are adverse and conflicting objectives among the parties, the integration of HRE into the existing traditional role of the WBG is in some ways parallel to traditional concerns for human rights at the core of the WBG mission.[91] The 2012 version of the IFC Performance Standards[92] and the June 2013 release of the Equator Principles III[93] include notable revisions that move further in the direction of addressing HRE concerns.

The conflict between developing HRE concerns and traditional WBG goals in some respects poses a threat of harm to the beneficiaries of the WBG mandate. HRE concerns could derail or add expense to a critical economic development project to combat poverty, expending resources otherwise directed towards the project beneficiaries. The added cost may further reduce the number of development projects to be funded by the WBG.

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86. HERBERTSON ET AL., *supra* note 15, at 2.
87. *Id.*
88. THE WORLD BANK, 2013 ANNUAL REPORT, 2 (2013).
89. Int'l Fin. Corp., 2013 Annual Report: The Power of Partnerships 1 (2013).
90. HERBERTSON ET AL., *supra* note 15, at 2.
91. *Id.*
92. *See infra* note 109.
93. *See infra* note 122.

The economic benefits of HRE protections are difficult to quantify.[94] The WBG has often judged investments on the basis of short term economic returns, diminishing the protection and promotion of human rights of disadvantaged people in developing countries.[95] Internal restraints slow progress, as risk management models fail to adjust for human rights risks or continue to be refined and developed.[96] The WBG believes fostering conditions in support of the attainment of human rights is a central objective of its development goals.[97] The failure to more fully and systematically integrate human rights into its policies and programs hampers the WBG from realizing its desired development outcomes.[98]

The WBG traditionally considered human rights beyond the scope of its development mandate and considered such human rights considerations to be political in nature.[99] However, the WBG's existing activities implicitly promote and protect human rights.[100] Despite this influence, the WBG struggles at times to articulate its role in promoting human rights in developing countries.[101] Central to this struggle is the traditional belief that the WBG acts only in a facilitative role by assisting members address human rights obligations.[102]

B. The 2006/2012 IFC Performance Standards

One of the most significant steps towards the integration of HRE into the WBG lending procedures has been with the IFC's Performance Standards. On January 1, 2012, the IFC updated its Performance Standards by further integrating HRE. The IFC's involvement in high profit and controversial private projects led to the adoption of "Performance Standards," a guide for corporate clients in environmental and social risk management.[103] More than 118 finan-

94. HERBERTSON ET AL., *supra* note 15, at 2.

95. *Id.*

96. *Id.* at 2-3.

97. THE INTERNATIONAL BANK OF RECONSTRUCTION AND DEVELOPMENT, DEVELOPMENT AND HUMAN RIGHTS: THE ROLE OF THE WORLD BANK 2 (The World Bank, 1998) [hereinafter THE ROLE OF THE WORLD BANK].

98. HERBERTSON ET AL., *supra* note 15, at 3.

99. *Id.* at 9.

100. *Id.*

101. THE ROLE OF THE WORLD BANK, *supra* note 97, at 2.

102. HERBERTSON ET AL., *supra* note 15, at 9.

103. INT'L FIN. CORP., WORLD BANK GROUP, PERFORMANCE STANDARDS ON ENVIRONMENTAL AND SOCIAL SUSTAINABILITY (Jan. 1, 2012), *available at* http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/publications/publications_handbook_pps.

cial institutions have adopted the Performance Standards.[104] The IFC Performance Standards adhere to several International Labor Organization (ILO) conventions on labor rights, but do not otherwise adhere to any international human rights customs or norms.[105] The updated 2012 Performance Standards replaced the original 2006 IFC Performance Standards.

In addition to the updated IFC Performance Standards, the IFC prepared a Sustainability Framework that sets out Policy and Performance Standards on Environmental and Social Sustainability.[106] Through this policy, the IFC aims to advance its commitments to environmental and social sustainability.[107] The commitments are based on IFC's mission and mandate to fight poverty for lasting results while helping people help themselves and their environment by providing resources, sharing knowledge, building capacity, and forging partnerships in the public and private sectors.[108] The IFC performance standards were designed to integrate these commitments into its lending process.[109]

The IFC promotes sound economic growth, grounded in sustainable private investment, to reduce poverty.[110] Central to IFC's mission is the IFC's intent to "do no harm" to people and the environment, to enhance sustainability and achieve positive development outcomes, and to ensure costs do not fall disproportionately on the poor or vulnerable.[111] The IFC seeks to provide accurate and timely information regarding its activities, recognizing the importance of disclosing information to manage environmental, social, and governance risks.[112]

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104. HERBERTSON ET AL., *supra* note 15, at 23.

105. *Id.* at 27.

106. INT'L FIN. CORP., IFC SUSTAINABILITY FRAMEWORK, POLICY AND PERFORMANCE STANDARDS ON ENVIRONMENTAL AND SOCIAL SUSTAINABILITY (Jan. 1, 2012) [hereinafter IFC SUSTAINABILITY FRAMEWORK].

107. *Id.* at 3.

108. *Id.* at 4.

109. INT'L FIN. CORP., WORLD BANK GROUP, IFC PERFORMANCE STANDARDS ON ENVTL. AND SOCIAL SUSTAINABILITY 2 (Jan. 1, 2012) [hereinafter IFC PERFORMANCE STANDARDS] (stating the IFC performance standards as Performance Standard 1: Assessment and Management of Environmental and Social Risks and Impacts; Performance Standard 2: Labor and Working Conditions; Performance Standard 3: Resource Efficiency and Pollution Prevention; Performance Standard 4: Community Health, Safety, and Security; Performance Standard 5: Land Acquisition and Involuntary Resettlement; Performance Standard 6: Biodiversity Conservation and Sustainable Management of Living Natural Resources; Performance Standard 7: Indigenous Peoples; and Performance Standard 8: Cultural Heritage).

110. IFC SUSTAINABILITY FRAMEWORK, *supra* note 106, at 4.

111. *Id.*

112. *Id.* at 5.

IFC's recognition of the business responsibility to respect human rights means avoiding infringement of human rights and addressing any adverse human rights impacts related to business activities.[113] Each performance standard contains elements related to human rights dimensions businesses may face in their operations.[114] Meeting this responsibility means creating access to effective grievance procedures to facilitate early indications and prompt remediation of grievances.[115] The 2010 iteration of the Performance Standards further integrated the human rights dimensions by recognizing the concept of Free, Prior and Informed Consent (FPIC) for indigenous peoples.[116]

Though not providing for FPIC with veto power, the new Performance Standard 7 articulates an FPIC with "consultation plus."[117] "Consultation plus" suggests more than just an acknowledgment and then dismissal for convenience of any impact on indigenous peoples.[118] Where a proposed business activity of a client triggers Performance Standard 7 that requires FPIC, IFC will now undertake an in depth review of the client's process as part of its environmental and social due diligence.

The IFC's sustainability framework integrates environmental and social due diligence into IFC's overall due diligence of the business activity under consideration, including the review of financial and reputational risks.[119] The IFC will work to only finance investment activities expected to meet the requirements of the Performance Standards within a reasonable period of time.[120] Persistent delays could now cost financial support.[121]

113. *Id.*

114. IFC PERFORMANCE STANDARDS, *supra* note 109.

115. IFC SUSTAINABILITY FRAMEWORK, *supra* note 106, at 5.

116. IFC PERFORMANCE STANDARDS, *supra* note 109, at 47 (Performance Standard 7 recognizes indigenous peoples as social groups with distinct identities subject to marginalization and vulnerable to adverse treatment).

117. Shalanda H. Baker, *Why the IFC's Free, Prior, and Informed Consent Policy Does Not Matter (Yet) to Indigenous Communities Affected by Development Projects*, 30 WIS. INT'L L.J. 668, 688 (2012).

118. *Id.* at 699.

119. IFC SUSTAINABILITY FRAMEWORK, *supra* note 106, at 6.

120. *Id.*

121. *Id.*

C. The Development of The Equator Principles III

The Equator Principles III represents the newest and most innovative standards to date governing lending practices of the private lending institutions.[122] The Equator Principles III are gaining recognition throughout the financing sector for projects in developing countries.[123] First adopted in 2006 based on the IFC Performance Standards, the Equator Principles III are a financial industry benchmark for determining, assessing, and managing environmental and social risk in projects.[124] The newly released 2013 Equator Principles III, the third iteration of the principles, made notable advancement in integrating HRE concepts into the framework of assessing social and environmental risk.[125] The Equator Principles III are aspirational and are voluntary in nature.[126] They represent a baseline framework for developing internal environmental and social policies, procedures, and practices.[127] The Equator Principles III do not create any rights or liability to or for any public or private person or entity.[128]

The 2013 Equator Principles III reflect two notable advancements that represent important new approaches in international lending standards.[129] First, Principle 5 is innovative in the development of the "stakeholder engagement" concept.[130] This principle provides that a client must demonstrate effective engagement as an ongoing process in a structured and culturally appropriate manner with "affected communities" and, where relevant, "other stakeholders." For a project with potentially significant adverse impacts on "affected communities," clients shall conduct an "informed consultation and participation process."[131] Second, Principle 5 recognizes the vulnerability

122. *See generally* THE EQUATOR PRINCIPLES III, EQUATOR PRINCIPLES III FINANCIAL INSTITUTIONS, (June 2013), www.equator-principles.com [hereinafter the Equator Principles III] (promoting sustainable environmental and social performance for improved financial, environmental and social outcomes).

123. *Id.*

124. THE EQUATOR PRINCIPLES III, *supra* note 122.

125. *Id.* at 2. The Equator Principles III were adopted by the Equator Principles III Financial Association (EPFI) and managed by the Equator Principles III Association, an unincorporated association of members of the EPFI, whose object is the management, administration, and development of the Equator Principles III. There are currently seventy-eight member financial institutions in the EPFI.

126. Baker, *supra* note 117, at 2.

127. THE EQUATOR PRINCIPLES III, *supra* note 122, at 11.

128. *Id.*

129. Baker, *supra* note 117, at 1.

130. THE EQUATOR PRINCIPLES III, *supra* note 122, at 7.

131. *Id.* at 7.

of indigenous peoples and adverse impacts on indigenous peoples require FPIC.[132] The Equator Principles III recognize the fact that FPIC is not universally defined.

III. The Pando Project's Failure to Fully Engage in the Integration of HRE Principles in Initial Project Due Diligence

The Pando Project exemplifies how more diligent adherence to the IFC and IDB lending standards could have dramatically improved the outcome of the Pando Project for all stakeholders, including positive outcomes for IFC, IDB, and Electron Investment S.A. The resulting costs expended on multiple flow reports and environmental impact assessments, as well as the time and money spent conducting multiple conferences with stakeholders, could have been mitigated by proactively engaging stakeholders and conducting adequate testing early in the due diligence phase.

Once the concerns were raised by AAPRODIUPA and negotiations failed to progress, Electron Investment S.A. disengaged, and both the IDB and the IFC followed suit.[133] Electron Investment S.A., IDB, and IFC fell short of full engagement in the initial due diligence and continued to be disengaged after the complaint letter filed by AAPRODIUPA.[134] Notably, the current concept of engagement developed during the initial stages of the Pando Project. The Pando Project began under the IFC's 2006 Performance Standards;[135] however, it was the 2010 Performance Standards that more fully developed and addressed the concept of engaging with stakeholders and proactively integrating HRE issues.[136] This section discusses more stringent integration of the 2010 Performance Standards and how effective engagement with stakeholders early in the due diligence process could have resulted in more positive outcomes for Electron Investment S.A., IDB, and IFC. At the same time, more effective due diligence provides an engaging process for stakeholders to achieve amicable solutions to their concerns surrounding the Pando Project. While not proposing to mandate adher-

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132. *Id.* at 7-8.

133. Kiene et al., *supra* note 1, at 15.

134. *Id.*

135. Int'l Fin. Corp., World Bank, Performance Standards and Guidance Notes - 2006 Edition (2007), *available at* http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/ifc+sustainability/sustainability+framework/Sustainability+Framework+-+2006/Performance+Standards+and+Guidance+Notes/.

136. *See* Performance Standards on Environmental and Social Sustainability, *supra* note 103.

ence to the 2010 Performance Standards, this paper illustrates how the WBG organizations and project developers can be motivated to adhere more stringently to the Performance Standards to manage risk and control project costs.

A. Human Rights and Environment Principles Not Fully and Effectively Integrated Into the Pando Project

The Pando Project affords an opportunity to analyze the due diligence process and illustrate the importance of timely and effective due diligence. The IBD Compliance Review Report raised five notable concerns where proactive engagement with stakeholders early in the due diligence process may have mitigated, if not eliminated, the AAPRODI-UPA's complaints.

The five concerns include the: 1) lack of an adequate flow control study early in the project planning; 2) absence of a comprehensive environmental impact assessment addressing the cumulative impacts of the planned investments in the watershed; 3) unsatisfactory consultation process with affected communities; 4) lack of effective participation by the leaders and citizens of the affected communities; and 5) lack of disclosure of the impact of the Pando Project on the affected communities and the CVR basin.[137] The absence of early stakeholder engagement resulted in conflicts with the lending standards articulated in the IFC Performance Standards.

The first concern is one of the two most critical substantive issues: the lack of an adequate flow control study. Electron Investment S.A.'s failure to complete an adequate flow control study and assess the HRE impact on the local population depending upon the river, including the populations downstream, conflict with IFC Performance Standards 1, 3, 4, 5, and 6. Performance Standard 1 addresses the assessment and management of environmental and social risks and impacts.[138] Environmental and socials risks refers to "any change, potential or actual, to (i) the physical, natural, or cultural environment, and (ii) impacts on surrounding community and workers, resulting from the business activity to be supported."[139] A flow control study was critical because it was essential in identifying such environmental and social risks.

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137. *See generally* KIENE ET AL., *supra* note 1; *see also* OMBUDSMAN ASSESSMENT REPORT, *supra* note 8.

138. PERFORMANCE STANDARDS ON ENVIRONMENTAL AND SOCIAL SUSTAINABILITY, *supra* note 103, at 2.

139. *Id.* at 5.

Absent an adequate flow control study, an effective Environmental and Social Management System could not be developed and limited stakeholder engagement was conducted with affected communities in the early due diligence phase.[140] The type of stakeholder engagement required by Performance Standard 1 includes stakeholder analysis and engagement planning, disclosure of information, consultation, informed consultation and participation, external communications and ongoing reporting to the affected communities.[141] In the public consultations, the concern regarding the availability, quality, and credibility of the existing studies and reports was raised.[142] This lack of an adequate flow control study is prima facia evidence that Performance Standard 1 was not effectively addressed in the preliminary due diligence.

Performance Standard 3 recognizes that increased economic activity increases pollution at the local, regional, and global levels and more effective resource utilization reduces pollution.[143] This Performance Standard comes into play when considering the sustainable use of water resources. A comprehensive flow control study would illuminate the adverse impact on downstream water resources and enlighten the stakeholders regarding necessary pollution prevention mitigation. One potential impact of reduced water flow to the surrounding rainforest is the potential need to mitigate an increase in greenhouse gas (GHG) emissions.[144]

The inadequate flow control study further violates Performance Standard 4 by not allowing stakeholders to anticipate the adverse impact on health and safety resulting from the reduced availability of clean water for consumption and irrigation.[145] The water flow modification has the potential to adversely impact clean water sources and should have been thoroughly addressed early in the due diligence process.

Performance Standard 5 aims to avoid and minimize the adverse impact, both social and economic, from land acquisition and

140. *Id.* at 7.

141. *Id.* at 13-15.

142. OMBUDSMAN ASSESSMENT REPORT, *supra* note 8, at 18.

143. PERFORMANCE STANDARDS ON ENVIRONMENTAL AND SOCIAL SUSTAINABILITY, *supra* note 103, at 22.

144. INT'L. FIN. CORP., WORLD BANK GROUP, UNDERSTANDING IFC'S ENVIRONMENTAL AND SOCIAL DUE DILIGENCE PROCESS, (October 2011), *available at* http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/feature_oct2011_esprocess.

145. *Id.*

restrictions on land use.[146] In this case, an adequate water flow control study to identify the downstream impact prevents stakeholders and Electron Investment S.A. from mitigating downstream impacts. To the extent local communities were displaced by the resulting low water flow, Electron Investment S.A. was not armed with adequate knowledge to mitigate these concerns with affected stakeholders.

Finally, Performance Standard 6 addresses the protection and conservation of biodiversity.[147] An adequate flow control study is a prerequisite to assessing the impact of changing water flow on the fish and the surrounding ecosystem. There is no plausible way to assess the impact and promote sustainable management of living natural resources without an adequate flow control study.[148]

The second critical substantive issue is the absence of an adequate environmental impact assessment of the planned investment in the watershed.[149] Similar to the flow control study, an inadequate environmental impact assessment inhibits the adherence to Performance Standards 1, 3, 4, 5, and 6.[150] The concerns raised by the inadequate environmental impact assessments broadly address the impact relative to the numerous dam projects throughout the Chiriqui River Basin in Western Panama.

Although beyond the company's scope of influence, Electron Investment S.A.'s inability to participate in an adequate comprehensive environmental impact assessment raises important concerns. Performance Standard 1 was compromised because a comprehensive environmental impact assessment is critical to assessing the environmental and social risks resulting from the cumulative development of the CVR basin. An effective Environmental and Social Management System was not in place at the time of loan approval.[151] IDB is still exploring opportunities with ANAM and other Panamanian authorities to address appropriate management of the collective watershed.[152] The lack of a comprehensive environmental impact assessment pre-

146. UNDERSTANDING IFC'S ENVIRONMENTAL AND SOCIAL DUE DILIGENCE PROCESS, *supra* note 144.

147. *Id.*

148. *Id.*

149. KIENE ET AL., *supra* note 1, at 15.

150. *Id.*

151. *Id.* at 12.

152. Inter-American Development Bank, Pando-Monte Lirio Hydroelectric Power Project: Management's Proposed Action Plan in Response to the Independent Consultation and Investigation Mechanism's Compliance Review Report (January 25, 2013) [hereinafter IDB Proposed Action Plan], *available at* http://www.iadb.org/en/mici/complaint-detail,1804.html?ID=PN-MICI001-2010.

cludes meaningful engagement with affected stakeholders and communities throughout the watershed early in the due diligence process. The scope of the hydroelectric power projects within the CVR basin mandates the involvement of the Panamanian government in a comprehensive EIA.

A comprehensive environmental impact assessment potentially expands significantly the number of stakeholders. Such an expansive study is essential to comply with Performance Standard 1, which includes stakeholder analysis and engagement planning, disclosure of information, consultation, informed consultation and participation, external communications, and ongoing reporting to affected communities.[153] The impact of an inadequate comprehensive environmental impact assessment and the inability to proactively engage with a broader scope of stakeholders contributes to the scope of the ongoing concerns raised by AAPODIUPA.

An adequate comprehensive environmental impact assessment illuminates the pollution impact across the entire river basin. The application of Performance Standard 3 provides for consideration of the broad impact of pollution on water resources and informs a broader range of stakeholders of the potential need to take preventive action. The key stakeholder at this level may be the Panamanian government. Empowered by an adequate comprehensive environmental impact assessment, the Panamanian government could utilize the comprehensive assessment in the overall management of Panama's natural resources.[154]

A comprehensive environmental impact assessment provides for more adequate adherence to Performance Standard 4 by identifying a broader range of adverse impacts on the overall health and safety of the CVR basin, particularly with respect to the availability of clean water for consumption and irrigation. The overall impact of the multiple dam projects throughout the CVR basin has potential adverse consequences and all parties would have benefited by addressing those consequences to mitigate the impact on community health and safety.

With respect to Performance Standard 5, a comprehensive environmental impact assessment would be essential to identify the adverse impact of the entire hydroelectric project from land acquisition and restrictions on land use. Without comprehensive impact assess-

153. UNDERSTANDING IFC'S ENVIRONMENTAL AND SOCIAL DUE DILIGENCE PROCESS, *supra* note 144.

154. *E.g.*, OMBUDSMAN ASSESSMENT REPORT, *supra* note 8, at 10 (stating that the impact of lack of water flow to the rainforest in the river basin region could adversely impact greenhouse gas emissions).

ments, the stakeholders and Electron Investment S.A. would be unable to mitigate the broader adverse impact. Electron Investment S.A., the Panamanian government and other hydroelectric project developers were not armed with the knowledge to address with key stakeholders the extent to which regional communities were displaced by the overall hydroelectric dam development in the CVR basin.

Finally, Performance Standard 6 addresses the protection and conservation of biodiversity. An adequate comprehensive environmental impact assessment is essential in providing the proper impact of the overall hydroelectric dam development in the CVR basin to fully address the protection and conservation of the CVR basin's biodiversity. There is no plausible way to adequately assess the environmental impact on a broader ecological scale without an adequate comprehensive environmental impact assessment. To comply with Performance Standard 6, the parties must succeed in pushing for a comprehensive environmental impact assessment to promote sustainable management of living natural resources throughout the CVR basin.

The final three issues, (1) the unsatisfactory consultation with affected communities and lack of meeting with stakeholders, (2) the lack of participation by affected citizens, and (3) the lack of disclosure early in the project due diligence, all fail to adhere to Performance Standard 1.[155] Performance Standard 1 specifically addresses the need to consult with stakeholders, to allow affected citizens to participate, and to disclose plans to the affected citizens. Without an adequate flow control study and an adequate comprehensive environmental impact assessment, Electron Investment S.A. could not effectively disclose to the relevant stakeholders the expected impact from the project. Moreover, without adequate disclosed information, stakeholder participation and ability to consult with Electron Investment S.A. is handicapped by the lack of adequate information. At the time of the IFC's decision to invest in the Pando Project, the details of the potential cumulative impact of the entire CVR basin remained undefined.[156]

Performance Standard 1 contains provisions for stakeholder engagement as the basis for building strong, constructive, and responsive relationships to successfully manage the project's environmental and social impacts.[157] The IFC maintains that Performance Standard 1 in-

155. KIENE ET AL., *supra* note 1, at 15.

156. ACCOUNTABILITY COUNSEL AND BANK INFORMATION CENTER, *supra* note 13.

157. INT'L FIN. CORP., IFC SUSTAINABILITY FRAMEWORK: PERFORMANCE STANDARDS 21 (2012), *available at* https://www.scribd.com/fullscreen/84697434?access_key=key-1do8v46kzf4u4h6nu17e.

cludes stakeholder engagement, which includes the disclosure and dissemination of information and consultation and participation.[158] The disclosure of relevant information regarding the Pando Project would help the stakeholders understand the risks, impacts, and opportunity presented by the project.[159]

The foregoing highlights key concerns raised by the early due diligence for the Pando Project and juxtaposes the key issues with the relevant IFC Performance Standards. The IDB maintains that its continued involvement, as opposed to withdrawing, has facilitated the ultimate receipt of the necessary studies.[160] The IDB board approved a proposed action plan on February 13, 2013, outlining progress made since the Compliance Review Report.[161] The proposed action plan also laid out recommendations to address remaining concerns, along with assigning responsibility and deadlines.[162]

The IDB maintains that the process, while admittedly not optimal, is leading toward a satisfactory resolution of the key issues: the ecological flow control issue and the development of the river basis management with the benefit of a cumulative impact analysis.[163] The IDB continues to pressure Electron Investment S.A. into compliance and continues to foster a positive environment for the resolution of the issues.[164] While moving towards ultimately addressing the concerns raised in the complaints filed by AAPRODIUPA, the lack of proactive engaged due diligence has led to significantly increased due diligence costs and additional resources consumed addressing the concerns being raised by the various stakeholders.

B. The Cost of Neglecting HRE Issues Evidenced by the Pando Project

While it is difficult to ascertain the total costs attributable to insufficient engagement during the initial due diligence, the additional studies resulting from the complaint, the studies created post loan disbursement, and the additional negotiations and meetings required to overcome the inevitable lack of trust increases the overall costs well beyond the initial budget. Even with IDB's proposed action plan ap-

158. *Id.*
159. *Id.*
160. KIENE ET AL., *supra* note 1, at 76.
161. IDB PROPOSED ACTION PLAN, *supra* note 152.
162. *Id.* at 2-6.
163. KIENE ET AL., *supra* note 1, at 76.
164. *Id.*

proved in February of 2013, addressing the issues raised in IDB's Compliance Review requires further cooperation from Electron Investment S.A. and ANAM.[165]

ANAM has asked for support to carry out ecological flow studies and cumulative impact studies of dams on the entire Chiriqui Viejo watershed.[166] ANAM's weak institutional capacity and lack of personnel to address the environmental problems arising out of these projects creates further difficulty.[167] Electron Investment S.A. has the staff and resources to do it, but there is a lack of trust that ANAM will enforce or implement mitigation measures. The lack of trust between parties leads to higher costs as lengthier negotiations become necessary to develop mitigation measures addressing the HRE issues.

The costs of inadequate due diligence and adherence to HRE principles can be severe. The IFC incurred excessive costs in 2003 when it began financing palm oil-processing facilities in the Ukraine.[168] In this instance, the IFC's CAO audit found due diligence reviews were not conducted as required by IFC policy.[169] The findings gained traction and the WBG suspended further IFC palm oil investments subject to a sector-wide review, which extended to the IFC's entire agribusiness operations.[170] This was costly not just to IFC, but also to the Wilmar Group and other agribusiness operators that procure lending from the IFC.

The IDB compliance review report suggests several steps to remedy the non-compliance and systems problems.[171] IDB's proposed action plan builds upon those remedies.[172] For the Pando Project, the IDB report suggests creating an Independent Monitoring Committee, making changes to the current construction design, and establishing a Civil Safety Bond.[173] For ANAM, the IDB report suggests the appointment of suitable independent personnel to implement monitoring plans in the watershed, conduct the necessary studies within the watershed, halt the process for granting water concessions until a Watershed Management Plan is in place, and implement a Watershed Management Plan.[174]

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165. IDB Proposed Action Plan, *supra* note 152.
166. Kiene et al., *supra* note 1, at 45.
167. *Id.* at 82.
168. Herbertson et al., *supra* note 15, at 15.
169. *Id.*
170. *Id.*
171. Kiene et al., *supra* note 1, at 82.
172. IDB Proposed Action Plan, *supra* note 152.
173. Kiene et al., *supra* note 1, at 82.
174. *Id.* at 83.

The IDB's proposed action plan approved early in 2013 advances a plan to collaborate with AMAN to complete this task.[175] The Watershed Management Plan to be formed with AMAN would include participatory workshops, provide support for other necessary studies, and ensure funds exist to implement the Watershed Management Plan.[176]

IV. Advancing Human Rights and Environment Outcomes in Economic Development Projects Through Proactive and Synergistic Engagement

Part IV analyzes how a more proactive engagement in the early due diligence would have minimized risk and lowered costs with the Pando Project. The section then assesses the efficacy of adhering to IFC Standards and the Equator Principles III as stringent guidelines with resulting decreases in risk and greater cost controls for Multilateral Development Banks (MNB). Finally, Part IV concludes by illustrating how synergistic engagement among stakeholders leads to better project due diligence outcomes.

A. Proactive and Synergistic Engagement Applied to the Pando Project

The Pando Project illustrates how MNBs and their borrowers benefit from adhering to either the IFC Performance Standards or the Equator Principles III when conducting due diligence prior to economic development projects. The IFC's Performance Standards have become the leading benchmark for environmental and social risk management.[177] With the growing attention on HRE principles and the HRE issues related to development projects, there is an emerging need for lenders and developers to proactively engage stakeholders to amicably resolve HRE issues in the early stages of project due diligence.

With significant adverse consequences disclosed, under Performance Standard 1 for example, a borrower would conduct an Informed Consultation and Participation to allow stakeholders to exchange views and information as informed participants.[178] Once

175. IDB Proposed Action Plan, *supra* note 152.

176. Kiene et al., *supra* note 1, at 83.

177. Int'l Fin. Corp. The World Bank, The Business Case for Sustainability 6 (July 2012), *available at* http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/publications/publications_brochure_businesscaseforsustainability.

178. *Id.* at 22.

disclosed, the stakeholders then benefit from the opportunity to express views and the extent and degree to which consultation takes place is consistent with the risk and adverse impact of the project.[179] Without adequate comprehensive information, the inability to identify all the potential stakeholders prevents the degree of engagement contemplated by Performance Standard 1. A lack of adequate disclosure results in consultation and participation inconsistent with the objectives of Performance Standard 1.[180] The suggestions to remedy the concerns raised by AAPRODIUPA in the complaint letter would have been more effectively considered, with less expense and fewer delays, by implementing the Watershed Management Plan earlier in the project due diligence.[181]

The Watershed Management Plan proposed in the IDB Management's proposed action plan, developed in compliance with IFC Performance Standards would have alleviated a substantial amount of the unplanned costs and expensive time delays.[182] In addition, the trust issues and problems associated with this project threaten to manifest themselves in future projects involving the stakeholders. As a result, Electron Investment S.A.'s project costs will continue to increase beyond the initial budgeted costs. These avoidable additional costs result from the lack of proactive engagement in the initial due diligence process.

Fully engaging with stakeholders promises to improve the impact the WBG and other MNBs have upon developing nations throughout the world. It is within the historical context of the WBG purpose and structure that the WBG is positioned to advance the evolution of the integration of HRE into the MND's lending paradigm.

The benefits of engaging in the implementation of HRE consideration in the initial due diligence are compelling. The IFC's Environmental and Social Due Diligence process provides a model in developing procedures to engage stakeholders. The first step in the process is an agreement between the Lender and the Borrower to work together.[183] By simply agreeing to work together, MDBs fall short and must position themselves to engage in the process. On the other hand,

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179. *Id.* at 22.

180. *Id.* at 14.

181. *See discussion supra* Part I.B.; *see also* IDB PROPOSED ACTION PLAN, *supra* note 152.

182. IDB PROPOSED ACTION PLAN, *supra* note 152.

183. UNDERSTANDING IFC'S ENVIRONMENTAL AND SOCIAL DUE DILIGENCE PROCESS, *supra* note 144.

NGOs and stakeholders must understand the limited influence and enforcement ability the MDBs have as regulatory bodies.[184]

MDBs benefit from borrowers adhering to bank standards pertaining to HRE issues, whether the policies are bank specific standards, the IFC Performance Standards, or the Equator Principles III. As evidenced by the Pando Project, Electron Investment S.A. agreed to work with the IDB and the IFC, but did not adequately perform early due diligence with adequate flow control studies, adequate environmental impact assessments, and by fully engaging with a broad array of stakeholders in a meaning and productive way. Adherence to HRE principles is realized through diligent good faith compliance with the chosen standard, whether that standard is the IFC's Performance Standards, the Equator Principles, or another comparable variation. In complying with HRE principles, borrowers and lenders will be best served through a more meaningful engagement with the stakeholders, NGOs, applicable government agencies, other lenders and the developer.

While Electron Investment S.A. acknowledges some of the complaints raised are legitimate concerns, Electron Investment S.A. maintains the company has already done more than required by IFC policies and the Panamanian government.[185] Electron Investment S.A. maintains they have expended significant resources to "do the right thing," including setting up four Community Development Committees (CDCs) in 2010.[186] The CDCs provided valuable mechanisms for communicating with local communities, but Electron Investment S.A. would have been much better served by setting up the CDCs earlier in the due diligence process.[187] Ultimately, the lack of early attention to due diligence resulted in higher costs to Electron Investment S.A., the IDB, and the IFC.

The second step in the IFC's Due Diligence Process is to review and agree on the next steps.[188] This is the critical point where the borrower, lenders, and stakeholders should all be mindful of the balancing of interests in most development projects and work towards solutions that maximize the benefits while minimizing the negative conse-

184. *See* Miller, *supra* note 16.

185. Assessment Report, *supra* note 8, at 13.

186. *Id.* (beginning in February of 2010, EISA created four CDCs "for the purpose of creating a communication mechanism with the local communities, identifying social investment projects, implementing social aid programs, and involving the community in reforestation and mitigation measures.").

187. *Id.*

188. Understanding IFC's Environmental and Social Due Diligence Process, *supra* note 146.

quences.[189] This stage provides a key opportunity to identify potential risks specific to a particular development project.

At this stage, the lender provides the borrower IFC's Performance Standards and relevant WBG Environmental, Health and Safety (EHS) Guidelines and other supporting documents.[190] The IFC Environmental and Social team engages with the borrower by asking the borrower to provide key information regarding assets and the management plan for environmental and social risks and impacts.[191] This is where the lender, along with the borrower, make key lasting decisions regarding the scope of the initial due diligence. The lender and borrower benefit from deriving a risk management plan at this early due diligence stage.[192]

The commitment to the proactive engagement with stakeholders regarding environmental and social issues starts here to be most effective. Depending on the quality of the borrowers' initial due diligence at this stage, the lender and borrow develop a plan to reasonably identify all anticipated stakeholders, assess the project against the IFC Performance Standards, Equator Principles III, or equivalent bank policies or procedures. At this point, the borrower and lender engage the known and identified stakeholders, including governments, for preliminary due diligence reviews and problem identification.

Once complete, the lender generates an Environmental and Social Review Summary and Environmental and Social Action Plan.[193] The summary and plans are approved by the lender and borrower, and possible key stakeholders that may be strategically included.[194] Once approved by the lender and borrower, the project is publicly disclosed and consultations begin with the community.[195] The lender and borrower should now be prepared to fully engage with identified stakeholders and remain open to identifying additional stakeholders not evident in the initial plan development.

More often in the early stages, risk management should continue to be assessed in the background. Risk management involves

189. INT'L FIN. CORP., RISK TAKING: A CORPORATE GOVERNANCE PERSPECTIVE 7 (World Bank Group, 2012).

190. *Id.*

191. *Id.*

192. *Id.* at 6 (outlining a four step risk management plan: 1) inventory of all risk; 2) measure and decided which risks to hedge, avoid or retain; 3) select course of action to hedge risk; and 4) determine risk dimensions and organization structure to address risk).

193. UNDERSTANDING IFC'S ENVIRONMENTAL AND SOCIAL DUE DILIGENCE PROCESS, *supra* note 146.

194. *Id.*

195. *Id.*

ongoing risk assessment, risk evaluation, and risk reporting with decision points assessing any necessary adjustments.[196] For projects that likely will have potentially significant adverse impacts on the affected stakeholders and for projects where one group of stakeholders are indigenous peoples, the lender should determine the required level of community support necessary to justify the adverse impact or the impact on indigenous people.[197] If Electron Investment S.A. had diligently engaged in the foregoing early due diligence progression, Electron Investment S.A., IDB, and IFC, through active engagement with stakeholders, would have ascertained early in the process the risk of moving forward without an adequate flow control study and environmental impact assessment.

Once fully engaged and once stakeholders have been fully informed, consulted, invited to participate, and advised of grievance procedures, then the lender and borrow finalize the investment agreement.[198] In this final investment agreement, the terms of the Environmental and Social Review Summary and Environmental and Social Action Plan are integrated along with any other environmental and social commitments.[199]

Under the IFC model of the Environmental and Due Diligence Process, funds are not disbursed until the client meets the disbursement conditions.[200] The disbursement conditions must be clear and fully agreed by the borrower, lender, and, sometimes, the key stakeholders. This was another critical turning point in the Pando Project. The IFC and IDB made the first disbursement despite not having an adequate flow control report as required.[201] Once funds are disbursed to the borrower, the lender's leverage is diminished as the borrower allocates the funds to the project and lender is vested with money in the project. While the lender and borrower can follow the steps outlined in the due diligence process, if the lender fails to hold the borrower accountable, the outcome is jeopardized. Lenders and borrowers benefit considerably by actively adhering to due diligence standards as the risk of neglecting HRE issues is becoming more pronounced.

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196. RISK TAKING: A CORPORATE GOVERNANCE PERSPECTIVE, *supra* note 189, at 28.

197. UNDERSTANDING IFC'S ENVIRONMENTAL AND SOCIAL DUE DILIGENCE PROCESS, *supra* note 146.

198. *Id.*

199. *Id.*

200. *Id.*

201. Accountability Counsel and Bank Information Center, *supra* note 13.

B. Adhering to IFC Standards and Equator Principles III Leads to Lower Risks and Costs to Multilateral Development Banks

Adhering to IFC Standards and the Equator Principles III benefits the lenders and the borrowers, as well as the stakeholders and affected communities. One key to motivating lenders and borrowers to fully engage lies partly in the recognition of the risk management benefits derived from engaging in complete due diligence. According to the IFC, the business case for integrating HRE into the due diligence process centers on the understanding of business risk and the mainstreaming of environmental, social, and governance factors in investment analysis and firm valuation.[202]

Risk comes in many varieties. First, of course, there is financial risk. Second, there is risk to a company's reputation, whether lender or borrower. Third, there is political risk. The WBG, and particularly the IFC, has played a leading role in facilitating private investments in the development of improving human rights conditions and minimizing project-related risks.[203] By doing so, the WBG minimizes risk to its own reputation and, in fact, enhances its reputation, thus reducing business risk.[204]

The failure to engage in adequate due diligence and adhere to lending standards risks substantial financial consequences. The filing of complaints, the response to complaints, and the growing risk of litigation all produce real financial risk. Both the lender and borrow stand to significantly benefit from reductions in financial risk.

The risk to reputation takes on a larger role in today's business climate. In an age of branding, business good will, and good corporate citizenship, the risk associated with ignoring HRE issues or, worse, simply ignoring known issues in HRE, puts a company at risk of losing future projects and developing an adverse reputation among NGOs. This negative increased attention draws greater scrutiny to future projects. The impact of the growing scrutiny has a financial dimension. As an example, due to the Gulf of Mexico oil spill, BP has lost more than $32 million a day in brand value. At one point, BP's market value dropped from $184 billion to $96.5 billion.[205] Sustainability is becoming a bigger and bigger factor in business strategies.[206]

202. HERBERTSON ET AL., *supra* note 15, at 14.
203. *Id.*
204. *Id.*
205. THE BUSINESS CASE FOR SUSTAINABILITY, *supra* note 177, at 2.
206. *Id.*

In modern business, companies are increasing being proactive in managing brands and reputations. Research from the World Bank Institute suggests that government investment projects financed by the WB have an economic return 8 to 22% higher in countries with the strongest civil liberties.[207] Larger and mid-size companies are taking longer-term views toward managing environmental and social risks to achieve better growth and cost savings, to improve brand and reputation, to strengthen shareholder relations, and, of course, to increase profits.[208] There is a positive relationship between good environmental and social performance and the financial performance of a company.[209] The correlation was stronger in sectors dealing with natural resources.[210]

Along these lines, businesses in today's business environment must be more aware of their social impact. The benefit of socially responsible business practices, including proactively engaging in HRE focused due diligence, leads to lower business risk, improved financial outcomes, improved branding and reputation, and international recognition as a leading investor in developing countries. The value of such positive outcomes is the attraction of new investments, greater acceptance of projects by NGOs and governments, and a "social license" to operate. These positive outcomes encourage business to improve development effectiveness.

C. Proactive and Synergistic Engagement Among Stakeholders Leads to Better Project Due Diligence Outcomes

The Equator Principles III, with its third iteration released in June of 2013, make further key shifts towards solidifying the full integration of HRE issues in the international economic development lending process.[211] The 2013 Equator Principles III embrace the concept of engagement of HRE issues. No longer is it enough to simply adhere to procedural requirements of disclosures, information dissemination, inviting participation, and consulting with stakeholders.

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207. HERBERTSON ET AL., *supra* note 15, at 16.

208. *Id.*

209. THE BUSINESS CASE FOR SUSTAINABILITY, *supra* note 177, at 3 (citing Eccles G.R., Ioannou I. Serafeim G., *The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance*, Harv. Bus. Sch. (Nov. 2011)).

210. *Id.* at 3.

211. *See generally* EQUATOR PRINCIPLES III, *supra* note 122 (adding to concept of engagement of stakeholder and FPIC).

Instead, borrowers and lenders must engage in these activities and be proactive in addressing HRE issues.[212]

Two key principles contained in the 2013 iteration support the development of an "engagement" standard. Principle 5, Stakeholder Engagement, directly supports the concept of engaging with stakeholders.[213] This engagement is limited to what Principles 1 defines as Category A and Category B projects.[214] For Category A and B Projects, the EPFI requires clients to illustrate an ongoing effective process of engaging stakeholders in a structurally and culturally effective manner with the affected communities and other stakeholders.[215]

For projects that have potentially significant adverse impacts, the clients must conduct informed consultation and participation.[216] Principle 5 also is one of the first standards to incorporate FPIC into its standards.[217] FPIC is applicable when a project adversely impacts indigenous people.[218] As defined by the Equator Principles III, FPIC builds on and expands the process of Informed Consultation and Participation and ensures meaningful participation by indigenous people but does not require unanimity or contain a veto. The Equator Principles III continue to adhere to a concept more akin to the concept of "consultation plus" contained in the IFC Performance Standards.[219]

The Equator Principles III applied to the Pando Project would likely have produced a more positive HRE outcome for the affected communities. The Pando Project would be classified as a Category A Project due to the dam's significantly adverse environmental impact and social risk that are diverse and irreversible. The effective stakeholder engagement requirement would have required Electron Investment S.A. to engage more effectively with the impacted stakeholders.[220] The stakeholder engagement requirement in the Equator

212. *Id.* at 7.

213. *Id.*

214. *Id.* (defining Category A Projects as projects with potential significant adverse environmental and social risks and/or impacts that are diverse, irreversible or unprecedented; Category B Projects as projects with potential limited adverse environmental and social risk and/or impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures; and Category C Projects as having minimal or no adverse environmental or social risks and/or impacts).

215. *Id.*

216. *Id.*

217. EQUATOR PRINCIPLES III, *supra* note 122, at 8.

218. *Id.*

219. *See generally* Baker, *supra* note 117.

220. EQUATOR PRINCIPLES III, *supra* note 122, at 7 (effective stakeholder engagement under the Equator Principles III requires demonstrating effective shareholder engagement

Principles III would have resulted in a more predictable and less costly outcome for the Pando Project. A more engaged approach to initial due diligence may have led Electron Investment S.A. to address the adequacy of the flow control study and environmental impact assessment issues early in the process, leading to reduced risk and cost savings.

As bank and corporate reputations become increasing important due to branding and imaging concerns, the goal of advancing HRE principles will certainly grow more prominent. Beginning with the framework contained within the Equator Principles III, there are opportunities for large and medium-sized private corporations to create substantive beneficial outcomes to millions of people through economic development projects. The application of the Equator Principles III will guide those corporations by providing a framework to begin by proactively engaging in early due diligence to ensure sustainable outcomes.

CONCLUSION

A review of the pitfalls surrounding the Pando Project corroborates the concept of engaging in early proactive project due diligence to better integrate HRE concerns. The Pando Project illustrates the potential benefits realized through early proactive due diligence. MDBs and development companies benefit from engaging early with the diverse and unique stakeholders inherent in each development project to create synergistic solutions to potentially competing interests. The goal is to effectively mitigate the risk associated with what otherwise become unresolved or ignored HRE issues. These issues then threaten the successful advancement of human rights through economic development. Stakeholders must correspondingly be mindful of the financial viability of economic development projects aimed at alleviating poverty while advancing these new and important HRE issues.

Proactive engagement begins with implementing procedural standards aimed at engaging all affected stakeholders. Prior to approving project funding, the WBG's role is to ensure compliance with applicable standards while harnessing the political will to fully engage stakeholders. The goal is to manage risk and proactively work towards synergistic solutions. Building upon the growing value of good corpo-

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as an ongoing process in a structured and culturally appropriate manner with the affected communities, conducting an informed consultation and participation process, making the appropriate assessment documentation readily available to affected communities and disclosing environmental and social risks and adverse impacts prior to construction commencement).

rate citizenship, borrower developers must also recognize the economic value in risk management, cost control, and the benefit of branding and corporate accountability.

Development projects and developer reputations are imperiled by the failure to proactively engage in initial project due diligence. The borrower, the MNBs, the developing country's national and local governments, and the growing number of NGOs must engage in early project due diligence and develop a greater awareness of how HRE issues increasingly put projects at risk, causing harsh consequence to human rights and economic development. Without engaging in early due diligence, development projects not only risk irreparable harm to indigenous peoples, affected communities, and the environment, but also place projects at risk of failing to realize the intended economic development outcomes.

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