

Joint IDB-IIC Management response to the MICI-BID-CR-2016-106 Request regarding the Reventazón Hydroelectric Project in Costa-Rica (the “Request”)

1. The Reventazón Hydropower Project , a model for sustainable infrastructure

- 1.1 The Reventazón Hydropower Project (the “Project”) has been carefully designed and implemented as a global model for sustainable infrastructure, taking advantage of the synergies between both public and private sector arms of the IDB Group. During the two years of preparation of the Project, between 2010 and 2012, IDB’s Technical Cooperation¹ strengthened significantly the Project’s environmental and social impact assessment² and capacity of Costa Rica’s national power company³ to manage environmental and social impacts and risks in line with international good practices – including the creation and staffing within ICE of an environmental supervision unit independent from the construction unit.
- 1.2 The ambition of the Project’s biodiversity mitigation programs is unprecedented for a hydropower project in the Latin America and Caribbean (LAC) Region. By focusing on the functional attributes of an area – rather than only its conservation status, the Jaguar Corridor Program is a first of its kind by aiming to restore and improve connectivity of a biodiversity corridor, using a variety of instruments such as payment for ecosystem services (PES). The Aquatic Offset Program⁴, which aims to protect another river system in compensation for the Project’s adverse impact on the Reventazón River, is the first ever implemented in LAC and constitutes a model for future hydropower developments in the Region. The innovative nature of those programs has been widely recognized, in e.g. broadcast on CNN⁵, IDB publications⁶ and blogs⁷, reports from International Conservation NGOs⁸ and articles in international press⁹.

¹ CR-T1074: Reventazón Hydroelectric Project Complementary Environmental Studies

² See on IDB’s website additional environmental and social studies

Phase 1: <http://www.iadb.org/Document.cfm?id=36689542> and

Phase 2: <http://www.iadb.org/Document.cfm?id=36879024>

³ The *Instituto Costarricense de Electricidad*, “ICE”.

⁴ In addition to the River Compensation Plan available on IDB’s website

(<http://www.iadb.org/Document.cfm?id=40297695>), see the documentary “*Parismina, Rio sin barreras*” :

https://youtu.be/W_gG0XWetDo

⁵ <http://edition.cnn.com/videos/world/2014/02/10/parker-costa-rica-dam.cnn>

⁶ <http://www.iadb.org/en/topics/sustainability/project-snapshot-hydroelectric-project-takes-unprecedented-measures-to-protect-habitat,7998.html>

⁷ “Costa Rica has implemented a river offset. How does it work?: <http://blogs.iadb.org/vivasustainability-en/2016/05/19/offsets/> ; “Can we protect our rivers and continue to build hydropower projects?”: <http://blogs.iadb.org/vivasustainability-en/2016/02/29/bigdams/>

⁸ See e.g. <http://www.nature.org/ourinitiatives/habitats/riverslakes/securing-a-future-that-flows.pdf>

⁹ See e.g. article published in May 2016 in WIRED: <https://www.wired.com/2016/05/death-birth-american-dam/>

- 1.3 Considering the Project's inherent complexity in delivering an ambitious mitigation strategy, specifically on biodiversity matters, the environmental and social monitoring framework of the Project was designed to include, above and beyond the normal monitoring activities from ICE and the Lenders, quarterly supervision from an independent environmental and social consultant (the "IESCM"), independent monitoring from the international NGO Panthera¹⁰, and high level guidance and supervision from the Advisory Group on Biodiversity (GAB¹¹).
- 1.4 Under the supervision of the Lenders and IESCM since the Project's approval in 2012, implementation of the Project's environmental and social mitigation measures and programs has progressed satisfactorily. The Project has been constructed in compliance with the environmental and social conditions specified in the legal agreements, and pending issues that were raised by the IESCM in the context of their routine supervision activities are in the process of being addressed and resolved as the Project is moving towards completion. All of the actions and activities required under the Environmental and Social Action Plan (ESAP) for this phase of the Project's implementation have been carried out to the satisfaction of the Lenders. The GAB also confirmed the soundness and robustness of the biodiversity mitigation strategy pursued by the Project¹². As the Project is transitioning to operations, the IDB and IIC, supported by independent consultants, are continuing close supervision to ensure that the objective of those programs is met.

2. Status of the IDB Group loans to the Reventazón Hydropower Project

2.1 IDB's loan CR-L1049: Power Sector Development Program 2012-2016

- 2.1.1 On June 25th, 2012, the IDB's Board of Directors approved a sovereign guaranteed loan to ICE (CR-L1049) for an amount of US\$250MM under the Conditional Credit Line for Investment Projects (CCLIP) of up to US\$500MM, granted by IDB to ICE in October 2007. This loan was legally formalized on October 31st, 2012.

¹⁰ <https://www.panthera.org/initiative/jaguar-corridor-initiative> - Monitoring reports from Panthera are available on IDB's website: <http://www.iadb.org/es/proyectos/project-information-page,1303.html?id=CR-L1049>

¹¹ The GAB consists of: Ms. Catherine Pringle from Georgia University; Claudio Sillero-Zubiri from University of Oxford; and Guy Dutson and Antoine Escalas from The Biodiversity Consultancy. Final report of the GAB is available on IDB's website at: <http://www.iadb.org/Document.cfm?id=40296876>

¹² "El GAB felicita al equipo del ICE ya que considera que está en el camino correcto, con una muy buena estrategia y planificación de las tareas de conservación asociadas al PH Reventazón." (Cuarto y último informe del GAB).

- 2.1.2 The loan was intended to finance ICE's program to meet the electrical demand in Costa Rica, maintaining adequate levels of quality, reliability and costs, through financing investments in power generation (including the Project) and other investments in electrical transmission and distribution.
- 2.1.3 The first subprogram in the IDB's loan to ICE includes the following works and procurement for the Project: (i) vertical metal sluice gates to be used in the bypass tunnels, spillway, intake, bottom outlet, and powerhouse; (ii) contract for stabilization of reservoir banks; (iii) auxiliary equipment; (iv) construction and equipping of the Reventazón substation and a bypass transmission line to the substation; and (v) advisory and supervision services.
- 2.1.4 The procurement and contracting processes of works and acquisition of equipment to support the Project through CR-L1049 loan have been concluded, and IDB has disbursed US\$51.7MM, approximately 55.2% of the amount initially estimated for financing the Project with sovereign guaranteed resources (US\$93.7MM). The overall level of loan disbursement is around 47.6%.

2.2 IDB's loan CR-L1056: Reventazón Hydroelectric Power Project

- 2.2.1 On October 19, 2012, IDB's Board of Directors approved a non-sovereign guaranteed (NSG) loan to *Fideicomiso Uno P.H. Reventazon/ ICE/Scotiabank/2013* ("the Borrower"), a special purpose vehicle established by ICE. The Project consisted of the design, construction, operation and maintenance of a hydroelectric plant and its associated facilities, including the transmission lines and substations.
- 2.2.2 The overall financing package to the Borrower totaled US\$1.4 billion and included loans from the International Finance Corporation and four Costa Rican banks, in addition to the private sector arm of the IDB. The IDB NSG portion was a US\$335 million A/B loan in which the B loan was structured as a bond issuance by institutional investors. The financing documentation was signed on December 20, 2013, and the final disbursement took place on May 12, 2016.

2.3 Project implementation status

- 2.3.1 The Project is nearly 100% complete and was officially inaugurated on September 16, 2016. The Project's power units, which have an installed capacity of 305.5-MW (10% of Costa Rica's total capacity), are synchronized with the National Electrical System and fully operational to generate and distribute the corresponding electricity; thereby providing a supply of clean energy to approximately 525,000 households, or about 12% of the country's population.

3. The Request

3.1 On February 9, 2016, the Costa Rica country office received an operational complaint from the owners of Finca Lancaster¹³, alleging environmental damages caused by the Reventazón Hydropower Project (the “Project”) against their property and questioning the expropriation process of a portion of their lands. Due to the importance of the Project as a model to promote sustainable infrastructure, IDB, IIC and IFC (“the Lenders”) have undertaken a variety of actions in response to the complaint and have reviewed the environmental and social aspects raised by the Finca Lancaster owners. Specifically, the Lenders requested a full report from ICE on the substance of the complaint, and decided to conduct a technical mission to acquire a first-hand understanding of the matters and issues raised by the complainants.

3.2 In April 2016, a technical IDB and IIC mission, together with the independent environmental and social consultant (IESMC) and a specialist from the IFC, visited the area, met with the complainants, visited their property and had further discussions with the Borrower about the complaint. The mission found:

- A high degree of disagreement between the owners of Finca Lancaster and ICE around the land acquisition process, which was and is still under judicial review;
- Reluctance of ICE to discuss expropriation issues outside of the judicial proceedings;
- No evidence of other direct actual or potential loss or damage experienced by the complainants as a result of the implementation of the Project;
- An apparent willingness of both the Borrower and the complainants to discuss further the environmental issues raised in the operational complaint.

3.3 After consultations with the complainants, the Lenders determined that a direct dialogue between the parties would be necessary to evaluate and better understand the nature and scope of the issues raised in the complaint. Hence, the Lenders facilitated a dialogue process between the complainants and ICE, to generate a space in which the parties could provide each other with clarifications and further information as an attempt to help the parties come together and re-establish the once existing negotiations between them, and if possible, to reach an agreement.

3.4 In June 2016, the Lenders engaged an independent facilitator to support such a dialogue process between the Borrower and the complainants. The independent facilitator undertook several rounds of bilateral discussions with each party, travelled to Costa Rica and started facilitating

¹³ Management understands that the Requesters have asked to maintain their identity confidential. The Request refers to the Finca Lancaster being the property of the Requesters. Management therefore assumes in its response that the Requesters are the owners of the Finca Lancaster.

the development by the parties of an agenda for the dialogue. However, shortly after these efforts were initiated, in August 2016, the complainants concluded the process unilaterally, allegedly due to ICE's lack of consideration to the agenda they proposed, which included expropriation matters. Despite several attempts by the independent facilitator and the Lenders to resume the dialogue process, the complainants confirmed¹⁴ their decision to stop their participation in the process and to pursue other avenues. Consequently, in September 2016, the Request was submitted to the IDB's ICIM, raising the same issues and concerns as expressed in the operational complaint previously sent to Management.

3.5 In addition to those issues and concerns raised in the original operational complaint, the Request submitted to the IDB's ICIM asks for compensation and payments, including legal expenses and fees. Management understands that the award of compensation or other benefits is out of the scope of the ICIM Policy¹⁵.

3.6 It is Management's view that no harm has occurred or is reasonably likely to occur in the future due to a failure of the Bank to comply with its Relevant Operational Policies. Furthermore, with the exception of the land expropriation process, the Project has not caused and is unlikely to cause in the future any direct damage or loss to the Requesters. The land expropriation process and related compensation are currently under judicial review in Costa Rica.

4. Management's perspective with respect to the allegations submitted by the Requesters

Management has the following comments about the specific harm alleged in the Request:

4.1 Alleged damages or potential damages on Lagunas Lancaster¹⁶

4.1.1 The Requesters allege that that the Project has damaged the stability of the Lagunas Lancaster by extracting materials from the river bed and banks, which would have increased the risk of landslide and collapse of Lagunas Lancaster; and that the change in the water table level due to the filling and operation of the reservoir is likely to damage the stability of the Lagunas Lancaster by exacerbating the risk of landslide.

4.1.2 This specific claim was reviewed in the monitoring mission of the Lenders and the Independent Environmental and Social Consultant that took place in April 2016. The mission did not find any evidence that the construction of the Project has damaged the stability of Lagunas Lancaster;

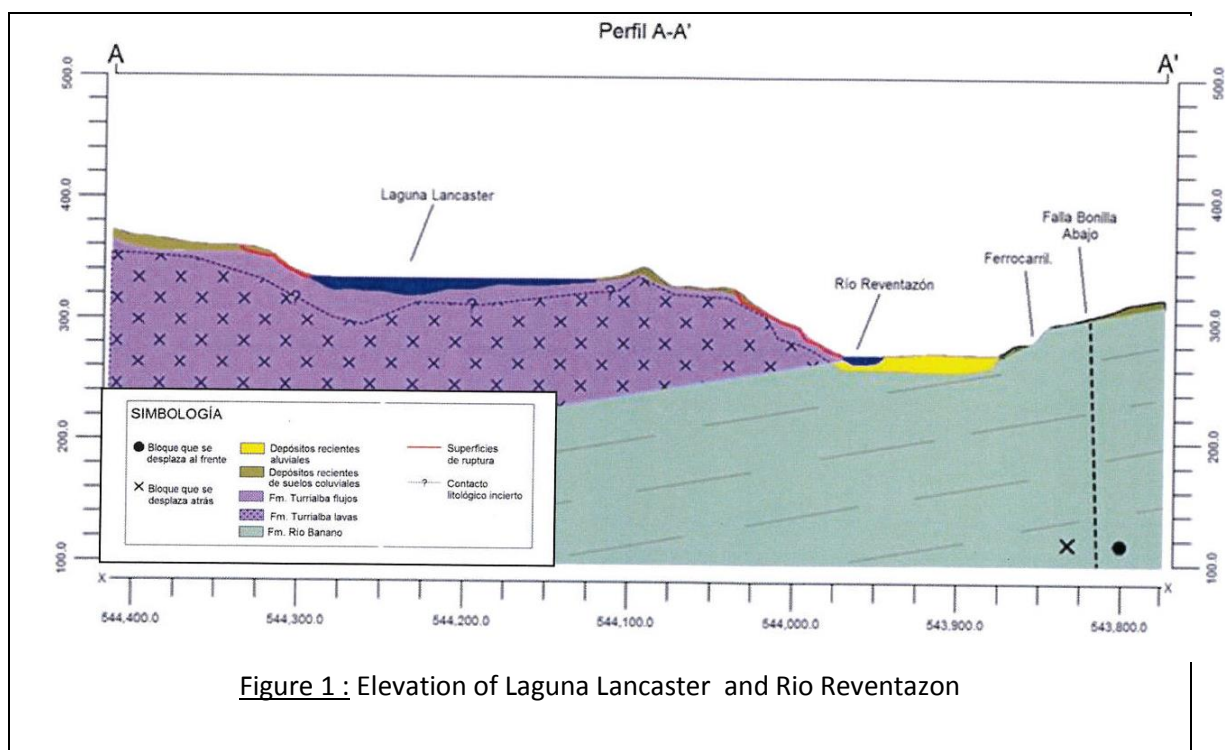
¹⁴ See in Annex 1 the last communication received by Management from the complainants.

¹⁵ MI-47-3, Paragraph 16.d: *"the ICIM does not award compensation, damages, or similar benefits"*.

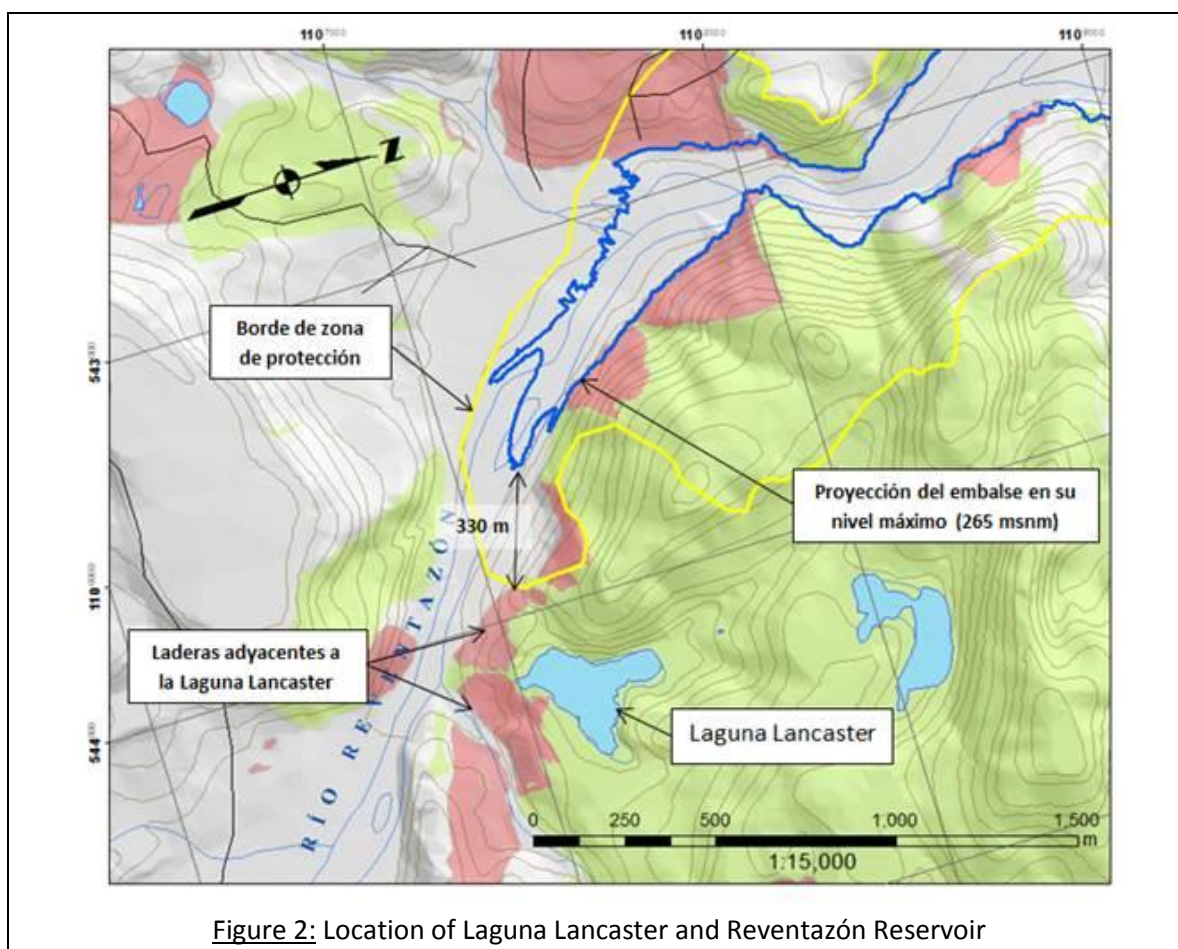
¹⁶ Items a and b of the Request.

nor of any deviation from local laws, regulations and permits applicable to the material extraction activities. ICE also confirmed that no material was extracted from the river banks. It is worth noting that a similar claim was raised by the Requesters with relevant authorities in Costa Rica, including with the Ministry of Environment, Energy and Technology (MINAET)¹⁷, which concluded similarly there was no evidence of damage by external agents to the Lagunas Lancaster.

- 4.1.3 Regarding the alleged exacerbation of landslide risk due to the filling and operation of the Reservoir, on the basis of geotechnical studies and monitoring carried out for more than a decade, ICE considers that while the risk of landslide is high in this area, it cannot be attributed to and has not been exacerbated by the Project. It is worth mentioning that the Laguna Lancaster is located outside of the direct area of influence of the Project's reservoir and its elevation is higher than the elevation of the reservoir at maximum operating level, meaning that it is unlikely to be directly affected by the reservoir (see Figures 1 and 2 below). It can also be observed from aerial and satellite photography that this area has been naturally subject to landslide for at least several decades, and there is no visual evidence that this situation has worsened since the Project has started implementation.



¹⁷ See in Annex 2 the resolution from MINAET.



- 4.1.4 Nevertheless, following a precautionary approach and considering the highly technical nature of this issue, the Lenders have requested the Independent Engineer's technical opinion about whether the Project could materially exacerbate the risk of landslide in the areas adjacent to Laguna Lancaster and contribute to the risk it may collapse. Management would like to highlight that this precautionary review has been pursued within the Project's operational monitoring and adaptive management framework and as part of the routine supervision by the IDB and IIC, supported by the independent consultants. The Independent Engineer has confirmed¹⁸ that the risk of landslides caused by weathering and erosion processes, which is naturally high in the reach of Laguna Lancaster, has not been and will not be exacerbated by the construction or the operation of the Project.

¹⁸ See in Annex 3: report of the Independent Engineer.

4.2 Alleged harm on the connectivity of the Sub-Corredor Biológico Barbilla Destierro (SBBD)¹⁹

- 4.2.1 The Project's potential adverse effect on the connectivity of the Sub-Corredor Biológico Barbilla Destierro (SBBD) was identified as a key issue during the Project's environmental and social due diligence. The mitigation strategy was described in the ESMR (paragraph 5.3) as follows:

The Project will restore and maintain connectivity within the SBBD through the restoration and maintenance of habitat at the tail of the reservoir. The Project will establish, and ensure the long term maintenance, of the institutional and organizational basis for the effective functioning of the SBBD. This will include providing direct support to complete baseline research, establishing a five-year plan and securing the legal and financial basis for management interventions. The management interventions will include prioritized programs of reforestation, land purchase, payments for environmental services, environmental education, and establishing sustainable agricultural practices within the corridor.

- 4.2.2 In 2012-2013 a Master Plan²⁰ for the implementation of this strategy was developed by the Centro Agronómico Tropical de Investigación y Enseñanza (CATIE). Its adequacy and relevance were confirmed by the IESCM and the Advisory Group on Biodiversity (GAB). Effectiveness of its implementation was monitored independently by the international NGO Panthera. Implementation of the Master Plan has progressed satisfactorily, and a key milestone required in the Environmental and Social Action Plan (ESAP) to initiate the filling of the reservoir was met²¹. The continuous implementation of the SBBD mitigation strategy and Master Plan will actually prevent any direct, material loss of or damage to the connectivity of the sub-corridor and, as confirmed by the evaluation of the Advisory Group on Biodiversity, is expected to achieve net positive gain over time.
- 4.2.3 It is also worth clarifying that: i) the area of Laguna Lancaster, along with many other properties, is indeed included in the priority area for the restoration of connectivity at the tail of the Project's reservoir (see figures 3 and 4 below); and ii) the tail end of the reservoir is defined by the Project's basic design parameters, and therefore its location cannot be changed. The dialogue process referred above was expected to generate a space in which ICE could have provided such technical clarifications, had the Requesters not opted out from this process.

¹⁹ Items c, d and f of the Request

²⁰ Available on IDB's website: <http://www.iadb.org/es/proyectos/project-information-page,1303.html?id=CR-L1049>

²¹ See in Annex 4 progress report on indicators related to activities implemented to maintain the functionality of the SBDD – Priority Area "Tail of the Reservoir".

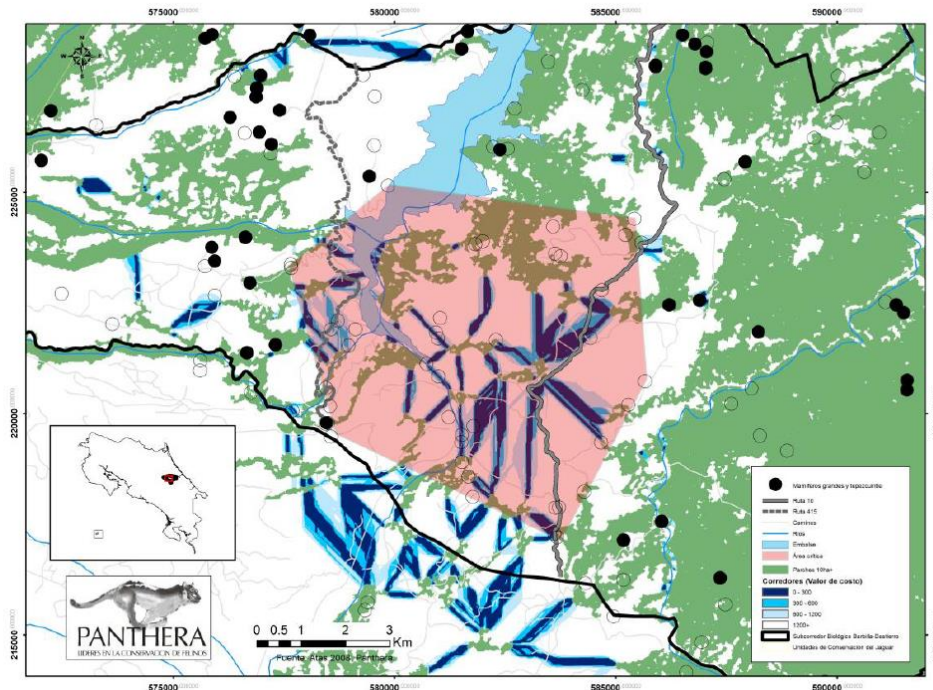


Figure 3: priority area (pink) and least cost routes (dark blue) identified by Panthera

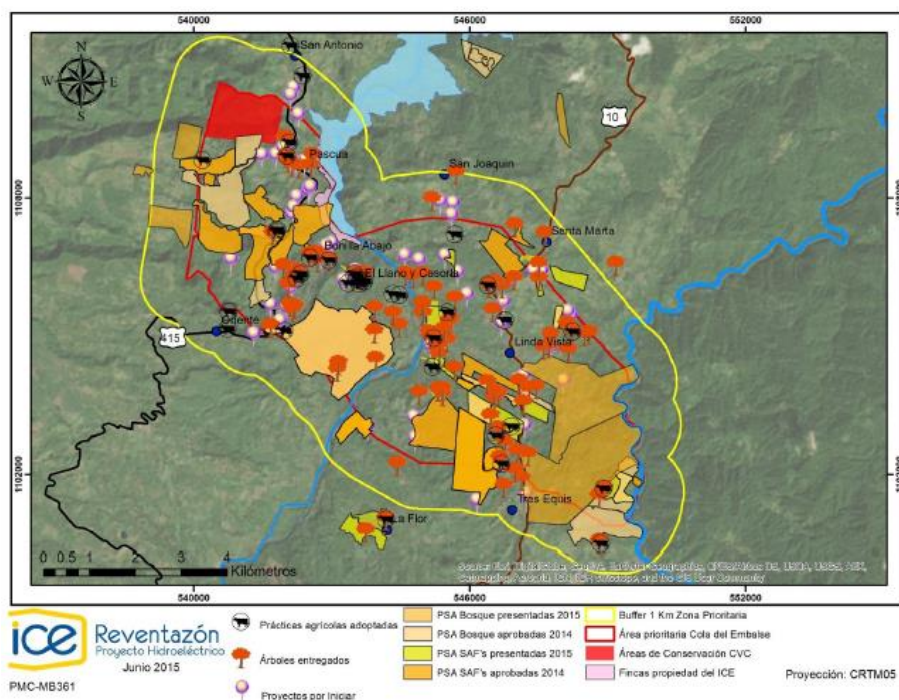


Figure 4: actions implemented by ICE in the priority area at the tail of the Project's reservoir

4.3 Alleged harm caused by not cutting all trees prior to the filling of the Reservoir²²

- 4.3.1 The Requesters claim that not all trees in the reservoir area have been cut prior to filling of the reservoir. Indeed, selective biomass clearance is a standard practice for large hydropower projects globally, as it is often impractical and not necessarily desirable to remove all biomass in a reservoir prior to its filling. It is in many cases, such as for the Project, the best strategy to minimize overall impacts on the environment, as full biomass clearance can lead to very detrimental environmental impacts, including increased risk of erosion and landslide on the river banks. Furthermore, water quality modelling²³ and GHG emissions estimation²⁴ studies were performed during project preparation and concluded that the level of biomass in the reservoir area is low and will not affect the water quality and GHG emissions during the Project operation. Monitoring programs are being implemented.
- 4.3.2 The Request does not describe how keeping some of the trees in the reservoir could result in direct material loss or damage for the Requesters or to the environment.

4.4 Alleged harm related to the expropriation process²⁵

- 4.4.1 Although the Project does not involve any physical displacement, it presented a risk of economic displacement for 19 households with moderate to high vulnerability due to their economic dependence on the land to be acquired for construction and operation of the Project. In line with requirements of OP-710²⁶, this risk was identified early during project preparation and resulted in the development of a *Marco Estratégico de Restitución o Mejora de las Condiciones de Vida*²⁷ and of a *Plan de Reasentamiento y Restitución de las Condiciones de Vida*, focusing on those vulnerable households. As confirmed through the Lenders' and IESCM's routine supervisory activities, the resettlement plan has been implemented satisfactorily, and households presenting some vulnerability to economic displacement were resettled in accordance with the plan, well before the filling of the reservoir was initiated. As mandated in the Environmental and Social Action Plan, a Resettlement Completion Audit will be executed prior to Project completion.

²² Item e of the Request

²³ Available on IDB's website: <http://www.iadb.org/Document.cfm?id=36689437>

²⁴ Available on IDB's website: <http://www.iadb.org/Document.cfm?id=36689431>

²⁵ Item g of the Request

²⁶ "The Bank's Policy on Involuntary Resettlement (OP-710, 1998) applies to all situations in which people are physically displaced or lose their source of livelihood (fisheries, agricultural land, employment, business outlets, and so on) as a result of land acquisition." (Guideline on Resettlement Plans, 2001).

²⁷ Available on IDB's website: <http://www.iadb.org/Document.cfm?id=36878994>

- 4.4.2 As per the criteria defined in the *Marco Estratégico de Restitución o Mejora de la Condiciones de Vida*, the owners of Finca Lancaster were not considered as vulnerable to the risk of economic displacement, and were eligible for cash compensation at full replacement cost following laws and regulations applicable in Costa Rica. The criteria for land valuation are also detailed in the *Marco Estratégico*. The land expropriation process and related compensation are currently under judicial review in Costa Rica.
- 4.4.3 It is also worth noting that as part of the implementation of the Project, ICE has acquired approximately 1,900 hectares extending to 137 properties. These processes entailed a variety of complex situations; most of them were satisfactorily resolved. In all cases, in compliance with the principles defined in the *Marco Estratégico de Restitución o Mejora de la Condiciones de Vida*, all lands were acquired by ICE prior to them being affected by the Project, including during the reservoir filling process.
- 4.4.4 In the case of Finca Lancaster, there have been almost four years of conversations, meetings and interactions²⁸ between the Finca Lancaster owners and ICE. These focused mainly on the areas to be expropriated and the price per hectare. According to ICE, the negotiations at that time were directly with the land owners of Finca Lancaster, but as soon as there was an intervention of the Lancaster lawyers, the negotiations were halted and ICE was left with no alternative but to proceed with legal action for expropriation. In this context, Management was very careful to not get involved in a legal dispute about the valuation of property subject to expropriation proceedings.

5. Relevant matters under arbitral or judicial review in Costa Rica

- 5.1 According to the information extracted from the Online Consultation System of the Judiciary Power of Costa Rica²⁹ and to certain information provided by ICE, there are ongoing lawsuits in Costa Rica addressing matters relevant to the Request. The following table identifies a handful of the ongoing lawsuits and Annex 6 hereto provides additional details:

File Number	Court	Date	Status
15-000585-1028-CA	1028-JUZGADO CONTENCIOSO ADMINISTRATIVO Y CIVIL DE HACIENDA DEL II CIRCUITO JUDICIAL DE SAN JOSE (CPC)	08/06/2015	Ongoing
16-006528-1027-CA	1027-TRIBUNAL CONTENCIOSO ADMINISTRATIVO DEL II CIRCUITO JUDICIAL DE SAN JOSE (CPC)	07/07/2016	Ongoing

²⁸ See in Annex 5 a detailed timeline of those interactions.

²⁹ Sistema de Consultas en Línea del Poder Judicial (<https://pjenlinea.poder-judicial.go.cr/SISTEMAGESTIONENLINEAPJ/Publica/wfpConsultas.aspx>)

15-000955-1028-CA	1028-JUZGADO CONTENCIOSO ADMINISTRATIVO Y CIVIL DE HACIENDA DEL II CIRCUITO JUDICIAL DE SAN JOSE (CPC)	07/09/2015	Ongoing
15-000956-1028-CA	1028-JUZGADO CONTENCIOSO ADMINISTRATIVO Y CIVIL DE HACIENDA DEL II CIRCUITO JUDICIAL DE SAN JOSE (CPC)	07/09/2015	Ongoing
16-006528-1027-CA	1027-TRIBUNAL CONTENCIOSO ADMINISTRATIVO DEL II CIRCUITO JUDICIAL DE SAN JOSE (CPC)	07/07/2016	Ongoing

5.2 In addition, two formal complaints were presented before the National Technical Environmental Secretariat³⁰ (SETENA) against ICE³¹ in 2015 and 2016, respectively. Regarding the former, SETENA found that no issue related to the claim was pending and therefore resolved to reject the claim as inadmissible. The latter, relating to several of the issues identified in the Request, was rejected by SETENA and very recently an appeal thereof was also rejected by the Office of the Minister of the Environment and Energy. The claimants have one year to request a judicial review of the SETENA's rejection of their claim from the date that their appeal was denied by the Office of the Minister of the Environment and Energy.

ANNEXES:

Annex 1: Last email exchange between complainants and Management (confidential)

Annex 2: Potential damage to Laguna Lancaster - Resolution SINAC (confidential)

Annex 3: Independent Engineer's Technical Opinion on stability of Laguna Lancaster (confidential)

Annex 4: SBBD Master Plan – Progress Report on Implementation June 2015 (public)

Annex 5: ICE's response on additional information requested by the Lenders in May 2016 (confidential)

Annex 6: Memorandum BLP on judicial review processes (confidential)

³⁰ Secretaría Técnica Nacional Ambiental

³¹ Expediente Administrativo No. D1-331-2008-SETENA and Expediente Administrativo No. D1-331-2008-SETENA