

## Inter-American Development Bank Financing of Responsible Oil and Gas Developments

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### I. Abstract

The Inter-American Development Bank (IDB) is supporting the development of responsible oil and gas development in Peru since 2004 with the Camisea and Peru LNG Projects, establishing a benchmark high for environmental and social practices and corporate social responsibility in the country. Notwithstanding the sensitive and controversial environmental and social aspects of the Camisea Project (Camisea fields located in areas reserved for indigenous peoples in voluntary isolation and in areas of unique biodiversity value, pipeline crossing three sensitive ecosystems and a fractionation plant located in the buffer zone of a national reserve) the Bank leveraged its limited presence in the transport (pipeline) component to extend its environmental and social requirements to the Upstream Component (exploration and exploitation), and to the Government of Peru (GOP), strengthening its ability to monitor the environmental and social aspects of the Project helping improve the overall environmental and social sustainability in the Project area.

The Peru LNG Project was financed by the IDB in 2008. The environmental and social requirements established as part of the Bank's financing to the Project built upon the Camisea experiences and the new Bank Environment and Safeguards Compliance Policy approved in 2006. Lessons learned and good practices implemented in the Camisea Project were expanded and improved for this project, setting exemplary practices for participatory monitoring, biodiversity protection, construction over sensitive peatbogs (Andean wetlands), social investments, and others. In parallel, the Bank is continuously working with the GOP to provide the technical basis for the development of a sustainable energy matrix for the country.

These projects have generated important environmental and social benefits, including enhanced legal protection for vulnerable indigenous populations, creation of close to 1 million hectares of environmental protected areas, establishment of a multi-stakeholder institution to develop and implement a sustainable development plan for the natural reserve Paracas, enhanced environmental protection legislation for hydrocarbon development, and increased governmental and civil society institutional capacity.

### I. Projects' Summaries

#### *The Camisea Project*

The Camisea Project (hereinafter "Camisea" or "Project") consists of two separate components with a total cost of approximately \$1.7 billion. The upstream component consists of exploration and exploitation of gas deposits in the Camisea field, processing facilities at Las Malvinas located 431 kilometers east of Lima, and a fractionation plant and marine terminal for natural gas liquids on the Pacific coast south of Pisco, all under the responsibility of a multinational consortium led by the private firm Pluspetrol. The downstream component includes 714 kilometers of a natural gas pipeline from Las Malvinas to Pisco and from Pisco to Lima, and a separate 540-kilometer natural gas liquids pipeline from Las Malvinas to Pisco.

Both pipelines share the same right-of-way and are the responsibility of the private firm Transportadora de Gas del Perú (TGP).

IDB involvement began in 2001, prior to initiation of construction<sup>1</sup>. The Project was approved by the Board of Executive Directors in December 2003 and started operations in August of 2004. In December 2002, the Bank also provided a US\$5 million loan to the Government of Peru (GOP) to help strengthen its institutional capacity to monitor the environmental and social effects of the Project. The IDB did not participate in the financing of the upstream component of the Project.

### ***The Peru LNG Project***

The Peru LNG Project consists of the development, construction and operation of a liquefied natural gas (LNG) plant on the coast of Peru, South of Lima; a marine terminal with a breakwater; and a 408 km, 34” natural gas pipeline through the highlands to the coastal LNG plant<sup>2</sup>, all under the responsibility of Peru LNG, a consortium led by Hunt Oil, SK Energy, Repsol, and Marubeni Corporation. The Project liquefies natural gas from the Camisea fields operated by Pluspetrol, and exports LNG to available markets.

## **II. Sustainability**

### ***Camisea***

IDB’s participation was based upon the principles of sustainable development including strong environmental and social safeguards for both the downstream and upstream components (this one not financed by IDB) and specific actions to create long-term benefits for local populations and the environment. The IDB took a series of proactive steps to improve the environmental and social sustainability of the project and ensure stakeholder participation, including semi-annual public meetings for the life of the loan. In addition to IDB supervision, the project is supervised by the GOP, the project companies, and by local communities, each with transparent reporting mechanisms.

During due-diligence, prior to any formal approval of the financing, the Bank innovated by implementing day-to-day monitoring of the construction to ensure adequate environmental and social protection measures were implemented.

The participation of the IDB clearly made a significant difference in the environmental and social viability of the Project. The institutional strengthening loan provided to the GOP increased its supervision and monitoring activities and enabled additional actions to mitigate environmental and social impacts.

As part of its involvement, the IDB strongly encouraged the GOP to improve the sharing of Camisea benefits with the local population in the area of influence of the project. In this context, the GOP, working with the IDB and Peruvian civil society, designed a mechanism known as the Camisea Fund. The proposed fund would have used 3.5 percent of the royalties from the upstream component to finance specific environmental, social and economic development projects in the area of the Project and would have been managed by an independent entity. However, in December 2004, the Peruvian congress passed a law (*Ley del Fondo Camisea, or FOCAM*), which while returning project royalties to the Project area, did not meet all the objectives established in the draft Camisea Fund proposed by IDB. On the positive side, FOCAM provides substantially more resources than had been proposed in the original Camisea Fund. However, FOCAM does not provide for an independent entity to administer the fund, resources are

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<sup>1</sup> 2002.

available only to governments and not to private or community organizations, and does not allow for financing productive projects or federal environmental protected areas created by the Project.<sup>3</sup> Specific data on the transfers authorized and accredited under FOCAM (and gas royalties) to regional and local Governments can be accessed at the Ministry of Economy and Finance (MEF)'s website <http://transparencia-economica.mef.gob.pe/>. Since the law came into effect in April 2005, FOCAM has generated over 1.3 billion soles (over 500 million US dollars) for local and regional governments in the Camisea area.

To facilitate the use of FOCAM resources by the regional and local governments, the Bank financed a series of regional sustainable development plans for the departments of Ayacucho and Huancavelica, and the province of La Convencion. In addition, various training programs were instituted for local governments on public sector investments, the Peruvian budget, and appropriation regulations. While the governmental institutions that access FOCAM resources still need further institutional capacity to more effectively and efficiently design and implement projects, significant progress has been made (all the more impressive given the limited capacity that existed prior to the creation of the FOCAM ).

With its involvement, the Bank significantly increased the environmental and social sustainability of the Project, in particular:

- Increased protection of and subsequent development of a protection plan for the Nahua-Kugapakori indigenous area (indigenous peoples living in voluntary isolation), which is the first and only time in Peru such enhanced legal protection has occurred. Creation of approximately 1 million hectares of new protected areas in the rainforest area, including Otishi National Park, Ashaninka and Machiguenga Communal Reserves, and Megatoni Sanctuary, and their respective management plans and financial resources to implement the plans.
- Creation of the Commission for the Sustainable Development of the Paracas Bay (CSDPC), public-private partnership between the GOP, IDB, regional and local governments of Pisco, San Andres and Ica, to develop and implement the Paracas Bay decontamination plan. The initiative leveraged significant resources (over \$24 million) to address priority decontamination efforts and implementation of remedial projects (such as a marine outfall for the effluents of the fisheries industry), properly manage the national marine park, and implement participatory monitoring programs.
- Land titling program for properties along the pipeline right-of-way (over 16,000 properties).
- Development of a specific construction method for crossing the Andean wetlands known as "peatbogs" or "bofedales", enabling the complete restoration of such sensitive environments.

An important indirect benefit of the Bank's involvement, though one not easily quantified, is the enhanced institutional capacity of local civil society organizations in large infrastructure projects. Similarly, while challenges still remain, the GOP's institutional capacity to develop environmentally and socially sustainable oil and gas projects in Peru has unquestionably progressed relative to the point at which the IDB's involvement in the project began.

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<sup>3</sup> Financing of these protected areas was subsequently incorporated into the federal budget.

## ***Peru LNG***

Lessons learned and good practices implemented in the Camisea Project were expanded and improved for the Peru LNG Project, setting exemplary practices for management of social impacts, biodiversity protection, construction over sensitive peatbogs (Andean wetlands), social investments, and others. In parallel, the Bank continues to work with the GOP to provide the technical basis for the development of a sustainable energy matrix for the country.

### ***Management of social impacts***

The social management plans and programs developed by Peru LNG are considered exemplary within the industry, in particular the cultural heritage management, stakeholder engagement, influx management, grievance mechanism, local hiring, participatory monitoring, and local purchases plans and programs. Throughout construction, approximately 20,000 meetings were held with plant and pipeline stakeholders; approximately 11 million dollars were spent in local purchases; and approximately 10,000 local workers were hired. The participatory monitoring program (community monitoring program) employed 83 community monitors and was instrumental to the successful conclusion of the construction through sensitive Andean communities.

### ***Biodiversity protection***

The company implemented various plans to ensure the preservation of biodiversity along the pipeline. Particularly relevant were the biodiversity action plan, the bio-restoration management program, and the marine environmental management plan. The company also built upon the experience of Camisea in constructing on the “bofedales” and implemented a state-of-the-art construction method for crossing the Andean wetlands.

### ***Social Investments***

Social investment plans were developed to add value beyond Project-related compensation and employment for communities in the PERU LNG’s area of influence. During construction, the community investment budget, which excludes monitoring costs, was distributed between the main components of the Project as follows: US\$4.1 million for the LNG Plant area, and US\$2.5 million for the Pipeline area. For the operation phase, the communities’ needs are being re-assessed and the social investment program will be modified to address those needs. Lessons learned from the construction-phase communities projects will be applied. The budget for the operation phase community projects will be equally distributed among the communities along the pipeline route.

### ***Sustainable energy matrix***

For the IDB, the Peru LNG Project represents a cornerstone for important cooperation with the GOP in the management of the social and environmental risks in the hydrocarbon sector in Peru. Specifically, the additional and complementary collaboration between IDB and the GOP includes a Programmatic Loan for a New Sustainable Energy Matrix; a Technical Cooperation on Sustainable Energy and Biofuels Strategy; and another Technical Cooperation for the Sustainable Development of the Lower Urubamba, the sensitive rainforest area where the Camisea fields are located. The Bank is also in the process of discussing with the GOP specific areas for capacity strengthening, in particular, to strengthen the capacity of local and regional governments to access the resources more efficiently generated by the gas

developments and to enhance the institutional capacity of the governmental agencies that are, ultimately and in the long term, responsible for ensuring that sustainable development goals are achieved

### **III. Conclusions and Lenders' Additionality**

Participation of multilateral development banks (MDBs) in financing large oil and gas projects is critical to ensuring environmental and social responsibility by project companies and enhancing the environmental and social protection of the people, biodiversity and natural resources. The supervision practices of MDBs, and IDB in particular, ensure these benefits throughout the life of the loan.

When financing projects, the IDB is committed to have important additionality and encourage borrowers to develop sustainable social and economic initiatives that extend beyond the mitigation of impacts or the creation of project-specific jobs in the project's area of influence. As an example, in the Camisea Project, over 10 US\$ million were invested by TGP in support to community projects and their local development plans, whereas Pluspetrol invested over US\$ 23 million in socioeconomic agreements with the fishermen organizations and local governments in the Paracas Bay area.

Peru LNG invested US\$ 6.6 million during the construction phase in community investment programs and has planned to have rolling budgets to be determined annually or at other intervals in the operations phase.

In addition, IDB's support for Camisea encouraged innovation by leveraging its relatively small financial contribution (6% of project costs) and extending its environmental and social safeguards to the upstream component not financed by the Bank. In Peru LNG, Bank involvement went beyond the Project financing to extend its support to the GOP in developing a new sustainable energy matrix for the country.

#### *Lessons Learned*

The IDB's experience with oil and gas projects provides important lessons that can hopefully benefit other financial institutions when financing large projects in the sector. Lessons include: the importance of pre-construction planning for works in sensitive environments and indigenous reserves; the need to create credible and effective supervisory systems (particularly in extremely complex projects with extensive information, and where there is a general lack of trust among stakeholders); workers' health and safety training during the early stages of the project construction; and the need for an effective communication strategy on environmental and social issues with all stakeholders. The IDB's experience has also demonstrated the importance of mainstreaming environmental and social aspects into sector planning and addressing issues of mixed responsibilities, belonging to public and private entities, and among the different public entities and private companies.

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