

Peru LNG
Position of the United States at the IFC
February 5, 2008

The United States recognizes that this project – the largest foreign direct investment in Peru and the first LNG export project in Latin America – represents an opportunity for the Peruvian people to create a cohesive energy matrix and undertake critical investments in poverty reduction in the project’s area of influence. The U.S. has closely followed the development of Peru’s hydrocarbon resources since the period leading up to financing of the Camisea project at the Inter-American Development Bank (IDB). The United States did not support the Camisea project because we questioned the need for IDB’s financing given the availability of private financing; we also had concerns regarding insufficient application of environmental and social protections.

While we recognize that the Camisea and Peru LNG projects are both physically and financially related, it is important to note that several factors differentiate them. First, the sponsors of the Peru LNG project demonstrated a willingness to set a standard of environmental and social best practices well ahead of construction. Second, the on-going learning process by the Peruvian Government has resulted in improved management of hydrocarbon development in the Lower Urubamba. And third, important lessons from Camisea have been incorporated into how the lenders approached the LNG project design, including environmental and social management.

In particular, we appreciate the efforts of the Peruvian Government to improve management of Peru’s hydrocarbon resources, notably through its extension of the Camisea inter-agency coordinating group and Camisea Ombudsman into the LNG project. The Government has expedited its request for an IDB policy-based loan (PBL) for a sustainable energy matrix, and has recently taken steps to establish an independent environment ministry and strengthen protections for indigenous peoples in the Camisea region. Furthermore, efforts by the Finance Ministry to simplify procedures for using gas royalties are enabling communities to benefit more directly and expeditiously from these hydrocarbon revenues. All of these actions took place in the context of a very complex decentralization and reform process that continues to unfold, and all parties recognize that there is much work left to be done.

Through Hunt Oil as the lead project sponsor, Peru LNG has committed to using industry best practices for the mitigation of environmental and social risks. Peru LNG has designed a detailed environmental management plan and has cross-referenced the environmental requirements of its multiple lenders. These practices also include the purchase of the maximum available emergency insurance to guard against the impacts of possible spills or natural disasters. Peru LNG’s community development program is well designed and participatory, and Hunt has also agreed to improve community development efforts by coordinating them with other funding sources. Finally, we welcome the sponsor’s plans to establish a community monitoring program, and expect that it will be operational in the near future.

For all the above reasons, the United States supported the IDB component of this project on December 19, 2007. In forming our position on IFC financing, however, we have examined the project's characteristics, the country context, and equally important, the justification for IFC's involvement. With respect to the latter, we examined whether IFC's involvement is likely to improve materially the project's economic, social and environmental outcomes *above and beyond those that would have obtained solely from IDB's much earlier involvement*. Thus far, the evidence is mixed.

With respect to environmental considerations, the IFC's environmental and social performance standards are broader in scope than their counterparts at the IDB, including labor conditions, community health and security, and cultural heritage. The application of these standards to Peru LNG thus reflects environmental and social additionality.

On the other hand, IFC's definition of associated facilities for environmental assessment is actually narrower than that adopted by IDB, as well as inconsistent with what we believe are the standards under U.S. domestic environmental law and international good practice. According to its definition, IFC does not consider any component of the original Camisea project to be an associated facility. IFC's determination of no "associated facilities" also means that it did not extend its formal analysis of "Broad Community Support" to the upstream facilities.

In lieu of formally applying its safeguards even to the gas field on which the Peru LNG project depends, IFC and the other lenders are seeking to manage the risks associated with upstream facilities via other mechanisms. Importantly, lenders will require the sponsor to use its "best efforts" to induce the gas field operator (Pluspetrol) to prepare and implement several environmental and social action plans. Given that the Peru LNG consortium controls an aggregate majority share of total Pluspetrol equity, we expect IFC to establish a very high bar for enforcing "best efforts".

IFC's project document references the Strategic Environmental Assessment (SEA) conducted by the Government of Peru as a tool for managing the broader cumulative environmental and social impacts from hydrocarbon development in the Lower Urubamba. However, IFC does not appear to have a role in promoting implementation of the eight programs proposed under the SEA. IFC and IDB are also seeking to catalyze a Lower Urubamba producers group that would coordinate their implementation of safeguards; we are disappointed with the slow progress to date in establishing this group.

The primary linkage of Peru LNG to poverty reduction is through the flow of gas royalties. For the gas extracted to serve the Peru LNG project, 63% of the royalties collected will flow to regional or local governments. In this regard, we welcome that IFC will support increased transparency of revenue distribution and use through independent monitoring in the provinces of Ayacucho and Huancavelica. Since Peru LNG will also generate major revenue streams to Cusco, we ask that IFC include this province as well in its monitoring and reporting efforts.

With respect to demonstrating additionality in the area of extractive sector governance, the IDB is complementing its support for the Peru LNG project with a forthcoming \$50-million public sector operation aimed at strengthening the Government of Peru's management of its energy sector. We would welcome similar complementary efforts by the World Bank Group. We are thus encouraged by the grant agreement between the World Bank and the Government of Peru, under which a pilot project to enhance revenue transparency will be started by the World Bank in the Cusco region. Consistent with the most recent Country Partnership Strategy for Peru, the Bank is planning an environmental development policy loan (DPL) for early in FY09, followed by an additional DPL later in the fiscal year. We welcome these planned operations, notably the link to this Peru LNG investment by supporting environmental institutions and governance.

Considering both the project characteristics and IFC's additionality, the United States supports IFC financing of this project. The potential for IFC to contribute uniquely to positive development outcomes is sufficient to warrant its involvement, although we would have liked to see more progress in several initiatives. Given the relatively nascent stage of these activities thus far, we encourage IFC Management to devote significant attention to post-Board monitoring and reporting to IFC's Board as well as to civil society. We have several suggestions in this regard.

First, IFC should strengthen its plans to report on development outcomes from the project. According to the project document, IFC will enhance and measure poverty reduction impacts but reporting details are lacking. Although current IFC information disclosure policy does not require it to report on project-level development outcomes, we urge IFC to do so in this case. In particular, we suggest that IFC measure the following for each district and province receiving gas royalties: annual trends in poverty rates and income; annual trends in access levels to basic services (e.g., water, sanitation, electricity, education); and trends in employment rates. Collecting such data is within IFC's capacity. We welcome IFC reporting on the indicators in the Project Supervision Report and on the inputs and outputs from various programs, but these are not a substitute for outcome indicators related to poverty reduction.

Second, we urge IFC Management to work with other Peru LNG lenders to strengthen the independence and coordination mechanisms of the overall monitoring framework for this project, and to extend them retroactively to the Camisea project. Doing so would help mitigate some of the distrust and misperceptions that are associated with Camisea. IFC would add value to the project's community monitoring program by applying its experience from another IFC-financed extractive project in Peru, the Yanococha gold mine. In that case, a Peruvian university was engaged to assist communities in some technical aspects of the monitoring program.

Third, given that the lenders will have a common terms agreement, we encourage IFC to coordinate closely with IDB in preparing and presenting monitoring reports. We understand that IFC has proposed annual reporting to the Board on this project. This

schedule may suffice given that IDB management has indicated a willingness to provide quarterly reporting to its Board as the project goes to financial closure and execution.

Finally, we urge IFC to support the U.S. Eximbank proposal to establish an advisory panel within six months that would conduct annual reviews and report to the lenders on all phases of the Camisea and Peru LNG projects (similar to panels established for the World Bank-financed Nam Theun 2 and Chad-Cameroon projects). This panel would accept input from civil society and its reports would be made publicly available.

In conclusion, this investment has the potential to impart significant benefits to the Peruvian people in terms of revenues for local development, expanded energy infrastructure, and development of hydrocarbon resources. We wish the Peruvian authorities and the project sponsors much success in realizing the benefits of this project, and we support IFC's investment in Peru LNG.