Case Study:

Complexities of Government Led Land Acquisition & Resettlement in the Case of a Renewable Energy Project

Lessons to be learned for financing an infrastructure project with a focus on understanding the scope of the project and the complexities of government led land acquisition and resettlement[1]

Summary

This case study presents a large scale renewable energy project in Kenya and the risks faced by financial institutions when their clients initially define the project's area of influence and scope too narrowly, and inadequately provide for a scenario where the land acquisition and resettlement process for associated facilities of the project are led by a quasi-state institution whose resettlement planning and compensation standards fall short of international good practice.

The Project and Responsible Parties

The investment involves the construction and operation of a large-scale renewable energy project located in a remote greenfield site in Kenya. The location was chosen because of the excellent prevailing conditions which allow electricity to be generated at a competitive tariff of 7,52 EUR cents/kWh and which makes the project an important element of Government of Kenya's (GoK's) energy expansion plan.

Besides power generation, the project includes ancillary infrastructure including substations, on-site roads, foundations, construction of permanent housing and related utility services and a wind farm control building. The Project will be positioned within an overall project site of 40,000 acres. In order to connect the project to the grid, a four-hundred-kilometre long transmission line will be constructed by a government-owned transmission company, T-lineco. The Project has been developed by an internationally renowned renewable energy company, which has considerable expertise in renewable energy projects in Africa. It is anticipated that the construction will take over two years, and the facility be commissioned at full capacity in early 2016.

The Financing Facility

Given the size of the project and the related costs, a consortium of international and local banks is financing the development. The total investment is €623m.

The lead debt arrangers are pan-African development finance and commercial banking institutions. The senior debt amounts to €430m, with participation from a number of development banks, development finance institutions and commercial banks.

The sub debt facility amounts to €50m.

A European development finance institution has an equity stake of €10m in the project sponsor.

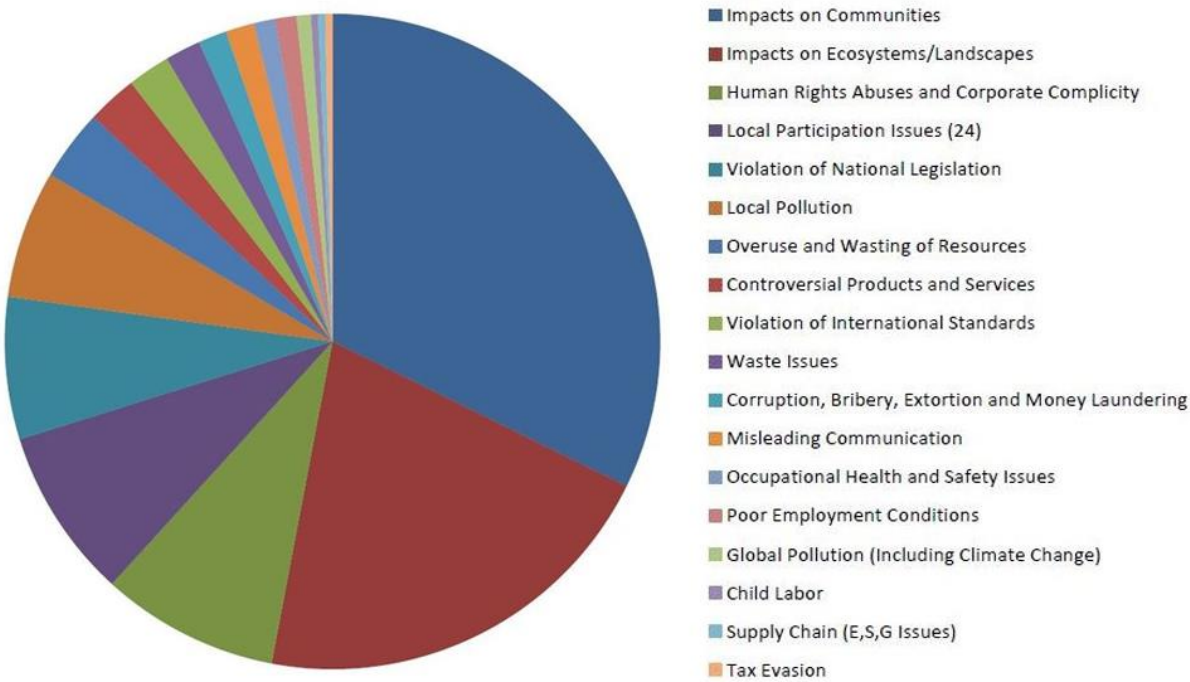
The Consortium and Sponsor agreed on the IFC Performance Standards as benchmark standards for the project.

[1] For confidentiality reasons, names have been changed or omitted where appropriate.

Context

The project is located in one of the poorest areas of the country, characterized by periods of prolonged drought, famine and socio-economic marginalization. It is also close to an area recognized internationally for its historical, cultural and biodiversity value.

An analysis by a provider of environmental, social and governance (ESG) business intelligence on environmental, social and governance risks for companies and projects shows more than 50% of non-governmental organization (NGO) campaigns and critical newspaper articles in Kenya relate to impacts on communities and on ecosystems. Almost all campaigns target larger infrastructure projects (including Gilgel Gibe III-IV-V Dam, the Lamu Port Southern Sudan Ethiopia Transport Corridor, Mombasa Nairobi Railway and Pipeline and Olkaria II and IV Power Station) as well as those with a considerable environmental footprint (Tana River Delta Sugarcane and Kwale Mineral Sands Project).



The Consortium's Environmental and Social Risk Management Approach

In 2013, the Consortium undertook an initial E&S screening of the project, which identified a range of impacts, some potentially unprecedented and a number that arose as a result of activities beyond the boundaries of the site. As such, the project was categorised as high risk (often referred to as Category A), triggering the requirement for a full E&S due diligence inquiry with the support of independent expert advice.

The impacts considered to be of potentially high risk included land acquisition and resettlement associated with both the project site and associated facilities, in particular the transmission line.

The transmission line was identified because of the number of people likely to be directly affected; because the responsible party had a poor track record with land acquisition and resettlement processes; and because the Sponsor had limited, if any, influence over the process but was exposed (as in turn was the Consortium) to significant financial and reputational risks.

Other key risks were the prevailing insecurity in the region, biodiversity impacts, the inherent risks to both worker and community health and safety associated with construction activities, in-migration into a remote area, and the potentially disruptive effect on social cohesion, stability and security.

The social impacts were identified as presenting the highest level of risk to both the Sponsor and the Consortium, especially in the context of existing levels of social tension and a relatively active civil society. As such, the E&S due diligence needed to establish how well these risks were understood by the Sponsor and other responsible parties and the level of commitment and management procedures and controls in place to manage them. More specifically, the Consortium determined that the E&S due diligence needed to focus on how well the Project was positioned against the following IFC PS Standards:

- IFC PS 1 Assessment and Management of Environmental and Social Risks and Impact – in particular how well understood the project scope was and the capacity of the project sponsor and other responsible parties to manage their respective impacts;
- IFC PS 4 – Community Health, Safety and Security – risks related to noise, vibration, construction impacts, etc.;
- IFC PS 5 – Land Acquisition and Involuntary Resettlement – the adequacy of the resettlement action plans for both the project site and the transmission line;
- IFC PS 6 – Biodiversity Conservation – the adequacy of biodiversity management plans.

Findings of the Consortium's Environmental and Social Due Diligence

The Consortium started the E&S due diligence process in early 2014 with a desktop review of the Environmental and Social Impact Assessment (ESIA) of Project against the IFC PS.

The key findings of the review were (for the power generation site):

1. The ESIA was of high quality, as the key issues had been identified and the appropriate recommendations made for impact management;
2. Public consultations had been undertaken and were in line with the requirements of IFC PS;
3. All relevant biodiversity issues, such as the impact on birdlife, had been addressed in accordance with the performance requirements of IFC PS 6;
4. The plan for managing the acquisition of land, and the associated involuntary resettlement of 200 households for the power generating facility, was almost complete and its implementation was being well managed and was in keeping with the intent of IFC PS 5. The necessary resettlement and compensation provisions were in keeping with the principle of not leaving households worse off than before;
5. All relevant permits and licenses had been granted to the project by the authorities; and,
6. The project sponsor had already started implementing the recommendations identified in the environmental and social management plans.

However, the review identified one significant gap in the Sponsor's ESIA: there was no analysis of the potential risk presented by the impact of the transmission line. Although it mentioned that a failure to adequately manage E&S impacts of the transmission line presented a risk, it did not say what the consequences might be and what strategies the Sponsor should adopt in order to be reassured that the responsible parties would manage their respective E&S impacts.

The Consortium's E&S due diligence noted that the land acquisition and resettlement along the transmission line right of way – affecting more than 1,000 households and associated land holdings – presented a potentially significant financial and reputational risk to both the Sponsor and the financial Consortium if T-lineco caused discontent within the communities directly affected.

> IFC PS 1: "*Environmental and social risks and impacts will be identified in the context of the* ***project's area of influence****. This area of influence encompasses* ***associated facilities****, which are facilities that are not funded as part of the project and that would not have been constructed or expanded if the project did not exist and without which the project would not be viable*"

The Concern

Land acquisition and the associated physical and economic displacement can be significantly detrimental to the livelihoods of the affected parties. If not managed appropriately they can lead to discontent, and if communities feel that the channels for articulating their grievances are not functioning, they may resort to disruptive action. This is more likely to arise where insecurity of land tenure and uncertainties over land ownership and occupancy rights are prevalent.

The current good practice articulated in the IFC Performance Standard No 5 on Land Acquisition and Involuntary Resettlement is a response to experiences of the World Bank and tends to set much higher standards than national policies and regulations. As a result, the Standard has a clause specifically relating to private sector responsibilities under government-managed resettlement.

> The IFC Performance Standards No 5. (Land acquisition and involuntary resettlement) is quite clear on **Private Sector Responsibilities Under Government-Managed Resettlement**:
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> "*Where land acquisition and resettlement are the responsibility of the government, the client will collaborate with the responsible government agency,* ***to the extent permitted by the agency****, …. In addition, where government capacity is limited, the client will play an* ***active role*** *during resettlement planning, implementation, and monitoring..*"
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> **But how much does the agency "permit"? What exactly is an "active role"? How "active" does it need to be to avoid conflicts with communities in the long run?**

In this case, the responsibility for land acquisition was with T-lineco, which was also responsible for the resettlement and compensation of the 1,000 households identified as being directly affected.

T-lineco is a recently formed parastatal and has a resettlement project team comprising a socioeconomist, surveyor, way leave officer, environmental specialist, transmission engineer, land valuer, legal officer, commercial officer and building technician. It also has an internal resettlement policy which is based on national policy and regulatory requirements. At the time, these requirements differed from IFC PS requirements, particularly with respect to defining categories of eligible parties for compensation, resettlement action planning and public consultation.

Given its prior experience of what can go wrong in such situations, its emerging concerns about the T-lineco managed resettlement process, and recent news coverage regarding community discontent with land acquisition processes on other projects, the Consortium mobilized one of the its bank's E&S specialists to investigate further, by:

- Visiting the project site and the T-Line;
- Talking to people affected by the project (both at project site and T-Line); and.
- Discussing resettlement issues with T-lineco and the Sponsor.

The Consortium needed to establish how well T-lineco was managing the land acquisition and involuntary resettlement process and whether there was an emerging risk to the feasibility of the project.

Findings of the Consortium's E&S Specialist

The findings of the E&S specialist affirmed the concern that the process of land acquisition could trigger project delays. Specifically, the specialist noted:

1. T-lineco's resettlement team was under-resourced and was already handling another 4-6 transmission line projects.
2. There were weaknesses in the documentation and monitoring capacity of the team, leading to concerns about the quality and completeness of the resettlement process and whether affected parties would raise concerns later.
3. The stakeholder engagement was by no means satisfactory, featuring poor information flows, a weak grievance procedure, and limited communication between the project and the affected communities.
4. The Project Sponsor acknowledged the shortcomings, but stressed the challenges of influencing the responsible party. Although T-lineco verbally communicated that sufficient resources are available to implement the "Resettlement Action Plan", no documentary evidence was shared with the Sponsor to reassure it that the commitment, capacity and financial resources were there to ensure a satisfactory outcome.

> ***"What is a business risk for the sponsor is a serious reputational risk for us (the Consortium)"*** – Consortium's E&S expert

So What Happened?

Although the Government of Kenya, on behalf of T-lineco, accepted to bear risks of project delays, the Consortium was still concerned about the potential for delays to the project even after the ten months that had been reserved as a buffer for late completion of T-Line and the considerable costs that this would incur.

The Consortium's concerns seemed to be confirmed when the estimated compensation budget increased from €5m to €12,2m between 2012 and 2013 for various reasons (realignment of T-line, changes in local legislation, an updated census). At the time, it was not clear whether T-lineco would bear the related costs, and furthermore it became apparent that the full costs of resettlement and compensation would need to be shared to a certain extent with the Project Sponsor.

The apparent absence of cooperation from the party responsible for the transmission line was also unnerving, especially given that disaffected communities might engage in acts of sabotage or cause reputational problems (refer to statistical information below on increasing number of campaigns and activities related to community impacts in Kenya).

As a result, the Consortium urged the Project Sponsor to mobilize a team to work with T-lineco to ensure that the resettlement process was strengthened. The Project Sponsor duly mobilized a team of ten highly experienced people to oversee the resettlement process, at an additional cost of €100.000.

Not All Plain Sailing

Despite these additional resources, the footprint of the T-line (31 different communities) was still proving challenging, as was the lack of an explicit Stakeholder Engagement Plan (SEP) or the availability of trained community liaison officers.

It also took time to develop a "cooperation mechanism" between the Project Sponsor and T-lineco, as there was no agreement between the two about their respective responsibilities. T-lineco made it very clear that there is a limit to the Sponsor's involvement and insisted on taking all important decisions without the latter's involvement. In the end, the Sponsor's specialists played more of an advisory role with no guarantee that their recommendations would be followed, and as such no guarantee that the affected communities would be appropriately resettled, compensated and have their grievances addressed.

Bearing business and reputational risks in mind, the Consortium contractually bound the Sponsor to comply with certain clauses that detailed the "expectations from the lenders towards the Sponsor with regard to his *active role* during resettlement planning, implementation, and monitoring", i.e. a specification of the above mentioned IFC PS clause.

It is too early to say whether or not this mitigation measure was successful or not, as resettlement is still ongoing. However, there is very strong evidence that banks should check that the full scope of the project is understood and addressed by the Sponsors ESIA and that a Sponsor has a clear strategy of engagement with other responsible parties when such risks are present.

"I am more and more requested by large corporates in Kenya to assist them in negotiations with local communities." -- Environmental due diligence expert

Lessons Learnt

1. The proper definition of **project scope** is key to E&S risk assessment. If it is too narrow it may miss important risk issues which can put projects in danger. The project scope does not end where the client's project influence stops (which is usually at the factory/project border) and may also involve other parties' responsibilities, which can make proper risk mitigation difficult.
2. The most important – and surprisingly often most underestimated - risk related to community protest and unsolved resettlement issues is **project delay resulting in higher costs for construction, possible changing of sub-contractors, increased security costs**. As a delay typically has considerable impact on the financial feasibility of the project, financial institutions need to stress the issue of building strong community relations. Furthermore, the company often incurs longer term costs associated with rebuilding their reputation.
3. Government agencies follow national legal requirements, but **business risks usually lie entirely with the project sponsors** and their banks. The IFC PS offer useful guidance to manage related risks. In some cases these standards may need to be refined and adapted to particular contexts but without undermining their underlying objectives.
4. In Kenya, "**negative impacts on communities" are the single most important E&S risk issue** addressed by NGO campaigns (see box). As these campaigns can extend to financial institutions as well, particular caution needs to be exercised through a bank's E&S risk management system.
5. Kenyan authorities responsible for land acquisition related to infrastructure projects tend to be **under-resourced and operating within the confines of an "outdated" policy and regulatory framework and in contexts often characterized by conflicting land tenure arrangements and less than transparent administrative systems.** These challenges should be taken into consideration when developing and financing such infrastructure projects. While project sponsors can offer to assist in this matter, such assistance has its limits, as local authorities may reject the involvement of private parties.
6. A final lesson relates to the increasing **"power" of local communities**. Around the world, and in Kenya in particular, local communities are increasingly aware of their rights and know how to fight for them. Furthermore, there is a tendency to resort to violent action where other grievance procedures are not available. Therefore, response mechanisms and alternative dispute resolution frameworks need to be key components of a business model.