COMMENTS ON THE CLIMATE-RELATED PROVISIONS OF IFC'S DRAFT POLICY AND PERFORMANCE STANDARDS ON SOCIAL AND ENVIRONMENTAL SUSTAINABILITY

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1. INTRODUCTION

The Program on International and Comparative Environmental Law at American University, Washington College of Law (PICEL), Bank Information Center (BIC), and Center for International Environmental Law (CIEL) welcome the opportunity to comment on the climate-related provisions of IFC's *Draft Policy and Performance Standards on Social and Environmental Sustainability* included in its *Progress Report* of April 14.[1]

The *Progress Report* notes that climate change is now one of IFC's "core operational pillars." (page 19). We fully support this strategic prioritization. We appreciate IFC's recognition that the existing Sustainability Framework does not adequately address the challenges climate change presents to its clients, affected communities, and the global commons, and IFC's willingness to revise its policy framework to better reflect the "importance of mainstreaming and strengthening climate change in IFC operations." (page 19). We see that the *Draft Policy and Performance Standards* is notably stronger than the existing Sustainability Framework in several key respects. In particular, the introduction of the concept of resource efficiency into Performance Standard 3 is an important substantive policy innovation.

The revised *Policy and Performance Standards* are likely to be in place for at least five years, and IFC intends them to define the "gold standard" policy framework for private-sector led sustainable development over that period.[2] Accordingly, we had hoped that the *Draft Policy and Performance Standards* would go further towards integrating existing and emerging best practices for promoting zero/ultra-low carbon, climate resilient private-sector investment in the developing world. Despite significant improvements over the existing framework, the *Draft* does not yet fulfill this aspiration.

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[1] IFC, *Progress Report on IFC's Policy and Performance Standards on Social and Environmental Sustainability, and Policy on Disclosure of Information: Review and Update Process* (April 14, 2010).
[2] http://www.ifc.org/sustainability

To meet this objective, the *Draft Policy and Performance Standards* must better align the imperatives of climate-sensitivity, environmental responsibility, and poverty alleviation. As a guiding principle, it should recognize that these objectives are not necessarily in tension. Rather, there are numerous opportunities to support projects that capture synergies among them, in particular by focusing narrowly on transformational improvements in end-use efficiency of energy and utility services. Capturing these synergies should be the *raison d'être* of IFC's climate-related work.

Towards this end, the ***Sustainability Policy*** should be strengthened to:

1. Explicitly prioritize an end-use oriented approach to delivering energy and other utility services. (see Section 2.1 below).

2. Require the use of assessment tools such as Integrated Resource Planning and full life-cycle accounting to ensure that end-use efficiency is prioritized, and that IFC's investments are as low-carbon, pro-poor, and sustainable as possible. (Section 2.2).

3. Establish criteria to prioritize support for zero/ultra-low carbon economic development and improved end-use resource efficiency in regulatory environments that incentivize throughput and investments in fossil fuel-based supply expansion. (Section 2.3).

4. Explicitly incorporate the agreements and commitments that member governments have made in other international venues, particularly the UNFCCC and the G-20. (Section 2.4).

Performance Standard 1 should be strengthened to:

1. Require the sponsors of long-term projects to assess the climate resilience of the project and its development impact, and specify how it will manage those risks in its management plans. (Section 3.1).

2. Require utility sector clients to use assessment tools such as Integrated Resource Planning and full life-cycle accounting to ensure that the costs and risks of all options for utility service delivery are adequately assessed (Section 3.2).

Performance Standard 3 should be strengthened to:

1. Apply the "mitigation hierarchy" to the provisions regarding resource efficiency, energy use, and greenhouse gas emissions. (Section 4.1).

2. Require large-scale emitters to achieve carbon-neutrality, and apply the "mitigation hierarchy" to allow offsets only for emissions that cannot be avoided or reduced. (Section 4.2).

3. Adopt rigorous efficiency standards for the plant and equipment of the projects it supports, and for the products they will produce. (Section 4.3).

By strengthening the *Draft* to integrate these planning and assessment tools and international priorities in a clear and binding manner, IFC could improve its development effectiveness, better assist clients to manage the climate-related impacts and risks of their operations, and achieve its aspirations of being a conduit for best-practice climate-sensitive, private-sector development.

2. RECOMMENDATIONS REGARDING THE SUSTAINABILITY POLICY

2.1 The Policy should explicitly prioritize an end-use oriented approach to delivering energy, water, and other utility services.

As the Independent Evaluation Group and numerous other observers have noted, efficiency is the single most important strategy for expanding and improving energy service delivery for the poor while facilitating the transition to sustainable, zero/ultra-low-carbon energy systems at least cost and risk.[3]

From a development perspective, systemic improvements in end-use efficiency—providing more energy services per unit of input—can do more, faster and at lower (and often negative) cost to help developing countries to meet their energy needs, and particularly those of the poor, than any other approach.[4] Investments in end-use energy efficiency can reduce the capital needed to provide energy services *ten-thousand fold* compared with expanding power plants and grids, by reducing capital inputs *one-thousand fold*, and returning that capital to investors in *one-tenth* the time.[5] For example, in 1996 researchers at Lawrence Berkeley National Laboratory found that a $3 million dollar capital investment in a manufacturing plant to produce five million compact fluorescent lamps (CFLs) per year will, over the lifespan of the factory, produce enough CFLs to deliver the same lighting services as a nearly $6 billion capital investment in constructing the 3,600 MW of coal-fired plants that would be needed to operate inefficient incandescent bulbs.[6]

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[3] World Bank Independent Evaluation Group, (2008). Climate Change and the World Bank Group, Phase I: An Evaluation of World Bank Win-Win Energy Policy Reforms; UN Secretary General's Advisory Group on Energy and Climate Change, 2010. *Energy for a Sustainable Future*. Amory Lovins, 2005. *Energy End-Use Efficiency*. www.rmi.org.

[4] Amory Lovins, 2005. *Energy End-Use Efficiency. available at* www.rmi.org.

[5] Lovins, *id.*, at 20.

[6] M. Angali Sastray and Ashok Gadgil. 1996. Bombay Efficient Lighting Large-Scale Experiment (Belle): Blueprint for improving energy efficiency and reducing peak electric demand in a developing country. Atmospheric Environment, Volume 30, Issue 5, March 1996, Pages 803-808, Supercities: Environment Quality and Sustainable Development.

Another Lawrence Berkeley National Laboratory assessment similarly found that a $10 million investment in a high-performance window glazing factory, which dramatically reduce commercial building air-conditioning demand, eliminated the need for a several hundred million dollar, 800 MW power plant. Advanced Lighting and Window Technologies for Reducing Electricity Consumption and Peak Demand: Overseas Manufacturing and Marketing Opportunities, by Ashok Gadgil, Arthur Rosenfeld, Dariush Arasteh and Ellen Ward, Lawrence Berkeley National Lab, 1992, presented at the International Energy

Since then, the costs of CFLs have declined dramatically. Given that the power sector currently consumes nearly 25 percent of global development capital, an efficiency oriented energy strategy that so dramatically reduces the capital consumption of the sector has the potential to free up enormous amounts of investment capital for other development purposes.[7]

Similarly, from a climate mitigation perspective, end-use resource efficiency improvements offer the greatest benefits and lowest opportunity costs—they can eliminate by far the most carbon emissions per year and per dollar spent.[8] Indeed, McKinsey Global Institute and others have identified a number of efficiency initiatives that can reduce emissions almost immediately, with very attractive returns on investment and short pay-back periods.[9]

Given the extraordinary opportunities for end-use energy and water efficiency initiatives to achieve IFC's development, environmental, and carbon mitigation objectives at least cost and risk, IFC should prioritize an end-use oriented approach to the delivery of energy services in all of its activities. ***Rather than supporting new centralized, generally fossil-fuel based power plants, IFC should focus on becoming the global leader in supporting "efficiency power plants"-- bundled sets of energy efficiency programs that can deliver the energy and capacity equivalent of a large conventional power plant.[10] IFC should not support a project to expand energy supply where the same energy services could be more advantageously delivered through improved end-use efficiency.***

It is profoundly disappointing that the *Draft Policy* does not incorporate any policy requirements or mandate the use of specific assessment tools to prioritize and catalyze systemic improvements in end-use efficiency. This is a serious oversight that can not be fully remedied by addressing these issues in other places. While a strategic prioritization of efficiency certainly should be included in the World Bank Group's forthcoming *Energy Sector Strategy*, it is the *Policy* that must articulate how IFC will integrate this strategic objective into its policy framework. Similarly, although *Draft Performance Standard 3* properly recognizes the importance of improving resource efficiency within the context of a specific project, it does not provide policy-based guidance for selecting *between* projects to best capture strategic opportunities.

Agency/ENEL Conference on Advanced Technologies for Electric Demand-side Management, April 4-5, 1991, Sorrento, Italy. Also appears as Lawrence Berkeley Laboratory Report LBL-30389.

[7] Amory Lovins, 2005. *Energy End-Use Efficiency*, at 20. *available at* www.rmi.org.

[8] Amory Lovins, Imran Sheikh, and Alex Markevich, 2008 *Nuclear Power: Climate Fix or Folly?* (Rocky Mountain Institute), at 7-9, *available at* www.rmi.org

[9] McKinsey & Company, *Pathways to a Low Carbon Economy. Version 2 of the Global Greenhouse Gas Abatement Cost Curve* (2009)*;* Lovins, *Id.*

[10] See, e.g., the World Bank's recent support for mass distribution of compact flourescent light bulbs in Bangladesh. http://siteresources.worldbank.org/EXTENERGY2/Resources/ELIB_Presentation.pdf. Meg Gottstein, *Planning, Financing and Building Efficiency Power Plants: Regulatory Practices in California and Other States*, The Regulatory Assistance Project (2008), available at www.raponline.org; David Moskovits, *Meeting China's Energy Efficiency Goals Means China Needs to Start Building Efficiency Power Plants (EPP)*, The Regulatory Assistance Project (2005), available at www.raponline.org.

2.2 The *Policy* should use assessment tools such as Integrated Resource Planning and full life-cycle accounting to ensure that end-use efficiency is prioritized, and that IFC's investments are as low-carbon, pro-poor, and sustainable as possible.

It is not clear whether IFC currently employs the tools to properly evaluate the full range of available options for delivering utility services, including end-use efficiency improvements. Towards this end, IFC should explicitly require "integrated resource planning" and "full life-cycle cost accounting" as part of its project appraisal and alternatives assessment methodology in the utilities sector:

- ***Integrated Resource Planning*** **(IRP):** An *Integrated Resource Plan* is a tool used by both regulators and utility operators to evaluate and rank all options for delivering local utility services--including all end-use efficiency approaches--according to comprehensive assessments of cost and risk. It is highly synergistic with other innovative policy initiatives, such as decoupling to encourage demand-side efficiency.[11] It facilitates transparency and stakeholder engagement around decisions that otherwise are constrained to supply options; enables fuller consideration of environmental and social costs; and reduces corruption and subsidies.[12] It also facilitates the use of the utility's lower cost of capital and earnings-on-capital requirements in comparing competitive end-use and distributed efficiency gains with supply options.[13]

  To fully capture the benefits of IRP assessments, IFC should ensure that utility clients that propose new energy supply projects 1) identify all end-use delivered services the project will provide; 2) identify the costs of improving the end-use efficiencies; 3) incorporate all end-use efficiency options into the project that have a delivered cost up to the cost of expanding new generating supply (including transmission and distribution costs and risk-adjusted costs for externalities like emissions and price volatility of fuels and water

[11] "Decoupling" aligns the financial interests of utility providers with those of their customers to promote the smarter delivery of utility service requiring less resource and capital inputs and waste and emission outputs. It enables utilities to recoup lost earnings from reduced sales in return for assisting customers to capture cost-effective end-use and locally distributed efficiency gains in buildings, factories, appliances and devices. California Energy Commission. 2007. *Integrated energy policy report*, November 2007, CEC-100-2007-008-CTF; California Public Utility Commission. 2008. C*alifornia energy efficiency strategic plan* (draft) Rulemaking 06-04-010, 8 February 2008, www.californiaenergyefficiency.com/

[12] Regulatory Assistance Project. 2005. Clean energy policies for electric and gas utility regulators. *Issues Letters*. January 2005, www.raponline.org/; Morse, D. 2006. *Water Conservation ratemaking disincentives, the case for decoupling sales from revenues*, 28 March 2006.

[13] IRP approaches can also be used to integrate electricity and water planning, and identify least-cost opportunities to save electricity and natural gas by delivering water services more efficiently. California Energy Commission. 2005. *2005 Integrated energy policy report*, Chapter 8 Integrating water and energy strategies. November 2005. CEC-100-2005-007-CMF, www.energy.ca.gov/2005publications/CEC-100-2005-007/CEC-100-2005-007-CMF.PDF; California Public Utility Commission. 2005. *Water action plan*. 15 December 2005, www.cpuc.ca.gov/Static/hottopics/3water/051109_wateractionplan.htm

requirements); and 4) develop programs to use their low-cost capital to finance these efficiency gains for their customers.[14]

- ***Full Life-Cycle Accounting*:** IRPs and other project appraisal methodologies should internalize the full life-cycle social and environmental costs and benefits of all proposed supply- and demand-side management alternatives as part of the options assessment. For traditional large-scale, fossil fuel investments, these would include: the costs associated with price volatility of fossil fuel, water, and other resource inputs; the opportunity costs of public subsidies; the risks of disruption of energy supplies;[15] the costs and risks of oil spills, toxic contamination, acid rain, urban air quality health impacts, and other environmental impacts;[16] the climate impacts of carbon dioxide emissions; and the opportunity costs of the "lock in" effects of promoting existing technological pathways that may inhibit the development and deployment of superior technologies.[17] Conversely, the intangible public benefits of investments in end-use energy efficiency and on-site and locally distributed renewable energy initiatives may include: increased local employment, improved security and resiliency of electricity systems, the demonstration effects of bringing new technologies on-line, and increased innovation and economies of scale to help eliminate the incremental costs of certain renewable technologies over time.

Integrated resource planning and full life-cycle accounting are tools that clients should also be required to use as part of the comprehensive environmental and social assessments required under Performance Standard 1. However, IFC must use them to conduct its own due diligence and to independently assess project alternatives and the development impacts of a proposed project. (*Draft Policy*, paras 17, 21).[18] ***IFC should make clear that it will not support supply expansion projects unless it is shown through an IRP process to be the most advantageous energy service delivery option.***

[14] IFC has an important role to play in helping clients to adopt best practice approaches to financing end-use efficiency initiatives. Examples of proven initiatives include (1) leasing and other schemes to enable customers to pay back the up front costs of efficient devices through their utility bills; (2) paying "bounties" for the replacement of inefficient devices (e.g. "cash for clunkers"); and (3) revenue neutral "fee-bate" schemes, which penalize less efficient users, and reward more efficient ones.

[15] See, Amory Lovins and Hunter Lovins, 1981. *Brittle Power: Energy Strategy for National Security*, U.S. Department of Defense, Civil Defense Preparedness Agency, *available at* www.rmi.org/.

[16] European Commission ExternE initiative, Externalities of Energy, http://www.externe.info/.

[17] See, W. Brian Arthur, 2009. *The Evolution of Technology and Its Implications for Investment Policy*, Santa Fe Institute, www.slideserve.com/presentation/7156/Powerpoint-648-KB; W. Brian Arthur, THE NATURE OF TECHNOLOGY, WHAT IT IS AND HOW IT EVOLVES (Free Press, 2009).

[18] It is essential for IFC to do this work independently, as clients will have an inherent conflict of interest in analyzing alternatives to the project they have proposed, and in identifying and quantifying externalized costs.

2.3 The Policy should establish criteria to prioritize support for zero/ultra-low carbon economic development and improved end-use resource efficiency in regulatory environments that incentivize throughput and investments in fossil fuel-based supply expansion.

Government regulations and policies can have a profound effect on the degree to which IFC's clients seek (or are able) to maximize end-use resource efficiency, and otherwise minimize greenhouse gas emissions and climate impacts. For example, some jurisdictions "decouple" utility profits from gross sales to provide a level playing field for cost-effective improvements in end-use efficiency.[19] Most others maintain perverse "throughput incentives" that encourage utilities to increase profits by expanding supply. Some jurisdictions have adopted policies to incentivize businesses and households to improve efficiency and invest in distributed power systems. Others have policies that create or reinforce structural, institutional, and regulatory barriers to the uptake of energy efficiency and distributed systems. Some jurisdictions have adopted initiatives such as feed in tariff programs[20] and renewable portfolio standards[21] to catalyze investment in renewable energy. Others heavily subsidize the consumption of fossil fuels, insulating market participants from the true costs and risks of the energy system.[22]

IFC must determine how to meet its sustainable development, climate mitigation, and resource efficiency objectives where bad policies, inappropriate subsidies, and perverse incentives externalize the environmental and social costs of fossil fuel based energy, and obscure its cost premium over end-use oriented service delivery. The *Draft Policy* properly recognizes that a project's ability to achieve appropriate social and environmental outcomes will often depend on the actions of government regulators. (*Draft Policy*, para. 19). It implies, but does not explicitly require, that both the client and IFC must conduct due diligence to assess whether the actions of regulators will impede the ability of a project to meet IFC's environmental and social objectives. (*Draft Policy*, paras. 19, 23).

The Policy should be strengthened to explicitly require IFC and its clients to conduct these assessments. The *Draft Policy* should also be strengthened to provide clear policy direction regarding how the regulatory landscape should be assessed, and how the outcomes of those assessments should be factored into project decision-making. In particular, it should provide some guidance as to what kinds of projects may or may not merit support given identified shortcomings in the regulatory and policy framework. Consideration of these

[19] California has been a leader in this regard. See e.g., California Energy Commission. 2007. *Integrated Energy Policy Report*, November 2007, CEC-100-2007-008-CTF, www.californiaenergyefficiency.com/; California Public Utility Commission. 2008. C*alifornia energy efficiency strategic plan* (draft) Rulemaking 06-04-010, 8 February 2008, www.californiaenergyefficiency.com/

[20] Dan Bihn, *A Feed-In Frenzy?*, SOLAR TODAY, (May 2010); Paul Gipe, *Grading North American Feed-in Tariffs*, World Future Council (May 2010).

[21] See e.g., *Freeing the Grid: Best and worst practices in state net metering policies and interconnection standards*, October 2008, http://www.newenergychoices.org/uploads/FreeingTheGrid2008_report.pdf

[22] IEA, OPEC, OECD, World Bank, *Analysis of the Scope of Energy Subsidies and Suggestions for the G-20 Initiative: Joint Report Prepared for submission to the G-20 Summit Meeting, Toronto, Canada*, 26-27 June 2010.

regulatory issues is too fundamental to project outcomes to be left entirely to uncabined staff discretion.

2.4 The Policy should explicitly incorporate the agreements and commitments that member governments have made in other international venues, particularly the UNFCCC and the G-20.

As a general rule, IFC's *Policy and Performance Standards* should respect and internalize the agreements, objectives, standards, and commitments regarding sustainable development and environmental protection that its Members agree to in other multilateral fora. By explicitly tethering its operational policies to the content of these agreements and commitments, IFC (1) pays due regard to its own technical and institutional limitations vis-à-vis other international bodies; (2) facilitates consistency across international institutions; and (3) ensures that its investments do not undermine a member country's efforts to meet its international obligations.

Over time, IFC has made noteworthy progress in this regard. In a number of substantive areas, IFC has recognized that international agreements and standards provide authoritative guidance for what its policies should include. Towards this end, the existing *Performance Standards* explicitly reference international agreements and standards with regard to labor conditions and practices,[23] hazardous waste and toxic pollution,[24] pesticide use,[25] the protection of habitats and biological diversity,[26] and the protection of cultural heritage.[27] Moreover, as part of the ongoing revision process, IFC has committed to take further steps towards harmonizing its revised policy framework with internationally agreed principles and standards related to human rights. (*Progress Report*, para. 33).

2.4.1 Agreements under the UNFCCC Process.

The World Bank Group has already recognized that the United Nations Framework Convention on Climate Change (UNFCCC) is the primary venue for the international community to devise modes of global cooperation on climate change, including the provision of financial assistance.[28] Accordingly, the Bank Group has also recognized that it must respect this primacy by deferring to the outcomes of UNFCCC decision-making

[23] IFC, April 2006. *Performance Standards on Social & Environmental Sustainability*, Performance Standard 2: Labor and Working Conditions, ftnt 1.
[24] IFC, April 2006. *Performance Standards on Social & Environmental Sustainability*, Performance Standard 3: Pollution Prevention and Abatement, ftnts 4-7.
[25] *Id.*, para. 15.
[26] IFC, April 2006. *Performance Standards on Social & Environmental Sustainability*, Performance Standard 6: Biodiversity Conservation and Sustainable Natural Resource Management, ftnts 3-5.
[27] IFC, April 2006. *Performance Standards on Social & Environmental Sustainability*, Performance Standard 8: Cutural Heritage, para. 1.
[28] World Bank, *Development and Climate Change: A Strategic Framework for the World Bank Group*, 2, 3 (2008).

processes with regard to a future financial architecture and funding strategy for climate change, and by avoiding actions that might prejudice ongoing negotiations.[29]

This institutional deference to the UNFCCC should be better integrated into the *Draft Policy*. Specifically, IFC should explicitly incorporate the agreements and national commitments that its members set forth under the UNFCCC into its policy framework. The final form and nature of these agreements and commitments will not be known until the conclusion of COP 16, at the earliest. Some of the contours, however, are already evident. Many developing countries may develop comprehensive low-carbon development plans to guide their mitigation actions. Developing countries will be expected to specify the "nationally appropriate mitigation actions" (NAMAs) they will take to control their emissions, consistent with their own national circumstances and development aspirations.[30] Indeed, many developing countries that have associated themselves with the Copenhagen Accord have already begun the process of articulating country-driven national action plans and NAMAs to limit their emissions.[31]

By definition, a country's national action plans and NAMAs will reflect its particular development priorities and challenges. As such, they should be critical planning tools for IFC, and the *Policy* should specify how they will be integrated into IFC's investment decision-making.

As an initial matter, IFC should not support a project that is inconsistent with the mitigation plans, priorities and objectives that countries bring forward to the international community as their response to the climate crisis. Moreover, given its limited funds, and the limited public funds available for climate-sensitive development generally, IFC should establish a clear framework for prioritizing support for those projects that are contemplated in low-carbon development plans and NAMAs. If the structure of the Copenhagen Accord is maintained, these planning tools will describe three distinct "baskets" of potential investments:

1. Low/zero-carbon NAMAs that have attractive rates of return and do not need international public support to be implemented.

2. Low/zero-carbon NAMAs that may need catalytic support or carry significant incremental costs, and will require international support to be implemented.

3. "Business as usual" investments that will not appreciably limit emissions growth.

IFC should focus on providing support to projects in the second category, as this is where IFC can best advance its poverty alleviation, sustainable development and climate mitigation objectives. By contrast, projects in the third category will involve fundamental

[29] World Bank, *The Clean Technology Fund*, paras. 11, 56, 57 (2008).
[30] Bali Action Plan, para 1(b)(ii); Copenhagen Accord, para. 5 (Dec. 2009).
[31] Copenhagen Accord, Annex II.

trade-offs between development and climate mitigation objectives, and IFC should treat these as inconsistent with its strategic focus on capturing synergies between its strategic objectives. It should consider these projects, if at all, only where no viable projects in second category seek funding. Finally, as described above, when selecting between NAMAs in the second category, IFC should prioritize those projects that can achieve the greatest carbon reductions per dollar spent and per year. This is particularly true where incremental costs are at issue.

2.4.2 The G-20 commitment to phase out fossil fuel subsidies.

Fossil fuel subsides have a range of deleterious effects that are inconsistent with IFC's sustainable development and climate-related objectives. At their September 2009 summit in Pittsburgh, the Leaders of the Group of 20 countries agreed that "[i]nefficient fossil fuel subsidies encourage wasteful consumption, reduce our energy security, impede investment in clean energy sources and undermine efforts to deal with the threat of climate change."[32] Other observers have similarly castigated the use of fossil fuel subsidies.[33]

Recognizing the harmful effects of these subsidies, the G-20 Leaders resolved in 2009 to eliminate fossil fuel subsidies that were not intended to expand energy access for the poor. They agreed to "phase out and rationalize over the medium term inefficient fossil fuel subsidies while providing targeted support for the poorest."[34] The Leaders reconfirmed this commitment at their recent 2010 Summit in Toronto.[35]

The G20 commitment to phase out fossil fuel subsidies creates an imperative for IFC to end its support for fossil fuel projects. As a threshold matter, IFC support for fossil fuel projects—like all IFC support—is undeniably a public subsidy. It meets the commonly accepted definition of a subsidy as a transfer of public resources to a private actor who benefits as a result.[36] In addition, since IFC is prohibited by its charter from providing financing that could be obtained in the private market,[37] it is difficult to see how IFC support can both be unavailable in the private marketplace, and not a public subsidy.

IFC should treat its subsidies for fossil fuel projects as falling within the rubric of the G-20 commitment. Countries represented in the G-20 control over 80 percent of the voting shares of the IFC. Their votes to allocate IFC's resources to support fossil fuel projects are

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[32] *Leaders' Statement: The Pittsburgh Summit*, September 24-25, 2009, para. 24. http://www.pittsburghsummit.gov/mediacenter/129639.htm

[33] David Coady, Robert Gillingham, Rolando Ossowski, John Piotrowski, Shamsuddin Tareq, and Justin Tyson, *Petroleum Product Subsidies: Costly, Inequitable, and Rising*, IMF Staff Position Note, February 25, 2010; IEA, OPEC, OECD, World Bank, *Analysis of the Scope of Energy Subsidies and Suggestions for the G-20 Initiative: Joint Report Prepared for submission to the G-20 Summit Meeting* Toronto (Canada), 26-27 June 2010.

[34] *Leaders' Statement: The Pittsburgh Summit*, September 24-25, 2009, para. 24. http://www.pittsburghsummit.gov/mediacenter/129639.htm

[35] *The G-20 Toronto Summit Declaration*, June 26 – 27, 2010, para 42.

[36] See e.g., the World Trade Organization's Agreement on Subsidies and Countervailing Measures, Article 1.1(a)1(i). http://www.wto.org/english/docs_e/legal_e/24-scm_01_e.htm

[37] IFC, *Articles of Agreement*, Article 3, §3(i).

inconsistent with their G-20 commitment. Accordingly, IFC should eliminate support for all fossil fuel projects that are not closely targeted to expanding access to energy for the poor as soon as possible.

3. RECOMMENDATIONS REGARDING PERFORMANCE STANDARD 1: ASSESSMENT AND MANAGEMENT OF RISKS AND IMPACTS

3.1 Performance Standard 1 should explicitly require the sponsors of long-term projects to assess the climate resilience of the project and its development impact, and specify how it will manage those risks in its management plans.

Institutional investors[38] and securities regulators[39] are increasingly recognizing that the proper assessment, management, and disclosure of climate-related business risks are critical to sound corporate governance. For its part, IFC has also recognized that climate change has the potential to put many of the businesses it supports at risk.[40] IFC's *Report on the First Three Years of Application* noted that "[p]rudent risk management requires a better understanding of climate risk on project activities into the future."[41] Accordingly, it recommended that (1) clients undertake climate risk assessments to gauge the climate resilience of their projects, and (2) these assessments be integrated at the project design stage to facilitate proactive risk management.[42]

The *Progress Report* only partially incorporates these recommendations into the Risk Assessments, Managements Systems, and Action Plans required in PS 1. References to climate risk assessment are confined to two footnotes to Paragraph 6, which requires clients to "identify the social and environmental risks and impacts of the project."[43] Footnote 7 explains that climate change is among the risks and impacts that a client should consider and identify, if those risks are expected to be significant.[44] Footnote 9 uses climate as an example to indicate the level of detail at which clients should assess risks and impacts. It explains that "[a]n example of an appropriate level of detail is accounting for projected variability in climatic and environmental conditions due to potentially significant

[38] For example, over 530 institutional investors with assets over $64 trillion participate in The Carbon Disclosure Project, which calls on companies to disclose emissions data and climate risks and opportunities for financial decision-makers to use in their investment, lending and insurance, analysis. Over 2500 companies globally reported to the Carbon Disclosure Project in 2009; most made their reports available to the public. www.cdproject.net

[39] See, e.g. United States Securities and Exchange Commission, *Commission Guidance Regarding Disclosure Related to Climate Change*, 17 CFR Parts 211, 231 and 241 (February 8, 2010).

[40] IFC, *IFC and Climate Change: The Critical Role of the Private-Sector in Tackling Climate Change* (2009).

[41] IFC, *IFC's Policy and Performance Standards on Social and Environmental Sustainability and Policy on Disclosure of Information: Report on the First Three Years of Application*, at 31 (2009).

[42] *Id*.

[43] *Progress Report*, at 45.

[44] *Progress Report*, at 45.

climate change that could occur over the life of the project which may require some level of adaptation where this is practical."[45]

Moreover, the draft of PS 1 does not adequately address how climate risks should be integrated into Management Systems or Action Plans. This is of particular concern because the Management Systems and Action Plans sections of the draft (Paragraphs 13-17) are directed at a qualitatively different set of environmental and social risks. These provisions require clients to explain how it will implement a "mitigation hierarchy" to avoid or reduce its impacts on the surrounding environment and the lives and livelihood of its neighbors. (Paragraph 14). In addition to the mitigation issue, however, climate change also poses a different question: how will the project adapt to the changes in the environmental and social context in which the project operates?[46] Because these sections focus on mitigation, they offer no indication of what is expected of clients with regard to adaptation, and could easily be misconstrued to impose no planning requirements.

Overall, PS 1's treatment of climate-related risks is too tepid and vague to ensure that IFC's clients will produce (1) rigorous and comprehensive analyses of the risks climate change poses to its operations and their development impacts, or (2) robust plans for achieving excellent development outcomes across a range of potential climate scenarios.

IFC should strengthen PS 1's treatment of climate risk by revising Paragraph 6 to specify that clients must assess and disclose all climate-related risks, including:

- **Development Risks:** Clients should be required to assess and disclose estimates of the development benefits of a project under various potential climate scenarios. For instance, a water-intensive project that offers significant development benefits when water is plentiful may simply displace other productive uses if climate change induces water scarcity.

- **Business risks:** Clients should also assess and disclose how their assumptions in their business plans are likely to be altered if climate change affects the local/regional economy and resource base. For example, a large industrial user of water may see its cost structure and social license to operate erode in the context of climate induced water shortages.

- **Regulatory risks:** Clients should be required to assess and disclose how their operations are likely to be affected by potential regulatory responses to climate change such as carbon-pricing schemes, more stringent efficiency requirements, etc.

IFC should also revise Paragraph 13-17 to specify that clients must incorporate climate-risk assessments into their Management Systems and Action Plans. And it should revise Paragraph 10 to require specific reference to the findings and conclusions of studies that address local/regional impacts of climate change.

[45] *Progress Report*, at 45.
[46] Though, of course, IFC should expect its clients to pursue adaptation strategies that minimize harm.

3.2 IFC should require utility sector clients to use assessment tools such as Integrated Resource Planning and full life-cycle accounting to ensure that the costs and risks of all options for utility service delivery are adequately assessed.

The substance of this recommendation is discussed in Section 2.2, above. It is referenced here to underscore the fact these tools should be employed both by IFC and its clients in the context of their respective project assessment and appraisal responsibilities.

4. RECOMMENDATIONS REGARDING PERFORMANCE STANDARD 3: RESOURCE EFFICIENCY AND POLLUTION PREVENTION

4.1 IFC should explicitly apply the "mitigation hierarchy" to the provisions regarding resource efficiency, energy use, and greenhouse gas emissions.

One of the most valuable concepts in the *Draft Policy and Performance Standards* is the "mitigation hierarchy" for addressing the risks and adverse impacts of project operations. The "mitigation hierarchy" requires project sponsors "to avoid, or where avoidance is not possible, reduce, restore, or compensate/offset for risks and impacts to workers, affected communities, stakeholders, and the environment." (*Draft Policy*, para. 8; *Draft Performance Standard 1*, para. 14). The elements of the hierarchy are listed in descending order of acceptability. Clients must "avoid adverse impacts, reduce significant impacts when avoidance is not possible, restore significant impacts when both avoidance and minimization is not possible, and offset significant residual impacts as a last resort." (*Draft Performance Standard 6*, footnote 5).

Greenhouse gases are pollutants of global significance, and should be treated with the same conceptual rigor as other pollutants. However, while PS 3 is unambiguous that the mitigation hierarchy applies to the generation of other hazardous and non-hazardous waste materials, (*Draft Performance Standard 3*, paras. 14, 15), it is unclear and inconsistent in applying the mitigation hierarchy to the provisions related to resource efficiency, energy use, and greenhouse gas emissions.

First, *Draft Performance Standard 3* contains contradictory provisions regarding the application of the mitigation hierarchy to energy use and greenhouse gas emissions. While the introduction to PS 3 reaffirms the client's obligation to "avoid, and if not possible, reduce adverse impacts on human health and the environment," (*Draft Performance Standard 3*, para. 4), the "Energy Use and Greenhouse Gas" section of PS3 does not seem to require large-scale emitters of greenhouse gas to avoid emissions to the extent possible. Rather, it requires only that they evaluate options to "*reduce or offset* project-related GHG emissions during the design and operation of the project." (*Draft Performance Standard 3*, paras. 7, 8). PS 3 does not explain why clients should not "avoid" wasteful resource consumption and greenhouse gas emissions wherever possible.

Second, while the mitigation hierarchy requires clients to take actions that are "technically and financially feasible," the resource efficiency, energy use, and greenhouse gas emissions provisions require the client to only implement actions that are "technically and financially feasible *and cost effective*." (*Draft Performance Standard 3,* paras. 6, 7, 8). PS 3 explains that "Cost-effectiveness is determined according to the capital and operational cost and also financial benefits of the measure considered over the life of the project." (*Draft Performance Standard 3,* ftnt 3). This definition is largely unhelpful in terms of providing operational guidance, and affords clients enormous discretion to determine cost-effectiveness. We are concerned that this provision could be read to only require clients to implement measures that will actually produce "financial benefits" (i.e. rates of return in excess of opportunity costs). Such a limitation would undermine the objectives of the "mitigation hierarchy", and would turn the polluter pays principle on its head.

The "mitigation hierarchy", including the primary obligation to avoid adverse impacts, should be applied to the resource efficiency, energy use, and greenhouse gas emissions provisions of PS3, and it should not be qualified by the additional limitation of "cost effectiveness." The mitigation hierarchy should be explicitly referenced in these provisions, following the practice IFC has used in a number of provisions in Performance Standard 6 on the conservation of natural habitats and the protection of biodiversity, and in Performance Standard 8 relating to cultural heritage.

4.2 IFC should require large-scale emitters to achieve carbon-neutrality, and should apply the "mitigation hierarchy" to allow offsets only for emissions that cannot be avoided or reduced.

IFC appears to be conflicted about the appropriate role of carbon offsets in abating the emissions of projects that it supports. Although the *Progress Report* to CODE recommends that "the option for clients to offset GHG emissions be eliminated," (*Progress Report*, p. 21), *Draft PS 3* continues to allow their use. Indeed, by eliminating the requirement that emissions be avoided to the extent possible, and by introducing the concept of cost effectiveness, PS 3 actually *encourages* clients to rely on offsets as a primary abatement tool. (*Draft Performance Standard 3,* para. 8)

IFC should resolve this dilemma by rigorously applying the mitigation hierarchy, and allowing offsets to be used only for the limited purpose of moving highly resource efficient, low-carbon projects towards carbon neutrality. First, IFC should establish "carbon neutrality" as a key benchmark for evaluating the contribution of high-emitting projects towards meeting its climate-related objectives. Then, in accordance with the "mitigation hierarchy", high-emitting projects should be expected to meet this standard primarily by eliminating and reducing emissions. Offsets should be treated as a "last resort" to abate "significant residual impacts" where avoidance and minimization are not possible, (*Draft Performance Standard 6,* footnote 5), and should never be allowed to substitute for the elimination or reduction of project-related emissions.

To date, the quality of offsets in the carbon markets has been notoriously uneven. As a result, a substantial percentage of traded offsets do not represent actual emissions

reductions.[47] IFC must adopt rigorous quality control standards—especially around the difficult issues of additionality and permanence—to ensure the environmental integrity of the offsets purchased by its clients. One way IFC could incentivize its clients to use higher quality offsets would be to impose a system of "buyer liability."[48] Under such an approach, offsets are treated like any other financial instrument, in that the holder of the offset bears the risk of non-performance. Thus, if the offsets are shown to not represent real emissions reductions, the project sponsor would be required to replace them.

4.3 IFC should adopt rigorous efficiency standards for the plant and equipment of the projects it supports, and for the products they will produce.

The resource efficiency provisions of PS 3 leave it entirely to the client to "evaluate and implement technically and financially feasible and cost effective measures" for improving resource efficiency. (*Draft Performance Standard 3,* para. 6). This should be strengthened by more specific policy guidance regarding acceptable efficiency performance standards for buildings, vehicles, appliances, industrial motor systems, lights, and other energy and water consuming devices.[49] ***In particular, IFC should create a presumption that clients will use "best available technologies" unless the client can make a compelling case that they should not be used.***

IFC should adopt similar standards with regard to its clients' products. ***IFC should not support the production of energy and water consuming appliances and devices that do not meet rigorous efficiency performance standards.***

There is ample precedent for IFC to be much clearer in articulating the kinds of technologies that it expects clients to employ or produce. For example, PS 3 specifies appropriate techniques for pest control, and excludes the manufacture, trade or use of persistent organic pollutants, ozone depleting chemicals, and particularly dangerous classes of pesticides. (*Performance Standard 3,* paras. 15-19). IFC's exclusion list also specifies technologies and processes that are not eligible for support.

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[47] Michael Wara, *Measuring the Clean Development Mechanism's Performance and Potential* 55 UCLA LAW REVIEW 1759 (2008); Patrick McCully, *Bad Deal for the Planet: Why Carbon Offsets Aren't Working...And How to Create a Fair Global Climate Accord* (International Rivers, 2008).
[48] David Victor, THE COLLAPSE OF THE KYOTO PROTOCOL AND THE STRUGGLE TO SLOW GLOBAL WARMING, at 71-73 (Council on Foreign Relations, 2001).
[49] See, e.g. SEEEM. 2007. Standards for Energy Efficient Electric Motor Systems, www.seeem.org.