



October 12, 2007

Ms. Laura Tuck
Sector Director
Environmentally and Socially Sustainable Development Unit
Latin America and the Caribbean Region
World Bank
1818 H Street, NW
Washington, DC 20433

Subject: Environmental Development Policy Loan to Peru – Oil & Gas Sector Issues

Dear Ms. Tuck:

We are writing with regard to the proposed environmental development policy loan (DPL) to the Government of Peru that is currently in preparation.

As the World Bank recognized in its 2007 Country Partnership Strategy for Peru, responding to environmental challenges, especially in the context of increased investment in the extractive industries, will require new and strengthened environmental institutions with adequate resources to fulfill their responsibilities. We support the Bank's initiative to raise the profile of environmental issues in Peru and to provide assistance to the Government of Peru in order to build its capacity to address environmental concerns. While the success of the DPL will ultimately depend on the political will of the Peruvian government, we are encouraged that the Ministry of Economy and Finance as well as several sector ministries have been actively involved in this process since its inception.

As you undoubtedly understand, there has been significant growth in Peru's oil and gas sector over the past three years. As of July 2007, nearly 70% of the Peruvian Amazon had been allocated for oil and gas activities, up from 13% at the beginning of 2005. Peru's previous experience with the hydrocarbon sector illustrates the numerous environmental and social impacts that can occur in the absence of effective environmental governance—including deforestation, erosion, increased migration, loss of biodiversity, contamination of water supplies, and health risks to impacted communities. In the context of numerous potential projects ecologically and culturally sensitive areas, developing the institutional capacity for better environmental and social management will be critical for minimizing future impacts of the oil and gas industry.

Given this critical need for strengthened environmental governance in the hydrocarbon sector, we are pleased to hear that the DPL will include support for reforms impacting the Ministry of Energy and Mines. While the Bank's attention to date has focused primarily on the mining sector, we encourage you to work with the Government of Peru and civil society in order to identify priorities for reform in the hydrocarbon sector.

The World Resources Institute (WRI) and the Instituto del Bien Comun (IBC) are developing a partnership that seeks to minimize the environmental and social footprint of the oil and gas sector in

the Peruvian Amazon, maximize opportunities for local communities to benefit from oil and gas activities, and ensure that areas with highly vulnerable populations (such as isolated indigenous peoples) and sensitive biodiversity are not harmed by oil and gas activities.

In this context, we write to share a brief analysis of some of the underlying challenges in the hydrocarbon sector and concrete recommendations for reforms the Government of Peru could adopt in order to address these challenges. Given that the World Bank has already developed a substantial body of work regarding the mining sector, and that the mining and hydrocarbon sectors face similar environmental and social challenges, an effort is made to highlight differences between the two sectors.

Additionally, creating a national environmental authority that is independent of the sector ministries and has the technical and budgetary capacity to enforce environmental regulations will be instrumental in the improvement of environmental and social management in all environmentally sensitive sectors. The World Bank has repeatedly recognized this need in recent reports on Peru.¹ Still, additional analysis of the various alternatives up for discussion – which range from strengthening the National Council for Environment (CONAM) to creating a new Ministry for the Environment, among other options – will be necessary to ensure that the resulting institution has the capacity and authority to efficiently and effectively protect the environment.

Finally, while we recognize that there are plans for consultations with civil society, the private sector, and professional societies further along in the formation of this development policy loan, we encourage you to establish a formal process for engaging with non-governmental organizations within this initial stage of project development, when there is still an opportunity to influence which objectives will be included under this loan. There are numerous groups within Peru, with expertise in sector-specific issues as well as the broader issue of environmental institutionalization, who have been working with allies in government in order to advance the types of reforms that will be included under this loan. Such groups have the capacity to play a critical role, both in informing the conditions of this loan, as well as in ensuring their fulfillment by the government in Peru.

We look forward to continued engagement with the World Bank regarding this loan. We welcome any questions, comments, or requests for additional information.

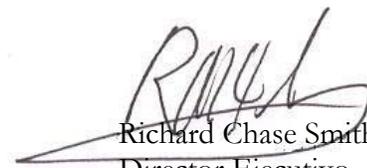
Sincerely,



Jon Sohn
Senior Associate
World Resources Institute
Washington, DC



Sarah Paraghamian
Project Consultant
World Resources Institute
Lima, Peru



Richard Chase Smith
Director Ejecutivo
Instituto del Bien Común
Lima, Peru

¹ See: World Bank and Inter-American Development Bank, *Peru Restoring Fiscal Discipline for Poverty Reduction: A Public Expenditure Review* (October 2002), pp 143-144. World Bank, *Country Assistance Strategy for the Republic of Peru: Fiscal Years 2003-2006* (August 2002); World Bank, *Wealth and Sustainability: The Environmental and Social Dimensions of the Mining Sector in Peru* (December 2005); World Bank, *Republic of Peru Environmental Sustainability: A Key to Poverty Reduction in Peru* (June 2007).

CC:
Glenn Morgan
Renan Poveda
Ethel Sennhauser
Kathy Sierra

IBC—WRI Analysis of Environmental and Social Challenges in the Hydrocarbon Sector in Peru

The following offers a brief analysis of some of the underlying challenges in the hydrocarbon sector and concrete proposals for reforms the Government of Peru could adopt in order to address those challenges. The analysis is organized according to three critical opportunities for environmental management: (i) during the establishment of hydrocarbon blocks; (ii) through environmental impact assessment; and (iii) through monitoring, audits, and enforcement.

Establishment of Hydrocarbon Blocks, Concessioning, and Contract Negotiation

The period prior to the signing of a contract for oil and gas exploration and extraction offers critical opportunities to lower the risk of social conflict and impacts on critical ecosystems. Yet, Perupetro currently creates and grants oil and gas concessions through a closed and non-transparent process that bypasses both government agencies tasked with the protection of the environment, health, and the rights of indigenous peoples, as well as the very communities who are most likely to be directly affected by oil and gas activities. Of the 55 Amazonian hydrocarbon blocks currently under contract or negotiation, 44 overlap with indigenous territories, while 43 overlap with protected areas and/or their buffer zones; yet neither Perupetro nor MEM formally sought the opinion of the *Instituto Nacional de Pueblos Andinos, Amazónicos y Afroperuanos* (INDEPA, now the Directorate General for Traditional Peoples in the Ministry of Women and Social Development) or the *Instituto Nacional de Recursos Naturales* (INRENA) prior to offering the blocks for concession.

In this way, rather than recognizing tensions between conflicting land uses and creating procedures to abate such tensions from the start, the current process for granting hydrocarbon rights has increased the potential for conflict between the State, investors, local communities, and other stakeholders. At the root of the problem is a lack of integrated, standardized, and spatially-explicit information available to identify overlaps in land-use plans. In fact, unable to receive comparable information from within the Peruvian government, Perupetro has turned to the Instituto del Bien Común for maps showing the location of indigenous communities. Information about the location of communities and the status of their land title and expansion claims, the location and status of forestry concessions, and other land uses is not routinely analyzed or distributed to oil and gas companies for their consideration, let alone to other stakeholders.

Local and regional governments also have a role to play in regulating the extraction of natural resources and managing its impact on the environment and communities, as recognized by the National System for Environmental Management.² Yet local and regional governments are often poorly informed about the status of oil and gas concessions, and consequently, unable to fully respond given the authorities and responsibilities granted to them.

Indicated Reforms: Adoption of procedures and protocols enabling (a) broad dissemination to the concession holder and other stakeholders of updated maps of the project zone that show the various land uses; (b) development and dissemination of plans to consolidate all pending demands on the land, including proposed territorial reserves, communities awaiting land title or expansion of titled lands, forestry concessions, and claims by other users; and (c) notification to local and regional

² *Sistema Nacional de Gestión Ambiental*, established by Ley No. 28245: Ley Marco del Sistema Nacional de Gestión Ambiental.

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governments on plans for oil and gas development in the area, all of which should occur prior to the granting of rights to hydrocarbon blocks.

Protected Areas, Buffer Zones³, and Reserve Zones⁴

Unlike in the mining sector, where the *Instituto Nacional de Concesiones y Catastro Minero* (INACC) must seek the favorable technical opinion of INRENA prior to granting mining rights, there is currently no parallel process to ensure compatibility between protected areas and oil and gas activities until the extraction phase of operations.

A report published by the Defensoria del Pueblo in March 2007⁵ documents the conflict between the Ministry of Energy and Mines (MEM) and INRENA that is the result of conflicting interpretations of the Law of Natural Protected Areas⁶. Article 27 of that law states: “The use of natural resources in Natural Protected Areas can only be authorized if the activity is compatible with the category, zoning, and master plan of the area. The use of the resources should not harm the ends for which the area was established.”⁷

MEM’s interpretation of its responsibilities under the law with respect to the conservation of protected areas hinges on its understanding of the term “use⁸” to signify extraction activities only. As a result, MEM’s *Dirección General de Asuntos Ambientales Energéticos* (DGAAE) is not required to consult with INRENA to ensure compatibility of conservation goals with exploration activities, despite the fact that oil and gas exploration can have profound impacts even prior to the drilling phase.⁹

Aside from failing to take adequate measures to prevent impacts that threaten the conservation objectives of protected areas, the current system also creates potential for conflict between the state and investors in the case that part of a hydrocarbon concession is later found to be incompatible with the zoning or management plan of the overlapping protected area. Both of these risks could be mitigated by creating a formal mechanism for considering the compatibility of protected areas with exploration and extraction activities prior to the creation of hydrocarbon lots.

Indicated Reform: Revision of the hydrocarbon administrative process to require Perupetro to solicit information from and receive the favorable technical opinion of INRENA during the definition of hydrocarbon concessions that overlap with protected areas or their buffer zones, a requirement that already exists in the mining sector. The concessioning of hydrocarbon blocks that overlap with

³ *Zonas de amortiguamiento*, areas adjacent to natural protected areas that require special treatment in order to guarantee the conservation of the natural protected area.

⁴ *Zonas reservadas*, areas that meet the conditions to be considered as natural protected areas, but that require additional studies in order to determine their categorization.

⁵ Informe No. 0092007-DP/ASPMA.CN: Superposition of Hydrocarbon Blocks with Natural Protected Areas and Territorial Reserves in the Peruvian Amazon.

⁶ Ley No. 26386.

⁷ Unofficial English translation.

⁸ *aprovechamiento*

⁹ Such as noise from surveying aircraft, helicopters, and explosives; erosion, water contamination, and sedimentation of local streams that can result from cutting for seismic lines; and impacts that result from the presence of the hundreds of workers required for seismic testing. See Conservation International’s 1997 Policy Paper, “Reinventing the Well: Approaches to Minimizing the Environmental and Social Impact of Oil Development in the Tropics,” for a discussion of the environmental and social impacts of exploration activities.

reserve zones should be prohibited until their status as protected areas is determined and adequate management plans are put in place.

Settled Indigenous Communities and Free, Prior, and Informed Consent

Despite the fact that the rights of indigenous peoples are formally recognized by Peru, both through domestic and international law, indigenous peoples continue to face discrimination and exclusion for a combination of historical, economic, and political reasons. Extractive industries have in many cases exacerbated the situation. In the case of hydrocarbons, Peru's sedimentary basin overlaps almost exactly with the Amazon rainforest, which is home to nearly 1,400 indigenous communities and 14 isolated ethnic groups. The vast majority of these communities are wholly dependent on their land, forests, and aquatic resources, and as a result often profoundly experience changes to their ecosystems, such as those caused by extractive industries.

As a signatory to Convention 169 of the International Labour Organization, Peru is obligated to guarantee the right of indigenous peoples to prior, informed consultation about any legislative or administrative measure that could affect them. The Convention requires that consultations are carried out with the objective of achieving consent to the proposed measures.¹⁰ Although more than a decade has passed since Convention 169 entered into force in Peru, the government has taken very few steps toward implementing their obligations under this international treaty. For example, the Peruvian government has yet to adopt the policies and legislation necessary for implementation, nor has it assigned responsibility for monitoring fulfillment of the Convention to any government agency.

In the hydrocarbon sector, there is currently no specific regulation regarding the right of indigenous peoples to informed consultation or consent, although the Ministry of Energy and Mines has facilitated participation in the hydrocarbon sector through informational workshops and public hearings in the exploration and extraction phases of hydrocarbon activities. However, as documented by the Defensoria del Pueblo in a special report on socioenvironmental conflicts in the extractive industries presented to the Peruvian Congress in April 2007, the Ministry of Energy and Mines conceives of participation and consultation as an "invited space." In other words, consultations and other mechanisms for participation have occurred in a space that is controlled by the State, which does not delegate any decision-making power to affected communities. As a result, their efforts to conduct consultations have only nominally fulfilled the objectives of participation as a fundamental right. Furthermore, the fact that there is no formal process for consulting indigenous communities prior to the signing of contracts granting rights to oil and gas exploration and extraction is almost certainly a violation of the right to prior consultation established under Convention 169.

¹⁰ ILO Convention No. 169, Articles 6-7. It is important to acknowledge that the right to consultation recognized by Convention 169 goes beyond mere exchange of information between government, project sponsors, and affected communities by requiring governments to share decision-making power with those who will be directly affected. While the ILO Committee of Experts has decided that the Convention does not give indigenous peoples the right to veto projects that affect them, it does require that consultations are carried out in good faith and in a way that allows communities to influence the project plans. The United Nations Declaration on the Rights of Indigenous Peoples, adopted in September 2007, goes a step further than ILO Convention 169 to require free, prior and informed consent before adopting any legislative or administrative measures which may affect indigenous peoples. Although the UN Declaration is not legally-binding on Peru or any other State, it does mark a shift towards a more rigorous standard that should be implemented by the Government of Peru.

There are currently several processes underway in order to address these issues, including:

- The Ministry of Energy and Mines is currently in the process of developing a regulation on consultation and community participation in the development of hydrocarbon exploration, extraction, and transportation activities. A draft of the regulation was released for public comment in early September 2007.
- The International Labour Organization's Regional Office for Latin America and the Caribbean is in the process of designing a project that will promote implementation of Convention 169 in the region. As part of the initial project phase, the ILO is working with the Directorate General for Traditional Peoples in the Ministry of Women and Social Development in order to develop a 10-year plan for implementation of the Convention in Peru.
- The working group on indigenous peoples of the *Coordinadora Nacional de Derechos Humanos*, a collective of non-governmental organizations dedicated to defending and promoting human rights in Peru, has developed a draft law on consultation and participation of indigenous peoples in coordination with AIDSESEP (*la Asociación Interétnica de Desarrollo de la Selva Peruana*, a representative organization of indigenous peoples from the Peruvian Amazon).

Ensuring that these distinct processes result in a coherent normative framework that effectively protects the right of indigenous peoples to prior, informed consultation guaranteed under ILO Convention 169 will require a significant degree of political will on the part of a government agency with the capacity to coordinate the various initiatives underway.

Indicated Reform: In order to implement Peru's obligations under ILO Convention 169, adoption of a regulation on consultation of indigenous communities in the hydrocarbon sector that includes specific measures to ensure that consultations are carried out with the intention of achieving consent and in a way that allows communities to influence project design. This regulation should establish a formal consultation process that begins prior to the signing of any contracts and is continuous throughout the life of a project. It should also contain detailed criteria with regard to minimum standards for consultations, such as the number and composition of participants, location of consultations, language, and access to legal and technical advice by stakeholders.

Isolated Indigenous Peoples, Territorial Reserves, and Proposed Reserves

While fewer of the oil and gas concessions overlap with territorial reserves for indigenous peoples in voluntary isolation, even minimal activities within reserves threaten their fundamental rights to life, health, personal integrity, territory, and use of natural resources.

In May 2006, the Peruvian Congress adopted a law¹¹ specifying measures for protection of the rights of indigenous peoples in isolation and initial contact. At the time it was introduced in Congress the previous year, the law contained a measure that declared territorial reserves¹² "intangible," thus prohibiting all economic activities from within the reserves; however, the final legislation created an exception to the intangible status of territorial reserves that enables the use of natural resources when it is in the "national interest." As a result, the legislation lost the support of numerous indigenous organizations, including AIDSESEP, and other non-governmental organizations, that had been instrumental in promoting the need for a law protecting the rights of isolated indigenous people to the Congress.

¹¹ Ley No. 28736: Ley para la protección de Pueblos Indígenas u Originarios en situación de aislamiento o en situación de contacto inicial.

¹² Referred to as *reservas indígenas*, or indigenous reserves, in Ley 28736.

At the time of the approval of the law, five territorial reserves had been created in Peru, but the government had yet to establish a protocol for their creation. The new law put INDEPA in charge of overseeing the process for establishing new territorial reserves and established a period of 60 days for the adoption of a regulation for the law.

Now more than a year after the law entered into force, it still lacks a corresponding regulation, in part a result of AIDSEEP and other indigenous organizations' request for a modification to the law that would make territorial reserves truly intangible and their refusal to support any regulation for the law in its current form. Unfortunately this stalemate has resulted in further delays in the consideration of five proposals for new territorial reserves¹³, some of which were initially proposed nearly a decade ago.

In the context of rapid development of oil and gas activities, the stalled initiative to implement legislation regarding the establishment and protection of territorial reserves has resulted in a serious and urgent threat to isolated indigenous peoples, in particular in blocks 67 and 107 where MEM has recently approved environmental impacts assessments (EIAs) for activities within proposed territorial reserves. Additionally, there are another 12 hydrocarbon blocks in various stages of the development process that overlap with proposed reserves that pose an equally grave, although less imminent, threat to isolated indigenous peoples. While the EIAs for these two lots included "contingency plans" for the case of contact with isolated indigenous peoples, the measures included—such as recruiting indigenous guides who speak the same language to offer gifts to the isolated peoples—are wholly inadequate for protecting their lives, right to territory, and right to self-determination. The only demonstrated way to fully ensure protection of the rights of indigenous peoples in isolation is to prohibit entry into territorial reserves.

Indicated Reforms: Adoption of a revision to Law 28736 that excludes the possibility of natural resource extraction in Territorial Reserves, in order to protect the rights to life, health, and territory of indigenous peoples in voluntary isolation and initial contact. Subsequent adoption of a corresponding regulation that includes a requirement that proposals for territorial reserves are resolved prior to the concessioning of hydrocarbon blocks that overlap with those reserves.

Environmental Impact Assessment

The environmental impact assessment is a critical tool for management of the impacts that can result from oil and gas exploration and extraction. Impact assessment offers the opportunity to achieve the best possible outcome for a project by avoiding, minimizing, and mitigating impacts; designing adequate compensation mechanisms for impacts that do occur; and maximizing benefits to society and the environment.

Environmental impact assessment in the hydrocarbon sector shares many of the challenges of the mining sector:

¹³ These include proposed territorial reserves for the Cacataibo, Kapanawa, Napo-Tigre, Yavari Mirim, and Yavari Tapiche.

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- Authority for the review and approval of EIAs lies with the Ministry of Energy and Mines, which is expected to simultaneously fulfill its dual role as promoter of hydrocarbon activity and environmental regulator.
- There is no formal mechanism for consultation of other relevant government agencies, such as INRENA or DIGESA, except in the case of EIAs for extraction activities in blocks that overlap with protected areas.
- The DGAAE lacks sufficient staff and financial resources to adequately review EIAs.
- Assessment of social impacts and consideration of measures to prevent such impacts is not required by the normative framework.

In addition to the challenges diagnosed by the World Bank's 2005 report on the mining sector in Peru, there are several additional challenges that deserve attention in this context:

- *Favorable Technical Opinions:* While the Law of Natural Protected Areas requires MEM to seek the technical opinion of INRENA in the case of an overlap between a hydrocarbon block and protected areas, there is a lack of definition as to what constitutes a "favorable" technical opinion. For example, in the recent case of the approval of seismic exploration activities in block 107, INRENA submitted a list of 65 observations noting crucial improvements to the EIA were necessary; yet in the same document INRENA declared a favorable technical opinion of the EIA.
- *Design of Public Hearings:* From the perspective of concerned stakeholders, there are several limitations in addition to those mentioned in the World Bank's report that merit consideration. In particular, given that the Ministry of Energy and Mines design public hearings in consultation with the project developer, there is no opportunity for the presentation of third-party views of the project or elaboration of the environmental impact assessment.
- *Access to Legal and Technical Advice:* An additional limitation to ensuring that the public hearing process provides a meaningful opportunity for stakeholders to influence the project's design is the lack of legal and technical capacity of stakeholders. This has been an issue with local communities as well as holders of forestry concessions in the project's area of influence.
- *Right of Third Parties to Participate in EIA:* The regulation on citizen participation in the evaluation of environmental studies for the energy sector creates two opportunities for public participation: during the public hearing, and in writing within 15 days following the public hearing. However, MEM does not recognize the right of third parties to comment on subsequent versions of the EIA, despite the fact that the Law of General Administrative Procedures establishes adequate protections for the rights of third parties to participate. Thus the sectorial hydrocarbon administrative procedure is not complying with the Law of the General Administrative Procedure.

Indicated Reforms:

* Establishment of an environmental authority independent of the sector ministries with sufficient technical and budgetary resources to coordinate review with other relevant authorities and grant final approval of EIAs.

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- * Adoption of a regulation that requires evaluation of social impacts in environmental impact assessment and ensures that third parties are directly notified and allowed to comment on the management plans. EIAs should consider impacts on people both within and outside of the project's area of influence. "Social impacts" should be understood to include aesthetic impacts, community impacts, cultural impacts, demographic impacts, development impacts, economic impacts, gender impacts, health impacts, impacts specific to indigenous peoples, impacts on infrastructure, political impacts, and poverty impacts, among others.¹⁴
- * Elaboration of a detailed guide for environmental and social impact assessment that includes a detailed socioeconomic description of stakeholders in the project's area of influence and plans to manage impacts on each group of stakeholders.
- * Adoption of protocols regarding use of strategic environmental assessment to evaluate impacts beyond the direct impact zone, cumulative impacts resulting from the combination of oil and gas activities with other land uses within the project's area of influence, and cumulative impacts that result from other oil and gas projects in adjacent areas or within the same watershed.
- * Development of a formal mechanism for the consultation and participation of other government institutions (INRENA, DIGESA, MINDES, and others) in the review and approval of EIAs.
- * Adopt a regulation that elaborates criteria and standards for what constitutes a favorable technical opinion.
- * Identification of resources and a mechanism to make available independent legal and technical advice to stakeholders in the project's area of influence.
- * Revise the Ministry of Energy and Mines regulation on citizen participation in the administrative proceedings for the approval of environmental studies in order to ensure adequate implementation of the protections of the rights to participation of third parties established in the General Law on Administrative Proceedings.

Monitoring, Oversight, Auditing, Enforcement & Fines

While the environmental impact assessment is critical for preventing negative impacts and developing plans for mitigation and compensation of impacts that do occur, monitoring and enforcement ensure that plans developed through the EIA are actually implemented. In addition, effective monitoring and enforcement are absolutely necessary to ensure restoration and adequate compensation to affected parties in the case of negative impacts.

Regulation of Relations Between Companies and Communities

To the present date, the government of Peru has taken few steps to set standards for or regulate interactions between oil and gas companies and communities within a project's zone of influence. Yet, given the state's interest in reducing socioenvironmental conflicts that result from extractive industries, it would be judicious to promote ongoing dialogue and mechanisms for resolving community grievances between corporations and affected communities.

¹⁴ According to the definition of the International Association for Impact Assessment.

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Indicated Reforms: The Government of Peru should take initial steps to regulate engagement of communities by oil and gas companies by developing the following:

- Standards for community engagement, including requirements for the timely provision of information and a continuous, iterative process of communication and negotiation that occurs over the life of the project.
- A requirement that oil and gas companies operating in Peru develop a grievance mechanism to resolve community complaints.
- Standards to ensure the effectiveness of community monitoring programs.
- A mechanism to provide communities with legal and economic advice during negotiation of compensation agreements. For example, communities could be required to contribute to a common fund managed by MEM's social management unit.

Independent Auditing and On-Site Supervision

In a manner similar to the mining sector, auditors of oil and gas operations are contracted and paid directly by the company being audited. The fee-based model for financing audits and on-site supervision used in the electricity sector provides an alternative that could be adopted by the hydrocarbon sector. Rather than contracting auditors directly, electricity generators are required to make an annual contribution based on the relative size of their operations to a fund that is used to pay for on-site supervision and auditing.

Indicated Reforms: Establish an alternative, fee-based system for financing audits that establishes the State as the party responsible for contracting and supervising auditors.