

**REPORT AND
RECOMMENDATION**

OF THE

INSPECTION COMMITTEE

TO THE

**BOARD OF DIRECTORS
ASIAN DEVELOPMENT BANK**

ON

**INSPECTION REQUEST: SAMUT PRAKARN WASTEWATER
MANAGEMENT PROJECT
SAMUT PRAKARN, THAILAND**

(ADB Loan Nos. 1410-THA [7 December 1995] and 1646-THA [3 December 1998])

28 FEBRUARY 2002

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SAMUT PRAKARN WASTEWATER MANAGEMENT PROJECT
REPORT AND RECOMMENDATION OF THE BOARD INSPECTION COMMITTEE
TO THE BOARD OF DIRECTORS

I. INTRODUCTION

1. The Inspection of the Samut Prakarn Wastewater Project (the Project) has reached its final stage. The Inspection Panel has concluded its work and has submitted its report and recommendation (Appendix 1) to the Board Inspection Committee (the Committee). In line with requirements of the Inspection Policy, Management has submitted its response to this report (Appendix 2) to the Committee. Now it is time for the Board of Directors of ADB (the Board) to make a final decision on this matter.
2. This report starts with a brief overview of the preceding steps in the Inspection (Section II). Section III sets out the rationale of the Inspection Policy and explains in some detail the respective roles of the Panel, the Committee, the Board and the Management. Sections IV and V deal with the major findings of the Panel and Management's response to them. Section VI discusses the Panel's recommendations. In Section VII the Committee makes some observations about the nature of the Management's response. The main purpose of this section is to provide some guidance for future inspections. Section VIII contains the conclusions and recommendations of the Committee.

II. CHRONOLOGY OF EVENTS

3. On 10 July 2001, the Board approved the establishment of an Inspection Panel (the Panel) to inspect the Project. The Panel began its work on 27 August 2001. It submitted an Interim Report to the Committee on 27 November 2001, and its Final Report (the Panel's Report) on 14 December 2001. A more detailed chronology of events is attached in Appendix 3.
4. The Committee sent a copy of the Panel's Report to the President on 17 December 2001, together with a request that Management provide a written response within 30 days, in accordance with paragraph 44 of the Board paper *Establishment of an Inspection Function* (Doc R225-95, 10 November 1995) (the Inspection Policy).
5. Management requested an extension of the deadline for its response from the Chairman of the Committee, which he granted on 26 December 2001. Management's Response was therefore due to be submitted no later than 14 February 2002. It was submitted on that day.
6. On 18 February 2002, the Committee met to consider the Panel's Report and Management's Response, and subsequently prepared a draft report.
7. On 25 February, the Committee consulted separately with Management and with the Board member representing Thailand on remedial steps, in accordance with the requirements of paragraph 44 of the Inspection Policy. After these consultations, the Committee finalized its report.

III. OUTLINE OF RATIONALE AND PROCEDURES

A. Rationale for Inspection Function

8. The rationale for the Inspection Function is set out in paragraph 5 of the Inspection Policy.

Paragraph 5: The rationale for establishing an inspection function independent of Management includes the following:

- a) Establishment of an inspection function and related inspection procedures would be consistent with the Bank's policy of encouraging transparency and accountability in its operations;
- b) Establishment of such a function would complement the Bank's policy of allowing greater public access to Bank documents and publications, as well as the Bank's increased emphasis on beneficiary participation in the formulation and implementation of projects;
- c) Independent investigation of the facts underlying the grievance of a group arguably affected by the Bank's failure to follow its operational policies and procedures would permit a fair hearing of the views of the affected group;
- d) The activities and recommendations of an inspection body would help to educate the public at large about the variety and complexity of issues involved in development programs in the region; and
- e) The existence of an inspection body would foster greater confidence in and support for the Bank and its operations.

9. From the wording of this paragraph it is clear that the purpose of the inspection is much broader than a legalistic determination of whether Staff has followed all inspectable policies and procedures. Very important objectives of an Inspection Function are the fostering of trust and offering a fair hearing of the views of the affected group.

B. Role of the Panel

10. The principal role of the Panel is to investigate the grievances of the requestors (see paragraph 21 of the Inspection Policy). It should be understood that the Panel is advisory, not adjudicative (paragraph 23 of the Inspection Policy). This means that it is ultimately the Board who takes a decision.

11. Paragraph 43 of the Policy determines that the Panel's report shall:

- (i) identify all relevant facts;
- (ii) make a finding as to whether the Bank has complied with its operational policies and procedures; and
- (iii) make recommendations, if appropriate, for any remedial changes in the scope or implementation of the inspected project.

12. The role of the Panel is further determined by the Terms of Reference of the Panel (TOR), dated 4 September 2001 issued by the Committee, which requested the Panel:

...to determine whether ADB has complied with its operational policies or procedures in processing or implementing the Samut Prakarn Wastewater Management Project in Thailand. If the Inspection Panel (the Panel) determines that the ADB has not complied with its policies, it must further determine whether this non-compliance has had, or is likely to have, a direct and material adverse effect on the rights and interests of the group making the request (the Requesters).

13. The Panel has made its findings and recommendations and these are contained in the Panel's Report. At this stage the Panel has no further role to play.

C. Role of the Committee

14. The role of the Committee is to perform the functions and duties entrusted to and imposed upon it by the Inspection Policy. The Committee consists of six members of the Board. It is a Committee of the Board, and its members must act independently, impartially and fairly. The guidelines governing the question of conflict of interest of members of the committee require the member of the Committee who represents the Government of Thailand not to participate in the deliberations of the Committee concerning this inspection. That member did not attend meetings of the Committee when this inspection was discussed. Its various functions are set out in the Inspection Policy. One of these functions is to ensure that the Panel observes the inspection process and the terms of reference issued by the Committee. The Committee's tasks at the stage when Management has responded to the Panel's Report are explained in paragraph 62 of the *Inspection Procedures*:

Paragraph 62: The Committee will make its recommendation to the Board in the form of a short Board paper, attaching copies of the Panel's report, Management's response and other relevant documents....

15. Paragraph 62 is not specific as to what this recommendation should contain. The Committee does not have the resources or expertise to act as if it were an appellate body, rehearing and revisiting the whole matter of the inspection on its merits. Plainly, this is not the intention of the Inspection Policy, an indication of which is the fact that this Committee has 14 days (subject to the power of the Board to extend) within which to consider the Management's Response in the light of the Panel's Report, to consult with Management and the Director representing the country concerned and report to the Board. Accordingly, the Committee has confined itself, in considering Management's response to the Panel's Report to major questions raised by the Response with which it is appropriate for the Committee to deal (sections IV, V and VI). The Committee is acutely aware that it is for the Board to take a final decision on all matters relating to the Inspection.

D. Role of the Board

16. The role of the Board at this stage is to consider the Panel's Report, the Management's Response, and the Committee's report and recommendation to the Board.

E. Role of Management

17. Following the submission by the Panel of its report, Management's role is to submit "to the BIC a written response", which Management has done. In the case of this inspection, where the Panel found that ADB had failed to follow its operational policies and procedures, to the

material detriment of the applicant, Management is also expected to participate in consultations with the Committee concerning remedial steps to address this failure. Management has done this. Finally, if the Board accepts the Panel's recommendations as to changes in the scope or implementation of a project, Management is obliged to implement these recommendations, in accordance with applicable ADB procedures, within an appropriate period designated by the Board.

IV. COMPLIANCE WITH OPERATIONAL POLICIES AND PROCEDURES

A. Supplementary Financing of Cost Overruns on Bank-Financed Projects

18. The Response highlights the importance of the Panel's analysis of ADB's compliance with the policy on supplementary financing of cost overruns. The central question here is whether full reappraisal of the Project should have been carried out at the time of the supplementary loan or not. The Panel has expressed the view that a full reappraisal would indeed have been required. ADB Management on the other hand has rejected the reasoning of the Panel by referring to alleged weaknesses in the analysis of compliance with this policy.

19. The Committee agrees with Management that the question whether a reappraisal would have been required is of fundamental importance. The Committee has therefore analyzed this issue, including the differing interpretations in the Panel's Report and Management's Response, in some detail.

1. The Panel's View

20. The Panel's Report states in paragraph 75 that "the Panel is of the view that in not carrying out a reappraisal of the entire project for the supplementary loan proposal there was non-compliance by the Bank of OM 13/BP/OP, 12 December 1995. This omission became a crucial factor from which other consequences followed."

21. The conclusion of the Panel was based on a literal interpretation of the first sentence of OM 13/OP, which reads:

The procedure for processing a supplementary loan, whether, by additional financing or by reallocating funds from other Bank-financed projects, is similar to that for new loans, and includes reappraisal of the entire project.

22. Further the Panel report rejects Management's contention in the Response to the Request (24 May 2001), that in line with the Policy on Supplementary Financing of Cost Overruns a reappraisal should be very much focussed on the financial aspects and that the project scope and design are reviewed only to confirm that the project is still viable and that the cost overrun cannot be avoided by changes in scope or design.

23. In this context the Panel states the view that OM 13/BP/OP clearly supercedes the 1983 and 1989 documents.

2. The Management's View

24. The Management's Response states very plainly that the Panel's conclusion on this point is incorrect. It also gives reasons for this interpretation. Paragraph 10 of the Response states (in full) as follows:

The Panel's conclusion is incorrect. The scope of a reappraisal required for a supplementary loan is based on para. 24(ii) of the 1983 policy paper which states: 'The review of each project should aim to establish the principal reasons for the cost overrun so that the Bank and the borrower can take remedial steps. With that end in view the analysis should seek to identify: [... etc]'; the text then continues to list issues to be identified, all of which relate to the reasons of the cost overrun and possible remedial actions. The 1989 document, which provides the indicative format for the RRP for a supplementary loan, emphasizes this focus of the reappraisal. Thus, the view taken of the purpose of the reappraisal was neither narrow nor broad; it merely followed the existing policy, no more, no less.

Further the Management's response asserts in paragraph 11:

The Panel's statement (paragraph 74) that OM13/BP/OP clearly supercedes the 1983 and 1989 documents disregards the hierarchical order of policy papers and the OM.

3. Assessment by the Committee

25. As a preliminary observation the Committee notes that on the face of it, the plain wording of OM 13/OP would appear to require ADB to carry out a full-scale appraisal of the entire project at the time of preparing a supplementary loan. Such a re-appraisal would presumably include application of all relevant ADB policies (whether or not such policies are subject to the provisions of the inspection policy).

26. The Committee notes that Management in its Response argues that the scope of the reappraisal that would otherwise appear to be required by OM 13/OP must be understood as being limited by the 1983 Board paper *Review of the Bank's Policy on Supplementary financing of Cost Overruns of Bank-financed Projects* (Doc. R115-83, Revision 1, Final, 29 November 1983) (R115-83) on which it was based. Against this backdrop the Committee has carefully examined the relationship between R115-83, OM 13 and related documents. Based on this examination the Committee wishes to make the following observations.

27. The Committee agrees with Management's Response to the extent that the Panel is incorrect in maintaining that OM 13 "supercedes" the 1983 policy paper. The Committee wishes to note however that if there were to be any inconsistencies between an underlying policy paper and the resulting OM this would be very unfortunate and would represent a failure of Management in itself.

28. The Committee notes that in its response to the request for Inspection (24 May 2001), Management has argued that only to the extent that policies are included in the Operations Manual (OM), they are subject to Inspection. In doing so Management has referred to paragraph 4 of the Inspection Policy which states that "In this paper the Bank's 'operational policies and procedures' are defined as the Bank Policies and Operational Procedures set forth in the Bank's Operations Manual (OM) and to the extent applicable, corresponding sections in earlier editions of the OM". It was for exactly this reason that a number of policies listed in the request were deemed to be ineligible for inspection. The Committee feels it is inconsistent to first invoke paragraph 4 of the Inspection Policy to limit the scope of the Inspection and then to subsequently argue that not the OM but the underlying policies are the relevant documents. The

Committee also notes in passing that members of the Board, as well as the President, expressed serious concern at the time the Samut Prakarn inspection was authorized on 10 July 2001, that some ADB policies had never been included in the OM at all. In this context the Committee had observed in its recommendation to the Board, dated 20 June 2001 (Sec. M35-01), that it is important that Management examine this issue as a matter of urgency (paragraph 24). The issue remains urgent.

29. The Committee would be seriously concerned by any limitation in the scope of an inspection of compliance by ADB with a fundamentally important operational policy if such limitation were based on inconsistency between the OM section and the underlying policy paper. With the scope of any inspection already limited by lapses in incorporating certain OM sections, it would be most unfortunate if an inspection were then to be further limited by an ambiguity in an OM section or by an inconsistency with an underlying policy paper.

30. The Committee has examined R115-83, together with the associated documents, with great care. Management's Response quotes paragraph 24(ii) of R115-83 as stating that "the review of each project should aim to establish the principal reasons for the cost overrun ..." (paragraph 10, Management's Response) in support of the Response's contention that "[T]he policy clearly specified that reappraisal should focus on the reasons for the cost overrun. Staff simply followed the policy." (Paragraph 78, Management's Response.) However, the Committee notes that the words quoted from paragraph 24(ii) are included in paragraph 24 (ii)(a) of R115-83, and are plainly intended to be subject to the opening words of paragraph 24(ii), which state that "[F]inancing of cost overruns will be considered on a case-by-case basis **after reappraisal of the project** concerned, taking full account of the following:"(emphasis added). The paragraph then goes on to list six factors to be considered, including a review of the principal reasons for the cost overrun.

31. On a plain reading of paragraph 24 (ii), a full reappraisal of a project is required in the event of a proposal for a supplementary loan. If there were any doubt about the intent of R115-83 as a whole, such doubt is removed by paragraph 22, which states that "The procedural arrangements for processing supplementary loans would be similar to those applicable to new loans, **including the reappraisal of the whole project.**" (emphasis added). Paragraph 20 is also unambiguous in requiring reappraisal of the project.

32. The Management's Response (and the earlier response of 24 May 2001 to the Request for Inspection) also referred to the Board paper *Simplification of Board Documentation for Supplementary Loans* (Doc. Sec. M48-89, 12 September 1989) (Sec M48-89) in support of a narrow interpretation of the requirements for reappraisal. It is quite correct that Sec. M48-89 proposed a shift in the emphasis of documents to be presented to the Board at the time of consideration of supplementary loans, but the paper did not intend to create or support any curtailment of the process of reappraisal. This is evident from the first sentence of the first paragraph Sec. M48-89, which states that: "[T]he Bank's procedures for the preparation of supplementary loans require that the arrangements for processing such loans be similar to those applicable to new loans, **including the reappraisal of the project.**" (Emphasis added). Similarly, paragraph 2 states that "[T]he rationale for preparing both RRP and AR for supplementary as for new loans rests **on the need to ensure that project reappraisal is as rigorous as appraisal.**" (Emphasis added). The point of Sec. M48-89 (and GP 13, which includes a model format for the RRP) is evidently to avoid duplication and reduce unnecessary documentation. The Board was nevertheless expected to receive "the essential information the Board needs to give supplementary loan proposals the same depth of consideration provided for new loans." (Paragraph 3, Sec. M48-89).

4. Conclusion

33. The Committee therefore concludes that a textual analysis of R115-83 supports the plain wording of OM 13 and the common sense view that a full reappraisal of the Samut Prakarn project was required at the time of preparation of the supplementary loan. The Committee therefore supports the Panel's conclusion in paragraph 75 of its Report that "in not carrying out a reappraisal of the entire project for the supplementary loan proposal there was non-compliance by the Bank of OM 13/BP/OP...." Hence the Committee rejects the dismissal of this conclusion contained in paragraphs 10-12 of Management's Response.

B. Compliance with Other Operational Policies and Procedures

34. The Panel's Report argues (in paragraph 75) that the failure to carry out a full reappraisal in accordance with the policy on supplemental financing of cost overruns became a crucial factor from which other factors followed. Management's Response has argued in several places (for example paragraph 14, in the context of operational missions; paragraph 25 in the context of involuntary resettlement; paragraph 35, in the context of incorporation of social dimensions; and paragraph 41, in the context of benefit monitoring and evaluation) that the Panel's reasoning or conclusions are weakened by its "incorrect" conclusion on supplemental financing of cost overruns. Management's position is therefore that "the question of staff failing to comply with other policies that were adopted after December 1995 does not arise..." The Committee disagrees. As is argued in section 4 the Committee feels that a full appraisal should have been carried out at the time of the supplementary loan.

35. Management has also put forward certain other arguments that other policies were not applicable and/or that ADB in fact complied with them. The Committee briefly addresses these issues below in the context of these policies. However, it should be noted that the purpose of this section is not to revisit in great detail the arguments put forward by either the Panel or Management. As was argued in section 3.3 the Committee neither has the resources nor the expertise to act as an appellate body, rehearing and revisiting the whole matter of the inspection on its merits. Rather the purpose of this section is to analyze whether there are obvious errors in either the Panel's or Management's reasoning.

1. ADB's Operational Missions

36. OM 32/OP on operational missions states in paragraph 29 that a "reappraisal mission is sent when substantial or basic changes have become necessary in the scope or implementation arrangements of an approved project or when cost overruns are incurred in the implementation." The Panel has noted that as a result of a combination of factors, including particularly the proposed adoption of trenchless technology for construction of the sewerage system and modification to the proposed treatment plant technology, the estimated cost of the Project soared from \$507 million at appraisal to \$948 million (although this amount subsequently declined in US dollar terms as a result of the depreciation in the Thai baht). So a very significant cost overrun occurred.

37. The Management's Response argues (at paragraph 17) that "[G]iven that none of the Project's most critical parameters had changed as a consequence of the cost increase, it was judged that a reappraisal at that point in time was not required."

38. The Committee does not accept this argument. A sudden increase of \$441 million in the estimated cost of a recently-approved ADB project is a significant event. Evidently, the massive

cost increase resulted from a change in a “critical parameter” of the Project, namely the basis of the technology on which the Project was originally appraised. Even if one accepts the argument that a change from two treatment plants to one did not constitute a change in scope, one cannot seriously argue that such a fundamental and far-reaching change in technology did not constitute a basic, major, substantial change in implementation arrangements.

39. The Committee also has reservations about Management’s argument that changes in scope and implementation arrangements occur on a continuing basis throughout project implementation and that individual changes must therefore be considered on a case-by-case rather than a cumulative basis. This is a difficult issue, and the Committee recognizes that judgements must be made in a dynamic process of project implementation. It is however important that a strategic view is taken, and that decision-making about a project is not split into numerous separate discrete decisions taken at a relatively low level about related matters that would benefit from an integrated approach at a more senior level.

40. Management’s Response on this point concludes (in paragraph 20) that “ADB’s judgement has been vindicated by the smooth implementation of the Project and the conclusions of the numerous independent technical reports, reviews and studies that have confirmed the Project’s technical design and cost effectiveness.” The Committee disagrees. ADB’s judgement is not being questioned on the quality of the Project’s technical design or cost effectiveness; rather, ADB’s judgement is being questioned about whether, in the circumstances, a reappraisal mission should have been sent to assist in reaching this conclusion. The Committee feels that it is not appropriate to rely on a satisfactory outcome to justify an inadequate process.

2. Environmental Considerations

41. The Panel found that the original categorization of the Project as environmental category A rather than B (paragraphs 83-94 of the Panel’s Report) has led to “a number of subsequent decisions which have resulted in non-compliance with the Bank’s policy on Environmental Considerations in Bank Operations OM Section 21, 21 December 1992 and the succeeding OM 20/OP, 7 January 1997”.

42. The Management’s Response argues that assigning environmental categories is a matter of exercise of professional judgement by Staff and thus outside the scope of the inspection. It continues to argue that the Project was correctly classified as environmental category A.

43. While the Committee does not feel competent to take a position on whether this particular Project should have been categorized as either A or B, it does not agree with Management’s position that assigning environmental categories to projects falls per definition outside the scope of inspection. On this matter the Committee notes that OM 21 contains clear instructions on how to categorize a project, and that therefore it does fall within the inspection. Moreover, while accepting that due consideration should be given to professional judgement, the Committee wishes to note that there are limits to this. If an Inspection would demonstrate that a particular project would have clearly adverse effects on the environment, while being classified as environment category B, the Panel could certainly question the original classification.

44. The Committee has not been able to reach a firm conclusion on the issue whether there has been non-compliance with ADB’s policy on environmental considerations in Bank

operations. However, the Committee notes that the recommendations that flow from the Panel's findings of non-compliance make sense regardless of whether the Project would have been categorized as A or B. Moreover Management's Response (particularly in paragraph 56) indicates that Management has taken or will take the necessary steps to address environmental monitoring issues. The Committee therefore recommends that the Board should accept Management's assurances in paragraph 56 of the Management's Response and should ask for periodic information on this important matter.

3. Involuntary Resettlement

45. For the reasons stated in section 4 the Committee does not accept Management's argument (in paragraph 26 of the Response) that "the reappraisal was necessarily limited to focus on the cost overrun". Nevertheless, even though the Management's Response has incorrectly argued that the involuntary resettlement policy was not applicable, the Committee accepts Management's view that the resettlement effects will be limited, as well as its assurance that significant steps have been, and will be taken to ensure that compensation and, if necessary, resettlement arrangements are adequate. In this context the Committee takes note of the fact that Management has pointed out in paragraph 55 of the Response, without conceding any non-compliance, that appropriate steps are being taken.

4. Good Governance

46. The Committee has had difficulty in reaching a conclusion on the different perspectives of the Panel and the Management on compliance with the policy on good governance. In the case of this policy, it is not easy to extract operationally useful and measurable parameters for the implementation of principles expressed in necessarily broad terms. The Committee acknowledges the arguments made in Management's Response, particularly in paragraph 31. The Committee is also aware that Management has acknowledged (although not in the Response) that consultation processes should have started earlier.

5. Incorporation of Social Dimensions

47. Management's Response disagrees with the Panel's conclusion of non-compliance on the basis that it was not necessary to conduct a comprehensive reappraisal. The Committee accepts the Panel's finding that there has been non-compliance. The Committee also notes that Management has pointed out (and the Panel's Report has specifically recognized) that substantial steps have been taken to meet the requirements of the policy during project implementation, particularly after ADB became aware of the concerns of the Klong Dan community.

6. Benefit Monitoring and Evaluation

48. The Committee disagrees with Management's contention that processing the supplementary loan did not require a full reappraisal. The Committee accepts the Panel's findings that there has been non-compliance. However, the Committee also accepts, based particularly on paragraphs 41-43 of Management's Response, that ADB has gone a considerable way towards meeting the spirit of the policy.

7. Summary

49. ADB's failure to comply with policies on supplementary financing of cost overruns and operational missions (and particularly the failure to carry out a comprehensive reappraisal after a fundamental change in technology and a massive cost overrun and again when a substantial supplementary loan was processed) constituted and led to important omissions. Management's Response has argued convincingly that, in several cases, the effect of these failures was diminished by sound project administration (as well as by the quality of the Project itself).

V. DIRECT AND MATERIAL HARM

50. In addition to challenging all the Panel's findings on non-compliance with operational policies and procedures, Management's Response also states that the basis of the Panel's assessment of direct and material harm is incorrect. The Panel acknowledged (in paragraph 151 of the Report) that it had "been seriously disadvantaged in making a fair assessment of the direct and material harm on the rights and interests of the Requesters, due to the Panel's inability to have access to the Requesters, the Project site and the experts in Thailand who have experience in this area." Management's Response (in paragraph 44) has used this statement to question the basis on which the Panel made its assessment of direct and material harm. In the Committee's view, the basis for the assessment was the other information available to the Panel, which was necessarily limited by the lack of a visit. However, the Panel was able to complete its report, although in far from ideal circumstances.

51. The Committee notes that Management has argued (paragraph 46 of the Management's Response) that a key question for this purpose is whether "earlier and more effective involvement of the community would have resulted in a different project design or location". It would be quite reasonable to believe that earlier and more effective community participation would have resulted in a confirmation of the Project design and location, but that adverse effects on affected persons would have been avoided or mitigated or addressed more speedily and efficiently. It is also reasonable to conclude that people affected by a project have a right to be consulted in the course of preparation and implementation, and that direct and material harm is suffered when this does not occur even if the outcome in terms of physical design and implementation of the project would not have changed as a result of the consultation. The Panel's Report does not seek to argue that the Project should have been designed differently or located elsewhere. Nor does it argue that any adverse effects of the design or location are so widespread that substantial (or indeed any) changes to the scope of Project would be justified at this stage. Instead, the Panel has recommended very minor changes to or clarification of implementation arrangements. The Panel has concluded on the basis of the information available to it that a relevant group has suffered direct and material harm as a result of ADB's non-compliance with operational policies and procedures. The Committee accepts this conclusion.

VI. DISCUSSION OF THE PANEL'S RECOMMENDATIONS

52. Paragraph 52 of Management's Response disagrees with the Panel's recommendations on two grounds. First, Management has argued that there was "no failure on the part of ADB staff to interpret and administer ADB policies correctly." The Committee notes that Management does not accept that there has been any non-compliance of any kind with any ADB operational policies or procedures. However, for the reasons set out in paragraphs 18-49, the Committee supports the Panel's findings on the issue of ADB's non-compliance with the policy on supplementary financing of cost overruns, and the policies on ADB's operational missions,

involuntary resettlement, incorporation of social dimensions, and benefit monitoring and evaluation.

53. Apart from Management's disagreement with the Panel's recommendations on the grounds that they are derived from an invalid conclusion (that ADB had failed to comply with some policies and procedures), paragraph 52 of the Response also challenges the recommendation to "institute negotiations with the Klong Dan community" because it is "based on a series of misconceptions". In the Committee's view, the Panel's recommendations, including the modest suggestion that negotiations should be instituted with the Klong Dan community, are readily implementable. Indeed, the Response has made it clear that at least some and probably most of the Panel's recommendations are already being implemented, or that mechanisms have been established to meet the objectives of these recommendations. The Committee wishes to clarify and remove any misconceptions, with a view to proposing a practical, realistic series of outcomes for this inspection process. The Panel's recommendations (in paragraphs 165-166 of the Report, and also the "non-recommendations" in paragraphs 167-168) are therefore discussed below, together with Management's reply in paragraphs 52-56 of the Response.

A. Recommendation 1: Acknowledging Non-compliance

54. Paragraph 165 of the Panel's Report invites ADB to acknowledge that there has been non-compliance with some of its policies. Management's Response declines to do so. The Committee feels that this is unfortunate in light of the broader objectives of the Inspection Policy. As has been stated in section IV of this report, the Committee holds the view that certain ADB policies, most notably the policy on supplementary financing of cost overruns in ADB-financed projects, have been breached.

B. Recommendation 2: Improving the Mechanisms for and Monitoring of Consultation and Participation Process

55. The Committee notes that the Panel's Report does not suggest that the Project as a whole is flawed in any fundamental way.

56. While finding that ADB has failed to comply in certain important respects with operational policies and procedures, the Panel has not recommended any far-reaching changes to the Project or to its implementation, nor has it recommended suspension of loan disbursement. Instead, the Panel has suggested some important improvements to the mechanisms for, and monitoring of, consultation and participation processes.

C. Recommendation in Paragraph 166(i) of the Panel's Report

57. Paragraph 166(i) proposes that negotiations should be instituted to establish the extent of damages and "appropriate and adequate compensation" for those affected. Management's Response has correctly pointed out (in paragraph 54) that "an inspection is not a judicial process and its purpose is not to adjudicate awards for damages or make suggestions for the settlement of possible damages." The Committee also agrees with paragraph 55 of Management's Response, which notes that the Government of Thailand is obliged (as a matter of Thai law and, by virtue of the loan documents for the project and ADB's resettlement policy) to make appropriate arrangements for the calculation and payment of adequate compensation to those affected by the Project and that it is ADB's job to ensure that ADB's resettlement policy is complied with.

58. The Committee notes however that the Panel's Report does not include any purported award of damages or any suggestion that the Panel regards it as part of the Panel's job to make one. Rather the Committee's interpretation of the Panel's recommendation is that ADB should be an active participant in the process of facilitating the proper assessment of damages by the Thai government and where relevant the award of appropriate compensation.

59. Against this backdrop the Committee believes that ADB should continue to monitor the (comparatively limited) resettlement effects and that ADB should ensure that all legitimate concerns with respect to consultation with and participation by affected people are met.

D. Recommendation in Paragraph 166 (ii) of the Panel's Report

60. Management has not responded to the Panel's recommendation in paragraph 166(ii) of the Report for negotiation on "the remedial action programs for the immediate and longer term solutions."

61. In the Committee's view, this recommendation lacks specificity; its objectives can probably be met as part of the process envisaged in the recommendation in paragraph 166 (iii).

E. Recommendation in Paragraph 166 (iii) of the Panel's Report

62. Paragraph 166 (iii) includes recommendations on

- establishment and monitoring of baseline data for socioeconomic parameters
- mechanisms for community involvement
- mechanisms for notification of "exceedances of limits for odor and effluent parameters"

63. Although the Management's Response does not indicate whether Management agrees with these recommendations, paragraph 56 notes that these data and mechanisms have either already been developed and incorporated in the Environmental Management Plan (EMP) or are being developed as recommended in the EMP.

64. The Committee therefore chooses to interpret Management's Response as an acceptance of these recommendations.

65. The Committee notes that the Panel said (paragraph 167) that at this stage of project implementation suspension of the loan should not be recommended. The Panel noted that the Requesters said that "We have never challenged the importance of an appropriate wastewater treatment facility to help deal with the pollution problem in Samut Prakarn." The Committee notes that the Government of Thailand has been and remains firmly committed to the Project since its inception.

VII. OBSERVATIONS ON MANAGEMENT'S RESPONSE

66. Management has provided a detailed response to the Panel's Report. They have traversed almost every finding of the Panel, joined issue with it, at times severely criticizing the findings as well as its methodology. While the Committee has doubts as to whether this is the most fruitful approach in light of the broader objectives of the Inspection Policy and mandate of ADB, it acknowledges that the Inspection Policy itself is silent on the appropriate content and

format of Management's Response and that there is no precedent in ADB's experience to guide Management. The Committee will therefore state its view on this difficult matter, for the purpose of guiding Management in future inspections. However no inflexible rules can be laid down of universal application because each inspection may give rise to different issues.

67. What constitutes an appropriate reaction to a panel's report? A logical starting point is the rationale of having an Inspection Function as described in paragraph 5 of the Inspection Policy, which makes it clear that the purpose of the Inspection Function is to encourage transparency, beneficiary participation, offering a fair hearing and fostering greater confidence and support for the ADB (see Section III A).

68. The Committee believes that a modern multilateral development bank must have an inspection process that is fair, speedy and inexpensive. It must do justice to the Requesters, ADB and all interested stakeholders. The most important point is that the inspection should be carried out in a way that contributes to achieving the fundamental objectives of the inspection as set out in paragraph 5 of the Inspection Policy. This means, amongst other things, that the inspection process should be geared to conflict resolution. The Committee feels that it does not behove ADB well for a response to engage in criticism of a panel's report, which can be perceived by the outside world as seeking to bring the inspection process into disrepute. If this is permitted, the ultimate sufferer will be ADB itself and lead it to have an inadequate inspection process and one on which eminent people would refuse to serve as panel members.

69. In the Committee's opinion, it is not a correct approach for ADB's Management to criticize findings of the panel on questions of fact, methodology or reasoning processes. However, if the panel makes a finding that is so demonstrably contrary to the weight of the evidence before it or so untenable that no reasonable panel could have reached the conclusion that it did, a case may be established for the intervention of the Committee. This is plainly not such a case.

70. Lastly, while not able to speak for the independent Panel, the Committee wishes to make some observations on some of the issues raised in Part B of the Management's Response (*Conduct of the Inspection*).

71. In **paragraph 59** of its response Management argues that the Panel's statement that the inspection is incomplete because the visit to the Project area did not materialize is an invalid statement, because the Government of Thailand has the right under the Inspection Policy to object to such a visit. In the opinion of the Committee, the fact that a Government has the right to object to a site visit does not automatically mean that if it chooses to do so the inspection is complete. It is obvious that the inspection would have been more complete with a site visit than without one. Moreover, given the fact that one of the explicit objectives of the inspection is to give a fair hearing to the affected group (paragraph 5 of the Inspection Policy) the Committee can understand the opinion of the Panel. Management expressed concern that the Panel did not have formal interviews with persons who could have provided relevant information notably, the two mission leaders with whom no formal interviews were held. The Committee understands that the Panel did in fact meet and have discussions with the two mission leaders, but no formal record of them was made.

72. In **paragraph 60** Management argues that in asserting (paragraph 32 of the Panel's Report) that the Government imposed "impossible" conditions for a visit to the Project area, the Panel has essentially criticized the Government for exercising an option allowed by the Inspection Policy. The Committee does not interpret paragraph 32 as a criticism of the

Government of Thailand. In this context the Committee points out that, contrary to the argument in Management's Response, paragraph 32 does not say that the Government of Thailand has imposed impossible conditions. Rather the view expressed in this paragraph is that it is probably impossible for ADB to ever accede to a condition to shoulder financial liability derived from inspection visits, and that such a condition makes site visits virtually impossible. As one of the objectives of inspection is to give a fair hearing to the affected group (paragraph 5 of the Policy) the Committee understands the concerns of the Panel on this point. The Committee acknowledges that one can debate whether such observations should be included in the Panel's Report. However, the Committee also wishes to note that it has requested Management by letter dated 12 September 2001 to respond to the question of financial liability, and that to date the Committee has not received a response to this question, despite reminders.

73. In **paragraph 61** of the Response, Management has criticized the Panel's decision to suspend the inspection process. The Committee acknowledges that such a suspension is not foreseen in the Inspection Policy. However, the Committee emphasized, and the Panel accepted, that it is clear from R225-95 and the *Inspection Procedures* that a government is entitled to object to a visit to its country. In such circumstances, the Panel is nevertheless required to modify its work plan and complete the process:

If the country raises an objection, the inspection nevertheless will continue to the extent feasible on the basis of reports and other information otherwise available to the Bank. (paragraph 41 of R225-95).

74. In accordance with paragraph 52 of the *Inspection Procedures*, the Panel modified its work plan to take account of the Government of Thailand's objection to a site visit. The Panel made periodic reports to the Committee, in accordance with paragraph 55 of the *Inspection Procedures* on the progress of the inspection. Faced with the Panel's decision to suspend the inspection, the Committee directed the Panel to first prepare an interim report, while awaiting further instruction. When it became apparent that a visit to Thailand would not be feasible within a short time period, the Committee directed the Panel to complete the inspection process within a reasonable time period and to prepare a final report.

75. The Committee regrets that it was not possible to reach agreement on the terms of a visit to Thailand, despite its best efforts (correspondence between the Committee, the Director representing Thailand, the Thai authorities and ADB's Management is in Appendix 4). It also regrets that, on the key constraint to making arrangements for a visit (the issue of compensation for possible financial losses arising from the inspection), ADB's Management never replied to the letter of 12 September 2001 from the Committee's Chairman. The Committee felt and still feels that Management – and Management alone – could have provided clarity on this issue. In this context the Committee notes that Management's failure to provide clarity on whether it could or could not agree to assuming such financial responsibility put the Panel and indeed the Committee in a very difficult position vis-à-vis the Thai Government. Neither the Committee nor the Panel was in a position to accept such liability on behalf of the ADB and hence could not agree to a visit to Thailand on that condition.

76. The Committee feels it is unfortunate that the Panel was not able to visit the project area and that the Requesters declined to visit Manila. The Committee agrees with paragraph 61 of Management's Response to the extent that the inspection was not as complete as it would have been if a visit to the Project area and complete discussions with all relevant stakeholders had taken place (see also the Committee's comments on paragraph 59 of Management's Response). Plainly, the depth and breadth of the analysis of the Report suffered as a

consequence, as the Panel has pointed out. However, the Committee does not accept that the blame for these adverse impacts is wholly, or primarily, attributable to the Panel, as suggested by Management's Response.

VIII. CONCLUSIONS AND RECOMMENDATIONS

A. Conclusions

77. The Committee has carefully studied the Panel's Report and Management's Response and is aware of the background of the matter.

78. On the question of compliance with ADB policies and procedures, the Committee has paid particular attention to the policy on supplementary financing of cost overruns. The principal justification for focusing on this policy is that most of the complaints of the Klong Dan community appeared to be linked to ADB's decision not to reappraise the project at the time of the supplementary loan.

79. After careful examination of the Panel's Report, the Management's Response and the relevant policies, the Committee has reached the conclusion that the Panel's finding that ADB's policy on supplementary financing of cost overruns has not been complied with, and that a reappraisal of the entire Project would indeed have been required, is correct. With respect to the issue of compliance with OM32 on ADB's operational missions, the Committee has come to a similar conclusion. The breaches of the policies on involuntary settlement, incorporation of social dimensions and benefit monitoring and evaluation have essentially followed from the incorrect decision not to reappraise the Project. The Committee is not in a position to reach a conclusion on the question as to whether the policies on governance and environmental considerations have been breached.

80. On the question of remedial steps to be taken to address the finding of the Panel that ADB has failed to follow its operational policies and procedures, the Committee has consulted both Management and the Director representing Thailand concerning remedial steps that can be taken to address the failure. This consultation took place on 25 February 2002. In this meeting Management indicated that it believed ADB had not failed to comply with its own policies, as argued in its response, and therefore it was troubled by the recommendation to acknowledge non-compliance with some of its Policies. Management did however accept the second part of the Panel's recommendation in paragraph 165, and expressed a clear willingness to do everything within its power to restore confidence between the community on the one hand and the Executing Agency and ADB on the other hand.

81. With respect to the recommendations in paragraph 166, Management acknowledged the merits of improving community participation. In this context Management noted that the Pollution Control Department is currently working on a compensation mechanism, in line with ADB's resettlement policy. Management will review progress on this matter every six months. Management further indicated that as an integral part of the EMP for the Samut Prakarn wastewater treatment plant, community liaison groups will be established to foster greater community involvement in the management and operation of the treatment plant. Management indicated that work on establishing baseline data for socio-economic parameters; a mechanism for meaningful community involvement in the risk assessment of future problems; and a mechanism for timely public notifications is already under way. Management confirmed that while strictly speaking it will not be a partner in any negotiations, it is keen to be an active participant in these efforts.

82. The Director representing Thailand noted that the recommendation contained in paragraph 165 of the Panel's Report did not concern Thailand. With respect to the recommendations contained in paragraph 166 of the Panel's Report he confirmed Management's submission that steps are being undertaken to improve community participation.

B. Recommendations of the Committee

83. The Committee recommends:

(i) That the Board confirm ADB's commitment to being an active participant in both the discussions with the Klong Dan community and all other efforts mentioned in paragraph 166 of the Panel's Report;

(ii) That the Board instruct Management to continue to monitor resettlement effects and to ensure that all legitimate concerns with respect to consultation with and participation by affected people are met. To this end the Committee recommends that the Board instruct Management to provide semi-annual reports on the status of implementation of the resettlement plan including payment of compensation; and

(iii) That the Board note paragraph 56 of Management's Response, in which it is stated that data and mechanisms for monitoring the social and environmental impacts have either already been developed and incorporated in the EMP or are being developed as recommended in the EMP; and that the Board instruct Management to provide semi-annual reports on:

- the system for monitoring of socio-economic impacts, based on baseline data
- the progress in community involvement; and
- problems associated with odor and effluent (if any), together with a description of measures taken.