



APPRAISAL REPORT

CAO Appraisal for Audit of IFC

CAO Compliance

CAO Ref Code: C-I-R9-Y12-F165

January 08, 2013

Avianca S.A.

Colombia

Case of

Complaint from Global Unions on behalf of unions representing employees of Avianca

Summary

This appraisal relates to labor issues around IFC's investment in Avianca, one of the largest airlines in Latin America and the largest in Colombia.

Key allegations raised by the complainant unions can be summarized as follows:

- That Avianca has violated IFC Performance Standard 2 (PS2) – Labor and Working Conditions – in particular by discriminating against union members and taking various measures to discourage union membership;
- That IFC failed at various stages in the project cycle to properly manage issues related to compliance with PS2 at Avianca;
- That IFC and/or Avianca failed to disclose documents as required by the IFC Performance Standards and Policy on Disclosure of Information;
- That IFC failed to conduct a rigorous assessment of PS2 compliance at Taca Airlines subsequent to its 2009 merger with Avianca.

Having held discussions with the IFC team and reviewed relevant documentation, CAO has questions as to the extent of implementation of IFC's policies and procedures, in particular requirements that IFC:

- make an informed judgment as to the likelihood that the investment would meet the requirements of the Performance Standards prior to financing new business activity (Sustainability Policy 2006, para 17); and
- take appropriate steps to supervise its Client's disclosure obligations under PS1.

At a more general level, CAO finds that this case demonstrates challenges in the assessment and supervision of PS2 risks that emerge from the nature of the relationships between an IFC client, its workers and the unions that represent them.

Thus, in accordance with its Operational Guidelines, CAO will develop Terms of Reference for a compliance audit with regard to the following issues:

- whether IFC exercised due diligence in its review and supervision of the PS2 risks attached to the Project; and
- whether IFC policies, procedures and staffing structures provide a robust framework for the advancement of the objectives of PS2 in its clients.

About CAO

The CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of IFC and MIGA.

CAO (Office of the Compliance Advisor Ombudsman) is an independent post that reports directly to the president of the World Bank Group. CAO reviews complaints from communities affected by development projects undertaken by the two private sector lending arms of the World Bank Group: the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

For more information about the CAO, please visit www.cao-ombudsman.org

1. Overview of the CAO Compliance Appraisal process

When CAO receives a complaint about an IFC or MIGA project, the complaint is first referred to the dispute resolution arm of the CAO, CAO Ombudsman, which works to respond quickly and effectively to complaints through facilitated settlements, if appropriate. If the CAO Ombudsman concludes that the parties are not willing or able to reach a facilitated solution, the case will be transferred to the compliance arm of CAO, CAO Compliance for appraisal and potential audit.

In the context of a CAO compliance audit, at issue is whether:

- The actual social or environmental outcomes of a project are consistent with or contrary to the desired effect of the IFC/MIGA social and environmental policy provisions; or
- A failure by IFC/MIGA to address social or environmental issues as part of the appraisal or supervision resulted in outcomes that are contrary to the desired effect of the policy provisions.

A compliance audit is concerned with assessing the application of relevant policy provisions and related guidelines and procedures to determine whether IFC and MIGA are in compliance. The primary focus of a compliance audit is on IFC and MIGA, but the role of the sponsor may also be considered.

In order to decide whether an audit is warranted, CAO Compliance first conducts a compliance appraisal.

To guide the appraisal process, CAO applies several criteria. These are framed as a series of questions to test the value of undertaking a compliance audit.

- Is there evidence of significant adverse social and environmental outcome(s) as a result of the project now or in the future?
- Are there indications that a policy or other audit criteria has not been adhered to or properly applied?
- Is there evidence that indicates that IFC/MIGA's provisions, whether or not complied with, have failed to provide an adequate level of protection?
- Is there an argument for the value of a compliance audit, either because an audit is likely to support the realization of better social and environmental outcomes in the project under review, or because a compliance audit could yield information or findings that might better inform the application of policies (or other audit criteria) to future projects?

As part of the appraisal process CAO Compliance reviewed relevant documentation and held discussions with the IFC project team to understand the validity of the concerns, which criteria IFC used to assure itself/themselves of project performance, how IFC assured itself/themselves of compliance with these criteria, and generally whether an audit is the appropriate response. In addition to providing access to project documentation the IFC team provided written responses to CAO's enquiries.

After a compliance appraisal has been completed, CAO can choose one of two options: to close the case, or to initiate a compliance audit of IFC or MIGA.

CAO will report and disclose the findings and decision of CAO compliance appraisal in an appraisal report in order to inform the President of the World Bank Group, the Boards of the World Bank Group, senior management of IFC or MIGA, and the public in writing about its decision.

If CAO decides to initiate a compliance audit as a result of the compliance appraisal, CAO will draw up a Terms of Reference for the audit in accordance with CAO's Operational Guidelines.

2. Background

Avianca ("the Company/Client") is one of the largest airlines in Latin America and the largest in Colombia, operating from its main base at El Dorado International Airport, Bogota. IFC invested in the company in 2009 with a view to supporting it to renew its fleet, reduce costs, improve efficiency and safety as well as provide better passenger service.

IFC's commitment to the company totaled US\$50 million comprising a subordinated (or C) loan of US\$15 million and a straight senior (or A) loan of US\$35 million disbursed in November 2008 and July 2009 respectively.

Since its merger with San Salvador based Taca Airlines in 2009, Avianca has been a subsidiary of a holding company, AviancaTaca Holding S.A., which in turn is owned by Synergy Group Corp., the Brazil based conglomerate which controlled Avianca at the time of the IFC investment. Synergy Group holds approximately two-thirds of the shares of AviancaTaca while the original owners of Taca have a one-third stake in the merged group.

The complaint in this case was drafted by International Trade Union Confederation (ITUC) in cooperation with the International Transport Workers Federation (Global Unions) on the basis of consultation with national level unions (ACAV/ACDAC) representing employees of Avianca.

3. Scope of Appraisal

As set out in the letter of complaint from Global Unions and the CAO Ombudsman Assessment Report,¹ the allegations raised by the Complainants can be summarized as follows:

- (a) That Avianca has violated IFC Performance Standard 2 (PS2) – Labor and Working Conditions – in particular by discriminating against union members and taking various measures to discourage union membership;
- (b) That IFC failed at various stages in the project cycle to properly manage issues related to compliance with PS2 at Avianca;
- (c) That IFC and/or Avianca failed to disclose documents as required by the IFC Performance Standards and Policy on Disclosure of Information;
- (d) That IFC failed to conduct a rigorous assessment of PS2 compliance at Taca Airlines subsequent to its 2009 merger with Avianca.

4. Discussion and Findings

The analysis that follows is organized chronologically following the IFC project cycle, dealing first with issues related to IFC's due diligence in its preparation of the project.

¹ Available at http://www.cao-ombudsman.org/cases/case_detail.aspx?id=176

Issues related to project preparation

In relation to the pre-commitment phase of the project cycle, the key question for CAO is whether IFC exercised due diligence in its review of and response to the client's assessment of the project's Environmental and Social (E&S) impacts (including labor issues). In this case, specific questions arise relating to IFC's assessment of Avianca's track record with regard to PS2 issues, and its commitment and capacity to manage a PS2 compliant business. The underlying principle established by the IFC Policy on Social and Environmental Sustainability (the Sustainability Policy, 2006) in this respect is that "IFC does not finance new business activity that cannot be expected to meet the performance standards over a reasonable period of time" (para 17).

Documentation of IFC's investment in Avianca begins in May 2007 when an Early Review was conducted. At this stage, and through until after the conduct of the Investment Review Meeting in March 2008, it would appear that IFC had no specific concerns regarding Avianca's performance on labor issues. On this point, in relation to issues of freedom of association, the IFC's Investment Review Memorandum (dated March 3, 2008) reports that all employees are free to unionize and have the right to collective bargaining.

In the E&S Review Summary (ESRS), which was released in June 2008, this positive finding regarding employees' freedom to unionize and right to collective bargaining is repeated, while the following text is added:

However, some complaints with regard to labor aspects have been raised by external organizations. Avianca will provide IFC with status reports on these complaints, including measures implemented or planned to ensure compliance with PS2 (...) In order to be in line with best practices, Avianca will amend, as necessary, its HR policies and agreements with contractors and cooperatives and suppliers to ensure non-employee workers are retained in a manner consistent with this PS (p.3).

The complaints mentioned in the ESRS relate to a series of communications between unions representing workers at Avianca and the International Labour Organization (ILO) Committee on Freedom of Association in the period 2004 to 2007. These communications raise allegations that Avianca had in place systems and practices that breach various ILO conventions, namely the Freedom of Association and Protection of the Right to Organise Convention, 1948 (No. 87), the Right to Organise and Collective Bargaining Convention, 1949 (No. 98), the Labour Relations (Public Service) Convention, 1978 (No. 151), and the Collective Bargaining Convention, 1981 (No. 154).

In particular, unions representing workers at Avianca had complained to the ILO that: (a) workers dismissed from Avianca were in fact replaced by others from cooperatives or other companies who did not have freedom of association rights; (b) the company was requiring flight attendants to accede to a voluntary benefits plan as a precondition for signing the employment contract, with the result that these workers cannot then join the union; (c) the company was offering employees higher wages in return for withdrawing from the union; and (d) the company was otherwise in breach of its collective agreements in various respects.

The cases before the ILO were noted in the August 2008 Project Summary prepared for the IFC Board of Directors, together with the conclusion that IFC believed that Avianca was in compliance with PS2. Despite this finding, the Project Summary committed IFC to ensuring that a labor assessment would be performed in order to have a detailed review of the unresolved cases and monitor continuous compliance with PS2.

Discussions with relevant IFC staff indicate that once they became aware of the complaints to the ILO they spoke to representatives of Avianca management, ILO and ITUC. These discussions, together with a review of the complaints to the ILO and Avianca human resources policies, formed

the basis for IFC's description of the labor issues associated with the project at the time it went to Board.

In relation to the pre-commitment E&S review, CAO finds that once the IFC team became aware of the proceedings before the ILO, it was proactive in requiring satisfactory completion of a labor assessment as a condition of disbursement. While it is unclear that IFC had sufficient evidence to support the assertion in the Board paper that Avianca was in compliance with PS2, CAO finds no issue with IFC committing to the investment, assuming appropriate labor related conditions of disbursement were agreed upon. In CAO's view, beyond the requirement of the labor assessment, it may have been appropriate to include as a condition of disbursement, a requirement that Avianca develop an Action Plan satisfactory to IFC to address potential PS2 compliance gaps identified by the labor assessment.

In line with its undertaking to the Board, IFC included in its loan agreements with Avianca provisions requiring a labor assessment to be conducted to IFC's satisfaction, prior to any disbursement of the loan.² Terms of reference (TOR) for this assessment were annexed to the loan agreement.³

Relevantly, the labor assessment TOR provided that the consultant would:

- “[s]pecifically describe the difference in terms of basic salary, benefits and rights between contracts covering unionized and non-unionized employees”;
- “[a]ssess the adequacy and compliance of practices with regards to freedom of association and collective bargaining with national labor law and IFC Performance Standard 2...”;
- “[p]rovide an accurate accounting of all pending cases presented to ILO against Avianca...” and
- “[i]dentify labor cases presented to the national labor agency and/or judicial system against Avianca...”

In terms of methodology, the TOR required the consultant to “engage with the management of Avianca, responsible staff in Avianca dealing with the labor issues identified in the scope, local government, labor inspectors and a representative sample of all categories of employees, including workers from cooperatives.” Given the subject matter of the concerns regarding issues of freedom of association, CAO is unclear why the methodology proposed in the TOR did not direct the consultant to engage with the relevant unions.

Issues related to project supervision – 1st disbursement

A key early E&S supervision activity was the review of the labor assessment, satisfactory completion of which was a condition of any disbursement under the loan agreement. According to the Environmental and Social Review Procedure (ESRP, 2007, para. 6.2.1), the Lead E&S Specialist is responsible for obtaining requisite information from the Transaction Leader to determine the status of any E&S condition of disbursement (CODs); informing the Transaction Leader if there are any E&S CODs not complied with (*ibid.*); and providing clearance on E&S CODs (para. 6.3.2). Any waivers of E&S CODs must be cleared by a manager in the E&S Department (*ibid.*).

Fieldwork for the initial labor assessment was conducted in December 2008. IFC's first disbursement to Avianca was processed on January 22, 2009. A final version of the assessment

² Loan agreement (Sep. 2008), Section 4.02 (m).

³ An initial loan agreement was executed on September 26, 2008 with an Amended and Restated Loan Agreement concluded on June 24, 2009.

was submitted to IFC by Avianca together with an agreed action plan on February 26, 2009. It is unclear, based on the documentation available to CAO, whether IFC considered the issue of the satisfactory completion of the labor assessment in the process of approving the first disbursement. Procedurally, this is unclear because: (a) the Project Data Sheet (PDS) First Disbursement (dated January 21, 2009) does not reference the labor assessment, and (b) the conditions of disbursement checklist attached to the PDS omits Section 4.02(m) (“Labor Assessment”) from the list of conditions to be satisfied prior to disbursement.

Substantively the 2008 labor assessment refers to the history of violence *vis-à-vis* trade unions in Colombia, and describes a context in which there exist significant legal obstacles for workers to fully exercise their right to freedom of association. Having reviewed the Avianca unions’ complaints to the ILO and referring to interviews with union members⁴ and senior management, the assessment team is unable to confirm any violation of the right to freely associate. However, the report also concludes that there was insufficient evidence to demonstrate that the company had a strong system in place to ensure that workers are not discouraged from joining unions, or that would protect workers against anti-union discrimination. Specifics in relation to these findings, or the grounds on which they are reached, are not provided. As a result, the assessment makes a general recommendation that the company strengthens its systems to ensure that all levels of management respect freedom of association while at the same time addressing allegations of union interference. Documentation of a review of the 2008 assessment by IFC E&S specialists was not available at the time of writing. In this context, it is unclear to CAO whether IFC exercised due diligence in its review of the 2008 labor assessment, and in particular whether this was considered to satisfactorily answer the key points of the TOR. For the procedural and substantive reasons outlined above, it is thus also unclear to CAO whether IFC was in a position to make an informed judgment as to the likelihood that the investment would meet the requirements of PS2 prior to disbursement of the loan.

Issues related to project supervision – general supervision

Following commitment, IFC’s obligation is to monitor the client’s E&S performance in accordance with its Sustainability Policy and ESRPs. Relevantly, this includes the requirement to review project performance on the basis of the client’s commitments in the investment agreement and Action Plan and, in cases where a client fails to comply with these commitments, to work with the client to bring it back into compliance (Sustainability Policy, 2006, para. 26). In cases where the client fails to reestablish compliance, the Sustainability Policy provides that IFC should exercise “appropriate remedies” (*Ibid.*).

IFC recorded its first supervision of the Avianca investment in April 2010. This included both a review of the client’s first Annual Monitoring Report (AMR 2009) and information from a visit by an E&S specialist to the client’s Bogota offices in December 2009. While noting that the 2008 labor assessment was inconclusive in relation to issues of freedom of association, the April 2010 supervision document raises ongoing concerns regarding the client’s compliance with PS2 and proposes a continued series of labor assessments until these concerns have been addressed. The supervision document also identifies what the author describes as failures of the 2008 labor assessment, among which was a lack of engagement with the unions as part of the assessment process. As a result, the E&S specialist recommends that a different consultant be contracted to undertake the next labor assessment. Finally, the supervision document remarks that AMR 2009

⁴ CAO notes that while the body of the 2008 labor assessment report refers to interviews with trade unions, no meetings with trade unions are listed in the annexed agenda.

provides no information on key PS2 issues and includes suggested text requesting that the client provide additional information in the next AMR.⁵

The next recorded supervision activity occurred following a site visit in September 2010. This took place at the same time as fieldwork for the second labor assessment. Based on meetings with unions and management and preliminary results of the labor assessment, the supervision documentation finds that there were questions about project performance in relation to PS2 issues including compliance with approval requirements.

The second labor assessment also identifies non-conformance in relation to freedom of association and collective bargaining; in particular, that workers were often influenced to opt for employment contracts under a framework known as the Plan Voluntario de Beneficios (PVB) in lieu of joining a union and receiving benefits under a collective bargaining agreement (CBA). While the PVB benefits are found to be essentially the same as those offered by the CBA, the assessment notes that workers often see the PVB as the only alternative for obtaining employment and were not informed of a CBA option. The assessment also notes that while the majority of workers interviewed did not express interest in joining a union, others mentioned that they had concerns that the company would retaliate against any worker that sought to join one of the unions. In these circumstances, the assessment recommends that the company should cease the practice of including the PVB form as part of the contract signing process and clarify for workers joining the company that they have the freedom to accept the PVB or participate in collective bargaining and be affiliated with a union.

Following a significant delay on the side of the consultants, the second labor assessment was finalized in May 2011. At this point, the IFC team firmed in its view that PS2 compliance issues at Avianca needed to be addressed, and as a result in August 2011, the relevant IFC Regional Industry Director wrote to the Company outlining IFC's concerns. This led to what the IFC team saw as a positive response from the Company and eventually, in November 2011, to agreement on new action plan regarding labor issues. In December 2011, as a result of what IFC E&S specialists saw as a agreement to a robust action plan and management changes in the human resources department at Avianca, IFC upgraded its assessment of project E&S risk.

The most recent recorded supervision activities occurred following a site visit in August 2012 and with the review of the client's 2011 AMR in December 2012. The site visit took place at the same time as fieldwork for the third labor assessment and incorporates draft findings of this assessment. Conclusions noted in the supervision document include: partial progress on implementation of the 2011 labor action plan with main gaps relating to PS2 requirements such as training and awareness of employees on human resources policies including the right to freedom of association and the need to enhance stakeholder consultation and engagement, specifically with trade unions. Based on these observations, IFC maintained its assessment of project E&S risk at partly unsatisfactory. Regarding the complainants' concerns that IFC did not conduct a rigorous assessment of PS2 compliance at Taca Airlines subsequent to its merger with Avianca, CAO notes that the supervision document includes as a "next step" that a labor assessment of Taca be scheduled for December 2012.⁶ Discussions with the IFC team indicate that this has now been

⁵ In relation to this last point, CAO notes the requirement in the ESRP (2009, para. 6.2.5) that IFC ensure that "[t]he information provided [in the AMR] is adequate" and if not that additional information be requested. It is unclear to CAO whether requesting further information in the subsequent year's AMR meets this requirement. In this context CAO notes that subsequent AMRs have not contained significantly more information on labor issues.

⁶ This is to be completed according to amendments to the legal agreement between IFC and the Company that extend the E&S provisions of the legal agreement to cover the operations of TACA in addition to those of Avianca.

delayed until February 2013. CAO also notes that in 2012 IFC, having identified gaps in the legal analysis provided by the labor assessments and acknowledging a number of ongoing legal actions by unions against the Company, commissioned advice from local counsel on matters related to PS2 compliance. This advice was pending at the time of writing. In relation to the 2011 AMR the IFC review notes that as in previous years, agreed labor related indicators are not adequately reported on.

In summary, on issues of general supervision CAO finds that the IFC team responded to identified PS2 concerns by pursuing a series of labor assessments focusing on freedom of association issues. When progress on implementing the action plans agreed subsequent to each of the labor assessments was perceived as less than satisfactory, CAO finds that the team was proactive in engaging IFC management to follow up with the client. Finally, while noting that this did not occur until four years after the initial labor assessment, CAO finds that IFC has acted appropriately in requesting advice from local counsel regarding outstanding PS2 issues. CAO is, however, unclear whether this record of supervision constituted an adequate and timely response to specific concerns being raised by unions regarding the client's PS2 performance.

Issues related to disclosure of information

IFC and its clients are committed to disclose certain information as part of the project cycle. While recognizing that transparency is fundamental to fulfilling its development mandate, IFC also respects the confidentiality of certain business information. Relevant requirements are set out in the Performance Standards and the Policy on Disclosure of Information (both 2006).

IFC's E&S disclosure requirements under the 2006 policies are focused on the ESRS. According to the Policy on Disclosure of Information, the ESRS must be disclosed and, "along with the ESRS," IFC must "make available electronic copies of, and where available, links to any relevant social and environmental impact assessment documents prepared by or on behalf of the client, including the Action Plan" (para. 13(a)). In addition under PS1, the client is required to disclose:

- a) "the Assessment document" where a "client has undertaken a process of Social and Environmental Assessment" (para. 20).
- b) "the Action Plan" prepared when "the client identifies specific mitigation measures and actions necessary for the project to comply with applicable laws and regulations and to meet the requirements of Performance Standards 1 through 8" (para. 16); and
- c) "periodic reports that describe progress with implementation of the Action Plan" (para. 26).

In the case of IFC's investment in Avianca, an ESRS was disclosed in June 2008. The ESRS notes that Avianca will provide IFC with status reports on "measures implemented or planned to ensure compliance with PS2"; however, no Action Plan or E&S impact assessment documentation is disclosed on the IFC website. As explained by the IFC team, this was because no formal E&S Assessment documentation or Action Plan was prepared prior to disclosure of the ESRS. In contrast to the current Access to Information Policy (2012), the IFC team explained that, in its understanding, the Policy on Disclosure of Information (2006) did not require "post board" disclosure of Action Plans or Assessment documentation by the IFC. In CAO's view this represents a defensible reading of the requirement that this documentation must be disclosed "along with" the ESRS, within a framework where post board disclosure becomes the obligation of the client with IFC in a monitoring role (see discussion of PS1 requirements above).

Regarding the client's disclosure requirements, the IFC team indicated that in its interpretation the client should be required to disclose Assessment documents and Action Plans in cases where

significant adverse affects are identified. Further, in explaining why documentation around the 2008 labor assessment was not disclosed, the team's view was that it would have been counterproductive to push for disclosure at the time given tensions between unions and management and the fact that that there existed internal structures for dialogue between Avianca and its unions based on Colombian law. By 2011 the team indicated that the atmosphere was more conducive to dialogue and as such that Avianca was encouraged to disclose its revised Action Plan and that this was done in the form of a letter informing unions of activities being carried out in fulfillment of the company's commitments to IFC.

Having considered the IFC team's views in the context of the relevant policy provisions, CAO is unclear as to the adequacy of IFC's supervision of its Client's disclosure obligations under PS1.

5. CAO Decision

Having held preliminary discussions with the IFC team and reviewed relevant documentation, CAO has questions as to the extent of implementation of IFC's policies and procedures, in particular requirements that IFC:

- make an informed judgment as to the likelihood that the investment would meet the requirements of the Performance Standards prior to financing new business activity (Sustainability Policy 2006, para 17); and
- take appropriate steps to supervise its Client's disclosure obligations under PS1.

At a more general level, CAO finds that this case demonstrates challenges in the assessment and supervision of PS2 risks that emerge from the nature of the relationships between an IFC client, its workers and the unions that represent them.

Thus, in accordance with its Operational Guidelines, CAO will develop Terms of Reference for a compliance audit with regard to the following issues:

- whether IFC exercised due diligence in its review and supervision of the PS2 risks attached to the Project; and
- whether IFC's policies, procedures and staffing structures provide a robust framework for the advancement of the objectives of PS2 in its clients.