



April 8, 2015

Office of the Compliance Advisor Ombudsman (CAO)

COMPLIANCE APPRAISAL REPORT

Appraisal of IFC investment in Harmon Hall, Mexico (IFC Project #29753).

CAO complaints numbered: 02 to 06 and 08.

Summary

This compliance appraisal considers six complaints regarding an IFC investment in Harmon Hall (“the company”), a chain of English-language schools in Mexico, with a network of 101 schools and approximately 1,500 employees.

In August 2010, IFC made a \$7.9 million equity investment in the company. The investment consisted of two components: the purchase of the founding shareholders’ shares; and a capital increase to finance the company’s expansion over an 18 month period.

In 2007, IFC invested in Nexus Capital Private Equity Fund III, which acquired a 60 percent equity stake in Harmon Hall in 2008.

Between September 2013 and March 2014, CAO received six complaints from current and former employees of the company. The complaints raise concerns about labor issues, including compensation, benefits, and inadequate performance of a grievance mechanism. All six complaints are considered together in this compliance appraisal.

The purpose of a CAO compliance appraisal is to determine whether an investigation of IFC’s environmental and social performance is required in response to a complaint. In deciding whether to initiate an investigation, CAO weighs factors including the magnitude of the environmental and social (E&S) concerns raised by a complaint, results of a preliminary review of IFC’s E&S performance in relation to these issues, and a more general assessment of whether a compliance investigation is the appropriate response in the circumstances.

Absent aggravating circumstances, disputes between an employer and individual employees around issues of pay and benefits will not raise substantial concerns regarding the E&S outcomes of an IFC investment such that would merit a CAO compliance investigation.

While CAO has identified questions as to IFC’s appraisal and supervision of its investment in the company, CAO also notes that IFC is supervising this investment with a focus on the implementation of Performance Standard 2 (Labor and Working Conditions). In particular, following a CAO facilitated dispute resolution process which concluded in July 2013, this involved the conduct of a labor compliance verification audit and the development of a related corrective action plan in 2014.

In conclusion, given the nature of the complaints, and considering IFC’s ongoing engagement with the company in relation to the implementation of Performance Standard 2, CAO finds that a compliance investigation is not the appropriate response in this instance. As a result, in accordance with its Operational Guidelines, CAO has decided to close this case.

About CAO

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 arms of the World Bank Group, the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

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

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Acronyms

Acronym	Definition
CAO	Office of the Compliance Advisor Ombudsman
E&S	Environmental and Social
ESAP	Environmental and Social Action Plan
ESMS	Environmental and Social Management System
ESRS	Environmental and Social Review Summary
ESRP	Environmental and Social Review Procedures
ESRR	Environmental and Social Risk Rating
HR	Human Resources
IFC	International Finance Corporation
MIGA	Multilateral Investment Guarantee Agency
PAE	Programa de Asistencia al Empleado (independent external grievance mechanism launched by Harmon Hall)
PS	Performance Standard
SPI	Summary of the Proposed Investment

I. Overview of the Compliance Appraisal Process

When CAO receives a complaint about an IFC or MIGA project, the complaint is referred for assessment. If CAO concludes that the parties are not willing or able to reach a facilitated solution, the case is transferred to the CAO compliance function for appraisal and potential investigation.

A compliance appraisal also can be triggered by the CAO vice president, IFC/MIGA management, or the president of the World Bank Group.

The focus of the CAO compliance function is on IFC and MIGA, not their client. This applies to all IFC's business activities, including the real sector, financial markets and advisory. CAO assesses how IFC/MIGA assured itself/themselves of the performance of its business activity or advice, as well as whether the outcomes of the business activity or advice are consistent with the intent of the relevant policy provisions. In many cases, however, in assessing the performance of the project and IFC's/MIGA's implementation of measures to meet the relevant requirements, it will be necessary for CAO to review the actions of the client and verify outcomes in the field.

In order to decide whether a compliance investigation is warranted, CAO first conducts a compliance appraisal. The purpose of the compliance appraisal process is to ensure that compliance investigations are initiated only for those projects that raise substantial concerns regarding environmental and/or social outcomes, and/or issues of systemic importance to IFC/MIGA.

To guide the compliance appraisal process, CAO applies several basic criteria. These criteria test the value of undertaking a compliance investigation, as CAO seeks to determine whether:

- There is evidence of potentially significant adverse environmental and/or social outcome(s) now, or in the future.
- There are indications that a policy or other appraisal criteria may not have been adhered to or properly applied by IFC/MIGA.
- There is evidence that indicates that IFC's/MIGA's provisions, whether or not complied with, have failed to provide an adequate level of protection.

In conducting the appraisal, CAO will engage with the IFC/MIGA team working with the specific project and other stakeholders to understand which criteria IFC/MIGA used to assure itself/themselves of the performance of the project, how IFC/MIGA assured itself/themselves of compliance with these criteria, how IFC/MIGA assured itself/themselves that these provisions provided an adequate level of protection, and, generally, whether a compliance investigation is the appropriate response. After a compliance appraisal has been completed, CAO can close the case or initiate a compliance investigation of IFC or MIGA.

Once CAO concludes a compliance appraisal, it will advise IFC/MIGA, the World Bank Group President, and the Board in writing. If a compliance appraisal results from a case transferred from CAO's dispute resolution, the complainant will also be advised in writing. A summary of all appraisal results will be made public. If CAO decides to initiate a compliance investigation as a result of the compliance appraisal, CAO will draw up terms of reference for the compliance investigation in accordance with CAO's Operational Guidelines.

II. Background

Investment

In 2010, IFC made a \$7.9 million equity investment in Harmon Hall (“the company”), a chain of English-language schools in Mexico, with a network of 101 schools in 63 cities. The company has approximately 40,000 students and 1,500 employees.¹ The IFC investment consisted of two components: the purchase of the founding shareholders’ shares; and a capital increase in the company to finance its expansion over an 18-month period.

In 2007, IFC invested in Nexxus Capital Private Equity Fund III (“Nexxus”), which holds 60 percent of Harmon Hall.² Nexxus is a private equity fund that targets investments in middle-market Mexican companies.³

Complaint

From 2011 to 2014, a total of 24 complaints relating to Harmon Hall were lodged with the CAO. The first CAO case, Harmon Hall-01 was filed with CAO in December 2011. It addressed 17 labor related complaints regarding the company. These complaints triggered a CAO-led dispute resolution process in which the company and 15 complainants agreed to a set of remedial measures designed to resolve issues similar to those raised in the current set of complaints. The two unresolved complaints from Harmon Hall-01 were transferred to the CAO compliance function and closed after appraisal in August 2013 on the basis that they did not raise substantial concerns regarding the E&S outcomes of the project or issues of systemic importance that justified a compliance investigation.⁴ In September 2014, an additional complaint (Harmon Hall-07) was resolved through a separate CAO-led dispute resolution process.

This appraisal pertains to six complaints from current and former employees of the company lodged with CAO between September 2013 and March 2014. These complaints are referred to as CAO cases Harmon Hall 02-06 and 08. Some of the issues raised in these complaints arise from allegations that remedial measures agreed as part of the resolution of the Harmon Hall-01 complaints have not been implemented. More specifically, the complainants in this case raise the following allegations:

- Unlawful dismissal with insufficient termination benefits;
- Inappropriate classification as part-time versus full-time employee, which affected benefits status;
- Poor working conditions (overtime and schedules, workplace stress) and inadequate compensation;
- Withheld benefits and pay;
- Inadequate implementation of the grievance redress mechanism;
- Inadequate implementation of remedial measures designed to rectify systemic human resources (HR) issues.

¹ IFC Investment in Harmon Hall, Summary of Proposed Investment. <http://goo.gl/NPo5TE>

² IFC Investment in Nexxus, Summary of Project Information. <http://goo.gl/N6VgHe>

³ Nexxus holds 60 percent of Harmon Hall; the remaining 40 percent is split, with IFC investing 40 percent of the remaining equity, and two other shareholders each holding 30 percent. Nexxus acquired its share of the company in April 2008.

⁴ CAO Compliance Appraisal, Harmon Hall-01, August 30, 2013, <http://goo.gl/YmaEtP>

III. Analysis

This section outlines the IFC E&S policies and procedures as apply to the project. It then analyses IFC's performance against these standards during preparation and implementation of the project and in the context of the issues raised by the complainants.

IFC Policies and Procedures

IFC's investment in the company was made in the context of its 2006 Policy on Social and Environmental Sustainability ("the Sustainability Policy") and Performance Standards (PS), together referred to as the Sustainability Framework. Through the Sustainability Policy, IFC commits to "ensure that the projects it finances are operated in a manner consistent with the requirements of the Performance Standards".⁵

Performance Standard 2 sets the policies for IFC's client in dealing with its workforce. PS2 objectives include:

- To establish, maintain and improve worker-management relationship;
- To improve the fair treatment, non-discrimination and equal opportunity of workers, and compliance with national labor land employment laws;
- To protect the workforce by addressing child labor and forced labor;
- To promote safe and healthy working conditions, and to protect and promote the health of workers.

IFC implements the commitments set out in the Sustainability Policy through its Environmental and Social Review Procedures (ESRP), which are updated periodically. The Harmon Hall project was approved under ESRP version 4.0 (August 2009) and supervised under the subsequent updated versions of the ESRP.

When financing a project, IFC first conducts an appraisal aimed at assessing the full business potential, risks, and opportunities associated with the investment. Once the project is approved and IFC has invested in a client, the investment is monitored throughout the project cycle to ensure compliance with the conditions in the loan agreement and IFC's policies and standards. This CAO compliance appraisal considers IFC's performance at these two stages in the project cycle as relevant to the issues raised by the complainants.

Pre-investment Environmental and Social Review

At the pre-investment stage, IFC reviews the E&S risks and impacts of a proposed investment and agrees with the client on measures to mitigate these risks in accordance with the Performance Standards. For the purposes of this compliance appraisal, a key question is whether IFC conducted an adequate pre-investment review of the labor related risks associated with its investment in the company.

Requirements

As required by the Sustainability Policy, IFC's E&S review should be "appropriate to the nature and scale of the project" and commensurate to risk (para. 13). In conducting the E&S review

⁵ Sustainability Policy (2006), para. 5.

IFC considers the E&S risks as assessed by the client and the “the commitment and capacity of the client” to manage these risks (para. 15). IFC also considers the client’s “track record” in relation to E&S issues⁶. A central principle of the Sustainability Policy 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).

Relevant to the issues raised in the complaints, PS2 (Labor and Working Conditions) includes the following requirements:

- Clients are required to adopt human resources policies appropriate to their size and workforce. The policies should set out an approach that is consistent with PS2 and clients must ensure that employees have information regarding their rights under national labor and employment law, including their rights related to wages and benefits. The client’s human resources policy has to be understandable and accessible to each employee upon employment (para.6).
- Clients should document working conditions and terms of employment, including entitlement to wages and any benefits, and communicate these to all employees and workers directly contracted by the client (para.7).
- When the client is not party to a collective agreement with workers’ organizations, it should provide reasonable working conditions and terms of employment (such as wages and benefits, hours of work, overtime arrangements and overtime compensation, and leave for illness, maternity, vacation, or holiday) that, at a minimum, comply with national law (para. 8).
- Clients must provide a grievance mechanism for workers to raise reasonable workplace concerns. PS2 further notes, “The mechanism should involve an appropriate level of management and address concerns promptly, using an understandable and transparent process that provides feedback to those concerned, without any retribution” (para. 13).

IFC’s pre-investment review of the company

IFC completed its early review of the company’s E&S risks in May 2010. Identified risks included labor practices and terms of employment. IFC required these risks to be assessed and conducted an appraisal mission.

Labor related risks and impacts were considered as part of the company’s overall E&S assessment prior to approval of the project. In relation to labor issues, this consisted of an on-site review of a number of documents provided by the company, such as its recruiting procedure, internal work regulation, payroll payment procedure and termination procedure. IFC reviewed this assessment, and concluded the client would be able to meet the PS requirements over a reasonable period of time.

In July 2010, IFC disclosed a Summary of the Proposed Investment (SPI), indicating that general human resource policies were in place, with no evidence of restriction of freedom of association. The SPI did identify that the company needed to formalize procedures and develop a grievance mechanism for employees and communities.⁷ IFC categorized the proposed project as a Category B, indicating that the project was expected to have limited adverse social and/or environmental impacts that could be readily addressed through appropriate mitigation measures.

Further, IFC’s Environmental and Social Review Summary (ESRS) (July 2010) for the investment notes that:

⁶ ESRP 3, para.3.2.1, version 4, August, 2009.

⁷ IFC. Summary of Proposed Investment, July 2010, <http://goo.gl/hL0PvE>

- Formal human resources procedures had not been finalized or communicated to the employees;
- The Internal Work Regulations were not available at several schools IFC visited and there was lack of a formal company grievance mechanism;
- School directors considered employee claims, but employees were largely unaware of the process for submitting grievances;
- The staff benefits such as insurance, vacation, and salary complied with Mexican labor regulations;
- Teachers interviewed by IFC stated they were paid for the hours worked;
- A written nondiscrimination policy had not been implemented by the company.⁸

Following IFC's review, the company prepared an Environmental and Social Action Plan (ESAP) that included remedial actions responding to the issues IFC identified around labor.⁹ Labor related ESAP actions were to be implemented within six months of the date of IFC's investment. Relevantly, the key ESAP provisions included:

- The finalization of the company's Human Resources Policy;
- An internal communication instructing the facility directors to publish the summary Human Resources Policy;
- An internal communication sending the internal work regulation to the facility directors and instructing them to notify the employees that it was available for their review;
- The formalization of the employee grievance mechanism (e.g., policies, procedures, formats, etc.);
- An internal communication notifying the employees about the employee grievance mechanism.

Regarding adherence to national law, IFC determined the company complied with Mexican law. In order to confirm compliance to national laws, IFC relied on (i) the Company's representation in the investment agreements; and (ii) local counsel's due diligence report on the investment. IFC received advice from local counsel on the acquisition of its shares. These, however did not address labor issues specifically.

CAO notes that, when conducting its pre-investment E&S review for the Harmon Hall investment, IFC did not draw on information from Nexxus, an IFC client and the majority shareholder in Harmon Hall. However, CAO also notes that IFC's investment in Nexxus was made in the context of IFC's pre-2006 E&S requirements. Nexxus was thus not required to report to IFC on its portfolio companies with regard to PS2.

Conclusion

CAO acknowledges that IFC conducted a review of the project's E&S risks and impacts, and identified issues related to the company's labor practices. Remedial actions to effectively manage these issues were included in an ESAP prior to commitment. However, given the gaps identified in the company's HR systems, CAO has questions as to whether IFC's E&S review of PS2 issues was commensurate to risk, whether it adequately considered the company's track record in relation to labor issues and more generally whether it provided sufficient assurance of the company's ability to meet the requirements of PS2 over a reasonable period of time.

⁸ IFC. Environmental and Social Review Summary, July 2010, <http://goo.gl/qHVuKd>

⁹ IFC. Harmon Hall. ESAP, 2010. <http://goo.gl/jYkEWz>

Project Supervision

IFC is required to monitor a client's E&S performance throughout the life of the investment. For the purposes of this compliance appraisal, a key question is whether IFC adequately supervised the company's compliance with the requirements of PS2.

Requirements

Project supervision is conducted through annual monitoring reports (AMR) submitted by the client and reviewed by IFC, discussions with the client, and site visits as required by the IFC's ESRP. As set out in the ESRP, "the purpose of E&S supervision is to develop and retain the information needed to assess the status of compliance with the Performance Standards (PSs) [...] and the Environmental and Social Action Plan (ESAP or Action Plan)".¹⁰ If a client fails to comply with its E&S commitments, IFC will "work with the client to bring it back to compliance to the extent feasible, and if the client fails to reestablish compliance, IFC will exercise remedies when appropriate".¹¹

In addition to reviewing a client's AMR, IFC conducts site supervision visits to certain clients. Criteria for prioritizing supervision site visits include the client's environmental and social risk rating (ESRR). The ESRP suggests that IFC should conduct supervision site visits of Category B projects with partly unsatisfactory ESRR on an annual basis.¹² However, this requirement can be waived if "adequate supervision information is available from other sources."¹³

IFC's supervision of the company

In the course of project supervision, IFC monitored the company's implementation of the labor related items in the ESAP. IFC also monitored the company's response to the issues raised in the complaints and the outcomes of the CAO-led dispute resolution process, which included further measures to improve its labor practices. Finally, IFC commissioned a PS2 compliance audit of the company.

Results of the CAO-led dispute resolution process and IFC's monitoring of ESAP implementation

In February 2011, the company produced an internal procedure regarding termination compensation, which specifies the calculation of such compensation according to Mexican national law. The procedure was communicated in an internal announcement informing employees of the new human resources policies and the availability of a new internal grievance mechanism. The company subsequently notified IFC it had completed all labor-related actions outlined in the ESAP in December 2011.¹⁴

In April 2012, in response to the CAO-led dispute resolution process, the company launched an independent and external grievance mechanism called Programa de Asistencia al Empleado (PAE) to address employees' complaints. However, in February 2013, the company discontinued the external grievance mechanism for its employees, opting instead to strengthen its internal employee grievance mechanism.¹⁵

Also in response to the, CAO-led dispute resolution process, the company agreed to a series of remedial actions to improve its labor practices. These included targeted training of staff, the development of job descriptions, class assignment methodologies, availability of information

¹⁰ ESRP 6, para.1, version 5, August 16, 2010.

¹¹ Sustainability Policy (2006), para. 26.

¹² ESRP 6, para. 2.6, version 5, August 16, 2010.

¹³ ESRP 6, para. 2.6, version 5, August 16, 2010.

¹⁴ ESAP Status Update, December 2011.

¹⁵ CAO. Conclusion Report (Harmon Hall 01), July 2013, <http://goo.gl/1p1cca>

materials, and strengthening of the company's response to complaints.¹⁶ The actions agreed in response to the CAO-led dispute resolution process were incorporated into the company's ESAP and are being monitored by IFC.

CAO notes that IFC has conducted only one site supervision visit to the company, in January 2013, despite an ongoing partially unsatisfactory ESRR. Nonetheless, from January 2013 onward, IFC's supervision documents note the company's continued progress toward the establishment of an effective internal grievance mechanism, and no outstanding labor issues related to the implementation of the ESAP are mentioned.

PS2 Compliance Audit

In 2014, IFC hired a consultant to conduct a PS2 Compliance Verification Audit of the company. This audit was designed to diagnose the company's performance against the requirements of PS2 and the action plan resulting from the CAO-led dispute resolution process. The methodology used was adapted from the Social Accountability International SA8000 standard. The consultant interviewed a sample of teachers at the company, both part and full time. The audit concluded that there existed some deficiencies in PS2 compliance and proposed a corrective action plan. It also recommended performing bi-annual monitoring of actions and recommendations made in the report for a minimum of one year. At the time of writing, however, it was unclear whether all elements of the corrective action plan had been agreed with the company. Further, CAO has questions whether this audit was sufficient to assure IFC of the company's compliance with the requirements of PS2 in a context where IFC was aware of multiple labor related complaints.

Conclusion

In the course of supervision, CAO notes that IFC identified issues in relation to the company's labor practices and has engaged to address these. Particularly, in 2013, IFC updated its ESAP for the company incorporating remedial actions that had been negotiated through the CAO-led dispute resolution process. Further, in 2014, IFC commissioned a labor compliance verification audit and developed a related corrective action plan, though at the time of writing a final corrective action plan had not yet been agreed. In these circumstances, continued active supervision of labor related issues will be needed. More generally, CAO notes questions as to the rigor and timeliness of IFC's supervision given the number of labor related complaints that have been filed with CAO starting in 2011.

¹⁶ *Ibid.*

IV. Decision

The purpose of a CAO compliance appraisal is to determine whether an investigation of IFC's environmental and social performance is required in response to a complaint. In deciding whether to initiate an investigation, CAO weighs factors including the magnitude of the environmental and social (E&S) concerns raised by a complaint, results of a preliminary review of IFC's E&S performance in relation to these issues, and a more general assessment of whether a compliance investigation is the appropriate response in the circumstances.

Absent aggravating circumstances, disputes between an employer and individual employees around issues of pay and benefits will not raise substantial concerns regarding the E&S outcomes of an IFC investment such that would merit a CAO compliance investigation.

While CAO has identified questions as to IFC's appraisal and supervision of its investment in the company, CAO also notes that IFC is supervising this investment with a focus on the implementation of Performance Standard 2 (Labor and Working Conditions). In particular, this involved the conduct of a labor compliance verification audit and the development of a related corrective action plan in 2014.

In conclusion, given the nature of the complaints, and considering IFC's ongoing engagement with the company in relation to the implementation of Performance Standard 2, CAO finds that a compliance investigation is not the appropriate response in this instance. As a result, in accordance with its Operational Guidelines, CAO has decided to close this case.