



**July 13, 2015**  
*Office of the Compliance Advisor Ombudsman (CAO)*

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## **COMPLIANCE APPRAISAL: SUMMARY OF RESULTS**

*IFC Investment in Bilt Paper B.V., Malaysia*  
*Project #34602*

### *Complaint 01*

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Ballarpur International Graphic Paper (Bilt Paper or “the client”) is a leading pulp and paper manufacturer in India and Malaysia. Bilt Paper is a subsidiary of Ballarpur Industries Limited, an existing IFC client since 2000 in which IFC holds a small equity stake.

In 2014 IFC made a \$250 million debt and equity investment in the client and its subsidiary – Sabah Forest Industries (SFI). SFI is a large integrated pulp and paper manufacturing unit in Sabah, Malaysia. The purpose of IFC’s investment in SFI was to support plantation expansion.

In September 2014, an individual claiming to live in an area affected by the project filed a complaint with CAO in relation to the client’s operations in Sabah. The complaint raises concerns about the adverse effects of the project operations on water quality of local rivers that the complainant and the surrounding communities depend on. The complaint also makes allegations regarding the improper takeover of community land, loss of biodiversity and other environmental impacts. The complaint was deemed eligible by CAO in October 2014. The complainant requested that the complaint not be publically disclosed.

After an initial exchange of emails through the eligibility phase, CAO was no longer able to make contact with the complainant. As a CAO facilitated dispute resolution process requires voluntary agreement to participate by the complainant and the client at a minimum, and this was not possible in this instance, the case was transferred to CAO Compliance for appraisal.

The purpose of a CAO compliance appraisal is to ensure that compliance investigations are initiated only for those projects that raise substantial concerns about environmental and/or social (E&S) outcomes, and/or issues of systemic importance to IFC/MIGA.

In this case, the complaint raised broad issues regarding the impact of the project on local communities and the environment. However, the complainant identified as being affected only by the project’s impacts on water quality in local rivers. As such this compliance appraisal focuses on the water quality concerns. In conducting the compliance appraisal, CAO was unable to make further contact with the complainant. As a result this appraisal is based primarily on IFC’s project documentation.

CAO notes that this is a category A project meaning that it has potential significant adverse E&S risks and/or impacts as recognized by IFC. However, considering the limited information on the impacts of the project available from the complainant, CAO has not identified substantial concerns regarding E&S outcomes of the project and/or issues of systemic importance to IFC such that would warrant a compliance investigation in accordance with CAO’s Operational Guidelines. Absent further information from the complainant, CAO has decided to close this case. CAO notes that this decision does not preclude a future complaint that provides more details in relation to the issues raised by the complainant or other potential E&S impacts of the project.

## **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](http://www.cao-ombudsman.org)

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## Acronyms

<b>Acronym</b>	<b>Definition</b>
BIGPH	Ballarpur International Graphic Paper Holdings
BILT	Ballarpur Industries Limited
CAO	Office of the Compliance Advisor Ombudsman
E&S	Environmental and Social
ESAP	Environmental and Social Action Plan
ESRS	Environmental and Social Review Summary
GIIP	Good international industry practice
IFC	International Finance Corporation
ITP	Industrial Tree Plantation
MIGA	Multilateral Investment Guarantee Agency
NFM	Natural Forest Management
PS	Performance Standard
SFI	Sabah Forest Industries (subsidiary of BILT)

## **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 can also 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

Ballarpur International Graphic Paper (Bilt Paper or “the client”) is a leading pulp and Paper manufacturer in India and Malaysia. Bilt Paper is a subsidiary of Ballarpur Industries Limited, an existing IFC client in which IFC holds a small equity stake (project number 10066 in 2000 and project number 20798 in 2003). These earlier investments were made prior to IFC’s implementation of the Performance Standards.

In August 2014, the IFC Board approved a \$250 million debt and equity investment in the client and its subsidiary – Sabah Forest Industries (SFI). At the corporate level of Bilt Paper, the purpose of the investment was to i) support the client in sourcing wood from rural households through utilizing modern farming techniques; ii) implement changes in the clients forestry operations; iii) support the client to obtain Forest Stewardship Council or similar certification; and, iv) implement an IFC Performance Standard environmental and social management system.<sup>1</sup>

SFI is an integrated pulp and paper manufacturing unit with a 243,033 million tons per annum (mtpa) pulp and 144,210 mtpa paper manufacturing capacity in Sabah, Malaysia (“SFI project”). The Malaysian government set it up in 1982. In order to ensure sustainability of raw material supply, a captive forest cum plantation concession was leased to SFI. The concession includes approximately 104,000ha zoned as of Natural Forest Management (NFM); approximately 171,000ha zoned as Industrial Tree Plantation (ITP) area, which can be converted to plantation for feeding raw material to the pulp mill, and approximately 12,000ha of land on which SFI has a title. Bilt Paper acquired SFI and the forest cum plantation concession lease in 2007. The purpose of IFC’s investment in SFI was to support plantation expansion.<sup>2</sup>

At present, SFI has approximately 54,000ha Eucalyptus and acacia plantation within the ITP area and titled land. SFI plans to expand this by 30,000ha within the ITP area in order to satisfy the plantation’s mill raw material requirement for the next five years. SFI is also considering, over the medium to long-term and subject to additional environmental assessments, an additional expansion of 45,000ha, increasing the total plantation area to 130,000ha.<sup>3</sup>

### Complaint and CAO Assessment

In September 2014, CAO received a complaint in relation to SFI’s operations Sabah, Malaysia. The complainant raised a series of broad issues regarding the impact of the project on local communities and the environment. Specifically, the complainant contends that the company’s harvesting operations have filled rivers in the catchment area with dirt and mud. The complainant states that these are waters that the community uses for drinking, irrigation, and herding. The complaint also mentions concerns relating to improper takeover of community land, loss of biodiversity, and other environmental impacts.

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<sup>1</sup> IFC Disclosure website (PN 34602), Summary Investment Information. See <http://goo.gl/YJmiFI> (accessed June 7, 2015)

<sup>2</sup> IFC Disclosure website (PN 34602), Environmental and Social Review Summary (ESRS). See <http://goo.gl/gE9LnQ> (accessed June 5, 2015)

<sup>3</sup> *ibid*

The complainant identifies as being a resident of a town in the project area who is affected by the project's impacts on water quality in local rivers. As such this compliance appraisal focuses primarily on the water quality concerns.

Based on information provided by the complainant during the eligibility phase, the complaint was deemed eligible in October 2014. However, after an initial exchange of emails, CAO was no longer able to make contact with the complainant. CAO completed its assessment on the basis of information presented in the complaint and without conducting a field visit. As a CAO facilitated dispute resolution process requires voluntary agreement to participate by the complainant(s) and the client at a minimum, and this was not possible in this instance, the case was transferred to CAO Compliance.

### **III. Analysis**

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

#### **IFC Policies and Procedures**

IFC's investment in the company was made in the context of its 2012 Policy on Environmental and Social Sustainability ("the Sustainability Policy" or SP) and Performance Standards (PS), together referred to as the Sustainability Framework and effective as of January 1, 2012. Through the Sustainability Framework, "IFC seeks to ensure, through its due diligence, monitoring, and supervision efforts, that the business activities it finances are implemented in accordance with the requirements of the Performance Standards" (para. 7).

Before making an investment the Sustainability Policy (SP para. 26) provides that IFC will undertake a process of E&S due diligence in a manner that is "commensurate with the nature, scale, and stage of the business activity and with [its] level of E&S risks and impacts." As a result, IFC "weighs the costs and benefits of the proposed business activity" and presents these to its Board for approval. The E&S due diligence is designed to allow IFC to finance only "investment activities that are expected to meet the requirements of the Performance Standards" (SP para. 22).

As required by the Sustainability Policy, IFC's E&S review should include "(i) reviewing all available information, records and documentation related to the environmental and social risks and impacts of the business activity; (ii) conducting site inspections and interviews of client personnel and relevant stakeholders [...]; (iii) analyzing the business activity's environmental and social performance in relation to the requirements of the Performance Standards ..." (SP para. 28).

In its review, IFC assesses the project in accordance with Performance Standards (PS) requirements. As relevant to the issues raised by the complainant, where a project is expected to release pollutants, IFC requires the client to "minimize and/or control the intensity and mass flow of their release". "Where historical pollution such as ... ground water contamination exists" IFC requires the client "to determine whether it is responsible for mitigation measures" and if so, resolve their liability "in accordance with national law, or where this is silent, with GIIP (good

international industry practice)” (PS3 para. 10). Further, IFC requires the client to “evaluate the risks and impacts to the health and safety” upon communities and “establish preventive and control measures consistent with GIIP” (PS para. 5).

Where IFC identifies gaps during the pre-investment review, to ensure the business activity of the client meets the Performance Standards, IFC and the client agree on an Environmental and Social Action Plan (ESAP) which includes any necessary conditions of IFC’s investment (para. 28). Prior to approval, IFC is required to disclose an Environmental and Social Review Summary (ESRS) detailing the findings and recommendations from its pre-investment review. As part of this disclosure, IFC is required to disclose relevant E&S assessments prepared by or on behalf of the client.<sup>4</sup>

Once the project is approved and IFC has invested in the client, the investment is monitored throughout the project cycle to ensure compliance with the conditions in the legal agreements and IFC’s applicable policies and standards.

### **IFC’s Appraisal and Supervision of Environmental and Social Risks**

For the purpose of this compliance appraisal, a key question is whether IFC conducted an adequate pre-investment review of potential risks and impacts of the project as relates to the water concern raised by the complainant.

During IFC’s pre-investment due diligence, IFC noted that SFI’s operations and plantation expansion plan had the potential to result in significant adverse E&S risks and/or impacts. Accordingly, IFC assigned the project an E&S risk categorization of “A”.<sup>5</sup> IFC noted that the most significant risks and impacts related to i) biodiversity, ii) indigenous peoples’ livelihoods, and iii) potential impacts on cultural heritage. Accordingly, IFC assessed the SFI project against the requirements of PS1-8.<sup>6</sup>

As part of its review of the SFI project, IFC staff reviewed a 2002 environmental impact assessment (EIA) and a 2008 supplementary EIA, as well as a retrospective Social Impact Assessment (SIA), and a biodiversity assessment all undertaken by a third party consultant in 2014. IFC also reviewed long term water data and regulatory submissions from the client. IFC staff met with corporate and plant level management responsible for SFI’s operations, representatives of affected communities, local government agencies and an NGO operating in the Silitang district of Sabah, Malaysia.

In reviewing the project’s impacts on water quality, the December 2008 EIA noted that soil erosion from logging and plantation activities could have major adverse environmental impacts on water quality and, as a consequence, impacts on local communities. As mitigation measures, the EIA proposed implementation of riverine reserves, erosion control measures, measures to control water surface runoff and a two-way stakeholder engagement process. In order to ensure implementation, the EIA proposed water quality monitoring at an additional six locations on the project site.

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<sup>4</sup> IFC Access to Information Policy 2012, para 31 (a)

<sup>5</sup> A Category A project involve “[b]usiness activities with potential significant adverse environmental or social risks and/or impacts that are diverse, irreversible, or unprecedented.” IFC Sustainability Policy (2012).

<sup>6</sup> IFC Disclosure website (PN 34602), Summary Investment Information. See <http://goo.gl/YJmiFI> (accessed June 7, 2015)



The June 2014 SIA noted that local communities are primarily dependent on surface water.<sup>7</sup> A “key area of concern” is identified in the executive summary of the 2014 SIA as follows:

*Logging in the water catchment zones of the rivers have the potential therefore of increased soil erosion and pollution of rivers and in some cases resulting in mud flood situations in the communities (p. xxix).*

Further, the SIA noted concerns that: i) logging activities in dry months have led to an increase in water pollution to the extent that water is considered unfit for consumption, and ii) illegal logging has resulted in soil erosion resulting in pollution of community water sources.<sup>8</sup>

In relation to water issues, IFC advised CAO that the focus of its review was on the systems and procedures that the client had implemented to prevent impact on streams and water quality within the project’s concession area. IFC also advised CAO that in its review of its client’s stakeholder engagement the primary concern raised by communities related to the project’s impacts on land, livelihoods and indigenous people’s rights. IFC further noted that its review of the cumulative impacts of the project did not raise significant concerns in relation to water pollution due to the location and limited scale of project activity at any one point in time relative to the size of the concession area.

In its ESRS, IFC concluded that the client was mitigating social impacts linked to pollution of rivers/streams and water sources through measures including: “a) leaving aside prescribed buffers as per the EIA on either side of riverine reserves, b) protection of riparian reserves; c) avoidance of activities within a specified distance of any surface water body.” IFC also noted that the client would “based on the concerns and grievances raised by the communities, identify sources of any pollution, develop and implement environmental mitigation aligned to good international industry practice.”<sup>9</sup>

Measures relevant to water quality were also included in the client’s ESAP. Specifically, the client agreed to i) implement a comprehensive ambient condition monitoring program for ambient air, marine environment and ground water, ii) operate as close to GIIP norms as is technically feasible and cost effective, and iii) prepare a plan to phase out the use of certain pesticides.

Prior to IFC’s first disbursement, the client was required to complete a third party audit confirming implementation of corrective actions referenced in the ESAP and ESRS. IFC’s initial supervision of the project, has included reviews of quarterly third party audit reports and site supervision visits. Initial audits, completed in 2014, raise concerns regarding the client’s monitoring of effluent from its processing plant but do not mention the erosion or silting issues raised by the complainant.

While concluding that the client’s ESAP is largely on track, IFC’s supervision has noted delays in the development of its systems for identifying and responding to key areas of E&S risk. Further, IFC has noted that strengthening the client’s capacity to manage environmental, health and safety issues should remain an area of focus during project supervision.

CAO notes that, while IFC disclosed the client’s E&S documentation from 2014, the 2002 and 2008 EIAs, which are referenced in IFC’s published ESRS, have not been disclosed. CAO also

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<sup>7</sup> Social Impact Assessment for Developed Areas: Sabah Forest Industries (SFI), Malaysia. June 2014. <http://goo.gl/Ysor4K> (Accessed June 15, 2015)

<sup>8</sup> Retrospective SIA, June 2014, page 131 and 188. See *Availability of Full Documentation* at <http://goo.gl/gE9LnQ> (accessed June 5, 2015)

<sup>9</sup> IFC Disclosure website (PN 34602), Environmental and Social Review Summary (ESRS), *E&S Risks/Impacts and Mitigation*. See <http://goo.gl/gE9LnQ> (accessed June 5, 2015).

notes IFC's commitment to disclosing the client's quarterly third party audits, and ESAP status updates, in accordance with its Access to Information Policy (2012, para. 41).

### Conclusion

In the course of its pre-investment due diligence, IFC reviewed E&S assessment documentation and determined that this was a Category A project having potential significant adverse E&S risks and/or impacts. Impacts on water quality were identified as part of this process. Relevant to the issues raised by the complainant, IFC concluded that the client was implementing measures to mitigate impacts linked to pollution of rivers/streams and water sources. At the same time, it was agreed that the client would identify sources of pollution causing concerns for communities and address these based on good international industry practice.<sup>10</sup> It was also agreed that the client would monitor water pollution levels on an ongoing basis and commission regular third party audits of its E&S performance. Progress towards implementation of agreed E&S mitigation measures were established as conditions of commitment and disbursement. Based on the information reviewed in the course of this compliance appraisal, however, it is unclear to CAO whether the complainant's concerns regarding the project's impacts on water quality are being satisfactorily addressed. This is a result of: (a) the limited information provided in the complaint; and (b) a lack of relevant information in IFC's supervision documentation.

## **IV. Decision**

The purpose of a CAO compliance appraisal is to determine whether an investigation of IFC's E&S performance is required. In deciding whether to initiate an investigation, CAO weighs factors including the magnitude of the E&S concerns raised in 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.

In this case, the complaint raised broad issues regarding the impact of the project on local communities and the environment. However, the complainant identified as being affected only by the project's impacts on water quality in local rivers. As such this compliance appraisal has focused on the water quality concerns. In conducting the compliance appraisal, CAO was unable to make further contact with the complainant. As a result this appraisal is based primarily on IFC's project documentation.

CAO notes that this is a category A project meaning that it has potential significant adverse E&S risks and/or impacts as recognized by IFC. However, considering the limited information on the impacts of the project available from the complainant, CAO has not identified substantial concerns regarding E&S outcomes of the project and/or issues of systemic importance to IFC such that would warrant a compliance investigation in accordance with CAO's Operational Guidelines. Absent further information from the complainant, CAO has decided to close this case. CAO notes that this decision does not preclude a future complaint that provides more details in relation to the issues raised by the complainant or other potential E&S impacts of the project.

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<sup>10</sup> IFC Disclosure website (PN 34602), Environmental and Social Review Summary (ESRS), *E&S Risks/Impacts and Mitigation*. See <http://goo.gl/gE9LnQ> (accessed June 5, 2015).