January 8, 2016
Office of the Compliance Advisor Ombudsman (CAO)

COMPLIANCE APPRAISAL: SUMMARY OF RESULTS

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

Complaint #02

Ballarpur International Graphic Paper Holdings (Bilt Paper) is a leading pulp and paper manufacturer with operations 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 October 2014, IFC committed a $250 million debt and equity investment in Bilt Paper and its subsidiary – Sabah Forest Industries (SFI or the company). SFI is a large integrated pulp and paper manufacturing company in Sabah, Malaysia. The purpose of IFC's investment in the company was to support the expansion of its plantations. IFC purchased the Bilt Paper equity in October 2014, but the loan to SFI was not disbursed.

In June 2015, CAO received a complaint in relation to SFI. The complaint was lodged by Building and Woodworkers International (BWI) union on behalf of the Sabah Timber Industry Employees Union (STIEU), a BWI affiliate in Sabah, Malaysia. The complainants allege that the company has persistently hindered workers' efforts to unionize in breach of ILO and IFC standards. The company has indicated that it supports the rights of workers to associate in accordance with the requirements of Malaysian law.

In September 2015, Bilt Paper announced that it had agreed to sell its stake in SFI. At the time of writing the sale was pending completion.

The purpose of a CAO compliance appraisal is to ensure that compliance investigations are initiated only in relation to projects that raise substantial concerns regarding environmental and social (E&S) outcomes and/or issues of systemic importance to IFC. In deciding whether to initiate an investigation, CAO weighs factors including the magnitude of the 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.

The complainants in this compliance process raise concerns regarding the rights of SFI employees to form and join workers' organizations of their choosing as required by IFC Performance Standard (PS) 2 – Labor and Working Conditions. IFC was aware of these concerns when it approved the project and has followed the issues during project supervision. It is unclear, however, from the material available whether IFC's handling of these concerns was consistent with the requirements of PS2, in particular: (a) whether IFC's pre-investment review of the issues was commensurate to risk; and (b) whether IFC's supervision of the project was sufficient to assess the status of the project's compliance with the Performance Standards. In these circumstances, CAO concludes that a compliance investigation is warranted. Terms of Reference for the compliance investigation will be issued in accordance with CAO's Operational Guidelines.

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
BIGPH	Ballarpur International Graphic Paper Holdings
BILT	Ballarpur Industries Limited
BWI	Building and Woodworkers International
CAO	Office of the Compliance Advisor Ombudsman
E&S	Environmental and Social
ESAP	Environmental and Social Action Plan
ESRS	Environmental and Social Review Summary
HR	Human Resources
IFC	International Finance Corporation
ITC	Integrated Timber Complex
ITP	Industrial Tree Plantation
JCC	Joint Consultative Committee
LWCA	Labor and Work Conditions Audit
MIGA	Multilateral Investment Guarantee Agency
MTPA	Million Tons Per Annum
NFM	Natural Forest Management
PnP	Pulp and Paper
PS	Performance Standard
SFI	Sabah Forest Industries (subsidiary of BILT)
SFIEU	Sabah Forests Industries Employees Union
SP	Sustainability Policy (IFC)
STIEU	Sabah Timber Industry Employees Union

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) 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 (projects #10066 and #20798). These earlier investments were made prior to IFC's adoption of the Performance Standards.

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

The company has 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 ("the project"). The Malaysian government established the project 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 of land zoned for Natural Forest Management (NFM); approximately 171,000ha of land zoned for Industrial Tree Plantation (ITP), which can be converted to plantation for feeding raw material to the pulp mill; and approximately 12,000ha of land for which the company has title. Bilt Paper acquired the company and the forest cum plantation concession lease in 2007. The purpose of IFC's investment in the project was to support plantation expansion.[2] IFC purchased the Bilt Paper equity in October 2014, but the loan to SFI was not disbursed.

In September 2015, Bilt Paper announced that it had agreed to sell its entire stake in SFI to a Malaysisan company, Pandawa Sakti.[3] At the time of writing the sale was pending completion.

Complaint and CAO Assessment

In June 2015, CAO received a complaint in relation to the company's operations in Sabah, Malaysia. The complaint was lodged by the Building and Woodworkers International (BWI) union on behalf of the Sabah Timber Industry Employees Union (STIEU), a BWI affiliate in Sabah. The complaint raised labor concerns regarding freedom of association for SFI workers and the company's non-compliance with provisions of IFC's Performance Standard 2 (PS2) on Labor and working conditions.

As documented in the CAO Assessment Report[4], the complainants reiterated their concerns about the lack of freedom of association and collective bargaining within SFI's operations in Malaysia. They explained that rather than engaging with the workers in good faith, the company has persistently hindered the workers efforts to unionize. They further informed CAO that SFI has filed three judicial reviews of STIEU's voting process which legally challenges STIEU's effort to

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[1] IFC Disclosure website (PN 34602), Summary Investment Information. See http://goo.gl/YJmiFl

[2] IFC Disclosure website (PN 34602), Environmental and Social Review Summary (ESRS). See http://goo.gl/gE9LnQ

[3] Livemint (Sept. 2015) *Bilt to sell entire stake in SFI,* http://goo.gl/sKxbNh

[4] CAO Assessment Report – Second Complaint regarding IFC investment in Bilt Paper B.V. See http://goo.gl/LoEbLw

gain recognition. The complainants contend that these actions by SFI contravene Malaysia's labor law on freedom of association as well as IFC's PS2. They report having raised their concerns both with the company and IFC, but do not believe that subsequent actions have addressed the issue or allowed the workers to freely choose a union to represent them.

The company expressed their support for workers to unionize. However, they stated that based on their understanding, the current set up of STIEU does not meet the requirements for recognition under Malaysian law (Trade Unions Act 1955). As a result, SFI has challenged the legality of STIEU.

The complainants indicated a preference for the case to be handled by CAO's compliance function. Since a CAO dispute resolution process requires voluntary agreement to participate by the complainant and Company at a minimum, this complaint was referred to the CAO compliance function in October 2015.

III. Analysis

This section outlines IFC's E&S policies and procedures as applicable 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.[5]"

The Sustainability Policy 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.[6]" 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.[7]"

At the pre-investment stage, IFC is required to consider the application of Performance Standard 2: Labor and Working Conditions (PS2) in relation to the client's employees. Relevant to this compliance appraisal, IFC is required to assure itself that the client will comply with the following PS2 provisions that relate to "Workers' Organizations":

- "In countries where national law recognizes workers' rights to form and to join workers' organizations of their choosing without interference and to bargain collectively, the client

[5] IFC Sustainability Policy, paragraph 7- http://goo.gl/v7B5cH
[6] IFC Sustainability Policy, paragraph 6
[7] IFC Sustainability Policy, paragraph 22

will comply with national law. Where national law substantially restricts workers' organizations, the client will not restrict workers from developing alternative mechanisms to express their grievances and protect their rights regarding working conditions and terms of employment. The client should not seek to influence or control these mechanisms",[8] and

- "In either case described in above paragraph, and where national law is silent, the client will not discourage workers from electing worker representatives, forming or joining workers' organizations of their choosing, or from bargaining collectively, and will not discriminate or retaliate against workers who participate, or seek to participate, in such organizations and collective bargaining. The client will engage with such workers' representatives and workers' organizations, and provide them with information needed for meaningful negotiation in a timely manner. Workers' organizations are expected to fairly represent the workers in the workforce.[9]"

Where IFC identifies gaps during its 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.[10] 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.

Following approval and disbursement IFC is responsible for supervising the E&S performance of its investments. The purpose of supervision is to obtain information to assess the status of the project's compliance with the Performance Standards and other specific E&S requirements agreed at commitment.[11] If the client fails to comply with its E&S commitments, as expressed in the environmental and social conditions for investment, IFC will work to bring it back into compliance to the extent feasible, and if the client fails to reestablish compliance, IFC will exercise remedies as appropriate.[12]

IFC's Appraisal and Supervision of Environmental and Social Risks

This section of the appraisal analyzes IFC's performance against its policies and procedures prior to commitment and during the supervision of the project in the context of the labor concerns raised by the complainants.

Labor related issues were considered part of IFC's pre-investment E&S review of the company. The findings of IFC's review are documented in IFC's Environmental and Social Review Summary (ESRS) of June 2014.[13] At this point, IFC also reviewed the company's Human Resources (HR) policies and procedures and a Labor and Working Conditions Audit (LWCA)[14] commissioned by the company.

The LWCA notes that there was no "formally registered union that is active" at the company. The LWCA, however, notes that in 1990 a number of SFI employees formed Sabah Forests Industries

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[8] IFC Performance Standards (2012), PS2, paragraph 13 - http://goo.gl/yp5xJ3
[9] IFC Performance Standards (2012), PS2, paragraph 14
[10] IFC Sustainability Policy, paragraph 28 - http://goo.gl/v7B5cH
[11] IFC E&S Review Procedures (2014) para. 6.1 - http://goo.gl/9huCWn
[12] IFC Sustainability Policy, paragraph 45
[13] IFC Disclosure website (PN 34602), Environmental and Social Review Summary (ESRS), *E&S Risks/Impacts and Mitigation*. See http://goo.gl/gE9LnQ (accessed November 2, 2015).
[14] Labour and Working Conditions Audit: Sabah Forest Industries (SFI), Malaysia – Draft Final Report. See http://goo.gl/HZY04L (accessed November 11, 2015)

Employees Union (SFIEU) and requested that the company officially recognize their union. The LWCA further notes that this request was rejected by the company on the basis that: (a) the documentation relevant to union formation was not in proper order and (b) a significant number of the employees who wanted to join were from departments (administrative, security and managerial) that were restricted from joining unions as per the stipulations of the Trade Unions Act (1955).

According to the LWCA, SFIEU then lodged a complaint regarding the issue with the Department of Industrial Relations under the Ministry of Human Resources ("The Ministry"). Upon SFI's acquisition by Bilt Paper in 2009, the Ministry forwarded a directive to the company to formally recognize the union. SFI subsequently challenged this decision by filing a judicial review of the case in the high court. It is reported that on October 6, 2009, the previous ruling was overturned in favor of SFI. Following this ruling, the LWCA describes the following chain of events:

- SFI employees became affiliated to an external union – Sabah Timber Industries Employees Union (STIEU), whose objective was to negotiate a collective bargaining agreement on the employees' behalf. STIEU was rejected by the company on the basis that the union was primarily for timber industries employees and SFI's pulp and paper employees were not considered to be under that work sector.
- The company's action was challenged by STIEU, which filed a complaint with the Ministry, which in turn issued a ruling in favor of the employees' affiliation to STIEU. On January 26, 2011, a notice was sent to SFI to recognize the union.
- On August 10, 2011, SFI filed a second judicial review of the case but the review application was dismissed by the High Court. Subsequently, a notice of appeal was filed by SFI on August 17, 2011.
- On November 27, 2012, the Court of Appeal ruled in favor of SFI and the January 2011 notice to SFI to recognize STIEU was quashed.

The LWCA notes that the company proceeded to form an alternative workers' association - the Joint Consultative Committee (JCC), an internal platform for the company to address employee grievances. However, the employees have not been actively engaged in the JCC and continue to push for the recognition of STIEU through the Ministry.

Based on the above findings, the LWCA indicates that SFI's practices are only partially aligned with the workers' organizations requirements of PS2, noting that SFI is not against formation of a union provided that "it is an internal union and not affiliated to any external entities which may lead to external influence on the company's operations and labor management."[15] In conclusion, the LWCA report recommends that the company sustain support for the JCC and ensure a transparent mediation process between the various stakeholders (i.e. the worker representatives, the government authorities, and the SFI management) to resolve the union issue.[16]

IFC's ESRS acknowledges the LWCA report findings and confirms that the freedom of association issue is of concern to workers. The ESRS also notes that the JCC is a temporary measure; that SFI commits to not opposing the unionizing of its workers, and that it will undertake steps to facilitate the formation of a union.

Following IFC's E&S review, the company agreed to an Environmental and Social Action Plan (ESAP)[17] that included remedial actions responding to issues identified in the LWCA. For example, the ESAP required the company to complete the development of upgraded HR Policies and Procedures; and also to upgrade its Grievance Management System in line with

[15] Labour and Working Conditions Audit. p.59.
[16] Labour and Working Conditions Audit. p. 58f.
[17] E&S Action Plans http://goo.gl/gNGDXm (Accessed November 17, 2015)

recommendations of the labor audit and the ESRS. The ESAP also included a requirement that a: "Third Party quarterly audit [is] completed and … confirms implementation of SFI specific HR Policies and Procedures, in addition to confirming on schedule implementation of the various mitigation measures described in the ESRS, the management plans referenced in the ESRS and this ESAP." However, the ESAP does not include specific mitigation measures to address the freedom of association issues identified in the LWCA.

IFC's investment was approved by its Board in August 2014, and IFC made its equity investment in Bilt Paper in October 2014.

During project supervision, IFC monitored the company's implementation of the general labor related actions as listed in the ESAP. IFC's monitoring included site visits and a review of SFI's quarterly third party audit reports. Documentation in relation to IFC's supervision of the freedom of association concerns raised by the complainants is limited. As explained to CAO, the IFC team's approach to these issues was to allow the government process to go through and recommend that the company accept the results without conditions.

Conclusion

The complainants in this compliance process raise concerns regarding the rights of SFI employees to form and join workers' organizations of their choosing as required by IFC Performance Standard (PS) 2 – Labor and Working Conditions. IFC was aware of these concerns when it approved the project, and has followed the issues during project supervision. It is unclear, however, from the material available whether IFC's handling of these concerns was consistent with the requirements of PS2, in particular: (a) whether IFC's pre-investment review of the issues was commensurate to risk; and (b) whether IFC's supervision of the project was sufficient to assess the status of project's compliance with the Performance Standards.

IV. Decision

The purpose of a CAO compliance appraisal is to determine whether an investigation of IFC's E&S performance in relation to a project 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.

The complaints in this compliance process raise substantial concerns as relate to the ability of employees of the company to organize a union as provided by PS2. Having considered IFC's approach to the review and supervision of this investment, CAO concludes that a compliance investigation is warranted. Terms of Reference for the compliance investigation will be issued in accordance with CAO's Operational Guidelines.