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Office of the Compliance Advisor Ombudsman (CAO)

COMPLIANCE INVESTIGATION

*IFC Investment in Bilt Paper B.V. (Project #34602), Malaysia
Complaint 02*

CAO Investigation of IFC Environmental and Social Performance in Relation to: Bilt Paper B.V., Malaysia (Bilt-02)

Office of the Compliance Advisor Ombudsman for the
International Finance Corporation (IFC) and the
Multilateral Investment Guarantee Agency (MIGA),
Members of the World Bank Group

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).

CAO's Compliance function oversees investigations of IFC/MIGA's environmental and social performance, particularly in relation to sensitive projects, to ensure compliance with policies, standards, guidelines, procedures, and conditions for IFC/MIGA involvement, with the goal of improving IFC/MIGA environmental and social performance.

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

Executive Summary

Bilt Paper B.V. (Bilt Paper), a pulp and paper manufacturer in India and Malaysia, is a subsidiary of Ballarpur Industries Limited (BILT). In August 2014, IFC approved a US\$250 million debt and equity investment in Bilt Paper and its subsidiary in Malaysia – Sabah Forest Industries (SFI or “the client”, and together with Bilt Paper, “the company”). The investment was structured as a US\$100 million equity investment in Bilt Paper, and loans of up to \$150 million to SFI. In October 2014, IFC purchased the equity in Bilt Paper, however the three loans were not disbursed.

At the time of finalizing of this report, SFI had gone into receivership to avoid compulsory liquidation. The client had also implemented a temporary layoff program affecting all its workers. IFC retained its ownership share in SFI through its equity investment.

This compliance investigation was initiated in response to a 2015 complaint to CAO from the Building and Woodworkers International (BWI) union on behalf of the Sabah Timber Industry Employees Union (STIEU), a BWI affiliate which sought to organize timber workers in the state of Sabah, Malaysia. The complainants allege that the company has persistently hindered workers’ efforts to unionize, by mounting a series of legal challenges to the recognition of STIEU and other measures. The complainants contend that the client’s actions contravene IFC’s Performance Standard 2 on Labor and Working Conditions, Malaysian laws on freedom of association, and international labor standards. A similar complaint was lodged with IFC prior to approval of the investment in 2014.

In Performance Standard 2, IFC recognizes that the pursuit of economic growth through employment creation should be accompanied by protection of the fundamental rights of workers, including those established by the ILO Convention on Freedom of Association. This compliance investigation considers whether IFC properly applied related Performance Standard 2 requirements to the company. Relevant to the issues raised by the complainants these include requirements: (a) not to discourage workers from forming or joining organizations of their choosing and (b) to refrain from attempts to influence and control workers’ organizations.

CAO finds that IFC did not correctly apply these requirements to SFI, thus contributing to a situation where SFI has been able to avoid recognition of STIEU to date.

Prior to investing, IFC conducted a general review of labor issues at SFI and required the client to commission a labor audit. However, neither the labor audit nor IFC’s review of the project considered PS2 compliance issues arising from the client’s longstanding opposition to the formation of a union. This issue remained live at the time of IFC’s investment. As noted in the labor audit, the client was only willing to support the formation of a union if it was internal to the company (an “in-house union”) and not affiliated to any external union. This position was, on its face, contrary to the principles of Freedom of Association as elaborated in Performance Standard 2. While the client agreed with IFC that it would not oppose formation of “a union”, details of what this meant were left unclear. In this context, CAO finds that IFC’s pre-investment review and

mitigation of risks associated with the union recognition issue were insufficient to provide assurance of Performance Standard 2 compliance.

Following approval of the project in 2014, CAO finds that IFC did not adequately supervise the company in relation to the union recognition issue. During the initial stages of supervision (2014/15) IFC did not conduct the analysis necessary to assess the client's compliance, despite evidence that the client continued to obstruct recognition of STIEU. The client's actions during this period included: (a) continued communications to employees and auditors that it would only recognize an in-house union; and (b) initiation of judicial review proceedings that delayed the government-facilitated process for recognition of STIEU.

From September 2015 to July 2016, IFC's supervision of the project was effectively suspended while the company tried to sell its Malaysian business. This was done at the request of the company, to avoid or minimize any transaction related sensitivities. CAO finds that this was inconsistent with IFC's duty to supervise the client's E&S performance, particularly when the union formation dispute was ongoing.

IFC acknowledges that, from June 2016, the client's continued resistance to recognition of the STIEU constituted non-compliance with PS2. In September 2016, IFC proposed that the client permit the government-facilitated union recognition process to move forward on a provisional basis, pending resolution of its court proceedings. This was a course of action that IFC held would satisfy PS2 requirements on Freedom of Association. However, the client rejected IFC's recommendation, deciding rather to continue to contest recognition of STIEU through the courts.

In circumstances where a client fails to comply with its E&S commitments, IFC is required to work with the client to reestablish compliance. If this fails, IFC is required to exercise remedies as appropriate. CAO finds no evidence that IFC considered remedies or communicated to the client that remedies could be exercised if the client did not comply.

In summary, CAO finds that IFC did not discharge its supervision duty in relation to the Freedom of Association issues raised by the complainants: (a) during the initial stages of supervision (2014/15), because IFC did not conduct the analysis necessary to determine the client's compliance; (b) during 2015/16, because IFC suspended supervision at the client's request; and (c) post 2016, because IFC did not exercise remedies in relation to a client that it acknowledged was in breach of PS2, and was unwilling to accept IFC advice on the issue.

CAO has identified a number of underlying causes of IFC's non-compliance in this case. First, the IFC team did not draw on specialist expertise needed to conduct a robust analysis of the union issues at SFI. Second, IFC's expectation that the client would cooperate with the government-facilitated union formation process—and that such cooperation would satisfy PS2—was not justified in the absence of a clear commitment from the client. Third, IFC pursued opportunities to facilitate dialogue between the client and worker representatives at the expense of ensuring client compliance with PS2. And finally, IFC did not consider the substance of the client's judicial review claims, and did not address the impacts of the client's litigation strategy on the workers' efforts to organize.

CAO concludes that shortcomings in IFC's review and supervision of this project have contributed to adverse outcomes for the complainants. The recognition of the worker's preferred union, STIEU has been delayed. As a result, workers have been deprived of representation. During CAO's site visit, workers highlighted concerns about unpaid annual salary increments, health and safety issues, social welfare and medical issues. CAO notes that, in the absence of any recognized worker representatives, the client has undergone substantial financial constraints and SFI employees have been further impacted as a temporary layoff scheme has been implemented. Membership of a union that can negotiate on behalf of workers in relation to these types of issues is a right under international law and one which is recognized in IFC's Performance Standards. This right was denied to the workers of SFI for a period of over three years from the date of IFC's investment.

Given the findings of this report, CAO will keep this investigation open and monitor IFC's response.

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Abbreviations and Acronyms

Acronym	Definition
ASI	Accreditation Services International
AMR	Annual Monitoring Report
BCS	Broad community support
BILT	Ballarpur Industries Limited
BWI	Builders and Woodworkers International
CAO	Office of the Compliance Advisor Ombudsman (IFC and MIGA)
CES	Environment, Social and Governance Department
DGIR	Director General for the Sabah Industrial Relations Department
E&S	Environmental and Social
EIA	Environmental Impact Assessment (at national level)
EMP	Environmental Monitoring Plan
ESAP	Environmental and Social Action Plan
ESIA	Environmental and Social Impact Assessment
ESMS	Environmental and Social Management System
ESRS	Environmental and Social Review Summary
ESRP	Environmental and Social Review Procedures
FSC	Forest Stewardship Council
GIIP	Good international industry practice
HR	Human resources
IFC	International Finance Corporation
ILO	International Labor Organization
ITC	Integrated Timber Complex
ITP	Industrial Tree Plantation
JCC	Joint Consultative Committee
LWCA	Labor and Working Conditions Audit
MIGA	Multilateral Investment Guarantee Agency
MOHR	Ministry of Human Resources
mtpa	million tons per annum
NGO	Non-Governmental Organization
PnP	Pulp and Paper
PS	Performance Standards
SFI	Sabah Forest Industries
SFIEU	Sabah Forest Industries Employees Union
STIEU	Sabah Timber Industries Employees Union
SPI	Summary of Proposed Investment
TOR	Terms of Reference
TUD	Trade Union Division
WBG	World Bank Group

Overview of CAO's Compliance Process

CAO's approach to its compliance mandate is set out in its *Operational Guidelines* (March 2013).

When CAO receives an eligible complaint, it first undergoes an assessment to determine how CAO should respond. If CAO's compliance function is triggered, CAO will conduct an appraisal of IFC's/MIGA's involvement in the project and determine whether an investigation is warranted. CAO's compliance function can also be triggered by the World Bank Group President, the CAO Vice President, or senior management of IFC/MIGA.

CAO compliance investigations focus on IFC/MIGA and how IFC/MIGA assured itself/themselves of a project's environmental and social (E&S) performance. The purpose of a CAO compliance investigation is to ensure compliance with policies, standards, guidelines, procedures, and conditions for IFC/MIGA involvement, and thereby improve the institution's E&S performance.

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

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

In many cases, in assessing the performance of a project and implementation of measures to meet relevant requirements, it is necessary to review the actions of the IFC client and to verify outcomes in the field.

CAO has no authority with respect to judicial processes. CAO is neither a court of appeal nor a legal enforcement mechanism, nor is CAO a substitute for international court systems or court systems in host countries.

Upon finalizing a compliance investigation, IFC/MIGA is given 20 working days to prepare a public response. The compliance investigation report, together with any response from IFC/MIGA is then sent to the World Bank Group President for clearance, after which it is made public on CAO's website (www.cao-ombudsman.org).

In cases where IFC/MIGA is found to be out of compliance, CAO keeps the investigation open and monitors the situation until actions taken by IFC/MIGA assure CAO that IFC/MIGA is addressing the noncompliance. CAO will then close the compliance investigation.

1 Background

1.1 IFC Investment in Bilt Paper B.V. and Sabah Forest Industries

Bilt Paper B.V. (Bilt Paper) is a leading pulp and paper manufacturer in India and Malaysia. Bilt Paper is a subsidiary of Ballarpur Industries Limited (BILT), an existing IFC client in which IFC holds an equity stake (projects #10066 and #20798). These earlier investments were made several years prior to IFC's adoption of the 2006 Performance Standards.

In August 2014, the IFC board approved a US\$250 million debt and equity investment in Bilt Paper and its subsidiary in Malaysia – Sabah Forest Industries (SFI or “the client”, and together with Bilt Paper, “the company”). The investment was to comprise US\$100 million equity in Bilt Paper, and three loans to SFI: an A loan of up to US\$50 million, a B loan of up to US\$62.5 million, and a syndicated loan of up to US\$37.5 million (IFC Project #34602).

SFI owns an integrated pulp and paper manufacturing unit, and holds the lease on a large concession of natural forest and industrial tree plantations in Sabah, Malaysia. The Malaysian government established the project in 1982, and it was later bought by a private entity – Lions Group. Bilt Paper acquired SFI and the concession lease from Lions Group in 2007.

IFC's investment was expected to deliver a number of development impacts. As disclosed by IFC these included:¹

1. Supporting rural households through sourcing wood, helping farmers use more modern techniques to improve yield and incentivizing farms to meet quality standards.
2. Sharing best available technology and practices to increase the efficiency of the forestry operations, and supporting the company's efforts to implement changes and improve its operations.
3. Obtaining and implementing Forest Stewardship Council (FSC) or a similar certification of sustainable forest and land management that conserves biodiversity, soil and water resources and safeguards the health and ecological functions of ecosystems, and leads to a strong demonstration effect.
4. Supporting company restructuring and thus contributing to the overall modernization of the industry.

IFC purchased Bilt Paper equity in October 2014. The proposed A loan and syndicated loan to SFI were committed in October 2014 but not disbursed. In September 2015, Bilt Paper announced that it had agreed to sell its entire stake in SFI. IFC cancelled its pending loan disbursements in

¹ IFC Project Information Portal, “Ballarpur International Graphic Paper Holdings B.V.: Summary of Investment Information,” disclosed June 26, 2014, available at: <https://goo.gl/jTayUo>.

October 2015. However, the sale did not go ahead.² At the time of publication, IFC retains its ownership share in SFI through its equity investment in Bilt Paper.

In 2016 and 2017, BILT and its group companies, including SFI, faced increasing debt servicing costs and reduced revenues.³ Additionally, SFI confronted liquidity constraints which resulted in temporary shutdowns and reduced productivity.⁴ In April 2017, media reports indicated that BILT was in talks with a Chinese corporation for the sale of SFI.⁵

In 2017, BILT entered into a significant financial restructuring plan, including a debt to equity conversion.⁶ In its 2016-2017 Annual Report, BILT noted that BILT Graphic Paper Products Limited was also undergoing financial restructuring, and stated that the BILT board remained on the lookout to sell SFI.⁷ In mid-2017, SFI was taken under receivership at the petition of creditors.⁸ In November 2017, SFI announced that it was implementing a temporary layoff program.⁹ At the date of publication of this report, SFI was financially classified as a “discontinued operation”.¹⁰

1.2 Complaint

In June 2015, CAO received a complaint in relation to the company's operations in Sabah, Malaysia.¹¹ 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, Malaysia. The complaint raised labor concerns regarding freedom of association (FoA) for SFI workers and alleged that SFI was not in compliance with provisions of IFC's Performance Standard 2: Labor and Working Conditions (PS2).

The complainants allege that, rather than engaging with workers in good faith, the company has persistently hindered workers' efforts to unionize. In particular, the complaint refers to legal challenges brought by the company to prevent recognition of STIEU. The complainants contend that the client's actions contravene PS2 requirements, Malaysian laws on freedom of association, and international labor standards.

² Annual Report, Bilt, 2015-2016, p. 7, available at: <https://goo.gl/eXYJIN>.

³ Annual Report, Bilt, 2016-17, pp. 5-6, available at: <https://goo.gl/tbNZDt>.

⁴ Daily Express, September 30, 2016, “Bid to recover RM13m debt,” available at: <https://goo.gl/tMt4mf>; Annual Report, Bilt, 2016-17, p. 11, available at: <https://goo.gl/tbNZDt>.

⁵ Indulal PM, Arijit Barman, “Ballarpur Industries in talks to sell Malaysian arm to China’s Nine Dragons,” Economic Times, 24 April 2017, available at: <https://goo.gl/7Pb7hR>.

⁶ Annual Report, Bilt, 2016-17, p. 8, available at: <https://goo.gl/tbNZDt>.

⁷ Ibid. p. 6.

⁸ The Borneo Post, December 1, 2017, “SFI to temporarily lay off its Staff,” available at: <https://goo.gl/C3nxv4>.

⁹ Olivia Miwil, “Sabah Forest Industries announces temporary layoff programme,” New Straits Times, November 30, 2017, available at: <https://goo.gl/fzywaM>.

¹⁰ Annual Report, Bilt, 2016-17, p. 6, available at: <https://goo.gl/tbNZDt>.

¹¹ BWI. “Letter of Complaint to CAO.” 29 May 2015. Available at: <https://goo.gl/o5LM4N>.

1.3 Scope of Compliance Investigation

In May 2016, CAO published terms of reference defining the scope of this compliance investigation.¹² In the context of IFC's E&S policies, Performance Standards and procedures, CAO's specific questions in relation to the investment are:

1. Whether IFC's pre-investment review was commensurate to risk, particularly in relation to union issues?
2. Whether IFC responded adequately to freedom of association issues identified in the client's Labor and Working Conditions Audit?
3. Whether IFC's supervision of the project was sufficient to assess the status of project's compliance with the requirements of the Performance Standards, specifically as relates to freedom of association issues?

1.4 Investigation Methodology

This investigation was conducted in accordance with the CAO Operational Guidelines (2013) with inputs from CAO staff and an expert panelist. The CAO investigation team reviewed available documentation and visited the company in Malaysia in October 2016. The team interviewed Bilt Paper and SFI management and staff, as well as representatives of the complainant unions and SFI workers, some of whom were members of STIEU and others who were not. The team also interviewed and consulted with key informants regarding laws and practice on FoA and industrial relations in Malaysia.

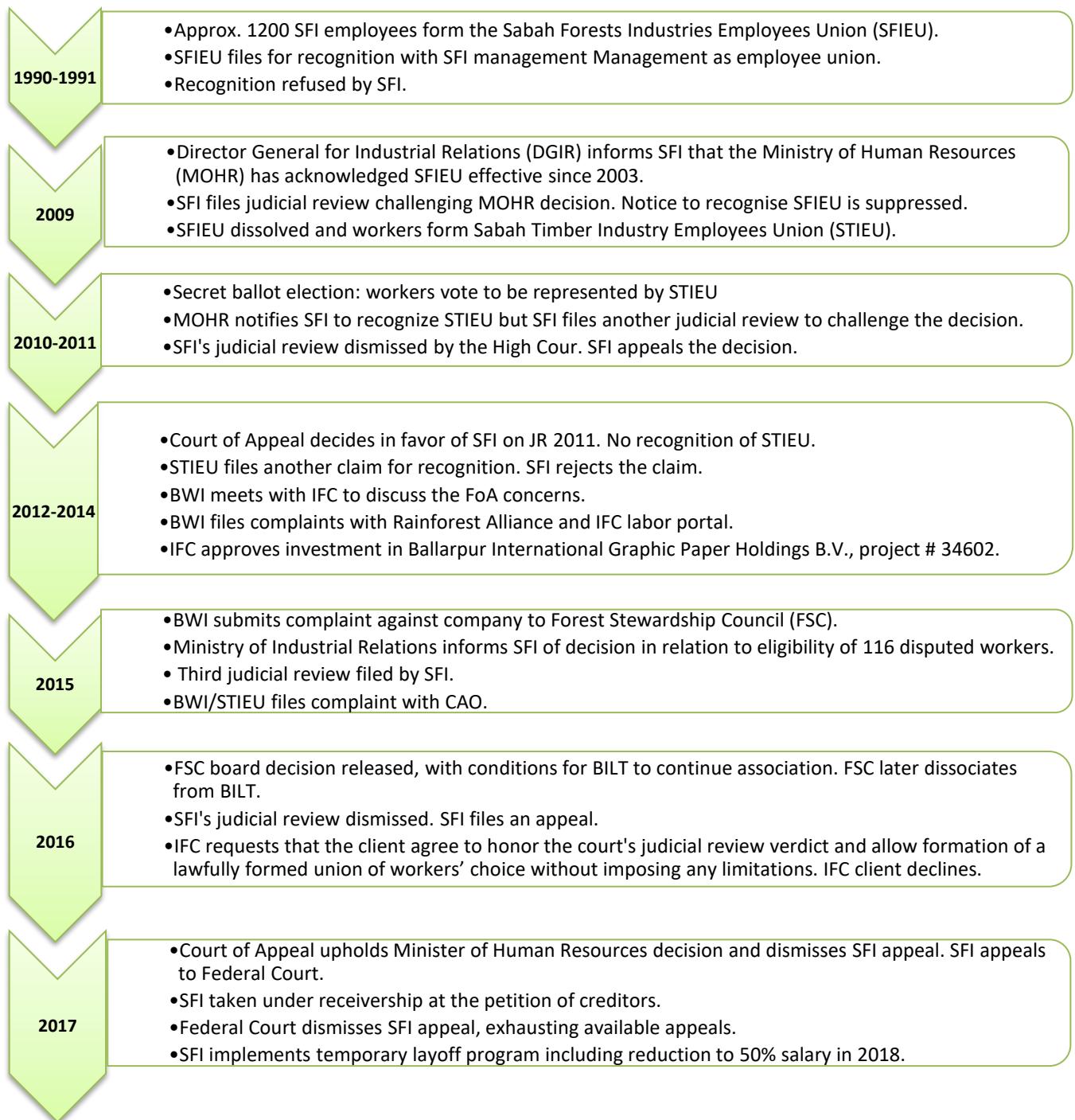
In order to maximize the opportunity for candid sharing of information, when conducting a compliance investigation, CAO conducts meetings with IFC staff on an individual basis. CAO interviewed two IFC social development specialists as part of this compliance investigation; however, IFC management and staff who worked directly on the project declined to participate in CAO interviews on these terms.

In considering IFC's environmental and social (E&S) performance in relation to this project, CAO has been conscious not to expect performance at a level that requires the benefit of hindsight. Rather, the question is whether there is evidence that IFC applied relevant requirements considering sources of information available at the time.

CAO's compliance mandate is focused on IFC's E&S performance. In accordance with CAO's Operational Guidelines, this report documents investigation findings with respect to IFC's compliance with relevant requirements and adverse environmental and/or social outcomes, including the extent to which these are verifiable.

¹² Relevant provisions of the CAO Terms of Reference for this investigation are set out in Appendix D.

1.5 Overview of Project Timeline



A detailed project timeline is available in Appendix B.

1.6 Labor and Freedom of Association Context

1.6.1 Labor profile of Sabah Forest Industries

As of April 2014, SFI employed 2542 direct workers. 1582 workers had permanent employment contracts with SFI. In addition to direct workers, the company contracted with approximately 27 small to medium contractors with 1218 workers. Of the direct workers 69% were Malaysian, 16% Nepali and 14% Indonesian. The company also employed 32 expatriate workers in executive and managerial positions contracted from BILT's Indian operations.¹³

SFI provides accommodation facilities to its workers in housing complexes and in permanent forest camps. Workers in the plantation division also spend periods in temporary camps.

1.6.2 Freedom of Association: Malaysian law and practice

While CAO makes no finding in relation to the situation in Malaysia regarding FoA, an engagement with national law and relevant commentary on industrial relations practice is necessary to establish the context in which IFC made its investment.

The law and Malaysia's Constitution provide all citizens the right to form associations¹⁴ and the Industrial Relations Act (1967) provides the right to form and join trade unions free from interference, restraint and coercion.¹⁵ However, a review of key sources indicates limitations on such rights in law and practice. Malaysian law requires unions to be registered and accorded recognition by the employer in order to exercise their rights, including the right to engage in collective bargaining.¹⁶ Registration and recognition require formal application and may be refused based on a wide latitude of discretion afforded to the government and subject to challenge by the employer.¹⁷ In practice, a relatively low percentage of workers in Malaysia are believed to be covered by collective agreements.¹⁸

By law, certain categories of employees—managers, executives, security or those in confidential posts—may be precluded from joining general unions.¹⁹ In practice, some employers have been criticized for reclassifying existing posts within companies to prevent employees from joining

¹³ Figures in this section are from ERM, *Labor and Working Conditions Audit: Sabah Forest Industries (SFI), Malaysia*, (labor audit), September 2014. An earlier version of the report is available on IFC's project Information Portal: ERM, labor audit, Draft Final Report, June 2014, available at: <https://goo.gl/8dYvoA>.

¹⁴ Federal Constitution of Malaysia, 31 August 1957, Art.10, reprint dated 1 November 2010 available at: <https://goo.gl/gQUbec>.

¹⁵ Industrial Relations Act 1967, section 5(1), reprint dated 1 March 2010 available at: <https://goo.gl/Q7RsdH>.

¹⁶ Industrial Relations Act 1967, section 2 (definition of “trade union”), and section 13(1) *et al.*

¹⁷ Industrial Relations Act 1967, section 9 *et al.*; Trade Unions Act 1959, section 7 *et al.* available at: <https://goo.gl/w3zgg3>.

¹⁸ International Labour Organization, *Observation (CEACR)*, adopted 2016, published 106th ILC session (2017), regarding the Right to Organise and Collective Bargaining Convention, 1949 (No. 98), Malaysia, “Application of the Convention in practice,” available at: <https://goo.gl/tMHzaa>.

¹⁹ Industrial Relations Act 1967, section 5(2).

unions.²⁰ Various restrictions on migrant workers' rights to join unions have also been reported (see *Box 1: Migrant Worker union membership in Malaysia*).

Relevant to FoA, Malaysia has ratified ILO Convention 98 on the Right to Organize and Collective Bargaining (1949); it has not ratified ILO Convention 87 on Freedom of Association and Protection of the Right to Organize (1948). Barriers to the effective recognition of rights to FoA in Malaysia are corroborated by international third-party observations.²¹ These include observations regarding the circumstances at SFI.²²

Concerns regarding delays in the process for union recognition in Malaysia have also been the subject of scrutiny by the International Labour Organization (ILO) Committee of Experts on the Application of Conventions and Recommendations (the Committee).²³ Noting that the average duration of proceedings for union recognition was nine months, the Committee observed “[it] considers that this average duration is excessively long and requests the Government to take measures to modify the legislation in order to reduce the length of proceedings for the recognition of trade unions.”²⁴

The United States Department of State publishes annual country reports on human rights practice covering internationally recognized human rights, including worker rights, as set forth in the Universal Declaration of Human Rights and other international agreements.²⁵ At the time of IFC's decision to invest in Bilt Paper, the annual report on Malaysia indicated that restrictions on FoA were among the most significant human rights problems in the country.²⁶ While Malaysian law recognizes the right of workers to form and join unions, the 2012 and 2013 Human Rights Reports noted restrictions on the right to strike, ineffective enforcement of legal provisions to prevent management taking reprisal actions against workers for union activity, and challenges and delays regarding the process for union recognition.²⁷ The 2013 report noted:

It was common for [trade union] applications to be refused or if approved, the decision challenged in court by the employer to delay recognition and consequently unions have gone unrecognized for one to several years.²⁸

²⁰ See, for example, Case No. 2717 (Malaysia) from Report No 360, June 2011, of ILO Committee on Freedom of Association, available at <https://goo.gl/qDzhDU>.

²¹ U.S. Department of State, “Human Rights Reports,” available online at: <https://goo.gl/thhcwQ>;

²² Individual Case (CAS) – Discussion: 2016, Publication: 105th ILC session (2016), para. 16, available at: <https://goo.gl/s8pBJK>

²³ ILO, Committee of Experts on the Application of Conventions and Recommendations, *Report of the Committee of Experts on the Application of Conventions and Recommendations*, adopted 2010, published 100th ILC session (2011): Right to Organize and Collective Bargaining Convention (C.98), available at: <https://goo.gl/qdWHLL>.

²⁴ *Ibid.*, p. 108.

²⁵ U.S. Department of State, “Human Rights Reports,” available online at: <https://goo.gl/thhcwQ>.

²⁶ U.S. Department of State, Bureau of Democracy, Human Rights and Labor, *Country Reports on Human Rights Practices for 2012: Malaysia*, (2012 Human Rights Report) available online at: <https://goo.gl/pEfMvh>; and *Country Reports on Human Rights Practices for 2013: Malaysia*, (2013 Human Rights Report) available online at <https://goo.gl/oEAqjq>.

²⁷ 2012 Human Rights Report, p. 61; 2013 Human Rights Report, p. 48 & 49.

²⁸ 2013 Human Rights Report, p. 50.

The International Trade Union Confederation (ITUC) has also recorded and published cases of violations of freedom of association in Malaysia, including charges of arbitrary and slow union recognition processes based on the actions and inactions by employers and government, alleged abuse of laws by employers to deny categories of workers from joining unions, and claims of retaliation and discrimination against workers attempting to form unions. In 2014 and again in 2015, the ITUC Global Rights Index designated Malaysia as among the lowest rated countries in terms of effective access to workers' rights and unfair labor practices.²⁹

Box 1: Rights of Migrant Workers to join unions in Malaysia

Among the issues raised in this case, the ability of migrant workers in Malaysia to join and participate in union activities merits special attention. A 2016 ILO review of labor migration policy in Malaysia summarizes the situation for migrant workers generally under the law:³⁰

“In principle, Malaysia’s labor laws provide equality of treatment for registered migrants with nationals in terms of wages, work hours, holidays, terminations, non-discrimination, freedom of association, access to complaint mechanisms and other protections. In practice, however, labour laws are often ineffectively enforced for migrant workers.”

Malaysia’s labor and employment laws, the Employment Act 1955, Trade Union Act 1959 and Industrial Relations Act 1967 generally impose no legal restrictions on migrant workers from joining existing labor unions or participating in their activities.³¹ The Trade Union Act recognizes trade unions as any association or combination of workmen or employers, but requires that any union officer must be a citizen of Malaysia.³²

Malaysia’s immigration laws do not restrict migrant workers from joining or participating in a registered trade union.³³ The Ministry of Home Affairs—which is responsible for administering migrant labor—previously had a practice of including specific conditions in the work permits (“Kad Jalan”) issued to migrant workers. Various sources indicate that it was common for such permits to stipulate that migrant workers may not join a “persatuan” or association.³⁴ This

²⁹ ITUC Global Rights Index 2014 and 2015, Description of the Ratings: <https://goo.gl/WwShxX> and <https://goo.gl/pNBqJY>

³⁰ ILO, “Review of labour migration policy in Malaysia,” 2016, p. 5, available at: <https://goo.gl/gEAZVU>.

³¹ Employment Act 1955, section 8, online update as at 30 April 2012, available at: <https://goo.gl/TUc7HS>; Trade Union Act 1959, section 2(1) et. al., online update as at 1 August 2014, available at: <https://goo.gl/4rDsiU>; Industrial Relations Act 1967, section 4 et. al. online update as at 1 October 2015, <https://goo.gl/Lqofbz>.

³² Trade Union Act 1959, section 1 “trade union”, section 28(1)(a). Note that this prohibition does not apply in the case of a union which, in the opinion of the Minister of Human Resources, is required by its objects to represent persons or the interests of persons who are not resident in the Malaysian state in question, section 28(1).

³³ CAO notes that certain sources refer to a provision regarding non-recognized associations in the Immigration (Amendment) Regulations 2011, section 6, Regulation 16A(5) (see, for example, the FSC Report). However, CAO was not able to review a copy of these regulations.

³⁴ See, for example, Evelyn Shyamala Devadson & Chan Wai Meng, “Policies and Laws Regulating Migrant Workers in Malaysia: A Critical Appraisal,” *Journal of Contemporary Asia*, vl. 44, 2014, pp. 19-35, Table 4, p. 30, available at: <https://goo.gl/Uoii54>; and ITUC, “Survey of Violations of Trade Union Rights: Malaysia,” 3 March 2010, available at: <https://goo.gl/VsaRAc>.

provision has reportedly been interpreted as an absolute prohibition on migrant workers from joining any kind of association, including a trade union (“kersatuan”).³⁵ CAO understands that, as of 2015, this practice had been stopped.

In practice, the vulnerable position of migrant workers makes it difficult for them to join labor organizations, and employers commonly discourage or prohibit freedom of association among migrant workers. However, focused ILO and national union efforts to support workers have seen some progress over the last decade, predominantly in the electronics industry.³⁶

1.6.3 Complaints in relation to Sabah Forest Industries’ FSC certification

The June 2015 complaint to CAO was preceded by complaints, to other bodies, from the same unions, BWI and STIEU related to freedom of association issues at SFI. Of relevance to this investigation were complaints raised from March 2013 to March 2015 related to SFI’s accreditation under the FSC. FSC is a major international standard setting body for forest management and chain of custody certification, which requires associated companies to meet FoA standards (See Box 2: *Forest Stewardship Council Certification at SFI*).

In March 2013, BWI communicated their concerns about union recognition to the auditing body that confirmed SFI’s FSC “controlled wood certification,” Rainforest Alliance.³⁷ The auditors inquired about the situation as part of their visit, and included commentary in their 2013 audit report.

In May 2014 BWI escalated the matter to Accreditation Services International (ASI).³⁸ ASI is the subsidiary entity of FSC that accredited Rainforest Alliance to audit against the FSC certification standards. In December 2014, ASI accepted the complaint for formal investigation and in February 2015, released a public summary of the decision.³⁹ ASI carried out a desk review of the complaint and did not find strong evidence that SFI had suppressed the collective bargaining rights of workers.

³⁵ ILO, Case No. 2637 (Malaysia) – Complaint date: 10 April 2008. See “complainant allegations,” available at: <https://goo.gl/J4fUK>.

³⁶ Eliza Marks and Anna Olsen, “The Role of Trade Unions in Reducing Migrant Workers’ Vulnerability to Forced Labour and Human Trafficking in the Greater Mekong Subregion,” *Anti-Trafficking Review*, issue 5, 2015, pp. 111-128, p. 7 of PDF, available at: <https://goo.gl/We58fw>.

³⁷ BWI complaint to Rainforest Alliance discussed in FSC, “Building and Woodworkers International v BILT Graphic Paper Products Limited,” p. 10, available at <https://goo.gl/cS4UCX>.

³⁸ Accreditation Services International, (ASI) “Building and Woodworkers International vs. Rainforest Alliance @ SW-CW/FM-004704.” Note that, in August 2014, the complainants filed a formal complaint to IFC through IFC’s online labor portal raising the same allegations regarding infringement of FoA and non-compliance with PS2 at SFI. IFC’s handling of the complaint is discussed further in the body of this report.

³⁹ ASI Complaint: Public Summary Report BWI vs Rainforest Alliance @ SW-CM/FM-004704, available at: <https://goo.gl/zNYfLc>.

In March 2015, BWI filed a complaint to FSC directly, alleging non-compliance with the FSC *Policy for Association*.⁴⁰ The complaint alleged SFI was in breach of the FSC Policy for Association through violation of the ILO Core Conventions (especially those related to freedom of association and union recognition), as they are incorporated in FSC policy.⁴¹ FSC accepted the complaint in July 2015 and convened a panel to investigate. The panel visited SFI and spoke with stakeholders in October 2015.⁴² Following the investigation FSC issued a report in December 2015 (the “FSC Report”), concluding that there was clear and convincing evidence SFI failed to uphold the principles of the ILO Core Conventions.⁴³ FSC initially agreed to maintain association with the company, subject to a number of conditions. In August 2016, FSC determined such conditions were not being fulfilled and disassociated from the company.⁴⁴

Box 2: Forest Stewardship Council Certification of SFI

Forest Stewardship Council (FSC) is an independent, non-profit organization that sets standards for certification of forests and companies. FSC certification is intended to ensure that “products come from responsibly managed forests that provide environmental, social and economic benefits.”⁴⁵ The FSC *Policy for Association* states that FSC will only associate with organizations that are not directly or indirectly involved in certain “unacceptable activities,” and lists “violation of any of the ILO core conventions” as an unacceptable activity.⁴⁶

The FSC Controlled Wood Standard minimizes the risk of using wood products from “unacceptable” sources in FSC-labeled products, including wood harvested in violation of civil rights. The FSC Principles and Criteria apply to FSC-certified forests, and include Principle #4: Community Relations and Worker’s Rights – “Forest management operations shall maintain or enhance the long-term social and economic well being of forest workers and local communities.”⁴⁷ SFI received a controlled wood certification for its Natural Forest Management area in February 2010, valid for 5 years.⁴⁸ FSC also issued a chain of custody certification that allowed SFI to sell logs from the forest as “controlled wood” certified logs or products from ITC as certified sawn timber or plywood.⁴⁹

⁴⁰ FSC, “Building and Woodworkers International v BILT Graphic Paper Products Limited,” available at: <https://goo.gl/JZCYgj>.

⁴¹ Complaint to FSC involved both SFI and BILT Graphic Paper Products Limited.

⁴² FSC, “Building and Woodworkers International v BILT Graphic Paper Products Limited,” p. 12, available at: <https://goo.gl/JZCYgj>

⁴³ FSC, “Building and Woodworkers International v BILT Graphic Paper Products Limited,” available at: <https://goo.gl/JZCYgj>.

⁴⁴ FSC, News Release, Bonn, Germany, “FSC Disassociates from Bilt,” 16 August 2016, available at: <https://goo.gl/LrbmBZ>.

⁴⁵ FSC Website, “Certification,” available at: <https://goo.gl/vJp4JT>.

⁴⁶ FSC, *Policy for the Association of Organizations with FSC*, FSC-POL-01-004 (v2-0), 1 September 2011, Part I, 1, f), available at: <https://goo.gl/3xnr6E>.

⁴⁷ FSC Website, “Mission and Vision,” available at: <https://goo.gl/tXyqH2>.

⁴⁸ SFI *Policy on Forest Certification*, WG Wooff, General Manager, Plantations, 1 September 2012, available at: <https://goo.gl/4KfjGH>.

⁴⁹ SFI *Policy on Forest Certification*, WG Wooff, General Manager, Plantations, 1 September 2012, available at: <https://goo.gl/4KfjGH>.

2 Analysis of IFC Performance

This section sets out CAO's compliance analysis in relation to the issues raised in the compliant. It describes applicable IFC policies, procedures and practice, and addresses each stage in the project cycle: due diligence, commitment, and supervision. It summarizes the relevant requirements on IFC and its client at each stage, highlights key events in the project, and presents compliance findings.

2.1 Applicable IFC Policies, Performance Standards, and Procedures

CAO oversees investigations of IFC's E&S performance, by assessing compliance with IFC policies, Performance Standards, guidelines, procedures, and requirements whose violation might lead to adverse environmental and/or social outcomes.⁵⁰

Relevant standards for the purpose of the project include IFC's *Policy on Environmental and Social Sustainability* (Sustainability Policy), which defines IFC's responsibility in supporting project E&S performance in partnership with clients. The Sustainability Policy sets out how IFC will conduct due diligence of E&S risks associated with a proposed project, how projects will be categorized and supervised. It requires IFC to identify compliance problems and work with the client to address these if they arise. The Sustainability Policy also makes specific reference to human rights, recognizing the responsibility of business to respect human rights including the International Bill of Human rights and the eight core conventions of the ILO (Core Conventions).⁵¹

IFC's *Access to Information Policy* sets out the scope of information that IFC makes available to the public, including in relation to specific projects.⁵² It states IFC's belief "that transparency and accountability are essential to fulfilling its development mandate."⁵³

The *Performance Standards on Environmental and Social Sustainability* (PSs) define clients' responsibilities for managing their E&S risks. SFI and Bilt Paper committed to implement the PSs in relation to the project in investment agreements concluded in October 2014. The PSs require that clients carry out an E&S assessment to identify actual and potential E&S risks and impacts, and that they implement an E&S Management System (ESMS). The client applies a mitigation hierarchy to anticipate and avoid adverse E&S impacts on workers, communities, and the environment, or where avoidance is not possible, to minimize, and where residual impacts remain, compensate or offset for the risks and impacts, as appropriate.⁵⁴ Each of the specific issues that are raised in this case fall within PS2: Labor and Working Conditions (PS2) (see Box 3: *Freedom of Association in IFC Performance Standard 2*).

PS2 acknowledges that "the pursuit of economic growth through employment creation and income generation should be accompanied by protection of the fundamental rights of workers."⁵⁵ The

⁵⁰ CAO, *Operational Guidelines*, 2013, para 4.3.

⁵¹ IFC, *Sustainability Policy*, 2012, para. 12, note 4.

⁵² IFC, *Access to Information Policy*, 2012, available at: <https://goo.gl/SjrgG3>.

⁵³ *Sustainability Policy*, para. 3.

⁵⁴ PS1, 2012, Objectives: Bullet point 2-4.

⁵⁵ PS2, 2012, para. 1, "Introduction."

standard includes a range of requirements related to (among other things) human resources policies and procedures,⁵⁶ working conditions and terms of employment (including worker accommodation),⁵⁷ non-discrimination and equal opportunity,⁵⁸ grievance mechanisms,⁵⁹ forced labor,⁶⁰ and occupational health and safety (OHS).⁶¹

Box 3: Freedom of Association in IFC Performance Standard 2

Paragraphs 13 and 14 of PS2 are of particular relevance in this case given the complaint to CAO raises specific issues regarding workers' right to organize:⁶²

Workers' Organizations

13. 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 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.
14. In either case described in paragraph 13 of this Performance Standard, 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.

More detailed guidance in relation to an ESMS and to PS2 requirements are set out in IFC's 2012 *Guidance Notes to Performance Standards on Environment and Social Sustainability* (Guidance Notes), the IFC's 2008 *Labor Toolkit* (Labor Toolkit)⁶³ and IFC's 2010 publication, *Measure & Improve Your Labor Standards Performance: PS2 Handbook for Labor and Working Conditions* (PS2 Handbook).⁶⁴

CAO notes that IFC's E&S department has designated three social specialists as regional PS2 focal points with a role to provide advice and backstopping support to other E&S staff on labor

⁵⁶ PS2, 2012, paras. 8-9.

⁵⁷ PS2, 2012, paras. 10-12.

⁵⁸ PS2, 2012, paras. 15-17.

⁵⁹ PS2, 2012, para. 20.

⁶⁰ PS2, 2012, para. 22.

⁶¹ PS2, 2012, para. 23.

⁶² PS2, 2012, paras. 13 and 14. *footnotes omitted.*

⁶³ IFC, 2008, *Labor Toolkit*, internal document on file with CAO.

⁶⁴ IFC, 2010, *Measure and Improve Your Labor Standards Performance: PS2 Handbook for Labor and Working Conditions*, available at: <https://goo.gl/AABAoB>.

issues. Since 2013, IFC has also retained a consultancy firm specializing in labor issues that is available to provide advice to IFC in relation to investments with complex PS2 issues.⁶⁵

IFC specifically refers to the Core Conventions, including Convention 87 on Freedom of Association and Protection of the Right to Organize (1948) and Convention 98 on the Right to Organize and Collective Bargaining (1949), as providing guidance on PS2.⁶⁶ In this case, the complaint to CAO also cites Convention 87 and Convention 98. While Malaysia has ratified Convention 98, it has not ratified Convention 87; nonetheless, as recognized by IFC's Guidance Note on PS2 (GN2), the ILO's 1998 Declaration on the Fundamental Principles and Rights at Work commits all Member States, including Malaysia, to respect and promote principles and rights related to the core labor standards, regardless of having ratified the relevant Conventions.⁶⁷

In accordance with the PSs, clients are also required to comply with applicable national law.⁶⁸ To the extent this case presents issues regarding freedom of association and workers' rights to form and join trade unions, relevant national law includes: The Federal Constitution of Malaysia; the Industrial Relations Act (1967); the Trade Unions Act (1959); the Employment Act (1955); and the Immigration Act (1959/63).

2.2 Environmental and Social Review

The complainants raise concerns about the rights of SFI workers to organize and the client's use of judicial review proceedings to prevent union recognition. The complaint notes that these issues were brought to IFC's attention in August 2014, during the pre-investment review period. This section considers whether IFC's pre-investment review of the issues was commensurate to risk, particularly in relation to union recognition issues.

Summary of Findings:

Given a range of significant potential E&S risks and impacts IFC appropriately categorized the project "A" and disclosed a labor audit commissioned by the client.

Neither the labor audit nor IFC's review of the project considered PS2 compliance issues related to the client's known opposition to the formation of an externally affiliated union or its promotion of an in-house joint consultative committee.

IFC's pre-investment review did not consider labor and freedom of association related risks that emerged from the country and sector context in which the client was operating.

A client commitment not to oppose formation of a union was captured as a mitigation measure and incorporated into the client's Environmental and Social Action Plan (ESAP), however, details of what this meant were not agreed.

Considering contextual risk factors and the fact that the company was involved in a long running dispute over union formation, IFC's pre-investment review and proposed mitigation measures were insufficient to provide assurance of PS2 compliance.

⁶⁵ See discussion in CAO, 2015, CAO *Investigation of IFC Investment in Avianca S.A., Colombia*, available at: <https://goo.gl/ZuiNF8>.

⁶⁶ PS2, 2012, para 2, footnotes 1 and 2.

⁶⁷ IFC, Guidance Note 2, footnote GN1.

⁶⁸ PS, Overview, para 5.

2.2.1 E&S Review: IFC Requirements

Pursuant to the Sustainability Policy, “IFC will only finance investment activities that are expected to meet the requirements of the Performance Standards within a reasonable period of time.”⁶⁹ To assess this, “IFC undertakes due diligence of the level and quality of the risks and impact identification process carried out by its clients against the requirements of the Performance Standards, informed by country, sector and sponsor knowledge.”⁷⁰ IFC’s E&S due diligence must be “commensurate with the nature, scale, and stage of the business activity, and with the level of environmental and social risks and impacts.”⁷¹ Where the review process identifies significant impacts associated with the business activity, including past or present adverse impacts caused by others, IFC should work with clients to determine possible remediation measures.⁷²

The Sustainability Policy identifies the following as key components of the E&S review process:⁷³

... (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, where appropriate; (iii) analyzing the business activity’s environmental and social performance in relation to the requirements of the [PSs and the EHS Guidelines] or other internationally recognized sources, as appropriate; and (iv) identifying any gaps therewith, and corresponding additional measures and actions beyond those identified by the client’s in-place management practices.

IFC’s pre-investment E&S review also includes a consideration of “inherent environmental and social risks related to a particular sector as well as the context of the business activity’s setting.”⁷⁴ IFC documents its findings in an Environmental and Social Review Summary (ESRS).

To ensure the business activity meets the PSs, IFC compiles supplemental actions needed to meet its E&S requirements into an ESAP which becomes a condition of IFC’s investment.⁷⁵ Prior to public disclosure, the Environmental and Social Review Procedures (ESRP) require that the ESRS and ESAP be sent to the client for review and approval.⁷⁶ Although it does not present a binding procedure or policy, IFC’s Labor Toolkit provides specific guidance to IFC staff on risk assessment for freedom of association (see *Box 3: IFC Labor Toolkit Guidance on Risk Assessment*).

⁶⁹ Sustainability Policy, 2012, para. 22.

⁷⁰ Sustainability Policy, 2012, para. 12.

⁷¹ Sustainability Policy, 2012, para. 26.

⁷² Sustainability Policy, 2012, para. 26.

⁷³ Sustainability Policy, 2012, para. 28.

⁷⁴ Sustainability Policy, 2012, para. 42.

⁷⁵ Sustainability Policy, 2012, para. 28.

Box 3: IFC Labor Toolkit Guidance on Risk Assessment

The IFC Labor Toolkit, developed in 2008, is internal guidance that aims to assist IFC E&S specialists to assess the risk of likely PS2 issues in relation to projects, to assess compliance and then to determine likely action points that need to be taken in relation to non-compliance.

At the first stage of risk identification, a determination should be made whether the project is in a particularly high-risk country, sector or location with regard to labor issues, including freedom of association. The Labor Toolkit identifies “Key higher risk matters,” including labor intensive industries, migrant workers, and countries where worker organization is difficult.

In relation to workers’ organizations, the Labor Toolkit recommends a risk assessment should:

- determine whether national legislation or practice restrict the right to form workers’ organizations;
- review information from sources including ITUC and the ILO; and
- determine whether there is a history of workers’ organization conflict.

Where there is a history of workers’ organization conflict, further due diligence is required. The Toolkit notes that “[a] history of problems is more likely to lead to conflict in the future and may be an indicator of poor management practices.”

2.2.2 E&S Review: IFC Actions

IFC began its pre-investment review of the project in late 2013. Though there had been an ongoing dispute regarding SFI workers’ attempts to form a union for approximately two decades, IFC pre-investment documentation did not identify freedom of association issues as a significant risk. In mid-2014, labor issues were considered in a dedicated audit. However, the audit presented an incomplete analysis of relevant PS2 provisions. Further, worker representation was not addressed in detail in the ESRS or ESAP which are disclosed prior to IFC approval of an investment.⁷⁷

Initial stages of E&S Review. Early documentation of IFC’s pre-investment review noted E&S risks related to the project including biodiversity issues, indigenous rights, and a lack of FSC certification for the plantations and natural forest. In relation to the client generally, IFC noted that the key risk/impact was the company’s staffing, capacity and systems in place to undertake projects and operations in accordance with the PSs, including provision of fair, safe and healthy working and living conditions for employees and contract workers. IFC also noted there had been a 2-3 year delay in the implementation of BILT’s ESAP under an earlier IFC investment. IFC provisionally categorized the project as a “category A” investment, meaning that the project had potential significant adverse environmental or social risks and/or impacts that are diverse, irreversible, or unprecedented.⁷⁸ In January 2014, IFC’s Corporate Operations Committee (COC) approved the project to proceed to appraisal.

⁷⁷ ESRS, “Environmental and Social Mitigation Measures; PS2: Labor and Working Conditions.”

⁷⁸ Sustainability Policy, 2012, para. 40.

IFC Environmental and Social Review Summary. The first explicit reference to SFI's union and FoA issues appears in the June 2014 ESRS, disclosed on IFC's website.⁷⁹ IFC reported that its review "consisted of appraising technical, environmental and social information made available by BILT including: ...Human Resource (HR) policies of both BILT and SFI; environmental impact assessments undertaken by SFI; [and] additional assessments undertaken for SFI's operations including a labor audit...."⁸⁰ The ESRS includes a general review of labor and working conditions in the context of PS2 at BILT and SFI. It records SFI's commissioning of an independent labor audit and the development of an action plan. The action plan required SFI to, *inter alia*: update and strengthen HR policies and procedures in line with PS2, upgrade payment policies, and strengthen its grievance management systems.⁸¹

The ESRS included specific reference to the union/FoA at SFI under the heading of "E&S Mitigation Measures" relevant to the application of PS2:

There is an ongoing litigation since 1998 in relation to formation of a union at SFI, which remains a key concern of the workers. While in the interim a joint consultative committee (JCC) has been set up, **SFI has committed to not opposing formation of a union and will undertake steps to facilitate union formation.**⁸² (*Emphasis added*)

The ESRS reference to "ongoing litigation" relates to the efforts by workers at SFI to form a trade union and SFI's resistance to such efforts, which had been ongoing for approximately two decades prior to IFC's involvement (see *Box 4: SFI litigation and union recognition*). Although the ESRS states that SFI had established the JCC as an alternative mechanism for engaging with workers, CAO notes that the client's efforts to convene the JCC were not successful. The ESRS does not include further discussion about the union issue at SFI or its potential implications with respect to PS2.

Union formation efforts and SFI position: As set out in the draft and final labor audit and other records, workers at SFI had sought to form a union without success. According to CAO interviews with workers, they sought union recognition to help them raise grievances with SFI management and to protect their rights. Specifically, workers raised allegations regarding occupational health and safety (OHS), including unsafe working conditions; treatment of migrant workers, including discrimination and exclusion from union participation; unfair pay; and poor on-site living conditions at SFI.

In mid-2013, as referenced in the ESRS, the client attempted to organize a JCC as a platform for dialogue with workers. International union representatives reported that, in August 2014, they were told by SFI management that the company would only accept an "in-house union." CAO understands that the client intended an "in-house union" to be one whose members and officers

⁷⁹ ESRS, "Environmental and Social Mitigation Measures; PS2: Labor and Working Conditions."

⁸⁰ ESRS, Overview of IFC's scope of review.

⁸¹ A draft version of the labor audit was circulated in or around June 2014, and the final version is dated September 2014; the action plan was also issued in June 2014, as set out below.

⁸² ESRS, "Environmental and Social Mitigation Measures; PS2: Labor and Working Conditions."

are comprised solely of employees of SFI. SFI also stated to CAO that Malaysian immigration requirements prohibited any migrant workers from joining any union in Malaysia.⁸³

Box 4: SFI Litigation and Union Recognition

Prior to, and during IFC's investment, the client has opposed recognizing a workers' union through various administrative and judicial challenges. Most significant are three judicial review (JR) proceedings that SFI brought against the government-facilitated union verification process in 2009, 2011 and 2015. A judicial review asks the court to consider the decision-making process of an executive authority. Courts do not assess the merits of a decision under judicial review, and do not substitute their own decision. In Malaysia, the court is empowered to issue certain orders, including *certiorari*, which quashes or cancels a decision made by an executive authority.⁸⁴

JR 2009: SFI filed judicial review proceedings in the High Court asking to quash a directive issued by the Minister of Human Resources that required SFI to recognize SFIEU retroactively. The court found in favor of the company and quashed the directive.

JR 2011: SFI filed judicial review proceedings in the High Court asking to quash a Ministerial Notice to the company to recognize STIEU as of 2009. SFI argued that STIEU (as a union of timber processing workers) was not competent to represent SFI workers, who also include forestry workers. The High Court dismissed the company's application. SFI appealed, and the application advanced to the Court of Appeal in 2012. The Court of Appeal found in favor of SFI and quashed the Ministerial Notice.

JR 2015: SFI filed judicial review proceedings in the High Court asking to quash a decision by the Director General of Industrial Relations related to eligibility of certain employees to vote in a union secret ballot. SFI argued that the decision had incorrectly classified certain workers and had failed to evaluate others. The High Court dismissed the company's application in 2016. SFI appealed, and the application advanced to the Court of Appeal. In May 2017, the Court of Appeal dismissed SFI's appeal and upheld the Director General's decision on eligibility.

Labor audit. During the E&S review, IFC requested that the company commission a third party audit of labor and working conditions at SFI. IFC was involved in selection of the auditor, and the resulting report was disclosed on the IFC project information portal.⁸⁵ According to the client, IFC carried out a review of the draft labor audit, dated June 2014, and the final labor audit, dated

⁸³ In discussions with CAO, SFI management explained that this position was based on immigration requirements that prohibited foreign workers from becoming members of any association. See discussion in Box 1, p. 15.

⁸⁴ In Malaysia, the powers of the court are set out in the Courts of Judicature Act 1964, Schedule 1, 1, available at: <https://goo.gl/yHVQGb>.

⁸⁵ ERM, *Labour and Working Conditions Audit: Sabah Forest Industries (SFI), Malaysia*, June 2014, (labor audit) available at: <https://goo.gl/66wdLb>.

September 2014. However, CAO did not receive any documentation of an IFC review of the labor audit.

The stated objective of the labor audit was to assess potential gaps between SFI labor practices and working conditions with respect to requirements of applicable standards as set out in national regulations, IFC PS2 and ratified ILO conventions.⁸⁶ The audit does not provide a country or sector analysis and there is no review of national labor or industrial relations policies or practices.

The labor audit sets out key issues requiring attention, including implementation of minimum wages, responsibility for contract workers, social security benefits and rights of migrant workers. FoA and union recognition are not listed.⁸⁷

In a section entitled “Legacy Issues of SFI Worker Union,” the labor audit reviews the history of unionization efforts at SFI, including the government-facilitated verification process for union recognition, filing of judicial reviews by the client, and the attempts by the client to form a JCC. The section concludes:

“...the employees and the company are in discussion with the Director for Industrial Relations for recognition of the Union and the way forward. In principal [sic], the SFI management are in favour of an employee union that is legally constituted. In the interim, they seek to establish the JCC that can provide a platform for all workers (including foreign workers) to raise workplace concerns with the SFI management.”⁸⁸

The audit assesses the client’s labor policies and practices against the requirements of IFC PS2 and Malaysian national regulations and discusses mitigation measures or recommendations.⁸⁹ CAO observes:

1. The gap assessment presents an incomplete statement of PS2 provisions on FoA (paras 13 and 14). In particular, it notes that the client should not restrict workers from developing alternative mechanisms, but excludes the requirement that the client “should not seek to influence or control these mechanisms.”⁹⁰
2. In relation to union formation, the audit observes that “SFI is not against the formation of any union provided that the union is an internal union and is not affiliated to any external unions or agencies which may lead to external influence on the company’s operations and labour management.”⁹¹

⁸⁶ Labor audit, p. 6. Note that the labor audit lists and summarizes “Applicable National Regulations,” including the Industrial Relations Act, 1967 (p. 11). It does not include the Trade Unions Act, 1959, in the list of applicable regulations but this law is referenced in the specific discussion of FoA issues (p. 49, pp. 58-59.) No reference is made to the Federal Constitution –which establishes the right to free association as a “fundamental liberty,” that may be restricted by any law relating to labor (Federal Constitution, Art. 10(1)(c) and (3)).

⁸⁷ Labor audit, Box 2.1, p. 15.

⁸⁸ Labor audit, p. 50.

⁸⁹ Labor audit, §5; Table 5.2, p. 53 ff..

⁹⁰ Labor audit, Table 5.2, No. 1.6, “Workers’ organization,” pp. 58-59.

⁹¹ *Ibid.*

3. The audit recommends that the client “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.” It also recommends that the client recognize the rights of migrant workers “to join any internal union or workers’ organization.”
4. The audit observes that the client’s management sought to create an alternative workers’ organization that was named a JCC. It states that the JCC was intended to provide a platform for workers’ representatives and company representatives to “jointly discuss and sort out any worker issues with respect to their terms and conditions of employment. All workers at Grade 7 or below are allowed to be part of the JCC.” The audit provides an account of the company’s efforts to convene the JCC, but noted that the two attempted meetings were adjourned because no worker representatives had come forth.
5. The audit recommended that the client sustain its support to form a JCC and noted that workers should be allowed to choose representatives to speak with management, inspect working conditions, and carry out other organizing activities.

The labor audit does not engage with the complainants’ concerns regarding the client’s preference for an “internal union.” Similarly, it does not engage with the question of whether the client’s approach to the union issues contravened the “influence or control” prohibitions of PS2. While the gap assessment indicates that the auditors had discussions with worker representatives, there is no record of structured engagement with union officials or members as stakeholders.⁹² Finally, the labor audit sets out an action plan with recommendations to address identified gaps.⁹³ The plan lists “Worker’s Union” as an issue of concern, but recommends only that the client recognize the rights of the migrant workers to participate in the worker’s association and does not address the broader union recognition issue.⁹⁴

Environmental and Social Action Plan. In June 2014, the same month the ESRS and draft labor audit were issued, IFC also issued the project ESAP. The ESAP made no specific reference to the labor/FoA issue at SFI. References to PS2 are limited to requirements that the client upgrade HR policies and procedures and the grievance management system. However, the ESAP does incorporate mitigation measures set out in the ESRS by reference:

ESAP Requirement: PS2 – Third Party quarterly audit completed and audit 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 all as per the schedule agreed with IFC....⁹⁵
(Emphasis added)

As noted above, the ESRS included the following under the heading of PS2 Mitigation Measures: (a) that client had “committed to not opposing formation of a union” and (b) that the client would

⁹² Labor audit, Table 5.2, No. 1.6, p. 59.

⁹³ Labor audit, §6; Table 6.1, p. 73 ff.

⁹⁴ Labor audit, Table 6.1, S.No 11, p. 74.

⁹⁵ IFC, Project Information Portal, “Bilt Paper B.V.: Environmental & Social Action Plan,” (ESAP) available at: <https://goo.gl/66wdLb>.

“undertake steps to facilitate union formation.” As a result, these commitments became part of the ESAP. In accordance with IFC’s ESRP requirements, the IFC project team shared the final ESRS/ESAP with the client for approval in June 2014.⁹⁶ The client’s acceptance of the ESRS/ESAP confirms agreement with the commitments and mitigation measures set out within the documents.

IFC acknowledges that the client’s actions prior to the IFC investment were not consistent with the requirements of PS2, but holds that the commitments made by the client as a condition of IFC’s investment were sufficient to provide assurance that PS2 Freedom of Association requirements would be met.⁹⁷

2.2.3 E&S Review: Compliance Analysis

CAO finds IFC’s pre-investment review of the issues was not commensurate to risk in relation to union issues. In particular, IFC did not: (a) take into account relevant information about FoA in the country or sector context, (b) analyze the client’s past performance against relevant requirements of the Performance Standards, or (c) address gaps between the client’s practice and the requirements of PS2, paras. 13 and 14.

Contextual information about freedom of association

CAO found that IFC’s pre-investment E&S review did not include an analysis of contextual risk as required by the Sustainability Policy.⁹⁸ Information about the Malaysian country context and challenges regarding FoA in law and practice was not reflected in IFC’s pre-investment due diligence documentation. IFC has acknowledged that a comprehensive review of contextual risk would have been relevant if there were contextual constraints that prevented the formation of a “lawful union of workers’ choosing.”⁹⁹ In this case, IFC’s stated position is that the government-facilitated process was expected to culminate in resolution of the union recognition issue at SFI. CAO notes, however, that relevant and readily accessible secondary sources such as reports of ITUC and ILO (recommended for review by the IFC Labor Toolkit) describe Malaysia as a particularly high-risk country with regard to FoA. In particular, the sources indicate union recognition processes as a significant obstacle to FoA in Malaysia. In these circumstances, CAO finds that IFC’s lack of analysis of contextual risk meant that challenges to PS2 were not adequately considered during the review process.

History of union recognition issues at SFI

In addition to the country context, CAO finds that the history of union-management engagement at SFI indicated a higher risk in relation to PS2. When IFC initiated its pre-investment review in 2013, STIEU had suspended its efforts to gain recognition. In or around March 2014, STIEU restarted its claim for recognition through submissions to the DGIR and to the client. The DGIR

⁹⁶ ESRP, §3, para 2.5.

⁹⁷ IFC submission to CAO, February 2018.

⁹⁸ Sustainability Policy, 2012, para. 42

⁹⁹ IFC written submission to CAO, February 2018.

proceeded with the statutory verification process; however, the client rejected the recognition of STIEU.

IFC's E&S due diligence included reviewing documents, conducting site visits, and interviewing the client. It is not apparent that IFC analyzed the client's actions vis-à-vis STIEU in the context of PS2 provisions on FoA, national law or other relevant international standards. In particular, CAO finds no evidence that IFC considered whether the following actions of the client were contrary to the requirements of PS2 paragraphs 13 and 14: (i) indicating that it would only support an in-house union; (ii) promoting the JCC as an alternative mechanism for the workers; and (iii) its track record of initiating judicial reviews challenging union formation.

The union issue is captured in the ESRS by referencing the "ongoing litigation" at SFI related to the formation of STIEU. This is identified as a key concern of workers, but the ESRS does not elaborate on this concern. Rather, IFC notes that in the interim a JCC had been established and that the client had committed to "not opposing" the formation of a workers' union and to "undertake steps to facilitate" the union formation. IFC documentation provided no detail about what steps would be undertaken in this respect.

Though the union recognition issue had been ongoing since at least 1998 and IFC was notified of ongoing concerns about labor and working conditions at SFI, IFC appears not to have considered this as a significant risk. Rather IFC's position is that the client's undertakings not to oppose formation of a union were sufficient to provide assurance that PS2 FoA requirements would be met.

IFC review of labor audit

IFC's request that the client complete and disclose a labor audit was appropriate in the context of the investment. However, the Sustainability Policy also requires IFC to review and identify any gaps in the client's assessment documentation.¹⁰⁰ CAO finds no evidence that IFC reviewed the labor audit for gaps against the requirements of Performance Standard 2.

The labor audit considered PS2 issues generally as well as the union formation issue in the context of PS2 requirements. However, the audit analysis excludes a key PS2 provision, namely that the company "should not seek to influence or control" mechanisms developed by workers to raise their grievances and protect their rights.¹⁰¹ While the audit summarizes the history of attempts at union formation at SFI, there is no engagement with the union's claim that the company was actively resisting recognition using litigation and other strategies. Similarly, neither the labor audit nor IFC's ESRS engages with the question of whether the promotion of the in-house JCC was consistent with the protections against employer control and influence over workers' organizations as established by PS2 (paras. 13 and 14). Rather, the labor audit recommends the client "sustain its support" for the JCC.

¹⁰⁰ Sustainability Policy, 2012, para. 28

¹⁰¹ PS2, 2012, para 13.

As IFC failed to identify gaps between the labor audit and PS2 FoA requirements, the client was encouraged to continue a course of action that—while permitted under Malaysian law—was potentially inconsistent with its ESAP commitment.

2.3 IFC Disclosure, Commitment and Subscription

The complainants contacted IFC in August 2014, prior to approval of the project, to raise concerns about the client's record on freedom of association. Through a series of exchanges in September 2014 the complainants and IFC shared information in relation to the client's engagement with STIEU representatives and the findings of the labor audit. In October 2014, IFC committed to the equity investment of \$100 million US and the planned \$50 million US loan to the client. While IFC did process its equity investment, the loan was not disbursed and was cancelled in October 2015.

This section considers the disclosure period, IFC's report to its board, and whether IFC had sufficient basis to conclude that the client would be able to meet the requirements of PS2 within a reasonable period of time. This section also considers whether conditions of IFC subscription¹⁰² ("conditions") relevant to the complainants' concerns were properly cleared.

Summary of Findings:

IFC's presentation of the project to its board did not include material information which IFC was aware of prior to board approval, particularly information related to the client's long-running dispute over union formation and a complaint from the unions received through IFC's labor portal.

Although the labor portal complaint included substantial new information about the adverse risks or impacts described in the ESRS and the mitigation measures described in the ESAP, IFC did not update its disclosures as required.

IFC processed its investment without ensuring that the client was meeting ESAP commitments not to oppose but rather to facilitate union formation.

2.3.1 IFC Disclosure, Commitment and Subscription: IFC Requirements

As noted above, IFC's Sustainability Policy provides that IFC will only finance investment activities "that are expected to meet the requirements of the Performance Standards within a reasonable period of time."¹⁰³

IFC Investment Operations Procedures for New Business provide that IFC board reports should "contain all the material facts which the Board needs to reach an informed decision" including E&S considerations.¹⁰⁴

¹⁰² For an equity investment agreement "Subscription Agreement", the conditions which the client is to fulfil are referred to as "Conditions of IFC Subscription" (COS). This is the equivalent of "Conditions of Disbursement" (COD) in a Loan Agreement. However, the ESRP does not make a distinction between conditions for equity investment and loans. For procedures guiding the due diligence process, supervision and monitoring of any IFC investment, the ESRP refers to all "conditions" as conditions of disbursement.

¹⁰³ Sustainability Policy, 2012, para. 22.

¹⁰⁴ IFC, Procedures: IFC Investment Operations – New Business, IO401, first issued January 9, 2007, updated August 2014, Section VII – Board – Regular Procedure, para. 11.

The ESRS, and the ESAP are disclosed publicly on IFC's website prior to board approval of the investment.¹⁰⁵ If, during the disclosure period, new project information is received that could substantially change the adverse risks or impacts described in the ESRS or the mitigation measures described in the ESAP, the disclosure duration must be restarted.¹⁰⁶ If there is an external complaint on E&S grounds related to a prospective or current IFC client, the Lead Environmental and Social Specialist (LESS) is required to immediately inform E&S department communications and senior management staff.¹⁰⁷ The LESS is required to update the ESRS with new information if required, and to file available documents.¹⁰⁸

After legal agreements are executed and while investment(s) are pending, the LESS is required to obtain compliance data and assess fulfillment of any E&S conditions. If all relevant E&S conditions and ESAP tasks have been completed, the LESS can update the record and provide E&S department clearance for the investment. A condition may also be amended or waived with written approval of E&S management.¹⁰⁹

2.3.2 IFC Disclosure, Commitment and Subscription: IFC Actions

Board Report: On August 13, 2014, IFC submitted its report to the board of directors for approval of the proposed investment. The board report identified certain E&S risks and mitigation measures, including those related to the FSC principles. However, the report did not mention the union recognition dispute.

Labor portal complaint: On August 25, 2014, IFC received a complaint filed by BWI on behalf of STIEU (the same parties who later filed the current complaint to CAO). The complaint was submitted through an online form available on the IFC website, titled *Communication Form for Issues Under PS2* (the “labor portal”).¹¹⁰ No specific policies or procedures are available in relation to the handling of communications received through the labor portal.

The complaint detailed alleged violations of PS2 (paras. 13 and 14) and international labor conventions arising from SFI’s opposition to the union and formation of the JCC. The complaint was received by IFC’s E&S department at headquarters (CES), which acknowledged receipt and agreed to look into the matter. The complaint was shared with the LESS on the same day.

Board approval: The board meeting was held on August 28. The board of directors approved the investment, with one abstention citing concerns about the potential development impact of the investment, the E&S risks, and the period of disclosure.¹¹¹ CAO found no indication that the board was informed of the ongoing union formation dispute or of the labor portal complaint. The

¹⁰⁵ ESRP, §4, para 2.6.

¹⁰⁶ ESRP, §4, para 2.9. The LESS is responsible for recognizing this need and advising the project transaction leader.

¹⁰⁷ ESRP, §5, para 2.3.

¹⁰⁸ ESRP, §5, para 2.3.

¹⁰⁹ ESRP, §6. para 2.2

¹¹⁰ IFC, “Communication Form for Issues under PS2,” available online at: <https://goo.gl/5k433y>.

¹¹¹ See statement of US Executive Director, abstaining on the proposed investment, “Proposed International Finance Corporation (IFC) Investment in BILT Paper B.V.; (World Region), August 28, 2014” available at: <https://goo.gl/uv6ajJ>.

disclosed ESRS and ESAP were not updated to reflect the allegations of FoA violations contained in the labor portal complaint.

CES engagement with complainants: Shortly after board approval of the project, CES staff and the complainant-union representatives engaged in a series of communications that continued through September 2014. Union representatives sought a status update regarding their complaint and raised concerns about the finalized labor audit's recommendation for the client to pursue the JCC as an alternative workers' organization. In response, CES staff articulated IFC's view that: SFI was committed to facilitating formation of a union in accordance with the law; SFI's commitment was reflected in the ESRS; there was a legally mandated process underway in which the client was cooperating with authorities; and the client was prepared to cooperate in accordance with the law as the process moved forward. Regarding the JCC, CES staff stated that: it was not intended to be a substitute union; the JCC was an interim means for the client to remain engaged with workers; it was created to receive worker grievances while a union was being constituted; it was unsuccessful due to lack of worker participation; and that a traditional, grievance mechanism had been established and would be upgraded in line with PS2. Union representatives stated their view regarding the illegitimacy of SFI's efforts to establish the JCC, and their view that it was in violation of PS2. CES staff acknowledged receipt of the communications and indicated that IFC was aware of their concerns and was following the ongoing government-facilitated process. As explained to CAO, these responses were prepared in discussion with the IFC project team.

September 2014 audit documents. In accordance with the ESAP, SFI engaged a third party auditor-consultant to obtain assurance on the status of implementation of the ESAP actions, elements of the ESRS and compliance with IFC PS requirements. The first quarterly audit was issued in September 2014. The scope of work included reviewing the status of E&S plans, assessing compliance with requirements under IFC's Sustainability Framework and Malaysian regulations, and suggesting corrective measures.

The first quarterly audit quotes from the ESRS on the topic the ongoing union recognition litigation and reviews the history of the union issue at SFI, including initial attempts to form a union starting in 1990 and various legal challenges to union recognition by SFI (in the form of judicial reviews and notices of appeal.) The first quarterly audit also provided a status update on the union issue, noting that the client had not recognized STIEU because it "does not represent the pulp and paper industry." The audit noted that the client did not want "interference from the STIEU" but was "open to have a union represented by only the employees of SFI or affiliated to [the] Pulp and Paper Union." In relation to the JCC, the audit stated that the client had attempted to form an alternative workers' association which would be an internal platform for the company to address employee grievances, but noted the lack of cooperation from workers.

The first quarterly audit recommends that SFI await the verdict from the Department of Industrial Relations before deciding on the next course of action, and describes the item status as "Open."

As noted above, the engagement with the third-party auditor was intended to provide assurance on the status of implementation of the ESAP actions, ESRS commitments and compliance with

IFC PSs. However, it is unclear from the audit report that any practical steps were being taken to ensure implementation of the client commitment not to oppose but to facilitate union formation.

Equity commitment. IFC committed to the equity investment of \$100 million on October 3, 2014. IFC documentation approving the equity investment noted that E&S requirements in the legal documentation had been cleared by the LESS, and stated that the client had materially met the E&S conditions prior to commitment. The approval documentation states that the first quarterly audit of SFI had been completed and that the audit confirmed progress in implementation of the agreed measures. It stated that the company had implemented its ESMS in line with PS requirements, and had upgraded its Human Resources policies and procedures. There was no discussion of union recognition issues.

Meeting with international unions. In Washington D.C. on October 9, 2014, CES staff met with representatives of international unions, including BWI, to discuss the SFI complaint. No member of the project team participated in the meeting. Union representatives outlined the history of union recognition efforts at SFI and expressed concern that the labor audit had been completed without engaging with the unions as stakeholders. Union representatives also reported having met with the CEO of the company in August. They reported that the CEO had stated that the company would only accept an in-house union. Among other issues discussed, the union noted that its complaint had been forwarded to the FSC.

IFC site visit in October 2014. The social specialist assigned to the project team conducted a supervision site visit (SSV) to Sabah, Malaysia, in mid-October 2014. Following the SSV, email correspondence from IFC to the client noted that the client's Human Resources team had undertaken steps to close gaps and comply with the recommendations of the labor audit and the First Quarterly Audit. Among key issues that remained, IFC noted the union issue at SFI; but, according to IFC, SFI was cooperating with the government-facilitated process to explore formation of a workers' union and SFI remained fully committed to enabling formation of a union through due process of law. IFC also commented that early and amicable resolution of the labor union issue should remain a top priority given the high global visibility, reputation and potential for operational risk.

Conditions for IFC subscription. Conditions for IFC's investment in the company were set out in a Subscription Notice, and a Policy Agreement (signed October 3, 2014) concluded between Bilt Paper, IFC and SFI.¹¹² These included:

- (a) Written confirmation that Bilt Paper was in agreement with the ESIA;
- (b) Written agreement with IFC on the form of the S&E Performance Report;
- (c) Confirmation that Bilt Paper remained in compliance with the S&E Management System; and

¹¹² Note, IFC also concluded a Loan Agreement with Bilt Paper and SFI in late-October 2014. However, the loan was never disbursed.

(d) Compliance with all matters set forth in the ESAP.

Regarding condition (d), as mentioned above, the ESAP incorporated mitigation measures described in the ESRS including the client's commitment not to oppose formation of a union and to undertake steps to facilitate the union formation.

IFC documentation for approval of the investment stated that all E&S investment conditions had been reviewed and cleared by the LESS. The documentation also noted that a complaint had been filed with CAO (Bilt-01)¹¹³ but stated that the company was generally on track to meet the objectives of the ESAP. The documentation made note of SFI's upgraded Human Resources policies and grievance management system in line with labor audit recommendations. The approval documentation for the equity purchase contains no discussion of the union recognition issue or the complaint filed through the labor portal. IFC's equity investment of \$100 million was completed on October 30, 2014.¹¹⁴

CES engagement with project team. In an email sent October 31, CES staff informed the project team of the October 9 meeting with union representatives. The email summarized the discussions and noted that: (i) while IFC had relied on the ongoing legal process, if that was not legitimate – or perceived as legitimate – IFC and the company likely would need to do more; and (ii) the key issue to be determined was whether SFI was obstructing the rights of workers to join the union of their choice and what could be done to address it. CES staff suggested convening a discussion with the project team to get a better understanding of the situation from the perspective of the client and to identify IFC's key counterpart in the company to discuss the issue.

In response, the LESS agreed to a meeting, noting that the union recognition issue had been discussed in detail with the company during the recent site visit, and that an initial supervision visit was planned for late November 2014.

2.3.3 IFC Disclosure, Commitment and Subscription: Compliance Analysis

IFC was aware of the freedom of association concerns at SFI prior to the board meeting. However, IFC's presentation to the board for project approval did not include pertinent information related to the long running union formation dispute and the complaint from the unions received through IFC's labor portal. CAO notes IFC's view that the board paper includes only a summary of issues and actions, and that several labor issues were of relevance at SFI along with other high-risk aspects of the investment that had to be mentioned in the board paper. CAO finds, nevertheless, that information about the union recognition issue and the labor portal complaint were material to the board's assessment of E&S risks associated with the project. They were thus required to be disclosed to the board under IFC's operational procedures.

IFC's policies and procedures do not prescribe how complaints received through the labor portal should be received or addressed. In relation to the complaint from BWI and STIEU received in August 2014, responsible IFC staff informed the project team and acknowledged the complaint.

¹¹³ CAO case: Malaysia/Bilt Paper-01/Sipitang available at <https://goo.gl/cXLCLQ>. Note: this complaint related to environmental not labor issues.

¹¹⁴ IFC. Summary of Investment Information: Ballarpur International Graphic Paper Holdings B.V. Available at: <https:// goo.gl/xVpSLw>.

CAO finds that the labor portal complaint presented project-related information that could substantially change the adverse risks or impacts described in the ESRS or the mitigation measures described in the ESAP. However, the information provided by the complainants through the labor portal, did not inform any amendment to the ESRS or ESAP, and the disclosure period was not restarted as required in such cases.

After board approval, IFC engaged with the complainants regarding their concerns, however, the record does not provide evidence that IFC sought to analyze PS2 compliance risks arising from SFI's position on union recognition at that time. Project documentation indicates that relevant information and concerns raised by the complainants were not taken into account when preparing the equity subscription clearance. Documentation related to IFC's engagement with the complainants was not included in the project file at that time, contrary to the requirements of the ESRP.¹¹⁵

Approvals of equity subscription were made on the assurance of the LESS that the client was in material compliance with its E&S commitments. This was given despite indications, in particular from the September 2014 quarterly audit, that the client did not want "interference" from STIEU and did not intend to recognize an STIEU affiliated union. This information raised questions as to the client's intention to meet its ESAP commitment not to oppose but rather to facilitate union formation. Consequently, CAO finds that IFC did not have sufficient basis to clear the investment for subscription.

2.4 IFC Supervision

Following its investment, IFC began a more intensive engagement with the complainants and with the client in an effort to understand the union recognition issue. Over the supervision period, the complainant-unions continued to seek union recognition, the relevant authorities approved union recognition and the client raised a series of legal challenges to aspects of the government-facilitated process.

In this section, CAO considers IFC's supervision program and its response to information presented by the complainants and from other sources. The section reviews IFC's approach to engaging the client on freedom of association issues in the context of ongoing domestic litigation.

Summary of Findings

IFC did not adequately supervise the project in relation to the FoA issues raised by the complainants.

During the initial stages of supervision (2014/15) IFC did not conduct the analysis necessary to determine compliance, despite evidence that the client had taken steps to hinder recognition of STIEU.

In 2015/16 IFC suspended supervision at the company's request, despite indications that the client was not in compliance with the requirements of PS2.

¹¹⁵ ESRP, §5, para 2.3. Relevant documentation was added to the project file in April 2017.

In 2016, IFC acted consistently with the Sustainability Policy when it recommended to its client an approach that it stated would enable SFI to meet the requirements of PS2. This involved taking steps toward union recognition in parallel with its ongoing litigation. However, the client declined to follow IFC's recommendation and, to date, no further action has been taken by IFC to ensure compliance. In these circumstances, IFC has not met the requirement of the Sustainability Policy to exercise remedies as appropriate if a client fails to comply with the Performance Standards.

2.4.1 Supervision: IFC Requirements

The Sustainability Policy provides that, after an investment is processed and until an investment is closed, IFC will carry out supervisory actions to monitor its investment, including the following:¹¹⁶

- Implement a regular program of supervision for business activities with E&S risks and/or impacts in accordance with the ESRP.
- Review implementation performance, as reported by the client and updates on the ESAP, against E&S conditions for investment and the client's commitments.
- If changed business activity circumstances might result in altered or adverse E&S impacts, IFC will work with the client to address them.
- If the client fails to comply with its E&S commitments, as expressed in the E&S conditions for investment, IFC will work with the client to bring it back into compliance to the extent feasible, and if the client fails to reestablish compliance, IFC will exercise remedies as appropriate.

The purpose of IFC supervision is to obtain information to assess the status of the project's compliance with PSs and other specific E&S requirements agreed at commitment; to assess current levels of E&S risk; to provide advice to clients on how to address critical E&S issues; and to identify opportunities for improvement and good practice that could be applied to similar projects.¹¹⁷ The ESRP sets out IFC procedures during supervision, and notes that IFC must "[c]learly communicate risks and probable consequences of client compliance failures with the E&S requirements."¹¹⁸

The IFC Labor Toolkit also sets out guidance for staff in relation to supervision of freedom of association issues (See Box 5: *IFC Labor Toolkit Guidance on Supervising Freedom of Association*).

Box 5: IFC Labor Toolkit Guidance on Supervising Freedom of Association

The Labor Toolkit observes that FoA "is one of the most difficult of the labor issues for which to suggest definitive methods of moving towards compliance...Due to the sensitivity of dealing with these issues, it is probably advisable to ensure that a social specialist is involved and,

¹¹⁶ Sustainability Policy, 2012, para. 45.

¹¹⁷ ESRP, §6. para 1.

¹¹⁸ ESRP §6, para 2.1. Review activities include reviewing the client's Annual Monitoring Reports (AMRs), undertaking Supervision Site Visits (SSVs), reviewing other project-related information, defining changed project circumstances that could or do result in adverse E&S impacts, and establishing the client's degree of compliance with all investment decisions. In addition, IFC is required to identify poorly performing projects and advise the client on how to manage E&S project issues.

where appropriate, external consultants. Trade union issues should be subject to peer review on a regular basis.”

Relevant to the issues discussed in this report, the Toolkit notes that:

The employer should not dismiss, discipline or otherwise threaten workers who are trying to form, join or participate in workers' organizations.

Employers should not interfere with the right to freedom of association by seeking to control workers' organizations or by favoring one workers' organization over another.

Workers' organizations have the right to elect their representatives and conduct their activities without employer or state interference.

2.4.2 Supervision: IFC Actions

IFC's supervision can be divided into three phases – an initial period of engagement, followed by a reduction in supervision as the client attempted to sell its Malaysian business, and subsequent re-engagement. IFC's supervision activities included reviewing project-related information, undertaking site supervision visits (SSVs), and engaging with the client, representatives of STIEU and others. During the supervision period, workers' efforts toward the recognition of STIEU at SFI have been ongoing, as has been the client's refusal to recognize STIEU. Worker representatives also filed or continued complaints to ASI, FSC and to CAO during this period.

In discussions with CAO, client representatives reported that IFC had identified the client's resistance to recognition of STIEU as a PS2 compliance issue and had verbally advised the client to recognize the union.

IFC's position, as conveyed to CAO, is that between March 2014 and April 2015 the client was on track to fulfilling its commitment not to oppose, but to facilitate formation of a union, because they remained engaged in the government-facilitated process for the recognition of the union. IFC acknowledges that, post-June 2016, the client was non-compliant with PS2 provisions due to the repeated challenges to DGIR/MOHR decisions regarding recognition of workers' preferred union. IFC's supervision activities are discussed further below.

Ongoing unionization activity. During the period of supervision, IFC received detailed information on the unionization activities at SFI. As mentioned above, in March 2014, STIEU had submitted a new claim for recognition which initiated a government-facilitated verification process. This required a secret ballot among eligible employees to demonstrate support for the union seeking recognition. A dispute arose between the client and STIEU as to which employees were eligible to participate in the secret ballot.¹¹⁹ As a result, in late October 2014, the Sabah Industrial Relations Department conducted interviews of several employees to determine eligibility. IFC was kept informed of the verification process via communications with the client, as well as with STIEU.

¹¹⁹ Presentation of SFI management to CAO, CAO visit to SFI, 13 October 2016.

In-house union memo: SFI management circulated a memorandum to all SFI employees on November 7, 2014 with the subject “Recognition of Union” (the “in-house union memo”). The memorandum referred to the client’s (conditional) support for a union as follows:

Towards this end the Management has indicated at several meetings its readiness and willingness to accord recognition, in accordance with the law, to an **in-house union** whose membership is open **exclusively to all eligible employees of SFI**.

The Management supports the employees of SFI to form and register an **in-house union** and thereafter submit the relevant documents for recognition. (*Emphasis added*)

Supervision site visits. IFC conducted two SSVs in November 2014, and one in April 2015. During the late-November 2014 SSV, IFC held a meeting with representatives of STIEU to solicit their views regarding the union issue. According minutes of the meeting prepared by STIEU, union representatives briefed IFC on the status of the verification process, and discussed prior legal challenges by the client against union recognition.¹²⁰ STIEU also informed IFC that the client had circulated the in-house union memo. STIEU put forward their view that the memorandum violated constitutional law and confused workers. IFC raised questions about STIEU’s representation at SFI, the name of the union, and general problems faced by workers.

IFC confirmed that the project team had been aware of the in-house union memo during the November 2014 SSV, and reported having clarified to SFI management that this position would be a violation of PS2 provisions.¹²¹ According to IFC, the project team advised the client that it must accept a lawfully formed union of workers choosing “without any limitations.”¹²² IFC also reported that the project team reiterated this message to BILT senior management and SFI management repeatedly in all subsequent interactions and supervision visits. CAO notes such advice was not recorded in any IFC documentation, nor in any internal correspondence available to CAO. Further there is no record that IFC advised its client to take action to mitigate the impact of the in-house union memo, for example by publishing a retraction.

Rather, correspondence with CES staff at headquarters indicates that the IFC project team concluded their SSV with the impression that there might not be a material difference in the expectations and positions of the client and of STIEU – but that they needed to engage better and accept each other’s positions. The project team reported that this feedback had been communicated with the company.

Second quarterly audit. A second quarterly E&S audit was issued in December 2014. No further quarterly audit reports were issued after 2014. It included reference to the in-house union memo, as well as updates regarding the government verification process for a secret ballot. The second quarterly audit adds an account from union members, including their rejection of the in-house union memo, their objections to management interference in the type of union that should be

¹²⁰ Minutes were prepared by STIEU and shared with IFC. IFC provided the minutes to CAO.

¹²¹ IFC written submission to CAO, February 2018.

¹²² IFC written submission to CAO, February 2018.

formed at SFI, their account of historic events pertaining to the union issue at SFI, and updates on the March 2014 union recognition claim.

The second quarterly audit repeats the same recommendation as the first quarterly audit to await the verdict of the Sabah Industrial Relations Department, and added a recommendation for the client to clarify the status of a previously formed union.

The third-party audit was intended to provide IFC with assurance that the client would fulfill its commitments as set out in the ESAP and the investment agreement. While the audit provided relevant information about the workers' efforts to unionize, it did not provide an assessment of whether the client had met its ESRS commitment not to oppose but rather to facilitate formation of a union.

IFC conclusion on the union issue. In January 2015, the project team recorded key observations from its SSVs and status updates on ESRS and ESAP implementation. Regarding the union issue, IFC noted it did not perceive a significant gap between the positions of SFI management and STIEU representatives; instead, they saw differences linked to the "nomenclature of the local union." Nevertheless, IFC concluded that early resolution of the union issue remained "a key challenge/concern."

IFC's perception was based on its understanding of each party's position at that time:

1. The IFC client was apprehensive about having a state-wide union based at SFI, as they felt this would draw attention and intervention from third parties. Union representatives indicated they would have an office outside SFI and that they expected membership to grow.
2. The IFC client agreed to recognize a union comprising only SFI employees, as they did not want external influence that would be detrimental in the long run. IFC understood that STIEU would register an SFI "branch" of the union, formed solely of SFI employees.¹²³ The branch would engage with SFI management and consult and seek guidance from STIEU as required.
3. The IFC client would be willing to engage with the SFI "branch" but would not want to deal with STIEU. The client did not want the union to be called "STIEU" but were open to other names and to an STIEU affiliation.
4. STIEU expressed the view that the name should not be changed. IFC concluded that the name of the union appeared to be the sticking point between the two parties

Regarding the SFI "branch" of STIEU, IFC noted that they had sought details but were not able to confirm its existence. The IFC client also was not aware of the STIEU "branch" at SFI.

Accreditation Services International Investigation. In February 2015, ASI released a public summary of its investigation into the audit of SFI's controlled wood certification.¹²⁴ The investigation concluded that there was not strong evidence that SFI was suppressing the rights of workers to engage in collective bargaining, noting certain efforts made by the company and

¹²³ CAO notes that IFC acknowledged in later correspondence that this position was not clearly indicated in the complainants' minutes of discussions.

¹²⁴ See ASI Report.

that, in Malaysia, “union validity is pivoted on the government authority’s … formal evaluation.”¹²⁵ However, ASI reiterated observations by the auditors that SFI had not done enough to ensure the basic conditions for freedom of association and the right to collective bargaining, and observed that the 2013 and 2014 audits were of questionable impartiality. ASI noted that neither it, nor Rainforest Alliance, should intervene until union validity was formally determined by the Sabah Industrial Relations Department. Should SFI challenge the ruling made by the authority, ASI suggested that Rainforest Alliance consider new [audit] findings, as continuous rejections would pose a potential risk against workers’ rights to form a platform for collective bargaining.¹²⁶

Forest Stewardship Council Complaint. On March 6, 2015, BWI filed a complaint with FSC in relation to the FoA/union issue at SFI.¹²⁷ The FSC complaint alleged that SFI’s refusal to recognize STIEU violated FSC’s policy for association by violating the principles of ILO’s Core Conventions on FoA and collective bargaining.¹²⁸

Complainant follow-up with IFC. BWI sent an email to IFC in March 2015 presenting its argument that the in-house union memo constituted a violation of PS2 and Malaysian laws, citing specifically the rights of workers to form a union free from interference, restraint or coercion. BWI also asked how IFC could direct its client to comply with PS2. According to the complainants, IFC did not respond to the email communication and there is no record of any response.

Discussions between SFI and STIEU. Also in March 2015, SFI management and STIEU representatives had a series of discussions about an in-house workers’ union at SFI. As reported to CAO, STIEU representatives felt that they were being pressured by SFI management to form an “in house” union that was separate from STIEU. On the other hand, SFI management felt that they were presenting to worker representatives an opportunity to form a union that would be acceptable to company management and would be granted recognition.

SFI management shared information about the exchanges and documentation with IFC, stating that after the November 2014 meetings they had understood there was an in-house union at SFI. The documentation shared with IFC included two organization charts – one with the name “Sabah Forest Industries Union – (Branch)” and one named “Sabah Timber Industries Employees’ Union.” SFI management observed that the Branch office bearers were almost the same group as representing STIEU, and noted that the Branch document maintained a reference to STIEU.

Recommendations of CES Staff. At the end of March 2015, CES staff proposed that the project team arrange to meet with client representatives and with union representatives. CES staff noted that it would be important for the client to clearly understand IFC’s role: IFC would facilitate a dialogue between the client and union representatives, but would not favor any union. CES Staff recommended that, if the union recognition issue is not resolved through the IFC facilitated dialogue, the project team should consider engaging IFC’s independent labor consultant to assist

¹²⁵ Ibid, p. 1.

¹²⁶ Ibid. p. 3.

¹²⁷ FSC, “Building and Woodworkers International v Bilt Graphic Paper Products Limited,” Case information page, available at: <https://goo.gl/JEEH7Y>.

¹²⁸ *FSC Procedure: Processing Policy for Association Complaints in the FSC Certification Scheme*, FSC-PRO-01-009 (V-3-0) EN, p. 17 available at: <https://goo.gl/YSnRwx>

with the case. It was envisaged that the independent labor consultant would independently assess the client's compliance with PS2 requirements. The project team proceeded to arrange a site visit for late April-early May and arranged meetings with union representatives. There is no record of any further discussion regarding the engagement of an independent labor consultant to assess the client's compliance with PS2.

Decision on eligible employees for secret ballot and judicial review. In April 2015, IFC was notified by BWI that the Minister of Human Resources had signed the report on the final list of SFI employees eligible to participate in the secret ballot election, paving the way for the union recognition verification process to move forward.

Later in the same month, IFC visited SFI and met with complainants. During the meeting and in correspondence with IFC thereafter, BWI urged IFC to communicate to its client that the secret ballot should be allowed to proceed, without legal challenge. There is no record indicating whether IFC communicated such message to its client.

Also in April 2015, in order to avoid de facto recognition of the union, the client ended communications with STIEU leaders on the advice of legal counsel.¹²⁹

On May 14, the IFC client filed an application for judicial review challenging the government's decision on the eligibility of employees for the secret ballot. The client's complaint (i) disputed the government's categorization of certain individuals, and (ii) identified 57 employees who the government had failed to categorize. The client's legal challenge effectively suspended the verification process for union recognition.

IFC was informed of its client's application for judicial review, and also received communications from BWI raising separate incidents in which SFI management were alleged to have harassed STIEU leaders and others and infringed on the rights of workers to form and join a union of their own choosing in violation of IFC PS2. IFC asked the client for information on the alleged incidents/events. The client denied the allegations and in turn accused STIEU of defaming its management. Near the end of July, BWI provided IFC with further allegations of potential PS2 non-compliance, including allegations regarding the client's appointment of an STIEU union leader to a managerial post with a view to severing the leader's association with the union. The IFC project record does not contain any inquiry or follow-up by IFC with the union representatives, SFI or BILT regarding these allegations. IFC also has not carried out any subsequent site visits to the client's Malaysian operations.

CAO complaint and IFC follow-up. In June 2015, the complainants submitted their complaint on FoA and union recognition to CAO (the Bilt-02 complaint).¹³⁰ In the following months, IFC engagement with the company indicates that IFC understood the court would shortly issue its decision on the issue of employee eligibility to vote in a secret ballot. IFC agreed that the client would wait for the outcome of that decision before re-engaging with union representatives. Also by this time, the project team were aware of the company's intention to sell SFI.

¹²⁹ FSC Report, p. 33, p. 39.

¹³⁰ BWI, "Letter of Complaint to CAO," 29 May 2015, available at: <https://goo.gl/o5LM4N>.

Thereafter, IFC's records did not contain any communications or any documentation regarding the union issue at SFI, until late 2016. In the interim, the client became the subject of another investigation arising from the complaint filed with FSC in March 2015 ("FSC Complaint").

FSC Investigation and Report. On 13 July 2015, FSC accepted the complaint filed by BWI.¹³¹ Thereafter, FSC formed an official complaints panel, conducted an evaluation (including a visit to SFI in Sabah in October 2015), and prepared an evaluation report, a public version of which was shared with SFI and the complainants on 22 December 2015 ("FSC report").¹³² The FSC report refers to documentation and audit materials that are internal to the client, and which CAO did not have access to during the current investigation.¹³³

The FSC report reviews the history of SFI workers' efforts to form a union and efforts by the client to delay or prevent union recognition. The FSC report specifically assesses the client's applications for judicial review, the client's position against allowing migrant workers to join any union, and the client's support for an in-house union.

The FSC report makes a series of factual and evaluative findings that support the complainants' concerns (see *Box 6: Findings of the Forest Stewardship Council Report*). For example, based on internal documentation, the FSC report states that the client had used the classification of workers to managerial categories to reduce the number of workers eligible for union membership,¹³⁴ and that the company had received legal advice in April 2015 to commence discussions with workers who were interested in forming an in-house union.¹³⁵ It also sets out a number of recommendations to the FSC board of directors about whether and on what conditions the IFC client should be allowed to continue its association with FSC. In May 2016, the FSC board issued its decision and conditions to maintain the association with the client.¹³⁶ FSC expected the client to "show clear and significant commitment to uphold the principles of freedom of association and collective bargaining" and required the client to submit an action plan and progress report by a deadline in June 2016. FSC stated, "[f]ailure to demonstrate such commitment and submit relevant documentation will result in immediate disassociation." The FSC board also requested that ASI conduct an internal review of the way it investigated BWI's May 2014 complaint against Rainforest Alliance.¹³⁷

¹³¹ The complaint to FSC was formally submitted by BWI against BILT Graphic Paper Products Limited, as the parent company of SFI, on 06 March 2015.

¹³² FSC, Impartial Complaints Panel, "BWI complaint against BILT; Recommendation to the FSC Board of Directors," (FSC Report) 18 December 2015, available at <https://goo.gl/FwEui3>.

¹³³ For example, the FSC Report refers to confidential e-mail correspondence between SFI, BILT, and legal counsel at n. 78, n. 89; and to Audit reports filed by Rainforest Alliance in 2012, 2013 and 2014.

¹³⁴ FSC Report, p. 34.

¹³⁵ FSC Report, p. 33.

¹³⁶ FSC, "Decision and conditions to maintain the association with BILT," 18 May 2016, available at: <https://goo.gl/z61Ytw>.

¹³⁷ Forest Stewardship Council, "Approved Minutes of the 71st meeting of the FSC Board of Directors in Bonn, Germany from 08th to 11th March 2016," 18 April 2016, p. 9, available at: <https://goo.gl/rYmiG>.

Box 6: Findings of the Forest Stewardship Council Report

The FSC report found “clear and convincing evidence” that the client had failed to respect the ILO fundamental principles and rights at work set forth in the ILO Core Conventions. Specifically, the client denied STIEU union recognition by using legal and judicial instruments to block and delay recognition.¹³⁸ The FSC report found “...there is clear and convincing evidence that SFI has used repeated resort to judicial review to needlessly delay union recognition.” In addition, the FSC report reviewed the client’s attempt to form an in-house union and concluded: “... there is clear and convincing evidence that SFI has interfered in the freedom of association of workers by attempting to form a company sponsored union.”

The FSC report explicitly rejected the company’s position that its actions to resist the recognition of STIEU had been fully compliant with the labor laws of Malaysia and therefore a defense against the complaint. The FSC report stated:

...this complaint does not [center] on the legality of the behavior of BILT and SFI but on whether the actions taken by BILT have violated the FSC policy for association specifically by violating any of the ILO core principles laid down in the ILO core conventions...

For all purposes FSC sees legal compliance as being the minimum standard of behavior for associated entities but often demands much more. In this case the argument that [the company] complied with Malaysian law is probably true but this is no [defense] in cases where ILO conventions are not ratified and effectively implemented in the country.

The FSC report recommended, *inter alia*: the client should compensate workers for costs of union membership dues while not receiving benefits of union recognition (US\$100,000) and should compensate STIEU for legal costs related to the client’s judicial review legal challenges; that FSC should disassociate from the client, until SFI recognized and completed a collective agreement with the union of the workers’ free choice; that STIEU be given an opportunity to show workers’ support for the union through a secret ballot process; and that the client withdraw its legal challenge to union recognition.

On 21 July 2016, FSC took the final decision to disassociate from SFI and BILT; FSC made the decision public in August 2016.¹³⁹

According to the client’s management, they understood what the consequences of not abiding by FSC’s conditions would be; but according to the client, the conditions set by FSC were unacceptable. The client further stated there were verbal discussions with IFC on this issue, and that they had informed IFC that the conditions imposed by FSC to maintain association were not acceptable.

¹³⁸ The FSC Report also found BILT Graphic Paper Products Limited, as the parent of SFI, exercised significant level of authority and control on all matters, and thereby was directly involved in the violation of FSC policy: FSC Report, p. 31.

¹³⁹ FSC, “FSC Disassociates from Bilt,” Bonn, Germany, 16 August 2016, available at: <https://goo.gl/ZaseNK>.

CAO's review of records in this case shows no written record by IFC or the client of any such discussions, nor any evidence IFC reviewed or advised the client on the implications of the FSC investigation or FSC's decision to disassociate in terms of IFC's E&S requirements. The sole reference in IFC's documentary record to the FSC decision appears in IFC's SSV Findings issued in June 2016 (discussed below).

IFC suspends supervision of SFI. IFC reported that it became aware that the company intended to sell SFI in July 2015. From mid-2015 to June 2016, IFC did not undertake any supervision activities for the client's Malaysia operations. According to IFC, the project team scaled down its engagement with SFI at the client's request. IFC reported that the reason for the request was that the sale was expected to be imminent (after which SFI would no longer be part of the IFC investment), and to avoid or minimize any transaction related sensitivities.

In February 2016, IFC visited Bilt Paper's plants in India. In accordance with the company's request, however, no supervision visit was carried out to SFI at that time. IFC recorded its supervision findings in a document dated June 2016.

IFC understood, based on limited updates available, that there had been no or very little progress on the implementation of the ESAP actions as agreed by SFI. IFC reported that FSC had sided with SFI workers and had asked the company to satisfy a number of conditions or risk disassociation. The supervision document referred to the CAO complaint that is the subject of this compliance investigation, and remarked that the case was under assessment by the CAO. Finally, IFC included among key areas of concern the amicable resolution of the union issue. The June 2016 supervision document does not suggest that IFC analyzed the implications of the FSC report in terms of PS2 compliance. The supervision document does not discuss any possible remedies to be exercised by IFC.

In June 2016, the proposed sale of SFI was called off.

Judicial review verdict; SFI appeal. On June 27, 2016, the court ordered the dismissal of the client's May 2015 judicial review application regarding the eligibility of employees in respect of the secret balloting process.¹⁴⁰ The project record indicates that IFC understood at this stage that the client would honor the court verdict and the secret ballot outcome and would allow formation of a lawfully formed union of the workers' choice without imposing any limitations.

However, on July 22, 2016, the client filed an appeal to the Court of Appeal against the judicial review decision. The client's appeal effectively prolonged the suspension of the union recognition process, which had begun in March 2014.

IFC reported to CAO that they became aware of the court's judicial review decision in August 2016.¹⁴¹ In September 2016, IFC again engaged with the client around the union issue and the client's judicial review proceedings. The project record indicates that IFC was not aware that the client had filed an appeal at this stage. IFC accepted the company's position that the list approved

¹⁴⁰ Order of The High Court in Sabah and Sarawak at Kota Kinabalu on Application for Judicial Review No. BKI-13NCvC-17/5-2015, 27 June 2016

¹⁴¹ IFC submission to CAO, February 2018.

by the Minister of Human Resources had errors and needed to be corrected. IFC advised the client of possible courses of action that would respect the client's right to seek judicial review and also allow a secret ballot to proceed without further delay. IFC presented these options as enabling the client to meet PS2 requirements.

The company declined IFC's recommended approaches and conveyed to IFC that it had decided to file an appeal to have the secret ballot list amended. The client indicated that it would allow the secret ballot to go ahead once this was done.

According to information available to CAO, IFC did not respond to the client's decision and has not at any stage sought to exercise remedies in relation to the client's continued non-compliance.

Two months later, IFC asked the company to provide a status update on the ESAP and certain other matters. The union/FoA issue was not among these matters.

Current status of union and labor issues at SFI. In discussions with CAO in October 2016, SFI management representatives noted that the client did not want to recognize STIEU as a union at SFI because: (i) STIEU was a state-wide timber union, that it considered could be subject to external influence and pressure; (ii) STIEU was not part of and did not have knowledge of the client's industry (pulp and paper); and (iii) the client did not want a union which was not "legally constituted." When asked about the possibility that their appeal would be unsuccessful, SFI management expressed an intention to pursue every option available to avoid recognition of STIEU.

In May 2017, the Court of Appeal issued its decision and upheld the decision of the Minister of Human Resources, dismissing the client's appeal.¹⁴² Thereafter, SFI appealed the Court of Appeal's decision to the Federal Court, the highest court and the final appellate court in Malaysia. In October 2017, the Federal Court dismissed the appeal of SFI, thereby exhausting available legal appeals on the matter.¹⁴³ In parallel, SFI was issued with several winding-up petitions by over 30 creditors in a bid to recover their debts.¹⁴⁴ To prevent compulsory liquidation, a receiver and manager was appointed to take control of SFI and facilitate repayment of debts via a sale process. Due to these financial constraints, SFI announced in November 2017 a temporary layoff program involving all its workers. The program was scheduled to commence in January 2018 and be implemented through to June 2018. Per the program, affected workers would be paid half their salaries each month and be able to seek employment elsewhere during the layoff period. SFI also noted that all affected workers would be allowed to stay in the company's housing colony as before.¹⁴⁵

¹⁴² BWI, "Malaysia: STIEU win at Court of Appeal," 19 May 2017, available at: <https://goo.gl/5MyiXQ>.

¹⁴³ Kamardin Bin Hashim, Judge, Court of Appeal, Malaysia, Decision in the Court of Appeal of Malaysia at Kota Kinabalu, "Civil Appeal No: S-01(IM)(NCVC)-291-08/2016 between Sabah Forest Industries and Hon Minister of Human Resources of Malaysia and others," 10 November 2017, available at: <https://goo.gl/586Ghm>; Borneo Today, "STIEU Wins At Federal Court; SFI Workers Want Union Set Up Now," 11 October 2017, available at: <https://goo.gl/PwPjvZ>.

¹⁴⁴ Daily Express, "SFI confident of not winding up," May 30, 2017, available at: <https://goo.gl/8pxng9>.

¹⁴⁵ The Borneo Postn, "SFI to temporarily lay off its staff," 1 December 2017, available at: <https://goo.gl/Rh1Ecx>

2.4.3 Supervision: Compliance Analysis

CAO finds IFC's supervision of the project was insufficient to assess the status of the project's compliance with PS2 requirements, specifically regarding union and freedom of association issues. Throughout the supervision period, IFC received information relevant to SFI's conduct with respect to the union and FoA issues from multiple sources, including the client and the complainants. During supervision, workers' efforts toward the recognition of STIEU at SFI were ongoing, as were SFI's efforts to deny recognition.

The project record does not indicate that IFC identified any FoA compliance issues during the initial stages of supervision (2014/15). IFC's position is that during this period the client was engaged and cooperating with the government-facilitated union recognition process, and as a result was acting in accordance with IFC requirements. However, IFC had knowledge of a number of steps taken by the client which raised compliance questions. These included: (a) the client expressed preference for an in-house union, rather than STIEU, which it communicated to employees and to auditors; and (b) the client's initiation of judicial review proceedings that delayed the government-facilitated process for recognition of STIEU. CAO finds that these provided sufficient indications of non-compliance with PS2 requirements for IFC to have taken further action.

IFC's position, as reported to CAO, is that it did advise the client that its preference for an in-house union was contrary to PS2. However, CAO found no record of IFC providing such advice. Rather, the project record indicates that IFC viewed the union issue as a difference in expectations, and advised that worker representatives and company management needed to accept each other's positions.

In an attempt to resolve the union recognition issue, IFC offered to facilitate dialogue between the client and representatives of STIEU. CAO recognizes that IFC's intention was to reach an acceptable compromise for both the client and workers. However, this engagement appears to have contributed to further misunderstanding between the parties.

CAO finds that the client's continued resistance to union formation required an assessment by IFC of whether the client's actions were aligned with agreed commitments and PS2 requirements. This was necessary in order to identify any non-compliance and to support IFC to exercise remedies as appropriate.

Rather than conducting such an assessment, IFC records indicate diminished supervision of the company's Malaysian business. From September 2015 to July 2016, IFC's supervision of the project was effectively suspended while the company tried to sell its Malaysian business. This was done at the request of the company, in part to avoid or minimize any transaction related sensitivities. CAO finds that this was inconsistent with IFC's E&S supervision duty, particularly given that the union formation issue remained unresolved. In this context, CAO finds that IFC did not meet the Sustainability Policy requirement to review the client's implementation performance against the E&S conditions for investment and the client's commitments.¹⁴⁶

¹⁴⁶ Sustainability Policy, 2012, para. 45.

IFC acknowledges that, as of June 2016, the client's ongoing resistance to recognition of the STIEU constituted non-compliance with PS2 and the project ESAP. In September 2016, IFC advised the client in writing of a course of action that it believed would allow the client to meet PS2. However, the project record shows that the client declined to accept IFC's recommendations on how to meet PS2 FoA requirements, deciding rather to continue to contest the recognition process through the courts.

In circumstances where a client fails to reestablish compliance with its E&S commitments, IFC is required to exercise remedies as appropriate. CAO finds no evidence that IFC has considered remedies or communicated to the client that remedies could be exercised if the client did not meet the requirements of PS2.

In summary, CAO finds that IFC did not comply with its supervision duty in relation to the FoA issues raised by the complainants: (a) during the initial stages of supervision (2014/15), because IFC did not conduct the analysis necessary to determine compliance; (b) during 2015/16 because IFC suspended supervision at the client's request; and (c) post 2016 because IFC did not exercise remedies in relation to a client that it knew was committed to resisting recognition of the STIEU in breach of its ESAP commitments and the FoA requirements of PS2.

3 Conclusion

This compliance investigation addresses concerns raised in a complaint from BWI, a global union federation, on behalf of its affiliate STIEU. For approximately two decades, SFI worker representatives have attempted—without success—to gain recognition as a trade union and engage in collective bargaining with IFC’s client. The complainants allege that IFC’s client had persistently hindered workers’ efforts to unionize. They allege that the client’s actions, which include bringing legal challenges regarding union recognition, contravene IFC’s PS2, Malaysian labor laws and international labor standards relating to FoA.

IFC made an investment in SFI and its parent company, Bilt Paper, in October 2014. In conducting this compliance investigation, CAO has considered whether IFC’s pre-investment review of the issues was commensurate to risk, particularly in relation to union issues. CAO has also considered whether IFC responded adequately to FoA issues identified in a client-commissioned labor audit. Finally, CAO has considered whether IFC’s supervision of the project was sufficient to address project compliance with the requirements of PS2, specifically as related to FoA issues.

PS2 recognizes the fundamental rights of workers including the right to FoA. Paragraphs 13 and 14 of PS2 acknowledge that domestic legal frameworks may not fully recognize or protect workers’ right to organize. Where there are substantial restrictions on this right, IFC clients are required not to restrict workers from developing mechanisms to express their grievances and protect their rights, and should not seek to influence or control those mechanisms. Regardless of the domestic law, IFC clients commit not to discourage workers from electing worker representatives, forming or joining workers’ organizations of their own choosing, or from bargaining collectively.

IFC conducted its pre-investment review of the project in early 2014. The E&S review considered labor and working conditions at SFI generally, albeit with little focus on FoA issues. IFC’s review was also informed by a labor audit commissioned by the client that documented the status of workers’ efforts to join STIEU. The audit also captured the position of SFI management at that time—that the client would not be against the formation of a union provided that the union was internal to the company and was not affiliated to any external unions or agencies.

In addressing the union formation issue, IFC’s review documentation noted “ongoing litigation” related to efforts by workers at SFI to unionize. While noting that SFI had established an alternative workers’ engagement mechanism—the JCC, IFC also noted that the client had committed to not opposing formation of a union and would undertake steps to facilitate this. However, details of what this would mean in practice were left unclear.

CAO finds that IFC’s due diligence in relation to FoA issues was not commensurate to risk. IFC did not identify or address weaknesses in the client’s labor audit in relation to FoA standards. IFC did not give required consideration to country and sector risks relevant to the realization of PS2 requirements on FoA. Also, IFC under-estimated the relevance of the client’s long history of resisting union recognition. In this context, the client’s broad commitment not to oppose formation of a union provided insufficient assurance of PS2 compliance.

After disclosure of the proposed project in June 2014, IFC received further information that indicated the client did not want “interference” from an externally affiliated union. At this point, the complainants contacted IFC to raise concerns about the client’s actions regarding FoA, including legal actions to challenge union recognition, and identified what they perceived as shortcomings in the labor audit. This provided IFC with additional information on its client’s capacity and commitment to implement the PS2 requirements. In particular, these actions signaled that the client was taking steps that ran contrary to its commitment to not oppose union formation and to “undertake steps to facilitate union formation.” However, the project record indicates that IFC did not engage with its client to determine whether it was acting consistently with this commitment, which was a condition of IFC’s investment. In this context, CAO finds that IFC did not have sufficient basis to clear the purchase of its equity in the company.

Following approval of the investment, IFC met with its client and with the complainants to obtain information about the union recognition dispute. In an attempt to resolve the issue, IFC tried to facilitate a dialogue between the client and the workers. Whilst IFC tried to support the client through dialogue, further evidence was presented showing that the client was attempting to block or influence the union formation process. The client’s continued resistance to the union formation required an assessment by IFC to determine whether the client’s actions aligned with agreed commitments and relevant PS2 requirements. This was not conducted.

IFC did not engage with its client when a third party certification body released a report that found breaches of FoA at SFI in 2015. After a period of inactivity while the client attempted to sell the Malaysian plant, IFC resumed active supervision of the project in mid-2016. At this point, following further legal action by the client to prevent union recognition, IFC advised the client to take steps toward union recognition in parallel to its ongoing litigation—an approach that IFC advised would enable the client to meet the requirement of PS2. IFC acknowledges that the client was not compliant with IFC requirements at this point. The client, however, declined to accept IFC’s recommendations deciding rather to continue to contest the registration process through the courts.

In circumstances where a client fails to comply with its E&S commitments, IFC is required to work with the client to reestablish compliance. If this fails, IFC is required to exercise remedies as appropriate. CAO finds no evidence that IFC considered remedies or communicated to the client that remedies could be exercised if the client did not comply.

In summary, CAO finds that IFC did not discharge its supervision duty in relation to the FoA issues raised by the complainants: (a) during the initial stages of supervision (2014/15), because IFC did not conduct the analysis necessary to determine compliance; (b) during 2015/16, because IFC suspended supervision at the client’s request; and (c) post 2016, because IFC did not exercise remedies in relation to a client that it acknowledged was in breach of PS2, and was unwilling to accept IFC advice on the issue.

CAO has identified a number of underlying causes of IFC’s non-compliance in this case.

First, the IFC team did not draw on the type of expertise that was required to conduct a robust analysis of the union issues raised by the complainants. IFC’s appraisal and supervision of the

project focused on addressing environmental and indigenous rights issues. Although labor issues were considered, analyzing FoA concerns presented a challenge for a project team that did not have specialist expertise in relation to these issues. When IFC headquarters offered to supplement the team with an expert external consultant, the project team chose not to draw on this expertise.

Second, although the project ESRS included a client commitment not to oppose but rather to facilitate union recognition, it was not clear that the client and IFC shared a common understanding of what this would mean in practice. According to IFC, there was an expectation that client cooperation with the government-facilitated union formation process would satisfy PS2 requirements. The client, on the other hand, maintained a position that it would support formation of an in-house union, but oppose the recognition of STIEU. An agreement as to what PS2 required in the context of the client's ongoing dispute over the recognition of STIEU was thus lacking.

Third, IFC pursued opportunities to facilitate dialogue between the client and worker representatives at the expense of ensuring client compliance with PS2. While attempts to problem solve are consistent with IFC's role under the Sustainability Framework, they do not replace IFC's duty to assess client performance against the requirements of the Performance Standards. In this case, concerns being raised by the complainants and the client's stated position (that they would oppose recognition of STIEU and only recognize an internal union) were indicative that PS2 requirements were not being met. IFC's decision not to engage with the issues from a compliance perspective meant that the alleged non-compliance was not addressed.

Finally, the project record indicates that the IFC team did not consider the substance of the client's judicial review claims, and did not articulate the consequence of the client's litigation strategy in relation to the union issue. This gave the client space to pursue a series of judicial review actions and appeals with the effect of delaying the government-facilitated process for union recognition. In undertaking these actions, the client's stated intention was to ensure that any union was legally constituted. However, as finally determined by the courts, the arguments made by the client lacked merit under Malaysian law. IFC's acceptance of the position that the client was entitled to exhaust all legal options to oppose recognition of STIEU without requiring analysis of the merits of the client's case under Malaysian law or the consistency of their legal strategy with the requirements of PS2, served to undermine workers' efforts to organize.

CAO concludes that shortcomings in IFC's review and supervision of this project have contributed to adverse outcomes for the complainants. Recognition of STIEU has been delayed. As a result, workers have been deprived of representation. During CAO's site visit, workers highlighted concerns about unpaid annual salary increments, health and safety issues, social welfare and medical issues. CAO notes that, in the absence of any recognized worker representatives, the client has undergone substantial financial constraints and SFI employees have been further impacted as a temporary layoff scheme has been implemented. Membership of a union that can negotiate on behalf of workers in relation to these types of issues is a right under international law and one which is recognized in IFC's Performance Standards. This right was denied to the workers of SFI for a period of over three years from the date of IFC's investment.

CAO will keep the investigation open and will monitor IFC's response to the investigation findings.

Appendix A. Table of Key Compliance Findings

IFC Appraisal
Given a range of significant potential E&S risks and impacts IFC appropriately categorized the project "A" and disclosed a labor audit commissioned by the client. Neither the labor audit nor IFC's review of the project considered PS2 compliance issues related to the client's known opposition to the formation of an externally affiliated union or its promotion of an in-house joint consultative committee. IFC's pre-investment review did not consider labor and freedom of association (FoA) related risks that emerged from the country and sector context in which the client was operating. A commitment not to oppose union formation was captured as a mitigation measure and incorporated into the client's Environmental and Social Action Plan (ESAP), however, details of what this meant were not agreed. Considering contextual risk factors and the fact that the company was involved in a long running dispute over union formation, IFC's pre-investment review and proposed mitigation measures were insufficient to provide assurance of PS2 compliance.
IFC Disclosure, Commitment and Subscription
IFC's presentation of the project to its board did not include material information which IFC was aware of prior to board approval, particularly information related to the client's long-running dispute over union formation and a complaint from the unions received through IFC's labor portal. Although the labor portal complaint included substantial new information about the adverse risks or impacts described in the ESRS and the mitigation measures described in the ESAP, IFC did not update its disclosures as required. IFC processed its investment without ensuring that the client was meeting ESAP commitments not to oppose but rather to facilitate union formation.
IFC Supervision
IFC did not adequately supervise the project in relation to the FoA issues raised by the complainants. During the initial stages of supervision (2014/15) IFC did not conduct the analysis necessary to determine compliance, despite evidence that the client had taken steps to hinder recognition of STIEU. In 2015/16 IFC suspended supervision at the company's request, despite indications that the client was not in compliance with the requirements of PS2. In 2016, IFC acted consistently with the Sustainability Policy when it recommended to its client an approach that it stated would enable SFI to meet the requirements of PS2. This involved taking steps toward union recognition in parallel with its ongoing litigation. However, the client declined to follow IFC's recommendation and, to date, no further action has been taken by IFC to ensure compliance. In these circumstances, IFC has not met the requirement of the Sustainability Policy to exercise remedies as appropriate if a client fails to comply with the Performance Standards.

Appendix B: Project Timeline

Date	Milestones, Events and Documents
1982	
April	Sabah Forest Industries (SFI) established by the Government of Malaysia.
1990-1991	
	Approx. 1200 SFI employees from the Pulp and Paper (PnP), Industrial Tree Plantation (ITP) and Integrated Timber Complex (ITC) formed the Sabah Forests Industries Employees Union (SFIEU). SFIEU filed a request with SFI management for recognition to represent the employees for collective bargaining. Management refused to recognize the union on the basis that its supporters did not represent a majority of workers.
1994	
January	SFI purchased by Lions Group and privatized. Change in corporate structure leaves 2% ownership with the state government.
2007	
March	BILT acquires Lion's Group, with SFI as a wholly-owned subsidiary.
2009	
January	Letter from Director General for Industrial Relations (DGIR) to SFI informs that the Ministry of Human Resources (MOHR) has acknowledged SFIEU effective since 2003.
	SFI files judicial review proceeding challenging decision by MOHR.
June	High Court finds in favor of the company and suppresses decision that SFI has to recognize SFIEU.
October	Workers decide to join Sabah Timber Industry Employees Union (STIEU). SFIEU dissolved.
2010	
November	SFI secret ballot election. Majority of workers vote to be represented by STIEU.
2011	
January	MOHR decision to register STIEU. DGIU sends notice to SFI to recognize STIEU with effect from Oct 2009.
March	SFI files application for judicial review of MOHR decision (JR 2011)
August	High Court Order dismisses judicial review (JR 2011). ¹⁴⁷ SFI appeals against High Court decision on JR 2011.
September	High Court grants interim order, staying its decision in JR 2011 pending appeal.
2012	
November	Court of Appeal decides in favor of SFI on JR 2011. No recognition of STIEU.
2013	
March	BWI contacts Rainforest Alliance to raise the issue of union recognition, prior to the annual surveillance visit of SFI for its "controlled wood certification."
June	SFI invites employees to form Joint Consultative Committee (JCC). STIEU writes explaining its decision not to support formation of JCC.
November	IFC's Bilt project #34602 submitted for internal concept review meeting.

¹⁴⁷ Kelimen Sawatan. "SFI's application for judicial review dismissed." *The Borneo Post*. Available at: <https://goo.gl/9TPzN6>.

Date	Milestones, Events and Documents
2014	
March	DGIR allows STIEU to serve another claim for recognition. STIEU files a second claim. DGIR initiates a secret ballot election.
April	SFI rejects claim for recognition on the basis that it may not comply with the Industrial Relations Act, 1967.
	Director of Trade Union Department (TUD) Sabah informs SFI that the Deputy Director will visit SFI to ascertain eligibility of STIEU to represent SFI employees.
May	BWI meeting with IFC staff to discuss FoA at SFI, in Washington D.C.
	BWI submits complaint to Accreditation Services International re. Rainforest Alliance failure to identify union recognition as a breach of its standards.
June	IFC discloses proposed investment in Ballarpur International Graphic Paper Holdings B.V., project # 34602.
July	STIEU requests a meeting with social/labor auditors. Meeting goes ahead, with the client attending for part of the meeting
	DGIR requests from the client a list of employees eligible to join a union.
August	STIEU and affiliate BWI submit a complaint through IFC labor portal.
	SFI submits list of employees eligible to join a union to DGIR
	IFC responds to STIEU/BWI acknowledging receipt of complaint
	IFC board approves investment in Ballarpur International Graphic Paper Holdings B.V., project # 34602. Abstention by one board member.
September	Labor and working conditions audit (labor audit) finalized, providing an account of labor union recognition issues at SFI. Labor audit includes incomplete statement of PS2 requirements. Quarterly EHS Audit Report submitted by client consultants.
	BWI requests information from IFC on status of project #34602 and notes concerns with IFC disclosure and labor audit.
	BWI/STIEU submit complaint to CAO.
	DGIR schedules secret ballot for STIEU. SFI requests postponement pending visit of Trade Union Division and reply from Ministry of Human Resources on competence of STIEU to represent SFI employees. First hearing to discuss secret ballot.
	IFC Commitment for equity investment signed October 3, 2014
October	October 9, IFC staff meet with complainant-unions in Washington DC
	October 14, IFC site visit and meeting with SFI to discuss CAO complaint
	October 15, IFC correspondence with SFI regarding site visit observations
	Hearing to discuss secret ballot
	IFC processes equity investment of USD 100 million, October 30, 2014
November	MOHR carries out three-day visit to SFI to interview workers.
	IFC client distributes a circular to all employees stating that the company will support the formation of an in-house union and encourages those eligible to form and submit the relevant documentation for recognition. STIEU responds to SFI circular, rejecting the call for an in-house union
	DGIR writes to the client informing them employees eligible to vote in secret ballot.
	IFC visits SFI Malaysia, meets with management and with STIEU representatives.
December	Second Quarterly EHS Audit Report submitted by client consultants.
	TUD completes competency investigation to determine workers eligible to vote in secret ballot.
	Accreditation Services International publishes report on BWI complaint, noting some failures on the part of Rainforest Alliance but determining that auditors did not err significantly in their judgment.
2015	
January	IFC commits B Loan but does not disburse.

Date	Milestones, Events and Documents
	IFC completes report on November 2014 site supervision visit noting union recognition as an “issue of nomenclature.”
	CAO releases Compliance Appraisal of Bilt-02 case, decision to investigate.
	SFI management engage with STIEU representatives to propose recognition of an in-house union. STIEU representatives decline.
March	BWI submits complaint against company to Forest Stewardship Council (FSC)
	MOHR decides on eligibility of workers for secret ballot
	IFC and complainants participate in a conference call to discuss union recognition issue and IFC's planned supervision visit to SFI Malaysia.
April	BWI writes to IFC informing IFC of MOHR execution of competency report on SFI employees eligible for secret ballot. BWI calls on IFC to direct the client to take a number of actions.
	April 15 – Ministry of Industrial Relations informs IFC client of decision in relation to eligibility of 116 disputed workers.
	April 27 – Sabah Industrial Relations Department informs IFC client of planned date for secret ballot meeting.
	IFC client contacts DGIR seeking clarification in relation to employees not assigned in April 15 letter.
May	On May 14, a third judicial review is filed by IFC client for review of the MOHR' April decision (2015 JR). IFC client argues that the decision was irrational, did not address the status of all employees, and did not take into account detailed duties and responsibilities of employees.
	May 18, BWI writes to IFC informing them of 2015 JR, and alleges certain actions taken by SFI management show it does not intend to allow recognition
June	Forest Stewardship Council accepts BWI complaint, after attempts to mediate were unsuccessful
	BWI informs IFC that SFI management have harassed STIEU leaders and have collected workers' national ID cards to support and register in-house union
July	Death of worker at chip mill in SFI, Sipitang
	Chemical explosion accident injures two workers at SFI, Sipitang
August	Death of worker at SFI, Sipitang.
	FSC complaints panel begins evaluation of BWI complaint.
September	Bilt announces agreement to sell stake in SFI.
	CAO assessment report finds no agreement between the parties to participate in Dispute Resolution. Case transfers to compliance.
December	JR 2015 Hearing
	FSC evaluation and recommendations submitted to FSC board.
2016	
May	FSC board decision released, with conditions for BILT to continue association.
June	High Court verdict released: JR 2015 Dismissed.
July	IFC client files an appeal of the court verdict in relation to JR 2015.
August	FSC disassociates from BILT.
September	IFC contacts the client, requesting that the client agree to honor the court verdict of JR 2015, honor the secret ballot outcome, and allow formation of a lawfully formed union of workers' choice without imposing any limitations. IFC client declines.
2017	
May	Court of Appeal upholds Minister of Human Resources decision and dismisses SFI appeal.
July	SFI taken under receivership at the petition of creditors
October	Federal Court dismisses SFI appeal, exhausting available appeals.
November	SFI implements temporary layoff program including reduction to 50% salary in 2018

Appendix C. IFC Investments in BILT Group

Project Number	Disclosure date	Approval date	Disbursement /subscription date	Investment mode	Currency	Cost in U.S. dollars (millions)
#10066	SPI: May 2000 ERS: Sep 2001	Oct 2000	Feb 2001	Guarantee of local currency loan	USD	27
#20798	SPI: Aug 2003 ERS: Aug 2003; Nov 2003	Nov 2003	Nov 2003	Loan	USD	15
#34602	SPI: Sun 2014 ERS: Jun 2014, Jul 2015	Aug 2014	Oct 2014 <i>Cancelled</i>	Equity Loan	USD	100 75

Appendix D. CAO Investigation Terms of Reference

May 10, 2016

... The focus of the CAO compliance process is on IFC/MIGA's appraisal and supervision of an investment, and whether or not IFC/MIGA complied with its own policy provisions to assure itself of the environmental and social performance of its investments. CAO does not undertake a compliance investigation of IFC/MIGA's client. CAO discloses the findings of its compliance investigation in an investigation report to inform the President and Board of the World Bank Group, senior management of IFC/MIGA, and the public about its decisions and reasoning...

Scope of the compliance investigation

The focus of CAO's compliance investigation is on IFC, and how IFC assured itself of the environmental and social performance of its investment at appraisal and during supervision.

The approach to the compliance investigation is described in the CAO Operational Guidelines (March 2013), and states that the working definition of compliance investigations adopted by CAO is as follows:

An investigation is a systematic, documented verification process of objectively obtaining and evaluating evidence to determine whether environmental and social activities, conditions, management systems, or related information are in conformance with the compliance investigation criteria.

As set out in CAO's appraisal report, CAO will conduct a compliance investigation of IFC's investment in the client in relation to the issues raised in the complaint.

The compliance investigation will consider whether IFC's investment in the client was appraised, structured and supervised in accordance with applicable IFC policies, procedures and standards. It will also consider whether IFC's Policy and Performance Standards on Environmental and Social Sustainability and Policy on Disclosure of Information as applied to this project provide an adequate level of protection.

In the context of IFC's E&S policies, Performance Standards and procedures, CAO's specific questions in relation to the investment include:

1. Whether IFC's pre-investment review of the issues was commensurate to risk, particularly in relation to union issues?
2. Whether IFC responded adequately to freedom of association issues identified in the client's Labor and Working Conditions Audit?
3. Whether IFC's supervision of the project was sufficient to assess the status of project's compliance with the requirements of the Performance Standards, specifically as it relates to freedom of association issues?

Complete Terms of Reference are available at: <https://goo.gl/dxVv88>