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Mr. Osvaldo L. Gratacós
Compliance Advisor Ombudsman
International Finance Corporation
2121 Pennsylvania Avenue, N.W.
Washington DC 20433

IFC Management's Response to the CAO Investigation Report on Bilt Paper B.V., Malaysia

Dear Mr. Gratacós:

Thank you for the opportunity to respond to the CAO compliance investigation report in relation to IFC's Investment (#34602) in Bilt Paper B.V., Netherlands (Bilt Paper), regarding Bilt Paper's subsidiary Sabah Forest Industries Sdn. Bhd. (SFI).

The CAO investigation report presents valid observations regarding IFC's identification of Freedom of Association issues during IFC's due diligence of the project. Prior to IFC's investment due diligence, SFI was not in compliance with Performance Standard 2 (PS2) regarding Freedom of Association due to, among other aspects, attempts to block union formation process through legal action. Prior to due diligence, IFC was primarily focused on environmental and social risks, particularly with respect to SFI's in-field forestry operations. Such risks had high profile and included sensitive issues regarding indigenous peoples, biodiversity, competing land claims, migrant labor, and community engagement.

During the investment due diligence process, IFC required an independent and publicly disclosed labor audit that resulted in: (i) a public commitment from Bilt Paper to address identified issues in accordance with PS2 provisions, (ii) a comprehensive public disclosure of the issue, and (iii) cooperation with the Malaysian Government-led union formation process. IFC followed up on the implementation of these measures through periodic supervision visits and third-party audits.

In June 2016, SFI fell out of compliance with PS2 when it re-attempted to block union formation through legal action. Several factors hindered IFC's ability to help move the client into compliance. These included: (i) efforts by Bilt Paper to sell SFI since 2015, (ii) uncertainty associated with the pending outcome of ongoing legal proceedings, and (iii) subsequently, financial distress at SFI as well as at Bilt Paper.

There is little scope under the present circumstances for further IFC intervention, given the imminent sale of SFI's assets already finalized under a court receivership. Bilt Paper, and as a result IFC, no longer have any direct contractual relationship or leverage to effect further progress.

Notwithstanding, IFC will engage with the new owner to explain IFC's environmental and social due diligence findings and, to the extent still relevant, mitigation measures associated with achieving PS2 compliance. This may serve to assist the new owner in pursuing further actions to regain Forest Stewardship Council certification, should they be interested in doing so. Also, it has recently been reported in the press that SFI employees, currently under a temporary layoff since early last year, will retain their jobs.

Labor matters, including Freedom of Association, need to be represented and disclosed as material risks in the same way as other challenging environmental and social risks related to critical habitat, indigenous peoples, free and prior informed consultation, community engagement, broad community support, and others. Moving forward, IFC will more prominently identify Freedom of Association risks in its Board reports.

Sincerely,

Ethiopis Tafara
Vice President and General Counsel

Stephanie von Friedeburg
Vice President and Chief Operating Officer

Annex: IFC Tabulated Management Response: Bilt Paper B.V.

	CAO Finding	IFC's Response	Actions Taken or Proposed
	IFC Appraisal		
1	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.	Agree.	N/A
2	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.	Disagree. IFC identified this issue as part of its due diligence and the issue was analyzed in detail in the Third-Party Labor audit, which was disclosed together with IFC ESRS (please see document at https://disclosures.ifc.org/#/projectDetail/ESRS/34602). Based on the findings, IFC required SFI to cooperate in the government led union formation process. This is consistent with IFC policies that are deliberately designed to allow progressive realization of Performance Standard objectives.	N/A
3	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.	Disagree. The FoA related risks in this project were not related to the context and primarily a result of client's actions prior to IFC's involvement. Hence, a contextual risk assessment was not considered relevant in this situation.	Since this transaction, IFC has enhanced and formalized its approach to assessing contextual risk analysis in its environmental and social due diligence.
4	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.	Disagree. Since a government led union formation process was already underway, non-opposition meant cooperation in that government led process to its culmination, which was agreed as the way forward.	N/A

5	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.	Disagree. IFC was deliberately not prescriptive as there was a well-defined government led process underway and IFC wanted the client to cooperate in this process which would, if fulfilled, culminate in the formation of a workers' union. IFC relied on this approach because of the client's explicit commitment as well as IFC's positive history on labor issues with Ballarpur Industries Limited (BILT), the Indian parent of Bilt Paper and IFC equity investee, where union representation of its workforce was well established.	N/A
	IFC Disclosure, Commitment and Subscription		
6	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.	Agree. IFC acknowledges that the Board report did not explicitly refer to SFI's opposition to union formation. However, the publicly disclosed E&S documentation did robustly reveal and address the issue of opposition to union formation.	IFC acknowledges and recognizes that labor issues, and in particular Freedom of Association issues, can be complex and material risks that can justify emphasis and escalation in management and board approvals. IFC teams now have access to specialist consultant support on labor issues when deemed necessary.
7	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.	Disagree. Detailed discussion on the FoA issue was included in the third-party labor audit report and this report was disclosed with the ESRS. Further, in accordance with the agreement with IFC, the client was cooperating in the government led union formation process.	N/A
8	IFC processed its investment without ensuring that the client was meeting ESAP commitments	Disagree. IFC recognized from appraisal onward that the client had a history of opposing formation of a union in SFI. As a condition of its investment, IFC explicitly required SFI to drop its opposition. Further, as agreed	N/A

	not to oppose but rather to facilitate union formation.	with IFC, SFI was at that the time of IFC investment cooperating in the government led, union formation process, which was IFC's requirement to meet PS2 provisions.	
	IFC Supervision		
9	IFC did not adequately supervise the project in relation to the FoA issues raised by the complainants.	Disagree. Adequacy should be considered in terms of effort/engagement. IFC did repeatedly engage the client (and complainants) in an effort to make progress on the Freedom of Association issue. Through periodic interaction, supervision visits and third-party audits, IFC monitored SFI's level of cooperation in the government-led union formation process. This oversight made clear that certain actions by SFI management such as issuance of an internal circular indicating their preference for an in-house union in November 2014, were contrary to PS2 provisions. IFC in all subsequent interactions with SFI and BILT management conveyed to them that this position was a violation of PS2 provisions and that SFI must accept a lawfully formed union of the workers choosing "without any limitations." Unfortunately, up until the time when IFC's leverage weakened because of Bilt Paper's decision to sell SFI and the financial distress faced by SFI and Bilt Paper, this engagement had not resulted in an outcome of PS compliance.	N/A
10	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.	Disagree. IFC proactively sought to facilitate dialogue—as recommended in the labor audit—between workers, the union and SFI management. IFC also made clear, immediately upon being made aware that SFI management was advocating with its workers for an in-house union, that this was not consistent with PS2 and this was a message reiterated to SFI management as well as BILT management in multiple subsequent meetings, including during IFC site visits to SFI.	N/A

11	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.	Agree. IFC did suspend site supervision at the client's request but this was done as the client had commenced the process to sell SFI.	N/A
12	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.	Agree. IFC agrees that the client did not follow IFC's recommendations to gain PS2 compliance. The severe financial distress SFI was then undergoing posed a real and present threat to its ability to continue to operate and thus to its workforce. Additionally, the IFC loan to SFI originally planned was never disbursed and ultimately cancelled in 2015. This meant IFC's relationship with SFI was solely via its equity investment in BILT. IFC's focus has been to facilitate a remediation of the financial distress such that SFI's employees have a sustained employment without which Freedom of Association would be moot.	Considering the pending Malaysian court ordered sale of SFI, and a new buyer being identified, IFC will offer to meet with the buyer to discuss E&S issues including those relating to FoA to encourage resolution and a path to recertification by FSC.