



APPRAISAL REPORT

CAO Compliance Appraisal

CAO Ref. Code: C-I-R4-Y12-F171

August 30, 2013

IFC Investment in Lonmin Platinum Group Metals Project, South Africa
[IFC Project #24803]

Case of

CAO Vice President initiated appraisal of IFC's projects with Lonmin

Summary

This compliance appraisal was triggered by the CAO Vice President following reports of serious violence which resulted in the deaths of Lonmin workers and members of the South African police in August 2012.

The CAO appraisal report considers the adequacy of IFC's appraisal and supervision of its Lonmin investment. In particular it considers how IFC reviewed, interacted with and advised its client on matters related to labor conflict, and how IFC assured itself of implementation of relevant IFC policy provisions.

Based on a review of documentation and interviews with IFC staff, the appraisal report raises concerns as to the adequacy of IFC's E&S performance in relation to this investment. It also identifies potentially more systemic issues regarding the way in which the Sustainability Framework was applied to an equity investment in a publically listed company, with regard to which IFC had limited leverage. Absent a complaint from affected workers, however, CAO finds that the nexus between the E&S performance issues outlined in this appraisal and the tragic outcomes of the August 2012 dispute is insufficiently established. Therefore, CAO decides that an investigation is not warranted and will close the case.

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

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

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

1. Overview of the CAO Compliance Appraisal Process

When CAO receives a complaint about an IFC or MIGA project, the complaint is referred to CAO's dispute resolution arm, CAO dispute resolution, which works to respond quickly and effectively to complaints through facilitated settlements, if appropriate. If CAO dispute resolution concludes that the parties are not willing or able to reach a facilitated solution, the case is transferred to CAO compliance for appraisal and potential compliance investigation.

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

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

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

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

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

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

2. Background

IFC's relationship with Lonmin commenced in 2006, with a multi-year program to support: (i) the development, expansion, and the mechanization of Lonmin's South African mines; (ii) the financing of planned transactions regarding broader and more equitable ownership of South African businesses through Black Economic Empowerment (BEE) participation in Lonmin's development programs; and (iii) through an IFC Advisory Service project, a comprehensive, large-scale community and Local Economic Development Program (LEDP) for the community of about 350,000 people living on and around Lonmin's main operations.

IFC presented this project to the Board of the World Bank Group (the Board) in December 2006. The Board approved a \$50 million equity investment, a \$100 million standby credit facility and an Advisory Service project. \$15 million of IFC's equity was earmarked towards LEDP while the balance was for Lonmin's expansion plans. The credit facility was expected to fund Lonmin's expansion plans and BEE participation.

The principal objective of IFC's Advisory Service project was the development of a comprehensive program to strengthen the social sustainability of the client and maximize the development impact of IFC's investment. There were five components to this project: (1) Local Supplier Development; (2) Supply Chain Initiative; (3) Gender Mainstreaming; (4) HIV/AIDS Risk Mitigation; (5) Community Development.¹ The Advisory Service project finished on June 30, 2010.

3. Scope of the Compliance Appraisal

On August 21, 2012 the CAO Vice President initiated a compliance appraisal of IFC's Environmental and Social performance in relation to its investment in Lonmin.

This decision was triggered by media reports of violent clashes between striking miners and police near Lonmin's Marikana mine which claimed 44 lives earlier the same month.

As requested by the CAO Vice President, this compliance appraisal will consider the adequacy of IFC's appraisal and supervision of its Lonmin investment. In particular it will consider how IFC has reviewed, interacted with and advised its client on matters related to labor conflict, and how IFC has assured itself of implementation of relevant IFC policy provisions.

From the perspective of CAO's mandate, the general questions raised are

- Whether IFC conducted an Environmental and Social (E&S) review that was "appropriate to the nature and scale of the project, and commensurate with the level of social and environmental risks" of the project (Policy on Social and Environmental Sustainability, 2006, para. 13); and
- Whether IFC adequately "monitor[ed] the client's social and environmental performance throughout the life of IFC's investment" (Policy on Social and Environmental Sustainability, 2006, para. 11).

¹ IFC (2006) Summary of Proposed Investment. <http://goo.gl/Z6CemV>

4. Discussion

Overview of applicable standards

This project is governed by IFC's 2006 Policy on Social and Environmental Sustainability (Sustainability Policy) and 2006 Performance Standards.

IFC's Sustainability Policy (2006) states that IFC's mission is to promote sustainable private sector development in developing countries. In order to accomplish its mission, IFC seeks to establish partnerships with clients on the understanding that the pursuit of social and environmental opportunities is an integral part of good business. Central to IFC's development mission is to carry out its investment operations in a manner that "do no harm" to people or the environment. "Negative impacts should be avoided where possible, and if these impacts are unavoidable, they should be reduced, mitigated or compensated for appropriately." Further, "IFC seeks to ensure that the projects it finances are operated in a manner consistent with the requirements of the Performance Standards."²

In the context of an investment project, IFC expects its clients to undertake an assessment of the environmental and social risks and impacts, and manage these in accordance with the Performance Standards. IFC's role is to "review the client's assessment; to assist the client in developing measures to avoid, minimize, mitigate or compensate the social and environmental impacts consistent with the Performance Standards; ... and to monitor the client's social and environmental performance throughout the life of IFC's investment."³

When appraising a project, IFC undertakes an E&S review as part of its overall due diligence. "This review is appropriate to the nature and scale of project, and commensurate with the level of social and environmental risks and impacts." The review has three components "(i) the social and environmental risks and impacts of the project as assessed by the client; (ii) the commitment and capacity of the client to manage these expected impacts, including the client's social and environmental management system; and (iii) the role of third parties in the project's compliance with the Performance Standards." Based on its review, IFC assigns the project an E&S risk categorization based on the expected impacts.⁴

IFC is required to monitor clients' E&S performance throughout the life of an investment. The Sustainability Policy commits IFC to "[r]equire the project to submit periodic Monitoring Reports on its social and environmental performance as agreed with IFC" and "[c]onduct site visits of certain projects with social and environmental risks and impacts." IFC will "[r]eview project performance on the basis of the client's commitments in the Action Plan, as reported by the client's Monitoring Reports, and, where relevant, review with the client any performance improvement opportunities."⁵ As set out in the IFC's Environmental and Social Review Procedures (ESRP) "the purpose of E&S supervision is to develop and retain the information needed to assess the status of compliance with the Performance Standards (PSs), general and sector-specific Environmental Health and Safety (EHS) Guidelines, and the Environmental and Social Action Plan (ESAP or Action Plan)."⁶

The analysis that follows is organized chronologically following the IFC project cycle.

² IFC (2006) Sustainability Policy, p 2.

³ Ibid, p.2.

⁴ Ibid, p.3.

⁵ Ibid, p.5.

⁶ IFC (2012) Environmental and Social Review Procedures, para 6.1. <http://goo.gl/Zol5nO>

May 2006 – March 2007 (Appraisal and Pre-commitment)

IFC uses a system of environmental and social categorization in order to reflect the magnitude of impacts expected and specify IFC's public disclosure requirements prior to presenting a project to the Board for approval. In this instance, IFC categorized this project as A; meaning that the project had potential significant adverse environmental or social impacts that are diverse, irreversible or unprecedented.

IFC E&S staff noted early on in the appraisal stage that this was an unusual project for IFC as the client was listed on the FTSE100, and the purpose of IFC's financing was a Technical Assistance program and expansion projects with the existing footprint. IFC staff noted that Lonmin had a genuine interest in a long-term relationship with IFC and that an equity investment was seen as a long-term facility to promote such a partnership.⁷

Community Support

The Performance Standards, require IFC clients to engage with affected communities through disclosure of information, consultation and informed participation. For projects with significant adverse social and/or environmental impacts on affected communities, to the Performance Standards require engagement with affected communities early in the E&S assessment process and on an ongoing basis.⁸

The Sustainability Policy and ESRP outline IFC's duties in assessing community engagement and support for a project. In all cases this includes determining "how the client has met or will meet its disclosure and consultation obligations, as outlined in the IFC PS."⁹ In addition, in relation to projects with significant impacts, IFC is required, "through its own investigation, to assure itself that the client's community engagement is one that involves free, prior and informed consultation and enables the informed participation of the affected communities, leading to broad community support (BCS) for the project within affected communities, before presenting the project for approval by IFC's Board of Directors."¹⁰

The ESRP outlines how IFC determine BCS. IFC first determines whether the client has conducted free, prior and informed consultation with affected communities and secondly determines the level of support and dissent related to the project among these communities.¹¹

At appraisal, IFC noted various measures that Lonmin was taking in order to transform their relationship with surrounding communities and stakeholders. IFC noted that "[o]verall stakeholder perceptions of Lonmin were fairly negative in the 2004 Stakeholder Perception Surveys" but that a Stakeholder Engagement Process in 2005 led to a "much improved, although ... a relatively low overall 'satisfaction' rating"¹² and there was an expectation of further improvement in the then forthcoming 2006 perception survey.

IFC established BCS for this investment based on "(a) the sponsor's well documented efforts to identify and consult with stakeholders on an ongoing and iterative basis in a free, prior and informed manner; (b) the outcome of several meetings held with key stakeholder groupings during appraisal; (c) attendance at two Stakeholder Engagement Forums (November 2005, November 2006) and (d) the publicly disclosed results of independent Stakeholder Perception Surveys for

⁷ IFC (2006) Corporate Investment Committee minutes.

⁸ IFC (2006) Performance Standard 1.

⁹ IFC (2006) Environmental and Social Review Procedures, para. 3.2.12(d).

¹⁰ IFC (2006) Sustainability Policy, para. 20.

¹¹ IFC (2006) Environmental and Social Review Procedures, 3.5 Annex.

¹² IFC (2006) Environmental and Social Review Summary (ESRS). <http://goo.gl/vxBGHf>

2004, 2005 and 2006. Further, IFC notes that BCS was not determined separately for the IFC 'project' as this project was not readily discernable from the sponsor's existing operations."

Performance Standard 2: Labor and Working Conditions

IFC Performance Standard 2 set a number of requirements for IFC clients. Relevantly, these include:

- adopt a human resources policy appropriate to its size and workforce (PS2, para. 6);
- communicate directly with workers about their working conditions and terms of employment (PS2, para. 7);
- respect collective bargaining agreements. Where these agreements do not exist, the client is required to, at a minimum, comply with national law (PS2, para. 8);
- not discourage workers forming or joining workers' organizations. Where national law restricts worker organization, IFC require the client to "enable alternative means for workers to express their grievances and protect their rights regarding working conditions and terms of employment" (PS2, para. 9);
- provide for non-discrimination and equal opportunity in employment (PS2, para. 11);
- developing a plan to mitigate the adverse impacts of retrenchment (PS2, para. 12);
- providing a grievance mechanism for workers to raise reasonable work place concerns (PS2, para. 13).

IFC's role during the appraisal phase is to assure itself that these requirements are adequately covered in the client's E&S assessment. Furthermore, IFC's Guidance Notes on PS2 affirm that "IFC will assist its clients in the application of Performance Standards 2 during the various stages of a project" (PS2, G4).

At appraisal, IFC considered Lonmin to have "extensive management capacity in the areas of Safety, Health and Environment" and "was steady increasing its management capacity to similar levels in the areas of Community Relations and Social Development."¹³ IFC's due diligence included site visits at Lonmin's facilities and with community representatives within the Greater Lonmin Community.

The findings in IFC's ESRS and documentation of its appraisal visits in relation to labor issues are positive without reservation noting in particular that:

- Lonmin had prepared and was in the process of implementing a comprehensive Social and Labor Plan which outlined commitments relating to the workforce, including training, grievance mechanisms, and reporting and monitoring. IFC considered this plan to go considerably further than PS2 requirements;¹⁴
- there were three accredited labor unions active at Lonmin operations in the Marikana area and three at the Limpopo Division (two of which are common to both facilities). All workers were guaranteed Freedom of Association as part of a formal agreement between Lonmin and these unions. IFC noted that a Joint Union Management Problem Solving Forum had been established in 2005 to work on employee issues. Furthermore, Lonmin had recently agreed to a five year New Era Labour Agreement (2005-2009) which IFC regarded during its appraisal visit as a major advance in labor relations; and
- the appraisal visits concluded that no supplemental actions were required by Lonmin to meet the requirements of PS2

IFC appraisal documentation noted that Lonmin housed a total of 9513 employees in hostels and provided a housing allowance to a further 9733. The company prioritized phasing out single-sex

¹³ IFC (2006) Environmental and Social Review Summary (ESRS). <http://goo.gl/vxBGHf>

¹⁴ IFC submission to CAO (March 2013).

hostels, which in May 2006 housed half of the Marikana workforce. IFC also noted that Lonmin was “undertaking an aggressive program of housing development and hostel conversion so as to be able to provide improved living conditions for its staff.”¹⁵ This was expected to be complete by 2011.¹⁶ IFC documentation notes, however, that housing for migrants,¹⁷ who formed the majority of Lonmin’s workers, was considered problematic in the host province due to traditional allegiances and cultural differences.

IFC’s appraisal visits included informal discussions with members of three trade unions (including the largest trade union at the time the National Union of Mine Workers - NUM) where the impacts of the New Era Labour Agreement, housing conditions and benefits, grievance procedures and key worker grievances were raised.

Performance Standard 4: Community Health, Safety and Security

IFC Performance Standard 4, sets a number of requirements for IFC clients. These include:

- that the client “assist and collaborate with the community and the local government agencies in their preparations to respond effectively to emergency situations, especially when their participation and collaboration are necessary to respond to such emergency situations” (PS4, para 12). IFC Guidance Note 4 (GN4) clarifies that “the client is required to design emergency plans based on the risks to community health and safety” (GN4, para G19).
- In meeting the conditions under “Security Personnel Requirements” (PS4, para 13-15), IFC’s GN4 clarifies that security arrangements will “depend in large part on security risks in the operating environment” and “[f]or larger operations or those in unstable environments, the review will be a more complex and thorough risk assessment that may need to consider political, economic, legal, military and social developments, and any patterns and causes of violence and potential for future conflict.”
- If the client decides to retain employees or contractors to provide security and safeguards for its personnel and property, “in making such arrangements, the client will be guided by the principles of proportionality, good international practices in terms of hiring, rules of conduct, training, equipping and monitoring of such personnel, and applicable law” (PS4, para 13). Appropriate conduct is clarified in GN4 to include “any security personnel who interact with workers should not harass or intimidate workers exercising their rights in accordance with Performance Standard 2” (GN4, para G26).
- “If government security personnel are deployed to provide security services for the client, the client will assess risks arising from such use, communicate its intent that the security personnel act in a manner consistent with [PS4], and encourage the relevant public authorities to disclose the security arrangements for the client’s facilities to the public, subject to overriding security concerns.”

At appraisal, IFC reviewed Lonmin’s Emergency and Disaster Management plan. IFC noted that emergency plans had been discussed with communities adjacent to potentially risky activities to the extent that IFC considered local community members to be aware of potential risks and what to do in an emergency situation. Further, IFC reviewed Lonmin’s security procedures and met with the relevant Lonmin team. IFC noted that Lonmin utilized privately contracted security guards for asset protection and control purposes and that the operational procedures governing the conduct of security personnel were designed around the UN Voluntary Principles. Lonmin also had an armed (guns and tazers) reaction unit to deal with organized crime. IFC asserted in the ESRS that

¹⁵ IFC (2006) Environmental and Social Review Summary (ESRS). <http://goo.gl/vxBGHf>

¹⁶ Lonmin (2007) Sustainability Development Report (SDR).

¹⁷ Migrants were considered employees not from the North West province.

“[s]hould an emergency situation arise on the Lonmin property there is a well established communication system to notify local authorities such as Police, Fire and Emergency Department, Environmental authorities and local communities.” Further, IFC noted that Lonmin worked closely with the South African Police force, specifically in relation to traffic control issues.

Conclusion

From the perspective of the CAO compliance mandate, the general question pre-commitment is whether IFC exercised due diligence in its review of the E&S aspects of the investment. In reviewing this project, IFC staff assessed the clients E&S procedures, met with the client’s staff and representatives of the community and employees. IFC determined that the client was already meeting and exceeding all the requirements of the Performance Standards, and thus that no Action Plan was required. Having reviewed IFC’s appraisal documentation CAO found no reason to doubt this judgment. CAO notes, however, that IFC’s appraisal documentation departs from the approach set out in GN4 in that it does not engage with what CAO would expect to be relevant background information on security risks in Lonmin’s operating environment, or the “patterns and causes of violence and potential for future conflict.” Relevantly these might have been expected to include risks emerging from: (a) the fractious nature of industrial relations in South Africa’s mining sector; and (b) generally high levels of societal violence, including concerns regarding the use of force by police.¹⁸

In relation to IFC’s determination of broad community support, CAO notes that community support was assessed by based on the outcome of several stakeholder meetings and the results of the client’s perception surveys. However, IFC’s documentation does not detail the outcomes of these stakeholder meetings. Further the results of the client’s perception surveys are reported as being low (albeit improving). In these circumstances it is unclear to CAO that broad community support for the project was established as required by the Sustainability Policy.

Board, Commitment and Disbursement

The joint IFC Investment and Advisory Service project was discussed by the World Bank Group Board on December 19, 2006. The Board Paper noted that the objective of the project “is to assist Lonmin achieve world class safety and efficiency throughout it mining operations, and to promote sustainable economic development in the area surrounding the mining operations. IFC partnership with Lonmin is aimed at building a long term partnership that has a significant development impact in South Africa and has a demonstration effect for sustainable development throughout Africa and the world.” Furthermore, the paper notes: “[i]f Lonmin, with IFC’s support, can achieve the objectives of the project, it will set a new standard for the mining industry’s relationship with the country and community in South Africa, and will forge a sustainable and mutually beneficial partnership with the community surrounding the operations.”¹⁹

IFC staff noted that the project “would support a competitive South African company intent on ensuring sustainable mining development and seeking to expand its operations in Africa. IFC’s support would facilitate equitable local participation in the project and integrate resources and expertise from across the World Bank Group.” Further, IFC’s equity investment “would demonstrate the Corporation’s commitment to a long-term risk-sharing partnership with Lonmin.” A number of Executive Directors questioned IFC’s rationale for making an equity investment in a publically listed company, suggesting that a loan would be more appropriate. In reply, IFC staff noted that “Lonmin had sought IFC’s participation as a long-term partner to share the risk and help the company plan and implement long-term sustainable mining initiatives ... [and] that such a partnership provided an

¹⁸ See for eg. US Dept. of State (2005) Human Rights in South Africa. <http://goo.gl/lvRqFT>

¹⁹ IFC Board Paper (December 19, 2006).

opportunity for IFC to help Lonmin become a best practice example of community development practices.”

In preparations for the legal agreements, IFC’s Environmental and Social department (CES) in December 2006 proposed the following IFC requirements to be referenced in the legal agreements²⁰;

- 1) The IFC Policy and Performance Standards on Social and Environmental Sustainability;
- 2) The IFC Policy on Disclosure of Information;
- 3) IFC Environmental, Health and Safety Guidelines for Mining and Milling – Open Pit, August 11, 1995;
- 4) IFC Environmental, Health and Safety Guidelines for Mining and Milling – Underground, August 11, 1995;
- 5) World Bank Group General Environmental Guidelines (Pollution, Prevention and Abatement Handbook), July 1, 1998;
- 6) IFC Hazardous Materials Management Guidelines, 2001; and
- 7) IFC Environmental Guidelines for Occupational Health & Safety.

IFC’s equity subscription agreement, loan agreement and agreement for the provision of advisory services are dated March 13, 2007. The equity agreement required Lonmin to make representations at each disbursement that it was not aware of any failure to comply with any matter covered by the Performance Standards. Further, Lonmin was required, subject to its obligations under United Kingdom Disclosure Rules, to inform IFC within three days of any incident or accident within areas of Lonmin’s management or control which may have a material adverse effect on its operations in accordance with the Performance Standards. Lonmin was required to provide IFC, at the same time it makes available to other shareholders, “a report on the environmental and social aspects of the operations.”²¹

IFC’s loan agreement required Lonmin to use reasonable efforts to ensure the continuing operation its business in compliance with the Performance Standards. Of the requirements that CES proposed for inclusion in the legal agreement, the client was to confirm compliance with points 3-7 on the date of the loan’s activation. There was no continuing requirement to operate its business in compliance with points 3-7 after the loan’s activation. Beyond the goals of the Advisory Service project, as detailed above in section two, the Advisory Service legal agreement did not include any specific E&S requirements.

IFC’s first equity disbursement was in April, 2007, with subsequent disbursements in August, 2007 and November, 2008. IFC sold 20% of its holding in April, 2009 and participated in two rights issue offerings in May, 2009 and December, 2012. As Lonmin did not draw down on the loan within the availability period, the loan agreement was cancelled in March 2010.

Conclusion

As the loan agreement was never activated and subsequently cancelled, only the E&S requirements in the equity agreement came into effect. As these are limited to reporting requirements, no requirement for Lonmin to conduct its operations in accordance with the Performance Standards was established. Further, Lonmin was not required to report regularly on its compliance with the Performance Standards. As such, IFC’s ability to “monitor the client’s social and environmental performance throughout the life of IFC’s investment”²² and assure itself that it (IFC) was meeting its commitments under the Sustainability Policy was limited.

²⁰ IFC (2006) Environmental and Social Clearance Memorandum.

²¹ Lonmin Equity Legal Agreement (March 13, 2007).

²² IFC (2006) Sustainability Policy, para 11.

Supervision of equity investment: March 2007 – Present

Following commitment, IFC's obligation is to monitor the client's E&S performance in accordance with its Sustainability Policy. On this topic, IFC's ESRPs provide that "[t]he purpose of E&S supervision is to develop and retain the information needed to assess the status of compliance with the Performance Standards (PSs), general and sector-specific Environmental Health and Safety (EHS) Guidelines, and the Environmental and Social Action Plan (ESAP or Action Plan)."²³

Relevantly this includes the requirement to review project performance on the basis of the client's commitments in the investment agreement as reported by the client's Annual Monitoring Reports (AMRs). In particular CAO notes that if serious incidents occur, IFC is committed to following up to ensure that the root causes of the incident are being investigated and appropriate corrective action is taken.²⁴

Since commitment, IFC has reviewed five of the client's *Sustainability Development Reports* (SDR) (2007, 2008, 2009, 2010 and 2012).²⁵ Four supervision missions have been undertaken by IFC E&S staff since commitment (January 2008, April 2009, April 2010, and July 2011).²⁶ As Lonmin is a publicly listed company, IFC's reviews of the clients SDRs frequently affirmed that "IFC is limited in the request for additional information or additional level of detail that is not otherwise available for all shareholders".²⁷ Multiple IFC reviews note that Lonmin had failed to report fatalities as per the requirements of the equity agreement. IFC SDR reviews also note that the client's SDRs do not contain sufficient information to assess compliance with aspects of the Performance Standards and IFC General EHS Guidelines. However, based on IFC supervision visits, knowledge of the client, the regulatory environment in South Africa and the information provided in the client's SDRs, IFC concluded each year that Lonmin was in material compliance with the Performance Standards.

Community Support

After board approval, IFC "continues to monitor the client's community engagement process as part of its portfolio supervision".²⁸ The Performance Standards affirm that "[c]ommunity engagement is an on-going process involving the client's disclosure of information...The purpose of community engagement is to build and maintain over time a constructive relationship with these communities."²⁹

IFC staff noted in their first supervision mission in January 2008 that Lonmin had revised its previously intensive community engagement process by reducing the number of consultants and meetings as it felt that the huge commitment and significant number of meetings were building community expectations without improving delivery. In 2008, IFC further noted that Lonmin's annual stakeholder perception survey showed the first decrease in community support since 2004.

In reviewing Lonmin's 2008 SDR, IFC noted that the results of the 2008 stakeholder perception survey were 48.3%, below the 60% target. This was attributed to poor communication with community members.³⁰ IFC's AMR Review for 2009 notes that annual stakeholder perception survey was not done in 2009 due to severe economic downturn and retrenchments.

²³ IFC (2009) Environmental and Social Review Procedures, para. 6.1.

²⁴ Ibid, para. 6.2.8.

²⁵ The client's SDRs are for year ending September 30.

²⁶ Upon completing a site supervision mission, IFC staff complete a Back to Office Report (BTOR) detailing their findings.

²⁷ IFC AMR (SDR) Reviews.

²⁸ IFC (2006) Sustainability Policy, para 20.

²⁹ IFC (2006) Performance Standard 1, para 19.

³⁰ IFC AMR Review 2008.

Subsequent Back to Office Reports (BTOR) from IFC supervision visits (April 2010 and July 2011) and AMR Reviews (2010) do not report on annual stakeholder perception survey results. BTORs for 2010 and 2011 note that “[t]he public perception survey, which has been implemented by Lonmin for several years, wasn’t undertaken in 2009, but Lonmin feels that it understands public sentiment towards the company due to large-scale social investments and stakeholder engagement initiatives.”³¹

IFC’s quarterly credit risk review of Lonmin in September 2011 noted incidents of community unrest which had disturbed Lonmin’s operations in August 2011. Communities protested at the perceived lack of local recruitment by Lonmin and alleged that R500m (US\$70m) had been given to some community members. In response, IFC noted that Lonmin held a number of meetings with community members to address the issues. In November 2011 Lonmin announced 643 jobs for people from the local community.³² In a subsequent quarterly credit risk review (June 2012) IFC noted the increased unrest in the South African mining sector following disruptions at a competitor’s mine. At this time IFC noted that Lonmin “experienced business disruption several times during the first half of 2012 and has tried to engage with relevant community stakeholders to address the matter.” IFC E&S supervision does not appear to have covered these incidents or any follow up with Lonmin with regards to their root causes.

Performance Standard 2: Labor and Working Conditions

As reported in a Lonmin press release and by international media organizations, in May 2011 an internal National Union of Mine Workers (NUM) dispute lead to an unofficial mining strike at Lonmin’s Karee facility in Marikana, South Africa.³³ Lonmin was granted an injunction on May 20, 2011 ordering all employees to return to work immediately. As the striking employees did not return to work, on May 24 Lonmin dismissed 9,000 employees and immediately began a recruitment process. Lonmin reported in its 2011 SDR that it “allowed those who wanted to work for Lonmin to re-apply for their positions. Approximately 8,200 of these employees were redeployed at Karee. The remaining employees we recruited were from the Greater Lonmin Community (GLC) and skilled employees from the nonoperational Aurora mines”³⁴. This incident is recorded by the IFC investment team in their quarterly credit review documentation in June 2011. It is unclear to CAO what steps IFC took to assure itself that its client was operating in compliance with PS2 in relation to the dismissals described above. It is also unclear to CAO whether IFC assured itself that the appropriate analysis of the root causes of what appears to have been a serious labor dispute was undertaken.

IFC conducted a further supervision visit in July 2011. The BTOR for this visit does not detail meetings with the client’s human resources department or representatives of employees. Also of note, sections of the BTOR in relation to PS2 in the 2011 and 2010 BTORs appear to have been duplicated from the 2009 BTOR. In particular, CAO notes that the 2011 BTOR replicates a section from the 2009 BTOR stating that the “most significant issue by far for Lonmin in the recent years in respect to PS2 was a large scale retrenchment.” This comment relates to a Company announcement from December 2008. While Lonmin did undergo a retrenchment process between 2008-2009, the client increased its employee headcount in 2010. As detailed in Lonmin’s 2011 SDR, by September 2011 there were 2,000 more employees than the pre-retrenchment stage. CAO notes that there is no discussion in the 2011 BTOR of the labor dispute and dismissal of 9000 employees which occurred two months prior to IFC’s visit. In this context, CAO has questions as to

³¹ IFC BTOR Supervision Visit April 2010 and July 2011.

³² Lonmin (November 28 2011) Jobs for the Community. <http://goo.gl/JCsNxy>

³³ Reuters (May 24, 2011) Lonmin starts sacking 9,000 over Marikana strikes. <http://goo.gl/1plrzV>

³⁴ Lonmin SDR (2011) p.64.

whether the 2010 and 2011 BTORs provided an accurate and up-to-date assessment of PS2 issues at Lonmin.

Lonmin discloses annually the percentage of employees that are members of trade unions it recognizes. From 2007 to 2010 this had fluctuated between 78% and 80%.³⁵ Lonmin's 2011 SDR, published in November 2011, notes that the percentage of employees that were a member of a recognized trade union on September 30, 2011 fell to 55.5%. The client affirms in its SDR that union membership fell as a result of industrial action in May/June 2011, which resulted in a large number of employees leaving their union. At the time, Lonmin recognized three trade unions at its Marikana facility: National Union of Mineworkers (NUM), Solidarity, and United Association of South Africa Trade Union (UASA).

In reviewing IFC's E&S supervision documentation, CAO notes limited discussion about worker-management relationships. Lonmin's 2011 SDR notes "poor employee relations due to internal and external factors that could result in strike action" as a principal risk. As a result, the SDR mentions as an objective developing and implementing "a strategy to move from Industrial relations to employee relations." These issues are, however, not addressed by IFC in supervision and a documented review of the 2011 SDR was not available for review.

In April 2012, Lonmin reported publicly the death of one employee and assault of five other employees in several separate incidents as they were on their way to work. At this time Lonmin noted that it had "recently experienced an escalation in reports of intimidation of employees at our Karee mine which is located at the Western point of Lonmin's operations."³⁶ It is unclear how IFC assured itself that Lonmin investigated the root causes of these incidents and ensured that appropriate corrective action was taken.

In May 2012 Lonmin announced that it had agreed "limited organizational rights" with the Association of Mineworkers and Construction Union. At this time, Lonmin also recognized that "Labour dynamics are going through a sea change" and that the "rivalry for membership between the unions could be a feature for the foreseeable future with a corresponding increase in the risk of escalation of costs and disruptions to production".³⁷

Performance Standard 4: Community Health, Safety and Security

IFC's SDR reviews and site supervision reports do not detail any significant PS4 issues prior to the violence at Marikana in August 2012. Following IFC's July 2011 site visit, IFC reported that "Lonmin has established and maintains international best practice standards of mining and smelting operations safety and emergency response at all its facilities." IFC noted that Lonmin provided emergency assistance at its operations and to communities in the area. Further, IFC affirmed that "Emergency and disaster management plans and procedures are revised on a regular basis, and training and scenario drills are conducted regularly to ensure emergency preparedness so that effective and dynamic response services can be rendered upon request". With the exception of the death of one employee and the assault of five others in April 2012, which was recorded by IFC in its quarterly credit risk report, IFC's documentation does not make reference to other violent incidents prior to August 2012.

IFC Advisory Service Project

IFC's Advisory Service (AS) project was active from July 2007 to June 2010. The principal objective of IFC's AS project was the development of a comprehensive program to strengthen the

³⁵ Lonmin Sustainability Development Reports from 2007-2010.

³⁶ Lonmin (April 23, 2012) Lonmin condemns fatal assault on employee. <http://goo.gl/JhVf1h>

³⁷ Lonmin (May 14, 2012) 2012 Interim Results Announcement. <http://goo.gl/AaCa5A>

social sustainability of the client and maximize the development impact of IFC's investment. IFC had two program officers resident at the client site who were supported by several consultants for the duration of the engagement. Upon completion, IFC noted that the AS project was largely successful with some areas of underperformance.

IEG Review

This project (Investment and Advisory Service) was selected by the World Bank's Independent Evaluation Group (IEG) for review. As part of this process, IFC and IEG conducted a joint supervision visit of the client in April 2009. In September 2011, IFC finalized its assessment of the project's performance which was documented in an Expanded Project Supervision Report (XPSR). This was reviewed by IEG and documented in an XPSR Evaluation Note (EvNote), which was released in June 2012. IEG noted that "interactions with the equity investment and AS programs did not contribute to significant development of client's SEMS and capacity building, but helped the Company to identify targets for energy and water consumption, and were instrumental in addressing supplier development, HIV and AIDS mitigation and gender issues. IFC's role was essential for the social and HIV/AIDS projects to go ahead and IFC made a major contribution to make them a success; thus IFC's E&S role and contribution are rated as Excellent." In particular, IEG rate the project's performance as excellent for PS4 and satisfactory for PS1, 2, 3, 5, 6, and 8. IEG noted that the overall project performance "was satisfactory at appraisal and at evaluation" and considered, the "overall Environmental and Social Effects are deemed strong Satisfactory."³⁸ Neither IFC's XPSR in September 2011 nor IEG's review in June 2012 discuss any trade union issues.

IFC response following August 2012 incidents

Following the violence at the Marikana mine, the IFC team updated Senior Management. They noted the violence at Lonmin occurring in the context of increasing tensions between rival unions in the mining sector in South Africa, mines being shut down, worker lay-offs and declining workers' bonuses. The team sought IFC Senior Management's guidance on whether, in principle, to participate in providing financial support to Lonmin should it seek it and whether IFC Senior Management should meet the management of Lonmin. Subsequently, IFC participated in a rights issue in December 2012. The purpose of the rights issue was to reduce the client's indebtedness and substantially strengthen its overall financial position.

Conclusion

From the perspective of the CAO compliance mandate, the general question in relation to supervision is whether IFC adequately monitored the client's social and environmental performance throughout the life of IFC's investment. During supervision and prior to the violence in August 2013, IFC conducted four supervision visits (2008, 2009, 2010 and 2011) and documented reviews of its client's annual SDRs (2007-2010, and 2012 (though notably not in 2011)). The supervision process, however, did not engage in any detail with reported worker security or industrial relations issues.

In particular CAO notes that the strike of May 2011 and incidents of community unrest in August 2011-while reported publicly by the client and international media and noted by IFC in its quarterly credit risk reviews-were not addressed in IFC's E&S supervision. It is thus unclear to CAO if IFC E&S staff were aware of the May 2011 strike and the subsequent dismissal of 9,000 Lonmin employees.

³⁸ IEG (2011) XPSR Evaluation Note 2011 – Lonmin.

5. CAO Decision

At appraisal IFC determined that its Performance Standards were applicable for this project. However, IFC did not convert the Performance Standards into a contractual requirement as would be expected under the Sustainability Framework for category A projects. Further, due to its status as a publically listed company, Lonmin was not required to report specifically on compliance with the Performance Standards. As such, IFC's ability to "monitor the client's social and environmental performance throughout the life of IFC's investment" (Sustainability Policy, para.11) and assure itself that it (IFC) was meeting its commitments under the Sustainability Policy was limited.

This compliance appraisal also raises concerns as to the adequacy of IFC's supervision of E&S issues around the project. In particular CAO is concerned that IFC's E&S supervision reports do not adequately engage with industrial relations and worker security issues which were publically reported in the 18 months prior to the violence of August 2012. Further, it is unclear to CAO if IFC adequately reviewed its client's 2011 SDR, in particular sections which discussed concerns around employee relations and risks of strike action.

As set out in the CAO Operational Guidelines (paras. 4.2.1f), the purpose of the compliance appraisal process is to ensure that compliance investigations are initiated only for those projects that raise substantial concerns regarding environmental and/or social outcomes, and/or issues of systemic importance to IFC/MIGA. CAO's decision on whether to initiate a compliance investigation requires the weighing of a number of factors including the significance of adverse E&S outcomes associated with a project, a preliminary review IFC's performance against the requirements of its Sustainability Framework, as well as a more general assessment of whether a compliance investigation is the appropriate response in the circumstances.

This compliance appraisal was triggered by CAO following reports of serious violence which resulted in the deaths of Lonmin workers and members of the South African police. Based on a review of documentation and interviews with IFC staff, this appraisal raises concerns as to the adequacy of IFC's E&S performance in relation to this investment. It also identifies potentially more systemic issues regarding the way in which the Sustainability Framework was applied to an equity investment in a publically listed company, over which IFC had limited leverage. Absent a complaint from affected workers, however, CAO finds that the nexus between the E&S performance issues outlined in this appraisal and the tragic outcomes of the August 2012 dispute is insufficiently established. Therefore, CAO decides that an investigation is not warranted and will close the case.