

PULP & PAPER INDONESIA
“ASSESSING RISK AND OPPORTUNITIES”
A Roundtable for Investors and Buyers

APRIL 10, 2008 at the offices of RANDOM HOUSE INC., NEW YORK

A SUMMARY OF THE ROUNDTABLE PROCEEDINGS

BACKGROUND

The Indonesia Pulp & Paper Roundtable was organized by WWF, ForestEthics, the Environmental Paper Network and Green Press Initiative. Graphic Communications and Limited Brands served as sponsors, and Random House provided the venue.

ATTENDANCE

The Roundtable was attended by 56 representatives from the office supply, retail, consumer products and paper manufacturing and distribution, printing, magazine, catalog, book and financial services sectors. 14 experts from Indonesia, academia and the non-governmental organization (NGO) community gave presentations, in addition to two presentations given by APP and APRIL. A support staff of 12 from the Roundtable hosting organizations was present to ensure smooth program operations.

PURPOSE

The purpose of the Indonesia Pulp & Paper Roundtable was to present and discuss issues associated with the Indonesian pulp and paper industry. The Roundtable included presentations on Indonesian forest policy and governance, trade initiatives and policy, deforestation, climate change and biodiversity loss, supply chain tracking and transparency, illegal logging and human rights, conservation science and best practices and sustainable business approaches.

The goals of the Roundtable were to:

- Provide information on and improve understanding of current and emerging issues in Indonesia’s pulp and paper sector;
- Facilitate business to business dialogue on key issues such as the potential for constructive engagement and responsible investment and procurement;
- Identify steps that consumer companies, financial institutions and other stakeholders can take to address risks, opportunities and issues associated with Indonesia’s pulp and paper sector.

ROUNDTABLE FORMAT

The Roundtable session was divided into eight separate components:

- A Contextual Overview
- Panel I: Social, Ecological and Environmental Realities and Risks
- A Perspective From the Indonesian Pulp and Paper Sector (APP and APRIL)
- Panel II: Legal and Economic Context and Trends
- Keynote Lunch Presentation
- Panel III: Approaches and Tools for Tracking Supply and Managing Risk
- Panel IV: Engaging Indonesia's Pulp and Paper Sector, Considerations, Implications and Lessons Learned
- Break Out Groups, Next Steps Discussion and Closing

Copies of all presentations from the Roundtable, as well as pertinent background documents, are available at <http://www.environmentalpaper.org/indonesiaroundtablesummary.htm>.

A CONTEXTUAL OVERVIEW

Indonesia's Pulp and Paper Industry – Overview of Risks and Opportunities

Chris Barr, Center for International Forestry Research (CIFOR)

- The pulp and paper industry is concentrated on Sumatra in the province of Riau;
- Since 1990, pulp and paper capacity in Indonesia has increased by over 1000%, with 6 producers (7.5 million adt/year), the largest of which are APP (2.3 million adt/year) and APRIL (2.5 million adt/year). These two companies control over 75% of the production;
- Capacity is expanding faster than plantations, which in turn is increasing reliance on natural forests (mostly from land clearing for Acacia and oil palm plantations);
- Plantations investments to support pulp mills total 3.4 million ha – 2.4 million ha for pulpwood and 1.0 million ha for solid wood;
- Indonesian government HTI Plantation Program spans 10.4 million ha of “degraded land” (with 271 licenses);
- Sustainability risks include: loss of natural forest cover (e.g. Riau lost 65% forest cover in 25 years), CO₂ emissions (e.g. above ground, 400-800 million tons were emitted from 1990-2006 with an additional loss of 108 million tons/year from peat drainage) and disputes associated with tenure conflicts and forest community displacement;
- APP and APRIL have two of the largest pulp mills in Riau which consume >10 million m³/year - for APRIL, 45% of this comes from plantations on peat, and for APP 75% of its fiber comes from plantations on peat;
- While both companies have made commitments to sustainability, and have been planting significant Acacia plantations, these sustainability commitments need to be viewed in the context of plans to expand capacity - many of the areas being developed are located on peat swamps. Acacia plantations have associated social conflict and uncertain land tenure issues;
- To avoid deforestation, there is a need to add more plantation land, but all plantations are not well stocked or managed (leading to yield over-estimates), and are susceptible to technical and financial risks and fire - this leads to continued reliance on fiber from natural forests;

- As a result of increased regional autonomy in post-Suharto era, land tenure claims are on the rise, which in turn serves as a catalyst for illegal logging as concessions are lost to land claims;
- The Indonesian Ministry of Forestry is encouraging increased plantation development (e.g. proposing to grant 9 million ha in tenures split 40% to large companies and 60% to small holders) and committing financial resources to a Restoration Fund – there are many challenges to accomplishing this and these numbers are just targets;
- Indonesia is now promoting significant pulp and paper capacity expansion, mostly on Kalimantan – this includes increasing pulp capacity to 16 million tons/year and paper capacity to 18.5 million tons/year.

PANEL I: SOCIAL, ECOLOGICAL AND ENVIRONMENTAL REALITIES AND RISKS

Forest Industries, Forest Conversion and Land Acquisition in Indonesia: Implications for Local Communities and Indigenous Peoples

Dr. Marcus Colchester of the Forest Peoples Programme gave a presentation on the implications of the pulp and paper sector timber harvesting on local communities. Dr. Colchester provided a profile of Indonesia--12,000 islands, 220 million people, 500 languages, 70% or 122 million ha of its land is forested, most of which is state owned, only 16% of which is gazetted for protection, with 60 to 90 million people living in the forests. He also discussed the emergence of Indonesia's governance (including independence from the Netherlands in 1945, the weak land rights associated with the introduction of the basic Agrarian Law in the 1960's, and the stronger rights associated with the UN Human Rights Declaration), a description of the conflict between traditional or collective tenures, a forestry department that acts as if all forests are state owned and hands them out as concessions, the associated impacts (denial of rights, loss of lands, loss of livelihood, loss of autonomy, self-respect, and cultural, social disruptions, as well as portions of natural forests serving as sacred sites) that lead to conflicts, illegality and migration, and how the UN Committee on Elimination of Racial Discrimination is promoting better practices (conflict resolution, legality, free prior and informed consent, crop choice) through pilots in select areas.

Principles for Conserving Biodiversity and Maintaining Ecological integrity in Tropical Forested Landscapes

Dr. Mark Leighton of Harvard University gave a presentation on rare species in Indonesia, and emphasized the need for large areas in order to sustain viable populations, and that many of these rare species are keystone seed dispersal agents and predators that maintain diversity of community species. Dr. Leighton also discussed how tropical forests are poorly surveyed, and the imperative to use the precautionary principle, how habitat mosaics must maintain integrity and connectedness to support migrating species, the need for meaningful collaboration between industry and NGOs to support forest conservation, and the development of "green products" with higher prices that can support this.

Peat, Pulp, and Paper: Climate Impact of Pulp Tree on Peatlands in Indonesia

Professor Jack Rieley of University of Nottingham gave a presentation on climate impacts associated with pulp tree plantations on peatland in Indonesia. This included a description of peat (an accumulation of partially decomposed organic plant matter, inhibited by a combination of water logging, oxygen deficiency, high acidity, low temperatures, and nutrient deficiency) and how peat lands, which cover 3% of global land area, can be found in temperate, boreal, and subarctic regions. He also provided an overview of the multi-functional characteristics of peatland cover (flood mitigating and control, recharging of aquifers and water supply, climate regulation, and carbon storage), the extent of peat lands in Indonesia (27 million ha with an average depth 10-12 m thick), the high biodiversity associated with these peat resources (800 tree species, 71 families, 237 genera, adaptations for ecosystem, orangutan, agile gibbon, sun bear), the carbon storage capabilities of peat lands (over 500 billion tons of carbon stored in world's peatland), and how alterations to peat leads to irreversible carbon emissions that can be exacerbated by fires and only be slowed through maintaining the water table. Dr. Rieley discussed how the carbon emission impacts of peat land drainage in Indonesia is equivalent to 1.4-3.5% of global emissions from fossil fuels (25,000 Mt CO₂/yr), and observed that while the sequestration of carbon in undisturbed peat lands is long-term, the sequestration associated with pulp plantations is 31 years, 37 years for degraded peatland and 51 years for oil palm plantations.

Deforestation, Forest Degradation, Biodiversity Loss and CO₂ Emissions in Riau, Sumatra

Yumiko Uryu of WWF Indonesia gave a presentation on the links between the Indonesian pulp and paper industry and the serious deforestation, decomposition and burning of deforested peat soil and resultant CO₂ emissions and biodiversity loss that occurs on Riau on the island of Sumatra. Riau has the largest volume of peat soil in Southeast Asia, is rich in biodiversity, including critically endangered Sumatran tigers and endangered Sumatran elephants. Indonesia has the highest deforestation rate in the world—11% forest cover was lost during 2005-2006 alone—and the decomposition and burning of deforested peat and forest degradation have been causing on average 0.22 gigatons/year of CO₂ emissions, which is equivalent to 24% of Kyoto Annex I countries' collective reduction targets for 2008-2012. This deforestation is also pushing Sumatran tigers and elephants into local extinction. Yumiko explained that Riau lost 4 million hectares of natural forest—twice the size of New Jersey—over the past 25 years (attributable to the pulp and paper industry: APP, APRIL and their associated palm oil companies and their wood suppliers for pulp production). The two companies produce 5 million tons/year of pulp in Riau and the neighboring province, Jambi, and still draw around 50% of their fiber supply from natural forests. WWF projects 1-2 million ha of additional deforestation in Riau would occur between 2008-2015, depending on whether the latest draft of the Provincial Land Use Plan is implemented or the current high deforestation rate continues ("business as usual"). In either case, most of the new deforestation would occur on peat soil for pulp production, and thus CO₂ emissions would be even greater than the past, increasing Riau's already significant contribution to global climate change.

The Discussion

- An emphasis needs to be made on gazetting land for protection not in areas slated for conversion;

- A priority should be placed on preserving and protecting what still remains (rather than investing in restoration—restoration of peatland is extremely difficult and expensive, for example);
- A priority should be to develop plantation on wastelands—lands where natural forest was cleared some time ago for timber harvesting, and left abandoned without any crops being planted. There are quite a lot of such lands available in Indonesia;
- The primary focus of most local communities is seeking restitution of their rights;
- It's important to remember that when buying paper from China, 20% of China's pulp requirements come from Indonesia. Both APP and APRIL are currently expanding their capacity into China.

PERSPECTIVES FROM THE INDONESIAN PULP AND PAPER SECTOR

The Challenges of Sustainable Forest Management in Indonesia

Jouko Virta of APRIL (President Global Fiber Supply) gave a presentation on the challenges of sustainable forest management in Indonesia. Jouko described actions being undertaken by APRIL to address a number of the issues described in Panel I (deforestation, impacts on local communities, CO₂ emissions). APRIL is establishing plantations with mixed hardwood stands in between to create healthy/vigorous mosaic landscapes in order to conserve biodiversity, provide ecosystem services and create wealth for society. HCVPs are currently the foundation of APRIL's approach to forest operations (with approximately 250,000 ha of conservation areas at present). Forestry accounts for 24% of the current deforestation in Indonesia, with the remaining 76% coming from population pressure, forest encroachment, and practices associated with subsistence practices (e.g. forests burned for rice paddies). APRIL's current mosaic plantation approach stores more carbon than degraded areas while maintaining 80-90% of the original biodiversity. The sustainable practices employed by APRIL (i.e. mosaic plantation concept with HCVP identification and protection, intensive R&D, site specific crop management) are consistent with APRIL's vision of rural Indonesia moving from an unsustainable subsistence economy to one based on sustainable development.

Aida Greenbury of APP (Director of Sustainability and Stakeholder Engagement) gave a presentation on the steps APP is taking to ensure biodiversity protection and manage carbon emissions through sustainable plantation management. This included a reference to the \$40 million APP is currently spending on a variety of Corporate Social Responsibility (CSR) measures, a review of some specific steps being taken by APP including its commitment to HCVP, and steps the company is taking to protect natural forest landscapes (including setting aside 850,000 ha for conservation/community uses, 300,000 ha for pure conservation and 72,000 ha to support a natural park in Riau). Ms. Greenbury acknowledged the need for continual improvement, and that strong multi-stakeholder approaches are being used to address these issues (both industry and NGOs need to be part of the solution).

The Discussion

- < 5% APP's pulp production from Indonesia goes into book publishing paper;

- Both APRIL and APP have significant palm holdings in Indonesia (with conversion of natural forests to palm plantations accounting for a significant component of the annual deforestation occurring in Indonesia each year) – for example, APP has the 2nd largest palm oil holdings in Indonesia;
- APRIL is currently working on a Certification Support Program (CSP) using relevant Forest Stewardship Council (FSC) Principles and Criteria for all lands that APRIL manages in Sumatera by mid 2009, and is likewise expecting 100% LEI certification of APRIL-owned concessions by 2009;
- The pulp used by APP in its paper production includes 50% virgin pulp from Indonesia, 35% recycled (12% pre-consumer, 23% post-consumer), and 15% imported. APP is increasing its use of recycled paper;
- APRIL does not currently use any recycled fiber as part of its business.

PANEL II: LEGAL AND ECONOMIC CONTEXT AND TRENDS

Due Diligence Concerns in the Pulp and Paper Sector in Indonesia

Stephanie Fried of Environmental Defense Fund gave a presentation on due diligence concerns in the pulp and paper sector in Indonesia. Ms. Fried reviewed some of the recent World Bank conclusions regarding the Indonesian forest sector--forest loss and forest crime dominate the Indonesian forest sector, Indonesia is losing forests at one of the fastest rates in the world, industrial timber demand exceeds sustainable supply, timber plantations are performing poorly, the lack of due diligence and unsustainable demand could lead to financial problems similar to those in the 1990's, and there remains an ongoing problem with inaccurate reporting of costs and projections. Large scale forestry projects in Indonesia require bank financing to be commercially viable, and banks need to exercise appropriate customer due diligence relative to the risks associated with both sustainability and illegality/corruption. Anti-money laundering statutes have generally been strengthened around the world in the last 7 years, and there has been an increased focus of NGOs and CSOs on the environmental and social impacts of international finance and its intersection with new anti-money laundering statutes. Illegal logging is a "predicate offence" for money laundering, which creates criminal liability for any financial institution that finances projects involving illegal logging. Therefore there is a need for financial institutions to exercise detailed due diligence throughout any projects that involve "politically exposed persons" or "unusually complex structures or arrangements", and scrutinize transactions with unusual features. Illegal logging is at epidemic proportions in Indonesia, with serious and deleterious impacts on ecosystems as a result of manipulation of court cases and protected areas being left open for exploitation (referencing the 2003 CGI Report). A case study of the United Fiber Systems proposal to build a \$1.2 billion pulp mill in South Kalimantan Claim was discussed, and how the claim that all timber would come from plantations is inaccurate and not supportable based on a variety of information. There is a need for all customers/consumers of forest products to know the source of the fiber they are purchasing, to ascertain the risk profile of the country of origin, and to ask questions of their suppliers to ensure illegal sources are avoided.

The Discussion

- Good sources of due diligence include the MIGA project, the Declaration for Jakarta, and NGOs;
- The Equator Principles and increasing environmental standards are restricting sources of cheaper finance from traditional sources;
- Alternative investment vehicles (hedge funds and private equity) have increased interest in environmental risk.

LUNCHEON KEY NOTE ADDRESS

Nazir Foead of WWF Indonesia gave the luncheon keynote address on his personal experiences with the pulp and paper industry in Indonesia. Nazir provided a summary of his background as a forester and conservation biologist and the time he spent living in the jungles in Kalimantan. The increasing global demand for paper is being met with new supply coming from Brazil, China, and Indonesia, while global consumption remains concentrated in countries such as the United States and Canada. Nazir described his experiences witnessing trucks and barges filled with timber from the Tesso Nilo forest that were being transported for conversion into pulp and paper (the Tesso Nilo forest has been identified as the most globally diverse forests—there are 218 different species of vascular plants in one 200m³ plot). He described the risks to personal safety associated with tracking the movements of such timber, and the dramatic decline of local elephant and tiger populations as a result of this deforestation. Nazir's firm belief that the disappearance of tropical lowland forests in Sumatra can be avoided by constructive engagement and cooperation between the Indonesian government, the Indonesian private sector, NGOs and citizens. Nazir provided a review of recent progress by APRIL, who has become more transparent and has a roadmap in place to address sustainability issues in Indonesia (e.g. its commitment to HCVF and improved tracking of the source of its fiber) versus the lack of similar progress made by APP. Nazir's concern is that both companies are still using >50% mixed tropical hardwoods and planning to convert large areas of tropical forest, and his strong belief that, while not necessarily easy, there are ways for the industry to operate and even expand without further damage to tropical forests or contribution to global warming (e.g. establishing plantations on truly degraded land).

PANEL III: APPROACHES and TOOLS FOR TRACKING SUPPLY AND MANAGING RISK

Financing the Pulp and Paper Sector in Indonesia: Some Lessons Learned

Jan Willem Van Gelder of Profundo Economic Research gave a presentation on some lessons learned in relation to financing the pulp and paper sector in Indonesia. The first expansion phase in the Indonesia pulp and paper sector occurred between 1988 and 1999. A total of US \$12 billion was invested, primarily by foreign investors lured by the cheap fiber costs (the risks to banks partly outsourced to EC and institutional investors). The Indonesian financial crisis of 1997-1998 saw the collapse of the Rupiah and witnessed the resulting failure of many companies and banks, and the continued financing of APP and APRIL projects from 1998 to 2000. The subsequent debt crisis of both APP and APRIL arose from the slump in pulp and paper prices, an unsustainable fiber supply, the unstable political situation, complicated cross-

guarantees, and the resulting impact on APP and APRIL both in terms of huge declines in share prices and defaults on their loans - \$13.9 billion for APP and \$1.3 billion for APRIL. The planned new pulp and paper expansion by APP and APRIL subsequent to 2003 (in both Indonesia and China) was also mentioned. Jan provided some lessons learned, such as ignoring sustainable fiber supply during due diligence has great risk that cannot be mitigated, with reference to the Basel Capital Accord II: there is a need to refine sector risks in the Internal Ratings Based Approach as sustainable forestry is a different sector from non-sustainable forestry. There hasn't been any studies conducted by banks on lessons learned from APP and APRIL, most likely as a result that most of the losses are being incurred by bondholders and ECA's, and there has been no discussion among banks and regulators on differentiating sector risk profiles. Sustainability is still not an issue in Basel II discussions.

Supply Chain Tracking and Transparency: How to Deal with These Issues?

Suzanne Apple of WWF (Business and Industry Group) gave a presentation on supply chain tracking and transparency which included the need to know where your paper comes from-- are you buying from forests that should be protected and carefully managed, are you sure your fiber was harvested responsibly, and was it traded legally? Companies need to ask questions if they don't know (using China's recent increased role in both consumption of fiber and exports and a summary of China's current trade flows as an example). Suzanne provided an overview of the WWF Global Forest and Trade Network (GFTN) and how it seeks to combat illegal and unsustainable logging by promoting responsible forest management through credible certification (with almost 30 regional Forest and Trade Networks established worldwide and more than 370 companies committed to credible certification). There are various GFTN tools available to assist purchasers, including the WWF Responsible Purchasing Guide and Keep It Legal manual, database tools, supplier questionnaires, how to build systems for traceability, how to implement a responsible purchasing policy, how to conduct a baseline assessment (i.e. where is your wood coming from) and establish an action plan with tangible goals to phase out illegal and unwanted wood sources, and to phase in wood and paper from responsibly managed forests. Suzanne presented a case study on Johnson & Johnson (a North America Forest and Trade Network member) that included guidelines, assessment, action plan, monitoring and reporting. There are many benefits to responsible supply chain management, including access to new markets, differentiation, enhanced corporate reputation, capital, etc) Other NGOs (e.g. The Nature Conservancy, Rainforest Alliance, Tropical Forest Trust) have helped GFTN build capacity on the ground in order to increase the amount of credibly certified forests.

Investing in Indonesia and Managing Risk: Policies, Due Diligence, and Outcomes

Courtney Lowrance of Citi Markets and Banking gave a presentation on investing in Indonesia and managing risks which included a description of Citi's Environmental and Social Risk Management (ESRM) team (Director, VP Analyst, four global champions and the use of portfolio bankers, ESRM approvers, and transactors), a description of how Citi looks at risks in the pulp and paper sector using its ESRM (screens deals, provides technical advice and counsel to bankers across Citi), a review of Citi's Sustainable Forestry Policy (risk is managed at two levels, namely the client level (forest products risk assessment and annual reviews) and the transaction level (project specific which may require adherence to broader ESRM policy

requirements) and a need for companies operating in high risk countries as defined by Citi to commit to achieve certification within a three to five year period. Ms. Lowrance reviewed the four levels of Citi's forest policy: Level 1 - all forest product obligors ("FPOs"), Level 2 - operations in high risk countries, Level 3 - legality of operations in question, and Level 4 - operations significantly converts or degrades a critical natural habitat, and associated requirements under the policy ranging from the completion of a FPO questionnaire during the annual review to preclusion of lending to the FPO (customers that are directly involved in logging or primary processing of timber). According to Citi's definition of logging or primary processing of timber, this includes milling of logs for pulp, paper, sawn wood, plywood/veneer and timber plantations (but does not include palm oil or other agriculture). Courtney referenced some of the challenges currently facing the ESRM team, including training bankers to do the required due diligence, and the portfolio approach being increasingly used in the current credit situation in which loans are sold with a resulting loss of leverage over borrow. Ms. Lowrance used a \$250 million syndicated corporate loan for paper machine in China as a case study, and posted potential diligence questions that should be asked, such as how much fiber is needed to meet the capacity of the pulp mill in Indonesia? Does the company have supply contracts for raw materials? What is the company's total gross concession area in Indonesia and how much of it is planted? How much area is HCVF and can a map be provided? What is the projected % of fiber to be sourced from mixed hardwoods? Various mechanisms are used in loan agreements to address environmental and social issues identified in the due diligence and to meet associated policy requirements, including representations and warranties by the FPO, covenants that the FPO must comply with over the life of the loan, and conditions of disbursement that must be met before any funds are disbursed.

Indonesian Forest Product Certification Challenges and Alternative Supply Options

Liza Murphy of FSC International (FSC Global Development) discussed how the publishing industry is a significant driver for FSC products (and a medium for the message). There is an increase in demand for FSC and recycled paper products, with customers beginning to recognize the FSC brand. There are over 1 million ha of FSC certified forests and on the ground changes as a result of FSC certification. There is the challenge in relation to pulp and paper from Indonesia in that established vendors within the supply chain are getting products that do not meet environmental attributes that customers are starting to demand. With 10% of world's harvestable forests under certification, 10% of world's pulp is also now available as FSC certified from all parts of world (Canada, South America, North America, Australia, New Zealand). In addition, there is significant new recycling capacity coming on line and significant new sources of FSC certified fiber coming on stream (e.g. 500,000 ha in China). It is relatively easy for non-integrated paper mills to begin participating in FSC.

The Discussion

- In assessing whether to finance loans in Indonesia, in addition to certification, Citi looks at other environmental attributes (effluents, air emissions) and uses consultants with some site visits for verification;
- FSC is not looking at the possibility of moving the cut-off date allowable for certification based on when deforested from natural forest up from 1994;

- The reason why banks have not undertaken a lessons learned approach on the APP and APRIL failures is that most of the loans had been transferred to Export Credit Agencies and institutional and private investors;
- Re-listing of APP or APRIL on stock exchanges would require and result in more transparency;
- The primary covenants required by Citi in relation to environmental and social issues are one that flow from the Equator Principles;
- While the topic of lending standards and carbon is currently under debate (e.g. REDD), many lending institutions are looking at carbon more as an opportunity than a risk – FSC is exploring if there is a way for FSC certification to be incorporated into carbon credit certification;
- A list of all pulp and paper companies FSC certified in Indonesia can be found at www.fsc.org/info.

PANEL IV: ENGAGING INDONESIA'S PULP AND PAPER SECTOR, CONSIDERATIONS, IMPLICATIONS AND LESSONS LEARNED

Reflections on the Aspects and Limits of Engagement – The Staples Experience

Mark Buckley of Staples gave a presentation on the aspects and limits of engagement based on the Staples experience. Staples is the largest reseller of office products in world, is 22 years old, operates in 23 countries with over \$20 billion in revenue, and is the 2nd largest e-commerce site behind Amazon. Staples' approach to sustainability includes continuous goal setting and learning. Mr. Buckley discussed their experience as the object of a 2000-2001 campaign by Forest Ethics and the Dogwood Alliance in relation to their paper procurement policy. Their now more robust policy includes a set of goals/guidelines to reduce pressures on forests by incorporating recycled paper, identifying HCVF, identifying where the fiber supply is coming from and making sure paper is not coming from these forests, and evaluating various certification schemes. Staples is working to source FSC products with the objective of moving to 50% FSC certified sources by 2010. Mark discussed their previous business engagement with APP, which then supplied 5% of their total paper supply. Staples responded to initial requests to disengage with APP as a supplier by treating it as an opportunity to leverage change. APP initially responded by increasing its recycled material to 30% for Staples products, and signed a Letter of Intent with WWF but, as a result of back tracking by APP in last 3-4 years, Staples terminated the relationship in January 2008. With the emerging focus on energy, climate and carbon markets, the pressure on forests will continue to increase. Mark concluded that there is no silver bullet with any certification scheme. There is a need for collaboration to jointly address the issues, and to look at the issues from the perspective of identifying business opportunities vs. risk mitigation.

Pulp and Paper in Indonesia: Challenges and Next Steps for Publishers and Printers

Andrew Van Der Laan of Random House gave a presentation on the pulp and paper industry in Indonesia from a publisher's perspective. Andrew provided an overview of the approach Random House is taking to environmental issues, including a summary of all of the various initiatives and measures being undertaken by Random House populated in a matrix of scope

(large/small) vs. effect (internal/external). Andrew discussed Random House's environmental policy which gives preference for FSC, stipulates that no fiber comes from endangered or HCVPs, and recycled targets for uncoated paper of 10% in 2007 and 30% in 2010 and beyond, and for coated paper of 5% in 2007 and 10% in 2008 and beyond. Random House's use of recycled fiber in 2007 saved 300,000 trees and prevented 26,000 tons of CO₂ emissions. Random House's current consumption of paper is 120,000+ tons of book paper/year, and the results of a recent carbon audit showed 89% of Random House's carbon emissions comes from paper and is nearly 10 times that of all other activities combined. The Random House building in NYC is LEED certified (the 2nd LEED certified building in Manhattan). Andrew explained how Random House's policy leadership and other critical mass events (e.g. increasing availability of FSC and recycled products) are having an impact on the publishing industry in the US, with other publishers now following suit. The corporate and market structure in the US has helped with domestic implementation (4 Random House paper buyers, 4 major printers, and 7 paper suppliers), but it is much more challenging on the international front where there are 80 buyers, 50 print partners and numerous paper suppliers. There are significant challenges in terms of data transparency with overseas paper suppliers in terms of paper source and other issues. Going forward, it is also likely consumers will hold publishers responsible for all the paper books are printed on. The key to going forward for publishers and printers is to duplicate a successful domestic model with open and honest dialogue with suppliers, partner with existing suppliers to make better paper choices, move toward transparent and credible data, and educate and involve employees who make paper decisions. In addition, make allowances for differences for international paper purchasing, but at the same consider altering international goals to emphasize certified sources and the value of consistent fiber certification across vendors.

Five Basic Principles for a Sustainable Pulp and Paper Business Model and Calls from Indonesian Civil Society Groups for the Reform of the Pulp and Paper Sector

Nazir Foad of WWF Indonesia gave a presentation on the five basic principles for a sustainable pulp and paper business model. These principles include no conversion of HCVP and high carbon storage forests, respect for local community rights, sustainable forest management, independent and transparent monitoring, and responsible wood supply procurement and investment. Nazir provided a summary of the assistance from the markets and investors in helping to bring about change. *Patrick Anderson of Friends of the Earth Indonesia/WALHI* gave a presentation on calls from Indonesian civil society groups for pulp and paper sector reform, which included an overview of seven areas for reform: 1) fiber supply (no conversion of natural forests, no use of fiber from natural forest, no expansion of mills until sustainable plantation sourcing), 2) climate impacts (no drainage of peat soils, restoration of the water table on plantations on peat soils), 3) rule of law (transparent, accountable, law-abiding, politically exposed persons identified), 4) human rights (indigenous and forest people to give or withhold free prior and informed consent; rights and compensation for lands), 5) social license (no displacement of existing livelihoods), 6) international norms and standards (voluntary certification standards), and 7) critically endangered species (forest habitat restored). Patrick then outlined a number of steps that financial institutions can undertake to assist in these seven areas, including: understanding the country where a pulp and paper company operates and the associated risks, develop a policy that will require the Indonesian government and Indonesian suppliers to act on the seven areas of reform required, employ independent verification, ensure

independent certifiers are used, and collaborate with peer investors on common positions. He outlined a number of steps pulp and paper customers can undertake to assist in seeing these reforms implemented, including: understand the country where a pulp and paper company operates and the associated risks, assess the extent to which the conditions are met by existing and potential suppliers, consolidate supply chains to those who are acting in accordance with the company's policy, proactively engage trade associations on steps to implement and act on the seven areas of required reforms, develop a policy that will require the Indonesian government and Indonesian suppliers to act on the seven areas of required reform, collaborate with peer companies to develop a common set of demands from US paper companies to suppliers sourcing fiber from Indonesia, and end contracts with suppliers who do not comply with the seven areas of required reform (e.g. APP and APRIL).

The Discussion

- There is value in paper purchasers undertaking joint research on a variety of issues associated with sourcing paper from Indonesia and identifying a set of common standards;
- There are indirect sources of APP fiber – demystify supply chain. It's not just Indonesia. FSC helps;
- Requiring FSC is a good answer to meeting transparency needs and demystifying the supply chain to help ensure you are not inadvertently ending up with non-sustainable fiber purchased from elsewhere that may have Indonesian pulp in it;
- Businesses need to enact a policy of being proactive and taking action when bad fiber sources are found;
- There may be value in involving FSC auditors in disputes that arise with APP and APRIL in relation to fiber sourced from them;
- It is important for companies operating in Indonesia to resolve claims by communities in relation to land – working with independent experts can assist – where results arrived through conflict resolution measures are not implemented by a company, it is important to pressure the company to carry through;
- Effecting real change may require joint efforts by NGOs and companies purchasing paper products to pressure the Indonesian government to hold local producers accountable to environmental laws;
- One recent example of successful pressure being applied to effect a change in policy were messages from the international community to the Ministry of Agriculture on sustainable palm oil that led to a policy of no more conversion of peat soil to palm plantations;
- While FSC is important, it only addresses part of the industry and doesn't broadly protect forests on its own – comprehensive land use policy is required.

BREAK OUT GROUPS, NEXT STEPS DISCUSSION AND CLOSING

Based on the five panel discussions, six breakout working groups were established: publishers, office suppliers, retailers, 2 paper merchant groups, and a producers group. Each group was posed with the following three questions:

- Is there anything you learned today that you were not aware of before and, if so, can you give two or three examples?

- Are there any actions you or your organization are presently taking relevant to what you have heard here today that may be helpful for others to be aware of and, if so, can you give two or three examples?
- Is there any action you, your organization, or your sector might take, or anything you might do differently, as a result of you attending today, and if so, can you give two or three examples?

A summary of each of the breakout group discussions is found at <http://www.environmentalpaper.org/documents/IndonesiaBreakoutGroupNotes.pdf>. A few key ideas from the groups are highlighted below:

Is there anything you learned today that you were not aware of before and, if so, can you give two or three examples?

- There is a high level of instability in Indonesia's tenure system, and the social component of forest management in Indonesia is complex;
- The large expansion plans that APP and APRIL have for expanding Indonesian pulp and paper production over the next 10 years, and the risks to natural forests in the region that these plans pose, especially in Papua and Kalimantan, where the pulp and paper sector has previously not been focused;
- Most of the areas that the Indonesian government is labeling as 'degraded forests' actually still maintain High Conservation Values (are HCVF's) from a biodiversity or social point of view. Therefore, they should not be designated for conversion to plantations or agriculture.

Are there any actions you or your organization are presently taking relevant to what you have heard here today that may be helpful for others to be aware of and, if so, can you give two or three examples?

- Once contracts with unsustainable pulp and paper companies have been cancelled, keep rejecting even often repeated offers to buy before environmental and social changes have been independently confirmed;
- Once the big and easy paper chain-of-custody issues have been solved within your own company, concentrate on the "little" issues where the true origin of the paper you use is hidden under several layers of traders;
- Execute your own responsible purchasing policy within the companies you acquire, even though that is difficult and time consuming.

Is there any action you, your organization, or your sector might take, or anything you might do differently, as a result of you attending today, and if so, can you give two or three examples?

- There is a need for even further discussion and collaboration between not only NGO's and the pulp and paper industry, but also government, supply chains and customers should be involved and consulted;
- There should be collaboration for investment to focus on forest protection together with Indonesian companies, looking into opportunities to sell conservation credits, development of degraded lands, or carbon sink protection;
- A need to improve due diligence procedures that include explicit consideration of carbon emissions in the Indonesian pulp and paper and oil palm sectors, including deforestation, given their high contribution to GHG emissions. This needs to be done as

part of pulp expansion project proposals, among other situations, with consideration of carbon emissions associated with securing necessary pulp feedstock supply, regardless of whether this is under the direct control of the pulp mill project proponent.

It was agreed that participants would be provided with a brief summary of proceedings, a copy of all of the Power Point presentations used by panel participants, and a contact list of those in attendance.