



APP: default on environmental covenant



Investigative Report
Eyes on the Forest

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Eyes on the Forest (EoF) is a coalition of environmental NGOs in Riau, Sumatra: Friends of the Earth "Walhi" Riau Office, Jikalahari "Riau Forest Rescue Network" and WWF-Indonesia, Riau Program. EoF monitors the status of the remaining natural forests in Sumatra's Province of Riau and disseminates the information worldwide.

More news on Eyes on the Forest, go to: <http://www.eyesontheforest.or.id>
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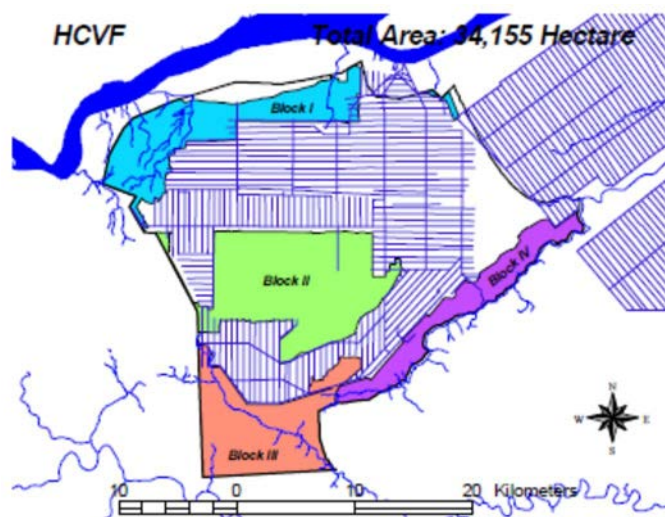
1. APP signs legally binding obligation to protect HCVF to restructure U.S.\$6 billion debt

In the early 2000s, the Sinar Mas Group's Asia Pulp & Paper (APP) defaulted on a debt of U.S. \$13.9 billion and became Asia's biggest corporate debt default until that point^{1, 2, 3}.

Soon after, APP began negotiating "Master Restructuring Agreements" with some of its creditors. In June 2004, APP's major creditors – comprised of the export credit agencies of Germany, Japan, France, Austria, Sweden, Finland, Italy, Spain and Denmark – announced agreement with APP over the "environmental covenants" of the Master Restructuring Agreements^{4, 5} an effort by the creditors to ensure some degree of sustainability in APP's operations. *The Jakarta Post* reported: "The so-termed 'environmental covenants' will become an integral part of Master Restructuring Agreements (MRAs) between the APP affiliates and the creditors."⁶ APP wrote: "APP clearly welcomes this agreement and the fact that it will become a legally binding contractual obligation."⁷ The agreements, covering U.S. \$6 billion, were approved by the creditors of APP's principal Indonesian operating companies in December that year⁸.

In 2004, APP commissioned the Rainforest Alliance SmartWood Program to conduct a High Conservation Value Forest (HCVF) assessment of SMG/APP's Pulau Muda forest management unit (FMU) based on the "Indonesia HCVF Toolkit"^{9, 10}. The published assessment report states: "APP requested this assessment as it was necessitated by company commitments made to customers and to export credit agencies, and as specified in forestry-related environmental covenants between APP and its creditors."^{11,12}

APP's Pulau Muda FMU covers close to 90,000 hectares and is operated by three companies managed by PT. Arara Abadi (AA), a Sinarmas Forestry companyⁱ. The assessment delineated more than 34,000 hectares of HCVF in this FMU (Map 1).



Map 1. APP committed to protect HCVF blocks I to IV (shown in light blue, green, pink and purple, respectively) identified by SmartWood (Figure 5 from the Pulau Muda assessment report, page 52).

Following the assessment, APP committed to set aside all of the delineated HCVF blocks for conservation, announcing the company had "set a new standard for the way in which the

ⁱ The forest management unit is managed by Sinarmas Forestry's Arara Abadi based on three separate concession licenses held by PT. Arara Abadi (AA), PT. Satria Perkasa Agung (SPA) and a collaborative venture with local communities known as KTH (*Kemitraan Tanam Hutan*) Sinar Merawang.

Indonesian pulpwood industry assesses its forests for conservation values.¹³”

APP's then-deputy CEO said in the company's statement on SmartWood's HCVF assessment in 2004: “We think that this is a very professional assessment. We accept the results and recommendations and have begun altering our operations accordingly. This report gives us a scientific basis for the sustainable development of our plantations and the management of our conservations areas. We believe that APP's approach to conservation is working and this assessment is yet another demonstration that real ‘on the ground’ progress is being made. The ‘Indonesian HCVF Toolkit’ and its commercial application is a first for the pulp and paper industry in Indonesia. ... Importantly for us, the SmartWood assessment has deepened our understanding of the biodiversity values in our concessions and given us practical information on what we must do to protect them.”¹⁴

2. APP breaks legally binding contractual obligation to its creditors

The vice chairman of the Japanese export credit agency stated in the creditors' 2004 press release on the “Environmental Covenants” agreement: “[APP] now has the opportunity to take a strong leadership position in the development of sustainable forestry.” At the same time, APP wrote in its Stakeholder Update: “APP clearly welcomes this agreement and the fact that it will become a legally binding contractual obligation.”¹⁵”

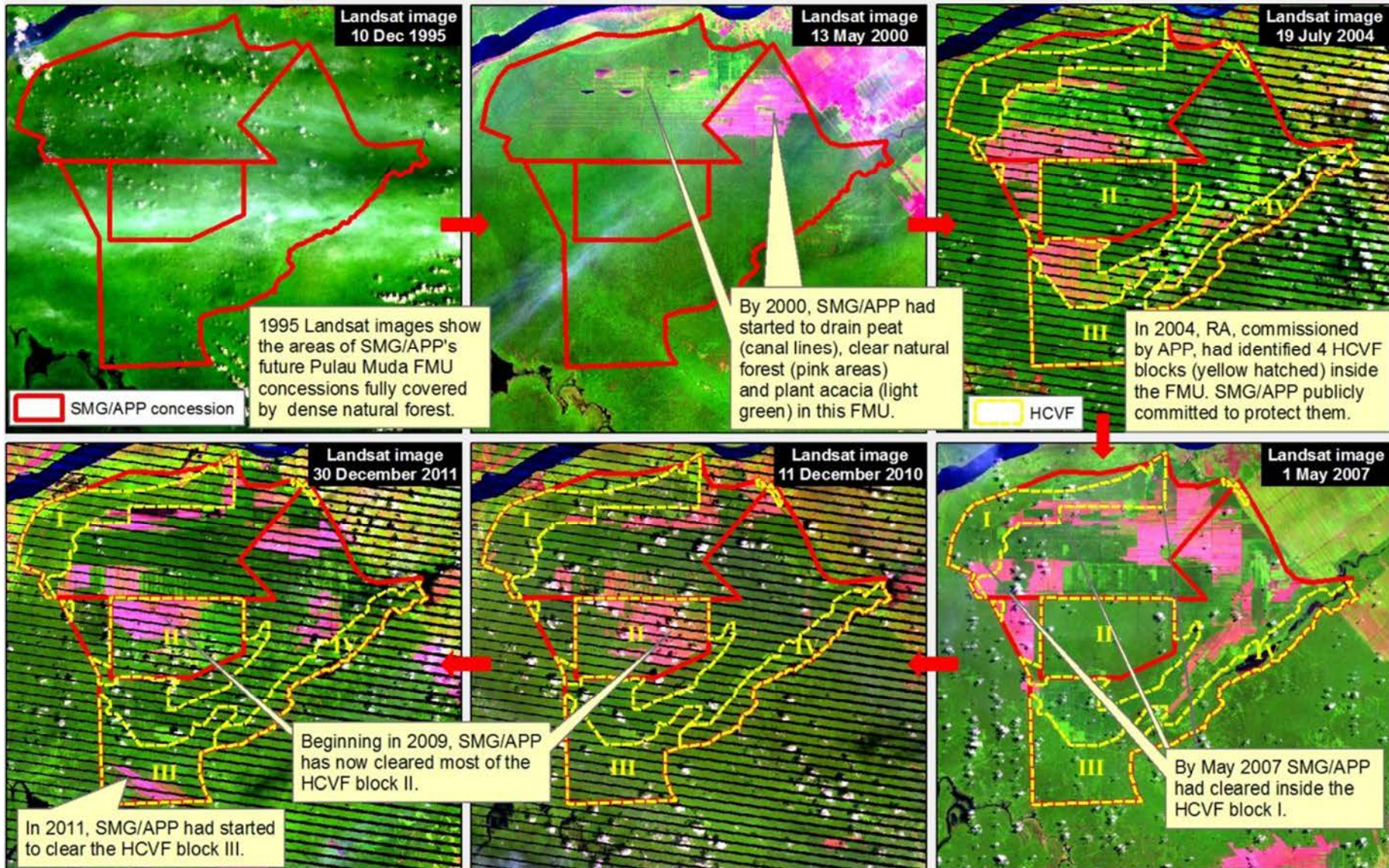
Eyes on the Forest investigated whether APP kept its legally binding contractual obligation to the financial community. Did APP in fact use the opportunity to take a strong leadership position in the development of sustainable forestry operation and pulp & paper production?

In December 2011, a satellite captured a clear image of the status of forests in APP's Pulau Muda forest management unit (FMU). Eyes on the Forest analysed this and a series of historical Landsat images to assess two key contractual obligations APP and its global creditors had agreed on:

1. APP committed to protect the 34,000 HCVFs identified by SmartWood (Map 1).
2. APP committed to achieve “full sustainability in all operations” by 2007¹⁶. APP defined this in its 2004 “Sustainability Action Plan”: “The company has previously committed to becoming sustainable in 2007. This means that, after this date, APP/SMG will be fully reliant on renewable, plantation-grown fiber from socially, environmentally and legally responsible sources.”¹⁷”

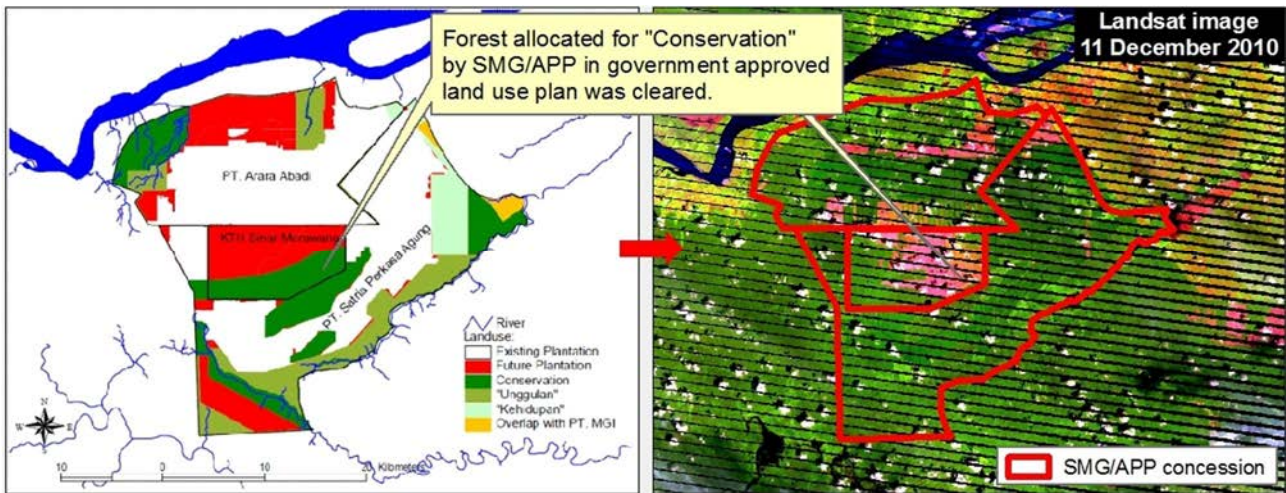
The investigation revealed that:

- APP began clearing the HCVF as early as 2007, only three years after it signed its legally binding obligation and the year by which APP had publicly committed to achieve “full sustainability”. Eyes on the Forest has reported in detail on APP's history of never fulfilling its sustainability commitments¹⁸.
- APP continued to clear HCVF until today, destroying a total of 12,000 hectares of HCVF, one third of the forest it had pledged to creditors to protect (Map 2).



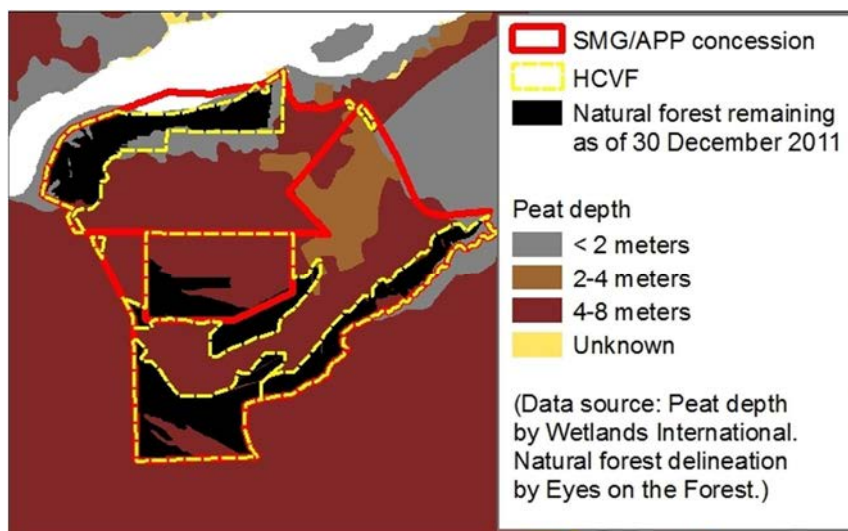
Map 2. History of deforestation in Pulau Muda by 30 December 2011. SMG/APP has cleared all natural forest outside four HCVF blocks it signed to protect (with block numbers as in Map 1), and has cleared a third of the forest inside those HCVF blocks, violating its legally binding contractual obligation with its creditors.

In addition, Eyes on the Forest discovered that APP cleared even the natural forest that the company had designated as a legally-required conservation set-aside. In its “Sustainability Action Plan” of 2004¹⁹, APP committed forest inside its KTH Sinar Merawang concession “towards permanent protection” (Map 3, left). Yet a satellite image from 30 December 2011 shows that APP has even cleared some of this forest.



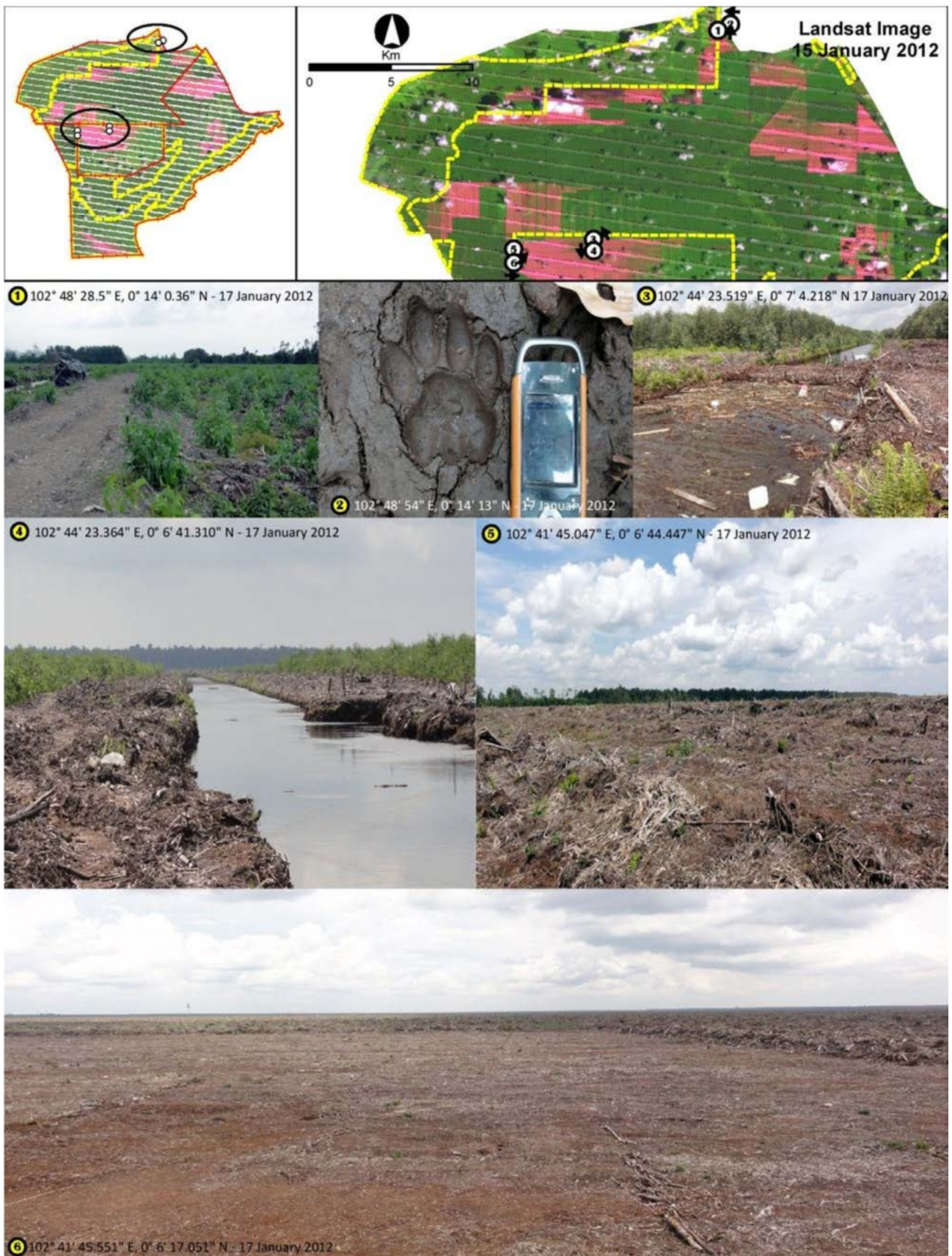
Map 3. Map on left: Government-approved land use plan for APP's Pulau Muda concessions with forests dedicated to conservation shown in dark green (Figure 1 in the assessment report, page 10). Map on the right: A 11 December 2010 satellite image shows that the forest inside one of the dedicated conservation areas had been cleared.

Most of APP's deforestation in the Pulau Muda FMU was preceded by draining of peat more than 4 meters deep (Map 4), in violation of Presidential Decree Number 32/1990 on Management of Protected Area²⁰, Act Number 5 of 1990 on Conservation of Living Resources and Their Ecosystems²¹, Law Number 26/2007 on Spatial Planning²², the currently active national spatial plan enacted by Government Regulation Number 26/2008 on National Spatial Planning²³.



Map 4. Peat depth in and around the Pulau Muda FMU.

EoF investigation in January 2012 observed cleared areas and deep peat canals and also a Sumatran tiger footprint in the area (Map 5). Kerumutan landscape, where this FMU is located, is considered a regional priority tiger conservation landscape by leading scientists²⁴.



3. *Eyes on the Forest Calls*

Eyes on the Forest calls on Asia Pulp & Paper to:

- cease violating its public commitments and legal obligations.
- stop pulping natural forest as it had promised to the creditors to do so by 2007.

Eyes on the Forest calls on the company's creditors to:

- hold APP accountable for breaching what the company stated were legally binding commitments on achieving "full sustainability" by 2007 and clearing HCVF in the Pulau Muda FMU.

Eyes on the Forest calls on customers, investors and other business partners of APP to:

- reject the company's public relations claims^{25, 26, 27} and join the growing list of responsible companies that have stopped business with the company not to purchase their products and finance their wood sourcing operations and expansion and new construction of pulp and paper mills.

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