Beyond EU, RSPO and ISPO Sustainability Requirements[1]

by

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Jakarta, 27th October 2014

Background

"Soy consumption in the Netherlands uses 4,000 Km2 of land in Latin America. Palm oil consumption in the Netherlands uses 2,300 Km2 of land in South East Asia. Most of this land use is without proper control."[2]

Perkumpulan Transformasi untuk Keadilan Indonesia or TuK INDONESIA trusts that making palm oil industry both responsible and accountable cannot be solely achieved only by the enforcement of voluntary standards and production certification implementations. There finance and supply chain sectors are legitimately powerful aspects that are also determinant to the agro-commodity sustainability and the global good governance of palm oil industry. The financial institutions and supply chain operations are important actors behind the expansion and increasing demands for palm oil and major factors behind deforestation and degradation of ecosystems and high carbon stock habitats.

Over the past decade, the total acreage planted with oil palms in Indonesia and Malaysia has increased with around 3.5 million respectively 1.1 million hectares. The CPO production increased in the same period with 14.8 million tonnes in Indonesia and 5.5 million tonnes in Malaysia. In the past decade Indonesia has clearly overtaken the leadership role in the global palm oil sector from Malaysia, which for a long time was the largest CPO producer in the world. Acreage increase in Indonesia was much larger than in Malaysia and the increase in CPO output was almost three times as high as in Malaysia.

Sustainable palm oil production and consumption must be deforestation free, no exploitation of labour and human rights. Corruption in the management of forest resources and oil palm plantation sector: corruption scale equates linear with deforestation. There are linkages between corruption and political [parties] campaign financing. Conglomerations in Indonesia are generally based on exploitation of natural resources.

The EU RED and RSPO certifications have tried to deliver sustainability commitments but such market incentives applicable to compliant palm oil business and the derivative companies who seek to enter plenty of opportunity in the EU food industry and biodiesel markets.

Palm oil biodiesel for the EU Renewable Energy Target

In 2013 the European Commission published its, long expected, report on renewable energies-

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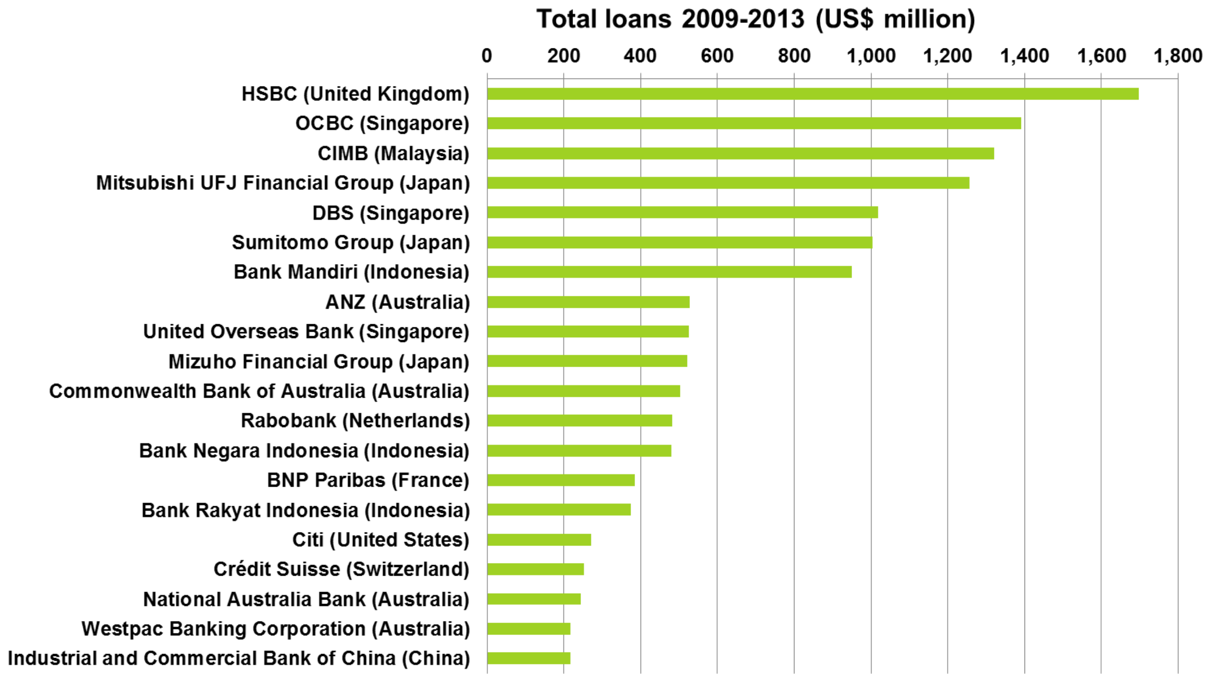
1 This paper is prepared for Ecosystem Alliance Agro-commodity Workshop, which is jointly organized by IUCN Netherlands, Both ENDS and Wetlands International, Amsterdam and The Hague, 27-31 October 2014 in Amsterdam and the Hague.

2 Certification and beyond: Solutions for responsible agro-commodity governance. Agro-Commodity Governance Event, October 2014

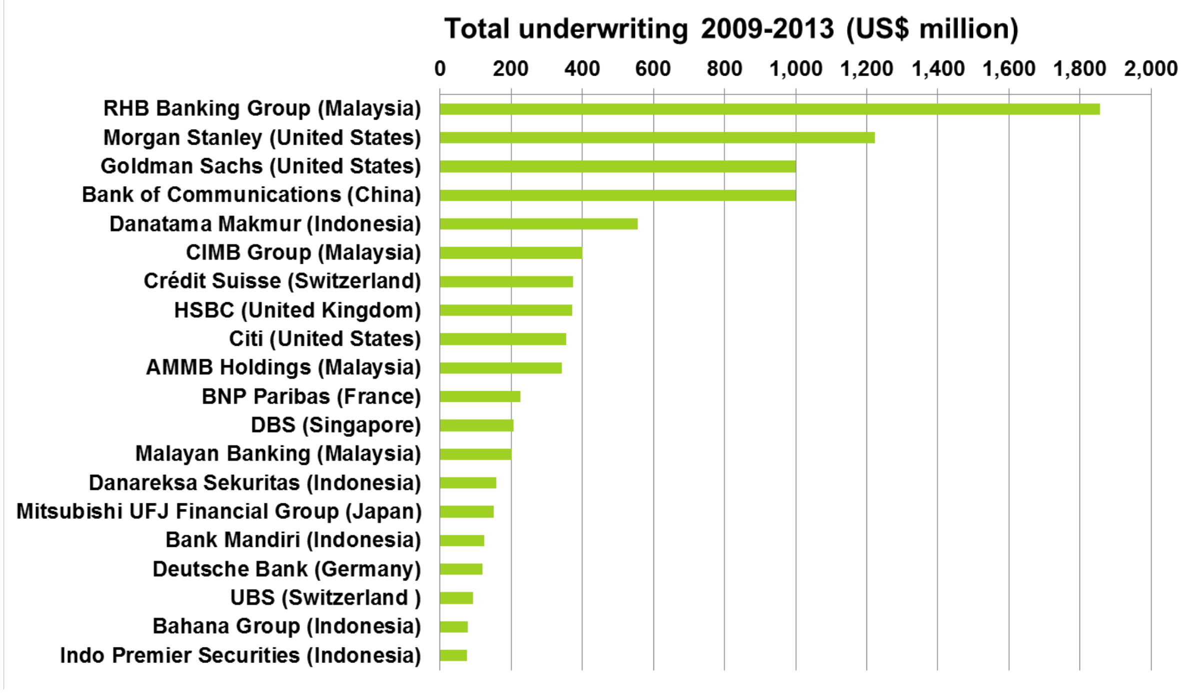
biofuels on progress made by the EU and member states in reaching the 2020 targets for renewable energy and sustainability biofuels. Since the base-line, benchmarks and reporting requirements for member states were so thin, if not absent, this report fails to present a fair and realistic picture of the social, ecological and climatic impacts of the EU shift towards use of biofuels notably as a consequence of the RED.

Banks providing loans to tycoon-controlled groups, 2009-2013



Biodiversity and land rights effects are superficial with unsubstantiated conclusions, misrepresenting the state of affairs at country level, notably in non-EU producer countries, in gross negligence of many high quality and relevant expert reports and scientific assessments.

Banks underwriting share and bond issuances of tycoon-controlled groups, 2009-2013



Some critics the report, if left unchallenged, may legitimize, ill informed, adoption of higher RED blending targets by EU member states. It downplays the urgency for stricter implementation of sustainability standards, improved monitoring and more adherence to a precautionary approach.

The report questions the quality of the ILC matrix, while disregarding detailed surveys and recordings of forest, wetlands and dry land clearances and large scale dis-possession and land right conflicts at district and provincial levels, findings which are backed up by arial/ GIS inventories and data collected by national level governmental agencies (such as the Indonesian Land Bureau, Human Rights Commissions) and scientific and expertise centers such as CIFOR, ICRAF, University of Wageningen and IIED.

This EU report deserves to be questioned, if not rejected, on the basis of lack of quality - in terms of analysis and substantiation - the absence of reference to sufficient markers and sustainability criteria and base line and the way it reaches it conclusions. A revised report needs to be asked for, which answers to basic principles of scientific analysis, proof and societal and policy relevance.

The Indonesia Sustainable Palm Oil (ISPO)

Indonesia Sustainable Palm Oil or ISPO is an Indonesian legal product issued by Ministry of Agriculture. ISPO is an official sustainability requirements on sustainable oil palm plantation in Indonesia. It regulates a mandatory standard comprises of 7 principles, 41 criteria and 127 indicators to verify sustainability of oil palm plantations in Indonesia. It was issued in March 2011, put a grace period, is expected to be effective fully and into force by December 2014. It has gone through field trials with the engagement of GAPKI members large oil palm growers, certification bodies, national, provincial, and district authorities of pilot provinces.

Currently, there are 191 large oil plantation companies already have applied for ISPO certification audit by ISPO Commission. By January 2014, there are some 40 oil palm plantation companies were awarded ISPO certificates covering 378,061.74 ha and 2,106,030.93 ton of CPO. Both draft and final audit reports of the plantation and mill certification assessment findings are neither disclosed nor made publicly available at ISPO website.

State lost from forest conversions by mining and plantations

No.	Province	Plantation		Mining		Estimated lost (Rp. Trillion)
		Unit	Acreage (Ha)	Unit	Acreage (Ha)	
1	Kalteng	282	3.934.963,00	629	3.570.519,20	158,5
2	Kaltim	86	720.829,63	223	774.519,45	31,5
3	Kalbar	169	2.145.846,23	384	3.602.263,30	47,5
4	Kalsel	32	370.282,14	169	84.972,01	9,614
5	Sultra	9	20.930	241	617.818	13,490
6	Riau	97	454.260,18	45	142.096	8,59
7	Jambi	52	298.088,00	31	62.747,00	4,73
Total		727	7945199,18	1722	8854934,96	273,924

Source: *Indonesia Corruption Watch (Emerson Yuntho 2013) concerning the estimation from State lost due to conversions by plantation and mining in forest areas (Ministry of Forestry:2011)*

Interestingly NGOs and experts are skeptical of ISPO standards to address the current challenges of the sustainability of the Indonesian palm oil production and propose more ambitious legal reforms rather than to let ISPO compromised implementations and should focus all efforts towards identified and known regulatory reforms towards just and sustainable palm oil industry. Government and private sector that support ISPO said that Indonesia needs its own mandatory sustainability standards to better address national interests and market demands. Other groups said the ISPO has been a tool for 'economic diplomacy' in EU market rather than solutions towards Indonesian sustainability problems.

Not all oil palm plantations can apply for ISPO certification programme. ISPO certification can only be pursued by large oil palm plantations holding I, II, and III class plantation. Class IV and V are given a 1-year grace improvement period with 3 time warnings before the license is withdrawn as the ultimate sanction for failure to comply. Prerequisite Plantation Business Assessment pursuant to plantation business assessment regulation conducted by qualified and trained assessors and approved by Provincial Directorate of Estate Crops. The assessment operations and field costs funded by State Budget (APBN) of the allocated Ministry of Agriculture Annual Budget.

What sustainability criteria are missing from ISPO?

Major sustainability concerns have been largely shaped and framed by economic, social and environmental considerations with particular attention to greenhouse gas emissions from deforestation and peat land, labor rights, smallholder partnership, community engagement commitments, etc. It is not the intention of this paper to create new restrictions and requirements towards Indonesian palm oil industry. It is therefore trying to demonstrate what have been in place, both nationally recognized under laws and regulations, and become internationally relevant standards.

It is obvious that Ministry of Agriculture claims that ISPO comprises of applicable laws and regulations but it does not introduce a critical criterion on ethical business conducts to prevent corrupt practices in palm oil operations and transactions. Meanwhile Indonesia palm oil is struggling to enter EU markets, either for foods or biodiesel opportunity, ISPO does not put a ban on hazardous and highly toxic pesticides and herbicides like Paraquat. On land right, ISPO stipulates compensation and negotiated agreement but it does not require a free, prior and informed consent of the affected communities and indigenous peoples. This is obviously inconsistent with the National Forestry Council (Dewan Kehutanan Nasional) Policy Recommendation on the implementation of Free, Prior and Informed Consent (FPIC) and the Indonesia's REDD+ National Strategy that requires an FPIC process with communities affected by the proposed REDD+ projects. Lastly, Indonesia a has Law Number 39 Year 1999 and its relevant regulations on human rights but the ISPO does not require a criterion on respect for human rights.

The palm oil and finance sector

Rapid and reckless expansion of large oil palm estates in SE Asia in combination with weak governance, unclear land tenure, and poor spatial planning is imposing human rights violations and billions of dollars in negative environmental, social and economic externality costs on the public at scales ranging from local communities to the global commons.

These unaccounted for costs include those associated with destruction of millions of hectares of rainforests, an associated loss of biodiversity, massive release of climate changing emissions, regional air pollution, public health impacts, social conflicts, and land grabbing, in contradiction to internationally recognized principles and norms of sustainable development and the protection of human rights. Palm oil from SE Asia is now found in consumer products in countries around the world, making its association with deforestation and social conflict a global reality and responsibility.

Land bank and plantation expansion is still the primary indicator for most analysts and asset managers in evaluating plantation companies' economic outlook, but such expansion is more and more an unsustainable and high-risk economic strategy. Instead, investors should develop alternative economic indicators, which align with social and environmental values such as increasing yields for smallholders.

Palm oil groups financing sources

Company	Total investments 2002-2011 (US$ mln)	Financed by… (US$ mln)		
		Shareholders	*Bondholders*	*Bank loans*
Golden Agri-Resources	8,105	6,348	0	1,757
Wilmar International	2,493	1,471	38	983
Indofood Agri Resources	1,945	933	380	631
Bakrie Sumatera Plantations	987	441	193	352
First Resources	939	571	267	101
Astra Agro Lestari	692	618	44	31
BW Plantation	330	154	24	152
Kencana Agri	327	211	0	116
Kuala Lumpur Kepong	320	277	10	33
Gozco Plantations	263	89	0	173
Genting Plantations	245	240	0	6
Sampoerna Agro	233	198	0	34
Sime Darby	169	130	8	31
Tunas Baru Lampung	151	76	14	61
Total	**17,197**	**11,757**	**978**	**4,461**
%		**68.4%**	**5.7%**	**25.9%**

Climate Change – The impacts of climate particularly threaten the natural resources and livelihoods of rural populations in developing countries. Anthropogenic climate change has been described as the largest market failure in human history. Greenhouse gas emissions from peat land degradation in SE Asia are already equivalent to those from the transport sectors globally. The use of fires to clear peatlands is a major contributor to regional air pollution alerts, and imposes billions of dollars in public health costs and economic damages. Oil palm expansion is a major driver of peatland degradation. Palm oil plantations on peatlands are projected to triple in the next one to two decades, with upwards of half a billion tons of associated CO_2 emissions annually, unless current trends are reversed.

Biodiversity and Deforestation– As recently as the 1960s, about 80 percent of Indonesia was forested, but with one of the highest deforestation rates in the world, less than half of Indonesia's original forest cover remains. Ninety percent of oil palm expansion in Indonesian Borneo has occurred at the expense of tropical rainforests. At the same time, due to failures of effective spatial planning, millions of hectares of forests were cleared for oil palm and then abandoned. Signaling the growing commercial urgency of the issue for producers, valuable consumer markets for palm oil increasingly demand deforestation-free, peatland expansion-free palm oil from their suppliers.

Rights of indigenous peoples and forest dependent communities – Standing forests are important sources of food, medicines and materials essential to the livelihoods of tens of millions of people in SE Asia. Corresponding to the regions rich biological diversity is its rich cultural diversity, with over 500 hundred distinct indigenous languages in Indonesia alone. At the same time, the customary land rights of indigenous peoples and forest dependent peoples are too often not recognized or respected by governments, who award concessions for industrial oil palm concessions over their traditional lands without their free, prior and informed consent. This failure is provoking human rights violations, social conflicts and loss of livelihoods, and cultural diversity and identity.

Forest Governance, Corruption and Money Laundering – Weak forest governance, pervasive corruption and widespread money laundering and tax evasion rob governments of billions of dollars in revenues that would otherwise be available to support essential and badly needed public services such as education, health and infrastructure. A study by Human Rights Watch found that between 2003 and 2006, an annual $2 billion in revenue lost to corruption and mismanagement in the timber sector in Indonesia was equal to the entire health spending at national, provincial, and district levels combined. This does not include additional losses due to tax evasion. According to records obtained from the Indonesian Ministry of Forests, potential forestry sector revenue losses related to irregularities in licensing procedures for 727 problematic oil palm plantation units and 1722 mining units in seven Provinces were predicted at $25 billion in 2011.

Indonesia is ranked 118th out of 176 countries on the Transparency International Corruption Perception Index, and is the fifth worst among SE Asian countries. Law enforcement is still weak, although a bribery case for obtaining a palm oil permit in Central Sulawesi was recently successfully prosecuted, and a $450 million fine levied for tax evasion against the large palm oil company, Asian Agri, is currently being litigated. Both cases are illustrative of wider patterns of endemic corruption running throughout the sector. The finance sector also has a major role. However, the finance sector is too often implicated in aiding and abetting this criminal financial activity, which lines the pockets of a few at the expense of the public.

Working Conditions – Malaysia and Indonesia's palm oil sectors are listed by the US Department of Labor as being at significant risk of using child and forced labor in violation of international norms and conventions. In addition to the risks of forced and child labor, migrant workers and their families generally have minimal rights and protections, and commonly suffer from sub-standard labor and living conditions, and lack of access to adequate health care and education for children. Dangerous and highly hazardous pesticides, including paraquat, are still too widely used, posing numerous risks to workers, children and their families and threatening the reproductive rights of women. The use of appropriate personal protective equipment for these pesticides is often impractical for workers in hot tropical conditions, as well as being ineffective in preventing long-term harm.

Land Grabbing and Food Sovereignty – large industrial oil palm plantations are too often imposed on rural communities to the detriment of communities' rights over their productive resources, existing local food production and food security. This is taking place around Southeast Asia and increasingly in Africa and Latin America in a process commonly referred to as "land-grabbing"; the buying or leasing of large pieces of land in developing countries, by domestic and transnational companies, governments, and individuals, with negative consequences for local communities.

Supply chain traceability – Supply chain traceability and control starting from suppliers of oil palm fresh fruit bunches to processing mills through to end users is an essential tool for promoting responsible palm oil production practices, eliminating illegal and egregious sources from global supply chains and ensuring accountability.

Conflict resolution and human rights – Indonesia's National Land Agency has registered more than 3,000 conflicts between local communities and palm oil companies. Communities resisting the takeover of their forests and farms for palm oil plantations are too commonly treated as criminals, subject of policy harassment and beatings, imprisonment of village leaders, forced relocations and extra-judicial killings. Regional authorities have the capacity to issue licenses, but lack the capacity to prevent and remedy social conflicts associated with these new licenses, making conflicts inevitable.

Regulatory Governance of the Financial Sector – Government has a unique regulatory role that includes close oversight of the financial sector. Green banking regulatory initiatives reflect growing recognition that it makes little sense to allow financing of projects and activities that worsens the very social and environmental problems that government policies are attempting to address and reverse. In Indonesia, for example, the president has committed to a 26% reduction in greenhouse gas emissions below the projected business as usual emission level by 2020, and yet financing in key sectors like oil palm, which are drivers of deforestation and social conflict, is allowed to continue, without use of sector best practice ESG performance standards, due diligence requirements and other accountability measures.

Palm oil investments in 2002-2011

In the past decade (2002-2011), the 27 companies invested a total amount of US$ 25.3 billion in the palm oil sectors of Indonesia and Malaysia: US$ 17.8 billion in Indonesia and US$ 7.5 billion in Malaysia. These investments represent at least half of all investments made in the palm oil sectors in Indonesia and Malaysia. The estimated half of total investments that we did not capture, has largely been invested by small and mid-sized companies in Indonesia and Malaysia.
This leads to the conclusion that Indonesia has been the prime focus of palm oil investments in the past decade. But this pattern might slowly change. What we have seen happening with Malaysia, which for a long time was the dominant palm oil producer but where expansion opportunities are more limited now, could also happen with Indonesia. Some of the larger South-East Asian companies are already looking for other opportunities, especially in Africa.

Groups of financiers

- The expansion of the palm oil sector in Indonesia and Malaysia during the past decade was financed by entrepreneurs (35%), banks (24%), institutional investors (6%) , governments (7%) and unknown financiers (27%).
- While the global oil palm sector has expanded strongly in the past few decades, it still remains dominated to a large extent by family-owned and family-controlled businesses. This is reflected by the large share of domestic entrepreneurs (total: 31%) in the financing of palm oil companies in Indonesia (34%) and Malaysia (22%).
- Governments only played a small role in the financing of the palm oil expansion in the past decade, as they financed 7% on average. The domestic government is important in Malaysia (20%), but in Indonesia governments are not important.
- Overall, banks have provided 24% of the financing needed for the expansion of the palm oil sector in Indonesia and Malaysia in the past decade.
- Multilateral banks hardly played a role in the expansion of the oil palm sector. The multilaterals mainly seem to focus on paving the way for the development of the palm oil sector in countries where this sector is still absent or not well developed yet.
- Domestic banks account for a bit less than half of all commercial bank loans in Indonesia and Malaysia (11% out of 24%), with the other half being provided by banks from other South-East Asian countries (4%) and by banks from the rest of the world (9%).

- Institutional investors financed at least 6% of the expansion of the Indonesian and Malaysian palm oil sector in the past decade. But it should be noted that for 27% of all investments we could not clearly identify which group of financiers is responsible. Most of these investments were financed by institutional investors as well, but we could not establish the country of origin of these investors.
- Within the group of institutional investors, domestic institutional investors account for only a small part of the financing provided by institutional investors in the past decade (1% out of 6%), while foreign and South-East Asian institutional investors account for the remaining 5%. However, we have to note that the group of unknown financiers (27%) mostly includes institutional investors of which we do not know the country of origin.

Important financial institutions

While the research has focused on classifying the financiers into groups, we also provided an overview of the largest individual financial institutions owning shares of the palm oil companies and of the banks providing them with bank loans. The largest institutional investors holding shares in the palm oil companies are Van Eck Associates (US$ 764 million), BlackRock (US$ 722 million) and The Vanguard Group (US$ 540 million). The financial institutions that provided the largest amount of loans are HSBC (US$ 1.5 billion), Mitsubishi UFJ Financial (US$ 1.2 billion), OCBC (US$ 961 million) and the Sumitomo Mitsui Financial (US$ 764 million).

Future trends

Despite upcoming competition in Africa, Latin America and elsewhere in Asia, South-East Asia will certainly continue to be the dominant force on the global palm oil market in the coming decade. But Indonesia now has definitively overtaken Malaysia as the most important CPO producer and aims to become the largest in the downstream segment as well. In the coming years, major investments are expected in the upstream and downstream palm oil sector in Indonesia. The investments are especially driven by a range of tax incentives issued by the Indonesian government, which are directed at expanding the domestic downstream sector. Indonesian companies plan to nearly double refining capacity to 43 million tons of palm oil, or 80 per cent of total world output of palm oil. Investments of around US$ 2 to 3 billion in the coming three years are expected.

To feed these downstream investments, CPO production is planned to reach 40 million tons by 2020 (from the current level of 25 million tons). This would imply that the plantation acreages will continue to increase at the same rate as in the past decade. These huge investments will be mainly undertaken by the existing Indonesian oil palm groups, which still rely for a significant part of their financing on domestic entrepreneurs and domestic banks. But foreign banks and institutional investors will play an increasing role, to make these huge investments possible.

Policy consequences

Of only 25 tycoon-controlled oil palm groups control an oil palm landbank of 5.1 million hectares, of which 3.1 million hectares are planted at present (31% of the total area planted with oil palm in Indonesia). If these groups would develop their 2.0 million hectares of unplanted landbanks in the coming years, the Indonesian oil palm acreage would grow by 20% and the share in the total planted area of these 25 tycoon-controlled groups would increase to 43%.

This concentration of power and landbanks is even stronger in some provinces: the planted and unplanted landbanks of the 25 tycoon-controlled groups on Kalimantan are equivalent to 98% of the area presently planted with oil palm on Kalimantan (3.2 million hectares). If their landbanks on

Kalimantan will be fully planted in the coming years, the total planted oil palm area on Kalimantan will increase by 50%.

The concentration of corporate power in the Indonesian palm oil sector in the hands of a few tycoons, asks for action by all involved parties who strive towards a sustainable and socially inclusive development of this sector:
· The Indonesian government and palm oil importing countries need to acknowledge that, while forests get destroyed and communities lose their land as a consequence of the expansion of oil palm plantations, tycoons park their growing wealth in tax havens and continue to strengthen their grip on the sector without sufficient transparency and public control. The Ministry of Agriculture regulation 98/2013, which limits the total landbank for oil palm production to 100,000 hectare per company group, fails to regulate this process of increasing corporate control. This is because publicly listed companies are exempted from this regulation 4 , while this study shows that 21 out of the 25 tycoon-controlled groups are operating via a listed holding company.

Domestic and foreign financial institutions also need to acknowledge that the process of concentration of land banks and power in the palm oil sector in the hands of a small elite is further facilitated by the funds of banks and external investors offering the tycoons a flywheel to accelerate their expansion. From 2009 until 2013, banks provided loans with a total value of US$ 11.3 billion to the 25 tycoon-controlled oil palm groups and have underwritten share and bond issuances of these groups for a total value of US$ 2.3 billion.
The most important banks providing bank loans to the tycoon-controlled groups were HSBC (United Kingdom), OCBC (Singapore) and CIMB (Malaysia), while the most important underwriting banks were RHB (Malaysia), Morgan Stanley (United States) and Goldman Sachs (United States).

Because their important role in the expansion of tycoon-controlled business groups, domestic and foreign financial institutions should therefore strengthen their social and environmental risk policies and improve their risk assessment and accountability mechanisms. Responsible financial institutions need to avoid that they are unwillingly facilitating the further growth of human rights abuses, land grabbing, social conflicts, labour and smallholder exploitation in this sector.

Specific recommendations

- We call on the EU finance sector to ensure that all its financing to the oil palm sector strictly prohibits further direct or indirect conversion, expansion, drainage or the setting of fires on any peat lands and to support peat land restoration.
- We call on EU banks and investors to ensure financing contributes to achieving zero deforestation, to sever ties with producers and suppliers linked to ongoing deforestation, and to support the development of government polices that further forest protection.
- We call on EU banks and investors to adopt financing safeguards consistent with upholding the rights of indigenous peoples, as articulated in the UN Declaration on the Rights of Indigenous Peoples (UNDRIP), and to limit support to palm oil producers that can demonstrate that they respect the right of indigenous peoples and local communities to give or withhold their free, prior and informed consent to proposed developments and respect their customary rights to their lands and forests.
- We call on the EU finance sector to aggressively increase due diligence efforts to identify and report suspected money laundering activities to appropriate authorities, and to avoid all financing to palm oil sector companies and their suppliers suspected of engaging in bribes, tax evasion or money laundering.
- We call on the EU finance sector to adopt zero tolerance policies for maintaining banking or

investor relationships with producers and suppliers linked to child or forced labor. Similarly, we call on banks and investors to ensure that their financing is limited to palm oil producers that do not use paraquat or other dangerous chemicals.

- We call on EU banks and investors to end any financing of industrial palm oil plantations associated with land grabbing and to ensure that any remaining financing to the palm oil sector is consistent with implementation of the *FAO Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security*.
- We call on the EU banks and investors to avoid financing of palm oil producers, refiners and traders that are unable or unwilling to implement full traceability systems in their supply chains back to all growers. We call on banks and investors to ensure that they assess what conflict resolution mechanisms, if any, of palm oil producer, traders and refining companies have and their effectiveness and do not finance companies without effective conflict resolution mechanisms. In addition, banks and institutional investors should create conflict resolution mechanisms of their own for any palm related financing which can be accessed by impacted rights-holders and stakeholders and functions to ensure that rights are respected and upheld.
- We call on the EU relevant financial regulatory bodies to develop mechanisms to ensure that: best-practice oil palm sector performance standards are consistently adopted and implemented by financial institutions; financial institutions are held accountable for compliance; accessible dispute resolution mechanisms are established; and these measures include regular and transparent reporting by regulatory agencies on the performance of individual financial institutions in contributing to the achievement of regulatory policies and the goals outlined in this statement for the oil palm sector.

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Indonesian Ministry of Agriculture Regulation Number 1 Year 2007 stipulates a restricted use of Paraquat contradicts the EU court ruling in 2007 that reconfirmed the ban on Paraquat. Recently FONAP-consumers of Germany, Swiss and Austria call for immediate ban of Paraquat by 2014.

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