



PRELIMINARY ASSESSMENT REPORT

Complaint Regarding IFC's Involvement in
the Pan African Paper Mills project

October 1, 2008

Office of the Compliance Advisor/Ombudsman
International Finance Corporation/
Multilateral Investment Guarantee Agency

CONTENTS

Introduction 1

The Complaint..... 1

The Project..... 1

CAO Ombudsman Assessment

- I. Rational..... 2
- II. Methodology..... 2
- III. Key issues raised in the complainant..... 3
- IV. Additional issues raised during the assessment..... 3
- V. Response and perspectives of PPM..... 5
- VI. Response and perspectives of IFC..... 6
- VII. CAO Ombudsman Assessment of Opportunities and Next Steps..... 7

INTRODUCTION

The Compliance Advisor Ombudsman (CAO) is the independent recourse mechanism for the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). The CAO reports directly to the President of the World Bank Group. Its mandate is to address complaints brought by communities or individuals affected by IFC or MIGA projects in a fair, objective, and constructive manner, and to enhance the social and environmental outcomes of these projects.

Upon determining that a complaint meets the specified criteria for a CAO intervention, the CAO Ombudsman conducts an assessment of the situation to clarify the issues, facilitate communication between the parties about their perspectives and interests, and help them identify opportunities for resolution.

THE COMPLAINT

The current complaint was filed in February 2008 by Resources Conflict Institute (RECONCILE), an environmental NGO based in Nakuru, Kenya. The complaint states that it is made on behalf of and with the authority of the residents of Webuye Town and members of the Centre for Environmental and Development Education Programmes (CEDEP), also based in the same town.

According to the complaint, the residents of Webuye believe they have been and continue to be negatively impacted by noxious, gaseous discharge into the air surrounding the facility, and by the release of untreated effluent into the River Nzoia by Pan African Paper Mill (PPM). The impacts stemming from these environmental conditions, according to the complaint, have resulted in a number of long-standing health and social problems that are impacting the entire community.

THE PROJECT

The IFC first invested in Pan-African Paper Mills (PPM) in 1974, and since then has supported the company through seven separate loans or equity investments. Other major shareholders besides IFC (24.9%), are Orient Paper and Industries, Ltd., a member of the Birla Group of India (29.4%), and the Government of Kenya (33.9%). PPM produces paper for domestic consumption in Kenya, providing the majority of the country's supply.

IFC currently has an outstanding loan to PPM of nearly \$30 million (USD). Through the years, the project's financial situation has deteriorated, due in part to dwindling wood supply and high fuel costs. In May of 1994, IFC led a financial restructuring of the company. Both the restructuring (in 1998) and the final IFC loan (in 1996) were intended to support a Technical Upgrade Program that included the elimination of elemental chlorine bleaching and conversion to chlorine dioxide. According to IFC, by March of 1996 the upgrade program had not been fully completed due to the continued cash flow difficulties. In May 2008, the Government of Kenya pledged to inject additional cash and adequate wood supply to help keep the company solvent.

CAO OMBUDSMAN ASSESSMENT

I. Rational

CAO Ombudsman assessments seek to clarify issues and concerns raised by complainants, to gather information on the perspectives and interests of other impacted stakeholders who may not have signed the complaint, and to assist the parties in determining their best alternatives for resolving the issues. It does not gather information to determine fault or make judgments on the merits of a complaint.

To be eligible for CAO assessment, complaints must demonstrate that:

- The complaint pertains to a project that IFC/MIGA is participating in, or is actively considering.
- The issues raised in the complaint pertain to the CAO's mandate to address environmental and social impacts of IFC/MIGA investments.
- The complainant may be affected if the social and/or environmental impacts raised in the complaint occurred.

The CAO determined that the eligibility criteria were met in this case, and initiated an Ombudsman assessment in March 2008.

II. Methodology

Following eligibility determination, the CAO Ombudsman met with IFC project team members who are working on the PPM project to summarize the issues raised in the complaint and discuss the history and current situation on the ground.

The Ombudsman team also spoke by telephone with the signatories to the complaint to discuss the issues, review CAO's operational procedures and complaint-handling process, and to schedule meetings in advance of a May 2008 site visit.

From May 11 to 16, 2008, a CAO team held meetings in Kenya with the following stakeholder groups:

- Signatories to the complaint from the NGO RECONCILE in Nakruru;
- PPM senior management in Webuye for an initial meeting to discuss the agenda and stakeholder list;
- Representatives of CEDEP (Center for Environmental and Development Education Programmes), a locally based NGO working in partnership with RECONCILE, for an initial meeting and to discuss the agenda and stakeholders;
- Residents, civic leaders and members of local NGOs and civil society organizations at a meeting in Webuye City Hall. Participants shared their perspectives on company-community relations, and worked in small groups to identify potential strategies for addressing and resolving issues of concern;
- A second meeting with signatories to the complaint, for a tour of the area immediately surrounding the PPM facility, including people's homes and fields, PPM effluent treatment

ponds, and a PPM plantation that serves as both a demonstration site for environmental compliance and a plant and tree nursery;

- Representative from the National Environmental Management Authority (NEMA), responsible for Bungoma District (encompassing Webuye). NEMA deals with licensing, audit review and reporting, etc.;
- The Deputy District Public Health Officer, Webuye Hospital, to discuss health issues raised by complainants and other stakeholders;
- The Mayor, Deputy Mayor, Town Clerk and Treasurer, and Town Councillors of Webuye, to discuss the perspectives of city leadership on company-community relations and possible improvements;
- A second meeting with PPM senior management for presentation of company's operations, tour of PPM facility, and final wrap-up meeting to discuss community perspectives and possible next steps.

III. Key issues raised in the complaint

According to the complaint, PPM's operations are responsible for a number of negative health, environmental, social and economic impacts in and around the town of Webuye.

The complaint maintains that a range of health problems are afflicting a disproportionate number of residents. These include upper respiratory problems, lung and throat cancer, asthma, bronchitis, bronchial pneumonia, hepatitis, conjunctivitis, dermatitis, tuberculosis, impotence and infertility, stunted reproductive organs in newborns, retarded intelligence among children, and chronic coughing.

According to the complaint, the impacts of PPM encompass the following:

- Environmental impacts – including a foul, irritating smell that pervades the town at periodic intervals, rusty and dry crops, reduced productivity of land, poor health and productivity of livestock, and fish stock reduction in the River Nzoia.
- Social impacts – including deterioration of iron roofs and walls which increases the cost of home maintenance; high drop-out rates from schools; poor hygiene and sanitation; and food and livelihood insecurity.
- Economic impacts – including the area's inability to attract business interests due to poor environmental quality.

The complaint also states that the project does not comply with specific IFC Performance Standards relating to pollution prevention and abatement, social and environmental assessment and management systems, and community health, safety and security.

IV. Additional issues raised during the assessment

In addition to the specific issues described in the written complaint, a number of others were raised by stakeholders who did not sign the complaint. These stakeholders were identified by

both the complainants and by PPM representatives as people with whom the CAO Ombudsman team should interview for a more thorough assessment of the situation. Some, but not all, of these concerns are similar or connected in some way with those mentioned in the original complaint. The concerns are categorized into several broad categories, as summarized below:

Health Impacts

Among the most frequently raised concerns of those interviewed by the CAO team was the impact of PPM's emissions on the health and physical well-being of residents. In addition to the impacts described in the complaint many of the interviewed stakeholders believe these impacts to also include:

- Solid matter (ash and airborne foam) lands on crockery and food, especially in the morning when there appears to be less wind to disperse it. The ingestion of this matter is believed to cause numerous health problems that are unique to this area.
- Airborne pollution from PPM is believed to lower resistance, making residents more susceptible to other diseases such as malaria and tuberculosis.
- The pollutants are believed to result in the failure of some girls to develop breasts, and impotence and infertility among men.

Economic Impacts

Many stakeholders interviewed during the assessment believe PPM's operations are responsible for some negative economic impacts in Webuye, and there is broad agreement with those impacts as described in the written complaint. Additional issues not raised in the complaint, but described by many of those interviewed, included:

- Rainwater that is believed to be polluted from PPM's emissions ("acid rain") leads to reduced agricultural productivity, which increases the demand for food imported from outside the immediate area, at a high cost to residents.
- Those crops that are successful are said to be difficult to sell because of a general perception outside Webuye that anything grown there is contaminated and unsafe.
- An increase in disease rates is believed to be associated with PPM-generated pollutants and has increased the need for medical treatment, at a high cost to residents. Higher demand for health services is said to be increasing pressure on an already under funded and under staffed health care system.

Social Impacts

The majority of stakeholders interviewed by the CAO said they believe there is a general lack of information about the company – both its problems and its successes. While there is wide agreement among the complainants and other stakeholders that PPM is a benefit to the community, a number of specific concerns regarding community relations were raised during the assessment interviews:

- Many people believe that low information flow and the lack of a regular community forum convened by PPM results in an atmosphere of mistrust of the company and its environmental performance. Particularly among interviewees in closest proximity to PPM's operation, there is little awareness of what projects or community outreach initiatives are being undertaken by the company.

- A number of people interviewed said that requests for re-location compensation from the 1970s (when the facility was first constructed), and claims for compensation for work-related illnesses, have never been addressed by the company, or have been dismissed as unauthentic.
- There is general agreement among those interviewed that PPM's decision making about where and how to allocate social investment monies should be a transparent process that includes a cross-section of Webuye residents.

Employee/community relations

A number of community members interviewed by the CAO were former PPM employees or have family members who currently work (or previously worked) for PPM. Nearly all of the stakeholders interviewed, including the signatories to the complaint, expressed confidence in PPM's recently appointed General Manager, who is regarded as someone with an ability to turn the company around, with a willingness to engage on the issues of most concern to residents. The community-relations concerns raised most frequently by these stakeholders include:

- Following a strike against the company in 1997, a number of people were reportedly sacked who refused the settlement offer that ended the strike. Those individuals say they never received a union-negotiated benefits package, and this is believed to have heightened ill will and negative perceptions of the company's corporate citizenship.
- Employees are believed to be largely recruited from outside Webuye, from entry-level jobs through senior management. Locals say they are uncertain how employees are recruited, or what the criteria are for employment with PPM.
- Many PPM employees are reportedly classified as 'casual' workers, even though they are given full-time responsibilities and have worked in the same position for many years. This also contributes to negative perceptions of the company and its wage structure.

V. Response and perspectives of PPM

From the perspective of PPM management, the company in the last several years has been demonstrating continuous improvement in both its social and environmental performance, and is complying with World Bank Group and Government of Kenya social and environmental requirements. According to the company's Executive Director, who joined the management team several years ago, PPM is operating under constant threat of closure due to its precarious financial situation. However, PPM says it is committed to restructuring financially and has a number of plans in place to improve what it views as an already good record of social and environmental performance.

PPM says it has been engaged for a number of years with members of CEDEP, the Webuye-based NGO that co-signed the current complaint, and is frustrated that many of the claims against the company are not based on sound science or evidence. Concerns similar to those in the CAO complaint have been raised previously by the same NGO, and PPM says it has been open to engagement and constructive dialog with those complainants. In response to the specific issues raised in the CAO complaint:

- PPM believes the signatories to the complaint do not represent the perspectives of the wider community, who benefit from the presence of the paper mill and the social development projects it supports.

- According to PPM management, a paper mill by design involves daily discharges of smoke and liquids. The smell associated with the facility is common to the industry and can sometimes be unpleasant, but it does not on its own constitute non-compliance with environmental regulations.
- PPM says it carefully monitors all discharges and that the project operates in accordance with ISO 9001 and 14001 standards. To retain its ISO certification, the company must conduct both internal audits as well as external audits by third party independents.
- PPM says it was visited by the National Environmental Management Agency (NEMA) and the Kenya Human Rights Commission, who investigated similar complaints of environmental and social non-compliances. According to the company, those agencies have not produced any public reports specifying non-compliances or infractions of Kenyan environmental requirements.
- Deteriorating roofs and metal fixtures, according to PPM, are a result not of the company's emissions but the quality and/or the age of the metal used in construction. PPM believes a similar pattern of deterioration of roofs is evident throughout Kenya, not only in Webuye.
- PPM's medical officer says the most commonly diagnosed health problem in the area surrounding PPM, and in much of the rest of Kenya, is malaria – not the respiratory diseases or other afflictions described by the complainants. They believe there is no evidence to support claims that pollutants from the factory are causing the range of specific respiratory, infertility, and congenital conditions as described in the complaint.

Partly in response to the complaint, and since the CAO's visit to Webuye, PPM management has drafted a Communication and Outreach Plan that seeks to address issues raised in the complaint, and to establish a comprehensive approach to community engagement. The plan acknowledges an "information gap" between the community and the company, and outlines a number of outreach initiatives that already have been undertaken or are planned for the future. The plan also describes PPM's commitment to designing a Corporate Social Responsibility (CSR) needs assessment, which it says will inform future CSR-focused activities.

The company has reported that implementation of this Communication and Outreach Plan is essential for raising awareness among the residents of Webuye about the range of PPM-sponsored social development programmes that provide benefits to the community. It further says it is committed to addressing specific complaints and taking corrective measures within its available resources, and to developing a comprehensive grievance mechanism through which current and future complaints can be systematically addressed.

VI. Response and Perspectives of IFC

Since the mid-1990s IFC has been working with PPM to help restructure the company's finances. Due to PPM's perennial cash crisis, the project was transferred from IFC's Global Manufacturing and Services department to a unit called "Special Operations", which oversees turn-around plans for projects that are unable to meet their financial obligations to IFC.

IFC says it and PPM's other lenders are in agreement that the socio-economic impacts of a company shut-down would be significant, and that it is preferable for PPM to continue negotiating a plan to restructure and become profitable again.

In late 2004, IFC and PPM's other lenders recommended that the company commission a study of the viability, turnaround potential and best long-term strategy for PPM. The company adopted this proposal and submitted a restructuring plan in late 2006, which IFC and the other shareholders adopted in principle in January 2007. The IFC has been supportive of the key elements of the proposal – including government-led pilot projects that involve community and the private sector in forestry management and replenishment of a fiber shortage that has hampered PPM's operations.

Regarding the environmental concerns raised in the complaint, IFC states that while PPM has previously had incidences of exceeding certain IFC guideline limits, the plants overall ambient air quality and effluent discharge impacts remain within acceptable limits. According to IFC, due to its financial circumstances, the company has not been able to implement plant-wide technological conversions and upgrades of its 30-plus-year-old facility to meet current industry best practice. However, while discussions regarding a financial restructuring of the project have been on-going, the company continues to report regularly on its performance, including independent testing for absorbable organic halides (AOX) in effluent. In addition IFC says that independent testing completed this year by a reputed international auditing firm on ambient air and river water quality indicate these are within acceptable ranges.

The IFC says it will continue to coordinate with PPM and its other partners to ensure proactive resolution of the company's situation, and will support PPM in strengthening social development initiatives aimed at building trust and addressing the ongoing concerns of NGOs and residents.

VII. CAO Ombudsman Assessment of Opportunities and Next Steps

Both PPM and the NGOs who filed the complaint, as well as a broader group of interested stakeholders, have expressed interest in improving the level of engagement between the company and the community. There is general agreement among the NGOs and community members interviewed during the assessment that:

- PPM should remain open. The company brings economic stability to Webuye and the surrounding area, and its closure could have a devastating economic impact.
- Disclosure of and access to information about PPM's environmental impacts is important to many residents who value the company's presence but believe the mill's emissions may be causing health problems and negatively impacting plants, animals, and buildings.
- Priority should be given to qualified local residents when filling job vacancies at the mill. PPM-sponsored training and mentorship programs could prepare young people and other residents for more senior-level positions that require specific expertise.

The complainants have requested that the environmental concerns be addressed through development of a collaborative Environmental Management Plan with PPM that includes a strategy for compliance monitoring and a forum for consultation and exchange of information among key stakeholders.

PPM says such an approach is not necessary, since the company already undertakes environmental monitoring that demonstrates compliance with government and World Bank requirements. PPM has proposed to address both the social and environmental concerns of complainants' and other community members through better communication and outreach with

residents, and by undertaking a systematic strategy for publicizing its environmental record and social development activities.

Improved communication and disclosure of information about PPM will help address the information gap that many stakeholders have identified. However, seeking the participation and input of other stakeholders in developing that strategy will be a key step toward building trust in existing information, demonstrating compliance and transparency, and ensuring a robust mechanism for resolving complaints.

PPM has committed to undertaking a Corporate Social Responsibility (CSR) Needs Assessment to identify areas for improvement and opportunities for strengthening its community development activities. If planned and implemented in partnership with a larger stakeholder group, this assessment could be the foundation for an inclusive and durable process aimed at addressing specific environmental and social concerns, and at demonstrating PPM's stated commitment to transparency and community engagement.

The CAO Ombudsman team proposes to facilitate the design and implementation of this Needs Assessment by working with the company and the signatories to jointly identify the appropriate stakeholders who would participate in the process. Once a stakeholder group has been identified, the CAO would work with all the participants to:

- Facilitate a series of meetings at which those stakeholders:
 - 1) Identify and prioritize the areas of greatest need or concern to stakeholders;
 - 2) Identify goals, strategies and key stakeholder groups for addressing those concerns; and
 - 3) Develop work plans, ground-rules and timelines for carrying out the activities.
- Provide facilitation and logistical support throughout the needs assessment process.
- Monitor the implementation of any projects or activities stemming from the assessment to ensure agreements are implemented within stated timelines.

Because a number of specific social and environmental concerns already have been identified by the parties during the CAO assessment, participants involved in the company-convened CSR Needs Assessment process could use this preliminary list of issues (as summarized in this report) as a starting point for the facilitated discussions. The participatory Needs Assessment process could begin by refining or modifying the issues identified by CAO, identifying appropriate stakeholder or sub-groups to address those specific issues (i.e. health impacts, impacts to buildings, water quality, etc.), and designing consensus-based implementation strategies with goals, action plans, and timelines.

The CAO assessment period for this complaint ends on November 15, 2008. On or before that date, the parties must determine whether to attempt to resolve the issues through a negotiated process – either by pursuing the approach proposed by CAO, described above, or by proposing and agreeing to an alternative negotiated process. The specific design and implementation of the negotiated process would begin only after the parties have formally agreed to work together; the November 15 deadline indicates the date by which the parties must make a decision whether to pursue a facilitated resolution .

If the parties decide to work together, an 'Agreement to Negotiate' would be drafted and signed, and would be made public unless otherwise agreed by the participants.

In the event the parties decide not to pursue a negotiated approach, the CAO Ombudsman will conclude its involvement in the case and transfer it to CAO Compliance.

A CAO Compliance process involves an appraisal of the issues raised in the complaint to determine how the IFC assures itself that a project is in compliance with the relevant policies and guidelines. If the CAO decides to initiate a compliance audit as a result of the appraisal, a terms of reference for the audit is developed in accordance with CAO's Operational Guidelines.

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