



May 12, 2005

To: FASE/ES – Federação de Órgãos para Assistência Social e Educacional / Espírito Santo and co-signatories of letter of April 7, 2005 to the President of the World Bank

Subject: IFC Investment in the Company Aracruz Celulose S.A.

Ladies and Gentlemen,

Thank you for your letter of April 7, 2005 to Mr. Wolfensohn, President of the World Bank Group, regarding the US\$50 million loan provided by IFC, in November of 2004, to Aracruz Celulose S.A. (“Aracruz”). Your letter questions IFC’s decision to support the new investment with particular focus on Aracruz’s impact on indigenous peoples and other vulnerable communities. We have carefully reviewed your concerns, comparing them with the information we gathered from a range of sources and stakeholders during our appraisal of Aracruz.

Having completed this review, our primary conclusions are that: (i) IFC could have improved upon the level of transparency associated with our review and evaluation of the project; (ii) contrary to the assertion in your letter, IFC did in fact identify, evaluate and factor into its investment decision and loan conditions the key issues you raise with respect to indigenous and disadvantaged communities, as well as the environmental impacts associated with Aracruz’s operations; (iii) consistent with our policies pertaining to indigenous peoples, special care and initiatives need to continue to address the needs and protect the rights of local communities neighboring Aracruz’s plantations; and, (iv) based on consultations with relevant indigenous leaders (Caciques) undertaken by an IFC representative prior to our approval of the investment, there was general comfort among them with respect to the agreements they had previously signed with Aracruz and the Government as well as a positive view of their relationship with the company. What follows below is a more detailed explanation as to why we reached these conclusions and addresses the additional issues you have raised.

1. *Assertion that the IFC project documentation did not cite or evaluate the issue of land disputes that involve indigenous and Afro-Brazilian communities.*

These land dispute issues were fully reviewed during IFC’s appraisal. The Environmental Review Summary is, by its nature, a brief document summarizing the project’s impacts and mitigation. However, it did address the overall agreements signed by Aracruz and the indigenous communities in 1998 and 2002, and described the efforts Aracruz is making to provide assistance to the indigenous communities. This document, along with the Company’s Environmental and Social Action Plan (ESAP) were both publicly disclosed before IFC made its investment. Nevertheless, we accept that IFC could have been more forthcoming in this public documentation in terms of the extent to which we were aware of and assessed the overall relationship and conflicts with local communities. IFC is currently working with the Company on further refining the ESAP, which will be agreed upon with IFC prior to its implementation. The ESAP includes a number of projects to improve the level of education and health of the people in the area, economic and social development programs in partnership with various NGOs and FUNAI, culture and leisure activities, and environmental management work involving environmental

management systems, protection of biodiversity and climate change. As a result of their findings during appraisal, IFC staff concluded that the proposed project would meet the applicable World Bank/IFC environmental and social policies and the environmental, health and safety guidelines upon successful implementation of the mitigation measures included in the ESAP.

Indigenous Communities. During project appraisal IFC learned about the agreements that Aracruz had signed with the Tupinikim and Guarani communities located in the Municipality of Espírito Santo. More specifically:

- On 2 April 1998 the indigenous communities of Caieiras Velhas and Pau Brasil, FUNAI (National Indigenous Peoples Foundation) and the Company signed an agreement called “Term of Conduct Adjustment” with the intervention of the Federal Public Prosecutor’s Office. These agreements were then discussed within the communities and ratified by their leaders and a majority of their members. Through the signing of this agreement, the indigenous communities recognized the Ministry of Justice’s administrative rulings of 9 March 1998, which increased the indigenous reservation by 2,571 hectares in lands, which had been previously registered in the name of Aracruz.
- On 30 June 1998 the Company donated 184 hectares to the Comboios indigenous community.
- As part of the agreements with the communities of Caieiras Velhas, Pau Brasil and Comboios, Aracruz committed to contribute R\$13,500,000 (in current values and adjusted to inflation) over the next 20 years to fund social projects.
- In 2002, through the mediation of the Federal Public Prosecutor’s Office, Aracruz and the indigenous communities signed an addendum to the Term of Conduct Adjustment, under which the Company increased its contribution to projects to generate income for the communities by R\$476,000 per year, which at the time totaled R\$1,400,000 annually. Aracruz also committed to (i) fund 41 university scholarships per year until 2018; (ii) support a program to increase employment opportunities for members of indigenous communities; and, (iii) support reforestation and other community development programs.
- In addition, Aracruz signed a Forestry Partners Program Contract with the indigenous communities (at their request) for the cultivation of eucalyptus trees on 1,700 hectares and the subsequent sale of the wood. As part of this agreement Aracruz also provides technical assistance to the indigenous communities.

IFC understood at the time of the appraisal that the decisions to demarcate indigenous lands in the State of Espírito Santo had been carried out with the involvement of the Ministry of Justice and FUNAI and that the Federal Prosecutor’s Office was involved in the negotiation of the agreements with the indigenous communities. According to the Company’s extensive land acquisition records, all of its lands in the State of Espírito Santo, including those donated by Aracruz to indigenous communities (1,636 hectares in 1981 and 2,755 hectares in 1998), were acquired from the legitimate owners, who transferred to Aracruz legally registered land titles.

In your letter you state that the agreements reached by Aracruz and the indigenous communities constitute an “illegal exchange of indigenous land for money”. However, in the absence of compelling proof—which has not been presented—that the agreements were reached under duress rather than a consensual agreement between the parties, IFC is not in a position to question their legitimacy or legal standing. Further, we have not found or been presented with any evidence to contradict the legality of Aracruz’s land acquisitions from previous owners.

Afro-Brazilian Communities. IFC examined the relationship between Aracruz and its neighboring Afro-Brazilian communities during project appraisal. Based on this assessment, IFC is aware of the needs and vulnerability of these communities and has strongly encouraged the Company to increase its support to them. As part of the Action Plan previously mentioned, IFC is supporting Aracruz's initiative to enhance the Project for Afro-Brazilian Communities in the North of Espírito Santo, which the Company started in 2004, which involves a number of income-generating projects in partnership with small rural producers' associations.

2. *Employment and economic impact of Aracruz.*

IFC examined the social and economic development impact of Aracruz during project appraisal. At that time Aracruz employed 9,827 persons directly (2,281 employees and 7,546 permanently outsourced workers). According to estimates made at that time, the Company generated US\$11 billion between 1989 and 2003. Over the same period, the company purchased US\$3.1 billion in products and services, giving priority to local suppliers whenever possible. In 2003, Aracruz ranked fifth in the Brazilian manufacturing sector as a generator of foreign exchange earnings, an outcome which generates significant benefits for Brazil.

Aracruz recognizes that the number of workers required to service its plantations only provides a partial solution and comparatively modest contribution relative to the overwhelming need for job creation in neighboring communities. This is a key factor in the company's decision and ongoing effort to support additional income-generating alternatives for Brazilians living in the region. IFC fully supports Aracruz's initiatives in this regard and is looking at ways to help expand their scope and impact. In particular, we believe it is possible to help grow and strengthen local businesses through greater participation in Aracruz's supply chain to enhance the employment generation associated with the company's operations.

3. *Allegation that Aracruz was involved in the destruction of 50,000 hectares of Atlantic Rainforest in the 1960's/1970's.*

Aracruz established its first eucalyptus plantations in Espírito Santo as of 1967. Most of the land, (which earlier in the century had been covered by native forest) it purchased for planting eucalyptus forests was already substantially degraded by coffee farming and a lumbering cycle in the region that had lasted for more than fifty years. At the time, more than 40 sawmills were in operation in the municipality of Aracruz alone, and native and secondary timber in the region was being cut down for raw material. However, Aracruz acknowledges that, at the time, some isolated and weakened forest fragments may have been converted, but the Company contends that this was done in compliance with the legislation at the time which was not as stringent as it is today.

Under its current operating policy and as a condition of IFC's loan, Aracruz is committed to ensure that the land it acquires for the expansion of its eucalyptus plantations does not involve conversion of natural forests. In the last five years, Aracruz has legally acquired approximately 72,500 ha of land in the southern part of Bahia state in order to supply its new fiber line. Around 68% of this area was formerly used by farmers for cattle raising. Another 28% was covered with native Atlantic Forest or similar recovering forests, and these have been entirely preserved by the Company. The remaining 4% includes other uses such as roads or agriculture crops. Aracruz has also invested in restoring areas damaged during previous timber harvesting that are not being used for eucalyptus plantation.

4. *Allegation that Aracruz is contaminating water with agrochemicals.*

Aracruz's use of pesticides is fully compliant with Brazilian legislation and with IFC policy. The products used by Aracruz have low toxicity and are all licensed by the Ministry of Agriculture and IBAMA. Application of these products follows the requirements of the Ministry of Health and the Ministry of the Environment. Furthermore, oversight of chemical application is part of the sustainable forest management certification system which is applied to all operations. Aracruz periodically analyzes water, sediments and soil samples collected from different locations, and these tests have shown no indications of any contamination deriving from pesticide residues. However, as a result of our due diligence it is clear that a negative perception regarding the use of agrochemicals persists amongst the local communities and other civil society representatives. Therefore IFC has recommended that Aracruz consults more closely with the government agencies responsible for such monitoring, and consider developing an independent community-driven system to monitor pesticide use and its effect on the environment and public health as a way of providing additional assurance.

5. *Allegation that Aracruz promotes persecution by police of neighboring peoples who depend on eucalyptus trimmings for their economic survival*

In recent years, and due to the rising price of fuel, Aracruz's neighboring communities have entered the plantations to collect small branches and trimmings for use as fuelwood and for production of charcoal. In some instances, police intervened to prevent trespassing, but in 2003 an agreement with the Municipality of Aracruz was signed to allow members of a community-based association to collect the residues in an organized fashion. However, this arrangement has not worked as well as anticipated. IFC and Aracruz are therefore discussing ways to develop a more suitable agreement, which will include the active participation of the community.

6. *Allegation that Aracruz is polluting and illegally diverting rivers that supply local communities.*

A public civil lawsuit was filed in relation to the lack of a full environmental impact assessment (EIA/RIMA) for work performed by Aracruz on a canal that belongs to the Municipality. The Plaintiffs requested the immediate suspension of the channel operations, alleging that severe environmental damages could derive from it. However, under Brazilian law such work requires a different type of environmental study, called a DIA (Environmental Impact Declaration), which the Company duly prepared and submitted, and which the appropriate authorities approved. The judge hearing this case determined that the alleged danger was not clearly characterized and denied the requested injunction. Aracruz completed the work as agreed with the Municipality and continues assisting in re-opening a previously inoperable canal to provide improved water supply to the company and local communities during dry years.

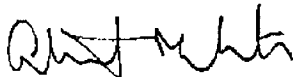
Another lawsuit in relation to pollution and illegal diversion of rivers by Aracruz is now in the hands of the corresponding authorities. The Company has not yet been officially notified of the existence or of the contents of this lawsuit. When such notification arrives, the Company will examine the matter and provide an appropriate response as Aracruz affirms that it has never diverted any rivers—nor does it have any legal right to do so.

7. *Allegations that: i) Aracruz financed elections in exchange for political favors, ii) that it manipulated public opinion through the media, and iii) that it co-opts community and trade-union leaders, as well as environmental NGOs..*

To our knowledge, Aracruz contributes to campaigns as permitted under Brazilian law. These contributions are reported to the Regional Electoral Courts and recorded in their books. It is also clear that the Company practices marketing through a range of media (TV, radio, various meetings, press releases, etc.). We do not understand the distinction you are making in Aracruz's case relative to any other private, civil society or Government entity which seeks, to use the media to influence public opinion and are unaware of any prohibition to do so under Brazilian law. Our general conclusion is that these accusations of co-option stem from the fact that the Company has traditionally engaged directly with trade union and community leaders rather than avoiding such interaction. IFC supports engagement with stakeholders on the part of all its clients, including Aracruz. However, we and the company agree that that they need to adopt a more participatory approach in dealing with the communities, and we are presently reviewing alternative approaches to achieve this objective.

In closing let me reiterate that we appreciate the fact you have raised these issues. While we do not necessarily agree with a number of your conclusions, based on the due diligence we have undertaken we do agree that it is essential to collectively ensure that the interests of surrounding communities, including indigenous peoples, are protected and their quality of life enhanced. We believe it is possible to make progress in this regard while also enabling Aracruz to operate successfully. Let me also assure you we remain open to continuing a dialogue with FASE/ES. We have been assured by Aracruz Celulose S.A that they welcome further engagement with you and other stakeholders as well.

Sincerely,



Atul Mehta
Director
Latin America and Caribbean Department

cc. Executive Directors and Alternates
Bank Group Senior Management
Vice Presidents, Bank, IFC and MIGA
Directors and Department Heads, Bank, IFC and MIGA