



BC TIMBER SALES

STRUCTURAL REVIEW

**BACKGROUND TO THE
REPORT TO THE
MINISTER OF FORESTS AND RANGE**

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A. PURPOSE AND SCOPE OF THIS REVIEW

The role of BCTS is to competitively auction 20% of the province's Crown timber, to provide information used in determining the stumpage price for the remaining timber harvest. To deliver this role, BCTS needs to be an innovative, results-driven organization, focussed on the market for standing timber, and operating as efficiently and effectively as possible. Since its inception in 2003, BCTS has established a reliable, consistent business approach, at the same time as expanding its auctioned timber volume by almost 50%.

Early in 2006, the BC Competition Council presented to the Premier the reports from its Forest Industry Advisory Committees and made a number of recommendations to the Premier on enhancing the competitiveness of BC, including one regarding structural models for BCTS.

- The Wood Products Industry Advisory Committee recommended that government *“carry out a third party independent review of BCTS in collaboration with the recently appointed new CEO (and) consider if a market responsive timber pricing system can be achieved through the BCTS, or a similar organization with a corporatized structure, or recommend if a form of privatization should be considered.”*
- In turn, the Competition Council recommended that government take *“steps to reduce and eventually eliminate its role as operator and seller of timber produced from the Crown timber supply.”*

As documented in the Terms of Reference, the purpose of this review has been to determine if the current organizational structure of BC Timber Sales most effectively addresses its mandate, and, in this report, to recommend any needed changes to either the BCTS structure or delivery model. The complete Terms of Reference are included in Appendix I.

At issue is the question of whether a different type of structure for BCTS would better address the elements of its mandate. That is, if change will allow BCTS to better fulfill its mandate. Accordingly, the possibilities for change range from BCTS within its current structure (with improved efficiency and effectiveness), through to an entirely new structure. In the context of this paper, “structural review” is synonymous with examining the governance model for BCTS, or examining alternative structural models for BCTS.

This review does not examine the detailed internal workings and relationships of BCTS, or make recommendations on issues such as office configurations, the number of offices, whether or not BCTS should have a Regional presence in addition to its Headquarters and its Business Offices, the desired degree of consistency between offices, etc. These issues will be addressed through an internal organizational review of BCTS that will follow the completion of this process.

The scope of the issues dealt with in this review is limited to consideration of the current mandate of BCTS as articulated by its Vision and Mission statements, and further refined in its key goals and objectives.

Although the Terms of Reference directed the review to assume that the running of BCTS will remain a function of government for the foreseeable future, they also directed the review to examine privatization options and solicit specific feedback on whether the BCTS function should be moved out of government in the long term.

B. STRUCTURAL REVIEW PROCESS

This review started from the documented mandate of the existing BCTS program, and then identified the critical organizational features or characteristics that could affect the attainment of that mandate. Once the key characteristics were identified, the potential for change to the BCTS structural model and the opportunities for improvement within any structure were considered. The current and alternative structures were evaluated in light of those characteristics and opportunities, and of the implications of moving to any alternative structure.

This review was carried out through a series of workshops involving BCTS and Ministry of Forests and Range (MoFR) staff and stakeholders represented on the BCTS Advisory Council (TSAC), public review and comment on discussion papers, and specific dialogue with key agencies. The co-chairs met or teleconferenced with MoFR Revenue and Economics and Trade Branches regarding the requirements of the Market Pricing System, the Crown Agencies Secretariat and Public Service Agency regarding alternative structural models, and the co-chairs of the BC Competition Council and members of the Wood Products, and Pulp and Paper, Industry Advisory Committees to the Competition Council, regarding their earlier recommendations on the BCTS structural model.

Two discussion papers were prepared and posted to the BCTS website, inviting comment. The *“Discussion Paper on the Key Characteristics of an Effective, Efficient BCTS Organization”*, published on July 31, 2006, outlined the mandate and issues that needed to be considered for this structural review, and proposed some key characteristics. The *“Discussion Paper on Alternative Structural Models and Opportunities for Improvement”*, published September 8, 2006, refined those key characteristics, identified areas where improvement was needed to attain the characteristics, and summarized the characteristics of alternative structural models in relation to these key characteristics, without weighing their merits.

The two discussion papers are considered part of this report by reference but neither has been reproduced here. Some detail on the key characteristics of an effective, efficient BCTS and on the nature of the spectrum of structural models is included in the Appendices of this paper, but readers seeking additional background are encouraged to review all the material on the public website.

Input on both discussion papers, received through the workshops and the public review and comment period, was considered in the preparation of this report and the recommendations. The first workshop also provided considerable feedback on specific points of practice for BCTS and other relevant MoFR branches.

This backgrounder to the final report summarizes the relevant observations arising out of the review process, which focused on three alternative structural models. This paper reviews those key characteristics that are relevant to BCTS' structure or delivery model and the capability of the three selected structural models to address these characteristics. The final report then recommends on a course of action to achieve those characteristics for the BCTS organization.

C. CONSIDERATIONS AROUND FULL PRIVATIZATION OF BCTS

Although the Terms of Reference directed the review to assume that the running of BCTS will remain a function of government for the foreseeable future, they also directed the review to examine privatization options and solicit specific feedback on whether the BCTS function should be moved out of government in the long term. This request was in response to the Wood Products Industry Advisory Committee recommendation for an independent review to "...recommend if a form of privatization should be considered" and to the Competition Council's recommendation that government take "steps to reduce and eventually eliminate its role as operator and seller of timber produced from the Crown timber supply."

One form of privatization, namely contracting with a private entity or entities to perform the BCTS function (essentially as sales agent), has been considered in this backgrounder report as one of three viable options for BCTS.

A second form was also discussed in the workshop groups: "full privatization" by sale or long term lease of a portion of the Crown resource to private entities, with a requirement for the private entity to supply data to the MoFR that would support MPS pricing of timber on major tenures.

The conclusion of the workshops and of this review is that this full privatization option should only be considered for the longer term, if there were a change in public policy regarding private ownership of what is now a Crown resource.

There are issues other than public policy that argue against full privatization of the BCTS. These centre on the potential difference between the primary goal of BCTS, which is to provide the data needed to price timber harvested by holders of major tenures; and that of a private timber holder. If BCTS was fully privatized, there could be a constant conflict between the interests of the private landowner and the obligations to provide representative information for MPS.

The problem of conflicting objectives is further complicated by the problem of changing objectives. The data required from BCTS to support the MPS model (notably BCTS costs) are still being clarified and will likely continue to change. At the same time, the broad forest policy framework continues to evolve. The fully privatized model would be the one least amenable to adaptive change.

Some argue that too much of the timber in BC is owned by government and that it would be better to diversify the ownership, with more private timber holdings. However, full privatization of BCTS is not a good way to achieve this as it would not provide all of the benefits ascribed to private ownership (because of the encumbrances imposed by the needs of MPS) and it would incur the greatest conflict of objectives of any of the structural models considered.

D. DESCRIPTION OF THE KEY CHARACTERISTICS

Any alternative structural model should facilitate, or at least not impede, fulfillment of the BCTS mandate. The following were identified as key features, or characteristics, of BCTS as an organization that would affect the attainment of the program's mandate. Four principal themes were identified, with specific characteristics within each theme. These characteristics were refined through the discussion papers and workshops, which also provided feedback on the performance measures that relate to these characteristics.

Theme 1: Clear Goals and Objectives

- Clarity within the BCTS Strategic Goals
- Clear separation from other MoFR, and government, objectives
- Consistent, transparent application of goals within BCTS
- Ability to link goals to performance measures

Theme 2: Timber Sales Program designed to support MPS

- Strong linkages with MPS equation development process
- Open and competitive timber auctions
- Transparent data generation and collection
- Full coverage of the timber profile and market cycle
- Stability of BCTS' operating areas

Theme 3: Program delivery such that costs can be used for MPS

- Symmetry of obligations and comparability of cost structures with major licensees
- Transparent, auditable cost accounting at appropriate detail

Theme 4: Effective and High-performing Organization

- Appropriate, effective employment practices
- Ability to link individual reward to BCTS performance
- Appropriate access to necessary expertise
- Ability to foster individual and corporate business acumen
- Ability to implement most-effective internal structure
- Effective communication with customers and stakeholders
- Appropriate information support systems and processes
- Budgetary processes tailored to BCTS business requirements

The following descriptions are based on the detailed text in Discussion Paper #2, *Alternative Structural Models and Opportunities for Improvement*. Note that they have been modified somewhat since that paper, to incorporate feedback at the September 21, 2006 stakeholder workshop.

Theme 1: Clear Goals and Objectives

- Clarity within the BCTS Strategic Goals

The meaning of each of the BCTS Vision, Mission and Goal statements must be clear and unambiguous, as must the relationship between the Vision, Mission and Goals, and the hierarchy within the four Goals. The review process identified a need for improvements to BCTS' goal statements, which are detailed in Appendix III

- Clear separation from other MoFR, and government, objectives

Government has a broad array of objectives around the management of BC's forest and range resources. Most, but not all, of these are contained within the mandate of the MoFR. A need for clarity was expressed around how the relatively narrow mandate of BCTS relates to these broader objectives.

- Consistent, transparent application of goals within BCTS

Having clear goals and objectives in themselves is not enough; there must be a mechanism to ensure that BCTS policies and procedures reflect the intent of these goals, are understood by staff, and are applied transparently and consistently across the province and among all customers.

- Ability to link goals to performance measures

Clear goals and objectives need to be supported by performance measures that directly relate to these goals, and are used to monitor and direct BCTS activities. This topic comes up again under **Theme 4 – Effective and High-performing Organization** in the context of the ability to manage to these performance measures.

Theme 2: Timber Sales Program designed to support MPS

- Strong linkages with MPS equation development process

BCTS generates sales data that are then used by other Ministry branches to determine an MPS equation that may be used to set the upset price for auction timber and, with adjustments, to set the price for

timber from major tenures. Both BCTS, as an organization, and the MPS pricing system are relatively new; therefore there are still many issues to be resolved within this relationship. It is at least convenient, and possibly necessary, that BCTS maintain an ongoing dialogue with the MoFR to ensure that the data it generates are adequate for the statistical requirements of the MoFR.

The linkage between BCTS, other branches of the MoFR, and the forest industry must continue as long as the MPS system remains in place, although the degree of interplay may fall as both BCTS and the MPS mature.

- Open and competitive timber auctions

BCTS' requirement to generate credible pricing data, to protect the Crown's revenue and to provide transparency and fairness to timber buyers depends on open and competitive timber auctions.

- Transparent data generation and collection

The generation and collection of auction results, and the capturing of the associated descriptive MPS data for the parcels of timber sold need to be done transparently for the data to be seen as credible.

- Full coverage of the timber profile and market cycle

From a technical perspective, BCTS needs to offer the full profile of timber being harvested by major tenure holders if it is to provide credible data to support MPS. To be credible both as a data source and as a consistent supplier of timber, it must also be engaged in timber sales, to some extent, in all stages of the market cycle. BCTS must continually test the market across all significant timber types, sale sizes, harvesting systems and geographic areas of the province. Related to this, as a provider of 20% of the available timber in BC, BCTS must function as a reliable supplier to the forest industry as a whole.

- Stability of BCTS' operating areas

BCTS has only recently received many of its new operating areas through the timber reallocation program; in some areas of the province, the process is still being finalized. BCTS needs to have stable, durable operating areas in order to effectively schedule its sales plans and thus meet the MPS target of selling 20% of the allowable annual cut in each pricing analysis unit. BCTS must have protection for these operating areas comparable to what the major licensees have. In addition, as

with the rest of the forest industry, the stability of the BCTS sales program is dependent on stable access to the forest land base. BCTS must be able to operate in a socially and environmentally sound manner, and maintain acceptable safety-related standards, in order to maintain the support of the general public for its use of the public forest resource.

Theme 3: Program delivery such that costs can be used for MPS

- Symmetry of obligations and comparability of cost structures with major licensees

For BCTS costs to be used to as an alternative for the costs that an average, efficient operator would incur for the same forest management responsibility, the obligations that BCTS holds must be symmetric to those of the licensees, and the categories used for cost accounting must be comparable. BCTS must face and address the same social and environmental challenges as do the major licensees.

- Transparent, auditable cost accounting at appropriate detail

MPS requires transparent, auditable cost accounting from BCTS in adequate detail to permit comparison with industry costs.

Theme 4: Effective and High-performing Organization

- Appropriate, effective employment practices

BCTS is seen to need the flexibility to pay competitive salaries, and hire appropriate staff. This could require program-specific flexibility on staff job classifications, management exclusions, the number of hours worked and the length of the business day.

- Ability to link individual reward to BCTS performance

Not only must BCTS have clear goals and objectives that can directly link to performance measures, but it needs the ability to use those measures to reward high performance and correct under- performance at the level of individual staff.

- Appropriate access to necessary expertise

BCTS' ongoing activities require ready access to specialized expertise including: foresters, accountants, engineers, MBAs, archaeologists, etc. BCTS must either be able to hire these experts where there is a

business case for internal resources, or to obtain the expertise through outside sources.

- Ability to foster individual and corporate business acumen

In order to operate as a timber marketer, BCTS needs to understand its markets and market drivers, and be responsive to market opportunities. The organization must be cost conscious, cost effective and competitive. BCTS needs the ability to pursue business opportunities that are consistent with its mandate.

- Ability to implement most effective internal structure

BCTS business requirements vary substantially across the province, and will fluctuate over time as market and industrial conditions change. BCTS needs the flexibility to adapt its internal structure to those changing conditions.

- Effective communication with customers and stakeholders

Effective two-way communication is essential for BCTS: both informing stakeholders and the public on BCTS priorities and programs, and gathering information on client and stakeholder needs, market intelligence, etc.

- Appropriate information support systems and processes

BCTS' activities are highly dependent on the collection, generation, and analysis of business information specifically tailored to BCTS needs. BCTS needs the ability to tailor its information systems to its specific requirements.

- Budgetary processes tailored to BCTS business requirements

BCTS activities and expenditures for any individual timber sale are spread over a number of years, and generally do not coincide with the year or years that revenue is generated from that timber sale. BCTS needs (and currently has) a multi-year budget cycle and the ability to capitalize costs, in order to match expenditures with revenues and manage and report its financial affairs in a fashion similar to the private sector.

In order to quickly react to changing market and other conditions, BCTS needs (and currently has) freedom to operate within an

approved overarching annual business plan, rather than requiring specific, individual spending approvals throughout the year. BCTS must be able to deliver its program in all parts of the market cycle, irrespective of government fiscal fluctuations, and to dependably deliver its sales to the marketplace throughout the year, unencumbered by periodic government-wide budget freezes and restrictions.

Future years' timber sales programs and revenue generation are dependent on up-front expenditures of capital funds for infrastructure, planning and development. Subject to standard capital funding approval processes, BCTS must have sufficient access to capital in every operating year.

The bulk of BCTS on-the-ground activities are delivered through the contracting or procurement of outside goods and services. BCTS needs the flexibility to source these goods and services in the most cost-effective way.

E. EVALUATION OF THE ALTERNATIVE MODELS

E. a) CONSIDERATION AGAINST THE KEY CHARACTERISTICS THAT ARE SENSITIVE TO THE BCTS STRUCTURAL MODEL

The following structural models were examined within this review. While each model was examined in isolation, in reality, there could be significant variability within any one of these alternatives, depending on the legislative or contractual terms that create the structure. These alternative structures are best viewed as a continuum along a spectrum of governance models and delivery options.

The extent to which any of the choices would address the key characteristics will be highly dependant on the detailed content of the legislation or contract establishing that entity.

The September 8, 2006 Discussion Paper #2 describes each of the following models, and should be used as a reference point for this section. Some background from that discussion paper has been included in Appendix II.

- The current BCTS structure
- Remaining within the MoFR, with greater separation
- A Special Operating Agency
- A Crown Corporation
- A private entity delivering the BCTS function under contract
- Full privatization of BCTS and the resources that support it

In turn, the review discussion narrowed down the selection to the following three principal alternatives, for the reasons below:

- Remaining within the MoFR, with greater separation
- A Crown Corporation
- A private entity delivering the BCTS function under contract.

The review participants recommended against the current model, as it was felt that in order to deliver on the key characteristics, at a minimum the changes noted below would be required and those changes would, by their nature, move the current model to the alternative titled "Remaining within the MoFR, with greater separation".

A Special Operating Agency (SOA) was removed from the consideration, primarily because it offers little advantage over "MoFR with separation" (assuming that the recommended degree of separation can be attained), while requiring considerable effort to establish the SOA. Moreover, it was felt that a Special Operating Agency would not be able to fully capture the potential opportunities that a Crown Corporation might, as discussed below, while the costs and complexity of establishing a SOA would be nearly as great.

Full privatization of BCTS was not recommended for the reasons outlined in Section C of this paper; briefly that it would be operationally very complex with the potential for conflicting objectives, and would represent a significant change in public policy that goes well beyond the scope of this review.

The remainder of this section looks at each of the key characteristics that are deemed to be sensitive to the BCTS structural model, and examines how that characteristic could be addressed within each of these three principal alternatives.

Theme 1: Clear Goals and Objectives

- Clear separation from other MoFR, and government, objectives

Government has a broad array of social and economic objectives around the management of BC's forest and range resources that extend well beyond the relatively narrow mandate of BCTS. Most, but not all, of these are captured by the broad mandate of the MoFR.

There was considerable discussion throughout the review regarding the degree of separation that is necessary between these other government and MoFR objectives and the BCTS mandate, so that BCTS' key goal of supporting the MPS pricing system and its ability to meet performance targets are not compromised.

Remaining within the MoFR:

Many of the review participants expressed considerable scepticism that BCTS could completely insulate itself from the pressure to address these other objectives while remaining within the MoFR. However, it was acknowledged that there were a number of steps that could be taken to strengthen the position of BCTS within the broader MoFR organization. Steps would need to be taken in each of the following three areas to attain the degree of separation necessary for "remaining within the MoFR" to be considered a viable alternative so that BCTS can deliver on its mandate. Potential options that could be considered for each area include:

Clear separation of roles; some or all of:

- Create distinct visible identity for BCTS and BCTS staff
- Ensure distinct office space for BCTS staff
- Clearly communicate the revised BCTS mandate statements

Stability of mandate and operating area; some or all of:

- Legislate the revised BCTS mandate statements
- Provide security/stability of BCTS operating areas at least comparable to the security/stability afforded major tenure holders

Change in reporting relationship; one or more of:

- Create a statutory independence for the ADM of BCTS, similar to that of the Chief Forester
- Create a senior Advisory Board to BCTS, of external stakeholders, akin to a board of directors but with advisory capability only
- Create a BCTS Forest Trust relationship with resource-dependent communities

A Crown Corporation:

Crown Corporations are established by legislation. Their operations are relatively arms-length from government, as they report to a Board of Directors rather than to a Minister. While government does have the ability to change the Crown Corporation's legislation, this model would provide significant insulation for the BCTS mandate and program from becoming a tool to accomplish government's broader objectives that could compromise BCTS' key mandate – to support MPS. (Special Operating Agencies report to a Minister, so that alternative would not provide the same degree of insulation as would a Crown Corporation.)

A private entity delivering the BCTS function under contract:

Under this model, the contract between the MoFR and the private entity would have to specify very clearly, and to considerable detail, the expectations of both parties and the rules around the private entity's activities. By nature, it would be difficult to modify these rules within the term of any contract, thereby insulating the program from changes that could compromise the ability to deliver on the key BCTS objective.

Theme 2: Timber Sales Program designed to support MPS

The review identified the following five specific characteristics within this broad theme. While the review participants agreed that all of these could be affected by the choice of structural model, there was not agreement on the exact effect:

- Strong linkages with Market Pricing System (MPS) equation development process
- Open and competitive timber auctions
- Transparent data generation and collection
- Full coverage of the timber profile and market cycle
- Stability of BCTS' operating areas.

Remaining within the MoFR:

For this model to be successful, it is assumed that the changes noted earlier regarding insulating the BCTS program within the MoFR would be put into place. Those provisions should work to stabilize and protect the BCTS operating areas, and to ensure fully open and competitive timber auctions and full coverage of the timber profile and market cycle.

As discussed earlier, MPS is still a relatively new timber pricing system, and the relationship between MPS and BCTS is still developing. This model provides the best ability for continued iterative development of this relationship, and for BCTS contribution to the MPS equations themselves.

It is assumed that most external parties will believe that BCTS sales data will be most transparent if generated by a government organization such as this model or a Crown Corporation.

A Crown Corporation:

As a separate agency, a Crown Corporation would not have the same direct linkages with the other MoFR branches as if BCTS remained within the ministry. The relationship between BCTS and MPS would need to be clearly established prior to the creation of the Crown Corporation's mandate and legislation.

The Crown Corporation's independence should work to help protect and stabilize the BCTS operating areas.

The Crown Corporation's mandate would be to generate revenue, working within the constraints of the MPS data requirements. While this should provide an incentive for fully open and competitive timber auctions, at times it might put pressures on the objective of full coverage of the timber profile and market cycle.

A private entity delivering the BCTS function under contract:

The relationship between BCTS and MPS would need to be clearly established and very well translated prior to entering into the contract with the private entity. This would make it very difficult to later modify that relationship within the term of the agreement.

The data created by this private entity might not be considered as transparent as if it came from a government entity.

The private entity could have a number of internal objectives other than supporting MPS data needs, while working within the constraints of their contract. This might, at times, put pressure on the auction procedures or on the objective of full coverage of the timber profile and market cycle.

The terms of the contract would limit government's ability to unduly intrude upon the BCTS operating areas.

Theme 3: Program delivery such that costs can be used for MPS

The review identified the following two specific characteristics within this broad theme.

- Symmetry of obligations and comparability of costs with major licensees
- Transparent, auditable cost accounting at appropriate detail

Remaining within the MoFR:

For this model to be successful, it is assumed that the changes noted earlier regarding segregating the BCTS program within the MoFR would be put into place. Those provisions should work to improve comparability with the cost structure of the major licensees, and should assist in the separation of BCTS costs from those of the broader MoFR. In comparing cost structures, the issues of costs for government provided facilities and services, and of differences in risk, insurance and legal liability compared to industry, need to be considered.

It is assumed that most external parties will believe that BCTS cost data will be most transparent if generated by a government organization such as this model or a Crown Corporation.

A Crown Corporation:

As a separate agency, it is assumed that a Crown Corporation would have a cost structure similar to that of a major licensee, and would have clearly identifiable, transparent costs.

A private entity delivering the BCTS function under contract:

It is assumed that the private entity would have a cost structure similar and comparable to that of a major licensee.

The cost data generated by this private entity might not be considered as transparent as if it came from a government entity. In addition, contract terms would have to be designed carefully so that there is no inducement for the private entity to manipulate its costs in order to increase its profits.

Theme 4: Effective and High-performing Organization

This review identified eight characteristics within this theme that fall into three broad categories:

Collective agreement/successorship issues

- Appropriate, effective employment practices
- Ability to link individual reward to BCTS performance
- Appropriate access to necessary expertise
- Ability to foster individual and corporate business acumen

Management flexibility

- Ability to implement most-effective internal structure
- Effective communication with customers and stakeholders
- Appropriate information support systems and processes

Governance/control

- Budgetary processes tailored to BCTS' business requirements

There was considerable discussion throughout the review and no consensus on the extent to which the current model constrains the effectiveness and efficiency of BCTS. The point was made often that BCTS has not fully explored the flexibility available within the current system. At the same time, there was no clear consensus on the degree to which a change in structure would allow BCTS to improve its performance.

Remaining within the MoFR:

It is unclear how much opportunity exists for BCTS to improve its efficiency and effectiveness while remaining within the MoFR. The review identified a number of potential areas for improvement in all three of the above broad categories, and questioned whether BCTS had fully explored those opportunities to-date. Appendix IV details those potential opportunities.

A Crown Corporation:

It is assumed that a Crown Corporation would have significant flexibility to implement any financially-related governance and control improvements needed, subject to the terms of its legislation. While the Crown Corporation would have significant flexibility to implement alternative work arrangements, including employee bonus programs, those changes would have to be negotiated within collective agreements. A Crown Corporation should have complete management freedom to implement all other needed measures to improve performance.

A private entity delivering the BCTS function under contract

Other than the terms of the contract with the private entity, there should be no constraints to the private entity pursuing all identified performance improvement measures. There would, however, be collective agreement issues for government in turning the BCTS function over to a private entity.

E. b) BROAD CONSIDERATIONS REGARDING ANY CHANGE IN STRUCTURAL MODEL

In addition to the specific points above comparing the alternative models, the review discussion and feedback identified a number of broad points that would need to be considered in evaluating any change in structure.

Remaining within the MoFR:

As noted in the previous section, the current BCTS model has not fully explored the opportunities available for achieving high performance within the MoFR organization. If the decision is for BCTS to remain within the MoFR and the essential recommendations are implemented, specific performance measures should be established and evaluated over the next few years to ensure that BCTS fully explores these opportunities.

By nature of its responsibilities, much of the on-the-ground MoFR expertise for delivery of activities, such as silviculture, resides within BCTS staff. Similarly, BCTS is much more closely aligned with market realities and industry trends. Should BCTS remain within the MoFR, both BCTS and the rest of the MoFR must ensure that this expertise and knowledge is fully utilized in the development of resource management legislation and policies.

Crown Corporation:

There would be significant start-up costs in the transition from the current model to a Crown Corporation: building the management structure; drafting the legislation; establishing the unique employment terms and other conditions; etc. In addition, there could also be a significant increase in ongoing operational costs due to a loss of the economies-of-scale that exist through facilities and services shared with the MoFR. The timeline did not allow for these costs to be assessed within this review, as that would be a major time and resource consuming exercise, but they would need to be assessed in a true business-case analysis of this option.

A private entity delivering the BCTS function under contract:

There would be considerable costs in the development of the complex contract needed under this option. Similarly, there would be ongoing contract management costs, and there would be a need to retain expertise within the MoFR to administer the contract. A private entity would not have the economies of scale available to BCTS within the MoFR, and liability issues would have to be carefully evaluated. Costs for agency fees or the amount of revenue sharing would have to be estimated, which might require solicitation of expressions of interest. Again, due to the timeline these costs have not been assessed within this review, but would need to be assessed in a true business-case analysis of this option.

These considerations, and information contained in this backgrounder and its appendixes, form the basis for the final report "BC Timber Sales Structural Review - Recommendations to the Minister of Forests and Range".

Appendix I: TERMS OF REFERENCE FOR THE STRUCTURAL REVIEW OF BC TIMBER SALES

Purpose:

To determine if the current organizational structure of BC Timber Sales (BCTS) most effectively addresses its mandate, and to recommend any needed changes to either the BCTS structure or delivery model.

Scope:

The review will be co-chaired by Howard Saunders, an external consultant, and Dave Peterson, the Assistant Deputy Minister of BCTS.

The co-chairs will make recommendations to the Minister of Forests and Range, through the Deputy Minister.

The review will be based on the current mandate of BCTS, as articulated by its Vision and Mission statements, and further refined in its Key Goals and Objectives.

The review will assume that the running of BCTS will remain a function of government for the foreseeable future.

The stakeholder groups represented on the Timber Sales Advisory Committee (TSAC) will be the primary external contacts for this review. As BCTS program participants, the TSAC members are highly familiar with the present BCTS model, and well positioned to provide input to this review.

Staff from BCTS and other Forest Service Divisions will be engaged in the review alongside the TSAC stakeholder groups.

Other interested parties are invited to provide written comments directly to the co-chairs. Documents will be posted on the BCTS public website, including the following key products:

- The Terms of Reference, and supporting documents
- The draft list of key structural characteristics affecting BCTS success
- The draft recommendations

Project Steps:

Step 1: Document the current BCTS Mandate.

Circulate a statement of the BCTS mandate, as documented in its existing statements of Vision and Mission, and further refined in its Key Goals and Objectives

- Mandate statement to be compiled by BCTS and posted on the website
- Completion: June 16, 2006

Step 2: Identify the Critical Organizational Characteristics that would affect the attainment of the BCTS Mandate.

Based on the current BCTS mandate, identify those characteristics of the organizational structure and delivery model that have a significant influence, positive or negative, on the efficiency and effectiveness of the delivery of the mandate.

- The co-chairs will discuss the potential key characteristics with BCTS and Forest Service staff, and with TSAC member associations, using a workshop format
- The co-chairs will compile a draft list of key characteristics, and post it on the BCTS website for public review and written comment
- Completion: July 31, 2006

Step 3: Evaluate potential BCTS structural and delivery models against these key characteristics.

Examine the current BCTS model, and potential alternative models, against the identified key characteristics affecting success.

Consider the implications, including financial, of moving to any alternative model.

Recommend any changes or improvements needed to the BCTS structural model.

Revisit the mandate, and recommend if any changes are needed to the Key Goals and Objectives to better align it with the recommended structural model.

The co-chairs will:

- Review literature on alternative structural and delivery models, and evaluate these alternative models against the key characteristics.
- Solicit specific feedback on whether the BCTS function should be moved outside of government in the long term

- Make recommendations on structural and delivery model, and mandate alignment
- Take their initial recommendations back to the parties identified in Step 2 above prior to finalization, through a workshop and by posting a draft paper for comment on the BCTS website
- Completion: September 30, 2006

ATTACHMENT TO THE TERMS OF REFERENCE STRUCTURAL REVIEW OF BC TIMBER SALES

Background:

In 1995, BC decided to revise the focus of the existing Small Business Program within the Ministry of Forests, and examined a number of alternative delivery structures that might accomplish that objective.

Over the next 11 years, the mandate of the Small Business Program evolved substantially into that of the current BC Timber Sales program. During this period, the delivery structure was examined and reviewed a number of times, and modified somewhat.

In 2006, the BC Competition Council presented to the Premier the reports from its Forest Industry Advisory Committees and made a number of recommendations to the Premier, including one regarding delivery models for BCTS.

- The Wood Products Industry Advisory Committee recommended that government *“carry out a third party independent review of BCTS in collaboration with the recently appointed new CEO (and) consider if a market responsive timber pricing system can be achieved through the BCTS, or a similar organization with a corporatized structure, or recommend if a form of privatization should be considered.”*
- In turn, the Competition Council recommended that government take *“steps to reduce and eventually eliminate its role as operator and seller of timber produced from the Crown timber supply.”*

Previous reviews of BCTS have focussed on examining one, or several, of the potential delivery models for BCTS, and identifying the positives and negatives of the models examined.

This review will build on all the information gathered previously, but apply a significantly different approach. This review starts from the identified mandate of the existing BC Timber Sales program, and then identifies the critical organizational characteristics that could affect the attainment of that mandate. Once those key characteristics have been identified, the potential delivery options would be evaluated in light of the characteristics and the implications of moving to any alternative.

Appendix II: DESCRIPTION OF THE STRUCTURAL MODELS EXAMINED

The review initially examined six alternative structural models which were reduced to three in the final analysis. The following descriptions of the six models are excerpts from the detailed text in Discussion Paper #2, *Alternative Structural Models and Opportunities for Improvement*.

The current BCTS structure

BCTS is a semi-autonomous organization within the MoFR. The activities of BCTS support the MoFR's overall mandate and the specific goal of providing British Columbians with sustainable benefits from the commercial use of public forests.

BCTS is nominally a division within the MoFR, with an Assistant Deputy Minister (ADM) reporting to the Deputy Minister. BCTS has a relatively small Headquarters located in Victoria, and 12 Business Areas across the province, with each Business Area having a business office and one or more field offices. The BCTS ADM is a member of MoFR Executive; all other BCTS employees are in a reporting unit discrete from the rest of the MoFR. BCTS shares offices, vehicles and other facilities with the MoFR in Victoria and throughout the province, generally with distinct office spaces within shared buildings. Any goods or services provided to BCTS by the MoFR, as documented in annually-revised Service Agreements, are charged as expenses to the BCTS program.

BCTS operates under a special financial account established under the *Forest Act*. The purpose of this account is to identify all revenues for BCTS and to provide an ongoing source of funds to defray the cost of the program. Revenues are collected from Timber Sale stumpage, program fees, and from the recovery by BCTS of the cost of goods and services provided to ministries and other organizations. Revenue in excess of current expenses and outstanding obligations is transferred to the government's Consolidated Revenue Fund. Disbursements are included to reflect capitalizable costs incurred for development of timber for sale in future years. These costs are recovered from future sales revenue. Under this account, BCTS annually files for approval a separate Service Plan that is included within the overall MoFR Service Plan, and gets annual approval for its budget, within the overall approval for the MoFR budget. This financial structure is significantly different than that of the rest of the MoFR.

BCTS employees fall under the *Public Service Labour Relations Act (PSLRA)* are covered by the existing 4 year collective agreements with the BCGEU and PEA.

Remaining within the MoFR, with greater separation

There is a spectrum in the degrees of separation that could be created between BCTS and the remainder of the MoFR. For the purposes of this paper, and for comparing with alternative structures, it is assumed that steps would be taken in each of the following three areas, by implementing one or all of the following potential options in each area:

Clear separation of roles; some or all of:

- Create distinct visible identity for BCTS and BCTS staff
- Ensure distinct office space for BCTS staff
- Clearly communicate the revised BCTS mandate statements

Stability of mandate and operating area; some or all of:

- Legislate the revised BCTS mandate statements
- Provide security/stability of BCTS operating areas at least comparable to the security/stability afforded major tenure holders

Change in reporting relationship for BCTS within the MoFR:

- Create a statutory independence for the ADM of BCTS, similar to that of the Chief Forester
- Create a senior Advisory Board to BCTS, of external stakeholders, akin to a board of directors but with advisory capability only
- Create a BCTS Forest Trust relationship with resource-dependent communities.

Special Operating Agency

There can be wide variability in the makeup of a Special Operating Agency (SOA), as they are established by legislation with terms specific to that agency. Prior to the establishment of an SOA, and the writing of the supporting legislation, a business case must be presented to government outlining the rationale for an SOA and for its legislative underpinnings. There are considerable start-up costs in establishing an SOA: building the business case, drafting the legislation, establishing the unique terms and conditions, etc. If a SOA required distinct office locations and facilities across the province, these start-up costs would be significant.

SOAs report directly to government, generally through a Cabinet Minister, but are completely distinct legal entities from any ministry or other agency reporting to that Minister. SOAs may have advisory boards, but government retains the ability to provide direction to the SOA through the Minister. Generally, a SOA is chosen over a Crown Corporation where the entity has both commercial and non-commercial objectives that must be balanced within the operation.

A SOA would be a distinct entity within the government accounts, subject to the *Financial Administration Act*, and other Acts, as per the terms of the SOA legislation. SOAs can remain subject to the PSLRA; employees retain their public service status and the existing collective agreements continue to apply. A SOA would have distinct seniority units.

It is assumed that a SOA would have complete flexibility to share services and facilities with other areas of government, including the rest of the MoFR, to the extent that sharing was practical and preferable, and within the terms of shared services agreements.

A Crown Corporation

As with SOAs, there is wide variability in the makeup of Crown Corporations, as they are also established by legislation with terms specific to that entity. Again, a business case must be presented prior to the establishment of a Crown Corporation and the development of its terms, and there are significant start-up costs.

Crown Corporations retain the public interest in the assets managed and owned by the Crown Corporation, but the operation of the Crown Corporation is arms-length from government. Crown Corporations report to a Board of Directors; generally only some of the Directors are appointed by government. Usually, a Crown Corporation structure is chosen over that of an SOA when the entity in question is purely focussed on commercial objectives.

A Crown Corporation is a distinct entity within the government accounts, with the relationship with the *Financial Administration Act*, and other Acts, established by the terms of its legislation.

The *Labour Relations Code* outlines the “successorship” provisions when a portion of government is transferred out of the public service to a Crown Corporation. Where “successorship” occurs, the terms of the existing collective agreements apply unless and until those agreements are renegotiated. Crown Corporations generally are not covered by the *PSLRA* and employees lose their public service status.

A Crown Corporation has complete flexibility to share services and facilities with other areas of government, including the rest of the MoFR, to the extent that sharing would be practical and preferable, and within the terms of shared services agreements.

Private entity delivering the BCTS function under contract

There is wide variability in the potential models for privatization of BCTS: this review examines two of the variants. Under the first variant, essentially a sales agency contract, the mandate of BCTS would be clarified as discussed in previous sections and would remain within the overall mandate of the MoFR. In turn, the BCTS function, in terms of supporting MPS and supplying fibre to the marketplace, would be fully contracted to a private firm, perhaps similar to the manner in which timber management companies operate timberlands owned by pension funds and other investment groups in the US. While it would be possible to implement this model over just a portion of BCTS, such as a single Business Area, either as a pilot or over the long term, it is difficult to see how this could occur and still maintain the overall integrity of the BCTS data set.

There are three general considerations that are usually applied prior to determining that a function should be moved out of government to the private sector: consideration of whether the function has a material affect on government's overall objectives; consideration of how easily the function can be contracted and whether there will be a need to continually re-specify the function; and consideration of the need for independence from the influence of government in the day-to-day operations.

Under this model, the contract between the MoFR and the private entity would have to specify very clearly and carefully the rules around its activities, as they relate to the delivery of the BCTS mandate. Where the activities of the private entity were not constrained by its contract, it would have complete freedom to operate in its own business interests. An issue with this model is that the pool of companies qualified to undertake this role could be constrained by conflict-of-interest considerations – a company could not be seen to be buying and selling in related markets.

The financial arrangements for this model would be very similar to those for an SOA or Crown Corporation, with the activity delivered by the private entity rather than the SOA/Crown Corporation. The contract would need to clearly specify how the private entity would be compensated for its services: if it would receive a fee for service or would obtain a share in gross or net revenues, so as to provide government fair revenue from the sale of the Crown timber and the private entity fair profit from its operations and innovations.

The *Labour Relations Code* outlines the “successorship” provisions when a business of government is transferred out of the public service to a private entity. Where “successorship” occurs, the terms of the existing collective agreements would apply unless and until those agreements are renegotiated by the private entity. These provisions would not include retention under the *PSLRA* and employees would lose their public service status.

The existing collective agreements include restrictions on the privatization of government activities or the transfer of such activities to an Alternative Service Delivery model.

Full privatization of BCTS and the resources supporting it

This model, full privatization of BCTS, is assumed to include the assets under the control and management of BCTS, including transfer of the ownership of the timber within the BCTS operating areas. The transfer of ownership of the timber could be as sale of the timber alone, timber and land, or by long term lease of the standing timber, as has been done in New Zealand. Any of these steps would raise significant public policy questions that are beyond the scope of this review.

The same three general considerations regarding shifting a function out of government that applied in the previous privatization model would again apply here.

As per the previous model, it would be possible to implement this model over just a portion of BCTS, such as a single Business Area, either as a pilot or over the long term, but it is difficult to see how this could occur and still maintain the overall integrity of the BCTS data set.

Under this model, the sale agreement would have to very clearly and carefully specify the expectations from the private company as they relate to the delivery of the BCTS mandate. Where the activities of the private entity were not constrained by the sale agreement, it would have complete freedom to operate in its own business interests, but one should expect conflict between the requirement to supply data that would support the MPS pricing system and the entity's desire to manage its cash flow potential to suit its business objectives.

The *Labour Relations Code* outlines the "successorship" provisions when a business of government is transferred out of the public service to a private entity. Where "successorship" occurs, the terms of the existing collective agreements would apply unless and until those agreements are renegotiated by the private entity. These provisions would not include retention under the *PSLRA* and employees would lose their public service status.

The existing collective agreements include restrictions on the privatization of government business or the transfer of it to an Alternative Service Delivery model.

Appendix III: IMPROVEMENTS NEEDED TO BCTS GOAL STATEMENTS

Goal 1: Provide a credible reference point for costs and pricing of timber harvested from public land in BC

No specific concerns have been raised around Goal 1. However, once the relationship between BCTS data and the MPS system has been clearly defined, it may be helpful to revise the wording of Goal 1 to be more specific. Given the current relationship between BCTS and MPS, clearly this is the paramount goal for BCTS.

Goal 2: Optimize net revenue to the province, within the parameters dictated by our benchmarking mandate and safe and sound for management practices.

There was considerable discussion around Goal 2. Participants have questioned if BCTS' goal to optimize net revenue will interfere with its working within a competitive timber market. For example - will BCTS forgo portions of the profile, or restrict supply in poor markets, or use excessive upset rates, in order to optimize revenue? Other participants believe that a business driver for BCTS is essential, and that this phrase provides that driver. The co-chairs support this rationale and believe this phrase should be retained, subject to the revisions below.

The use of the word "optimize" rather than "maximize" net revenue, has led to some confusion. When this goal was written, "optimize" was chosen to indicate that net revenue would never be maximized, but would be subject to the limitations imposed by MPS data needs and by safe and sound forest management. In addition, short term revenue maximization could be limited by the need to be a consistent supplier of fibre to the market, and by the need to be selling in times of weak prices as well as when prices are high in order to generate pricing data for MPS. The co-chairs suggest some clarity could be provided by re-stating it as "maximize net revenue generation from each timber sale", acknowledging that the other Goals could affect revenue generation from the program as a whole.

As this goal is intended to be secondary to Goal 1, the phrase "benchmarking mandate" should be revised to ensure it clearly refers to Goal 1.

As per the discussion under Goal 3 below, it may be helpful to acknowledge that Goal 2 is also secondary to a revised Goal 3, and to re-order Goals 2 and 3.

Goal 3: *Provide opportunities for customers to purchase timber in an open and competitive market*

There are two distinct components to this goal that have each raised considerable discussion.

The phrase “provide opportunities for customers to purchase timber” was included when this goal was written to indicate the importance of customers to BCTS’ success. Comments received suggest that this concept be even further emphasized. At the same time, this phrase has been interpreted at times to mean that BCTS’ sales program must be designed to meet the needs of every potential customer. Strictly meeting this interpretation could conflict with Goal 1. A solution to the issue of these varying interpretations may lie in the following:

- Revise this phrase to recognize the critical role that BCTS plays in supplying 20% of the province’s timber supply to harvesting and manufacturing operations, i.e., the critical linkage to the customers as represented by the forest industry as a whole.
- Recognize that this role is still subordinate to the role of supporting MPS as articulated in Goal 1.
- Recognize that this role can result in limitations on BCTS’ ability to maximize revenues, and re-order the current Goals 2 and 3, and re-word the old Goal 2 accordingly.

The phrase “in an open and competitive market” was included when this goal was written to reinforce the linkage with Goal 1, and is completely consistent with the Vision and Mission of BCTS. However, “open and competitive auctions” more accurately reflects the degree of control BCTS can exert over the competitiveness of the timber market.

This phrase has also triggered considerable discussion around the Category 2 program. , The future of the Category 2 program is outside the Terms of Reference of the Structural Review and must be addressed in a broader discussion elsewhere.

Goal 4: *Be a high performing organization with skilled, motivated and proud people*

No specific concerns have been raised around Goal 4. However, once the opportunities for improvement discussed under Theme 4 have been considered, it may be helpful to revise the wording of this goal.

Appendix IV: OPERATIONAL IMPROVEMENTS SHOULD BCTS REMAIN WITHIN THE MOFR

Should the BCTS function remain within the MoFR, it is recommended that the following be actively pursued.

- BCTS should open all jobs to Out-of-Service applicants, should consider the benefits of moving to an 8 hour workday, and should review present job classifications to ensure that they adequately match the work duties.
- BCTS must ensure that individual employee performance plans are closely linked to the corporate Service Plan and corporate performance targets. Under performance must be corrected and all possible opportunities for rewarding high performance should be pursued.
- BCTS must ensure that it has adequate access to all necessary expertise, either internally or through consulting support.
- BCTS staff must have both corporate and individual targets for communication with the business sector and the development of business acumen.
- The use of BCTS cost data for MPS must be designed so that BCTS is encouraged to, not constrained from, exploring business opportunities that are consistent with its core mandate.
- Where needed, BCTS must have the ability to modify office structures and change office locations as timber markets fluctuate around the province.
- BCTS is currently undertaking an intensive review of its information systems and processes; BCTS must have flexibility to implement the conclusions from that review.
- It is not perceived that BCTS' current budget and fiscal management constrains its ability to operate. BCTS should be given formal exemption from budget and operating plan changes where they are not linked to changes in timber markets, and the opportunity to put all goods and services out to tender where practical.

Appendix V: SUBMISSIONS ON DISCUSSION PAPER #2

These comments have been placed into a separate document also available on the BCTS public website, to avoid making this document too unwieldy for distribution.