

**CANADA - UNITED STATES
SOFTWOOD LUMBER TRADE DISCUSSIONS**

**British Columbia
Proposed Forest Policy Changes**

**Province of British Columbia
December 2001**

CANADA – U.S. SOFTWOOD LUMBER TRADE DISCUSSIONS British Columbia Forest Policy Proposal

INTRODUCTION

The United States and Canada have been holding discussions since July 2001 to assess whether there is an alternative to litigation to resolve the softwood lumber trade dispute. British Columbia and other Canadian provinces have actively participated in these discussions. Alternatives to litigation may include changes in forest policy and these policy matters fall largely within the jurisdiction of the various provincial governments.

Pursuant to these discussions, British Columbia is here proposing a series of forest policy changes intended to form one component of an overall settlement of the dispute.

This proposal includes a comprehensive set of forest policy changes, all designed to create truly competitive markets for standing timber, logs and tenure; and expand the role of market forces in its forest sector. As a result, any “trade distortions” –real or perceived—that may be attributed to current British Columbia forest policies will be eliminated.

British Columbia’s public forest resources will continue under government ownership. However, government will focus on basic forest stewardship. Market forces will drive commercial decisions.

British Columbia believes that these policy reforms can provide a basis for a durable resolution of the softwood lumber trade dispute.

CONDITIONS

This proposal is submitted to the United States in the context of discussions to allow Canada (including its provinces) and the United States to assess whether there may be an alternative to litigation. It is not a formal settlement offer.

Specifically, this proposal is submitted to the United States without prejudice to British Columbia’s position in the ongoing trade litigation; and is conditional on achieving final agreement on all of the elements of a settlement between the United States and Canada and each of the provinces.

BRITISH COLUMBIA'S PROPOSED FOREST POLICY CHANGES

British Columbia is proposing a series of 21 specific forest policy change measures. In what follows, these changes are discussed under the “three baskets” – pricing, tenure and mandatory requirements – which the United States has suggested.

1. Timber Pricing

1.1 Timber Sale Licences

Proposal

The price of standing timber sold under Timber Sale Licences will be determined by competitive auctions. The licences will be awarded to the highest bidder. (See 2.1 below).

Measures

1.1.1. Non-price criteria for the award of Timber Sale Licences will be eliminated.

Discussion

Timber Sale Licences are presently awarded under the Small Business Forest Enterprise Program (SBFEP). They represent about 13% of the provincial timber harvest.

At present, about half of the SBFEP timber allocation is sold competitively (under S. 20 of the *Forest Act*) on the basis of the highest bid price.

The remaining Timber Sale Licences are awarded under S. 21 and S. 23 of the *Forest Act*. These awards are made directly or are based on proposals and include consideration of bid price, employment, investment and value-added criteria. These non-price criteria will be eliminated.

These measures will ensure that 13% of the harvest is awarded at auction to the highest bidder. (See also 2.1 below).

1.2 Tree Farm Licences, Forest Licences and other tenures

Proposal

The price of standing timber under long-term tenures will be based on the price of standing timber established in the competitive auction market for Timber Sale Licences. (See 1.1 above and 2.1 below).

Measures

- 1.2.1. A new timber pricing system will be established for standing timber under all provincial tenures other than Timber Sale Licences (which are sold at auction).
- 1.2.2. The new system will determine timber prices by referring to the prices established in competitive auction markets for timber of like species, quality and site characteristics.
- 1.2.3. Adjustments will be made to account for the forest management obligations borne by long-term tenure holders that are not borne by holders of Timber Sale Licences. These adjustments will recognize the differential costs, including a return for the investment and risk incurred by long-term tenure holders in forest management.
- 1.2.4. A transparent process will be established to identify and measure the appropriate adjustments.
- 1.2.5. A system for making arms length log transactions more transparent will be established.

Discussion

At present, timber prices for these tenures are established using the Comparative Value Pricing (CVP) system (although on the coast a portion of the harvest is priced under the Coast Hemlock Pilot Pricing Project). There are separate coast and interior versions of CVP.

The CVP system would be terminated on both the coast and the interior and replaced with auction-based pricing systems. As with the CVP, separate coast and interior versions would be developed; and the coast hemlock pricing pilot would be terminated. The new pricing system will be based on auction sales of standing timber representing almost 13% of the total provincial softwood harvest. This represents an annual auction volume of approximately 9.5 million cubic metres from across the province and which is representative of British Columbia's species, timber quality and site characteristics.

The ability of market participants to arbitrage between standing timber and log markets improves the reliability of prices in both markets. With the proposed reforms, these markets will become substantial.

The competitive *standing timber* market, comprised of private land stumpage and public auction sales, will become almost 23% of the provincial softwood harvest. The competitive *log* market, comprised of private land logs and the unencumbered (i.e. with no linkage to processing facilities) public land harvest, is also over 20% of the provincial softwood harvest. This share will increase in response to other reforms included in this proposal (e.g. the elimination of appurtenancy and timber processing requirements per 3.2 below).

See Attachment for further detail on standing timber and log market volumes for the province in total and the coast and interior regions.

1.3 Below Cost Sales

Proposal

Timber will not be sold at a price below the Ministry of Forests' cost.

Measures

- 1.3.1. The minimum stumpage rate for cutting authorities will be set by regulation to equal the Ministry of Forests' incremental cost of managing commercial timber harvesting.
- 1.3.2. A transparent process will be established to identify and measure or audit the relevant costs.

Discussion

The current minimum stumpage rate is C\$0.25 per cubic metre, a rate which is below the Ministry's unit cost. This measure will reduce the harvest of otherwise uneconomic timber.

Note that the minimum stumpage rate referred to here differs from the reservation prices (minimum acceptable prices) established for individual auction sales.

1.4 Cross-Subsidies

Proposal

The potential to cross-subsidize from higher to lower value timber in order to encourage the harvest of otherwise uneconomic timber will be eliminated.

Measure

- 1.4.1. The Ministry will require that cutting authorities (the basis for timber pricing) constitute logical units so that disparate cut blocks cannot be “blended” and receive a common stumpage rate that embeds a cross-subsidy.

Discussion

A number of the other measures included within this proposal also have the effect of removing the potential for cross-subsidization. Taken together, this proposal removes any potential for cross-subsidization.

2 Forest Tenures

2.1 Award of Timber Sale Licences

Proposal

Competitive timber auctions will be expanded to 13% of the provincial harvest.

Measures

- 2.1.1. At present, some Timber Sale Licences are awarded (under S. 21 of the *Forest Act*) through a bid-proposal process in which factors in addition to price are considered. The bid-proposal process will be terminated and all future awards based solely on price.
- 2.1.2. The Small Business Forest Enterprise Program, which is responsible for the administration of competitive sales and bid-proposal sales, will be placed on a commercial footing with a mandate to obtain full market value for the resource.

Discussion

These measures mean that 13% of the provincial harvest will be awarded on a competitive basis—by auction to the highest bidder. An award will be made if the highest bid equals or exceeds both (a) the reservation price established for the sale (70% of estimated market value); and (b) the minimum stumpage rate (per 1.3 above).

At present only 6% of the harvest is awarded competitively.

2.2 Award of Long-term Tenures

Proposal

New long-term tenures will be awarded to the highest bidder on the basis of the highest bid price or bonus offer.

Measures

- 2.2.1. The *Forest Act* will be amended to stipulate that new long-term tenures must, subject to the following, be awarded through a competitive process based on the highest bid price or bonus offer. As a partial exception to the above, the government reserves the right to provide preferential awards to First Nations.

Discussion

This measure in conjunction with 2.1 means that virtually all timber rights in the province will henceforth be awarded competitively—either on the basis of highest lump sum bid; or volumetric bonus offer per cubic metre of harvest.

It should be noted that virtually all of the provincial forest resource is committed to existing tenures or the SBFEP allocation and that there will be limited opportunities for new long-term tenure awards.

2.3 Sub-dividability of Forest Licences and Tree Farm Licences

Proposal

Forest Licences and Tree Farm Licences will be made sub-dividable. Measure

- 2.3.1. The *Forest Act* will be amended to allow tenure holders to sub-divide their Forest Licence or Tree Farm Licence subject to the approval of the Chief Forester that the sub-division will not unduly compromise forest management.

Discussion

The *Forest Act* currently provides for the Minister of Forests to sub-divide some tenures. The amendments will ensure that tenure holders have the right to initiate the sub-division and that the grounds for disallowing the sub-division is the determination by the Chief Forester that the sub-division would compromise

forest management. This could occur if the original tenure became highly fragmented.

This provision is intended to create a more active secondary market in these tenures and, at the same time, create new opportunities for firms to enter to the industry. See also 2.4 below.

2.4 *Transfers of Forest Licences, Timber Licences and Tree Farm Licences*

Proposal

Forest Licences and Tree Farm Licences will be made freely transferable subject to competition policy and routine regulatory requirements.

Measures

- 2.4.1. The *Forest Act* will be amended to limit the discretion of the Minister of Forests to disallow tenure transfers to specific grounds: the Minister's satisfaction that the proposed tenure transfer will not unduly impact competition for timber or logs; and the tenure holder's compliance with routine regulatory requirements respecting outstanding obligations.
- 2.4.2. The *Forest Act* will also be amended to eliminate the mandatory 5% AAC reduction (in the case of Timber Licences, the payment of 5% of appraised value) effective upon transfer; and eliminate the provision allowing the return of that AAC reduction upon the Minister's approval of a proposed "job plan".

Discussion

Although the *Forest Act* allows tenure transfers, they are presently subject to Ministerial approval and the payment of a "transfer tax" (i.e. the 5% AAC reduction). The Minister's approval may include conditions, including conditions for maintaining jobs, continuing certain operations, making certain investments or other requirements.

The proposed measures, in conjunction with 2.3 above, are intended to facilitate a more active secondary market in long-term tenures in order to allow for increased entry to and exit from the industry.

3 Mandatory Requirements

3.1 Cut Control Requirements

Proposal

To eliminate the minimum levels at which companies must harvest timber under provincial tenures.

Measure

- 3.1.1. The *Forest Act* will be amended to eliminate: (a) the annual requirement for tenure holders to harvest at least 50% and no more than 150% of their AAC; and (b) the five-year requirement to harvest at least 90% of the five-year AAC.

Discussion

AAC is effectively apportioned to licencees for a five year period (AAC x 5). The annual and five-year minimum and maximum harvest volumes for each licencee are specified by the province's "cut control" provisions: a licencee must harvest within plus or minus 50% of the AAC each year, and within plus or minus 10% of the aggregate AAC over the five year period. The "penalty" for undercutting the AAC in a cut control period is loss of AAC in the subsequent cut control period.

In order to preserve the ability to manage the forests on a sustainable basis, the province does not propose to eliminate the maximum five-year cut control provision.

3.2 Utilization

Proposal

To eliminate requirements for tenure holders to remove and process timber or logs.

Measures

- 3.2.1. Specific utilization standards will be eliminated.

- 3.2.2 Forest management objectives will be specified for bio-diversity, forest health, silviculture, reforestation and fire management.

Discussion

Each cutting authority is presently subject to government utilization standards. These requirements may force tenure holders to utilize uneconomic timber or logs. Under this proposal, tenure holders will be free to make commercial decisions with respect to utilization subject to meeting forest management objectives for bio-diversity, forest health, silviculture, reforestation and fire management. These objectives will be specified as results to be achieved based on sound forestry practice.

3.3 Appurtenancy and Timber Processing Requirement

Proposal

To eliminate legislated and contractual provisions that direct companies to process timber in company-owned mills.

Measure

- 3.3.1. The *Forest Act* and every pertinent tenure agreement will be amended to remove appurtenancy and timber processing provisions.

Discussion

One common provision of major tenures directs, specifically or generally, the tenure holder to process timber at a mill or other facility. When the direction is specific – the timber from a tenure is to be processed at a specific mill, plywood plant or other facility – the provision is called appurtenancy. When it is general – the timber from a tenure, or its equivalent volume, is to be processed at a facility owned by the tenure holder – the provision is referred to as a processing requirement.

These provisions of major tenures create a link (direct or indirect) between harvesting rights and processing requirements, and hamper both the movement of logs within the province and the operating decisions of mills and other processors. British Columbia proposes to break this link by eliminating the legislated and contractual appurtenancy and processing requirements. This will help foster the growth of competitive log markets and permit entry to/exit from the industry.

There will be transitional issues: certain Timber Sale Licences (bid proposal sales) may be grandfathered for the remainder of the term of the licence; pulpwood agreements may be handled differently.

3.4 Mill Closure Requirements

Proposal

British Columbia proposes to eliminate legislated provisions that impede temporary or permanent mill closures.

Measure

- 3.4.1. The *Forest Act* provision that gives government the right to reduce a company's AAC when a mill closes, or is likely to close, for 90 days or longer will be eliminated.

Discussion

The *Forest Act* authorizes a reduction in AAC approximately equal to the volume of timber that would otherwise have been harvested during the closure.

The risk of loss of AAC – effectively access to timber – is a disincentive to take protracted downtime. To remove that disincentive, and to help enable companies make operating decisions based only on market signals, British Columbia proposes to eliminate the legislated provisions related to mill closures.

Labour-related or other generally required notification provisions (as, for example, under the Employment Standards Act) will not be revised.

3.5 Job Protection Plans

Proposal

British Columbia proposes to eliminate the framework for company-specific assistance to forest companies.

Measure

- 3.5.1. British Columbia proposes to delete the forest industry's designation as a strategic industry for purposes of the *Job Protection Act*. This means that companies in the forest industry will no longer be eligible for Economic Plans.

Discussion

The only program in British Columbia that provides for company-specific assistance is the Job Protection Commission. A significant percentage of the Economic Plans developed by the Job Protection Commission have focussed on companies in the forest industry.

British Columbia's Job Protection Commission was established, through the *Job Protection Act*, to minimize job loss and other economic disruption, particularly in one-industry communities, and to alleviate the negative impact on regional or local economies of business failures.

The Commission provides two types of services:

- mediation between a company and its creditors to help develop a mutually acceptable restructuring plan; and
- for a company in an industry designated as a strategic industry, development of Economic Plans. These plans are also a mutually acceptable restructuring plan, but under which the Commission has the authority to modify monies owed under provincial legislation or certain limited regulatory concession.

Although the Commission does not provide financial assistance itself, Economic Plans can provide the platform for assistance from government and the private sector. The forest industry is currently designated as a strategic industry, and companies in the forest industry are, therefore, eligible for Economic Plans.

Economic Plans can allow forest companies to maintain production and employment during market downturns and may contribute to export shipments above free market levels. These plans will be eliminated.

Forest industry sector companies will remain eligible for the mediation services of the Job Protection Commission.

CONCLUSION

British Columbia believes that this proposal represents a fundamental change in forest policy. This means that market forces will drive commercial decisions within the forest sector pertaining to what, how much and when to harvest; where to process timber; and what products to produce. At the same time, these measures substantively address any real or perceived trade distortions that may be attributed to provincial government policies.

Other provinces are also considering modifications to their forest policies; and the United States is considering measures to provide long-term security of market access to Canadian softwood lumber producers.

If the overall package of Canadian and United States' proposals is accepted as a basis for further discussion, British Columbia is prepared to work with the parties to elaborate the forest policy measures it has proposed and to incorporate them within an overall settlement agreement.

STUMPAGE AND LOG MARKETS IN BRITISH COLUMBIA: 2000

1.1 PROVINC E	CURRENT		PROPOSED	
	<u>Volume (Cubic Metres)</u> ¹	<u>Percent</u> ²	<u>Volume (Cubic Metres)</u> ¹	<u>Percent</u> ²
Standing Timber				
Crown	4,648,545 ³	6.3	9,407,173 ⁷	12.8
Private	<u>7,359,716</u> ⁴	<u>10.0</u>	<u>7,359,716</u> ⁸	<u>10.0</u>
Total	12,008,261		16,766,889	22.8
Logs				
Crown	8,684,753 ⁵	11.8	13,443,382 ⁹	18.3
Private	<u>6,663,095</u> ⁶	<u>9.1</u>	<u>6,663,095</u> ¹⁰	<u>9.1</u>
Total	15,347,848	20.9	20,106,477	27.3

-
- All volumes are stumpage billings for January 1, 2000, to December 31, 2000. Includes all coniferous logs. Excludes deciduous, waste, reject and special forest products.
 - Percentages are derived by dividing by the total coniferous log volume billed in the Province excluding deciduous, waste and special forest products from January 1, 2000, to December 31, 2000 (73,540,581 cubic metres).
 - Volumes billed from timber sale licences issued under Section 20 of the *Forest Act*.
 - Volumes billed from all private land.
 - Volumes billed from woodlot licences (1,327,752 cubic metres), timber sale licences issued under Section 20 of the *Forest Act* (4,648,545 cubic metres) and market logging licences (Husby's Forest Licences A16869 and A16871 total 156,886 cubic metres; Canfor's Forest Licences A19208, A19213, A19223, A19233 total 383,234 cubic metres and Tree Farm Licence 37 totals 897,835 cubic metres; Ilsiak Forest Resources Ltd. Tree Farm Licence 57 totals 14,347 cubic metres; T.F.L. Forest Ltd.'s Forest Licences A16870, A20913, A29159 total 136,055 cubic metres and Tree Farm Licences 46 and 47 totals 1,187,388 cubic metres; Lakeside Pacific's Forest Licence A19207 totals 175,718 cubic metres; Cattermole Timber's Forest Licence A19202 totals 98,105 cubic metres; Tamihi's Forest Licence A20542 totals 55,223 cubic metres; Revelstoke Community Forests Tree Farm Licence 56 totals 84,725 cubic metres).
 - Volume billed from private land excluding private land in tree farm licences.
 - Volume billed from all tenures issued under the Small Business Forest Enterprise Program.
 - Volume billed from all private land.
 - Volumes billed from woodlot licences (1,327,752 cubic metres), all tenures issued under the Small Business Forest Enterprise Program (9,407,173 cubic metres) and market logging licences – see No. 5.
 - Volume billed from private land excluding private land in tree farm licences.
 - Percentages may not add up due to rounding.

Prepared by Revenue Branch, Ministry of Forests (December 4, 2001)

STUMPAGE AND LOG MARKETS IN BRITISH COLUMBIA: 2000

1.2 COAST	CURRENT		PROPOSED	
	<u>Volume (Cubic Metres)</u> ¹	<u>Percent</u> ²	<u>Volume (Cubic Metres)</u> ¹	<u>Percent</u> ²
Standing Timber				
Crown	1,091,306 ³	4.5	1,859,536 ⁷	7.6
Private	<u>5,570,573</u> ⁴	<u>22.8</u>	<u>5,570,573</u> ⁸	<u>22.8</u>
Total	6,661,879		7,430,109	30.4
Logs				
Crown	3,901,778 ⁵	16.0	4,670,008 ⁹	19.1
Private	<u>4,874,495</u> ⁶	<u>20.0</u>	<u>4,874,495</u> ¹⁰	<u>20.0</u>
Total	8,776,273		9,544,503	39.1

-
- All volumes are stumpage billings for January 1, 2000, to December 31, 2000. Includes all coniferous logs. Excludes deciduous, waste, reject and special forest products.
 - Percentages are derived by dividing by the total coniferous log volume billed on the Coast excluding deciduous, waste and special forest products from January 1, 2000, to December 31, 2000 (24,408,933 cubic metres).
 - Volumes billed from timber sale licences issued under Section 20 of the *Forest Act*.
 - Volumes billed from all private land.
 - Volumes billed from woodlot licences (186,741 cubic metres), timber sale licences issued under Section 20 of the *Forest Act* (1,091,306 cubic metres) and market logging licences (Husby's Forest Licences A16869 and A16871 total 156,886 cubic metres; Canfor's Forest Licences A19208, A19213, A19223, A19233 total 383,234 cubic metres and Tree Farm Licence 37 totals 897,835 cubic metres; Ilsaak Forest Resources Ltd. Tree Farm Licence 57 totals 14,347 cubic metres; T.F.L. Forest Ltd.'s Forest Licences A16870, A20913, A29159 total 136,055 cubic metres and Tree Farm Licences 46 and 47 totals 1,187,388 cubic metres; Lakeside Pacific's Forest Licence A19207 totals 175,718 cubic metres; Cattermole Timber's Forest Licence A19202 totals 98,105 cubic metres; Tamih's Forest Licence A20542 totals 55,223 cubic metres).
 - Volume billed from private land excluding private land in tree farm licences.
 - Volume billed from all tenures issued under the Small Business Forest Enterprise Program.
 - Volume billed from all private land.
 - Volumes billed from woodlot licences (186,741 cubic metres), all tenures issued under the Small Business Forest Enterprise Program (1,859,536 cubic metres) and market logging licences – see No. 5.
 - Volume billed from private land excluding private land in tree farm licences.
 - Percentages may not add up due to rounding.

STUMPAGE AND LOG MARKETS IN BRITISH COLUMBIA: 2000

1.3 1.4 INTERIOR	CURRENT		PROPOSED	
	<u>Volume (Cubic Metres)</u> ¹	<u>Percent</u> ²	<u>Volume (Cubic Metres)</u> ¹	<u>Percent</u> ²
Standing Timber				
Crown	3,557,239 ³	7.2	7,547,638 ⁷	15.4
Private	<u>1,789,143</u> ⁴	<u>3.6</u>	<u>1,789,143</u> ⁸	<u>3.6</u>
Total	5,346,382		9,336,781	19.0
Logs				
Crown	4,782,975 ⁵	9.7	8,773,374 ⁹	17.9
Private	<u>1,788,600</u> ⁶	<u>3.6</u>	<u>1,788,600</u> ¹⁰	<u>3.6</u>
Total	6,571,575	13.4	10,561,974	21.5

-
1. All volumes are stumpage billings for January 1, 2000, to December 31, 2000. Includes all coniferous logs. Excludes deciduous, waste, reject and special forest products.
 2. Percentages are derived by dividing by the total coniferous log volume billed in the Interior excluding deciduous, waste and special forest products from January 1, 2000, to December 31, 2000 (49,131,648 cubic metres).
 3. Volumes billed from timber sale licences issued under Section 20 of the *Forest Act*.
 4. Volumes billed from all private land.
 5. Volumes billed from woodlot licences (1,141,011 cubic metres), timber sale licences issued under Section 20 of the *Forest Act* (3,557,239 cubic metres) and market logging licences (Revelstoke Community Forests Tree Farm Licence 56 totals 84,725 cubic metres).
 6. Volume billed from private land excluding private land in tree farm licences.
 7. Volume billed from all tenures issued under the Small Business Forest Enterprise Program.
 8. Volume billed from all private land.
 9. Volumes billed from woodlot licences (1,141,011 cubic metres), all tenures issued under the Small Business Forest Enterprise Program (7,547,638 cubic metres) and market logging licences – see No. 5.
 10. Volume billed from private land excluding private land in tree farm licences.
 11. Percentages may not add up due to rounding.