

Restructuring the Coastal Forest Industry

A DISCUSSION PAPER

THIS DISCUSSION PAPER BRIEFLY OUTLINES A CONCEPTUAL FIVE POINT PLAN FOR A MARKET BASED RESTRUCTURING OF THE COASTAL FOREST INDUSTRY. IT HAS BEEN DEVELOPED IN RESPONSE TO THE MINISTER OF FOREST'S REQUEST FOR SUBSTANTIVE SOLUTIONS THAT ALLOW THE MARKET TO DICTATE FOREST INDUSTRY FUNDAMENTALS. THE HAYES PLAN IS INTENDED TO FURTHER DISCUSSION BETWEEN THE PARTIES AND INCLUDES SOME IDEAS THAT HAVE ALREADY BEEN FLOATED IN THE INDUSTRY. WHILE NO ONE PLAN CAN BE THE COMPLETE SOLUTION, THE HAYES PLAN IS INTENDED TO SET THE STAGE FOR THE INDUSTRY TO REPLACE THE CURRENT BUSINESS ENVIRONMENT OF "ENTITLEMENTS" WITH A BROAD BASED MARKET OPPORTUNITY.



HAYES

End Goals

The Hayes plan has been developed to achieve the following set of end goals:

1. Market forces should be allowed to:

- Determine stumpage rates
- Establish the cost of harvesting
- Identify the timber to be harvested
- Control the timing of harvesting
- Control the success or failure of companies

2. Industry must maintain its social licence to use the forest resources by:

- Providing access to timber for First Nations
- Attracting capital investment in manufacturing and other job creating endeavours
- Maximizing economic rent on forest resources to the people of British Columbia
- Avoiding non-market driven interruption to employment and communities

3. Globally competitive industry must be re-established by:

- Removing substantial costs from our harvesting and milling sectors
- Removing excess harvesting and milling capacity from the industry
- Removing duplication of effort by Government, tenure holders and contractors
- Fostering entrepreneurship in timber resource management and conversion
- Replacing the business environment of "entitlements" with a sole entitlement "to compete"

4. Reform must directly address the long-term US trade issues by:

- Ending the appearance of timber production subsidy
- Creating an active standing timber market
- Creating an active log market
- Creating an active forest tenure market

5. Reality dictates that:

- Everyone shares the pain
- Everyone shares the opportunity
- Cash compensation is off the table
- There is no magic stumpage reduction bullet



Hayes proposes the following five point plan for a market based restructuring of the coastal forest industry:

1. Convert all Bill 13 full phase contracts to full phase market contracts

Convert existing Bill 13 full phase contracts into market contracts that may require limited first right of offer on logs to the original tenure holders and profit gain sharing. This effectively:

- Removes all Bill 13 controversy
- Separates a substantial portion of harvesting from milling
- Provides the ultimate market test for harvesting costs
- Harnesses entrepreneurial skill
- Creates an active log market
- Attracts capital investment in market dependent processing facilities
- Removes duplication of effort between tenure holders and contractors

2. Create a On-Line Log Market (OLM) to auction cutting permits for use in setting stumpage

Require every tenure holder to auction off the rights to harvest and take to market 20% of their annual AAC on a government controlled eBay style auction, OLM. This continuous on-line auction of fully engineered and roaded cutting permits would be a real time market verification of what a willing buyer in the market will pay for standing timber. The selection of the CP's to

be auctioned should be a combination of self-selected by the tenure holders and random sampled. The development costs would be refunded to the tenure holders. The tenure holders would be permitted to bid on their own CP's. In addition, tenure holders would be allowed to auction additional CP's from their AAC on the OLM at their option. The OLM effectively:

- Creates a real time auction of cutting permits for stumpage setting purposes
- Requires no Government agency to manage or develop the auction timber base
- Ensures that the timber auctions will not be subject to government influence
- Ensures that the "take back" timber gets to market on a timely basis
- Allows tenure holders to vary their own timber harvesting profile for species, logging method, timing etc.
- Allows tenure holders to retain the competitive advantage of their infrastructure, workforce etc.
- Allows cutting permits, which tenure holders deem to be uneconomic under the administrative stumpage system, to be auctioned off at market value and come into production
- Allows competitive and efficient tenure holders to both likely retain their own CP's in the auction and lever their efficiency into additional CP's
- Accelerates the success of the strong and the failure of the weak

3. Use the On-Line Log Market (OLM) to collect and report real time log market information

Effective markets are based on accurate timely information. The OLM can be used as a real time on-line reporting system that collects, calculates and reports on:

- Log sales
- Stumpage rates paid at auction
- Stumpage rates paid on the administrative formula
- Logs for sale
- Tenure transfers
- Administrative stumpage calculated on CP's
- Aggregated log value trends by species, grade, and region

In this way, the industry has real time understanding of all of the fundamental log commodity market indicators. The OLM can also allow industry to use the data on-line to project real time changes to and report on actual stumpage rates on non-auction cutting permits. With the free flow of information from OLM, the market will ensure that the log supply is optimally deployed and priced. The OLM will provide real time log sales values for Government for the purpose of stumpage rate setting and will assist the industry by:

- Replacing tenure holders internal transfer pricing formulas (ID Prices) with real time market log pricing, resulting in optimal harvest, milling, and capital deployment decisions
- Removing the delay in stumpage rate setting



- Removing the element of stumpage change surprise that continually interrupts production planning, workers and communities

4. Utilize existing SBFEP AAC to provide direct First Nations timber access

The AAC of the existing SBFEP should be used to provide access to timber for First Nations. Any underutilized AAC from the SBFEP can be auctioned on the OLM. The availability of the SBFEP timber to First Nations:

- Provides broadly distributed timber rights throughout every tenure and region that can be closely matched to the traditional territories of First Nations
- Puts an end to competitive bidding on sales that are really targeted to specific First Nations
- Provides a tangible and measurable First Nation timber access volume that can be identified on a 5-year development plan

5. Avoid cash compensation to the stakeholders by vastly improving the regulatory environment and tenure property rights

Compensate the stakeholders by improving the regulatory environment and tenure property rights. The improvement will unlock unbiased market valuation of tenures, allow for a flow of investment capital and facilitate ownership rationalization of tenures. The required improvements should include:

- Removal of Private Lands from tenures, which unlocks industry equity and increases return on investment

- Removal of all appurtenance clauses in tenures, which encourages mill rationalization and the proper allocation of capital spending
- Removal of mill closure regulation, which facilitates rationalization of excess mill capacity
- Addition of strong lien protection on log inventories, which facilitates debt and equity financing
- Addition of strong lien protection on work-in-progress (including, investment in roads, engineering, silviculture and infrastructure on public lands), which facilitates debt and equity financing

- Registration of claims similar to mortgages or PPSA registration on tenures
- Unfettered transfer rights for tenures, which ensure continuous rationalization of tenure ownership
- Subdivision rights for tenures, which ensure continuous rationalization of tenure ownership
- Amendment of the term of all tenures to a minimum term remaining of 15 years plus, which assists debt and equity financing and supports the market values of tenures by not allowing the market to discount near term to completion tenures
- Transition to a results based code

END GOAL ACHIEVEMENT

1 Market forces should be allowed to:		Plan
Determine stumpage rates		Yes
Establish the cost of harvesting		Yes
Identify the timber to be harvested		Yes
Control the timing of harvesting		Yes
2 Industry must maintain its social licence to use the forest resources by:		
Providing access to timber for First Nations		Yes
Attracting capital to invest in manufacturing and other job creating endeavours		Yes
Maximizing economic rent on forest resources to the people of British Columbia		Yes
Avoiding non-market driven interruption to employment and communities		Likely
3 Globally competitive industry must be re-established by:		
Removing substantial costs from our harvesting and milling sectors		Most Likely
Removing excess harvesting and milling capacity from the industry		Most Likely
Removing duplication of effort by Government, Tenure Holders and Contractors		Most Likely
Fostering entrepreneurship in timber resource management and conversion		Yes
Replacing the business environment of "entitlements" with a sole entitlement "to compete"		Yes
4 Reform must directly address the long-term US Trade issues by:		
Ending timber production subsidization		Yes
Creating an active market in standing timber		Yes
Creating an active log market		Yes
Creating an active market for timber cutting rights		Yes
5 Reality dictates that:		
Everyone shares the pain		Yes
Everyone shares the opportunity		Yes
Cash compensation is off the table		Yes
There is no magic stumpage reduction bullet		Yes