



NSW Department of Primary Industries
Review of Coastal Hardwood Wood Supply Agreements
Final Report

March 2017

Table of contents

1.	Introduction.....	1
1.1	Purpose of this report.....	1
1.2	Scope and limitations.....	1
2.	Background information	2
2.1	Coastal hardwood forestry industry	2
2.2	NSW Forest Industry Roadmap.....	2
2.3	Role of Forestry Corporation NSW	3
2.4	Arrangements in other jurisdictions	4
3.	Overview of the current arrangements.....	6
3.1	South Coast and Eden WSAs.....	6
3.2	North Coast WSAs.....	7
3.3	Pricing arrangements.....	9
4.	Issues raised in consultation	13
4.1	Allocation of hardwood timber resources.....	13
4.2	Roles of the NSW Government, FCNSW and customers	14
4.3	Key components of WSAs	15
5.	Key findings.....	19
5.1	Effectiveness of allocation of hardwood timber resources	19
5.2	Appropriateness of roles of the respective parties	20
5.3	Appropriateness of WSAs in their current form	21
6.	Recommendations	22
6.1	Overarching	22
6.2	South Coast and Eden.....	23
6.3	North Coast.....	23
7.	References	25

Table index

Table 1	Summary of supply volumes under South Coast and Eden WSAs.....	7
Table 2	Summary of supply volumes on the North Coast by WSA type	9
Table 3	Summary of pricing arrangements by WSA.....	10
Table 4	Summary of stakeholder feedback on components of WSAs	15

Figure index

Figure 1	Location of coastal hardwood sawmills	4
Figure 2	Stumpage prices per product (\$/m ³) – South Coast and Eden (Source: FCNSW)	11
Figure 3	Stumpage prices per product (\$/m ³) – North Coast (Source: FCNSW)	11
Figure 4	Delivery charges per product (\$/m ³) –South Coast (Source: FCNSW).....	12
Figure 5	Delivery charges per product (\$/m ³) – North Coast (Source: FCNSW)	12

Appendices

Appendix A – Scope of the Review

Appendix B – Consultation Schedule

Appendix C – Review of WSA Conditions

1. Introduction

1.1 Purpose of this report

The NSW Department of Primary Industries (NSW DPI) engaged GHD to undertake a review of coastal hardwood Wood Supply Agreements (WSAs). The review, undertaken between September 2016 and December 2016, is a key action of the recently released *NSW Forestry Industry Roadmap*. GHD engaged Forest Strategy Pty Ltd to assist with the review.

In summary, the terms of reference for the review are to:

- Review current coastal hardwood WSAs to determine whether they are effective in achieving an efficient allocation of NSW hardwood timber resources, and
- Evaluate the processes to develop WSAs to determine whether they reflect contemporary commercial best practice.

The full scope of the review is provided in Appendix A.

As part of the review, GHD considered a range of relevant background information, the experience in other jurisdictions and related sectors, and feedback obtained through consultation with key stakeholders. A list of consultation activities undertaken as part of the review is provided in Appendix B.

Following stakeholder consultation, GHD presented a summary of the issues raised and an overview of preliminary findings to a workshop of representatives from NSW DPI and the Forestry Corporation of NSW (FCNSW) in Sydney on 2 November 2016.

The purpose of this report is to outline the key findings and recommendations from the review.

1.2 Scope and limitations

This report has been prepared by GHD for the NSW DPI and may only be used and relied on by the NSW DPI for the purpose agreed between GHD and the NSW DPI as set out in section 1.1 of this report.

GHD otherwise disclaims responsibility to any person other than the NSW DPI arising in connection with this report. GHD also excludes implied warranties and conditions, to the extent legally permissible.

The services undertaken by GHD in connection with preparing this report were limited to those specifically detailed in the report and are subject to the scope limitations set out in the report.

The opinions, conclusions and any recommendations in this report are based on conditions encountered and information reviewed at the date of preparation of the report. GHD has no responsibility or obligation to update this report to account for events or changes occurring subsequent to the date that the report was prepared.

The opinions, conclusions and any recommendations in this report are based on assumptions made by GHD described in this report. GHD disclaims liability arising from any of the assumptions being incorrect.

GHD has prepared this report on the basis of information provided by the NSW DPI and others who provided information to GHD (including the Forestry Corporation of NSW), which GHD has not independently verified or checked beyond the agreed scope of work. GHD does not accept liability in connection with such unverified information, including errors and omissions in the report which were caused by errors or omissions in that information.

2. Background information

2.1 Coastal hardwood forestry industry

The hardwood forestry industry has been operating on the North Coast and South Coast of NSW for over 100 years and is recognised as an important social and economic driver for the respective regional communities. ABARES (2013) estimates that the North Coast forestry industry is worth \$184 million annually and supports 3,800 local jobs while the South Coast forestry industry is worth \$75 million annually and supports 1,430 local jobs.

Coastal hardwood processors currently source the majority of their wood supply from the Forestry Corporation of NSW (FCNSW), with a smaller volumes sourced from private native forestry. The major wood products sourced from State forests include high quality sawlogs, poles, piles and girders, veneer logs, low quality sawlogs and pulpwood (FCNSW 2016).

High quality sawlogs are generally used for appearance grade products such as flooring and decking, with the Blackbutt and Spotted Gum species currently providing the highest commercial return (FCNSW 2016). There are a range of markets for low quality, or salvage grade sawlogs including mining timber, pallets and fencing. Pulp logs are currently supplied to a business specialising in the production of high density fibre board on the North Coast and to a woodchip mill for export at Eden on the South Coast. A woodchip facility at Tea Gardens on the North Coast processing pulp log for export closed in 2014 (NRC 2015).

Currently the vast majority of coastal hardwood resources are allocated to saw millers and other timber processors in 20-year wood supply agreements. The majority of these agreements will expire in the period from the end of 2018 up until the end of 2023, and as a result, the industry is now seeking clarity of future access to the resource to inform ongoing investment decisions.

2.2 NSW Forest Industry Roadmap

The review of coastal hardwood WSAs is a key action under the NSW Government's recently released *NSW Forestry Industry Roadmap* (2016a). The Roadmap outlines the Government's vision for the State's \$2.4 billion forestry and wood-manufacturing industry and its planned actions to support an economically viable and ecologically sustainable industry into the future.

The Roadmap recognises that the coastal hardwood forestry industry has specific local challenges in relation to resource access and regulation. For the South Coast, it states that the industry is transitioning from a multi-age resource toward a total reliance on smaller regrowth beyond 2018. For the North Coast, it states that differences in access arrangements amongst customers has led to both annual and monthly variations in supply volumes and species mix.

In response, the NSW Government has outlined a number of actions for the coastal hardwood forestry industry in its Roadmap, including:

- Completing a review of coastal Integrated Forest Operations Approvals
- Working with industry to investigate and resolve concerns with North Coast timber supply contracts
- Renegotiating expiring native forest Wood Supply Agreements
- Assisting industry transition to smaller log sizes
- Developing new native forest harvest and haulage standards
- Supporting innovation and new markets, and
- Building community understanding and confidence in the forest industry.

It is important to note that this independent review of coastal hardwood WSAs is happening in parallel with a number of other key actions identified in the NSW Government's Roadmap and will be used to inform the renegotiation of expiring WSAs. As outlined in section 1.1, the review is to evaluate the effectiveness of the approach to resource allocation and the appropriateness of the WSAs in their current form. The verification of the accuracy of resource forecasts and sustainable yield estimates is not within the scope of this review.

2.3 Role of Forestry Corporation NSW

FCNSW is the State Owned Corporation (SOC) responsible for the multiple-use management of State forests and the environmentally sustainable commercial harvesting of the state owned timber resource from State forests and other crown-timber lands. FCNSW is the largest manager of commercial native and plantation forests in NSW managing more than two million hectares of forests and contributing 14 percent of all wood produced in Australia each year (FCNSW 2016).

Previously the Forestry Commission of NSW, FCNSW was corporatised in 2013 under the *Forestry Act 2012* with the intent of improving the commercial performance of the organisation.

The objectives of FCNSW, as set out in the Act, are to:

- Be a successful business and, to this end:
 - operate at least as efficiently as any comparable business, and
 - maximise the net worth of the State's investment in the Corporation
- Have regard to the interests of the community in which it operates
- Where its activities affect the environment, to conduct its operations in compliance with the principles of ecologically sustainable development contained in section 6 (2) of the Protection of the Environment Administration Act 1991
- Contribute towards regional development and decentralisation, and
- Be an efficient and environmentally sustainable supplier of timber from Crown-timber land and land owned by it or otherwise under its control or management.

FCNSW operates predominantly in two business segments, being its Hardwood Forests Division and Softwood Plantations Division. In 2014/15 the Hardwood Forests Division returned a positive Earnings Before Income Tax (EBIT) for the first time in over ten years (FCNSW 2015). The majority of revenue from commercial activities on State forests comes from the sale of wood supply products.

Most of the current coastal hardwood WSAs were made between WSA holders, FCNSW (or the then Forestry Commission of NSW) and the State of NSW in line with the NSW Regional Forestry Agreements and are managed as commercial contracts by FCNSW (FCNSW 2016). It is understood that following its corporatisation, FCNSW is now able to enter into sales contracts directly with customers, i.e. there is no requirement for the NSW Government to be a signatory to future agreements.

FCNSW has current coastal hardwood supply commitments in the order of 860,000 m³ per year with approximately 36 WSA holders from Kyogle on the far North Coast down to Eden on the far South Coast.

A map showing the distribution of FCNSW's coastal hardwood WSA customers is provided as Figure 1.

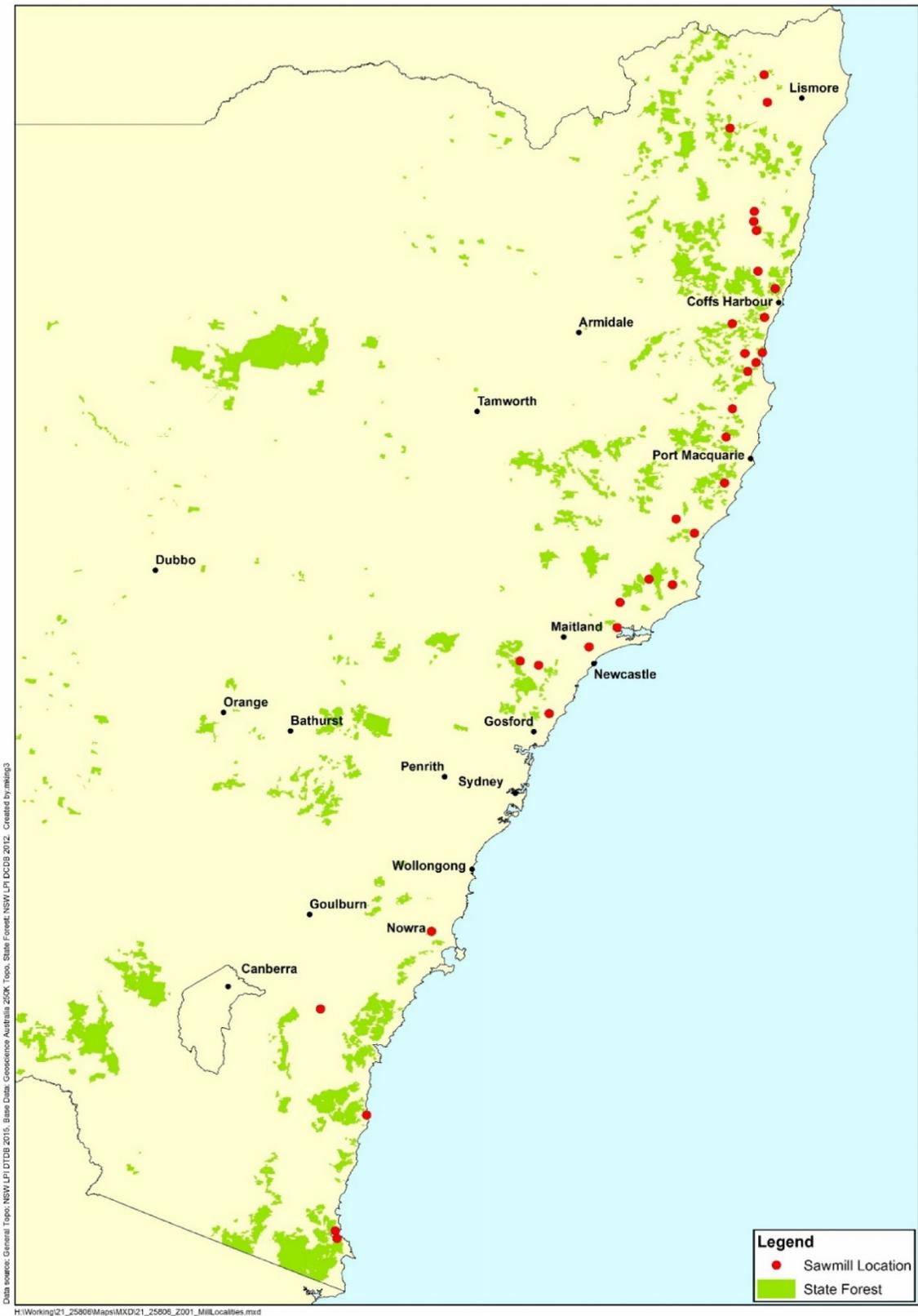


Figure 1 Location of coastal hardwood sawmills

2.4 Arrangements in other jurisdictions

As background to this review, GHD considered the arrangements in other states for the supply and sales of hardwood forestry products. A summary of these arrangements is provided below.

2.4.1 Victoria

The sustainable harvest and commercial sale of timber from public forests in Victoria is undertaken by the State-owned business VicForests (VicForests 2016). In the period from 2005 to 2008, a series of business-to-business auctions were held to replace the previous 15-year licences that had been granted to customers based on their historic intakes and value adding capacity. The auctions utilised an online platform that allowed customers to bid for landed mill door prices with the system calculating the best value to VicForests, as the resource manager. The contracts allocated in this way were for various terms around 5 years in duration.

The auction approach resulted in a price surge that was both politically and economically unsustainable. The auctions resulted in a high degree of industry rationalisation that would not otherwise have been achieved. The system also allowed for new entrants while some established business missed out on allocations, sometimes due their distance from the resource offered.

The current timber sales process used by VicForests is based on a Request for Proposal (RFP) process for resources available on the expiry of existing supply contracts. The RFP allows existing customers to nominate the price, quantity, quality and tenure for a future sales contract.

Some contracts have been allocated from this process for 20 years. It is noted that the application of this process has recently stalled as the Victorian Government considers resource withdrawals to create a new national park.

2.4.2 Western Australia

In Western Australia native forest products (primarily logs) are purchased from the Forest Products Commission, which is a statutory authority of the Western Australian Government.

Sales are typically made to major buyers under authority of specific State Government agreement acts, and contracts of sale (known as production contracts under the *Forest Products Act 2000 (WA)*).

Most contracts of sale are awarded following a competitive process, typically via a public tender or auction. Sometimes the public process involves requests for expressions of interest or proposals. Most contracts of sale for native forest sawlogs, firewood logs, fencing logs, feature grade sawlogs and other non-regular sawlog products have been awarded via these competitive processes. Occasionally, a contract of sale is allocated by private treaty pursuant to the *Forest Products Act 2000 (WA)*.

2.4.3 Queensland

In Queensland, native forest harvesting on State-owned forests is administered by the Forest Products unit of the Queensland Department of Agriculture and Fisheries. The unit authorises timber harvesting in native cypress and hardwood forests on State forests and other State-owned native forests in Queensland.

Most State-owned timber resources are sold to individual timber processing companies as standing trees under long-term sales permits to provide planning certainty for the timber processing industry. Long term sales permits are based on forest inventory, growth predictions, and market and social factors, including the need to promote a stable and viable timber industry.

Long-term sales permits have been negotiated with timber processors for South East Queensland hardwoods under 25-year sales permits to 2024, Western hardwoods under 15-year sale permits to 2030, with capacity for a rolling annual extension commencing from 2016, Cypress under 25-year sale permits to 2037, and Sandalwood under 5-year sale permits.

3. Overview of the current arrangements

Further information on the current supply commitments and pricing arrangements for coastal hardwood WSAs is provided in this section. This overview is based on a review of individual WSAs, background documentation provided by NSW DPI and FCNSW, including the NSW Government's *Project 2023 – North Coast Resources Review* (2014) and the Natural Resources Commission's *North Coast Timber Industry Issues Paper* (2015) reports, and discussions with key industry stakeholders.

3.1 South Coast and Eden WSAs

3.1.1 Current supply commitments

The South Coast and Eden WSAs are 20-year agreements entered into at the time of the Regional Forest Agreements (RFA) process in the late 1990s. The WSAs for the Eden Management Area will be the first to expire at the end of 2018, while the South Coast WSAs will expire at the end of 2020.

The RFAs, agreed between the Australian Government and state governments across commercial native forestry regions, sought to balance the competing economic, social and environmental uses of forests, deliver certainty of resource access and supply to industry, provide for ecologically sustainable forest management, and deliver an expanded and permanent forest conservation estate (Dept. of Agriculture 2015).

The expansion of the conservation estate ultimately reduced access to the resource for the existing forestry industry, and as such, the RFA process required major industry structural adjustment, which was accompanied by government funded regional development initiatives.

As a result, the provisions of the current WSAs reflect pre-existing arrangements, the prevailing Government policy at the time, and the outcomes of negotiations between the NSW Government and timber processors. The supply commitments were formalised by WSAs entered into by the NSW Government, the then Forestry Commission of NSW trading as State Forests, and its respective customers.

There are currently six Wood Supply Agreements (WSAs) on the South Coast, including two for the Eden Management Area and four for the South Coast. The WSAs are predominantly for High Quality Sawlogs (Large and Small), Low Quality Sawlogs and Pulp Logs.

There have been some transfers in ownership and some rationalisation during the current term of the agreements, notably the assignment of the Davis & Herbert Forestry Pty Ltd WSA to Allen Taylor & Co Ltd (Boral) in 2005 and the assignment of the South East Fibre Exports (SEFE) WSA to Allied Natural Wood Exports (ANWE) in late 2015.

Pressure from export markets to increase woodchip quality resulted in a change to the specifications for the pulpwood supply in the early 2000s. This change did not result in a formal amendment to the WSA for pulpwood, however, it has meant that subsequent supply volumes have been at the lower limit (i.e. 83%) of the allocation.

In early 2016, areas of State forests previously used to supply customers in the Eden Management Area were converted to flora reserves under the *Forestry Act 2012* and are now being managed for conservation purposes. The resultant shortfalls to Eden supply contracts have been made up via Parcel Sale Agreements from the South Coast, which will expire in line with the original WSAs. There is to be no net impact on either FCNSW or its Eden customer's businesses from this decision with the difference in supply costs to be subsidised via a grant

from the NSW Government's Environmental Trust. However, there will be resultant impacts to the South Coast supply area.

FCNSW has a current annual supply commitment of approximately 410,000 m³ of native hardwood products to WSA holders in the South Coast and Eden Management Area. A summary of the current supply volumes under WSAs by product type is provided in Table 1.

Table 1 Summary of supply volumes under South Coast and Eden WSAs

Product	Eden (m ³)	South Coast (m ³)	Notes
High Quality – Large	22,080	32,597	An additional 11,960 m ³ from the South Coast has been allocated to Eden via a Parcel Sale Agreement covering the period 1/1/2016 to 31/12/2018
High Quality – Small	1,920	5,750	An additional 1,040 m ³ from the South Coast has been allocated to Eden via a Parcel Sale Agreement covering the period 1/1/2016 to 31/12/2018
Low Quality Sawlog	20,000	19,100	Supply of the Eden Low Quality volume is non-compulsory
Pulpwood	273,000	35,000	The Eden volume represents 83% of the original contracted volume. The South Coast volume is not under WSA but may be included in the Eden WSA by annual negotiation.
TOTAL	317,000	92,447	

Source: Information provided by FCNSW

3.1.2 Future resource projections

While resource forecasting suggests that existing supply commitments can be met for the South Coast and Eden, the industry will face a reduction in total supply volumes beyond the term of the current agreements and a complete shift to a regrowth resource in the Eden Management Area (FCNSW 2016). The Eden resource is already transitioning from a multi-age resource to a predominantly regrowth resource and it is recognised that this supply shift will require new and potentially significant investment to retool sawmills to process the smaller log sizes (NSW Government 2016).

3.2 North Coast WSAs

3.2.1 Types of WSA

Hardwood supply arrangements on the North Coast typically fall under a number of different WSA types entered into by the NSW Government, State Forests, and its respective customers in the early to mid-2000s.

The negotiation of North Coast WSAs followed a number of government led processes throughout the 1990s that resulted in changes to the management of State forests and the way timber was allocated to the North Coast industry, which had historically been via annual quotas. These processes included the finalisation of the North East Regional Forest Agreement in early 2000 and a decision by the NSW Government in 2003 to transfer an additional 65,000 hectares of the North Coast State forests to the national park estate (NRC 2015).

In 2003, the NSW Government entered into direct negotiations with Boral to finalise a WSA for the supply of a fixed volume of High Quality Sawlogs. Additional supplies of High Quality Sawlogs were subsequently issued via Type A WSAs to a number of other sawmills that had historically received similar supplies through the annual quota system. The Type A WSAs were also fixed volume allocations, however, differed to that of the agreement with Boral, in that the Boral contract included species specific provisions whereas the other agreements included a schedule with indicative price zones where timber supplies may come from.

Following the negotiation of the Boral and Type A WSAs, available supplies of High Quality Small Sawlogs and other logs, such as specialised Poles, Piles and Girders were then allocated as Type B WSAs. Both Type A and Type B WSAs were for a term of 20 years and are due to expire at the end of 2023. The Type B WSAs, however, provide greater supply flexibility and allow for reviews in years 10 and 15 based on the most recent inventory data (FCNSW 2016).

Following the allocation of High Quality Sawlogs, a process was then undertaken to allocate quantities of Low Quality Sawlogs expected to be produced each year as a by-product of harvesting the High Quality logs. Volumes allocated under both Types C and D WSAs are based on a share of production, which may vary from year to year, such that the available volume is distributed equitably amongst customers (FCNSW 2016).

Type C volumes were generally allocated for terms of approximately 20 years using a number of different approaches, including tenders. Type C WSAs are also due to expire at the end of 2023. Type D WSAs were offered to companies who were unsuccessful in obtaining Low Quality Sawlog allocations via the Type C WSA processes. Type D WSAs are a lower priority supply than Type C WSAs and were entered into directly with the then Forestry Commission of NSW, i.e. the NSW Government is not a party to these agreements, for a period of 10 years. Type D WSAs expired at the end of 2015, however, it is understood that some of these have been extended for a further 12 months.

3.2.2 Project 2023 – North Coast Resources Review

During the first half of the WSA term, supply issues, particularly affecting High Quality Sawlog customers, began to emerge on the North Coast. In 2012 the then Forestry Commission of NSW was found to be in breach of both volume and species commitments to Boral and corrective action was sought. However, meeting the conditions of the Boral WSA would lead to changes in the species mix that other High Quality Sawlog customers had come to rely upon, based on both the indicative supply areas outlined in their WSAs and actual deliveries. Up until this point there had been little, or no, awareness amongst industry participants of the differences that existed in regard to species conditions between the Boral WSA and Type A WSAs, which had previously been held as commercial in confidence.

In response to emerging supply issues and more general concerns about the sustainability of timber supply on the North Coast to the end of the current WSAs, the NSW Government instigated the *Project 2023 – North Coast Resources Review* in May 2012 (NSW DPI 2014). A key conclusion of the review was that the while the total volume of High Quality Sawlogs, then a supply commitment of around 275,000 m³, could be maintained until the end of the WSAs, beyond 2023 the volume was predicted to decline markedly (NSW DPI 2014). The reduction in

supply would impact primarily on the highly desirable Blackbutt species, which was considered likely to remain the predominant commercial species.

The Project 2023 Steering Committee recommended to the NSW Government that the preferred option to address the High Quality resource sustainability on the North Coast would be to buyback 50,000 m³ per year of High Quality Sawlog allocation, including 40,000 m³ per year of Blackbutt. It was further recommended that this volume be recovered from Boral to reduce the impact of the buyback on the broader industry (NSW DPI 2014).

The NSW Government acted on the Steering Committee’s recommendations and FCNSW instigated the allocation buyback and renegotiation of Boral’s WSA, which was finalised in June 2014. The new agreement between FCNSW, the NSW Government and Boral provided a five-year extension to the original term of the agreement, i.e. to the end of 2028. The new agreement with Boral retained specificity around total supply and species volumes, and included a relative decrease in the less desirable New England species, and an increase in Boral’s pole allocation (NRC 2015).

3.2.3 Current supply commitments

Following changes that have occurred during the term of the current WSAs, FCNSW has a current annual supply commitment of approximately 450,000 m³ of native hardwood products to around 30 WSA holders on the NSW North Coast. A breakdown of the supply volumes by WSA type is provided in Table 2.

Table 2 Summary of supply volumes on the North Coast by WSA type

WSA Type	Volume (m ³)	Notes
Type A	59,523	Fixed volume allocations of High Quality Sawlogs
Type B	50,110	Available supplies of other High Quality Sawlogs including specialised Poles, Piles, Girders and High Quality (Small) Sawlogs
Type C	134,326	Allocation of Low Quality Sawlogs for up to 20 years
Type D	74,799	Subsequent allocation of Low Quality Sawlogs for initial 10 year term with some extensions
Other	132,025	Comprising 117,025 m ³ in High Quality and Low Quality Sawlog allocations, including Boral’s, and a 15,000 m ³ Pulp Log allocation
TOTAL	450,783	

Source: Information provided by FCNSW

3.3 Pricing arrangements

Pricing of log products is undertaken by FCNSW in line with the relevant provisions of the WSAs and the documented Price System (FCNSW 2010). There are generally three different pricing arrangements used for WSAs, being a delivered price, which is obtained from combining the stumpage price with a delivery charge, a fixed delivery price, calculated in a single process, i.e. without separately determining the value of the timber and the cost of delivering it, and a stumpage price that is used alone (FNSW 2010).

While there are documented pricing principles and methods, some conditions for review and general requirements to consult with customers in price setting, both stumpage prices and delivery charges are ultimately determined at the discretion of FCNSW. A summary of the pricing arrangements by customer or WSA type is provided in Table 3 below.

Table 3 Summary of pricing arrangements by WSA

Pricing method	WSA types	Price review conditions
Stumpage + Delivery	North Coast – Types A & B (HQ Sawlogs) North Coast – Boral South Coast – HQ & LQ	Stumpage price reviews are conducted by FCNSW in line with the Price System, which may be reviewed at any time nominated by FCNSW. Delivery charges are reviewed by the parties annually against relevant market rates for harvest and haulage and FCNSW’s administration costs. If no agreement is reached, FCNSW will determine the annual delivery charge. Major reviews of the delivery charge mechanism are to occur every five years in the case of North Coast Type A & B WSAs for HQ Sawlogs and South Coast WSAs for HQ & LQ Sawlogs. There is no contractual right to amend or replace the delivery charge mechanism for the Boral contract. Any amendment would have to be by agreement.
Delivered price	North Coast – Type A (Veneer) North Coast – Type B (Poles, Piles & Girders) North Coast – Types C & D (LQ Sawlogs) North Coast - Pulpwood	The delivered price is determined annually using a formula based on the relative changes in indicators for harvesting difficulty, haulage distance, timber product prices, wages and fuel. Major reviews of the delivered price mechanism should occur every 4 years, or every 5 years in the case of the North Coast pulpwood WSA. Any changes or replacement mechanisms are to be negotiated in good faith, however, FCNSW can determine the outcome in the absence of an agreement. Any changes are required to be in line with specified pricing principles.
Stumpage only	Eden WSAs	Stumpage pricing for the Eden HQ & LQ Sawlog WSA is conducted by FCNSW in line with the directions of the Minister and the principles and methods contained in the Price System. Stumpage pricing for pulpwood is conducted bi-annually and undertaken jointly by FCNSW and the customer considering a range of factors affecting the value of the timber. There is no requirement for major reviews other than by agreement of the parties. It is noted that Eden customers engage harvest and haulage contractors directly and as such, the levying of a delivery charge is not applicable.

Source: Information provided by FCNSW

As part of this review, FCNSW provided further commentary in respect to supply shortfalls and surpluses. It was noted that FCNSW is required to supply a specified annual quantity, or a specified share of production, except in the event of force majeure. On the customer side, all of the WSAs contain “take or pay” provisions, which typically require the customer to take or pay for a minimum of 90% of the annual quantity that FCNSW is required to supply. Further, use or lose provisions allow FCNSW to terminate a WSA if a customer takes less than 80% of the annual quantity for 2 consecutive years or less than 70% of the annual quantity in any one year.

3.3.1 Stumpage prices

As outlined in Table 3, the Price System is used to determine the stumpage price, otherwise referred to as the royalty from the value of the timber itself. One of the key principles relevant to stumpage pricing, is that price reflects value. That is, the price should reflect the value the market places on log products based on the customer's willingness to pay and recognise the differential that exists between log species, size, location and qualities, thus the State receives an appropriate share of the return generated from the resource.

FCNSW has provided stumpage prices per product for the South Coast and Eden, and the North Coast. Prices over the last ten years are shown in Figure 2 and Figure 3 respectively. It is noted that annual variations typically reflect annual changes in log size and species make-up.

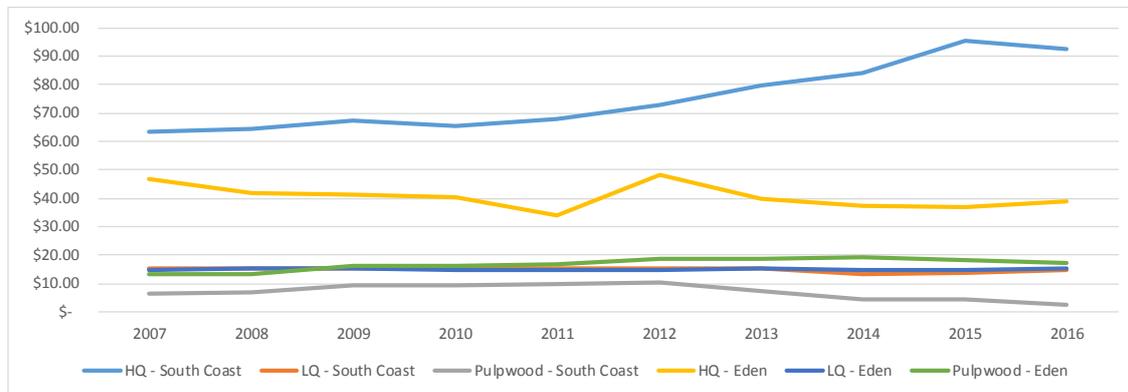


Figure 2 Stumpage prices per product (\$/m³) – South Coast and Eden (Source: FCNSW)

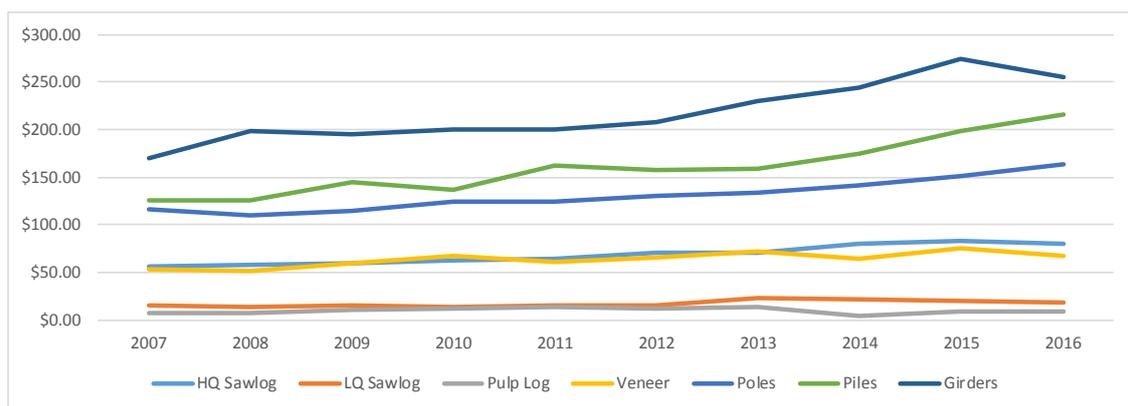


Figure 3 Stumpage prices per product (\$/m³) – North Coast (Source: FCNSW)

3.3.2 Delivery prices

Similarly, FCNSW has provided the delivery charges per product for the South Coast and North Coast, noting that there are no delivery charges applicable under the current contract arrangements for the Eden Management Area.

Delivery charges by product for customers on the South Coast and North Coast for the past ten years are shown in Figure 4 and Figure 5 respectively.

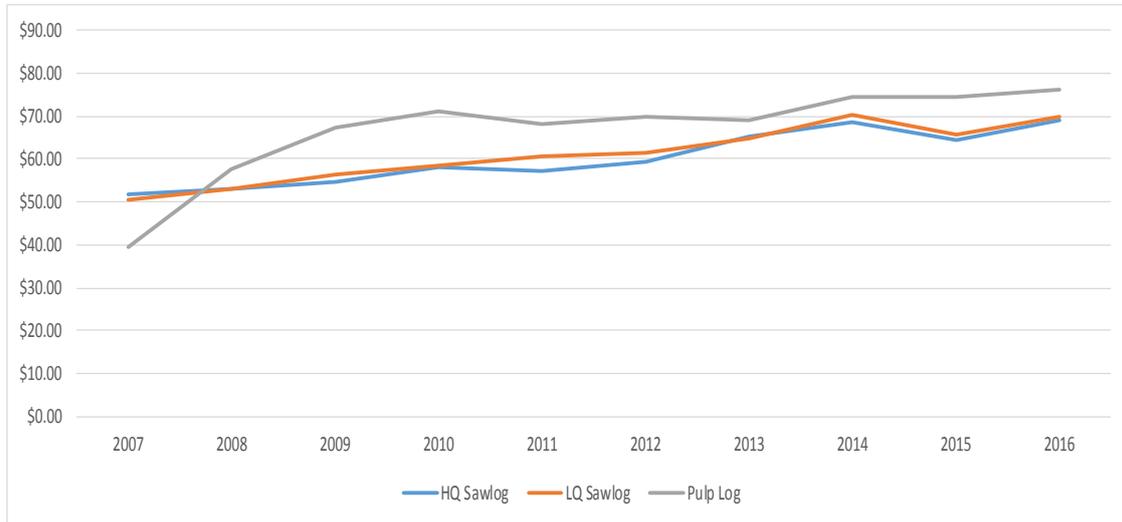


Figure 4 Delivery charges per product (\$/m³) – South Coast (Source: FCNSW)

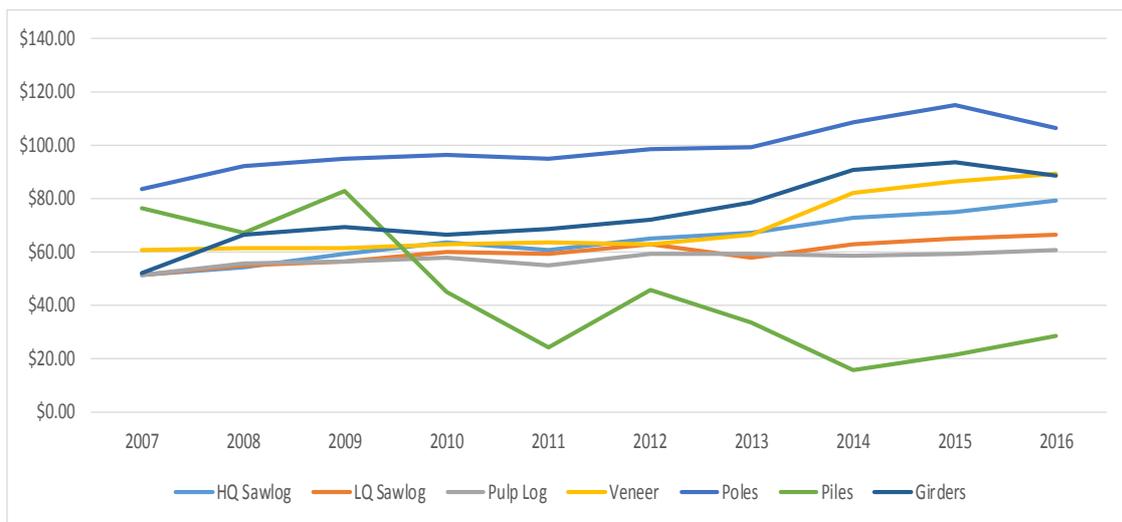


Figure 5 Delivery charges per product (\$/m³) – North Coast (Source: FCNSW)

4. Issues raised in consultation

GHD has undertaken consultation with key stakeholders to inform the review of coastal hardwood WSAs, including consultation with FCNSW, its customers and peak industry group Timber NSW. The list of consultation activities undertaken as part of this review is provided in Appendix B. Attempts were made to contact all customers to allow them to contribute to the review by email, telephone or face-to-face discussions. The consultations were based on a semi-structured interview approach using the scope of the review, which was provided to stakeholders in advance, to guide the discussions. Some stakeholders provided written responses to supplement verbal responses provided at the face-to-face meetings. A summary of stakeholder feedback and the key issues raised in consultation is provided in this section.

4.1 Allocation of hardwood timber resources

Recognising the historical context of the agreements, stakeholders were broadly supportive of the WSAs per se, however, raised a number of issues in relation to implementation and administration of contract provisions and broader concerns regarding resource security.

The feedback received on specific components of the current WSAs is summarised in Table 4 in section 4.3. Broader concerns regarding resource security and allocation are discussed below.

4.1.1 South Coast and Eden

For the Eden Management Area in particular, the transition to a greater reliance on smaller log sizes beyond 2018 is a primary concern for FCNSW and its customers. FCNSW has undertaken and shared modelling with its South Coast and Eden customers for the period beyond the terms of the current WSAs. The headline forecasts suggest that the industry will also face adjustment to a reduction in timber supply beyond 2018.

South Coast and Eden customers currently source the majority of their timber from FCNSW and many of the businesses report to be operating below capacity. As such, it was felt that further reductions in supply would require some adjustment to their businesses, including efforts to source timber from other areas. The Eden woodchip business, ANWE, is already sourcing timber from plantations and considers this an area for expansion in the longer-term.

The Eden sawmill, in particular, faces major challenges in transitioning to a smaller log size with redevelopment of one of its two processing lines required to process the 'super small' log class. So far the required technology is untested in Australia on hardwood regrowth logs of the species and quality expected from the Eden forests. Considerable investments are required in the short to medium term to determine the feasibility of the required redevelopment with no certainty of success. However, the existing sawmill operated by Blue Ridge Hardwoods has established markets and detailed experience with the resource and is considered well placed to undertake this investment experiment.

The recent decision to declare an area of State forest in the Eden Management Area as a flora reserve to provide habitat for a koala colony was highlighted as an example of government decisions that compromise the security of supply commitments to timber processors. Further concern was noted in regards to the potential third party impacts of this decision, given that the resultant shortfall in supply to Eden customers is being made up through short-term Parcel Sale Agreements from the South Coast. It was felt that this decision has led to inefficient allocation of resources from the South Coast, where the increased delivery costs associated with hauling logs from a greater distance are being subsidised by the NSW Government. Further, there is concern that the decision may have placed the sustainable management of the South Coast resource in jeopardy.

4.1.2 North Coast

Major issues were raised from stakeholders in relation to the transparency, equity, fairness and efficiency of the allocation of hardwood timber resources on the North Coast. These concerns related predominantly to the differences between the Boral contract and other WSA holders for High Quality sawlog allocations and the impact this is having on supply areas and species mix.

Prior to the release of the details of the 2003 Boral contract through State freedom of information processes in 2012, stakeholders claimed to be unaware of the difference in species provisions between the Boral contract and other High Quality sawlog customers. Up until this point, non-Boral customers were generally satisfied with their supply mix from the indicative areas provided in their WSAs, however, supply of these volumes was ultimately found to be unsustainable and in breach of the then Forestry Commission's supply commitments to Boral.

A number of customers provided evidence of the subsequent and necessary changes to their indicative species mix, which is having resultant impacts on their business viability. These impacts typically included:

- A decrease in supply of the preferred species, including Blackbutt and Spotted Gum, required to meet contractual obligations to Boral
- An increase in the less desirable species, particular the New England tableland species following the closure of the Walcha sawmill
- Increasing delivery charges as supply is required to be met from harvesting of forests further away from their respective businesses, and
- Lumpy monthly deliveries in terms of both total volume and species mix.

There was a strong industry view that the situation with the Boral contract is stifling innovation and making the rest of the industry uncompetitive. While a number of customers indicated that they have concerns over their viability under the current supply arrangements, few indicated a desire to exit the industry. Rather, a number of customers indicated that they are currently operating below capacity and should the resource be available, they would like to expand their current operations.

4.2 Roles of the NSW Government, FCNSW and customers

Stakeholders were asked their views in relation to the appropriateness of the roles of the NSW Government, FCNSW and its customers in negotiating, entering into and renewing WSAs, including transferring timber supply rights. It was noted that there is no longer a requirement for the NSW Government to be a signatory to agreements with FCNSW able to enter into business to business contracts directly with its customers.

Despite this allowance, and potential simplification of the process, customers typically indicated a preference for the three interests to remain party to the agreements. This preference was mainly associated with a means to managing sovereign risk. It was also suggested the NSW Government provided a third-party intermediary between the commercial entities. There was a strong feeling amongst the majority of customers consulted as part of this review that since its corporatisation, FCNSW had put its commercial objectives above the interests of many of its customers and regional development imperatives. The apparent breakdown in trust was also closely linked to the renegotiation of the Boral contract on the North Coast in 2012.

4.3 Key components of WSAs

GHD sought feedback from stakeholders on the key components of WSAs in their current form. A summary of the responses is provided in Table 4 below.

Table 4 Summary of stakeholder feedback on components of WSAs

Component of WSA	Stakeholder feedback and issues raised
Term	<p>Customers indicated a clear preference for longer term contracts, i.e. up to 20 years. There were also a number of suggestions that the agreements provide renewal options effectively provide rolling contract terms. On the other hand, FCNSW indicated a preference for shorter term contracts, i.e. up to 10 years.</p> <p>The preference for longer term contracts tended to be linked to investment certainty and financing arrangements. It was noted that investment winds down considerably within the last five years of an agreement. A number of stakeholders also indicated that they considered longer term supply contracts a means of managing sovereign risk, even though in reality, the term of existing agreements has not protected the industry from government decisions affecting land tenure in the past.</p> <p>It is noted that there were customers on the North Coast who indicated that they may not remain viable for the remaining term of their agreements under current supply arrangements.</p>
Shortfall conditions	<p>Customers generally understood the need to have shortfall conditions although there was some difference in the suggested +/- allowances. While it was generally agreed that an allowance for annual variations in the order of +/- 10% is reasonable, there was a suggestion that with appropriate accompanying notice provisions, variations of up to +/- 20% could be managed.</p> <p>A number of customers on the North Coast indicated issues with the provision of Annual Delivery Plans and Monthly Delivery Schedules, with little confidence expressed in both the timeliness and accuracy of the information provided by FCNSW.</p> <p>These customers further indicated that unscheduled make-ups and delivery spikes arising from previous delivery shortfalls had flowed on to problems with billing practices and cash flow management, which in turn, had adversely affected future deliveries.</p>
Log price (stumpage)	<p>There was reasonable support for The Pricing System from stakeholders, although many felt that it could be simplified and transparency improved. A number of customers suggested that annual increases could be linked to CPI increases with a five yearly review and reset applied at this point if it was found to be warranted.</p> <p>There was a good general awareness of the pricing review that is currently underway, and although there was concern expressed with the timeliness of the current review, it was generally acknowledged that a five yearly review timeframe is appropriate.</p>

Component of WSA	Stakeholder feedback and issues raised
<p>Log price (stumpage)</p> <p><i>Continued</i></p>	<p>Some stakeholders did, however, question the appropriateness of FCNSW’s role as both the “judge and jury” in respect to pricing decisions. It was highlighted that the open-ended nature of royalty pricing is a considerable business risk for customers.</p> <p>On the South Coast, it was noted that the Pricing System will need be amended to include a new small log category (i.e. 25-30cm) and to better align pulp log pricing to its export markets.</p>
<p>Log price (delivered)</p>	<p>Customers in the Eden Management Area noted their satisfaction with their current pricing arrangements and highlighted the importance of the integrated nature of their supply. They expressed a preference for continuing to directly engage contract harvest and haul, and therefore a FCNSW delivery charge is not applicable.</p> <p>In regards to the South Coast, the view was expressed that the current pricing arrangements do not provide an incentive for FCNSW to manage its delivery costs.</p> <p>On the North Coast it was noted that FCNSW has entered into a new haulage contract, which aims to create delivery efficiencies.</p> <p>A number of customers indicated “teething issues” with the new arrangements. Further, many questioned the appropriateness of Boral’s contract management role for the new haulage consortium suggesting that it gives them a potential supply advantage over other customers. It was highlighted that this perception was causing further angst and mistrust amongst the industry when considered in the context of the already differing WSA provisions between Boral and other North Coast High Quality sawlog customers.</p> <p>Many High Quality sawlog customers indicated a preference for total fixed price, calculated annually with review options similar to that applied to softwood customers.</p>
<p>Total supply level</p>	<p>South Coast and Eden customers have been made aware of a total reduction in both supply volume and log size beyond the term of the current WSAs and there is recognition that any new agreements will need to reflect the change in resource specifications.</p> <p>The reduction in volume is a concern for the existing businesses, who are currently operating below capacity. It is acknowledged that there will be adjustment challenges for businesses, in particular, the saw mill operation in Eden.</p> <p>Supply concerns on the North Coast more typically related to log quality, species mix and scheduling rather than total volume.</p> <p>Despite assurances that FCNSW is able to meet its future supply volumes on the North Coast, most customers indicated a lack of confidence and/or awareness of FCNSW resource projections.</p> <p>Customers on both the North and South Coast raised concern that areas of forest are being over cut in some instances to manage supply commitments.</p>

Component of WSA	Stakeholder feedback and issues raised
<p>Log quality and species mix</p>	<p>As previously noted, Eden customers are experiencing a transition to a smaller log size. The future challenges presented by this transition were discussed and it was reiterated that the technology required to process a 'super small' class of sawlog not yet developed.</p> <p>Some salvage log customers on the North Coast also indicated that reductions in log sizes is becoming problematic to their businesses. There was a view that specifications on salvage logs need to be reviewed.</p> <p>Relative changes in species mix, however, was the primary issue raised by customers on the North Coast. Non Boral sawlog customers are now receiving a greater proportion of the less desirable species, and the New England Tablelands species in particular, and a lower proportion of the more desirable species, including Blackbutt and Spotted Gum.</p> <p>Concern was expressed that the change in species does not align with the indicative price zones outlined in their WSAs and to which their businesses, in terms of processing capacity and markets, were developed. A number of customers indicated that they will struggle to remain viable for the remainder of the contract period under the current supply arrangements.</p> <p>There is a strong feeling of inequity amongst the industry in relation to Boral's species specific provisions and that the original granting of these provisions lacked both accountability and transparency.</p> <p>Changes in markets and supply of pole logs over the term of the current agreements has also meant that some rationalisation is likely to be required for this product.</p>
<p>Supply areas</p>	<p>Concern was expressed in relation to the current supply of Eden customers from South Coast forests following a decision earlier this year by the NSW Government to declare a new area of flora reserve in the Eden Management Area. It was suggested that the supply arrangements are leading to cross-subsidisation and third party impacts on resource sustainability.</p> <p>Further it was noted that FCNSW have struggled to undertake efficient harvesting in the foothills of the South Coast supply areas, and as a result, are tending to harvest the "easier" coastal areas at rates above long-term sustainability.</p> <p>There is a view that supply issues on the South Coast need to be addressed before the end of the current term in 2020. There was a further suggestion that the South Coast region could be managed as a single supply zone in the future.</p> <p>On the North Coast, many customers noted changes to their indicative supply areas as a result of FCNSW's contractual obligations to Boral. A number of customers provided evidence of considerable price increases as a result of supply moving further away from indicative areas.</p>

Component of WSA	Stakeholder feedback and issues raised
<p>Supply areas</p> <p><i>Continued</i></p>	<p>Coupled with a decline in supply of the more desirable species, the price impact was highlighted as “a double hit” to customer viability. Some customers expressed concern that FCNSW is selling logs that should be used to meet existing supply commitments to customers without WSAs.</p>
<p>Take or pay clauses</p>	<p>Customers were generally accepting of the need for take or pay clauses to manage FCNSW supply risks, however, indicated that the issue of resource security is paramount.</p> <p>Further, customers suggested that the risk is not appropriately shared as there is no equivalent ‘supply or pay’ clause</p> <p>There was discussion around whether take or pay clauses have ever been enforced. It was suggested that clearer direction on this could be provided for those customers who may be seeking to exit.</p>
<p>Review mechanisms</p>	<p>There is interest in improving resource security through review and renewal options.</p>
<p>Price discovery</p>	<p>FCNSW has expressed an interest in exploring options to make some of its resource contestable, however, acknowledge limitations for the South Coast and Eden Management Area in particular, in terms of market depth and existing supply pressures.</p> <p>While ANWE currently own the infrastructure supporting the regions export capacity for the pulpwood resource, there may be competition / alternative options for redeveloping the existing sawmill business to meet the changing resource projections.</p> <p>On the North Coast, customers provided examples of a functioning secondary market for some products. Some customers noted that lack of information can be an impediment to such markets.</p> <p>Customers generally expressed caution in relation to market-based allocation processes such as auctions. There was also a view expressed that making a proportion of the product contestable will not give a true indication of the value of the product as it is being purchased at the margins.</p>

5. Key findings

GHD has undertaken an independent review of existing coastal hardwood WSAs, relevant background information, including FCNSW supply and sales data, and sought feedback from key stakeholders, including FCNSW, its customers and industry body Timber NSW. The key findings from our review are outlined in this section.

5.1 Effectiveness of allocation of hardwood timber resources

5.1.1 South Coast and Eden

GHD found that the current supply arrangements have supported a viable hardwood timber industry on the NSW South Coast over the term of the current agreements. The 20-year agreements, along with structural measures implemented at the time, supported the necessary redevelopment of processing facilities across the region to align with resource availability.

Wood supply over the term of the agreement has not been without its challenges, however, and changes to both volume and make-up have occurred that have not been reflected in the WSAs. For example, early changes to the supply specifications for the Eden pulpwood allocation were not formalised through an amendment to the WSA.

Existing customers have indicated their commitment to the South Coast industry beyond the term of the current WSAs but will face challenges as a result of predicted reductions in the volume of supply and in transitioning to a smaller log size in the Eden Management Area. Significant reinvestment in sawmill capacity will again need to take place (either from the existing customer or a new party) beyond the term of the current agreement.

It is likely that the term of any future agreement will need to be long enough to provide security to customers to undertake this investment and achieve returns over a planned payback period. Similarly, any new agreement will need to consider appropriate review clauses such that should the venture prove unviable, the resource can be put back to the market.

We note that shortfalls in supply in the Eden Management Areas as a result of recent expansion of the State's conservation area is being met by supply from the South Coast subregion. We consider that this arrangement is neither economically or environmentally sustainable in the future due to the price differential in supply and the potential impacts on the resource and other WSA holders in the South Coast subregion.

5.1.2 North Coast

GHD found that the supply process established in 2003 was largely based on the supply of logs as they were produced, using "run of the bush" averages. This method does not suit the current markets and customer business models. A reliable, distributed supply of timber of known species and quality is required to allow customers to run profitable businesses.

Balancing the uncertainty of what timber will be produced from the compartments approved for harvest, monthly, quarterly, annually and over five years with the reliable supply required by customers over the same period is the fundamental challenge for the WSA issuance and management. One option to address this challenge could be the use of log merchandising yards.

We found that there are particular issues around equity and efficiency of allocation of high quality sawlogs on the North Coast. While it is acknowledged that the renegotiation of the Boral WSA in 2014 was undertaken through best endeavours to minimise disruption to the broader industry, and to achieve the least cost buyback of allocation to return the industry to long term

sustainability, it is not clear why the species specific provisions were included in the original Boral contract in 2003.

It is generally accepted commercial practice that businesses may enter into different supply and sales arrangements with different customers, however, this is generally the case when it can be determined that there is a commercial advantage from doing so. During the course of this review, GHD has not been advised of a clearly documented rationale for the allocation of species specific conditions to any one customer in 2003, nor did the original allocation of Type A WSAs rely on a market-based approach to determine best value options against a pre-determined set of criteria.

Similarly, there is no price premium available under the current Price System from which FCNSW and the State of NSW can recover increased value from providing a premium supply to any one of its customers. Rather, it is argued that FCNSW incurs higher transaction costs in meeting species specific contract provisions and that the overall efficiency of the industry is reduced as volume commitments to other customers are required to be sourced from supply areas that are further away from their processing facilities.

On the other hand, it is noted that the buyback of resource from Boral resulted from the NSW Government's *Project 2023 – North Coast Resources Review* (2014), which includes a clearly documented process, consideration of options, and a recommendation. Whilst the buyback for 50,000 m³ is considered to have returned the North Coast hardwood industry back to long term sustainability, it has not addressed the issue of the most efficient and equitable allocation of species amongst its customers.

A buyback of WSAs could be considered as a precursor to a reallocation of the resource. The resource allocation removed from the existing market could be used to adjust the available resource levels and allow for greater redistribution or even new entrants. The effective allocation of the New England resource could be considered at this time and during a buyback process. GHD considers that an allocation in the order of 15,000 m³ might be adequate for a buyback to adjust for all these considerations and potentially rationalise the industry or allow a new entrant, however, this would be subject to the development of a full business case.

We found that the pole market on the North Coast also needs special consideration. Pole supply arrangements are structured to account for the full range of pole sizes that are produced on average from the range of harvesting compartments. In 2003, utility companies purchased a range of pole sizes matched to this availability. Today, utility companies only want to buy the poles matched to the risk profile to transmission lines. They no longer want to buy poles larger and more expensive than those calculated to meet the risk managed thresholds. The key size poles cannot be supplied in sufficient numbers to suit all four pole buyers. The utility companies have indicated they would prefer only two suppliers and greater volumes of the key size poles to be produced.

5.2 Appropriateness of roles of the respective parties

Sovereign risk remains a realistic concern for the coastal hardwood WSA holders. These risks are partially controlled now by having the State of New South Wales as a signatory to the WSAs. The new legislative framework since the creation of FCNSW allows business to business contracts for the supply of log resources. This however will leave customers and FCNSW exposed to the sovereign risk of unexpected and unplanned resource withdrawals to create land tenure changes for perceived biodiversity benefits.

The legislative and certification frameworks that apply to FCNSW require them to simultaneously provide timber and biodiversity values, however, this process is compromised when land tenure changes are imposed on the integrated landscape. A replacement risk control

for unplanned resource withdrawals will be required if the WSAs are to be established as business to business contracts.

Periodic testing of the market to determine willingness to pay and value is worthwhile in an ideal arrangement. The sale of non-critical resource by public tender should be considered. There is an over-capacity in the existing industry so nearly all the resource could be considered critical to maintaining the existing industry. Open sales will most likely be applicable to uncommitted resources such as pulp and salvage logs and any returned volumes of high quality logs.

We consider that direct business to business negotiations via way of private treaty can provide an effective way of allocating the available resource where a known or limited market exists, for example, the supply of pulp logs for export from the Eden wharf. Such an approach can reduce transaction costs and provide investment security for both FCNSW and its customers.

The accountability and transparency of private treaty contracts can be improved by clearly documented policies and procedures at the outset, including separation of approval functions. Appointment of an independent arbitrator could also be considered to assist improve transparency and accountability of the process as well as provide a 'level playing field' where there is a perceived imbalance of power in contract negotiations.

5.3 Appropriateness of WSAs in their current form

GHD has undertaken a comprehensive review of the existing contract provisions in the various WSAs. We have found that the WSAs contain a number of important and enduring clauses that are generally well supported by FCNSW and its customers.

New terms will be required in future contracts to redefine the relationship between buyer and seller as a business to business sales agreement and to reflect changes to resource volumes and species mix arising from future allocation processes.

Timber NSW has asked for the replacement WSAs to provide equity, fairness and transparency. GHD believes that the allocation processes should be tested to provide these values but that the resultant sale contracts be based on what is best for the individual buyers and their supplier consistent with the requirements of the *Forestry Act 2012*.

More detailed information is provided on our review of WSAs, including clause by clause commentary, in Appendix C. Appropriate legal advice should be sought in drafting the template sale contract for future timber allocations. It is advised that in the interests of transparency, the template sale contract be made publicly available.

It is our view that clearly specified and secure supply rights will encourage the necessary competition, innovation and development required for a viable industry into the future.

6. Recommendations

As part of the scope of this review GHD was asked to consider whether changes to the pricing methodology or mechanism for allocating timber supplied by FCNSW should reasonably be expected to improve the efficiency and equity of resource allocation.

As outlined in section 5, and in line with the findings from a number of recently completed reports relating to the coastal hardwood timber industry, GHD has found that there a number of current issues with the efficient and equitable allocation of coastal hardwood timber supplies.

Taking these issues into account, GHD provides the following recommendations that the NSW Government and FCNSW could consider in the future to improve the current approach to allocation and pricing of hardwood timber resources.

6.1 Overarching

1. GHD recommends that FCNSW create a marketing strategy for all supply regions that describes the future markets and customer base it needs and a transition to those conditions. It is our view that FCNSW needs a range of profitable customers to reliably buy all of the products generated from its forests. An ideal marketing strategy would balance the needs of the customers with the needs of the resource supplier. It would also allow for the entry of new and innovative customers that can maximise the value of the log resource. The marketing strategy should establish the principles and set the parameters that will apply to the issuance and management of future sale contracts, including:
 - Timing of future contract expiries (i.e. synchronised, aggregated or rolling renewals), and
 - Customer treatment (i.e. determine that sale contracts can be tailored to the needs of individual customers if the process to do so is equitable, fair, transparent and accountable).
2. We recommend that a review of the future resource availability in the South and North Coast supply areas in terms of indicative grade, species and location is undertaken. The resource available in both the next five-year period and the future five-year periods needs to be estimated by FCNSW and made available to the industry.
3. We recommend that FCNSW create a resource allocation model that allows the evaluation of delivered prices to existing and potential customers. The model, based on the reviewed resources available by grade, species and location (price zones or aggregates of price zones), can then be used to compare delivered prices of competing proposals for common resource types to determine the most valuable offer to FCNSW, the State and the timber industry.
4. We recommend that FCNSW create a template sale contract to be used as the basis of future sales. The sale contract will retain the important and enduring clauses from the current WSA (refer Appendix C) and include the new terms required to define the relationship between buyer and seller as a business to business sales agreement. The negotiable clauses should be identified and referred to in schedules. The negotiable terms would include allocation, grade, species or species group, price zones, term, renewal provision, and failure to supply or buy provisions. Appropriate legal advice should be sought in drafting the template sale contract and it is advised that in the interests of transparency, the template be made publicly available.
5. We recommend that FCNSW design a Request for Proposal (RFP) process that provides an identified resource statement to proponents, who then submit proposals to buy that

resource on an offer of quantity by quality grouping (grade and species), tenure, and delivered prices. The process should rank the proposals by value against a set of predetermined criteria and proceed to negotiate and finalise outcomes for new sale contracts to ensure the complete sale of the resource.

Specific recommendations for the South Coast and Eden Management Areas and the North Coast are provided below.

6.2 South Coast and Eden

6. On the basis that the Eden woodchip business, ANWE, currently own the infrastructure supporting the regions export capacity, we recommend that FCNSW begin direct negotiations with ANWE for the issuance of a sale contract for pulp logs for at least 10 years from the expiry of the current WSA. It is noted that these negotiations can occur under clause 5.2 of the existing WSA.
7. Given the relative uncertainty that exists in the processing capacity for the expected future sawlog resource, the need for procedural fairness and the interactions between the supply areas, we recommend that FCNSW call for a RFP from the current industry and potential new proponents for the sale of sawlogs of all grades, including the super small grade from the South Coast and Eden Management Areas. Negotiations with proponent should commence with the objective of finding profitable buyers for all of the available resource from 2018 and 2020 in the two supply areas.

We note that the NSW Government will need to acknowledge that the profitable processing of the 'super small' sawlogs is not assured and that industry rationalisation may have to occur. While government intervention is not recommended, GHD considers that a policy framework is required to allow a full range of suitable buyers to be found for all of the resource available. It is recommended that opportunities for innovation and new players should be considered along with exports from the port of Eden. Review decisions relating to the successful allocation of the resource will be required about every five years.

6.3 North Coast

8. Having considered the issues that currently exist on the North Coast and the time remaining to the expiry of current WSAs, GHD recommends that the NSW Government consider a further WSA buyback to reduce the current allocation. We consider that a voluntary buyback would assist:
 - Reduce current resource commitments
 - Create a resource that could be put back to the market of the species, locations and grades that are actually available
 - Allow industry rationalisation that is orderly and dignified, and
 - Provide some recourse to business affected by previous Government decisions that resulted in the disparities in the original WSA processes in the early 2000s.

GHD has reviewed the current North Coast supply commitments against delivery volumes by species and concludes that a buyback in the order of 15,000 m³ is targeted.

There are two options that should be further considered for undertaking the buyback:

- A reverse auction where agreement holders tender a price per cubic metre to surrender part or all of their WSA allocation. The lowest tenders are accepted up to the point the target quantity is reached.

- A fixed offer of \$300 per cubic metre be offered to all agreement holders on a first in basis. The cost of this option is capped at \$4.5M.

A detailed business case and risk assessment is required to support the selection of a preferred option.

9. Should the NSW Government consider that a voluntary buyback process is not supported, we recommend that FCNSW advise customers considering retiring part of all of their allocation that the wavering of the take or pay option would be favourably considered.

We recommend that future allocation of the available resource proceed on the following basis:

- FCNSW begin negotiations with holders of Type D WSAs under clause 4.2 for a renewal of the agreement until December 2023 for allocations that are known to be available and for grades similar to the current WSAs.
- FCNSW call for a RFP from the current industry and new proponents for the sale of all grades of timber including residual grades for the periods after 2023 from the North Coast supply area.
- FCNSW takes no direct action to intervene in the operation of the current Boral WSA given its extended term.

We suggest that FCNSW use the current price review process and the results of the RFP process to determine willingness to pay for the desirable and undesirable species and use this information to inform price reviews on all of the current WSAs.

10. Finally, we recommend that a separate reform project to be led by FCNSW is required to review and adjust the pole industry. The objectives of the project should be to:
 - Guarantee the ongoing viability of a pole industry
 - Review supply options to optimise production
 - Review pole specifications to better match them to the market's needs
 - Simplify the price schedules
 - Involve the existing pole industry in the identification of reforms, and
 - Plan a RFP process tailored to the pole market to ensure a fair but competitive allocation of the resource.

7. References

ABARES (2013) [Online] www.agriculture.gov.au/abares/forestsaustralia/sofr/sofr-2013

Department of Agriculture (2015) *Regional Forest Agreements – an overview and history*, Canberra, Australia.

FNSW (2010) *The Price System, NSW Native Forest and Hardwood Plantation Pricing System*. Forests NSW, Sydney. June 2010.

FCNSW (2015) *Annual Report 2014-15*. Sydney. October 2015.

FCNSW (2016) *Forest Management Plan for the Coastal Forests of NSW*. Hardwood Forests Division, Sydney.

Forestry Act 2012 (NSW)

Natural Resources Commission (2015) North Coast Timber Industry Issues Paper – Confidential.

NSW Department of Primary Industries (2014) *Project 2023 – North Coast Resources Review*. [Online] Available: http://www.dpi.nsw.gov.au/__data/assets/pdf_file/0013/520042/north-coast-timber-supply-summary-north-coast-forestry-resources-review.pdf

NSW Government (2016a) *NSW Forestry Industry Roadmap* [Online] Available: <http://www.dpi.nsw.gov.au/land-and-water/forestry/nsw-forestry-industry-roadmap>

NSW Government (2016b) *NSW Forestry Industry Roadmap – What does it mean for the South Coast forestry industry?* [Online] Available: <http://www.dpi.nsw.gov.au/land-and-water/forestry/nsw-forestry-industry-roadmap>

NSW Government (2016c) *NSW Forestry Industry Roadmap – What does it mean for the North Coast forestry industry?* [Online] Available: <http://www.dpi.nsw.gov.au/land-and-water/forestry/nsw-forestry-industry-roadmap>

VicForests (2016) [Online] Available: www.vicforests.com.au

Appendices

Appendix A – Scope of the Review

- Review current coastal hardwood Wood Supply Agreements (WSAs) to determine whether they are effective in achieving an efficient allocation of NSW hardwood timber resources, considering particularly the issues of:
 - i. transparent, equitable and efficient allocation of resources to timber processors;
 - ii. facilitating industry resource security and industry competition, innovation and development;
 - iii. achieving the best commercial outcomes for the Forestry Corporation of NSW (FCNSW) and the State;
 - iv. ensuring commercial risk is appropriately shared between FCNSW and its customers; and
 - v. facilitating harvesting in state forests that is consistent with maintaining a sustainable forest resource over the short, medium and long term.
- Evaluate the processes to develop WSAs to determine whether they reflect contemporary commercial best practice, with particular focus on reviewing:
 - i. the appropriateness of the roles of NSW Government, FCNSW and FCNSW customers, for negotiating, entering into and renewing WSA and transferring timber supply rights; and
 - ii. the appropriateness of the components of WSAs in their current form in comparison with contemporary commercial best practice, including:
 - term,
 - shortfall conditions,
 - log price (stumpage),
 - log price (delivered),
 - total supply level,
 - log quality and species mix,
 - supply areas,
 - take or pay clauses,
 - review mechanisms and
 - price discovery.
- The consultant will consult with FCNSW, its customers and relevant key industry stakeholders including Timber NSW. The details of the stakeholder consultation should form an Appendix to the final report.
- The review should also make recommendations on whether changes to the pricing methodology or mechanism for allocating (e.g. auctioning or other forms of market based allocation) timber supplied by FCNSW should reasonably be expected to improve the efficiency and equity of resource allocation.
- A confidential draft report shall be provided for consideration to the Minister for Primary Industries, ahead of a final report being prepared for public release.

Appendix B – Consultation Schedule

Customer consultation

South Coast and Eden

Company	Face to Face	Phone	Date
Allied Natural Wood Exports	✓		20 September 2016
Blue Ridge Hardwoods Pty Ltd	✓		20 September 2016
Boral Timber – Davis and Herbet	✓	✓	27 September 2016 17 October 2016
Romney Park Sawmill Pty Ltd		✓	

North Coast

Company	Face to Face	Phone	Date
Adams Sawmills Pty Ltd	✓		19 October 2016
Albert Johnson Pty Ltd	✓		19 October 2016
Aquafern Pty Ltd	✓		18 October 2016
Australian Ironwood Antique Timbers Pty Ltd		✓	26 October 2016
Big Rivers Timbers	✓		18 October 2016
Boral Timber	✓		17 October 2016
Coffs Harbour Hardwoods Pty Ltd	✓		19 October 2016
Cooper Timber Pty Ltd	✓		19 October 2016
Hayden Timbers Pty Ltd	✓		18 October 2016
Henson Sawmilling Pty Ltd	✓		18 October 2016
Hurford Resources Pty Ltd	✓		17 October 2016
J Notaras & Sons	✓		6 October 2016
Kempsey Timbers (Sawmilling) Pty Ltd	✓		5 October 2016
Koppers Wood Products Pty Ltd	✓		18 October 2016
Leonard J Williams (Timber) Pty Ltd	✓		19 October 2016
Machins Sawmill Pty Ltd		✓	19 October 2016
Pilliga Natural Timbers		✓	17 November 2016
RA Sweetman & Sons Pty Limited	✓		26 October 2016
SA Relf & Sons Pty Ltd, Newells Creek Sawmilling Co. Pty Ltd	✓		19 October 2016
WeatherTex Pty Ltd	✓		19 October 2016

Key stakeholder meetings

Activity	Face to Face	Phone	Date
North Coast Industry Briefing – Kempsey	✓		5 October 2016
North Coast Industry Briefing – Grafton	✓		6 October 2016
NSW DPI and FCNSW Draft Findings Workshop	✓		2 November 2016
Timber NSW	✓		7 November 2016
Stuart Coppack for Timber NSW		✓	10 November 2016

Appendix C – Review of WSA Conditions

Type A – non Boral

Clause	Current requirement	Comment	Proposed change
1. Parties	The Forestry Commission The "Company" The State of New South Wales	FCNSW has a principle function to sell or supply forest products.	Make the agreement business to business binding two parties, FCNSW and the "Company".
2. Definitions and Interpretation	Lists definitions and standard interpretations.	Needs updating.	Revise definitions to match new WSA and update interpretations.
3. Scope of Agreement	Statement of Company's business and obligation to accept and pay for Timber supplied. Obligation to make Timber available. Obligation of the State of NSW to ensure State Forests has sufficient resources to make Timber available.	Recitals or scope are fundamental to an agreement. This clause was also to manage sovereign risks.	Use a scope or recital clause. An alternative sovereign risk statement is required that quotes the Forestry Act 2012
4. Duration of Agreement	Nineteen and a half years. Company can apply for a renewal to be negotiated in good faith. Assignment results in new agreement.	Renewal clause has been evoked without success.	Duration could be negotiable on assignment. Do not use half years. Renewal should be offered but in a stand-alone clause.
5. Allocations	Allocations must be made available to the Company. Conditions apply to supply made available from outside the Area of Supply. Indicative proportions of the supply by price zone are acknowledged. Annual supply can be plus or minus 10%. Cumulative undercuts or overcuts must less than 10% of the Allocation. Notice periods for variations are specified. Total supply not to exceed Total Allocation.	Allocations specify only log quality and size in most agreements.	Allocations could include species. Variations of plus or minus 20% may be required to manage the risk of supply of species based allocations.
6. Substitution	Small logs can be substituted for large logs if available. Large logs can be substituted for small logs if unavailable. The calculation of shortfall prices are determined.	Substitution rules will be required.	Include substitution rules for species allocations. Shortfall price setting should be in clause 7.
7. Shortfall	Allocation not taken according to the rules is forfeited which may be resold and comes off the Total Allocation. Allocations not taken below thresholds can result in agreement termination. Payment can be demanded for Allocations not taken less than 90% of Annual Allocation. Waivers can be granted.	Required to force the Company to buy Timber it may have otherwise not wanted to protect the harvesting contractors. Not required if short term markets exist.	Either a secondary market is encouraged for Agreement holders to trade Timber OR FCNSW establishes a short term market for spot sales of unwanted Timber itself.
8. Method of Supply	Contracted harvesting and delivery done by State Forests. Supply is determined by the volume able to supply	Clause 8.2 provides no guidance as to how or why the supply needs to be defined in this way.	Revise or remove clause 8.2

	not actually supplied.		
9. Annual Delivery Plan	Rules applying to the operation of the Annual Delivery plan.	Plan acknowledges the potential of uneven flow	Similar provisions will be required.
10. Monthly Delivery Schedule	Rules applying to a more detailed operational delivery schedule	Reasonable endeavours are required to supply to the schedule.	Similar provisions will be required.
11. Amendment of Annual Delivery Plan or Monthly Delivery Schedule.	Company or State Forests can request amendment to plan or schedule. State Forests can amend plans or schedules due to Force Majeure.	Needed for operational or market changes.	Retain similar provisions.
12. Delivery	Timber to be delivered as prescribed and cannot be refused. Unloading arrangements and conditions are prescribed.	Needed for smooth conduct of delivery operations	Could be prescribed in other documents.
13. Title and Risk	Ownership transfers on payment. Risk transfers on unloading.	Standard provisions.	Retain.
14. Specifications	Supply and acceptance is of Timber conforming to the Specifications. Seven days to determine conformity. Rules are prescribed for the determination and treatment of non-conforming Timber. Replacement with non-conforming timber can be agreed.	Replacement Timber is not defined in definitions.	Clause 14.6 should be part of the Substitution clause (currently 6).
15. Determination of Quantity of Timber	Establishes the role of the Code of Procedure. Prescribes the operation and amendment to the Code of Procedure.	Foreshadows the introduction of electronic delivery docket system.	Clause and Code need to be updated.
16. Delivered Price	Delivered prices are Stumpage Price plus Delivery Charges.	Stumpage comes from the price system. Delivery Charges are a forecast for the year.	Change to a Total Delivered price that shares the risks between the customer and FCNSW.
17. Stumpage Price	Describes the operation of the Pricing System with review and notification provisions.	The principles in the pricing system are supported.	Retain but in relation to a component of the Total Delivered Price
18. Delivery Charges	Describes the operation of the mechanisms to create and maintain the Delivery Charge Schedule with review, dispute resolution and notification provisions.	Concerns about basing the schedule on compartments that are subsequently not harvested.	Include the mechanisms used in softwood agreements.
19. Payment	Monthly invoices issued due at the end of the month or 14 days after issue. Notices of suspension give 7 days to pay and then suspension may occur.	No Issues were detected.	Retain.
20. Goods and Service Tax	Compliance with federal GST legislation.	Some better provisions may have been written since 2003.	Retain but update if required.
21. Compliance	Required to comply with laws, Code of Procedure and those exercising statutory powers directly and through contractors.	Procedural.	Retain.
22. Sale of Timber to Other Persons	State Forests can sell timber to others. Customer can sell to others. Customer must report sales to others annually.	Need for reporting not identified.	Review reporting requirement. It may be an unwarranted regulatory burden discouraging the secondary market that should be encouraged.
23. Security	Describes the processes for the lodging and	No Issues were detected.	Retain.

	management of a security if required to ensure payment of money.		
24. Force Majeure	Procedures to protect the Company and State Forests from unforeseen interruptions to the supply and taking of Timber.	No Issues were detected.	Retain.
25. Legal Responsibility and Limitation of Liability	Liabilities assigned to each party and limited to loss, damage or expenses.	Identifies the State of NSW as separate party.	Update to match the relevant provisions of the Forestry Act 2012.
26. Issue of Required Licences	Licences must be issued consistent with the agreement.	May not be relevant under new Act.	Update or delete.
27. Default or Insolvency	Provides conditions for the termination of the agreement by either party for defined breaches of the agreement.	Procedural.	Retain.
28. Resolution of Disputes - Mandatory Mediation and Arbitration	Mediator appointed after 28 days of an unresolved dispute. Dispute submitted to arbitration after a further 28 days. Special conditions apply to making information available, price disputes and retrospectivity.	Clause may not reflect current best legal practice.	Update based on legal advice.
29. Assignment	Assignment requires prior approval of Minister. Assignment includes transfer of more than 50% control.	Provisions need to be freed up to allow the commercial transfer of all or part of the agreement.	Review and consider if assignment results in a new agreement or the continuance of the assigned agreement.
30. Minister's Approval for Assignment	State Forest may recommend or not the assignment within 3 months of application. Minister may approve or not the assignment. Grounds for refusal are listed and conditional approval can be granted.	Power to not assign should be retained by FCNSW.	Delete and include conditions in old clause 29.
31. Assessment of Value Added Performance	Company must meet and report on Value Added Criteria.	Outdated requirement. The operation of the price system will ensure good use of timber.	Delete.
32. Variation	Provisions of the agreement can be varied in writing.	Agreements need to be varied periodically to match them to current market conditions.	Consider if variations result in new agreements.
33. Interest	Interest is due on unpaid monies according to the Supreme Court Rules of NSW.	Business to business agreements need commercial provision for interest payments.	Change to interest clauses operating in commercial business arrangements.
34. Notice	Rules for the serving of notices.	Does not include an address for the customer in the example investigated.	Update to commercial agreement practice. Provide addresses in a schedule.
35. Governing Law	Laws and courts of NSW apply.	Procedural.	Retain.
36. Severability	Other provisions continue to apply if any are found invalid	Procedural.	Retain.
37. General	Limit damages on termination. Act alone and consult in good faith	Procedural.	Retain.
38. Confidentiality	Written consent required to disclose contents of agreement with exceptions listed.	More transparency is required especially if agreements issued by private treaty.	Consider making the agreements more openly available.
39. Obligation to Consult	Required to consult in good faith and when acting alone to do so in good faith.	Duplicates general provisions in clause 37.	Remove duplication.
Schedule 1. Specifications	Specifies dimensions and	Specifications should	Provide the current

for Hardwood Timber between 1 July 2004 to 30 June 2005	quality of High Quality Large and Small Sawlogs by price zone. Details process to determine a revised specification after July 2005.	apply to the life of the agreement.	specification without review provisions during the life of the agreement.
Schedule 2. The Allocations	Part I. Quantities of Timber that apply to the agreement. Part II. Indicative Quantities as proportions by quality and price zones	Complicated formulas were required for start-up years. Half allocation specified for final year. Indicative quantities were based on traditional supply and can no longer be supported. Species is not included but is now required.	Consider including allocations by species rather than price zone especially for HQL and HQS.
Schedule 3. Maps	Map 1. North Coast Price Zones and Management Areas. Map 2. Map of Area of Supply.	Map of supply may be a means to manage sovereign risk.	Review and retain.
Schedule 4. Code of Procedure	Section 1. Quantity, Measurement and Marking of Timber. Section 2. Delivery Dockets	Adds unnecessarily to the size of the agreement.	Consider providing separately from the agreement.
Schedule 5. Price Schedule	List of starting stumpage prices by quality and species.	Schedules required to establish prices operating in first year before the application of indexations.	One price schedule for total delivered price
Schedule 6. Delivery Charge Schedule	Delivery charges applying from 1 October 2003 to 1 October 2004 for region and prize zone.	Incorporate with schedule 5.	One price schedule for total delivered price
Schedule 7. Delivery Site and Delivery Hours	Mill locations and delivery hours are specified	Procedural.	Retain.
Schedule 8. Review of Delivery Charge	Factors used in changes in the level of costs of conducting contract harvesting and delivery.	Procedural.	May need to be reviewed and updated. Item 6 Capital items may need an index.
Schedule 9 Example Application of Clause 5.5	Allocation adjustments provided as examples required to meet the rules explained in clause 5.5	Customers understand the rules now.	Delete.
Table of Contents	List of Clauses and Schedules	Procedural.	Move to second page.

Type A – Boral

It is noted that key differences with other Type A agreements are marked in italics. Clauses that have not changed have been removed.

Clause	Current requirement	Comment	Proposed change
Table of Contents	List of Clauses and Schedules	Procedural.	See table above.
1. Parties and Recitals	The Forestry Commission The "Taylors", and "Duncans" The State of New South Wales <i>Acknowledges previous agreement.</i>	FCNSW has a principle function to sell or supply forest products.	
4. Duration of Agreement	Nineteen and a half years. <i>Company can apply for a renewal to be negotiated in good faith.</i> <i>Assignment results in new agreement.</i>	<i>Renewal clause is absent.</i>	
5. Consolidation of the Companies Rights and Obligations	Clause required to assign rights between <i>Taylors and Duncans</i> .	Agreements should generally be with one company representing the buyer.	
6. Substitution	<i>Large logs can be substituted for small logs if unavailable.</i> <i>The calculation of shortfall prices are determined.</i>		
9. <i>Planning Information</i>	Establishes mechanisms and processes to create a two year Plan of Operations		
15. Specifications	Supply and acceptance is of Timber conforming to the Specifications. Seven days to determine conformity. Rules are prescribed for the determination and treatment of non-conforming Timber. <i>Includes handling fee for timber removed.</i> Replacement with non-conforming timber can be agreed. <i>Requirements for proportions of major species.</i> <i>Requirements for proportions of diameter classes.</i> <i>Requirements for proportions of preferred lengths by species.</i>	These additional requirements form a set of key performance indicators for the agreement.	
39. Obligation to Consult	<i>Required to consult in good faith and when acting alone to do so in good faith.</i>	<i>Duplicates general provisions in clause 37.</i>	
Schedule 1. Specifications for Hardwood Timber	Specifies dimensions and quality of High Quality Large and Small Sawlogs by price zone. <i>Details process to determine a revised specification after July 2005.</i>	Specifications should apply to the life of the agreement.	
Schedule 9.	Sets Handling Fee at \$2		
Schedule 10. <i>Small Diameter Timber</i>	<i>Sets maximum quantities by supply zone and delivery site of small diameter logs.</i>	These effectively create an additional key performance indicator.	

Type B

Clauses that do not differ have been removed.

Clause	Current requirement	Comment	Proposed change
5. Allocations	Allocations must be made available to the Company. Conditions apply to supply made available from outside the Area of Supply. Indicative proportions of the supply by price zone are acknowledged.	Allocations specify only log quality and size in most agreements. No variation provisions.	Allocations could include species. Variations of plus or minus 20% may be required to manage the risk of supply of species based allocations.
6. Special Conditions Regarding Allocation 2	State Forest supply obligations qualified for Allocation 2 but not 1. Obligation to supply Company's Percentage Share of production.	Establishes three priority classes of obligation to supply. Type A, Type B Allocation 1 and B2.	No longer required. Annual or short term sales can be used to manage supply risk. All customers need equal certainty.
32. Amendment of Allocations	Reviews of Allocations set for 2012 and 2017. State Forests to review timber resource availability taking into account inventory data, regulatory restrictions and yield schedules and forecast to 2023. Notice can be given to alter allocations based on the review results. Method of calculating the changes is provided.	Needed at the time with resource uncertainties and long term agreements.	Not required for shorter term agreements.

Type C

Clauses that do not differ have been removed.

Clause	Current requirement	Comment	Proposed change
6. Qualification of the Obligation to Supply the Allocation	State Forest supply obligations qualified for Allocation. Acknowledgement of allocation supply from integrated operations. Obligation to supply Company's Percentage Share of production. Notification of estimated quantities.		No longer required. Annual or short term sales can be used to manage supply risk. All customers need equal certainty.
17. Preferred Price Zone Delivered Price Review	Describes the operation of the Delivered Prices procedures with review and notification provisions.		Delivered prices are proposed for all agreements.
18. Delivered Price for Timber from Outside the Preferred Price Zone	Describes the mechanism to set Delivered Prices for Timber supplied from outside the preferred price zones.		
32. Amendment of Allocations	Reviews of Allocations set for 2012 and 2017. State Forests to review timber resource availability taking into account inventory data, regulatory restrictions and yield schedules and forecast to 2023. Notice can be given to alter allocations based on the review results. Method of calculating the changes is provided.	Needed at the time with resource uncertainties and long term agreements.	Not required for shorter term agreements.
32. Market Development	State Forests may undertake marketing activities. The Company must participate in such marketing.	Unclear as to the intent of this clause in a Type C agreement.	Review the need for such a clause.
Schedule 6. Delivered Price Review Mechanism	Factors used in changes in the level of costs of conducting contract harvesting and delivery.	Procedural.	May need to be reviewed and updated. Item 6 Capital items may need an index.

Type D

Clauses that do not differ have been removed.

Clause	Current requirement	Comment	Proposed change
1. Parties	The Forestry Commission The "Company" The State of New South Wales	FCNSW has a principle function to sell or supply forest products.	
4. Duration of Agreement	Ten years. Company can apply for a renewal to be negotiated in good faith. Assignment results in new agreement.	Calendar year agreement administered on financial years.	Duration could be negotiable on assignment. Renewal should be offered but in a stand-alone clause.
Schedule 1. Specifications	Specifies dimensions and quality Salvage Classes 1, 2 and 3.		

GHD

133 Castlereagh St Sydney NSW 2000

T: +61 2 9239 7100 F: +61 2 9239 7199 E: sydmail@ghd.com.au

© GHD 2016

This document is and shall remain the property of GHD. The document may only be used for the purpose for which it was commissioned and in accordance with the Terms of Engagement for the commission. Unauthorised use of this document in any form whatsoever is prohibited.

n:\au\sydney\projects\21\25806\WP\218360.docx

Document Status

Revision	Authors	Reviewer		Approved for Issue		
		Name	Signature	Name	Signature	Date
Final	G Featherston S Madden	P Dellow		S Madden		30.03.17

www.ghd.com

