

Michelle Lauder
Assistant Secretary
Forestry Branch
Department of Agriculture and Water Resources
GPO Box 858, Canberra, ACT, 2601

23 December 2016

Dear Ms Lauder,

Thank you for the opportunity to make this submission on the *Reforming Australia's illegal logging regulations - Consultation regulation impact statement*. Peter Feilberg asked me to prepare this submission as I have the oversight of the NEPCon Forest Legality Programme, and extensive experience implementing the European Timber Regulation. My colleague Alexandra Banks, a Senior Forest Legality Specialist and I have prepared the enclosed submission. Alexandra is now based in Melbourne, so if you would like any further information, or have questions about the content of this submission, please contact Alexandra on alb@nepcon.org or 0432 993 987.

NEPCon has followed the development and implementation of the Australian Illegal Logging Prohibition Act with great interest. We hope that this submission will be useful in ensuring the law is implemented effectively. Our experiences in Europe have shown us that the most significant and far reaching impacts of legislative measures to combat the illegal timber trade are achieved when governments actively enforce the requirements.

Kind regards,



Christian Sloth

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Submission to *Reforming Australia's illegal logging regulations - Consultation regulation impact statement*

Introduction to NEPCon

NEPCon is an international, non-profit organisation, founded in Denmark in 1994. We are experts in forest certification and forest & trade legality issues. We have offices in 15 countries across Europe, Russia and Asia and more than 100 permanent staff members. Our mission is 'to build capacity and commitment for mainstreaming sustainability', and our vision is 'a world where human choices ensure a sustainable future'. We specialize in forest and biodiversity conservation, from management planning and implementation to sustainability-assurance and capacity-building services, including certification of sustainable production systems, supply chains, legal sourcing, carbon foot printing, and training and skill development.

In 2007, we established an online database for publishing risk assessments - the [Global Forest Registry](http://www.globalforestregistry.org/)¹ - which provides companies with easy access to available public information about potential risks related to sources of timber products from more than 150 countries. The system has become a big success, and is available for use by any company wishing to avoid sourcing wood from controversial sources.

In 2011, we began developing a due diligence system to address legality risks in timber supply chains. Due to our work on this system, called LegalSource, and our expertise in the area of risk assessment, we were one of the first two organizations recognised by the European Commission as an official Monitoring Organization for the EU Timber Regulation.

In 2014, we were asked to develop risk assessments for timber-sourcing based on FSC's criteria for "Controlled Wood" for 20 countries, including criteria regarding legality, forest conversion and use of genetically modified trees. The project was later expanded to an additional 43 countries and to include more risk criteria.

General comments

Given that NEPCon's experience is primarily with the international timber trade, we have focussed this submission on importers and not domestic processors.

We have worked with the EU Timber Regulation (EUTR) for a number of years, and have worked with a wide variety of industry participants on their due diligence obligations. We have clients ranging from very small importers and traders of specialist timber products, importing once or twice per year, through to some of Europe's largest and most complex timber companies. What is universally true of this experience is:

- The more active the Competent Authority in a European country is, the more active the industry are with their compliance - the Authorities have an important driving effect on market response to the legislation;
- Reports of enforcement activities within Europe and the US are having a noticeable impact on the industry's awareness of their EUTR obligations and their action in terms of compliance;
- There is increased uncertainty within the industry in countries with inactive or inefficient Competent Authorities due to higher levels of general industry awareness of the EUTR requirements;
- Due diligence is possible, and can be cost effective, even on the most complex and high risk supply chains;
- The compliance burden on industry increases significantly for un-certified timber from high risk countries;

¹ <http://www.globalforestregistry.org/>

- Companies use the legally-required due diligence process as a way of ensuring quality control and improving their supply chain controls;
- The impact of due diligence on the trade can be immediate and noticeable, i.e. companies change their supply chains as a direct result of their due diligence processes, with the resulting impact being noticeable in supply countries;
- Requiring companies to know their supply chains, and eliminate high risk products from those supply chains is something that is happening for numerous commodities that are traded internationally. Consumers are becoming more aware of the origins of their products, and *business as usual* is no longer sufficient to meet the demands consumers are placing on the industry;
- Corruption, at all levels of government, is often a key issue with timber legality. Many countries with high levels of corruption, supply timber to the Australian market.
- Documentation from high risk countries is often not sufficient, as a stand-alone measure, to provide the necessary levels of assurance that a product has not been illegally logged. This has been confirmed by the governments of the Netherlands and Sweden through recent enforcement activities in the respective countries.

Option 1: The status quo

Our recommendation: End the soft start to the Act

According to the *Reforming Australia's illegal logging regulations - Consultation regulation impact statement* (the RIS), approximately 10% of the timber entering Australia could be from illegal sources. NEPCon have reviewed the activities of the Australian Government following the regulatory requirements coming into effect in Australia, the guidance materials published by the government, the KPMG prepared *Independent Review of the impact of the illegal logging regulations on small business* and associated *Government response to the Independent Review of the impact of the illegal logging regulations on small business* and the RIS. NEPCon is concerned that the balance being struck between the cost of compliance for small businesses and reducing the risk of illegally logged timber entering into the Australian market leans too heavily on reducing costs, and does not focus enough on the policy objective. We are concerned that consideration is being given to amending an Act that has not been properly implemented or tested for effectiveness. The continually extended 'soft-start' to the Regulation has undeniably limited the effectiveness of the Act to curb the levels of illegal timber coming onto the Australian market.

NEPCon is aware that considerable time and effort was put into the design of the due diligence requirements in their current form, including extensive consultation with a wide variety of stakeholders. We strongly believe that the government should seek to enforce the existing requirements, ending the soft start.

Option 2: Changing the consignment value threshold

Our recommendation: Do not amend the Regulation. The consignment value threshold should not be increased

NEPCon believes the government should not make any change to the consignment value threshold. We note that the regulatory costs would potentially be reduced if the consignment value threshold were to be increased. However, changing the consignment value threshold will increase the Australian market's exposure to illegal materials.

By reducing the number of importers subject to the due diligence requirements and thereby the consignments which have due diligence conducted on them prior to entering the Australian market, there is a risk that illegal timber will enter the market through these channels. It is not possible to reduce the number of importers subject to the Regulation by more than 50% while retaining the integrity of the Regulation and meeting the policy objectives. We believe that such an exemption would further reduce the strength of the Australian requirements in comparison to the other regulated jurisdictions and thereby, further limit the credibility of the Australian efforts.

In our work in Europe we have seen that there is often a positive correlation between the size of a company and the level of compliance with the due diligence requirements. Generally speaking, the larger the organisation, the more comprehensive and sophisticated their due diligence system will be.

The RIS states that the introduction of a \$10,000 threshold would reduce the proportion of imports from China which are covered by the Regulation by 15% and Indonesia by 20%. For China, this would mean \$117 million of products imported into Australia would be exempted. There are numerous reports, and field experience has shown us, that China has been and continues to be a hub for the laundering of illegal timber. As there are currently no requirements in China to reduce the risk of illegal timber being imported into the country, there is a real risk that considerable amounts of the illegal timber entering the Australian market come via these channels.

Option 3: Removing 'personal' imports from the scope of the Regulation

Our recommendation: Amend the Regulation. Remove 'personal' imports from its scope

NEPCon supports the amendment of the Regulation to preclude persons from having to undertake due diligence when they import a regulated timber product for 'a personal and non-commercial purpose' as it would further align the Regulation with the EU Timber Regulation and the United States Lacey Act.

The proposed definition of 'a personal and non-commercial purpose' contains a number of terms that should be explained and defined, such as 'personal non-commercial use', 'a commercial basis' or 'a non-commercial setting'.

As noted in the RIS, the primary risk associated with a personal use exemption is fraudulent use of the exemption by importers who are in fact importing for commercial purposes. Controlling fraud is something the Australian border protection agency has extensive experience in, and can likely control with appropriate language and verification activities. In addition, the government's counterparts in the US and Europe are likely to have more specific experience with this particular type of exemption and should be consulted to ensure best practice. The proposal to include a cap for the exemption is likely to limit the ability of companies to fraudulently use the exemption, but further data analysis would be necessary to determine the nature of current imports for personal use to ensure the correct cap is used.

Option 4: 'Deemed to comply' arrangements for timber legality frameworks

Our recommendation: Do not amend the Regulation. Certified material should not be deemed to automatically comply with the law

NEPCon has serious concerns about the option to include 'deemed to comply' arrangements for timber legality frameworks. We acknowledge the significant role certification can play as part of a robust due diligence system. In Europe, the EUTR recognizes the value of certification as a tool for risk assessment and mitigation without automatically including a "green lane" for certified products. The European Commission explains that companies "may rate credibly certified products as having negligible risk of being illegal, i.e. suitable for placing on the market with no further risk mitigation measures, provided that the rest of the information gathered and the replies to the risk assessment questions do not contradict such a conclusion".

As such, we encourage our clients to use certification as a risk mitigation tool. We require companies to consider the following questions included in the EUTR Guidance document to assess the credibility of a third-party certification system.

1. Are all the requirements of the Regulation fulfilled?
2. Is the certification or other third party verified scheme compliant with international or European standards (e.g. the relevant ISO guides, ISEAL codes)?
3. Are you sure that you are buying certified material? An FSC logo on your supplier's website or invoice, for example, does not automatically prove this.

4. Are there substantiated reports about possible shortcomings or problems of the third party verified scheme in the specific countries from which the timber or timber products are imported?
5. Are the third parties that are making the required checks and verifications referred to in Article 4 (b), (c) and (d) of the Commission Implementing Regulation (EU) No 607/2012 independently accredited organisations?
6. Are there risks in the supply chain that may indicate that certified material is being substituted or mixed with non-certified material. Recent studies indicate that certification systems are subject to risks of non-eligible material being mixed in certified supply chains.

Internationally, there are numerous certification schemes in operation. We have recently undertaken a comprehensive analysis of the leading international certification schemes. We include our preliminary CONFIDENTIAL findings as an annex to this submission.

FSC certification

We found the Forest Stewardship Council's Forest Management and Chain of Custody certification to be the most robust, although there are still some issues with FSC certification which we encourage companies to consider as part of a robust due diligence process. In particular, we agree with the findings of the government's enforcement officers mentioned in the RIS, that 'some businesses that have sought to use timber legality frameworks have found that while they have been dealing with FSC or PEFC 'certified' suppliers, they are often not being provided with certified products'. As a result, we believe it is critically important to ensure the 'fast track' provided through the recognition of certification systems does not undermine the Regulation's ability to restrict high risk timber entering the Australian market.

The following illustration sets out the verification process we use for FSC certification as part of a due diligence system.



PEFC certification

In addition to FSC forest management and chain of custody certification, the Regulation recognises PEFC sustainable forest management and chain of custody certification as a timber legality framework. Although the PEFC scheme has many strengths, it has some core issues which we believe limits its ability to provide the level of assurance required to fully mitigate the risk of illegal timber entering a supply chain if relied on without other risk mitigation measures in place. These main issues are that:

- The legal requirements related to trade and customs are not addressed beyond the forest management level, meaning that trade and customs legality throughout the supply chain is not necessarily considered.
- The chain of custody standard allows mixing of non-certified materials with certified materials that have been subjected to due diligence. However, NEPCon is of the opinion that several gaps exist in the PEFC DDS that may allow material with high risk of illegal harvesting entering certified supply chains. For example, PEFC applies a Transparency International Corruption Perception Index score of less than 50 as

a high risk indicator, BUT low risk indicators include ‘supplies verified by governmental or non-governmental verification or licensing mechanisms.’ This means that for countries perceived as having a high risk of corruption, government documentation can be used as an indicator of low risk of illegal harvesting.

We are deeply concerned consideration is being given to removing the only safeguard to ensure that the risks in certified supply chains are assessed. The safeguard, is the inclusion of the requirement to “consider any other information the importer knows, or ought to reasonably know, that may indicate whether the product is made from, or includes, illegally logged timber”. As it is stated in the RIS, the requirement to consider ‘any other information the importer knows’ ensures that an importer cannot use a timber legality framework to assure themselves of the legality of a product if they are aware of additional information that calls that information into question.

NEPCon strongly advocates for the retention of the Regulation in its current form, and encourages the government to publish detailed guidance material for the industry on what the requirement to “consider any other information the importer knows, or ought to reasonably know, that may indicate whether the product is made from, or includes, illegally logged timber” means in practice and what can be done to meet this requirement.

Option 5: ‘Deemed to comply’ arrangements for Country Specific Guidelines and State Specific Guidelines

Our recommendation: Do not amend the Regulation. Deemed to comply arrangements should not be included for Country and State Specific Guidelines.

NEPCon strongly opposes the ‘deemed to comply’ option for Country Specific Guidelines. We have extensive experience analysing the risk of illegal timber production in countries around the world. Often, the most significant risks identified are associated with systematic, far reaching and endemic corruption within governments. NEPCon recognises the benefits of having government-produced and endorsed information about timber legality for countries supplying the Australian market. However, unless importers are required to consider the risks of illegality in countries with Country Specific Guidelines, the credibility of the Regulation will be severely undermined.

NEPCon has been working on risk assessments for timber legality, in partnership with a number of organisations, since 2007. We have developed more than 50 risk assessments of timber-exporting countries all over the world as part of several projects supported by FSC, the EU Delegation in Vietnam, UK aid from the UK Government and the EU Life Programme. By mid-2017, we will have 63 risk assessments completed. The countries covered by the risk assessments are shown illustrated in Figure 1.

1.21. Due diligence and due care requirements

For each national risk assessment, we analyse each of these 21 sub-categories so that we:

- Define source types: source types are defined as different types of areas where from timber can be legally sourced. Source type may be defined by the forest type (natural or plantation), ownership (private, public or communal), land classification (permanent forest estate or non-permanent forest estate), management regime (private concession or state management) or a combination of all of these.
- Identify and document:
 - applicable laws and regulations, i.e. the legal title, and reference to relevant Chapter, Section or Clause as appropriate;
 - legal authority, the relevant competent authority responsible for legal compliance; and
 - legally required documents or records that can be used to indicate legality.
- Keep a record of the sources of information used to describe, identify and evaluate risk, such as reports, laws, regulations, articles, web pages news articles etc.
- Determine the level of risk determination, including an overview of the legal requirements, a description of risk, and a risk conclusion
- Specify potential control measures and verifiers

Once this analysis has been carried out, a conclusion of “**low risk**” or “**specified risk**” (i.e. high risk) is reached for each of the 21 sub-categories of law.

The table below sets out the results of the risk assessments conducted for the countries currently covered by Country Specific Guidelines.

Country	Risk Assessment results: the number of categories found to be low risk out of the total number of categories assessed.	Note on the number of categories The maximum total number of categories is 21, but note that some categories do not apply to all countries.	Link to the assessment
Canada	21 / 21		Link
Finland	18 / 18	There are no legal requirements in place for 3 of the 21 categories	Link
Indonesia	0 / 20	There are no legal requirements in place for 1 of the 21 categories	<i>Not currently available - This risk assessment is currently being updated to reflect the recent endorsement of the SVLK system by the European Commission, and the use of FLEGT licenses for Indonesian timber</i>
Italy	8 / 20	There are no legal requirements in place for 1 of the 21 categories	Link
Malaysia	Peninsular: 5 / 20 Sarawak: 1 / 20 Sabah: 7 / 20	There are no legal requirements in place for 1 of the 21 categories	Link

New Zealand	19 / 19	There are no legal requirements in place for 2 of the 21 categories	Link
Papua New Guinea	1 / 20	There are no legal requirements in place for 1 of the 21 categories	<i>The risk assessment is still being conducted; these results are preliminary only.</i>

The table above shows that for a number of countries currently covered by the Country Specific Guidelines, there are significant risks of legal non-compliance in the supply chains. In a number of these jurisdictions, notably Sarawak and Papua New Guinea, corruption has been identified as a specific issue in the forestry sector, and cannot in our opinion be mitigated by obtaining government documentation.

There is a potential risk that if the additional 'information gathering' and 'consideration' steps are removed from the Country Specific Guidelines and State Specific Guidelines process then companies may ignore relevant contextual information when conducting their due diligence. This could lead to situations where a company imports or processes a CSG or SSG-documented product despite the situation or circumstances suggesting that it is likely to contain illegal timber. For example, the documentation may have been provided in a questionable manner, or the importer or domestic processor may become aware of incidents of fraudulent documents being distributed.

Option 6– 'Deemed to comply' arrangements for low-risk countries

NEPCon in principle supports this option, however, we perceive there is a significant administrative burden associated with a proper national assessment, and a risk of a politicising of the process if it is done internally by the government. As discussed in the previous section, NEPCon has conducted numerous national assessments for the risk of timber legality at a national level. The rigorous process we carry out take approximately six months per country (we often have a number of evaluations ongoing at one time), involved numerous in country experts and in country stakeholder consultation. We believe producing an accurate risk assessment is a complex process, which necessitates care and objectivity. Based on the risk assessments we have conducted to date, the following countries scored low risk across all applicable indicators:

- Germany
- Denmark
- France
- UK
- Austria
- Belgium
- Sweden
- Canada
- Finland
- Japan
- New Zealand
- South Africa

Should the government choose to amend the Regulation to establish 'deemed to comply' arrangements for countries that are assessed as being of 'low risk' of illegal logging, we believe it will be necessary to engage a neutral external party to conduct the risk assessments, and that the government is bound by the expert findings. Unless these control measures are put in place, we believe the process will not have sufficient integrity to ensure the risk of illegal timber entering in

market is low. In addition, we believe that if this option is pursued, it should take a form similar to the approach used for Timber Legality Frameworks and GSGs, in particular that the additional ‘information gathering’ and ‘consideration’ steps are included.

Conclusion

Our position on the options is summarised in the table below:

Option 1–The Status quo.	NEPCon supports this option, with caveats.
Option 2–Changing the consignment value threshold.	NEPCon does not support this option.
Option 3–Removing ‘personal’ imports from the Regulation’s scope.	NEPCon supports this option.
Option 4– ‘Deemed to comply’ arrangements for timber legality frameworks.	NEPCon does not support this option.
Option 5– ‘Deemed to comply’ arrangements for Country Specific Guidelines (CSGs) and State Specific Guidelines (SSGs).	NEPCon does not support this option.
Option 6– ‘Deemed to comply’ arrangements for low risk countries.	NEPCon supports this option, with caveats.