

HOUSE BILL REPORT

HB 2307

As Reported by House Committee On:

Natural Resources
Appropriations

Title: An act relating to timber substitution.

Brief Description: Providing flexibility in the operation of the timber substitution rules.

Sponsors: Representatives Doumit, Sump, Sommers, Sehlin, Kessler and Eickmeyer.

Brief History:

Committee Activity:

Natural Resources: 1/18/02, 1/29/02 [DPS];

Appropriations: 2/6/02, 2/9/02 [DP2S(w/o sub NR)].

Brief Summary of Second Substitute Bill

- The prohibition against the substitution of timber is codified in statute and is administered by the Department of Revenue.
- Exemptions to the definition of substitution are added.
- Ineligible bidders may bid on restricted timber on a contingent basis, and the bids may only be opened if there are less than three bidders on a sale.
- Allows 50 percent of export restricted timber to become available to all bidders over a 10-year period: 25 percent becomes available immediately, an additional 13 percent is available after five years, and the remaining 12 percent is available after 10 years.
- Establishes civil penalties for violations.
- The ban against exporting unprocessed timber from public lands is not changed.

HOUSE COMMITTEE ON NATURAL RESOURCES

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 8 members: Representatives Doumit, Chair; Rockefeller, Vice Chair; Buck, Eickmeyer, Jackley, McDermott, Orcutt and Upthegrove.

Minority Report: Do not pass. Signed by 3 members: Representatives Sump, Ranking Minority Member; Ericksen and Pearson.

Staff: Bill Lynch (786-7092).

Background:

In 1990 Congress passed the Forest Resources Conservation and Shortage Relief Act. (See 16 U.S.C. Section 620 et seq.) This law made permanent the federal ban on the export of unprocessed timber harvested from western federal lands, restricted the substitution of timber from federal lands, and restricted the export of unprocessed timber harvested from western state lands. This federal law also directed the Governor of Washington to adopt rules to carry out the purposes of the federal act.

In 1990 the Governor adopted rules, found in chapter 240-15 WAC, to implement the Forest Resources Conservation and Shortage Relief Act. These rules included a prohibition against the substitution of unprocessed timber which was not required under the federal law. The federal law was declared unconstitutional in 1993 because the directive for the Governor to adopt rules violated the Tenth Amendment. [See Board of Natural Resources v. Brown, 992 F.2d (937 1993)]. Congress amended the federal act in 1993 to reinstate the export ban. These amendments also did not require the state to adopt restrictions on the substitution of timber.

The rules prohibiting the substitution of timber are administered by the Department of Revenue. The purpose of the substitution rules is to keep log exporters from buying public timber to process in their mills as a substitute for their own private timber which they are exporting. The intent of the rules is to make more logs available for domestic processing in order to preserve timber jobs because of the cut-backs in timber sales from federal lands.

Although the Department of Revenue administers the substitution rules, they have no authority to make changes to these rules because the rules were adopted without the benefit of state statute. Concerns have been raised about whether the rules are accomplishing the purposes for which they were intended, and whether the rules are causing an impact upon revenues received by the trust beneficiaries from the harvest of timber from public lands.

The Legislature created a Joint Select Legislative Task Force on Timber Substitution during the 2001 session pursuant to EHCR 4410. This task force was assisted by an advisory committee made up of affected stakeholders. The advisory committee developed a report to the task force in November 2001 which discussed a number of recommendations on how the current rules might be changed.

Summary of Substitute Bill:

The current rules prohibiting the export or substitution of restricted timber are codified into state statute, with certain exceptions. The Department of Revenue is responsible for administering these laws, including the authority to adopt or modify rules to ensure that the rules are consistent with the statutes. The absence of language that is contained in the current rules from the statutes is not to be construed as a change or repeal to the current rules.

Each state and local agency managing public lands must designate timber sales as export restricted until the restrictions are changed. No person may export from the United States export restricted timber, or convey this timber to another person for the purpose of export from the United States. No person may bid on a restricted timber sale from a state or local agency if the person owns and operates a processing facility, and the processing of the export restricted timber at the facility by the person constitutes substitution. This prohibition also extends to the purchase or possession of an active contract for export restricted timber by an ineligible bidder. It is prohibited for an ineligible bidder to purchase export restricted timber from another person in excess of the amount allowed.

SUBSTITUTION DEFINED

"Substitution" is defined as the purchase of export restricted timber or possession of an active sale contract for this timber by a person:

- Who owns and operates a domestic processing facility;
- Who exports or sells for export unprocessed timber that originates from private lands in Washington, Oregon, or Idaho (currently this only applies to Washington lands); and
- Who owns the lands, or has the exclusive right to harvest timber from the lands at any time during a period of more than seven years.

PARTIAL PHASE-IN OF AVAILABILITY OF PUBLIC TIMBER TO ALL BIDDERS

Beginning on July 1, 2002, all agencies selling public timber must make 25 percent of its annual sales volume available to bidders who would otherwise be excluded under the substitution rules. This amount must be increased to 38 percent after five years, and to 50 percent after 10 years. The Department of Natural Resources (DNR) must submit a report to the appropriate legislative committees after five years and after 10 years which summarize how this partial phase-in is working. Each agency selling timber must try to distribute these open sales proportionately throughout the geographic area they own or manage.

EXEMPTIONS FROM SUBSTITUTION

The exemptions from the prohibition against substitution contained in the current rules are generally maintained, but contain some modifications. These changes include:

- An ineligible bidder may purchase up to 50 percent of the volume of any sale on the secondary market. The current rules allow secondary market sales up to 10 percent of the volume of a sale;
- The sale of timber that includes trees that have been damaged by fire, insects, disease, wind, ice, volcanic, or other biological or geological events;
- The sale of thinnings and small patch clear-cuts; and
- The purchase of export restricted timber originating from lands east of the crest of the Cascade Mountains if the person purchasing the timber does not export or sell for export timber from private lands in that geographic area. This is a change from the limitation contained in current rules which uses the Columbia River rather than the Cascade Mountains as the boundary. A person previously ineligible to bid on restricted timber east of the Columbia River may not bid on export restricted timber sales located in the Loomis Forest until July 1, 2004, unless one of the exemptions to substitution applies.

CONTINGENT BIDS

State and local agencies must accept bids from ineligible bidders for sales of export restricted timber, but these bids may only be opened on a contingent basis. If less than three bids are received from eligible bidders on the proposed timber sale, then the contingent bids are opened and treated as if they were received from eligible bidders. If the agency receives at least three bids from eligible bidders, the contingent bids must be returned without being opened. Each agency must collect information on an annual basis regarding contingent bids and forward it to the DNR. The DNR must maintain the information on contingent bids and provide a biennial summary to the appropriate legislative committee.

PENALTIES

A person who wilfully violates prohibitions related to export, substitution, or indirect transactions may be debarred for a period of two years from bidding on or purchasing public timber. A second violation by the same person will result in a debarment from bidding on or purchasing public timber for a period of five years.

Civil penalties are established for violations related to exporting and for other violations. A fine not to exceed \$50,000 is established for exporting unprocessed restricted timber when the person should have known that it was a violation. If a person wilfully exported unprocessed restricted timber, they may be fined up to \$500,000. If a person should have known that a violation unrelated to exporting constituted a violation, they may be fined up to \$25,000. If a person wilfully violates a provision unrelated to exporting, they may be fined up to \$100,000. A person may be fined up to \$10,000 for inadvertent minor violations. The Department of Revenue must adopt the standards for determining civil penalties by rule.

The Governor is directed to submit this act and any implementing rules to the United States Secretary of Commerce for approval.

Substitute Bill Compared to Original Bill:

The substitute bill adds a partial phase-out of the substitution rules. This phase-out allows 50 percent of the annual sales volume of public timber to be available to any bidder in 10 years. The pilot program for Skamania County is deleted. Penalties are modified so that debarment is similar to the federal law and the laws of other states. Categories of lesser civil penalties are also added. The exemption from the substitution rules pertaining to the sourcing area at the crest of the Cascade Mountains is clarified. The substitution exemption for thinnings and small patch clear-cuts is simplified. Several technical amendments are also made.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The rule-making authority for the Department of Revenue and the availability of 25 percent of public timber to all bidders takes effect on July 1, 2002. The remainder of the act takes effect upon approval of the act by the United States Secretary of Commerce.

Testimony For (Original Bill): This is a step in the right direction, but a total phase-out of the substitution rules would help the trust beneficiaries even more. Timber revenues account for about one-third of school construction costs, with the remainder coming from the General Fund. Things have changed in the marketplace since the rules were first adopted. The timber industry is strong and will be able to make adjustments. Small timber counties are looking at shortfalls of over a million dollars each, partly because the local mills can't bid on public timber and are laying-off workers. You can count 200 log trucks crossing the Columbia River a day for processing in Oregon, and the harvesting is even being done by workers from Oregon. Eliminating the substitution rules will mean more jobs in Washington. Relaxing the substitution rules will mean more bids on the timber sales and increased money for the trusts. Washington State University just built a building in Spokane from trust revenues derived from timber sales, so these revenues are important to the universities. The marketplace should be allowed to work. Substitution rules act as disincentive to good management and stewardship. Economic studies by independent economists show that bid rates increase when there are more bidders. Much of the state is not benefitting under the current rules. Relaxing the substitution rules will allow us to find out what the timber is really worth. Timber companies that have owned land in Washington for over 100 years can't bid on public timber sales. There is a market for increased secondary sales. Restrictions run counter to the mandate to benefit the trusts.

Testimony Against (Original Bill): Changing the substitution rules will hurt small mills and communities because they won't be able to compete. Some companies that benefit by the current rules have invested a substantial amount of money in the state. The increased revenue estimates from the DNR are not accurate. The trusts are receiving full market value now for timber harvest. Changing the substitution rules will not result in more bidders or more revenue for the trusts. Timber companies that export don't have to export. The export premium earned by companies that do export give them an unfair advantage in bidding, and gives them preferential treatment under the law. This bill will result in family wage jobs being transferred to Asia. Logs are going to Oregon because there is a huge demand for the timber in those mills. The data that supports this bill is unsubstantiated and poor quality. Investments by companies are made on a long-term basis, and this throws a monkey-wrench into their planning. Many of these investments have been made in Washington, so it is important to look at the total tax picture. This bill does not reflect the advisory committee report. The DNR misled the trust beneficiaries on the potential impact of the bill. This bill could lead to collusion and increased administrative costs. Lack of bidders on sales are due to the DNR miscalculations of what the timber is worth. When a proposed sale that gets no bidders is revised, there are usually plenty of bidders. This is a labor-negative bill.

Testified: (In support) Terry Bergeson, Office of Superintendent of Public Instruction; John Perez-Garcia, University of Washington; Larry Ganders, Washington State University; Dan Cothren, Timber Counties of Washington and Wahkiakum County; Joan Frey, Klickitat County; Kevin Rogers, representing Simpson Investment Company, Longview Fibre Company, and Weyerhaeuser; Curt Copenhagen and Dave Bowden, Longview Fibre Company; Dana Peck, Klickitat County; Jason Spadaro, SDS Lumber Company; John Gorman, Simpson Investment Company; Bruce Beckett, Weyerhaeuser; and Bruce Mackey, Department of Natural Resources.

(Neutral) Gary O'Neil, Department of Revenue.

(Opposed) Al McKee, Skamania County; Ron Parker, Hampton Lumber; Dick Just, Boise Cascade Corporation; Duane Vaagen, Vaagen Brothers Lumber; Harold Abbe, Association of Western Pulp & Paper Workers; Paul Ehinger, Small Business Timber Council; Bob Waltz, Seattle-Snohomish Mill; Nick Kirkmire and David Ivanoff, Substitution Rules Retention Coalition; and Ron Schneider, Wilkins, Kaiser & Olsen, Inc.

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: The second substitute bill be substituted therefor and the second substitute bill do pass and do not pass the substitute bill by Committee on Natural Resources. Signed by 17 members: Representatives Sommers, Chair; Doumit, 1st Vice Chair; Fromhold, 2nd Vice Chair; Sehlin, Ranking Minority Member; Boldt, Buck, Cody, Cox, Kagi, Kenney, Kessler, McIntire, Pflug, Ruderman, Schual-Berke, Talcott and Tokuda.

Minority Report: Do not pass. Signed by 7 members: Representatives Alexander, Clements, Dunshee, Grant, Linville, Mastin and Pearson.

Staff: Jeff Olsen (786-7157).

Summary of Recommendation of Committee On Appropriations Compared to Recommendation of Committee On Natural Resources:

The second substitute clarifies the exemption from the substitution rules for sales of damaged timber, and that the Department of Revenue makes determinations regarding violations of the substitution rules. Provisions requiring the DNR to collect information on contingent bids and provide a list of ineligible bidders on contracts are removed in the second substitute bill.

Appropriation: None.

Fiscal Note: Preliminary fiscal note available.

Effective Date of Second Substitute Bill: Ninety days after adjournment of session in which bill is passed.

Testimony For: The state has a fiduciary responsibility to generate revenues for the trusts, which include common schools, higher education institutions, and timber counties. Market forces have changed since the implementation of these rules, and they need to be updated. The relaxation of rules will increase bidders, resulting in more revenues for the state. The current rules are costing the state \$15 million per year.

Testimony Against: Changes to the rules will impact jobs and disrupt the market. The pulp and paper mills have gone from 15,000 workers to 7,000 workers. Companies have made significant investments in mills, and these changes threaten those investments. This bill will cost more to implement than the estimated revenues it will generate.

Testified: (In support) Terry Bergeson, Office of the Superintendent of Public Instruction; Paul Boardman, University of Washington; Kevin Rogers, Simpson, Longview, Fibre and Weyerhaeuser; Paul Parker, Washington Association of Counties; Curt Copenhagen, Longview Fibre Company; Bruce Mackey, Department of Natural Resources and Larry Ganders, Washington State University.

(Opposed) Harold Abbe, Association of Western Pulp and Paper Workers; Ron Forest, Pacific Northwest Council of Carpenters; Tim Boyd Vaagan Brothers; Bill Howard, Boise Cascade; Linda Hull, Hampton; and Nick Kirkmire, Substitution Rules Retention Coalition.