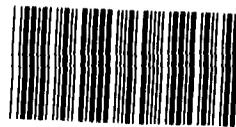
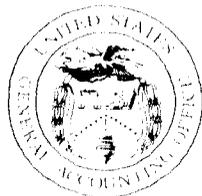


March 1991

TONGASS NATIONAL FOREST

Contractual Modification Requirements of the Tongass Timber Reform Act



143579

**Resources, Community, and
Economic Development Division**

B-243377

March 28, 1991

The Honorable J. Bennett Johnston
Chairman, Committee on Energy
and Natural Resources
United States Senate

The Honorable Morris K. Udall
Chairman, Committee on Interior
and Insular Affairs
House of Representatives

The Tongass Timber Reform Act (P.L. 101-626) enacted on November 28, 1990, unilaterally made nine modifications to long-term timber sale contracts held by two companies—the Alaska Pulp Corporation (APC) and the Ketchikan Pulp Company (KPC)—that harvest large amounts of timber in Alaska's Tongass National Forest. These contracts provide timber for the companies' wood pulp and saw log operations in southeast Alaska. The nine modifications to the contracts were intended to enhance the balanced use of resources in the Tongass and promote fair competition within the southeast Alaska timber industry. Specifically, the act required the Secretary of Agriculture to revise the contracts to reflect the modifications and transmit the text of the modified contracts to the Congress, together with a certification that such revisions were in compliance with the modifications included in the act.

The act required the Comptroller General to (1) audit on a continuing basis the actions taken by the Secretary to revise the texts of the contracts and (2) submit a report to the Senate Committee on Energy and Natural Resources and the House Committee on Interior and Insular Affairs describing the revisions made by the Secretary and stating whether the revised contracts complied with the act. This report discusses (1) compliance with the act and (2) our concerns regarding implementation of these modifications. Appendixes I to IX of this report describe in detail the revisions the Secretary of Agriculture made in the long-term contracts for each of the nine modifications and contain our opinion on whether such changes reflect the modifications required by section 301(c) of the act and comply with its requirements.

Results in Brief

The Forest Service, acting on behalf of the Secretary of Agriculture, made extensive revisions to the two long-term contracts. To address the act's requirements it generally adopted and modified provisions from

independent short-term timber sale contracts used in the Tongass National Forest. Except with respect to purchaser road credits (see appendix VII), we determined that all the changes comply with the act's requirements.

While the Forest Service made significant modifications to the long-term contracts, the manner in which the Forest Service implements these modifications will determine how successfully the objectives of the Tongass Timber Reform Act are carried out. The modifications do not specifically describe how the Forest Service will implement these contract revisions. Accordingly, the Congress does not have information on the specific manner in which the Forest Service will implement the contract modifications.

Background

The Tongass National Forest covers about 16.8 million acres in southeast Alaska. It is the largest national forest in the United States, equal in area to an area about the size of West Virginia. The Forest Service manages the Tongass for multiple uses such as timber production, outdoor recreation, and fish and wildlife habitat.

In the 1950s, the Forest Service awarded long-term (50-year) timber contracts to KPC, now a wholly owned subsidiary of the Louisiana-Pacific Corporation, and APC, a Japanese-owned firm. As stipulated in their contracts, each company built a pulp mill—KPC near Ketchikan, APC in Sitka. In return, the government guaranteed a 50-year timber supply totaling about 13.3 billion board feet on both contracts.¹ KPC's contract expires in 2004, APC's in 2011.

The Forest Service also sells timber from the forest to companies other than APC and KPC. These firms are referred to as independent short-term contractors. This timber is sold under timber sale contracts usually lasting from 3 to 7 years. Since 1980, about 30 percent of all Tongass timber sales have been made under independent contracts. In addition to their long-term contracts, both APC and KPC have been awarded short-term timber contracts.

Since the early 1980s, congressional concerns have emerged about the adverse impacts of the long-term contracts on the competitiveness of the timber industry in southeast Alaska and on the Forest Service's ability to effectively manage the Tongass National Forest. Part of the concern

¹ A board foot is equivalent to a piece of wood 12 inches wide, 12 inches long, and 1 inch thick.

centered on differences between provisions in the long-term contracts and provisions in contracts used for the short-term independent timber sales in the Tongass and throughout the rest of the national forest system. A major reason for legislative proposals affecting the long-term contracts was to eliminate the perceived competitive advantages of the long-term contract holders. These concerns were reflected in the 1990 Tongass Timber Reform Act, which states that

“it is in the national interest to modify the contracts in order to assure that valuable public resources in the Tongass National Forest are protected and wisely managed. Modification of the long-term timber sale contracts will enhance the balanced use of resources on the forest and promote fair competition within the southeast Alaska timber industry.”

The act unilaterally modified the contracts in nine ways (see table 1).² The required modifications included adopting timber sale planning, management, and environmental assessment procedures consistent with independent short-term sales. The modifications also addressed matters such as credit for building logging roads, protection against over-harvesting in high-yield areas, and equity between the prices of timber offered for sale to independent short-term contract holders and long-term contract holders. A glossary of timber management terms used in this report appears after appendix X.

²Some of these modifications are similar to recommended provisions in a Department of Agriculture report entitled Reid Brother Anti-trust Case Review Team Findings following an antitrust action brought against APC and KPC in 1975 by the Reid Brothers Logging Company.

Table 1: Modifications to the Long-Term Contracts

Modification	Section of a
Assure that all timber sale planning, management requirements, and environmental assessment procedures regarding the long-term contracts are consistent with such procedures for independent timber sales (see app. I).	301(c)(
Eliminate the practice of long-term contract holders harvesting a disproportionate amount of old-growth timber (see app. II).	301(c)(
Assure the long-term contract holders substantially harvest timber offered for harvest within 3 years before the Secretary offers additional timber to the companies (see app. III).	301(c)(
Assure that the Forest Service determines the precise stands of timber to be harvested and when harvests will occur (see app. IV).	301(c)(
Allow the long-term contract holders to reject timber offered, which, if rejected and subsequently resold within 12 months, will be deducted from the amount of timber required to be made available under the contract (see app. V).	301(c)(
Assure that the long-term contract holders count utility logs against the total volume of timber required to be made available for harvest under the contracts (see app. VI).	301(c)(
Assure that the long-term contracts are provided with purchaser road credits in a manner consistent with independent national forest timber sales (see app. VII).	301(c)(
Assure that the price of timber sold to long-term contract holders will be adjusted to be comparable with the price of timber sold in competitive independent timber sales (see app. VIII).	301(c)(
Assure that timber offered under the long-term contracts meets the economic criteria consistent with the timber offered in independent timber sales (see app. IX).	301(c)(

Compliance With the Act's Contract Modification Requirements

We found that except for the text on purchaser road credits, the texts of the APC and KPC long-term contracts have been revised to reflect the modifications required by section 301(c) of the Tongass Timber Reform Act and comply with the requirements of this provision. The texts of the long-term contracts were not revised to make changes in purchaser road credits that would make them substantially similar to independent sale (see app. VII).

The Forest Service extensively modified the format and terms of both the KPC and APC long-term contracts to resemble short-term independent timber sale contracts in the Tongass National Forest. From the date of the modifications forward, new timber will be made available under each long-term contract through individual offerings, which generally will incorporate the format and contract provisions utilized in short-term independent sales in the Tongass National Forest. In addition, ongoing timber operations were modified and incorporated into the individual offering format.

With regard to purchaser road credits, the Forest Service has adopted the provisions of short-term independent timber sale contracts, except in one important respect. The provisions still permit the long-term contractors to carry forward for possible future use from one offering to another certain road credits that would be cancelled at the end of a short-term independent timber sale contract. Thus, the long-term contractors have the advantage of being able to use credits over a period of time longer than that available to the short-term contractors.

Effective Forest Service Actions Necessary to Properly Implement the Act

While the contract modifications were made to comply with the requirements of section 301(c), the modifications did not generally specify how the Forest Service would implement them.³ For example, the modifications do not specify how the Forest Service will perform environmental assessments or how large an area they will cover.

In addition, questions exist as to whether the actions to implement certain contract modifications will achieve the objectives of these provisions. For example, we cannot presently ascertain the extent to which the price adjustment modification will accomplish the objective of achieving comparability with prices paid by independent short-term contractors.

Section 301(e) of the act requires that within 1 year after the date of enactment the Secretary shall transmit a study to the Senate Committee on Energy and Natural Resources and the House Committee on Interior and Insular Affairs. This study is to include (1) an assessment as to whether the Secretary can meet the requirements of other laws applicable to the management of national forests while providing the volume of timber required by the modified contracts and (2) an analysis of the potential impacts of eliminating the two contract areas provided for in the modified contracts.

Section 301(f) of the act provides congressional direction regarding the need for additional Forest Service actions to implement the Tongass Timber Reform Act. According to the act's conference report, this section requires the Secretary to take "other actions" necessary, beyond

³Implementation of the contract modifications could be affected as a result of any litigation filed to halt the carrying out of the revised provisions. The companies may also sue the government for damages allegedly resulting from the government's breach of contract and/or the taking of their property rights as a result of the contract modifications. Nowhere in the Tongass Timber Reform Act or its legislative history did the Congress clearly indicate that avoidance of taking claims should be a factor that the Forest Service should consider in planning its contract revisions.

modifying the contracts, to bring management of the Tongass into conformance with the provisions of section 301(c).

Conclusions

While the Forest Service has made significant modifications to the long-term contracts, the manner in which the Forest Service implements the contract modifications will determine whether or not the objectives of the Tongass Timber Reform Act are effectively carried out. The contract modifications will require a great deal of additional effort on the part of the Forest Service. However, generally the contract modifications do not specify exactly how the Forest Service will implement these modifications.

In addition, the Secretary of Agriculture did not make the contract modifications in purchaser road credits necessary to make them substantially similar to independent sales.

Recommendations

Accordingly, we recommend that the Secretary of Agriculture direct the Chief of the Forest Service to make the contract modifications in purchaser road credits necessary to preclude the carrying forward of certain credits from one offering to another.

We also recommend that the Secretary of Agriculture direct the Chief of the Forest Service to add to the study required by section 301(e) a detailed description of the manner in which the agency will implement each requirement of section 301(c). In addition the Secretary should include in the study an assessment of how the implementation actions would achieve the objectives of the act.

As required by the act, we audited the Forest Service's actions to modify the contracts during the period between the enactment of the act and the completion of the required modifications on a continuing basis. To conduct our analysis, we reviewed (1) the act and its legislative history; (2) the two prior long-term contracts and the subsequent modifications; (3) the Tongass National Forest Land Management Plan; (4) the Forest Service regulations, guidance, and procedures for preparing timber sale contracts; (5) short-term contract provisions; and (6) other documents needed for assessing the contract revisions. We worked with Forest Service and Department of Agriculture officials at headquarters in Washington, D.C., and at Region 10 headquarters in Juneau, Alaska, to review and analyze Forest Service position papers and fact sheets concerning

the revisions needed to the two long-term contracts, as well as various drafts of the changes to the two contracts. As a part of our review of the Department of Agriculture's actions, we reviewed and provided comments to the Forest Service on drafts of both the legislative history and contract modifications. As a consequence of the 30-day statutory reporting requirement, we did not have time to review whether the Forest Service made substantive changes to the long-term contracts that went beyond the unilateral modifications required under section 301(c) of the Tongass Timber Reform Act.

For further information about the revisions, we interviewed legal counsel for APC and KPC at their offices in Portland, Oregon, and Washington, D.C., respectively. In addition, we interviewed officials from the Southeast Alaska Conservation Council, the Sierra Club Legal Defense Fund, and the Southeast Alaska Natural Resources Center in Juneau, Alaska. We conducted our review between November 1990 and March 1991 in accordance with generally accepted government auditing standards.

Forest Service officials reviewed the factual information in a draft of this report and concurred with its presentation. Their comments have been incorporated where appropriate. We are sending copies of this report to the appropriate Senate and House committees; interested Members of the Congress; the Secretary of Agriculture; the Chief of the Forest Service; the Director, Office of Management and Budget; and other interested parties.

This work was done under the direction of John W. Harman, who may be reached at (202) 275-5138. Major contributors to this report are listed in appendix X.



J. Dexter Peach
Assistant Comptroller General

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Table 1: Modifications to the Long-Term Contracts

Abbreviations

APC Alaska Pulp Corporation
KPC Ketchikan Pulp Company

Timber Sale Planning, Management Requirements, and Environmental Assessment Procedures

Requirement of Act

Section 301(c)(1) of the Tongass Timber Reform Act modifies the APC and KPC long-term timber contracts to

“assure that all timber sale planning, management requirements and environmental assessment procedures regarding the contracts are consistent with procedures for independent national forest timber sales, pursuant to the National Forest Management Act of 1976 (Public Law 94-588), the National Environmental Policy Act of 1969 (42 U.S.C. 4321 et seq.), and other applicable laws.”

Contract Changes

The format and terms of both the KPC and APC¹ long-term contracts were modified to generally resemble short-term independent timber sale contracts in the Tongass National Forest. Timber would be made available under each long-term contract through individual offerings, which generally will incorporate the format and contract provisions utilized in independent sales in the Tongass National Forest. These provisions specify the procedures to be followed with respect to timber sale planning, timber management, and environmental assessments in keeping with applicable laws, such as the National Forest Management Act of 1976 and the National Environmental Policy Act of 1969.

All of these provisions apply to future offerings under the long-term contracts. With regard to long-term contracts that were ongoing at the time of the effective date of the contract changes, February 27, 1991, only timber management procedures will be applicable to such activities. Timber sale planning and environmental assessment procedures had already been completed for such ongoing operations.

Opinion

In our opinion, the texts of the APC and KPC contracts have been revised to reflect the modifications required by section 301(c)(1) of the Tongass Timber Reform Act and comply with the requirements of this provision. Both the APC and KPC contracts have been revised and reformatted, as described above, so that timber sale planning, timber management, and environmental assessment procedures are generally consistent with short-term competitively bid sales in the Tongass National Forest. Neither the Tongass Timber Reform Act nor its legislative history defines the term “independent national forest timber sales.” Consequently, the Secretary of Agriculture had the discretionary authority to select short-term competitively bid sales in the Tongass National Forest

¹The APC contract had already been modified to provide for timber offerings to be made for specific forest areas, instead of providing for a sale of all timber over a 5-year operating period, while the KPC contract still contained that 5-year provision of timber.

**Appendix I
Timber Sale Planning, Management
Requirements, and Environmental
Assessment Procedures**

as “the independent national forest timber sales” with whose procedures subsection (c)(1) requires the long-term contracts to be consistent.

Disproportionate Timber Harvest

Requirement of Act

Section 301(c)(2) of the Tongass Timber Reform Act modifies the APC and KPC long-term contracts to

“eliminate the practice of harvesting a disproportionate amount of old-growth timber by limiting the volume harvested over the rotation in volume classes 6 and 7 as defined in TLMP [Tongass National Forest Land Management Plan] and supporting documents, so that the proportion of volume harvested in these classes within a contiguous management area does not exceed the proportion of volume currently represented by these classes within the management area.” (Brackets added.)

Contract Changes

The APC and KPC contracts now contain provisions specifying that the proportion of high-volume, old growth timber (volume classes 6 and 7) in a management area will, at the end of each contract, be the same as the proportion such volume classes represented at the time the Tongass Timber Reform Act became law, November 28, 1990. The revised contracts provide that with respect to timber operations in a management area that were ongoing on the effective date of subsection (c)(2), February 27, 1991, such operations will be reviewed to assure that the remaining timber harvest units in a management area comply with this provision.

Opinion

In our opinion, the texts of the APC and KPC contracts have been revised to reflect the modifications required by section 301 (c)(2) of the Tongass Timber Reform Act and comply with the requirements of this provision. The literal wording of subsection (c)(2) would have permitted the companies in each management area to cut excessive amounts of volume classes 6 and 7 during the remaining years of each contract—APC for 20 years and KPC for 13 years—so long as over the rotation, 100 years, the proportion of these volume classes harvested did not exceed the proportion of these classes on November 28, 1990, the date the act was enacted. The Secretary of Agriculture adopted a formula more appropriate to the purpose of this provision to prohibit highgrading by providing that, at the end of the contract period, the proportion of remaining timber in volume classes 6 and 7 will be the same as existed on November 28, 1990. Section(c)(2) does not require that the proportion be determined separately for each volume class.

Substantial Harvest of Timber

Requirement of Act

Section 301(c)(3) of the Tongass Timber Reform Act modifies the APC and KPC long-term contracts to

“assure that all timber offered under each contract be substantially harvested within three years or the Secretary shall withhold further offerings pursuant to such contract, unless harvesting has been delayed by third-party litigation.”

Contract Changes

The APC and KPC long-term contracts now provide that an offering or subdivision must be “substantially harvested” within three normal operating seasons from the date the Forest Service releases the timber to the companies. Generally, timber is released to a contract holder when the logging/construction approval notice for a timber harvest unit in the offering area or subdivision has been issued by the Forest Service.

The Forest Service has determined that a stand of timber is substantially harvested when at least 75 percent of the estimated volume has been cut and removed. The contracts provide that this 3-year period may be extended for causes beyond a contract holder’s control, including third-party litigation, acts of God, labor disputes, fires, and floods. The harvest of remaining timber must be completed within the fourth year of the offering. With regard to operations ongoing on the effective date of the modification, February 27, 1991, subsection (c)(3) only applies to timber harvest units released on or subsequent to this date.

Opinion

In our opinion, the texts of the APC and KPC contracts have been revised to reflect modifications required by section 301(c)(3) of the Tongass Timber Reform Act and comply with the requirements of this provision. The Secretary of Agriculture exercised reasonable discretion in measuring the 3-year substantial harvest requirement from the release of a timber unit for harvest. Subsection (c)(3) does not clearly indicate how the 3 years are to be measured. The legislative history provides support for the Secretary’s determination about when to begin the 3-year period. The act’s conference report explains that subsection (c)(3) prohibits future offerings to the contract holders unless they have “substantially harvested” all timber previously released within a 3-year period. Generally, timber is released to the companies under the contracts when the Forest Service issues a logging/construction approval notice.

The Secretary also exercised appropriate discretion in (1) defining “substantially harvested” to be at least 75 percent of the volume to be harvested in an offering or subdivision and (2) interpreting the 3-year period to mean 3 operating seasons, instead of 3 calendar years.

In our view the Secretary also had the authority to include provisions in the revised contracts that allow the 3-year substantial harvest period to be adjusted (extended) for certain reasons outside the contract holders control, besides the reason provided by subsection (c)(3), third-party litigation. These additional reasons, which include acts of God, labor disputes, fires, and floods, are included in short-term Tongass sales contracts to allow adjustments of harvest periods. Both the Tongass Timber Reform Act, e.g., subsection (c)(1), and its legislative history make clear that the Congress wanted the long-term contracts to be consistent with independent timber sales contracts. Neither the act nor its legislative history indicates that the Congress expected that third-party litigation would be the exclusive reason justifying adjustment of the harvest period. Reasons that the Forest Service added are often included in commercial contracts, as justifiable excuses for not performing contract obligations or extensions of contract periods.

Selection of Timber Harvest Units

Requirement of Act

Section 301(c)(4) of the Tongass Timber Reform Act modifies the APC and KPC long-term contracts to

"assure that the Secretary determines the location and size of sale units and the timing of timber harvests."

Contract Changes

The contracts now provide that the Forest Service specify the boundaries of each harvest area and any of its subdivisions and determine the location and size of the harvest areas and the timing of timber harvests. The Forest Service eliminated the prior APC contract provision, which required that harvest plans be developed jointly by the contract holder and the Forest Service. The Forest Service eliminated the prior KPC contract provision, which allowed the contract holder to select the timber harvest units to be cut during a specified 5-year period, according to guidelines provided by the Forest Service. The Forest Service will be required to consult with the long-term purchasers as to the volume of timber to be offered in the current timber supply and the offering areas that will be included in the tentative offering schedules. However, after consultation, the Forest Service determines the size, location, and timing of each timber offering and harvest units within each offering.

Opinion

In our opinion, the texts of the APC and KPC contracts have been revised to reflect the modifications required by section 301(c)(4) of the Tongass Timber Reform Act and comply with the requirements of this provision. The contracts give the Forest Service responsibility for specifying the boundaries of each harvest area and for determining the location and size of the sale units and timing of timber harvest.

Rejection of Timber Offered

Requirement of Act

Section 301(c)(5) of the Tongass Timber Reform Act modifies the APC and KPC long-term contracts to

“allow rejection of timber offered under the contracts. Upon rejection of any timber offered, the Secretary may re-offer such timber to any qualified bidder under independent national forest timber sales. If the rejected timber is subsequently sold within 12 months, that amount of timber shall be subtracted from the volume remaining under the appropriate contract.”

Contract Changes

The APC and KPC long-term contracts now specify that the companies may, in writing, reject as a whole timber offered for harvest within 30 days of receipt of the offer. The Forest Service can subsequently sell the rejected timber as part of the independent timber sale program. The contracts specify that the long-term contract holders cannot bid on such sales, which must take place within 12 months after the timber is rejected. If the reoffered timber is sold, the Forest Service will deduct the estimated volume of the sale, including utility logs, from the timber volume remaining under the long-term contracts. The contracts also provide that the rejected timber, if not resold within the 12-month period, shall, in a timely manner, be replaced in the contract holder's current timber supply.

Opinion

In our opinion, the texts of the APC and KPC contracts have been revised to reflect the modifications required by section 301(c)(5) of the Tongass Timber Reform Act and comply with the requirements of this provision. The text of the contracts follow the requirements of subsection (c)(5). This provision will be applicable only to new offerings made after the effective date of this provision, February 27, 1991, because operations occurring on that date concerned offerings previously accepted. The Secretary has the discretion to exclude a contract holder from participating as a bidder in an independent sale for the timber it has rejected.

Utility Log Volumes

Requirement of Act

Section 301(c)(6) of the Tongass Timber Reform Act modifies the APC and KPC long-term contracts to

“assure that utility logs offered under the contracts shall be counted against contract volume requirements. As used in this paragraph, the term ‘utility log’ means the same as it does in the official Log Scaling and Grading Rules, Northwest Log Rules Advisory Group, January 1, 1982.”

Contract Changes

The APC and KPC contracts were revised to assure utility log volumes will be counted against contract volume requirements. The Forest Service revised the APC contract to require that “utility log volume scaled after February 26, 1991, will be counted as part of Included Timber and against other contract volume requirements in effect after February 26 1991.” The Forest Service revised the KPC contract to provide that “utility log volume will continue to be counted as part of Described Timber and against other contract volume requirements.”

Opinion

In our opinion, the texts of the APC and KPC contracts have been revised to reflect the modifications required by section 301(c)(6) of the Tongass Timber Reform Act and comply with the requirements of this provision. Each contract now provides that utility logs will be counted against contract volume requirements.

Purchaser Road Credits

Requirement of Act

Section 301(c)(7) of the Tongass Timber Reform Act modifies the APC and KPC long-term timber contracts to

“assure that purchaser road credits are provided under the contracts in a manner consistent with independent national forest timber sale procedures.”

Purchaser Road Credits

Under national forest timber sales contracts, “purchaser road credits” are credits earned by a timber purchaser for constructing Forest Service roads, which will provide access to the timber to be harvested. The maximum amount of purchaser road credits allowed for each timber contract is the Forest Service’s estimate for the cost for all such roads. Earned purchaser road credits can be used instead of cash to pay for the value of that timber actually harvested, at rates in excess of base rates. Base rates represent the minimum price the Forest Service is required to charge in cash for timber.

“Effective purchaser credits” are unused earned purchaser credits that can be used to pay for the value of timber that will subsequently be harvested under the contract. Such credits cannot exceed the difference between the value of the estimated remaining (unscaled) timber at current contract rates and the estimated value of such timber at base rates. Unused earned purchaser road credits are “ineffective” when they exceed this difference.

“Effective” purchaser road credit may be transferred to another of the purchaser’s timber contracts in the same national forest to pay for timber. “Ineffective” credits cannot be transferred to another contract, and accordingly, at the end of the contract are cancelled. The term of short-term contracts typically is from 3 to 7 years.

By contrast, prior to the Tongass Timber Reform Act, under the long-term contracts, “ineffective” purchaser road credits from one 5-year operating period were not cancelled, but retained over the remaining life of the 50-year contracts. Thus, when timber prices would be adjusted upward, “ineffective” purchaser road credits became “effective” up to an amount equal to the total increase in contract price. Consequently, they could be used to pay for the value of other timber harvested under the contracts.

Contract Changes

The Forest Service revised the two long-term contracts in response to section 301(c)(7). Under the revised long-term contracts, “purchaser

credit” is credit earned by the companies for the construction of Forest Service roads with respect to each contract offering. The maximum amount of purchaser credit under a contract is the sum total of the credits under each offering. “Effective purchaser credit” refers to unused earned purchaser credits that do not exceed the difference between the sum of the value of the estimated remaining timber in each contract offering at current contract rates minus the sum of the estimated value of such timber at base rates in each offering.¹ The companies will be able to carry ineffective purchaser credits forward until the end of the long-term contracts, at which time they will be cancelled.

This provision applies to construction work recorded by the Forest Service as accomplished after February 26, 1991.

Opinion

In our opinion, the texts of the APC and KPC contracts have not been revised to reflect the modifications required by section 301(c)(7) of the Tongass Timber Reform Act and, therefore, do not comply with the requirements of this provision.

The Forest Service has not modified the texts of the long-term contracts as required by subsection (c)(7), to “assure that purchaser road credits are provided under the contracts in a manner consistent with independent national forest timber sales procedures.” Ineffective road credits under the long-term contracts can still be carried forward from one harvest area to another as was the case prior to the enactment of subsection (c)(7). Pursuant to the modifications made by subsection (c)(1) of the act—which requires that the contracts be made consistent with short-term sales timber management requirements—the Forest Service has revised the long-term contracts into a series of contract offerings that are designed to resemble short-term sales. These contracts have generally incorporated the provisions of the short-term contracts.

Thus, with regard to purchaser road credits, the Forest Service has adopted the provisions of short-term sales contracts, except in one important respect. It still permits the long-term contract holders to carry forward ineffective purchaser road credits from one contract offering to another. By contrast, under the short-term sales contracts, ineffective purchaser road credits are cancelled at the end of the contract, usually about 5 years. We believe that the language of subsection (c)(7), as well as its legislative history, makes clear that the Congress expected the

¹We believe that offerings under the long-term contracts would average about 3 to 7 years.

Forest Service to make changes in purchaser road credits that would make them substantially similar to independent sales. They did not do so.

We recognize that the Forest Service has made certain changes in the long-term contracts accounting for and for the use of purchaser road credits. But, while such changes may be beneficial, they do not achieve the substantial similarity in treatment of ineffective purchaser road credits between long and short-term contracts that would result from the elimination of the carrying forward of such credits from each offering under the long-term contracts. The Forest Service argues that with regard to ineffective credits the contracts did not have to be modified because they were already consistent with independent sales contracts. This is so because under both short-term and long-term contracts ineffective purchaser road credits are cancelled at the end of the contracts.

The problem with the Forest Service's argument is that while ineffective credits are cancelled at the end of both contracts, the treatment of such credits is fundamentally different under these agreements. The short-term contract holders can only use ineffective road credits during the length of their contracts, which are considerably less than the long-term contracts, on average about 5 years. The long-term contract holders have the advantage of being able to use these credits over a longer period of time—20 years for APC and 13 years for KPC—and thus have the potential to partially offset the payment of stumpage fees if the price of timber rises over the remaining life of such contracts. This possibility gives the long-term contract holders an advantage over the short-term purchasers.² The changes required by subsection (c), including (c)(7), are aimed at eliminating the advantages of the long-term contracts and, as provided in subsection 301(b), promoting fair competition within the timber industry in southeastern Alaska.

While we recognize that the elimination of the carrying forward of purchaser road credits from each offering under the long-term contracts in the future³ may give rise to claims of breach of contract and the taking

²It would be difficult to estimate the value of the advantage the long-term purchasers may gain from carrying ineffective credits forward over the life of the contracts.

³According to the Forest Service, at the present no ineffective road credits would have had to be cancelled if the Forest Service had eliminated the carrying forward of ineffective credits from each offering under the long-term contracts. It would be difficult to estimate what the size of any such claims might be in the future.

of contract rights, we found no evidence in the act or its legislative history indicating the Congress wanted the Forest Service to avoid the possibility of such claims when revising the texts of the contracts.

Timber Price Adjustment

Requirement of Act

Section 301(c)(8) of the Tongass Timber Reform Act modifies the APC and KPC long-term timber contracts to

“assure that the price of timber offered under the contracts shall be adjusted to be comparable with that of independent national forest timber sales, with stumpage rates and profitability criteria comparable to those of independent purchasers in competitive sales.”

Contract Changes

The Forest Service revised the APC and KPC long-term contracts to include an upward price adjustment procedure to be applied to the tentative long-term timber prices arrived at under the residual value appraisal method. The residual value appraisal method is used by the Forest Service to determine both the price at which timber will be sold under the long-term contracts and the advertised price for competitive bid independent timber sales.¹ The premise of this appraisal method is that standing timber should be priced to enable a purchaser to (1) harvest the timber, (2) process it into finished products, and (3) sell those finished products at prices that recover all of the purchaser’s harvest and manufacturing costs and that also allow a margin for profit and risk. This method does not consider Forest Service costs in establishing price.

The Forest Service will adjust the appraised price of timber in long-term contracts on a quarterly basis using the average value of timber harvested over the previous rolling 4 quarters under the Tongass independent timber sale program. This sale program is designed to provide timber to independent operators, who must competitively bid for the right to harvest the timber. The value that independent timber operators pay for Tongass timber is equal to the appraised rate of the timber in the harvest area, as determined by the Forest Service, plus the value determined by the bidding process.

Before the quarterly price adjustment is made, however, the value of the timber harvested under the independent sale programs will be adjusted to take into account potential differences in the appraised rate between the long-term and independent sale timber contracts. This adjustment is used to account for differences between harvest areas in timber species, timber quality, logging costs, road construction, and other relevant factors. Thus, the long-term and independent contract

¹ More detailed information regarding the residual value appraisal method is contained in our report entitled *Federal Timber Sales: Process for Appraising Timber Offered for Sale Needs to Be Improved* (GAO/RCED-90-135, May 2, 1990).

appraised rates will be standardized so that the price-adjustment mechanism captures the value attributable to the bidding process. The adjusted independent harvest value is referred to as the comparable rate.

The price of timber offered in long-term contracts will not be adjusted in cases in which the comparable rate is less than the appraised rate on the long-term contracts. For example, at the end of each quarter, the price of timber offered under the long-term contracts will return to its initial, appraised value. The price adjustment is then made using the average independent sale value over the previous rolling 4 quarters, adjusted for differences in appraisal rates (that is, the comparable rate). If the comparable rate is less than the long-term initial appraised value, no price adjustment will be made.

The Forest Service included other conditions in the long-term contracts for determining when price adjustments are not to be made. These qualifiers—the volume of timber harvested and the number of sales—were added so that the volume of the independent timber being harvested adequately represented competitive sales. The rate adjustment thus derived can only be a positive or a zero adjustment to a tentative long-term rate. Contract procedures do not provide for a negative adjustment because the Forest Service is prohibited (16 U.S.C. 472a) from selling timber for less than its appraised value.

The Forest Service will not be required to adjust long-term timber contract prices in cases in which (1) the comparable rate (that is, the adjusted independent harvest value) is less than the appraised rate on long-term contracts and (2) a low degree of competition on independent sales precludes price adjustment.

Opinion

In our opinion, the texts of the APC and KPC contracts have been revised to reflect the modifications required by section 301 (c)(8) of the Tongass Timber Reform Act and comply with the requirements of this provision. Neither the Tongass Timber Reform Act nor its legislative history specifies the method or the criteria for assuring price comparability between the long-term contracts and independent Tongass National Forest timber

Appendix VIII
Timber Price Adjustment

sales. The methodology selected by the Forest Service to comply with the requirements of subsection (c)(8) appears to be reasonable.²

²Although the methodology appears reasonable, the two long-term purchasers in the Tongass timber market appear to have a dominant position through ownership of the major timber processing facilities. They might be able to use this position to influence the prices that emerge from the independent sales bidding process resulting in "comparable" rates that are derived from other than fully competitive prices.

Economic Criteria

Requirement of Act

Section 301(c)(9) of the Tongass Timber Reform Act modifies the APC and KPC long-term timber contracts to

“assure that timber offered under the contracts meets economic criteria, consistent with that of independent national forest timber sales.”

Contract Changes

The Forest Service revised the APC and KPC long-term contracts primarily by deleting the mid-market assessment clause from the APC contract and the Puget Sound clause from the KPC contract. These clauses provided that timber offerings had to meet certain quality and value criteria. Each long-term contract now requires consistency with independent timber sale planning procedures that incorporate economic criteria found in the Forest Service Handbook, the Timber Sale Preparation Handbook, and Alaska Region Supplements. The economic criteria applied to each long-term contract will be subject to change to keep them consistent with any future changes in criteria applied to Tongass independent sales.

The Forest Service will be required to consult with the long-term purchasers as to the volume of timber to be offered in the current timber supply and the offering areas to be included in the tentative offering schedules.¹ However, after consultation, the Forest Service determines the size, location, and timing of each timber offering and harvest units within each offering.

Opinion

In our opinion, the texts of the APC and KPC contracts have been revised to reflect the modifications required by section 301(c)(9) of the Tongass Timber Reform Act and comply with the requirements of this provision

¹Subsection (c)(9) only applies to future contract offerings. The timber harvested under timber operations ongoing at the time subsection (c) became effective was offered prior to the passage of the Tongass Timber Reform Act.

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Glossary

Base Rates	The lowest authorized rates for timber per unit of measure and species that must be paid in cash and represent the minimum rates plus any costs of necessary regeneration.
Bid Premium	The amount by which purchaser bids are in excess of the advertised rates.
Described Timber	The 1,500,000,000 cubic feet (approximately 8,250,000,000 board feet) of timber, more or less, designated by the Forest Service for cutting under the KPC contract.
Five-Year Operating Periods	After longer initial operating periods the long-term contracts were divided into 5-year increments in which cutting units were selected, cutting boundaries determined, stumpage prices established, and contract modifications made, if necessary.
Included Timber	The 4,974,700,000 board feet of timber, more or less, designated by the Forest Service for cutting under the APC contract.
Independent National Forest Timber Sale Provisions	The standard provisions used by the Forest Service for the competitive sale of national forest timber.
Logging/Construction Forest Approval Notice	A written notice given by the Forest Service to a contract holder as a prerequisite for the commencement of harvesting and construction activities.
Mid-Market Clause	A clause in the pre-Tongass Timber Reform Act APC contract specifying that mid-market timber is timber for which a mid-market assessment will provide a weighted average margin for profit and a risk of at least 60 percent of normal. The assessment was based on weighted average pond log value, estimated logging and road costs, normal profit ratios, and base rates.

Glossary

Offering	Forest Service specification of timber harvest units, subdivisions, roads and other facilities and operations to meet the requirements of the long-term contracts for an offering area.
Offering Area	A geographic area identified by the Forest Service within which an offering is made.
Operating Season	The normal period of time specified in a timber sale contract during which the contract holder's harvesting operations will normally be conducted.
Puget Sound Clause	A clause in the pre-Tongass Timber Reform Act KPC contract specifying that the weighted average estimated costs of Tongass pulp logs delivered at KPC's pulp plant shall not be higher than a percentage of the weighted average of similar quality logs purchased by mills in the Puget Sound region.
Purchaser Road Credit	Credit that is earned by purchasers for constructing or reconstructing roads necessary to remove timber and that can be used in lieu of cash for above-base rates or stumpage charges, when "effective."
Effective Purchaser Road Credit	The unused purchaser credit earned by the contractor that does not exceed the sale's above-base rates, which may be used to pay the above-base charges on the sale or transferred to another sale within the same proclaimed unit.
Ineffective Purchaser Road Credit	Purchaser credit that may not be used to offset above-base rates, since there is insufficient above-base value to cover the full value of the purchaser credit.
Release	The date that the logging/construction approval notice for every timber harvest unit in the offering or subdivision has been issued by the Forest Service or deemed approved, provided that the release for any offering or subdivision shall be no sooner than February 27, 1991, and no later than the projected road completion for the offering or subdivisions.

Rotation	The planned number of years (approximately 100 years in Alaska) between the time that a forest stand is regenerated and its next cutting at a specified stage of maturity.
Sawlog	A log at least one-third sound that may produce either sawn or pulp products.
Scaling	The sampling, measuring, counting, or weighing of removed timber in order to determine the volume for charge purposes.
Stumpage	The value of timber as it stands uncut in terms of dollar value per thousand board feet.
Subdivision	The individual segments of an offering area.
Substantially Harvested	When a minimum of 75 percent of the estimated included timber within an offering area or subdivision has been cut and removed from the offering area.
Timber Harvest Unit	A portion of an offering area within which the Forest Service specifies for harvest all or part of the timber to meet the requirements of the long-term contracts.
Tlmp	Tongass National Forest Land Management Plan, completed March 1979 and amended Winter 1985-1986.
Transfer-in Purchaser Credit	Effective purchaser credit established on other sales and subsequently transferred to another sale.
Utility Logs	Those logs that do not meet sawlog grade (less than one-third sound), but are suitable for production of firm usable pulp chips to an amount of not less than 50 percent of the gross scale.

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