

**COMPLIANCE AUDIT OF PART OF THE PROJECT  
ALLOCATION PROCESS FOR THE ROTTOCK BAY  
CONSOLIDATED FORESTRY PROJECT**

**Prepared For:**

**THE GOVERNMENT OF PAPUA NEW GUINEA**

**c/- THE CHIEF SECRETARY TO  
GOVERNMENT**

**Prepared By:**

**THE 2003/2004 REVIEW TEAM**

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1. Findings of the 2000/2001 Review Affecting Rottock Bay Consolidated
2. Notes Regarding the Sustainable Annual Allowable Cut
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## EXECUTIVE SUMMARY AND RECOMMENDATIONS

This audit examines compliance of the project allocation process for the Rottok Bay Consolidated forestry project with the requirements of Government as set out in the National Forest Policy 1991, the Forestry Act 1991 and its Regulations, the relevant environmental legislation, and other regulations and guidelines. The 2000/2001 Review of "In Process" Forestry Projects examined compliance to the stage of Project Guidelines being developed. The current audit examines compliance from the Project Guidelines being developed to the negotiated Project Agreement being presented to the Board for execution. It also examines the degree to which the recommendations for remedial action made by the 2000/2001 Review Team and endorsed by the National Executive Council (NEC) have been implemented by the relevant Government agencies (in particular the National Forest Service (NFS) and the Department of Environment and Conservation (DEC)).

The key audit conclusions are as follows:

### CONCLUSIONS AFFECTING ALL FORESTRY PROJECTS

- There has been a major change in the process for the allocation of forestry projects due to the requirements of the new Environment Act 2000 which came into force on 1 January 2004. The Act requires an extensive process involving an Environmental Impact Assessment and an Environmental Impact Statement before the activity being planned can be approved (or declined) by the Director for Environment, and subsequently the Minister, and before an Environment Permit may be issued.

Rottok Bay Consolidated falls short of being an "existing activity" under the Act, and to the Audit Team it appears that the full procedure for obtaining the required Environmental Permit must be observed. The Minister for Forests cannot entertain an application for a Timber Permit until an Environment Permit is approved.

- The current Government through the NEC has made confusing decisions. On one hand through Decision 43/2002 (November 2002) it "*endorsed the Minister for Forests to process timber projects ..... without any hindrances<sup>1</sup> .....*" yet on the other hand through Decision 170/2003 (August 2003) it has "*approved the revised Time Bound Action Plan*". A clarifying direction from Government is required. The key question to be answered is whether the Government wishes to continue with the World Bank loan funded Forestry and Conservation Project (FCP) or not.

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<sup>1</sup> Although not stated, it is clear that the "hindrances" referred to are the Forestry and Conservation Project (FCP) and the Time Bound Action Plan, both of which are seen as an impediment to progressing timber projects.

- The Board and staff of the PNGFA continue to fail to implement the Time Bound Action Plan endorsed by the NEC. The Government is contractually bound to do so under the terms and conditions of the World Bank loan. The issues intended to be resolved by implementation of the plan are typically either trivialised or ignored.
- The Audit Team agrees with the view of the PNGFA Board (Meeting 102 of June 2004) that *“complacency and lack of technical and managerial capacity exists within the Divisions and Branches [of the National Forest Service] which are directly or indirectly responsible for resource allocation”*. A lack of professionalism is evident, especially with regard to the poor quality of the forest resource descriptions which underpin new forestry projects, and which despite recommendations made four years ago, have not yet been improved.

#### CONCLUSIONS REGARDING THE ANNUAL ALLOWABLE CUT (AAC)

- That due process has not yet been observed. Mainly:
  - There is still no reliable forest resource description. Through the Time Bound Action Plan the NEC directed that Rottok Bay Consolidated was to be progressed only after NEC policy decisions had been made regarding the loggability of fragile forests, the 10% conservation set-aside, and the cutting cycle. This has not yet been complied with. Also the additional field inventory directed by the plan has not yet been undertaken;
  - The Time Bound Action Plan endorsed by the NEC under the current Government has still not been implemented, and consequently a policy decision regarding the logging of fragile forests is still pending; and
  - The State Negotiating Team’s accepted a higher AAC for the first five years of the project at the cost of long term project viability and sustainability.

#### CONCLUSIONS REGARDING LEGAL COMPLIANCE

- That development of Rottok Bay Consolidated is in breach of s54 of the Forestry Act in that the consolidated project is not mentioned in the National Forest Plan, nor are two of the four component FMA area (Rottok Bay and Inland Rauto-Miu).
- For that part of the allocation procedure examined by the audit, due process has generally been observed. However, there needs to be increased attention to the completion and filing of the prescribed statutory forms.
- There is no legal instrument to formally record landowner agreement to consolidation. This is seen as a vulnerability in the event that there are disputes between the landowners from the Forest Management Agreement (FMA) areas making up the consolidated project.

## CONCLUSIONS REGARDING LANDOWNERS

- Differences between two factions of landowners regarding the choice of preferred developer are noted. In response to the expressed concerns of the Board, the PNGFA Legal Counsel advised that as it was dealing with the majority of the landowners there was no cause for concern. The Audit Team does not agree.
- There appear to be at least two Incorporated Land Groups (ILGs) within the project boundaries who claim that they have not signed the FMA.

## RECOMMENDATIONS

Recommendations are made for consideration by the relevant parties. These are primarily aimed at:

- Meeting the sustainability requirements of the National Forest Policy 1991 by progressing the project on the basis of a reliable forest resource description, and consequently a reliable estimate of the sustainable annual allowable cut (AAC);
- Ensuring compliance with the requirements of the new Environment Act 2000; and
- Ensuring that the Government meets its contractual obligations under the terms and conditions of the World Bank loan for the Forestry and Conservation Project.

At the current stage of project development (the Board has not yet executed the Project Agreement and as thus has not yet contractually committed the State), the opportunity to make changes still exists. Consequently **the key recommendation is:**

- **That the PNGFA Board does not execute the Project Agreement at this time.**

**Further recommendations** are as follows:

- That Government make a clear decision whether it wishes to retain the Forestry and Conservation Project (and thus implement both the project and the Time Bound Action Plan), or to formally withdraw from the project and the World Bank loan agreement<sup>2</sup>.

**If** the Government decides to proceed with the FCP, then **it is further recommended:**

- That Government revise the timetable inherent in the Time Bound Action Plan, and direct its implementation.

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<sup>2</sup> It is noted that PNG is a signatory to the International Tropical Timber Agreement which requires observance of sustained yield management of tropical forests.

- That the Minister for Forests prepares a submission to the NEC requesting it to formally approve a change to the National Forest Policy implementing a 35 year cutting cycle to replace the current requirement for a 40 year cutting cycle.
- That the PNGFA Board:
  1. Directs the member representing the DEC to provide the Board with a full and detailed brief explaining the requirements of the Environment Act 2000, and how the Department sees the Act will impact on the development of new forestry projects;
  2. Directs the NFS to expedite it's participation in the joint DEC/NFS Committee considering the requirements of the Act;
  3. Satisfies itself that the requirements of the Environment Act 2000 can be met; and
  4. Informs the Minister of the impact of the Act on new project development (both in terms of procedure and time requirements).

**Provided** the Board is satisfied that the further development of Rottok Bay Consolidated is able to comply with the requirements of the Environment Act 2000, then **it is further recommended:**

- That the PNGFA Board direct the NFS to:
  1. Update the National Forest Plan in order that s. 54 of the Forestry Act 1991 may be complied with;
  2. Implement those aspects of the Time Bound Action Plan which impact on the estimate of the sustainable AAC, and in particular to undertake field inventory work to provide a reliable estimate of the loggable volume per hectare and the sustainable AAC<sup>3</sup>; and
  3. Take into account the provision in the FMA for a 10% conservation set-aside, when recalculating the AAC.
- That the NFS:
  1. Confirms the gross project area by verifying the ILGs, with particular attention to those ILGs which may not have signed the FMA; and

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<sup>3</sup> The 2000/2001 Review Report recommended that a minimum sample of 1% was required. The bigger the sample, the more reliable the AAC estimate. The PNGFA have indicated that there is insufficient funds. Even half of the recommended sampling intensity would be a significant improvement on what exists. Costs can be significantly reduced by assessing only saw/export logs. An independent audit of the survey procedures and the resulting data is recommended.

2. Reconfirms the AAC after dealing with all the requirements of the Time Bound Action Plan which impact on the AAC (with particular attention to additional field inventory).

**Provided** the recalculated sustainable AAC exceeds the Board determined 70,000 m<sup>3</sup> minimum for a viable stand alone log export project, then **it is further recommended**:

- That as the proponent of the project, the PNGFA initiates the process required to obtain an Environment Permit under the Environment Act 2000;
- That DEC abandon the option of asking Cakara Alam (PNG) Ltd to apply for a variation of the Environment Permit which exists for the Rottok Bay component of the consolidated project;
- That the PNGFA enter into a formal agreement with the landowners for each FMA area recording their agreement to the consolidation, and to the consolidated area being managed as a single sustainable project;
- That the permitted maximum AAC set out in the Project Agreement is revised;
- That the PDB is properly implemented as originally designed by removing the requirement for the developer to pay levies and to deliver social infrastructure;
- That the long term commercial viability of the project is not compromised by allowing an increase in the log harvest during the early period of the project at the expense of the later permitted cut; and
- That the PNGFA makes an increased effort to ensure that landowners are adequately consulted, and provided with a real opportunity to present their case where there is dissent.



## **1. INTRODUCTION AND BACKGROUND**

### THE 2000/2001 REVIEW

During 2000/2001 an independent Review Team undertook an audit of 32 “in process” forestry projects which were at that time being developed by the PNG Forest Authority (PNGFA). None of the projects had yet reached the stage where a Timber Permit had been issued by the Minister. The purpose of the audit was to check that each project was being progressed in proper compliance with the National Forest Policy, the Forestry Act 1991, and other regulations and guidelines.

The 2000/2001 Review Team made a number of project specific recommendations for each of the projects reviewed. In addition it made a number of generic recommendations applying to all projects. A copy of the recommendations is set out in Attachment 1. The recommendations were endorsed by the National Executive Council (NEC), and developed by the Department of the Prime Minister and the NEC into a Time Bound Action Plan for implementation by the relevant Government Departments and Authorities, mainly the PNGFA and the Department of Environment and Conservation (DEC).

### ROTTOCK BAY CONSOLIDATED

One of the project reviewed was Rottok Bay Consolidated. The 2000/2001 Review Team report notes that the Rottok Bay component of the consolidated project had been progressed to the point of advertising and receipt of expressions of interest in 1996, at which time a sensible decision was made to consolidate it with three others (Aria Vanu Block 2, Vanu Tamu and Inland Rauto-Miu) to make up a commercially viable logging project. One of the proponents (Cakara Alam (PNG) Ltd), had sought to have the Rottok Bay component allocated to it as an extension of it’s Arowe logging project, and had submitted a detailed Environmental Plan to DEC. This option was rejected by the PNGFA.

At the time of the 2000/2001 Review, the consolidated project had been progressed to the point of draft Project Guidelines being prepared by the Provincial Forest Management Committee (with the assistance of the PNGFA Resource Development Division). The guidelines had not yet been considered by the Board<sup>4</sup>.

### THIS COMPLIANCE AUDIT REPORT

Since the 2000/2001 Review Report was produced and the Time Bound Action Plan was endorsed by the NEC under both the previous and the current Government (NEC Decisions 188/2001 and 170/2003), the PNGFA Resource Development Division has

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<sup>4</sup> Project Guidelines were subsequently approved by the Board at its meeting No 89 in February 2003.

further progressed the consolidated project to the point of negotiating a Project Agreement with a duly selected developer (Cakara Alam (PNG) Ltd), and submitting the agreement to the Board for execution. This compliance audit report was requested by the (acting) Managing Director of the PNGFA in order that any compliance issues might be addressed before the Project Agreement is executed by the Board, and thus becomes a legal contract binding the State.

## THE PROJECT DEVELOPMENT ENVIRONMENT

This compliance audit has been undertaken against a background of strongly divergent views with regard to new logging project development. The 2000/2001 Review Team recommended that a number of generic issues be addressed, as well as a number of issues specific to Rottok Bay Consolidated, before the project was progressed any further. The NEC approved Time Bound Action Plan was designed to address the issues raised and to ensure that the recommended remedial actions were implemented. In addition to the NEC approving the plan, the Government also agreed to the implementation of the plan being included as a condition of a forestry related loan under negotiation at the time with the World Bank (for the Forestry and Conservation Project (FCP)). The loan agreement was duly signed in December 2001.

In August 2002 a new Government was elected. The new Government almost immediately directed that it wanted 10 new logging projects to be initiated as soon as possible as a contribution to its Export Led Economic Recovery Strategy. A number of senior NFS managers saw the Time Bound Action Plan as a serious impediment to meeting the directions of the new Government, despite the new Government retrospectively endorsing the Time Bound Action Plan through NEC Decision No 170/2003. It is clear from meeting minutes that this view was shared by a number of the members of the PNGFA Board.

At the time of this audit it is the observation of the Audit Team that the situation remains strongly polarised. The NFS continues to ignore the requirements of the Time Bound Action Plan and to push the further development of a number of new projects, including Rottok Bay Consolidated. It is being encouraged by the failure of the Board to insist that the relevant decisions of the NEC are implemented, and by the Board continuing to support the development of new projects by approving various necessary instruments (e.g. the Project Guidelines, draft Project Agreements) before the requirements of the Time Bound Action Plan are fully complied with. Board members in the minority regularly raise the need to resolve the issues identified by the 2000/2001 Review Team and set out in the plan. Whilst the issues do receive some attention, typically they are trivialised or ignored by senior NFS officers or other members of the Board.

It is true that the NEC also (Decision 43/2002 in response to a submission by the Minister for Forests):

*Endorsed the Minister for Forests to process timber projects particularly the 10 projects with the exception of Kamula Doso project approved for development by the Independent Review Team without any hindrances, to contribute towards Economic Recovery.*

The term “hindrances” was not defined. However it is clear from the Minister’s submission that it is a reference to the FCP and the Time Bound Action Plan. A number of NFS staff and members of the PNGFA Board appear to interpret the NEC direction to mean that the Time Bound Action Plan may be ignored. This is despite the current Government having endorsed the plan under NEC Decision 170/2003, and implementation of the plan being a contractual obligation on Government by being a condition of the loan agreement with the World Bank.

The Audit Team is gravely concerned. Although as noted above the PNGFA Board periodically discusses issues raised by the Time Bound Action Plan, little is resolved. The Board’s decision (Board Meeting 101 of May 2004) that it:

*..... resolves to advise the Ministerial Committee on Economic matters that the National Forest Service has been complying, and is complying and will continue to comply with the conditions set by the World Bank .....*

can only be interpreted as self-delusion. Not only were the conditions not set by the World Bank (they were negotiated between the World Bank and the PNG Government), but key aspects of the conditions, including the requirement to implement the Time Bound Action Plan, continue to be ignored.

There continues to be strong and ongoing political pressure to issue new Timber Permits quickly. Previous compliance audits<sup>5</sup>, which also identify the situation as described above, are seen by some as unnecessary and unwelcome impediments to progress.

## METHODOLOGY

The same methodology as developed by the 2000/2001 Review Team has been adopted as the basis for this audit.

## **2. FOREST RESOURCE ISSUES**

Notes regarding the sustainable annual allowable cut (AAC) are set out in Attachment 2.

The National Forest Policy 1991 requires that the forests be managed on a sustainable basis. A consequential requirement is that the forest resource be properly assessed and described in order to determine the net loggable area in accordance with the limitations on logging set out in the PNG Logging Code of Practice; the net loggable volume per hectare based on field inventory; and the sustainable AAC. Whilst an overly conservative estimate is acceptable (the allowable cut can always be increased), any overestimation of the AAC will result in the forest being logged faster than the rate of sustainable growth, and the eventual depletion of the resource. This undesirable outcome is already evident in some existing logging projects in PNG, e.g. Makapa.

Rottock Bay Consolidated was considered by the 2000/2001 Review Team as being one of six which:

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<sup>5</sup> Previous compliance audits have been carried out for East Awin (February 2004), Wavoi Guavi (April 2004) and Amanab Blocks 1-4 (August 2004).

..... may have the potential to be developed into successful commercial log export projects depending on decisions made regarding the exclusion of Fragile forests from logging; the implementation of the [10%] forest set-asides for conservation; and the cutting cycle. All six require some remedial action.

In terms of identifying which forestry projects had the potential to be developed as stand alone viable log export projects, the Review Team recommended to the NFS that:

..... it reconsiders the viability of the following six projects following decisions regarding the loggability of Fragile forests; the implementation of the conservation set-asides; and the cutting cycle – Rottok Bay Consolidated ..... - and where a viable project is found to exist, undertakes the remedial actions required (as set out in Table 5 of this report) and further develop the project.

Project viability was assessed against the Board determined minimum sustainable AAC of 70,000 m<sup>3</sup> for a stand alone log export project. The Review Team concluded that there is little or no scope for smaller size log export projects, or for commercially viable domestic processing. The remedial actions required for Rottok Bay Consolidated were that the NFS should:

- Check and amend if necessary the project areas and gross volume per hectare information for all four component FMA areas, and in particular undertake field inventory work for Rottok Bay;
- Recalculate and amend as necessary the permitted AAC for inclusion in the Project Guidelines;
- Check and amend as necessary the species distribution assumed for the Rottok Bay FMA area; and
- Amend the DOS and the Project Guidelines to make it clear to potential investors that there are four FMA areas each of which is contractually required to be managed on a sustainable basis.

#### MATTERS AFFECTING THE AAC

The 2000/2001 Review Team recommended that a clear Government policy statement be articulated regarding:

- The 10% of gross loggable area set-aside provided for in the FMA for forest conservation purposes which the PNGFA Resource Development Division had not taken into account when calculating the sustainable AAC;
- Forest types which do not grow fast enough to be harvested sustainably based on a 35 year cutting cycle, or which do not have the capacity to regenerate after logging. These “fragile forests” were identified in a report prepared for DEC in 1999, and the relevant forest types have been appropriately tagged in the PNGFA’s FIMS data base allowing them to be deducted from the net loggable

area. The PNGFA Resource Development Division had not provided for the fragile forest areas to be excluded from logging when calculating the sustainable AAC; and

- The sustainable cutting cycle. The PNGFA Resource Development Division uses a cutting cycle of 35 years whereas the National Forest Policy requires that a 40 year cycle is to be used.

Although directed to do so by the NEC through the Time Bound Action Plan, and although some discussions have been held and some draft papers produced, a submission on any of the above issues has yet to be forwarded to the NEC.

At the time of this audit the current status is as follows:

- 10% set-aside:

This has been the subject of a number of discussions by the PNGFA Board. A draft NEC submission was prepared jointly by DEC and the PNGFA in mid 2004 but not submitted. The Board resolved at its meeting No 99 (January 2004) that it:

*Approves a limit of 10% reduction in net operable area as conservation set-aside in all Forest Management Agreements (FMAs).*

Whilst being a useful endorsement of the concept, the limit of 10% of the net loggable area is already set out as a maximum in the terms and conditions of each FMA. The issue is that the set-aside has not been allowed for in the calculation of the sustainable AAC by the PNGFA Resource Development Division, and that the PNGFA's right to set aside forest for conservation purposes has not been carried forward into the Project Agreement. As far as the Audit Team is able to ascertain, conservation set-asides have not yet been satisfactorily dealt with.

- Fragile Forests:

This has been the subject of a number of discussions by the PNGFA Board, and was also considered in the draft NEC submission referred to above. At one point the Board resolved that a 50 year cutting cycle should be applied. At its meeting No 102 (June 2004) the Board resolved to place the issue in the hands of DEC to reach a formal position. Discussions held with DEC Senior Managers indicates their wish to see some if not all fragile forests protected from logging. As at February 2005 there is no formal NEC approved resolution.

- Cutting Cycle:

This was discussed at Board Meeting No 107 (December 2004). It was pointed out by a Board member that the change from 40 to 35 years was a condition of

the Economic Recovery Policy agreed between the PNG Government and the World Bank in 1992<sup>6</sup>. Consequently the Board resolved:

*That the Board approves the Amendment to the National Forest Policy to reduce the cutting cycle from forty to thirty-five years.*

This decision by the Board does not however resolve the issue, as the Board does not have the power to alter policy instruments set in place by the NEC. What is required is a request through the Minister for Forests for the NEC to agree to a variation of the National Forest Policy.

The conclusion reached by the Audit Team is that the required policies have not yet been satisfactorily clarified, and consequently the PNGFA is not yet in a position to reassess the viability of the Rottok Bay Consolidated project in accordance with the recommendations of the 2000/2001 Review Team and the requirements of the Time Bound Action Plan. The PNGFA has not however, felt itself constrained by these requirements, and has progressed the project anyway. The fact that the PNGFA Board approved the Project Guidelines indicates that the Board likewise does not feel itself constrained.

#### THE NEED TO VERIFY THE INCORPORATED LAND GROUPS

As set out in the 2000/2001 Review Report, much of the work involved in incorporating landowners into Incorporated Land Groups (ILGs) was done by the landowners themselves, sometimes with the aid of consultants. Only in some instances was the NFS involved. The quality of the work was questioned.

During the work of the 2003/2004 Review Team (which reviewed current logging projects), landowners from at least two areas within the Rottok Bay Consolidated project area approached the Review Team to seek advice regarding the inclusion of their land within the project area. In both cases the landowners claimed that they had not signed the FMA document. One area is referred to as Inland Via (by some), and the other is referred to as Gaha Malasa. The latter is the site of an eco-forestry project set up under the EU funded Eco-Forestry project.

It is clear that the NFS needs to put some effort into verifying that all of the ILGs within the project boundary have indeed agreed to the project by signing the FMA. Where the FMA has not been signed then the NFS needs to either excise the area from the project, or negotiate with the landowners to sign the FMA.

#### THE ESTIMATE OF THE AAC

The AAC set out in the Project Guidelines approved by the Board in February 2003 (Meeting 89) is 78,000 m<sup>3</sup>. This is a reduction from the 92,000 m<sup>3</sup> shown in the draft

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<sup>6</sup> This has not been verified by the Audit Team. The Time Bound Action Plan requires (Clause 2.2.10) that "A standard cutting cycle must be agreed and applied to the calculation of the sustainable annual cut to ensure proper, scientifically based, compliance with the sustainability requirement under the Forestry Act".

Project Guidelines at the time of the 2000/2001 Review. The opinion of the Review Team was that the original estimate was unreliable for the following reasons:

- There was no field inventory undertaken in the Rottok Bay component. A subjective guess of the volume per hectare was used;
- The field inventory undertaken in Aria Vanu Block 2, Vanu Tamu and Inland Rauto-Miu was less than adequate at an estimated 0.15%, 0.08% and 0.16% of the gross loggable area (as recorded in the PNGFA's Forest Information Management System (FIMS)) respectively;
- The results of the field inventory work (gross volume per hectare estimates) are considered to be unrealistically high at 54.9, 41.3 and 31.1 m<sup>3</sup>/ha respectively;
- The gross project areas recorded in the FMA document are 22% and 44% higher than the gross area data recorded in FIMS for the Rottok Bay and Vanu Tamu components respectively; and
- The conversion of gross loggable area to net loggable area for all four component areas was based on a standard 30% reduction rather than being based on the more detailed analysis possible with FIMS which more properly reflects the restrictions on logging set out in the PNG Logging Code of Practice.

The records show that an attempt by some National Forest Service staff to use lower and more credible volume per hectare data was made at the Development Options Study stage of project development. This attempt was however reversed by other staff at the draft Project Guidelines stage.

#### OBSERVATION OF DUE PROCESS

With regard to the determination of the AAC for Rottok Bay Consolidated it is the opinion of the Audit Team that there has been inadequate observation of the due process required to meet the requirements of the National Forest Policy 1991 and the Forestry Act 1991. The key aspects of non-compliance are:

- The failure to develop reliable forest resource descriptions;
- The failure to properly implement the requirements of the Time Bound Action Plan which impact on the estimate of the AAC; and
- The State Negotiating Team's acceptance of a higher AAC for the first five years of the project at the cost of long term project viability and sustainability.

### **3. LEGAL COMPLIANCE**

#### CHANGES TO THE LEGAL REQUIREMENTS FOR NEW FORESTRY PROJECTS

A new Environment Act 2000 came into force on 1 January 2004. It represents the most substantive change to the legislation affecting the allocation of new forestry projects

since the Forestry Act 1991 itself came into force in mid-1992. The Act has placed a significantly stronger emphasis on national environmental values, and thus has placed significantly stronger controls on where logging operations may be undertaken.

Under s. 77 of the Forestry Act, an application for a Timber Permit must be accompanied by an Environmental Plan which has been approved under the Environmental Planning Act (Chapter 370). The Environmental Planning Act has been repealed by the new Environment Act 2000.

The Environment Act 2000 requires that a logging operation must have an Environment Permit, thus strengthening the requirement for appropriate environmental controls set out in the Forestry Act. The Environment Act 2000 provides (s. 136(1)) that Environmental Plans approved under the repealed Environmental Planning Act are deemed to be Environment Permits for the purposes of the new Act – thus the Environmental Plan approved for the Rottok Bay component of the consolidated project in about 1999 becomes an Environment Permit (see further discussion below). In addition, where a logging project was lawfully being carried out at the time the Act came into force, then it is permitted to continue.

For new logging projects however, the Environment Act 2000 sets out an involved process which must be completed before a Timber Permit can be granted under the Forestry Act 1991. Notes regarding the Environment Act 2000, and the process for obtaining an Environment Permit, are presented in Attachment 3. A significant part of the process is intended to evaluate whether or not logging is to be permitted. Clearly a positive outcome would be needed before the PNGFA would be justified in proceeding with the acquisition of forest resources from landowners under an FMA.

There appears to be no transition provisions for the treatment of forestry projects for which the forest resource was acquired before the Environment Act 2000 came into force and the allocation process has not yet been initiated, or new projects where the allocation process is at an advanced stage, as is the case for Rottok Bay Consolidated. It is the Audit Team's interpretation that for Rottok Bay Consolidated the Act will require the full environmental assessment procedure to be applied. A component of the procedure is a decision by the Director for Environment, or the Minister for Environment, as to whether logging will or will not be permitted on environmental grounds.

It would seem sensible for the PNGFA Board to defer the signing of the Project Agreement until such time as the implications of the Environment Act 2000 are clearly understood. Discussions held with senior DEC Managers indicates that DEC is still clarifying the requirements of the Act in relation to forestry projects for itself.

### ENVIRONMENT PERMIT

Prior to the consolidation of the Rottok Bay project, the Rottok Bay component was allocated to Cakara Alam (PNG) Ltd, although the required Timber Permit was never granted. The company had however obtained an approved Environmental Plan for the Rottok Bay component under the Environmental Planning Act. Under s. 136(1) of the Environment Act this continues to have effect, and is deemed to be an Environment Permit.

In order to take advantage of the existing Environment Permit, DEC is considering requiring the developer to apply for a variation to the permit, so that the consolidated area is covered by the existing permit. The use of variations is common in the mining industry. It is the opinion of the Audit Team that this would be inappropriate in this case for the following reasons:

- The Rottok Bay component makes up only 15% of the consolidated area. The additional area may present entirely different and more acute environmental challenges than those identified for the component area only;
- The consolidated area includes a very significantly larger population. The additional population will not have had the benefit of the public consultation process carried out in the component area under the repealed legislation; and
- The permitted AAC is significantly higher, resulting in a much larger logging operation, and increased environmental impacts.

In the opinion of the Audit Team, the character of the logging project has changed so significantly that it can no longer be considered to be merely a variation of the previous very much smaller project. Accordingly the full requirements of the Environment Act 2000 ought to apply.

In the case of Rottok Bay Consolidated, the selected proponent Cakara Alam (PNG) Ltd, has already registered its intent to undertake a logging project with DEC, and has also submitted an (undated) Environmental Impact Statement (EIS). Discussions with Senior DEC managers indicated that DEC is due to undertake the field work required to assess the EIS in March 2005.

#### COMPLIANCE WITH THE FORESTRY ACT 1991

Notes regarding legal compliance issues are set out in Attachment 4. For that part of the allocation procedure covered by this audit, due process has generally been observed.

The 2000/2001 Review Report recommended;

- That the PNGFA Board review the change of Cakara Alam (PNG) Ltd's shareholding and its failure to amend its registration particulars.

There is no evidence in the Board meeting minutes that this was done. A current company search indicates that Cakara Alam (PNG) Ltd has not lodged a copy of its annual accounts with the Business Registration and Regulation Division of the IPA since the 1999 calendar year.

#### COMMENT REGARDING THE FINAL PROJECT AGREEMENT

The following comments are made regarding the details of the final Project Agreement:

Clause 37: A separate clause for variation poses the risk of abuse by either party particularly to the disadvantage of other stakeholders such as the landowners. As the landowners are not privy to the contract such a clause leaves room for the

PNGFA and the proponent company to vary any term/s of the agreement as and when they think fit.

Instead of a separate clause it is recommended that the variation clause be tied in with clause 38.3 (periodic review), or that the clause be rewritten so that in the event of a need to vary a term/condition, the parties can negotiate with proper consultation and participation of the landowners.

Clause 5.1(c): The opening sentence should commence with 'Subject to the grant of a Timber Permit', so that it is clear to the parties that the representations and warranties do not apply until the Timber Permit is granted. This will then be consistent with clause 21.2 of the agreement where in the event of conflict between the terms of the agreement and those contained in the Timber Permit the terms of the permit prevail.

#### **4. AUDIT CONCLUSIONS**

The conclusions of this Audit with regard to the AAC are as follows:

- That the forest resource description for Rottok Bay Consolidated is not based on any sound data sourced from the project site, and as thus is not sufficiently reliable to ensure that the sustainability requirement of the National Forest Policy is being met. In the opinion of the Audit Team it is also not sufficiently reliable to be used as the basis for a long term (35 year) commercial agreement which must be commercially viable if the payments required of the company (royalty, PDB, log export tax) are to be made.
- That there is no evidence that the Government has rescinded NEC Decision 188/2001 or 170/2003 and consequently that the NEC's directions that the Time Bound Action Plan be implemented, and that the policy consequences be applied to all new and in process forestry projects, are still in force. Compliance with the Time Bound Action Plan is judged to be a requirement of due process.
- That the above conclusion is strongly supported by the fact that the Government has not terminated the Loan Agreement with the World Bank. Under the agreement the Government has contractually undertaken to implement the Time Bound Action Plan.
- That the PNGFA Board, the NFS and DEC have not complied with due process by failing to implement the Time Bound Action Plan, and by progressing new forestry projects before the policy consequences of the Time Bound Action Plan were properly decided by the NEC. Of particular relevance are the policy decisions regarding the loggability of Fragile Forests, and the length of the cutting cycle.
- That the Resource Development Division has continued to ignore the right of the PNGFA to set aside 10% of the gross loggable area for conservation purposes

when calculating the AAC. In addition, this right is not properly brought forward into the Project Guidelines or the Project Agreement.

- That the State Negotiating Team compromised the requirements of the National Forest Policy when it agreed to alter the AAC in the final Project Agreement. Based on the claims of the developer that it needs an AAC of 100,000 m<sup>3</sup> to be viable, the AAC of 76,194 m<sup>3</sup> provided for under the Project Agreement from year 6 onwards cannot be sufficient to support a viable log export operation. The Board did not object.
- That the Resource Development Division, despite giving advice to the Board to the contrary, has not identified through the Project Guidelines that each of the four FMAs making up the consolidated project undertakes that the forest area covered by the FMA will be sustainably managed. This will have implications for operational management, and the flow of benefits to landowners, which appear to be being ignored. (See conclusion set out below regarding the lack of a formal agreement for consolidation).

The conclusions of this Audit with regard to legal compliance are:

- That the new Environment Act 2000 has put in place an involved process for assessing the impact of new forestry projects which may result in the Director for Environment, or the Minister for Environment, declining to approve logging as an acceptable activity for the proposed site. As a consequence it behoves the PNGFA to obtain approval under the Act before commencing to acquire forest resources from the landowners. The Act has placed a significantly stronger emphasis on environmental values, and thus has placed much stronger controls on where logging operations may be undertaken.
- That the Environment Act 2000 makes no special provisions for projects such as Rottok Bay Consolidated, where the forest resource was acquired before the Act came into force, and where the project allocation procedure set out in the Forestry Act 1991 is well advanced. It would appear that the PNGFA will need to first implement the requirements of the Environment Act 2000, and confirm that logging will be permitted under the Act, before the allocation procedure may be completed.
- That the approach to putting in place the required Environment Permit being considered by DEC, whereby it would ask the developer to apply for a variation of the existing Environment Permit for the Rottok Bay component only, is not appropriate. The consolidated project is about seven times larger.
- That neither DEC nor the PNGFA have yet come to understand clearly the requirements of the Environment Act 2000, and that discussions are urgently required.
- That Rottok Bay Consolidated is in breach of s. 54 of the Forestry Act 1991 in that it is not mentioned in the National Forest Plan. S. 54 requires that "*forest resources shall only be developed in accordance with the National Forest Plan*". An update of the plan will be required before there is compliance.

- That in respect of legal compliance, due process has generally been observed, although there is a worrying lack of attention to the completion and filing of the prescribed forms.
- That the lack of a formal consolidation agreement between the PNGFA and the landowners representing the four FMAs which make up the consolidated project, is of concern. Disaffected landowners could conceivably use this to their advantage if they wished to disrupt the project, or mount a legal challenge.
- That the opinion expressed by the PNGFA legal counsel that the Board could ignore differences between two factions of landowners because “the PNGFA is dealing with the majority” is overly simplistic, and that greater attention should be paid to dissenting landowners, rather than forcing the project ahead.

## **ATTACHMENTS:**

1. Findings of the 2000/2001 Review Affecting Rottock Bay Consolidated
2. Notes Regarding the Sustainable Annual Allowable Cut
3. Notes Regarding the Environment Act 2000
4. Notes Regarding Legal Compliance

