

Meeting Summary: The EU Timber Regulation and the Pulp and Paper Sector

19-20th March 2014



Introduction

The European Union Timber Regulation (EUTR) came into force in 2013, requiring all European Union (EU) Member States to identify and ready a Competent Authority to ensure that its three core requirements are adhered to: that operators exercise due diligence in their sourcing of timber; that they avoid 'first placing' illegal timber and products on the European market; and that subsequent traders keep records to ensure that supply chains within the EU can be traced if necessary.

The meeting was held at the National Measurement Office on the 19 and 20th March 2014 and hosted by Forest Trends and Chatham House. It was part of an on-going process of supporting networking and information sharing between EUTR Competent Authorities and relevant enforcement officials in the US. It aimed to build an understanding of the challenges surrounding the implementation of the EUTR in the pulp and paper sector and analyse relevant supply chain complexities. This report summarizes the presentations and related discussions held at the meeting.

SESSION 1: Overview

Svetla Atanasova of the European Commission DG ENV outlined the scope of the EUTR, focusing in particular on pulp and paper. The EUTR Annex determines which products are covered by the EUTR by reference to the combined nomenclature (a method for designating goods and merchandise which was established to meet the requirements both of the Common Customs Tariff and of the external trade statistics of the Community). Chapters 47 and 48 of the Annex deal with pulp and paper, with several exclusions, for example, waste materials, recovered materials, recycled materials, and bamboo. Ms Atanasova indicated that the explanatory notes and the guidance document produced by the European Commission and Member States should, additionally, be consulted when assessing the scope of the EUTR. As the combined nomenclature and the explanatory notes are amended annually, the scope of the Annex may change from year to year. While the European Commission has not decided whether to amend the Annex in 2015, Ms Atanasova explained that there is nonetheless an obligation to consider including printed paper (Chapter 49) within the EUTR. Discussion of this potential inclusion will happen in early 2015, and stakeholders will be invited to submit views. Amendments to parts of the Annex (i.e. including or excluding products) may also be considered, but will be subject to the outcome of the planned assessment of the implementation and impact of the existing Regulatory arrangements.

Rupert Oliver of Forest Industries Intelligence Limited presented on pulp and paper trade flow trends. The EUTR covers all pulp and paper products listed on the combined nomenclature in Chapters 47 and 48 (with the exception of bamboo-based and recovered products). Its scope excludes paper products contained in the combined nomenclature in Chapter 49, and all post-consumer recycled products.

Pulp and paper accounted for approximately 50% of all EUTR-regulated extra-EU timber imports between 2008 and 2013. Pulp has a high proportion of external trade, whereas paper is mostly of EU origin. On average 8 million tonnes of wood pulp is imported into the EU each year, and recent years have seen an increase in hardwood pulp. Mr Oliver explained that limited wood pulp is imported from Asia; the majority comes from South or Latin America where it is sourced mainly from plantations. Of the EU Member States, Germany is by far the largest pulp importer, but most of the country's imports come from within the EU. Italy is the largest importer of pulp from outside the EU.

Paper imports into the EU have declined by 15% over the last three to four years but levels of consumption have only gone down by 5%, implying a greater reliance on domestic paper. Value added products tend to be traded outside the EU, while bulkier products (such as coated and uncoated papers) tend not to be traded outside the EU. In terms of paper trade flows into the EU, the picture is more diverse with trade flowing from Asia (dominated by China), North America and Europe. Germany is the largest net importer of paper products in total and the United Kingdom is the largest importer of paper products from outside the EU.

Graham Toft of Paper Technics presented a view on pulp production, consumption and trade flows. Currently, 187 million tonnes of pulp for paper are produced worldwide. The United States is responsible for a significant proportion (26.9%) followed by China (11.3%), Canada (9.8%), and Brazil (7.4%). In terms of exports, Canada is the most significant worldwide exporter of pulp for paper production followed by Brazil, and then the United States. The three countries export 8.5 to 9 million tonnes each. China is the largest importer of pulp for paper, followed by the United States, Germany and Italy.

Looking at trade flows for the Confederation of European Paper Industries (CEPI) region, significant volumes of pulp, paper and board were imported from Latin America (5 million tonnes) and North America (2 million tonnes) into the CEPI region in 2012.¹ By comparison, little was imported from Asia (0.1 million tonnes). Data from 2008 indicate that the integration of the pulp product into the paper mills varies depending on the mill type and the process. For example, in the case of the kraft process, integrated mills (where the pulp and paper mill are on the same site) account for only 66.67% of the total. This contrasts with mechanical mills, where 92.19% are integrated.²

Waste paper, although not within the scope of the EUTR, is nonetheless worthy of trade flow analysis since its exclusion represents a possible 'loophole'. China is a significant importer of recycled material, taking huge volumes from the recovered paper industry. Other flows are insignificant in comparison. One participant asked whether this is because European producers are not using recycled materials. Toft explained that the reutilisation rate in Europe is high (70%), and was of the opinion that Europe had reached a maximum likely threshold. In the CEPI region, 46 million tonnes of recycled paper are used to produce paper and board. This is supplemented by another 42 million tonnes from virgin pulp supply. In terms of consumption, case materials (used in corrugated board production) account for 23.5 million tonnes followed by other graphics, packaging and newsprint. In terms of paper production in CEPI countries, in 2012 Germany, Sweden and Finland dominated.

Clarification was sought on how mill-broke (defined as recycled fibre generated during the production of paper or the conversion of recycled paper) is treated under the EUTR – specifically whether it should be considered 'virgin' or recycled fibre. The general view was that that mill-broke is considered virgin material and so falls within the scope of the EUTR as a regulated product regardless of its CN code. A participant commented that the question of CN code consistency should be referred to customs authorities and that the meeting was not the right forum for discussion of this issue. This triggered a brief debate, as not all participants were confident that a consistent interpretation could be provided across the customs authorities of different EU Member States, which was felt to be important for international companies operating across the EU28. It was concluded that this issue should be followed up with the World Customs Organization.

A participant asked for elaboration on the public consultation process for possible inclusion of Chapter 49 of the combined nomenclature within the EUTR annex. Ms Atanasova noted that there is some degree of flexibility in the way that this will be carried out and explained that a process will be based on planned reporting on the Regulation by Member States. This is because upon receipt of national reports, and the results of a commissioned independent analysis, as well as opinions from stakeholders, it will then become evident whether it is necessary/realistic to amend the product scope. It was made clear that for an internal decision there are no procedures, rather, there is free and open discussion between the EC and Member States on any draft that the EC prepares.

One participant pointed to the arbitrary nature of the distinction between graphic paper and printed books under the EUTR– the former being required to comply with the EUTR and the latter not. In response, another participant explained that when this decision was initially taken, it was based on the opinions of the industry about supply chain complexity.

¹ CEPI trade flows of pulp, paper and board and production in 2012

² The speaker reported that kraft and mechanical mills are the most numerous mill-types in the CEPI region (as of 2008 data)

SESSION 2: Source Validation and Producer Country Risks

Stewart Begg, Fibre Sustainability and Public Affairs Director at SCA gave an industry view on responsible Due Diligence in pulp and paper supply chains. Mr Begg highlighted that a large, international producer / supplier of paper products should be responsible enough to know where their fibre comes from and every point in the supply chain, particularly as it is very difficult for small and medium sized enterprises (SMEs) buying products to verify legality later on in the supply chain. Nonetheless, Mr Begg conceded that getting information on exactly what goes into each mill in a large supply network is very difficult. He noted that there are often many forests feeding into any given mill. It is thus important that companies know their sources, and then judge any risk assessment based on that information, excluding all high risk sources where there appears to be no chance of improvement as soon as possible.

Begg explained that the first step in a due diligence system is obtaining key source information, and making sure that it is verified, ideally by a third party. A risk assessment should then be carried out, based on the country of origin of fibre. Begg referred to a 2013 paper commissioned by Chatham House from Forest Trends and Forest Industries Intelligence as a reputable source for identifying 'high risk' countries. The last step in a credible due diligence system is the implementation of mitigation steps. Begg acknowledged that SCA does use mitigation where necessary, and has removed suppliers from their supply lists.

The presentation described some of the due diligence procedures used by SCA. These include using only known and preferred suppliers, carrying out site audits, developing a questionnaire designed to elicit information from all suppliers, and carrying out field visits. Begg also described how SCA has introduced a new additional check which involves randomly examining species present in the pulp using scientific methods. When asked, Begg explained that SCA also carries out follow-up audits according to risk and went on to describe that typically they encounter problems associated with supply chain documentation rather than meaningful non-compliances. He nonetheless acknowledged that SCA has had a fairly consistent low-risk supply base over the past five years, and as they now move into China and Eastern Europe, they may face more challenges. Another participant asked why SCA doesn't source from China currently. Begg explained that they do source a small amount from China, but that they face challenges accessing and verifying information on fibre sources.

One participant asked for elaboration on the reasons why SCA has previously removed suppliers from their supply chain. Begg explained that any such action was due to poor and inconsistent control and management, and social issues, and emphasised that most companies were operating very well from an environmental perspective. When asked about the costs involved in carrying out due diligence, Begg acknowledged that it is expensive, but affirmed nonetheless that SCA is committed to its due diligence procedures for reasons of legal compliance and brand protection.

John Hontelez of the Forest Stewardship Council (FSC) gave a presentation on the FSC and the pulp and paper sector in the context of the EUTR. The FSC sets standards under which forests and companies are certified, and plays an important role in the pulp and paper sector. According to the 2013 CEPI sustainability report, 98.4% of production capacity for pulp production has a chain of custody certificate. Actual production and use percentages are lower, but nonetheless still impressive. The FSC supports the EUTR because legality is an important step towards sustainable forest management. When the EUTR entered into force, the FSC took measures to improve its standards in order to align them with EUTR requirements. For example, its advice notes oblige the passing on of information on species and country of harvest on request, the clarification of categories of laws to be taken into account, and termination of tolerance for minor fibre components of unknown origin. Mr Hontelez noted that the FSC is currently working on a special rule on reclaimed materials, which will also support companies wishing to demonstrate compliance with the EUTR.

The FSC claims to be low risk in relation to illegality. Nonetheless, the FSC's message to operators is that due diligence is still necessary. Responsibility remains with the operator to check the validity of any FSC product claim, and FSC has issued an advice note to help them collect the source information required by the EUTR. In response to a question, Hontelez provided two examples of the FSC's 'special attention' in high risk countries. The first was Russia, where FSC is undertaking stakeholder discussions with certification bodies in order to improve the

credibility and consistency of audits. The second example was China, where FSC has employed extra staff to work on brand/copyright protection because of perceived fraud risks.

There was no reliable global label for recycled fibre, so FSC developed its own FSC recycled product claim, which is now used worldwide. Hontelez noted that this may only be used if at least 85% is post-consumer waste. A valid FSC mixed or recycled claim indicates that the supplier or a company further up the supply chain has validated the pre- or post-consumer status of fibre inputs. A participant sought clarification as to whether source material can be non-FSC for the FSC reclaimed certificate. Hontelez explained that as long as the material can be proven to be waste paper, it can be used and sold as an FSC product.

SESSION 3: Forensics: Strengths & Weaknesses

Dr. Andrea Olbrich of the Thunen Centre of Competence on the Origin of Timber gave a presentation on the identification of mixed tropical hardwood in pulp and paper. The Thunen Centre is the central contact facility for government agencies, timber traders and consumers who wish to verify the species of wood or wood products and their origin. Dr. Olbrich explained that the microscopic identification of wood fibres in pulp and paper to generic level is possible, but only where reference material is available. She described the following three steps in the microscopic identification of pulp and paper: first is defibration and staining of cells, followed by light microscopy to identify 12 main characters, and then finally the matching of characters with reference material. The Thunen Institute has produced references for 28 timber species from Southeast Asia, but there is clearly a need for more. The results of blind tests, currently being carried out, will reveal whether it is possible to use this process to distinguish between different genera. There is the potential that additional, and more detailed, information can be provided by electron microscopy.

Rob Langley of the Intertek Paper Technology Group presented on commercial fibre testing for paper and board products. The testing procedure used by this Group – the Tappi Method T401 om-8 – is an internationally recognised procedure for fibre identification. However, it does have problems, for example, it requires standard samples of known composition against which you can test (i.e. a reference database), it needs experience and familiarity with the reaction of fibres to different stains, and it is very difficult to perform. The analysis procedure involves first separating the fibres without damage or chemical sensitisation to stain, staining the fibres, identifying the fibres using reference samples, counting the fibres (furnish count), and quantifying fibres using weight factors (wall thickness). Hardwood vessel architecture and perforations, and softwood cross field pitting allow for genus and potentially species identification. Difficulties facing the analyst include those associated with identifying hardwood species content of furnish, seasonal wood differences, as well as degree of fibre conversion and damage to fibres. In response to a question on data sharing, Mr Langley conceded that the Group does not share its database and suggested that there is a need for discussion on this in order to increase the capacity of all laboratories to perform the tests.

There was a general discussion among participants on the identification of individual fibres in a mix. The speakers explained that as there are likely to be many genera in a mix, and as there is a significant lack of reference material, it would likely not be possible to identify all fibres present. For this reason, Langley explained that the Intertek Group prefers to not use the term ‘mixed tropical hardwood’ (MTH) as, without identifying all species, it is not possible to make this claim conclusively. It is possible, however, to know that there is a mixture of species, and it may also be possible to quantify the number of species present. Mr Langley further explained that if an individual hardwood is identified in a mix, it may be possible to apply weighting factors to estimate its relative proportion. In response to a question on recycled content, the speakers explained that it is not possible to quantify the amount of recycled content in any given product using these methods.

One participant asked about the cost of the fibre identification processes presented. Dr Olbrich stated that costs at the Thunen Institute vary depending upon whether identification is required to the genus level, or just by ‘group’. For the identification of one sample to genus level, she estimated costs at 250 Euros. Mr Langley stated that costs are 200 GBP per one-off sample with discounts for bulk orders.

SESSION 4: Due Diligence in Importing

Neil Everett from Carnstone Partners LLP presented on due diligence in importing pulp and paper products, focusing on retail companies in the United Kingdom (and their SMEs). He presented four generic case studies. Carnstone Partners is a management consultancy firm specialising in sustainability with a strong focus on global supply chains, the media sector and the publishing sector. Most paper is produced in mills in the United States, Nordic countries and China, where the paper manufacturing industry is experiencing significant growth. Some mills are more reliant on imported fibre than others. In the United States and Nordic countries, the majority of mills rely on domestic sources. China on the other hand is a significant importer of wood and fibre from a variety of sources.³

Downstream, a reasonable proportion of retailers already have sustainable paper sourcing policies, which have been in place for many years. Based on conversations with retailers, Mr Everett was of the view that the EUTR has caused a shift from historical to 'upfront and real-time' data collection and verification in the paper sector. Due to fast-moving, seasonal and varied product lines, it is however difficult to carry out thorough investigations of supply chains. Consequently there is heavy reliance on forest certification and the 'creation' of chains of custody. A participant asked whether Mr Everett's clients understood that third party certification is not EUTR compliance *per se*. Everett affirmed that his clients understand that certification is not a green light, but noted that it is difficult and expensive for them invest in their own due diligence.

From the case studies presented by Mr Everett, the following themes emerged. First, it is a particular challenge for SMEs and importers to get documentation and verified information about species and country of harvest implicated in processed products. The challenge is largely one of influence, and bigger companies closer to the source are more likely to have the leverage to obtain the information. This leverage lessens further down the supply chain. The level of confidence in a supply chain thus tends to depend on relationships between suppliers, and the suppliers' influence and understanding of requirements.

Second, there is heavy reliance on certification. In high-risk countries where it is impossible to label all products with an intact chain of custody, there is instead a reliance on creating artificial chains of custody. Third, the speed and value of purchases make it difficult for retailers to conduct an on the ground due diligence process. Finally, the credibility of supply information is also based on the characteristics of the supply company. For example, if a big company is buying large volumes directly/regularly from any given source, the information available about that source is likely to be relatively reliable.

Mr Everett concluded by offering a view of the future of due diligence in importing. He was of the opinion that as time goes by, and as retailers continue to interrogate the information and increase their understanding of sourcing practices and risks, they will perhaps reach a stage where they will be able to focus solely on those suppliers/brands they feel confident of, focus their activities on finding out more about those supplier, and then maybe even be able to establish direct contact with mills.

One participant asked about the differences in the treatment of due diligence for different products. Everett explained that this depends on the company. For printing material for example, although currently outside the scope of the EUTR, some retailers treat as if it is already within the scope. The big players in the publishing community, for example, have sustainable sourcing policies, and have had for many years, in order to manage reputational risk associated with brand protection. Another participant asked Mr Everett for his clients' reactions to the FSC online claims platform, which would provide small suppliers with more reliable information about the certified products they may purchase. Everett explained that it is viewed as a positive development and that his clients welcome steps to create transparency and certainty in supply chains.

There was discussion about the proposed exception to the declaration requirements of the Lacey Act for some composite products - potentially that only the sources of 90-93% of a composite need be identified, and that there need be no identification of the genus, species or country of harvest. One participant commented that

³ The speaker explained that this is based on the paper in the system, not volumes

some pulp and paper industry trade groups were in favour of this change, particularly the second exception. However, other participants were of the view that if it is possible to trace the product to the mill, it should be possible to identify all sources. There is, additionally, a danger that if all the high-risk sources were be ignored under the 7% exemption, a significant amount of illegal wood may still be being traded. It was also pointed out that trace amounts – 2% or below – are not of concern at present, and that CITES listed species would not be allowable in such an exception.

SESSION 5: Fibre Research in China, India and Indonesia

Gary Bull of the British University, Columbia presented recent research relating to China’s pulp and paper industry. Mr Bull emphasised that, with the exception of customs data, statistics relating to forest industries in China are generally poor. Given that fuel wood demand in China is high, that national forests are young, and that plantations are underperforming, it is to be expected that the Chinese will be huge fibre importers of the future, much of which will come from high-risk regions. This is not however reflected in the official statistics, which present a much more positive picture of increasing domestic timber availability and high production capacity.

Bull described the results of a randomised survey carried out in 2010 and 2011, which investigated Chinese awareness of legality requirements in the EU and US. Responses were obtained from 170 mills and results indicated that the number of survey participants who fully understood the requirements was modest, with more attention being paid to the Lacey Act than the EUTR, appropriately, since the latter was not yet in force. Several variables were identified as predictors of legal compliance: managers who were actively involved in learning, who ran bigger firms, and who had more experience with exports, all showed a medium or strong correlation with legal compliance. Bull thus emphasised that effort needs to be put into educating mill managers, supporting small and medium firms, and supporting firms with less export experience. It was suggested that educating mill managers might be easier with the pulp industry as there are a few very large producers, and many of the smaller mills are shutting down. Indeed, when questioned on this, Bull suggested that in the future we could see the top 50 mills producing 80% of pulp.⁴ One participant commented that perhaps on this basis, specific education efforts could be targeted at the largest 50 firms.

Jeremy Williams, a consultant to Forest Trends, presented recent research relating to India’s pulp and paper fibre sources. Mr Williams described heavy use pressure on forests in India, explaining that fuel and cattle are the key sources of degradation. Since much of India’s pulp and paper industry is traditional or inefficient, there is huge demand for fibre (58 - 64 million cubic metres), which cannot be met domestically. Of this estimated 64 million cubic metres timber demand, forests provide 12 million cubic metres of timber, other sources (including imports) provide 31 million cubic metres of timber and the remainder is unaccounted for; potentially being met by illegal felling and unreported imports.

India’s first and only natural forest was certified in 2013 yet 40% of fibre for paper-making is sourced from local pulp. Imported pulp accounts for a small but growing percentage. Most waste paper imports come from United States and United Kingdom, some also come from United Arab Emirates, Saudi Arabia, Sri Lanka, and China. Although not high in terms of overall volume, 35-40% of bleached kraft pulp imports come from Indonesia, Malaysia, Russia and China, all of whom are considered relatively high-risk.

The United Kingdom is the main EU importer of Indian paper products and only small amounts are imported into other EU countries. Williams speculated that this was due to historical bonds between the United Kingdom and India.

A participant asked whether, when conducting risk assessments and mitigation, India should be placed towards the “Sierra Leone or the Ghana end of the spectrum”, even though the Corruption Perceptions Index (CPI) rating there is not notably high for the region. The speaker explained that when conducting a risk assessment, SMEs should use multiple sources, for example, the Greenpeace website, this presentation, and the previously

⁴ Note: the speaker emphasised that this is a ball park figure only

mentioned 2013 Forest Trends and Forest Industries Intelligence report, rather than relying on a single source such as the CPI.

Art Blundell, of Natural Capital Advisers and also a consultant to Forest Trends, presented on the pulp and paper sector in Indonesia and the Indonesian Timber Legality Assurance System (SLVK in the Indonesian acronym). Indonesian Ministry of Forestry data indicate a gap in the legal supply of timber, which suggests widespread corruption, mismanagement and losses in royalties estimated by Human Rights Watch at around US\$ 2 billion per year. Despite increasing the area cleared for plantations, the pulp and paper sector continues to rely on timber from natural forests, the majority of which comes from timber clear cut during the conversion of forest areas to agricultural uses, some of which is allegedly 'laundered' through plantations. There is thus no plausible deniability relating to due diligence on Indonesian paper imports and the risk of illegality is not negligible. This is important to note when determining the need for risk assessment and means that enhanced due diligence efforts are required from operators regulated under the EUTR.

The legality of Indonesian forest products will be demonstrated by a national system known as the SLVK Sistem Verifikasi Legalitas Kayu), which will be also used to issue Forest Law Enforcement Government and Trade (FLEGT) export-licences. However Mr Blundell described the following criticisms of the SVLK: that it allows a 'pass' even if criteria are still under verification, that it does not verify compensation or consent on the part of local communities as set out in law, and that auditors only assess the behaviour of companies (not government agents). Given all this Mr Blundell urged competent authorities to carry out checks at regular intervals to verify that monitoring organizations continue to fulfil their functions and that this should be prompted by substantiated concerns from third parties of shortcomings in implementation. Mr Blundell further suggested that competent authorities should ask to see SVLK's regular verification check and exchange information on serious shortcomings, in order to prohibit the placing of illegally harvested Indonesian timber on the EU market in any EU Member State.

An Lambrechts from Greenpeace spoke on Indonesian pulp mill supplies and legality risks. The presentation described some of the weaknesses and loopholes of the SVLK. These include the fact that less than 50% of timber sources are certified, the fact that a pulp mill certificate does not preclude illegality, and the fact that there is no chain of custody audit or audit of permitting or harvesting processes. Ms Lambrechts also contended that although the rate of illegal logging in Indonesia has decreased since the 1980s, illegal harvesting figures do not capture illegal licensing processes. It was noted that corruption is rife in Indonesia, and thus while there may be evidence of improved law enforcement this has not necessarily be accompanied by a decline in illegal deforestation.

Lambrechts explained that there are two major sources of fibre supplies for pulp mills in Indonesia. The first is acacia plantation fibre which, although not a CITES protected species, is not necessarily low risk. As a result of weak governance in Indonesia, due diligence is still required. The second is rainforest fibre (mixed tropical hardwood), and this fibre source should be avoided (or very careful due diligence conducted) due to the high likelihood of Ramin, CITES protected species and illegal conversion timber.

Lambrechts concluded by stating that all pulp and paper from Indonesia (including plantation fibre) is still very high risk and warrants serious scrutiny and careful due diligence. Corporate policy is very important, as is Non-Government Organization (NGO) evaluation, and both need to be combined with a broader legality check. Given the weaknesses of the SVLK, it is not a credible solution for EUTR compliance in the paper sector at present.

There was general discussion on whether the SVLK is a sufficient third party verification scheme for issuance of a FLEGT licence. While this is the Indonesian negotiating position, the European Commission has a clear stance that the SVLK is not a FLEGT licence and will not turn into a FLEGT licence. Several participants commented that were the EU to accept the Indonesian position, there would be implications for future Voluntary Partnership Agreements (VPAs) with other countries, as well as for the level of scrutiny of supply chains under the EUTR with other countries. A competent authority representative observed that while buyers might accept SVLK, they would expect to see due diligence, just as with any other third party verification scheme. Another participant commented that were a FLEGT permit to be given for certain product, it may be difficult to show a lack of 'due care', the Lacey Act requirement, in the United States, on the part of companies buying these products.

There was further discussion on the format of FLEGT licences and potential plans for a public database. One participant noted that FLEGT licences will be shipment-based; each shipment will have a licence with its own unique number, which will be checked at customs just like other import documents. Whether the licence numbers will be available to companies and EUTR enforcement officials, or even in a public database, was unknown. Another participant reported that an electronic FLEGT licence system, which will connect all enforcement authorities, is under preparation, although the extent to which this will be publicly accessible also remains unclear.