

**OBSERVATIONS REGARDING THE EXTENSION OF THE TERM
OF THE TIMBER PERMIT AND/OR THE PROPOSED
AMENDMENTS TO THE PERMIT TERMS AND
CONDITIONS FOR:**

TP 2-16 VAILALA BLOCKS 2 & 3

TP 15-51 OPEN BAY

TP 13-34 BULOLO

Prepared For:

THE GOVERNMENT OF PAPUA NEW GUINEA

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

Prepared By:

THE 2003/2004 REVIEW TEAM

(Reviewing Current Logging Projects)

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Attachments:

1. Extract From the Forestry (Amendment) Bill 2005 Dealing With the Extension of the Term of Saved Projects
2. Findings and Recommendations of the 2002/2003 Review Team Regarding TP 2-16 Vailala Blocks 2 & 3 – March 2003

Observations Regarding The Extension Of The Term Of The Timber Permit And/Or The Proposed Amendments To The Permit Terms And Conditions For: TP 2-16 Vailala Blocks 2 & 3, TP 15-51 Open Bay, and TP 13-34 Bulolo

EXECUTIVE SUMMARY AND RECOMMENDATIONS

1. GENERAL

The main general conclusions reached by the Audit Team are:

- That the PNG Forest Authority (PNGFA) has in the past been poorly served in terms of legal advice regarding compliance with the acquisition and allocation procedures prescribed by the Forestry Act 1991.
- That the extensions of the term of saved Timber permits granted by the Minister are not lawful. They will only be lawful if the Forestry (Amendment) Bill 2005 is passed into law, and then only if the requirements of s. 78 have been properly complied with (which in most cases they have not).
- That currently the PNG Forest Authority Board is exceeding its authority by resolving to grant 6 month extensions of the term of some Timber Permits saved by the Forestry Act 1991, pending enactment of the Forestry (Amendment) Bill 2005, and further by resolving to approve more generally 12 month extensions for all Timber Permits on application. Under the Act, only the Minister may grant or extend permits.

The **key recommendations** are:

- That the PNG Forest Authority Board not approve the proposed changes to the logging authorities/agreements for Vailala Blocks 2 & 3, Open Bay, or Bulolo, until other matters raised in this report have been considered and fully and properly resolved.
- That the PNG Forestry Authority Board notes that where the Timber Permit holder learns of any “approval”, it can later claim in a court of law to have relied on that approval, and to have suffered consequential losses.
- That the PNG Forest Authority Board rescinds its resolution to offer 12 month extensions to the term of saved Timber permits on application. It does not have the power to do this.

It is **further recommended**:

- That the PNG Forest Authority Board and the Department of Environment and Conservation (DEC) take note of the increasing lack of confidence by the

international community in the proper enforcement of environmental standards set by nations logging tropical forests.

The latest event which impacts on logging in Papua New Guinea is the environmental policies adopted by the United States banking giant Citigroup. This bank has dealings with the Rimbunan Hijau Group of Companies, which has an extensive interest in logging tropical forests in PNG. Citigroup has directed Rimbunan Hijau to comply with the new policies, and to verify compliance through credible independent third-party certification.

2. TP 2-16 VAILALA BLOCKS 2 & 3

AUDIT CONCLUSIONS

Nearly everything regarding the acquisition and allocation of this project has been irregular or illegal:

- The forest resource estimates for TP 2-16 Vailala Blocks 2 & 3 are too high to be credible. The Forest Management Agreement sets out a net loggable volume of 40 m³ per hectare. However, no field based forestry inventory work has been done. Generally net loggable volumes in Gulf Province are in the range 10 to 20 m³ per hectare. A conservative estimate of the sustainable annual allowable cut (AAC) which ought to have applied before logging was permitted is 72,000 m³ per annum.
- The AAC provided for in the original Timber Permit (300,000 m³ per annum) far exceeds any estimate of the sustainable AAC, and to persist with such a high AAC would not be in compliance with the sustainability requirement of the National Forest Policy 1991.
- The Project Agreement negotiated by the PNG Forest Authority drastically front loads the AAC. It is estimated that resource remaining as at 2005 is about 2.0 million m³, and if harvesting proceeds at the permitted rate it is further estimated that the remaining resource will be depleted in about 13 years.
- The Timber Permit was granted before the State had acquired any rights to the forest resources from the landowners. This in itself should have been sufficient cause to invalidate the permit. The permit was, however, despite objections by the PNG Forest Authority, validated by the Court¹.
- The forest resources were subsequently acquired under a Forest Management Agreement under the Forestry Act 1991. The Act prescribes a resource allocation procedure which, given validation of the permit by the Court, was not followed.

¹ The reports of the 2000/2001 Review Team suggest that this decision warrants a formal Government enquiry.

- Given validation of the permit by the Court, the permit became a “saved” permit under s. 137(1) of the Forestry Act 1991. There is no provision for the extension of the term of saved permits in the Act. Whilst there were some dissenting opinions in this regard, the Government has accepted this position, and has drafted an amendment allowing the term of saved permits to be extended. The amendment is yet to be processed by Parliament. Despite this, on expiry in 2002 the term was extended by the Minister for a period of 10 years. This extension was not legal.
- When extending the term, the (then) Managing Director and the Minister disregarded due process, in particular in that they bypassed the Board. (Although there are no provisions for extending the term of saved permits in the Act, the Act does set out procedures for extending the term of permits granted pursuant to the Act, and it is reasonable to accept that the tests required to be met for the extension of permits granted pursuant to the Act would also apply more or less to the extension of the term of saved permits).
- The amendment to the Act which has been prepared to allow the extension of the term of a saved permit includes a proposed clause which if accepted would legitimise all extensions to saved permits granted by the Minister pursuant to s. 78 (the section which provides for the extension of the term of permits granted pursuant to the Act). However, in granting the extension the (then) Managing Director and the (then) Minister did not observe the requirements of s. 78, so there is further strong argument that the extension is illegal, even if the amendment is passed into law.
- Although an approved Environmental Plan exists, DEC has no records of the required Environmental Management and Mitigation Plan or the required Waste Management Plan. In addition DEC has archived the project file.
- The landowners have taken several Court cases against the permit holder, suggesting that the continued presence of the company may not be socially acceptable. Social acceptability is a precondition for the extension of the term of a Timber Permit specified in the Act.

RECOMMENDATIONS

With regard to Vailala Blocks 2 & 3 the recommendations of the Audit Team are:

- That the PNGFA Board accepts that the extension granted by the Minister in 2002 is not legal, and in any event did not follow due process. The permit saved under s. 137(1) of the Forestry Act 1991 is thus no longer in effect.
- That the PNGFA Board direct the logging operator to cease all activity at the site, using if necessary their powers under s. 137(2) of the Act.

- That the PNGFA Board directs the National Forest Service (NFS) to undertake field based forest inventory to determine a reliable estimate of the net loggable volume per hectare, and use this, and the net area data derived from FIMS², to determine a reasonable estimate of the sustainable AAC. Company logging records will provide useful data.
- Implement the resource allocation procedures prescribed in the Forestry Act 1991. The requirements of the Environment Act 2000 will need to be observed.

3. TP 15-53 OPEN BAY

AUDIT CONCLUSIONS

- The term of the Timber Permit was illegally extended a number of times between about 1994 and 2004. The last purported extension expired on 18 December 2004, and thus the permit and the attendant Project Agreement are no longer effective. As a consequence the proposed revisions to the agreement, and the proposed ancillary agreement dealing with forestry plantation resources, have no legal basis.
- That the logging company's request to set the permitted AAC (and the level of permitted exports) at 50,000 m³ per annum, would set the cut below the 70,000 m³ per annum specified by the PNG Forest Authority Board as the minimum for a commercially viable stand alone log export operation.

RECOMMENDATIONS

With regard to the natural forest areas included under the Open Bay forestry project the recommendations of the Audit Team are:

- That the PNGFA Board directs the National Forest Service to commence the process of acquiring the forest area under Forest Management Agreements.
- That the Board directs the National Forest Service to progress the Forest Management Agreement areas as if they are new projects in compliance with the Act.
- That in setting the sustainable annual allowable cut, that the Board directs the National Forest Service to take into account the period of time during which logging has already taken place.

With regard to the forestry plantations the recommendations of the Audit Team are:

² Forest Information Management System. This provides an estimate of the net loggable area after taking into account the requirements of the PNG Logging Code of Practice which prescribes some areas where logging is prohibited.

- That the rights to plantation forest resources provided for under the agreement be restructured under a plantation Timber Authority (as prescribed in the Forestry (Amendment) Bill 2005).

4. TP 13-34 BULOLO

AUDIT CONCLUSIONS

- The so-called Bulolo project agreement is not a Project Agreement pursuant to the Forestry Act 1991.
- The so-called project agreement gives PNG Forest Products Ltd pre-emptive rights to natural forest resources which have not yet been acquired by the State. It thus attempts to circumvent the forest resource allocation procedures prescribed by the Act.
- The so-called project agreement requires the PNG Forest Authority to “use its best endeavours” to circumvent the resource allocation requirements of the Act.
- The so-called project agreement fetters the legal rights of the Minister. This is not lawful.
- Generally contracts or agreements through which the parties agree to undertake actions which are not legal, or which attempt to avoid due legally prescribed processes, are deemed to be illegal. However, given that the agreement was executed by the Governor-General on behalf of the State, it is possible that the PNG Forest Authority may be bound by the agreement. This question would need to be settled by a Court of law.
- There is an irregularity in that the Minister granted the Timber Permit on 27 January 1995, prior to the so-called project agreement being executed 16 months later on 10 May 1996.
- The permit document is not compliant with the requirements prescribed in s. 73(2) of the Forestry Act 1991.

RECOMMENDATIONS

With regard to the so-called Bulolo project agreement, it is recommended:

- That the PNG Forest Authority apply to the Court to have the agreement declared null and void. Alternatively that the PNG Forest Authority initiate discussions with PNG Forest Products Ltd with a view to restructuring the project in a manner that complies with the Act, and if passed, the amendments to the Act contained in the Forestry (Amendment) Bill 2005.

- That if the natural forest areas specified in the agreement are to be sustainably managed and harvested in compliance with the National Forest Policy 1991, then the proper resource acquisition and allocation procedures prescribed by the Act be applied.
- That the rights to the Bulolo plantation forest resources provided for under the agreement be restructured under a plantation Timber Authority (as prescribed in the Forestry (Amendment) Bill 2005).

1. PURPOSE OF THIS REPORT

The National Forest Policy 1991 requires that the forest resources of Papua New Guinea (PNG) be managed on a sustainable basis. Accordingly the Forestry Act 1991 introduced a new approach to the State obtaining access to forest resources from the traditional landowners³, and to the allocation of those resources to the private sector for development in a transparent manner⁴.

The State's commitment to sustainable forest management was reinforced through the terms and conditions of a loan agreement under which the Government obtained funds from the World Bank to support the further development of the sector⁵. Generally the terms and conditions commit the Government of PNG to sustainable management, and to an independent review of compliance with the Policy and the Act (and other Acts and regulations) before any "logging permit" is granted. Logging permits are defined (Loan Agreement Schedule 5 Clause 8) as any Forest Management Agreement, Timber Permit, Timber Authority or geographic extension to Timber Permits. Given that Project Agreements (entered into with regard to Timber Permits granted under the previous Forestry Act (Chapter 216)(repealed), or the current Forestry Act 1991), are given effect by the grant of a Timber Permit, the definition is also deemed to include Project Agreements and variations to the terms and conditions of any Project Agreement or Timber Permit.

This report was commissioned by the acting Managing Director of the PNG Forest Authority to obtain an overview of compliance for three Timber Permits granted before the 1991 Policy and Act came into force, for which variations are being negotiated by the National Forest Service (NFS) with the permit holders.

2. CURRENT LEGAL POSITION REGARDING THE EXTENSION OF THE TERM OF "SAVED" TIMBER PERMITS

THE FORESTRY ACT 1991

The Forestry Act 1991 came into force on 25th June 2002. Under s. 137(1) it "saved" Timber Permits which had been granted under the previous Forestry Act (Chapter 216), and Dealings which had been granted under the previous Forestry (Private Dealings) Act

³ Forest Management Agreements (FMA) replaced Timber Rights Purchase Agreements (TRP).

⁴ This involves in turn a Development Options Study (DOS), Project Guidelines, public advertising, and a Project Agreement with a selected developer.

⁵ The Forestry and Conservation Project (FCP). Loan agreement signed 20 December 2001.

(Chapter 217). The Forestry Act 1991 repealed both previous Acts. The new Act also provided that saved Timber Permits and Dealings would continue:

..... to have full force and effect for the term for which they were granted or entered into until they sooner expire or are revoked.

UNDERLYING POLICY

Explanatory notes produced at the time⁶, under the heading “Transitional Arrangements – Status and Review of Existing Projects” made it clear that:

Saved permits, dealings, licences and authorities do not come within the definitions of “timber authority” or “timber permit” in the new Act. This means that any provision in the new Act which is expressed to apply to the holder of a permit or authority would not apply to the holder of a saved permit or authority or to a party to a saved LFA dealing. Thus most of the provisions do not automatically apply to saved projects.

(Underlining as in the original document).

As a consequence the provisions in the Forestry Act 1991 for the extension or renewal of a Timber Permit (s. 78) do not apply to saved permits and dealings. In the absence of any alternative specific provisions for the extension or renewal of saved permits and dealings, it is clear that it was not intended that saved permits and dealings should be able to be extended or renewed. Instead it was expected that the Board would use its powers under s. 137(2) to implement the intention of the Act set out in s. 137(3) that:

.....registrations, permits, licences, agreements, timber rights purchase agreements and other authorities saved by this section are able to be adapted to conform to the provisions of this Act

The key objective set out in the National Forest Policy is the achievement of sustained yield management, and the intent of s. 137(2) and (3) was that where timber rights had already been secured by the State under the previous legislation, that the Board would use its powers to amend the terms and conditions of the Timber Permits (and the associated Project Agreements where these existed) to reduce the annual allowable cut (AAC) to a sustainable basis.

This intent was particularly relevant at the time as immediately prior to the Forestry Act 1991 coming into force, the then Minister for Forests had issued a large number of new Timber Permits which provided for unsustainably high AACs.

⁶ Document entitled “Forestry Act 1991 – An Explanatory Overview” dated 25 June 1992 produced by the (then) Forestry Transitional Management Council.

In 1993 the Act was amended to allow for the extension and renewal of Dealings which had been saved. There was no similar amendment to allow for the extension or renewal of saved Timber Permits.

NEGOTIATIONS

At the time the PNG Forest Authority (PNGFA) made a significant effort to renegotiate the AAC set out in some of the saved Timber Permits down to a sustainable level. However the Timber Permit holders objected strongly, and to avoid possible litigation the attempt was stopped. Saved permits were allowed to continue to have full force and effect for the term for which they were granted or entered into⁷.

PRACTICE

It is clear that the PNGFA at the time did not fully understand the requirements of the Act. Timber Permit 15-53 Open Bay was granted under the previous legislation, and saved under s. 137(1) of the then new Act. It was granted in June 1992 for term of three years, and hence expired in June 1995, after the Forestry Act 1991 had come into force. The PNGFA, however, through the Board, recommended to the Minister that he grant an extension which he duly granted. The assumption made was that s. 78 which deals with the extension and renewal of Timber Permits granted under the 1991 Act, also applied to saved permits. This is not correct, and was never the intent. Even if the requirements of s. 78 were properly observed, the extension granted by the Minister was not lawful.

TP 15-53 was extended a number of times, and it was not until the 2002/2003 Review Team examined the extension of the term of a number of saved Timber Permits granted by the Minister that it became more generally understood that the extension of saved permits was not lawful. The latest extension of TP 15-53 was for two years from 18 December 2002. Thus as well as having been extended unlawfully, the unlawful extension has now expired.

In 2002, a number of saved Timber Permits were due to expire, despite the fact that the volume of logs which were allowed to be taken under the terms and conditions of the permit had not yet been harvested. Harvesting delays are common, and reasons include landowner disputes, changes in logging contractors, and the weather. Assuming that the permits could be extended under s. 78, the PNGFA initiated the required due process. Although it appears that due process was not properly observed⁸, the Minister granted a 10 year extension to the term of TP 1-7 Wavoi Guavi on 4 February 2002, and to TP 2-16 Vailala Blocks 2 & 3 on 25 July 2002 (although the later had already expired on 23

⁷ The exception is TP 1-9 Makapa. This logging project is governed by the Timber Permit issued to Innovision (PNG) Ltd in 1992 immediately before the Forestry Act 1991 came into force. Consequently it is a "saved" permit. Under clause 3 of the permit Innovision and the State were required to enter into a Project Agreement, which would set the controlling conditions of the Timber Permit. This was done in 1996, and a sustainable annual allowable cut was determined and able to be applied.

⁸ Reports of the 2002/2003 Review Team regarding TP 1-7 Wavoi Guavi and TP 2-16 Vailala Blocks 2 & 3.

June 2002). A 2004 report on Wavoi Guavi⁹ points out, given that as at 2004 the remaining resource is too small to support a financially sustainable logging operation, that to attempt to restructure the project so that it complies with the Forestry Policy and Act of 1991, 10 years after the opportunity was created to do so, seems impractical.

In the case of Vailala Blocks 2 & 3 however, there is sufficient remaining resource to place the project on a sustainable basis. It would be possible for the Board to use its powers under s. 137(2) to ensure that this happens, and consequently that the project is bought into line with the sustainability objective of the National Forest Policy.

EXTENSIONS FOUND TO BE UNLAWFUL

The finding of the 2002/2003 Review Team that extending the term of saved permits was not lawful resulted in considerable debate, and a number of conflicting legal opinions. Eventually however, it was accepted that the team's findings were correct, and that if the Government wished to extend the term of saved permits, that a legislative amendment to s. 137 would be required. An attempt to progress the required amendment as a quick short amendment through the Office of the Chief Secretary in 2003 was not supported by the Minister who decided that a number of pending legislative amendments, including the required amendment to s. 137, should be progressed in one single Forestry (Amendment) Bill.

PROPOSED AMENDMENTS TO THE ACT

At the time of writing this report (early March 2005), the PNGFA had produced the Forestry (Amendment) Bill 2005 and submitted it to the Minister for his consideration. There had not yet been any indication of the Minister's views. As well as providing for the extension of the term of saved permits, the Bill includes a proposed clause which would retrospectively validate any extensions of the term of saved permits which have been granted in the meantime, viz

(1F) All Timber Permits saved under subsections [137(1) and (1A)] and extended under section 78 are deemed to be extended under this section.

As drafted, this amendment provides that if the requirements of s. 78 were properly met, then any extension granted pursuant to s. 78 are deemed to be valid. However if the requirements of s. 78 were not properly complied with, then they are illegal. A copy of the relevant provisions of the Forestry (Amendment) Bill 2005 are presented in Attachment 1.

⁹ Observations Regarding the Extension of the Term of Timber permit 1-7 Wavoi Guavi and the Proposed Alterations to the Permit Terms and Conditions. 6 April 2004. Prepared by the 2003/2004 Review Team for the PNG Government.

INTERIM ACTION BY THE BOARD

In the meantime a number of additional saved permits had expired, and the PNGFA Board, as an interim solution, decided on a number of six month extensions¹⁰. At a subsequent Board meeting¹¹ the Board resolved to approve:

..... An extension of 12 months for all timber permits on application when they expire as an interim arrangement until the amendments to Section 137 of the Forestry Act comes into force.

CONCLUSION

Whilst it is appreciated that the Board faced a dilemma, unless and until the Forestry (Amendment) Bill 2005 becomes law, all extensions or renewals of saved permits are illegal. Further the Board does not have the powers to grant extensions.

The observations made in the following sections of this report are based on these conclusions.

3. TP 2-16 VAILALA BLOCKS 2 & 3

The NFS initiated negotiations with the Permit holder in 2002 with the intent of arranging a new permit under the Forestry Act 1991. This would have required reducing the annual allowable cut to a sustainable level, and implementing the Project Development Benefit (PDB). The PNG Government was obligated to take this course of action under the terms and conditions of the loan from the World Bank for the Forestry and Conservation Project. The permit holder was of the opinion that an extension of the term granted by the Minister in 1992 was legal, and that restructuring the project to comply with the sustainability objective of the National forest Policy was not required. It reserved the right to take legal action. It also refused to implement the PDB.

The NFS and the company continued negotiations, and these were completed in late 2004. The negotiated position has been recorded in the form of a draft Project Agreement which the NFS plans to present to the Board for its approval.

3.1 LEGAL OBSERVATIONS

BACKGROUND

The project is operated by Frontier Holdings Ltd under Timber Permit No. 2-16 Vailala Blocks 2 & 3. The permit was granted on 24 June 1992¹² and was thus saved under s.

¹⁰ Six month extensions were "granted" for TP 14-41 Bakada Consolidated, TP 3-27 Iva Inika and TP 5-10 Kumusi Saiho at Board meeting No 101 (May 2004).

¹¹ Board meeting 104 (September 2004).

137(1) of the Forestry Act 1991 when it came into force on 25 June 1992. There was no Project Agreement. The Timber Permit expired on 23 June 2002 and was (see Section 2 of this report) illegally extended by the Minister for a period of 10 years on 25 July 2002, being one month and two days after its expiry.

The position agreed to between the NFS and the permit holder, instead of being written up as a variation to the saved (but expired) Timber Permit, has been written up as if it is a Project Agreement under the Forestry Act 1991. A condition precedent is:

The grant of a Timber Permit by the Minister for Forests under s. 73 of the Act
.....

Thus an attempt is being made to convert the permit granted under the previous legislation but saved under s. 137(1) of the Forestry Act 1991 (but since expired) to a Timber Permit under the current Act. There is no provision for doing so in the Act. The Act is clear that resource allocation must go through the prescribed process of a Development Options Study, Project Guidelines, public advertising, and then negotiating a Project Agreement with the selected developer.

The Forestry (Amendment) Bill 2005, as noted in Section 2 of this report, includes a proposed clause which would retrospectively validate any extensions of the term of saved permits which have been granted in the meantime, viz

(1F) All Timber Permits saved under subsections [137(1) and (1A)] and extended under section 78 are deemed to be extended under this section.

As also noted it is the opinion of the Audit Team that this amendment requires the provisions of s. 78 to be adequately observed if it is to be used to validate extensions already granted. However, as pointed in the report of the 2002/2003 Review Team (see Attachment 2 to this report), when the Minister granted the 10 year extension for TP 2-16 Vailala Blocks 2 & 3, due process (as defined by the requirements of s. 78) were not at all complied with.

It is the intention of the National Forest Service to present the Project Agreement to the next meeting of the PNGFA Board for its approval and execution. It is the view of the Audit Team that the permit has expired, and even if the permit had not expired, then the correct approach would have been to negotiate variations of the saved permit. It is also the view of the Audit Team that if a Timber Permit is to be granted under s. 73 of the Forestry Act 1991, then the full resource allocation procedures set out in the Act must be followed. To do otherwise would not be compliant with the Act.

¹² This was very irregular as the State had not yet acquired the forest resource from the landowners. Resource acquisition was achieved 1995 through two Forest Management Agreements. Although challenged by the Forest Authority, the Court validated the permit granted in 2002, and the project was progressed on the unusual basis of resources acquired under the Forestry Act 1991, and allocated under a Timber Permit issued under the preceding legislation.

It would be expected that the current operator, having equipment and personnel on site, would be in a position to submit the best proposal, and be selected as the preferred grantee of the Forestry Act 1991 type permit. This assumes that the continued presence of the current operator in the area is socially acceptable to the landowners and the Provincial Forest Management Committee. The requirements of the Environment Act 2000 will need to be observed.

IF THE ACT IS NOT AMENDED

If the Forestry (Amendment) Bill 2005 is not passed in Parliament, or if it is significantly delayed, then because the extension to the term of the saved Timber Permit was illegal, the permit has expired, and the project no longer has a legal basis to continue operations. A Project Agreement without a Timber Permit has no legal basis under the Act.

Under these circumstances the only way available to regularise a lawful operation is for the Board to direct that the project be deemed to be a new project, and that the process for the allocation of the resource as prescribed by the Act commenced. This would include tendering the project, and inviting expression of interest from potential proponents including the current operator.

IF THE ACT IS AMENDED

If the Forestry (Amendment) Bill 2005 is passed in Parliament and becomes law there will be an opportunity for the term of saved permits to be extended. In addition extensions granted before the amendment became law, and granted pursuant to the requirements of s. 78, will be legalised. However in the case of TP 2-16 Vailala Blocks 2 & 3 the extension at the time it was granted did not comply with the requirements of s. 78, and thus will not be legalised. The legal question of whether the permit could be said to have been extended 1 month 2 days after it expired still remains.

The Minister is the granting authority for a Timber Permit, and if the concerns regarding the legality of the extension granted by the Minister in 2002 are disregarded, and thus the saved permit is deemed to have been legally extended, then the condition precedent in the Project Agreement for the granting of a Timber Permit under the Forestry Act 1991 should be deleted as a permit would already exist.

LEGAL CONCLUSIONS

The Audit Team concludes that:

- The extension of the term of the saved Timber Permit granted by the Minister in 2002 was not legal. Consequently there is no legal basis for the project at this point in time.
- If the Forestry (Amendment) Bill 2005 becomes law, then again the term of the saved Timber Permit granted by the Minister in 2002 is unlikely to be legal as due

process required under s. 78 of the Act was not observed when the extension was granted.

- The draft Project Agreement negotiated by the PNGFA with the company, even if it is approved and executed by the PNGFA Board cannot on its own (without a valid Timber Permit) authorise the continuation of the project.
- Under these circumstances the only way to create a legal basis for the continued operation of the project is for the PNG Forest Authority to treat the resource as a new project to be allocated in accordance with the allocation provisions of the Act.

3.2 RESOURCE OBSERVATIONS

THE ANNUAL ALLOWABLE CUT

The proposed/negotiated draft Project Agreement between the PNGFA and Frontier Holdings Ltd records (Preamble Clause C) that:

The Authority and the Company are desirous of recording hereunder the terms and conditions of the said forest development project agreement for the harvesting, reforestation, processing and forest utilisation activities on a sustainable basis in the Forest Development Project Area which is the subject of the Forest Management Agreement.

(underlining added).

The draft Project Agreement also sets out (Schedule 9) the permitted AAC as follows:

YEAR	AAC (m3/annum)
Year 5 (2005) to year 7 (2007)	200,000
Year 8 (2008) to year 14 (2014)	160,000
Year 15 (2015) to year 35 (2035)	80,000

The above schedule allows a total harvest of 3.40 million m3 over the 31 year period. The sustainable AAC over the same period for the same resource is 110,000 m3 per annum¹³.

The National Forest Policy 1991 requires that the forest resources of Papua New Guinea be managed on a sustainable basis. Whilst the basis for forest management has changed from the provincial basis referred to in the National Forest Policy to the more appropriate and practical project basis, the principles set out in the policy still apply.

¹³ This compares to the total net loggable volume estimate set out in the FMAs of 8.6 million m3, indicating a sustainable AAC of 245,000 m3. It would appear that the estimate of the total net loggable volume has been significantly reduced at some point in time.

On page 6 of the policy, under the heading “Sustained Yield Management”, the intent that the sustainable yield should be an equal annual cut is clear. In Clause 3(d) it states that:

The allowable cut will be set initially by dividing the total merchantable resource within the production forest by an assumed cutting cycle of 40 years.

The FMA for both Vailala Block 2 and Vailala Block 3 state that:

The National Forest Policy requires that production forests be managed according to sustained yield principles.

In practice a 35 year cutting cycle is used, and spreading the total harvestable resource over 31 years as indicated above takes into account that the project has been logging for four years already¹⁴. Also as noted above, spreading the total harvestable resource of 3.40 million m³ over the 31 years indicates a sustainable AAC of 110,000 m³.

In this respect the revision of the Project Agreement does not comply with the requirements of the National Forest Policy, or the Act which implements it.

LACK OF FOREST INVENTORY

Investigations by the Audit Team revealed that the net loggable volume per hectare data set out in the FMA documents (40 m³ per hectare) was not based on any field inventory. Instead a “guesstimate” was used. The reason given for this approach was that the NFS was under pressure to get the project operational as soon as possible, and that no time was allowed for field based inventory.

FRAGILE FORESTS

The report of the 2000/2001 Review Team noted that a report prepared for DEC had identified a number of forest types for which the growth rate was not considered high enough to be harvested on a 35 or 40 year cutting cycle, or which were not expected to recover from logging. These forest types were referred to as “Fragile Forests”, and it was recommended that these forest types be excluded from logging. The Review Report recommended that the PNGFA and DEC prepare a policy paper in order that the NEC might make a policy decision in this regard. To date a policy paper is yet to be submitted.

An analysis of Vailala Blocks 2 & 3 using FIMS indicates the following data:

¹⁴ This implies that logging started in 2001. Log export data indicates that logging at Vailala 2&3 started in 1997, but that the level of production was less than 100,000 m³ per annum. From 2001 to 2004 average log production averaged nearly 190,000 m³ per annum. It appears that the logging from 1997 to 2000 has been ignored.

	Vailala Block 2 (ha)	Vailala Block 3 (ha)	Total (ha)
Net loggable area	85,786	121,264	207,050
Fragile Forest within this	3,461	25,103	28,564
Percentage Fragile Forest	4%	21%	14%

The above data does not take into account the areas that have been logged since the project started.

ESTIMATE OF THE SUSTAINABLE AAC

As well as recommending that an NEC policy be promulgated regarding the loggability of Fragile Forests, the 2000/2001 Review Team also recommended similar NEC policy decisions be facilitated to decide whether the 10% conservation set-aside provided for in all FMA documents should be allowed for in the calculation of the total net harvestable volume, and whether the cutting cycle should be 35 years (as currently used) or 40 years (as specified in the National Forest Policy).

Based on the above area data and:

- An estimate of the net loggable volume per hectare for the Gulf province of 17.9 m³ per hectare¹⁵;
- A policy decision which excludes Fragile Forests from logging;
- Allowing for the 10% conservation set-aside provided for in the standard FMA; and
- A 40 years cutting cycle:

then the total net loggable volume estimate is 2.9 million m³, and the sustainable AAC is 72,000 m³. This is marginally above the 70,000 minimum set by the PNGFA Board for a commercially viable stand alone log export project.

Given that an estimated 900,000 m³ have already been logged to date, then the remaining resource is estimated to be about 2.0 million m³. If this is spread evenly over the remaining 31 years of the project, then the AAC would be 64,500 m³ per annum. Logging at the rate provided for in the draft Project Agreement would deplete the remaining forest resource in about 13 years.

¹⁵ This is the net volume per hectare data the logging company used for logging planning purposes in its Annual Logging Plan 2003-2004. Its accuracy has not been verified.

3.3 OTHER COMMENTS

The following sets out a number of issues noted by the Audit Team. It should not be seen as an exhaustive review of the document.

- The FMA includes a clause which absolves PNGFA of any responsibility for the forest resource estimates. To have the intended effect, the same clause should be included in the Project Agreement between the State and the developer.
- The FMA includes a provision for the PNGFA to set aside up to 10% of the gross loggable area for conservation purposes. This right is not recognised in the resource information set out in the Project Agreement. Either the PNGFA should make it clear in the project Agreement that it undertakes not to exercise its right in this respect, or the resource data should be adjusted accordingly.
- The Project Development Benefit (PDB) was specifically designed to replace all of the multitude of levies and infrastructural obligations contained in earlier Timber Permits. The key reasons were to allow the logging company to focus on what it is good at i.e. logging, and also to provide for more direct and timely input from the landowners and the local authority into decisions regarding the use of the funds. The Project Agreement for Vailala Blocks 2 & 3 includes both the PDB plus a range of levies and infrastructural obligations.
- Clause 18.2 of the Project Agreement makes reference to the Environmental Planning Act (chapter 370), the Environmental Contaminants Act (Chapter 368), and the Water Resources Act (Chapter 205). All three Acts have been repealed by the Environment Act 2000 which came into force on 1 January 2004.

4. TP 15-53 OPEN BAY

The State through the PNG Forest Authority and the Company have been undertaking a review of the Project Agreement pursuant to Clause 37 and 38 of the agreement. Under the review the parties have proposed to separate the natural forest and the plantation forest and to have two separate agreements to govern them respectively. The parties have produced drafts of the proposed variations and agreements, being a Deed of Variation of the original Project Agreement to deal with the natural forest component, and a separate Project Agreement dealing with the plantation forest component.

4.1 LEGAL OBSERVATIONS

BACKGROUND

The project is situated in the Open Bay area of the East New Britain Province. It has been operating under Timber Permit 15-53 which was granted following the execution of a Project Agreement dated 18 December 1984. The permit effectively brings the

agreement into force. The initial term of the Timber Permit was 3 years. It has been extended by one or two year periods ever since. The permit was "saved" under s. 137(1) of the Forestry Act 1991. Extensions granted since the Forestry Act 1991 came into force in June 1992 are not legal.

The Permit Holder is Open Bay Timber Limited, a joint venture company owned by Kowa Lumber of Japan (80%) and the State (20%). The Permit Holder is a registered Forest Industry Participant since November 1993 (FI 082).

There are no current operations on natural forest areas after the illegally extended Timber Permit and Project Agreement expired on 18 December 2004. Applications for Timber Authorities are being processed by PNGFA for logging operations within the Plantation Forest areas.

The proposed 2005 Amendments to the Forestry Act aim to provide for the grant of Timber Authorities for the harvesting of plantation forests. There are no current provisions under the Forestry Act 1991 for the development or harvesting of plantation forests.

LEGAL COMPLIANCE

The Timber Permit for this project (and consequently the Project Agreement) has expired. Even if the proposed clause in the Forestry (Amendment) Bill 2005 to save the permits which have been illegally extended under s. 78 of the Act is made law, then there is still no permit to be saved. Thus the proposed amendment will not provide for the continuity of operations on the natural forest component of the project. Given the lack of a legal permit, the Deed of Variation being negotiated between PNG Forest Authority and Open Bay Timber Ltd for the natural forest lacks validity.

It would appear that the only avenue open for logging of the natural forest to continue would be for the PNG Forest Authority to acquire the right to manage the forest under a FMA as the current underlying Timber Rights Purchase Agreements expire. However, if the National Forest Policy 1991 and the Forestry Act 1991 are to be complied with, then the project will need to be set up on a sustainable harvest basis, and to be allocated in accordance with the Act.

The draft Deed of Variation seeks to give the company the right to a:

*..... fair opportunity to enter into a long term agreement with respect to the land areas for which Forest Management Agreements have been concluded
..... for the Company to continue timber harvesting in such areas.*

Whilst the company has been managing the forest for many years, and would seem to have a moral right to continue to do so where the landowners agree to enter into an FMA, to allocate the areas under Forest Management Agreements to the company

through the Deed of Variation circumvents the allocation procedures prescribed in the Act¹⁶.

If the natural forest areas are acquired under an FMA, and the allocation procedures prescribed by the Act are complied with, then it would be expected that the current operator, having equipment and personnel on site, would be in a position to submit the best proposal, and be selected as the preferred grantee of the Forestry Act 1991 type permit. This assumes that the continued presence of the current operator in the area is socially acceptable to the landowners and the Provincial Forest Management Committee. The requirements of the Environment Act 2000 would need to be observed.

With regard to the forest plantation component of the project, currently there is no provision for plantation management and harvesting under the Act. This is the main reason why the Forestry (Amendment) Bill 2005 proposes a new form of Timber Authority specifically for the harvesting of plantation forests.

LEGAL CONCLUSIONS

Given that the term of both the Timber Permit and the Project Agreement expired in December 2004, the Audit Team concludes that:

- There is currently no legal basis under the Act for the project to be continued for both the natural forests and the plantations.
- The negotiated draft Deed of Variation without a current Timber Permit can not, on its own, legitimise the continuation of the project.
- The Forestry (Amendment) Bill 2005 offers the prospect of a new legal basis for dealing with the forest plantations.

4.2 RESOURCE OBSERVATIONS

The current Timber Permit for Open Bay was originally granted on 18th June 1992¹⁷. It permits the following maximum annual harvest:

Regular Logs (natural forest logs)	107,800 m3
Small Girth Logs (plantation forest logs)	31,200 m3

Given that there has been natural forest harvesting in the project area since about 1985, the opportunity for the PNGFA Board to invoke s. 137(2) of the Act and thus effectively amend the AAC to reflect the sustainability requirements of the National Forest Policy and the Act, has passed.

¹⁶ This would be similar to the so-called project agreement for the Bulolo forest plantations which also seeks to pre-empt rights to forest resources – see Section 5 of this report.

¹⁷ This replaced an earlier 10 year permit granted in 1984, being about the same date as the Project Agreement.

The proposed Deed of Variation would reduce the AAC of natural forest logs to 50,000 m³. The Deed recognises that the Timber Rights Purchase Agreements underlying the Timber Permit will all have expired by June 2008. It records an obligation on the PNGFA to try and re-secure access to the forest resource by pursuing FMAs with the landowners. The outcome of such an attempt cannot be predicted, and the longer term right for the company to harvest natural forest logs is deemed to be uncertain.

5. TP 13-34 BULOLO

TP 13-34 Bulolo was granted pursuant to an agreement (entitled a project agreement, but which is not a Project Agreement pursuant to the Forestry Act 1991) dated 10th May 1996 between the State of PNG, the PNG Forest Authority, and PNG Forest Products Ltd. The State of PNG is a 20% shareholder in PNG Forest Products Ltd. Clause 10 of the agreement stipulates that the terms and conditions of the agreement must be reviewed at the end of every five year period. The first review was due in May 1991, but was delayed until late 2004. Generally the amendments proposed at this time are not of any great consequence.

5.1 LEGAL OBSERVATIONS

NATURAL FOREST RESOURCES

The “Project Agreement – Bulolo” is not a Project Agreement under the Forestry Act 1991 and in no way should it be regarded as such. It attempts to give PNG Forest Products Ltd pre-emptive rights to natural forest resources (and to plantation forest resources) and thereby avoid the due resource allocation procedure mandated by the Act. The natural forest resources are termed “Additional Areas” and are made up of:

- The Waime Timber Resource Area (approximately 60,000 ha);
- The Wampit 4A and B Timber Resource Area (approximately 4,000 ha);
- The Kuper Range Timber Resource Area (approximately 30,000 ha); plus the
- The Nauti Extension Timber Resource Area (approximately 20,000 ha).

Under the so-called project agreement the PNG Forest Authority agrees (Clause 9.3) to:

Use its best endeavours to enter into FMAs with the owners of the Additional Areas for a period of 50 years;

Consider exempting the Additional Areas from advertising for open tender pursuant to s. 64 of the Forestry Act;

Utilise feasibility studies for the Additional Areas previously prepared by the Permit Holder (if any) as relevant options studies for the purposes of the Forestry Act;

Negotiate and execute a project agreement for the Additional Areas which project agreement will be substantially in accordance with this agreement; and

If the Authority is satisfied recommend to the Minister the issuance ofPermits.

The terms and conditions agreed to by the PNG Forest Authority, if implemented, deviate significantly from the due process prescribed by the Act.

The so-called project agreement has been executed by the Governor-General on behalf of the State, and bizarrely, it seems that the State itself by executing the agreement may have subverted the Act. Whilst in general terms it is not lawful to contract out of the law, as a consequence of the State executing the agreement the PNGFA may well be contractually bound by the agreement. Its obligations are to “use its best endeavours”, consistent at all times with the Act, to facilitate the company to obtain logging rights to the Additional Areas specified in the agreement. It goes without saying that the only way in which the Forest Authority can ever use its “best endeavours” is to ensure total compliance with the National Forest Policy, the Act, the regulations, and all supporting guidelines.

The Additional Areas can only be regarded as allocated to PNG Forest Products Ltd if the landowners agree to logging and are properly incorporated (as Incorporated Land Groups), if a FMA is entered into, and then if:

(a) The Additional Areas are truly and properly determined to be extensions as defined in the Act;

OR

(b) The company submits the tender considered to be the most favourable one;

AND

The company enjoys the support of the landowners, the Provincial Government, the Provincial Forest Management Committee, and the Minister at every relevant step of the process prescribed in the Act.

To date the PNG Forest Authority have not made any attempts to try and secure a FMA over the Additional Areas.

As well as the Additional Areas listed above, the so-called project agreement (Clause 9.5) also requires the PNG Forest Authority to “use its best endeavours” to enter into an FMA with the owners of the Watut West Timber Resource Area, to consider exempting it

from advertising etc as set out above for the Additional Areas. However a Timber Permit for this area was granted by the Minister on 24 June 1992, immediately before the Forestry Act 1991 came into force. Under s. 137(1) the permit was saved. The permit expired 23 June 2002, but was extended illegally to June 2007¹⁸. The PNG Forest Authority have not made any attempts to try and secure an FMA over the area.

The acquisition and allocation of any of the natural forest resource areas listed in the agreement as Additional Forest Areas should proceed in accordance with the Act, and no conclusions as to the outcome should be drawn.

The so-called project agreement calls for a five yearly review (Clause 10). It would be prudent for the State and the PNG Forest Authority to use the opportunity to delete any obligations placed on the State or the Forest Authority to undertake any actions which are not in compliance with the spirit and the substance of the National Forest Policy and the Forestry Act 1991, even if the obligation was only to use “best endeavours”.

PLANTATION FOREST RESOURCES

The so-called project agreement also deals with plantation forest resources. Under Clause 9.2 the PNG Forest Authority is required to use its best endeavours to secure a Timber Permit in favour of the company for the Bulolo Plantations, and also to consider exempting the allocation of the plantation from the requirement of the Act (s. 64) for open tender.

Further the so-called project agreement requires the PNG Forest Authority (Clause 9.4) to use its best endeavours to enter into FMAs with the owners of “Additional Plantation Areas”, to consider exempting the allocation of the Additional Plantation Areas from the requirement of the Act (s. 64) for open tender, and to secure a Timber Permit in favour of the company. The Additional Plantation Areas are listed as:

- The Wau plantation;
- The Heads Hump Plantation; plus the
- Andersons Plantation.

The same comments regarding the use of a so-called project agreement to secure forest resource rights in a manner which is not compliant with the Forestry Act 1991 as are set out above for natural forests apply. In addition the Minister had already issued a Timber Permit for the Bulolo Plantations dated 12 February 1995.

A failing of the Forestry Act 1991 is that it does not distinguish between natural forests and plantations, which in terms of acquisition and allocation have substantially different requirements, in particular if the plantations have been developed and funded by a

¹⁸ Compliance with due process was reviewed by the 2002/2003 Review Team. Their report on Vailala Blocks 2 & 3 is appended as Attachment 1 to this report.

private sector investor. Consequently where there are dealings which involve plantations, the parties, in an attempt to observe the laws, have generally made an attempt to apply the provisions of the Forestry Act 1991 although these were designed with natural forests in mind. The 2000/2002 Review Team¹⁹ concluded that the requirements of the Forestry Act 1991 were not appropriate for forest plantations. The view of the Review Team was that plantations should be treated in a similar manner to agricultural crops, and thus could be exempted from the Forestry Act 1991. Under this proposal private sector forest plantations would be subject to the general laws regarding the leasing of land, contracts, and the environment, but not subject to any regulatory control by the State. Where the State owns plantations, it would be subject to the same laws.

In February 2005 the PNG Forest Authority produced the Forestry (Amendment) Bill 2005 which at the time of writing this report sits with the Minister for his consideration. A proposal included in the Bill is that under s. 87 there be an additional form of Timber Authority specifically for harvesting forest plantations. The proposed amendment would require, where a forestry plantation is to be harvested whether it is privately or State owned, the holder of the Timber Authority to produce a five year project statement, a five year working plan, and an annual logging plan, all for approval by the relevant Provincial Forest Management Committee. Whilst the proposed amendment certainly clarifies the situation with regard to plantations, the Audit Team is of the view that a private forest plantation investor may feel excessively regulated.

THE TIMBER PERMIT FOR BULOLO PLANTATIONS

Timber Permit 13-34 governs the operations at Bulolo Plantation. It was granted on 12 January 1995 for a period of 35 years, 16 months before the Project Agreement was executed on 10 May 1996.

There are a number of reasons why the project is not duly compliant with due process under the Act.

1. The TP has been granted ahead of the so-called project agreement. Even though the Act does not distinguish plantation forest from natural forests, if the PNGFA has been regulating plantation forests in the same way as it does natural forests, then it is incumbent on it to ensure that the due process stipulated under the Act was followed. In this instance a Project Agreement should have been executed prior to the grant of the Timber Permit by the Minister upon the recommendation of the Board. The (then) non-availability of the forms at the time of the grant of the Timber Permit in 1995 and the subsequent so-called project agreement in May 1996 should not be an excuse for not complying with the basic legal process under the Act.

¹⁹ The 2000/2001 Review Team reviewed the compliance of new projects being progressed by the PNG Forest Authority with the National Forest Policy, the Forestry Act 1991, and other relevant laws, regulations and guidelines. Thirty-two pending projects were reviewed.

2. The Timber Permit applies only to the Bulolo Plantation. The so-called project agreement on the other hand covers other areas yet to be acquired under the pre-emptive provisions relating to both the natural forests and plantations. The draft amendments to the project agreement also refer to the possible consolidation of the Watut West FMA allocated to Bulolo Forest Products under TP 13-33 (which expired on 23 June 2002). It is not only improper, but it is absolutely not within the spirit and intent of the Forest Policy or the Act for the PNGFA and the State to by contract determine resource area allocations. This is also tantamount to fetter of executive discretion where the Minister's discretion to grant the Timber Permit under the Act is fettered by the contract. It is unlawful to fetter executive discretion in PNG and such contractual provisions can be declared void and unlawful by a Court of law.
3. The Timber Permit under clause 2(a) subjects itself to the terms and conditions contained in the so-called project agreement. This again compromises the executive discretion of the Minister to enforce a condition of the Timber Permit and the provisions of the Act.
4. Clause 11 of the draft amendments to the so-called project agreement (Representations and Warranties) is onerous on all the parties in that they can not contract out of the Act or by contract try to avoid the requirements of the law including the Act.
5. The Timber Permit is legally defective both in form and substance. The permit is not numbered and does not accord with the requirements of s. 73(2) of the Act, e.g. the requirement for a performance bond is not specified in the permit.

LEGAL CONCLUSIONS

- The so-called Bulolo project agreement is not a Project Agreement pursuant to the Forestry Act 1991.
- The so-called project agreement gives PNG Forest Products Ltd pre-emptive rights to natural forest resources which have not yet been acquired by the State. It thus attempts to circumvent the forest resource allocation procedures prescribed by the Act.
- The so-called project agreement requires the PNG Forest Authority to "use its best endeavours" to circumvent the resource allocation requirements of the Forestry Act 1991.
- The so-called project agreement fetters the legal rights of the Minister. This is not lawful.
- Generally contracts or agreements through which the parties agree to undertake actions which are not legal, or which attempt to avoid due legally prescribed processes, are deemed to be illegal. However, given that the agreement was

executed by the Governor-General on behalf of the State, it is possible that the PNG Forest Authority may be bound by the agreement. This question would need to be settled by a Court of law.

- There is an irregularity in that the Minister granted the Timber Permit on 27 January 1995, prior to the so-called project agreement being executed 16 months later on 10 May 1996.
- The permit document is not compliant with the requirements prescribed in s. 73(2) of the Forestry Act 1991.

5.2 RESOURCE OBSERVATIONS

With regard to natural forests, most of the Additional Areas listed in the so-called project agreement (see above) are likely to be too small to be managed on the sustainable basis mandated by the National Forest Policy. Unless there is scope to consolidate to form a forest resource base which is capable of producing a sustainable yield of at least 30,000 m³ per annum²⁰, then any thought of utilising these areas should be abandoned. Given that PNG Forest Products Ltd domestically processes all of the logs it harvests, then alternatively Timber Authorities (s. 87) may be able to be used where annual log production from a specific area is less than 5000 m³.

5.3 OTHER COMMENTS

- The original agreement and the draft amended agreement both refer (Clause 14(1)(a)) to the Environmental Planning Act (chapter 370), the Environmental Contaminants Act (Chapter 368), and the Water Resources Act (Chapter 205). All three Acts have been repealed by the Environment Act which came into force on 1 January 2004.
- Observance of due process for resource acquisitions and allocation under the Forestry Act also means observance and compliance with the requirements of the Environment Act 2000 which came into force on 1 January 2004.

²⁰ The minimum annual production required for a commercially viable logging operation. Lower annual production will result in significantly increased unit costs as logging machinery will not be fully utilised and will sit idle.

ATTACHMENTS

1. Extract From the Forestry (Amendment) Bill 2005 Dealing With the Extension of the Term of Saved Projects
2. Findings and Recommendations of the 2002/2003 Review Team Regarding TP 2-16 Vailala Blocks 2 & 3 – March 2003

Observations Regarding The Extension Of The Term Of The Timber Permit And/Or The Proposed Amendments To The Permit Terms And Conditions For: TP 2-16 Vailala Blocks 2 & 3, TP 15-51 Open Bay, and TP 13-34 Bulolo