

Due Negligence

The case for stronger EU legislation on illegal timber

Executive Summary

Nearly five years after the launch of the Forest Law Enforcement Governance and Trade (FLEGT) Action Plan, the European Commission (EC) in October 2008 finally issued a proposal for a regulation "*laying down the obligations of operators who place timber and timber products on the market*".

EIA believes that in its current form the proposal is seriously flawed. It fails to prohibit the import and sale of illegally-logged timber, resulting in wood products made from stolen timber remaining available on the market.

Main Flaws at a Glance

1. Failure to prohibit illegal timber in the EU market.

Instead of prohibiting it, the EC proposal permits continued trade in illegally-logged wood within the EU market – failing to address the "*weak rules to prevent trade in illegally harvested timber*" cited in the proposal as the key driver for illegal logging.

2. Proposed due diligence systems are vague, limited in coverage, and lack common and dissuasive penalties.

- a) Uncertain legal obligations: the proposal fails to adequately define or lay down clear and common rules on systems and monitoring of "due diligence" that will be applied equally across member states.
- b) Limited company coverage: the due diligence systems proposed are restricted to only the first company to place timber on the EC market – effectively exempting the majority of the EU timber trade.
- c) No clear and common sanctions: the proposal fails to define any EU-wide deterrent penalties.

3. Unacceptable product exemptions and implementation delays.

The proposal exempts wood used for energy production and also states that the regulation will not be applied for a full two years following passage into law.

Solutions at a Glance

The proposed regulation should be amended, by:

1. Including a general prohibition on the placement of illegal timber in the EU market, with EU-wide sanctions for infringement.
2. Strengthen the requirement for due diligence measures applicable to all EU companies in the supply chain
3. Remove unjustified product category exemptions, and ensure the regulation applies from the date of final agreement by the Council of Ministers

Key Weaknesses in the EC's proposed legislation on illegal timber

1. Permitting illegally-logged timber to be traded in the EU

In its "Context to the Proposal", the EC states that the reasons for illegal logging "*start with the high demand for timber and the weak rules to prevent trade in illegally harvested timber*". Yet the current EC proposal fails to prohibit continued imports and sales of illegally harvested and traded timber in the EU. This is a substantial failure to deliver on the "grounds and objectives of the proposal", which are explicitly stated as being to "*support the international fight against illegal logging and its related trade*".

The lack of a prohibition on illegal wood in the EU market will seriously undermine the effectiveness of the due diligence systems which form the core obligation embodied in the current proposal. Due diligence requirements that are not underpinned by a clear general prohibition clarifying the rules for all operators will lead to varying standards and differing levels of implementation and enforcement between EU countries.

Member states with weaker due diligence could emerge as laundering hubs for illegal timber to enter the EU. (See the Circumvention Case Study, on page 3)

2. Inadequate due diligence provisions with no common penalties

While the central provisions of the EC proposal – risk assessments and due diligence requirements – should be retained, at present they are vague, limited and lacking in credible penalties for non-compliance. The current proposal will lead to a range of widely differing standards of due diligence, enforcement levels and penalties between EU states.

a) Uncertain legal obligations

The EC claims that the proposed regulation is guided by the principles of “*effectiveness and clarity in terms of legal obligations*”, that it will “*avoid the coexistence of different standards between member states*”, and that a core goal is “*the establishment of common obligations of operators*”. Yet the articles on the standards and procedures for the implementation of due diligence systems, monitoring, and enforcement are woefully vague, with the majority of detail due to be outlined only after the regulation is passed. This will likely result in: widely different diligence standards across, and within, member states; divergent monitoring standards; and uncertain legal rights during enforcement of cases of non-compliance.

The proposal also fails to adequately define the provisions on monitoring and enforcement of the due diligence requirements. While national monitoring organisations must “*have in place ... measures to ensure the use of due diligence systems*”, and take “*appropriate disciplinary measures*” for non-compliance, no measures for either monitoring or enforcement are defined, and it is uncertain what recourse to legal rights these organisations will have in cases of poor implementation.

The EC is effectively laying down rules without adequately defining standards and obligations. In this way it essentially delegates the bulk of enforcement obligations embodied in the proposed regulation to the private sector, with no information as to the legal rights of these organisations to bring credible sanctions against operators who fail to comply with due diligence systems. The conflict of interests is clear while the scope of competent authorities to police the performance of monitoring organisations is uncertain. The scope for monitoring organisations to levy weak and non-deterrent sanctions is an obvious concern.

b) Limited company coverage

The EC’s proposed legislation limits the scope of the due diligence requirements to “*operators that place timber and timber products on the market for the first time*”. Such a limitation provides substantial loopholes and fails to recognise the roles and responsibilities of large “downstream” companies underpinning the demand chain. Despite covering all exporters of wood products to the EU, it perversely exempts the vast majority of EU traders from the regulation.

Companies operating in countries with the weakest due diligence systems, and the weakest monitoring, enforcement and penalties provisions will be able to launder large volumes of high risk timber onto the EU market. Retailers and wholesalers trading timber from illegal sources will be able to protect themselves from any form of sanction by employing other companies to import timber for them.

Further legal uncertainties are likely over who is defined as the first company to place timber on the market. Within the EU, wood products often pass through the hands of a number of companies between initial import and final sale. Regardless of which company may be liable to the as yet undefined sanctions if due diligence systems fail and illegal timber is imported, only one company in the chain will be covered by the proposed regulation, a serious oversight.

c) No clear and common penalties

The EC has failed to mandate a clear EU-wide sanctions regime for non-compliance with due diligence requirements. While member states are instructed to withdraw recognition of monitoring organisations who fail to adequately perform their function, recourse to penalties against the actual offending operators are extremely uncertain, and again left to the discretion of each country. There is currently no common legal provision ensuring operators in one country face the same penalties as operators in another. This fails to establish a level playing field, and will mean countries with robust penalties and robust monitoring and policing of due diligence systems will stand to suffer unequal burdens.

While the proposal requests member state governments to provide “*effective, proportionate and dissuasive*” sanctions, the most the EC suggests is that during monitoring, competent authorities “*may request the operator to take corrective measures*”. No other form of sanction is mentioned, and no means of dealing with persistent offenders suggested.

Because of the failure to prohibit illegal timber across the EU community, the lack of common rules and penalties on due diligence requirements could result in countries with low penalties and weak enforcement emerging as entry points for high risk timber subsequently sold onto the EU market.

3. Exempted product categories and delayed implementation

The proposal exempts wood subject to mandatory future EU sustainability criteria: this means “energy wood” and biomass. Yet the EU sustainability criteria will only apply to those materials that will constitute part of the Renewable Energy Directive. As such, some energy wood will be subject to the regulation, while others will not, depending on usage. Operators, competent authorities and monitoring organisations will have to navigate multiple EU rules in order to establish whether a batch of such wood material is regulated by the regulation, setting up unnecessary burdens and confusion.

The proposal also suggests that the regulation will not be applied for two years following passage into law. This is an unacceptable timeframe. EIA believes that delays in implementation of the regulation are being proposed because the regulation is not clear enough to be fully enacted in its current form.

Circumventing the Regulation – A Case Study

Below is a case study demonstrating how the weaknesses outlined above may be exploited by irresponsible operators, and highlighting the corresponding consequences. Numerous different examples of circumvention techniques are possible.

Scenario 1: The Front Company as Vehicle to Circumvent the Regulation

Employees of Company A (e.g. a plywood and flooring importer, broker or agent with large markets across Europe) set up Company B (as a front company plywood and flooring broker). Company B is registered in the member state certifying the weakest due diligence standards, implementing the lowest monitoring and enforcement standards, and embodying the lowest legal penalties. Company B adopts the Due Diligence System of the Monitoring Organisation (e.g. a Panel Products Importers Association) with the weakest standards, monitoring regime and penalty system certified by that member state.

Company B then imports 500,000 M3 of plywood and flooring from high risk countries in high risk species, without applying a due diligence system. Intelligence indicates that all of the suppliers are known to be receiving, or have received, illegal wood in the past.

The monitoring organisation inadequately audits Company B’s due diligence compliance, and the shipments are sold on to the wider EU market completely unhindered. Company B then does the same thing again 6 months later. This time the Monitoring Organization notices non-compliance with due diligence obligations, and reprimands Company B.

Company B promises to do better next time; 6 months later they do exactly the same thing, but in larger volumes. This time the Monitoring organisation takes “firm” action, and withdraws the rights of Company B to trade under its system. Nevertheless, all three batches of timber are already “untouchable” in the market, and Company B has received payment for these.

The owners of Company B close down the company and transfer its assets to Company A. Employees of Company A then set up another front company and repeat the process.

The Consequences

Effectively, Company A has imported large volumes of illegal timber without using a due diligence system, and every company in the downstream supply chain has been allowed to trade this timber unhindered. The companies involved have suffered no legal consequences for repeat offences. No country in the EU has any legal recourse to penalise any company profiting from this illegal wood.

This case shows how, under the proposed regulation, illegally-logged timber entering the market still cannot be seized in any EU state, and how the consumer remains free to continue buying these wood products. Progressive EU businesses implementing robust due diligence systems continue to be undermined. The regulation has failed, and business as usual continues on an uneven playing field.

Strengthening the regulation

EIA believes the proposal can be made fit for purpose, and strongly urges the European Parliament and Council of Ministers to make the following changes to the proposed regulation:

1. **Explicitly prohibit the placement on the EU market of timber and wood products that have been harvested or traded in contravention of the laws of producer countries.** While EC officials have claimed that this is not possible under EU competences, experience from efforts to control trade in other natural resources indicate that it is. For example, European Regulation 1005/2008 to prevent, deter and eliminate illegal, unreported and unregulated (IUU) fishing, which was passed into law on the 29 September 2008, explicitly prohibits the placement of illegal fish in the EU market, including fish caught outside community territory or waters.¹ The EC must be mandated to use equivalent measures for timber. With such a prohibition, clear and credible incentives will exist to ensure due diligence systems are strong, and are met, thereby underpinning the current proposal. More importantly, such a prohibition will ensure that when due diligence fails or is not implemented; illegal timber that does enter the market is seized.
2. **Ensure that all companies involved in the commercial trade in timber in all EU member states are subject to the above law, and that each member state has obligations to implement the same standards and penalties framework for infringements of that law, with forfeiture of illegal timber as an absolute minimum.** Again, the EC should be mandated to employ the same legal mechanisms to achieve this as are embodied in the IUU fishing regulation which specifically highlights how divergent penalties in differing member states “*encourages illegal operators to operate in the waters/territory of the Member States where these are the lowest*”, and therefore mandates all member states to levy penalties that “*effectively deprive those responsible of the economic benefits derived from their serious infringements*”.² Under this regulation serious infringements across the EU incur a maximum penalty of at least five times the value of the consignment.
3. **Remove the exception for wood fuel and biomass products, as espoused in Recital 13 of the Proposal, and implement the regulation immediately upon its passage into law.**

EIA believes that due diligence systems are only an effective response to the problem of illegal logging if they are underpinned by a prohibition on trade in illegally-logged timber with common penalties across the EU. Due diligence alone, particularly when as weak and restricted as is the case in the current proposal, is inadequate for the task at hand.

Important timber industry associations have supported legislation clearly prohibiting illegal timber in the market as a means to ensure a level playing field applicable to all operators. These include the UK Timber Trade Federation (TTF)³, and 73 leading European timber companies.⁴

The European Council of Ministers and European Parliament should urgently revise the proposal with the inclusion of a clear prohibition in time to pass the regulation before the current parliament is dissolved.

¹ Council regulation (EC) no 1005/2008 of 29 September 2008; article 12, Para 1, page 10, & Para 7, pg 2.

² Council regulation (EC) no 1005/2008 of 29 September 2008; Para 34, pg 4, & article 46, page 23.

³ “TTF chief executive John White said [The Federation](http://www.ttjonline.com/story.asp?storycode=57415) favoured the introduction of a substantive law banning illegal wood”, *EU illegal timber plan puts onus on traders*, <http://www.ttjonline.com/story.asp?storycode=57415>

⁴ FLEGT: Industry Statement. Common European rules for fair competition and sustainable markets, March 2005, cited in; <http://www.publications.parliament.uk/pa/cm200506/cmselect/cmenvaud/607/607i.pdf>