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Due diligence in the EU timber market

Analysis of the European Commission's proposal for a regulation laying down the obligations of operators who place timber and timber products on the market

by

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1. Introduction

On 17 October 2008, the European Commission published a draft regulation aiming to establish a system of ‘due diligence’ to prevent the entry of illegal timber and timber products to the EU market.

This represents the most recent stage in the long-running ‘additional options’ debate, signalled in the EU’s Forest Law Enforcement, Governance and Trade (FLEGT) Action Plan published in 2003. The Action Plan recognised that the main instrument proposed to exclude illegal products – the licensing system established under a series of bilateral voluntary partnership agreements (VPAs) – would not succeed in controlling all illegal timber entering the EU:

In the EU there is currently no Community legislation prohibiting the import and marketing of timber or timber products produced in breach of the laws of the country of origin. For a variety of reasons, some important wood-producing countries may choose not to enter into FLEGT partnership agreements with the EU, despite the advantages outlined above in 4.2.3. The Commission will therefore review options for, and the impact of, further measures, including, in the absence of multilateral progress, the feasibility of legislation to control imports of illegally harvested timber into the EU, and report back to the Council on this work during 2004 ...

... Specific questions to be addressed will include the likely impact on customs services responsible for enforcing the rules and procedures for distinguishing legal from illegal timber arriving from countries which are not participating in the voluntary licensing scheme; and how to treat shipments of wood from non-partner countries which are suspected to be of illegal origin.¹

The Commission undertook an extensive consultation process, together with an impact assessment, during 2006–07, on a range of five options:

- Extended coverage of VPAs (option 1)
- Voluntary measures by the private sector (option 2)
- Border measures to prevent the import of illegally harvested timber into the EU (option 3)
- Legislation prohibiting the trading and possession of timber and timber products harvested in breach of the laws of the country of origin (option 4A – similar to the Lacey Act in the US, which was extended in 2008 to timber and timber products)
- Legislation which requires that only legally harvested timber and timber products be placed on the EU market (option 4B)

In the end the Commission decided not to proceed with any of the options, because of their perceived drawbacks, and developed instead option 5, the ‘due diligence’ proposal. This has some characteristics in common with each of options 2, 4A and 4B, but differs significantly in key respects.

This paper presents an analysis of the current proposal for a regulation, including identifying areas where its provisions need to be clarified and areas of potential inherent weakness. The analysis draws on three documents, all published by the Commission on 17 October 2008:²

- The draft regulation laying down the obligations of operators who place timber and timber products on the market.
- Questions and answers on the proposed regulation.
- Commission staff impact assessment – report on additional options to combat illegal logging.

¹ European Commission, *Communication from the Commission to the Council and the European Parliament: Forest Law Enforcement, Governance And Trade (FLEGT) – Proposal for an EU Action Plan* (COM (2003), May 2003), section 4.2.4.

² All available both on the European Commission’s website and at [www.illegal-logging.info/Additional legislative options](http://www.illegal-logging.info/Additional%20legislative%20options)

This analysis is accompanied by an analysis of relevant due diligence systems operating in non-timber sectors, and will be followed by an assessment of the likely impact of the proposal on the UK timber and forest products industry.

2. Objectives

The objectives of the due diligence proposal are described in the accompanying impact assessment:

The main overarching objectives of this proposal are to:

- Support the international fight against illegal logging and related trade
- Address the weaknesses entailed in the current framework [i.e. VPAs] i.e. circumvention, laundering, rerouting etc. due to its bilateral, voluntary and geographically limited nature without nevertheless compromising its implementation
- Reinforce EU consumers' confidence in timber
- Improve forest governance and law enforcement in timber-producing countries

Taking these objectives into account the following specific objectives have been established:

- Close the EU market to illegally harvested timber
- Ensure consistency and legal clarity in terms of the requirements for placing timber and timber products in the EU market
- Avoid trade disputes and reciprocal measures that will devalue the measures
- Reward existing good practices for timber purchasing policies
- Avoid creating a burdensome and expensive system
- Establish a level playing field and foster a pro-competitive market environment
- Facilitate smooth functioning of the internal market
- Avoid impeding trade with low-risk countries

By means of:

- Laying down concrete rules for placing timber and timber products in the EU market
- Endorsing existing schemes that comply with specific requirements in terms of demonstrating legality
- Introducing a risk-sensitive approach

3. Definitions

3.1 Products covered

The annex to the draft regulation lists the products to which it applies. This seems comprehensive, though the impact assessment comments that 'almost all timber products'³ are covered. This presumably refers to the exemptions for products covered by CITES permits and FLEGT licenses, and biomass and wood fuel for renewable energy (see below), but it would be interesting to know whether the Commission itself thinks that anything else is not covered.

Further clarification would also be useful on whether the packaging (e.g. wooden pallets or containers) that other (non-timber) goods are shipped in is intended to be included. The annex to the draft

³ Impact Assessment, p. 54, Annex II, section 1.1, second bullet point.

regulation does indeed list packaging materials, but the US Lacey Act, as amended, explicitly excludes packaging (other than shipments of packaging material) because of the implications for shippers. If the draft regulation does intend to cover packaging, this could imply that the importers of *any* products transported in wooden packaging materials would be required to establish due diligence systems.

3.2 Operators covered

Article 2(b) of the draft regulation defines ‘placing on the market’ as ‘any supply of timber and timber products for the first time on the Community market for distribution or use in the course of a commercial activity whether in return for payment or free of charge’. The phrasing used here is ambiguous.

Question 14 in the Q&A document defines operators as those who are ‘the first to place timber and timber products on the EU market. This essentially covers importers of timber and timber products and primary producers of timber in Europe.’ Similarly, Q&A 15 states that ‘as this Regulation is limited only to the first time timber or timber products are placed on the market, it doesn’t apply to all operators involved in the distribution chain’.

This would seem to imply that all other operators in the timber industry, including processors, retailers and end-users who do not directly source the products themselves, are exempt from any requirements – even a requirement to deal with a reputable importer or producer. This is not completely clear, however, from the draft regulation itself, where Article 2(c) defines an operator as ‘any natural or legal person that places timber or timber products on the market’ – the word ‘first’ is omitted, as it is from Article 3, which defines the obligations of operators.

Larger processors and retailers often import products directly (e.g. furniture from Chinese factories). Presumably in this case these enterprises would be the ones required to establish a due diligence system, though it could be argued that it is the shipping company that would first be introducing the products to the EU market. This is almost certainly not what the regulation intends, but it could usefully be clarified.

In addition, it is not clear what happens when timber is imported and then processed into a different category of product – e.g. mouldings into window frames, or pulp into printed paper. Does the operator who places the new product on the market also have to establish a due diligence system, or does this only apply to the operator who introduces the original product?.

3.3 Illegal logging

Article 2(f) of the draft regulation sets out the definition of illegal logging. This seems reasonably comprehensive, but questions could be raised about whether legislation on ‘forest conservation and management’ covers, for example, the lawful and non-corrupt allocation of concessions, and the protection of the rights of forest communities (to the extent specified in the host country’s laws), and whether ‘legislation on trade in timber or timber products related to forest conservation and management and to the harvesting of timber’ covers payment of export duties.

In each case it could be read as though it does, but explicit clarification would be helpful. Q&A 1 implies that corrupt allocation of concessions, and non-payment of export duties, do qualify as illegal logging, but is silent on infringements of the rights of forest communities.

4. Establishing due diligence systems

Article 4 contains the definition of the due diligence system. Many issues are currently left unclear, but Article 4:2 allows the Commission to adopt measures for the implementation of the article (in particular to establish criteria for assessing risk), which will presumably clarify matters. The way in which these criteria are drawn up and implemented will be crucial: any operator following the criteria would then have a defence of being in compliance with the regulation, even if the system itself proves to be flawed. The analysis below suggests several areas where the Commission needs to take further measures to explain and define what it intends.

Article 4:1 has three elements:

4.1 Information requirements

First (Article 4:1(a)), the information that has to be provided on the timber and timber products. This is similar to the import declaration requirements of the Lacey Act, including the requirement to know the country of harvesting of the timber – though the EU requirements go beyond the US in requiring information about the legality of the product (this is of course implicit in the US legislation, but only needs to be proved once challenged) and details of the supplier.

There are two other relatively minor differences. The US system requires the value, as well as the quantity, of the shipment, whereas the EU regulation only asks for the volume and/or weight – though information on the value would be collected in any case in standard import data. The US also specifies that the description of the timber must comprise its scientific name (including genus and species), whereas the EU only asks for the ‘description’. Given the wide variation in names of species of timber, it would be sensible for the EU regulation to include a requirement for the scientific name.

The key requirement, of course, is the need to show information on legality, i.e. ‘compliance with the requirements of the applicable legislation’ (Article 4:1(a)(v)). Exactly when and to what extent this information has to be provided is not completely clear (this is not an import declaration which must accompany every product). Q&A 13 includes the statement that:

Traders shall demonstrate the exercise of due diligence on the basis of a system of procedures and measures which will enable legality to be reasonably assured. This standard does not require that it is proven that each individual piece of timber is legal.

A straightforward reading of Article 4 would imply that the operator must at least have the *ability* to be able to prove that each piece of timber is legal (or, at least, that it is ‘reasonably’ likely to be legal) – presumably if subjected to the checks by the authorities specified in Article 7. The extent to which they are likely to have to provide this proof in practice will presumably vary with the risk assessment of the source (see next para), but for high-risk areas, presumably potentially any shipment could be challenged.

The degree of proof of legality that will have to be provided – in other words, the exact meaning of ‘reasonably assured’ – is crucial to this system, yet is not really defined. Q&A 18 hardly makes things clearer (emphases added):

... it is not required that [operators] ensure legality *beyond reasonable doubt*. Operators have to show due diligence. In other words, they need to ensure legality *to their best ability*. Although

lower as a standard, due diligence is not exercised in a haphazard manner but calls for concrete steps to be taken. It takes the form of ascertaining the negative, *the absence of any doubts as regards legality*. Operators are required to demonstrate due diligence on the basis of a properly documented and effectively audited system of procedures and measures (due diligence system) which will *enable legality to be reasonably assured*. It essentially relies on knowing the product placed on the market in terms of species, volume, value and origin in order to understand any issues relevant for its legality in order to be able to mitigate possible risks.

Phrases such as ‘best ability’, ‘absence of any doubts’ and ‘reasonably assured’ are inevitably subjective and do not provide much certainty for importers. It is not unreasonable for the details not to be spelled out in the regulation, but it is essential that the Commission provides greater clarity when it publishes guidance.

The use of real-world examples as standards would be helpful. For example, the recent Seneca Creek Associates analysis commissioned by the American Hardwood Export Council⁴ showed that there was less than a 1 per cent chance of any hardwood sources from a US hardwood state originating from an illegal source. Presumably this kind of analysis will be considered to provide ‘reasonable assurance’ that US hardwood imports are legal without any further need for additional documentation. Equally, documentation provided by the original supplier from a high-risk area, perhaps in a foreign language, with no external verification, could not be regarded as robust – but this again comes down to the definition of ‘reasonable assurance’.

4.2 Risk management procedure

The second requirement in Article 4 is for a risk management procedure (Article 4:1(b)). If the system is to work properly it is essential that a common risk management framework be adopted across the EU – i.e. that the definition of ‘high-risk’ is the same across all timber operators – otherwise there will be too much variability between operators’ practices.

As noted, Article 4:2 specifies that the Commission will ‘establish criteria for assessing whether there is a risk of illegally harvested timber’. It would be very useful to know more details of this procedure:

- How quickly will the criteria be published? It would be helpful if it becomes available well before the two-year deadline for implementation, to allow time for operators to adjust their systems.
- What form will the criteria take: a list of high-risk countries, or regions or vulnerable species, or suspect companies, within these countries? There are possible dangers, in terms of the infringement of WTO rules, in publishing crude lists of high-risk countries which are then treated differently in international trade from others; in general, WTO rules forbid discrimination in trade based only on the national origin of products.
- Or will the criteria take the form of a list of issues which timber operators should be aware of and use as the basis of their own assessment? There are obvious dangers in leaving it up to operators to determine risk; almost inevitably, different operators will reach different

⁴ Seneca Creek Associates, *Assessment of Lawful Harvesting & Sustainability of US Hardwood Exports* (American Hardwood Export Council, October 2008); available at http://www.illegal-logging.info/item_single.php?item=document&item_id=704&approach_id=8

conclusions about the same products, and any of them seeking to evade the controls will find it easier to make spurious judgements as to perceived risk.

- How quickly and regularly the criteria will be modified in the light of market intelligence, feedback from operators or foreign governments, and so on.

Studies such as the Seneca Creek analysis referred to above will presumably inform the risk analysis process.

4.3 Audits

The third requirement in Article 4 is for audits (Article 4:1(c)). There is no further specification anywhere, in the draft regulation, Q&A or impact assessment, of what these audits may comprise, yet this is another key question to which operators will want to know the answer. Will they need third-party audits of their systems (or to use external systems which are third-party audited), which would be the most robust but also the most costly; or could they use internal audits, which would be the cheapest but least robust? How frequently will they need to be audited?

Article 7 of the draft regulation provides for ‘competent authorities’ to ‘carry out checks to verify if operators comply with the requirements set out in ... Article 4(1)’, but it is not clear whether these checks would themselves amount to audits, or would just check whether the system was audited by someone else – and if so, who.

It will accordingly need to be clarified what qualifies as a suitable auditing body (the UK Central Point of Expertise on Timber, for example, has established a definition of an individual or body carrying out ‘independent verification’ in reference various ISO standards), and, of course, what standards the auditors are auditing against (so the questions above about definitions will need to be answered).

5. Monitoring organisations

Article 3:2 specifies that operators may use the due diligence systems of a ‘recognised monitoring system’ rather than set up a system themselves. Article 5 further specifies that a ‘monitoring system’ will be recognised by the competent authorities if it satisfies a number of criteria:

- (a) it has legal personality;
- (b) it has established a due diligence system which contains the elements set out in Article 4(1);
- (c) it obliges operators it certifies to use its due diligence systems;
- (d) it has in place a monitoring mechanism to ensure the use of the due diligence systems by the operators which it has certified as making use of its due diligence system;
- (e) it takes appropriate disciplinary measures against any certified operator who fails to comply with the due diligence system of the monitoring organisation.

Q&A 19 gives examples of monitoring organisations as trade federations or certification bodies – legality verification schemes would also presumably be included. The next question, therefore, is

whether these schemes' systems would satisfy the draft regulation's criteria for 'monitoring organisation' (Article 5) and 'due diligence system' (Article 4).

5.1 *Certification systems*

Certification systems such as FSC or PEFC are product identification rather than due diligence systems in themselves, but they could provide the underpinning of a due diligence system, as long as operators establish procedures to ensure that they source only certified (or otherwise legal-verified) products. (In fact the FSC controlled wood standard, which requires companies to assess the risk of uncertified wood used in FSC-mixed products being illegal (among other things) and then take steps to minimise the risk, does in effect amount to a due diligence system – though only for FSC-labelled products, not for all products handled by the company.)

At the moment, however, there is no means by which certification bodies could qualify as monitoring systems themselves, since they do not oblige any operators who use their systems *only* to use their systems (i.e. they would not be able to satisfy the requirements in (c), (d) or (e) above). It may be that under the pressure of this regulation, the certification bodies will start to develop standards for 'certified operators' (i.e. operators that source only certified products), but with certification still relatively uncommon in most high-risk areas, this is not likely to be practicable for operators handling timber from such locations.

It seems more likely that certification could provide the underpinning to a due diligence system established by another organisation. Can certification, then, provide 'reasonable assurance' of legality? Under both the main systems, FSC and PEFC, legal compliance during forestry operations is a baseline requirement of the standard, so it is reasonable to assume that the likelihood of illegal material being certified is low. The situation is complicated somewhat by the possibility of uncertified material being present in mixed-source products. While both systems have established procedures to ensure that none of this wood is illegal (like the FSC controlled wood standard mentioned above), these tend to be less rigorous; the PEFC system, for example, relies heavily on self-declarations of legality (although this is currently under review).

Quite apart from the systems themselves, there is also the problem of fraudulent use of the labels. Anecdotal evidence suggests that misuse of the FSC label is already present in the Far East, and it should be expected that such misuse will become more common as certification systems are increasingly used as keys to market access (to underpin a due diligence system, for instance, or as a public procurement standard). Whether the certification systems themselves have the capacity to deal with this is an open question.

How these matters are addressed will be key to establishing a workable system. The system envisaged by the regulation simply will not work if the operators introducing due diligence systems have themselves to police the certification systems; they should be able to treat the labels as an assurance of legality and their responsibility should not need to extend beyond some basic checks that the supplying company is a legitimate chain of custody holder.

5.2 *Legality verification systems*

Legality verification systems such as those run by the Tropical Forest Foundation, Certisource, SGS or Smartwood have developed rapidly over the last few years, with growing market requirements for proof of legality. If they are effective enough to provide the 'reasonable assurance' of legality required

by the EU, they could provide the same kind of underpinning for due diligence systems as certification systems. The extent of the activities these schemes guarantee as legal, however, does vary, and this would clearly need to be assessed against the regulation's definition of legality.

In addition, the same caveats apply as to certification schemes – where these are product identification schemes rather than operator certification systems, they cannot qualify as monitoring organisations as envisaged by the draft regulation.

5.3 Trade associations

Several wood product trade associations are currently developing codes of conduct and responsible purchasing policies designed to encourage their members to source legal products. It seems unlikely, though, that many of them would currently meet the requirements for due diligence systems laid out in the regulation. For example, a study for the Timber Trade Action Plan found that out of fifteen federations assessed (twelve in the EU), eleven had codes of conduct with the common objective of members trading in legal timber and progressing towards sustainable timber only, six had purchasing policies helping to implement environmental commitments, and only four included monitoring members' performance and progression towards purchasing only legal and sustainable timber.⁵

It may well be that in time such policies could develop into fully-fledged due diligence systems through, for example, increasing the minimum requirements and introducing third-party auditing of compliance, but this would require significant further developments – and also greater capacity; few trade associations currently have one, let alone more, dedicated environmental staff.

5.4 Conclusion

There are one or two other schemes that could potentially operate as monitoring systems – for example the WWF Global Forest and Trade Network – but in general none of the schemes identified in this section could currently satisfy the criteria set out in the regulation. The certification and the better legality certification schemes could probably provide the 'reasonable assurance' of legality necessary under a due diligence system, but this is not the same as acting as 'monitoring organisations' in the way that Q&A 19 implies.

It is not too difficult to envisage systems being developed by companies or, perhaps, certification bodies, to allow them to operate as monitoring organisations, making use of the standards set by certification and legality verification schemes, but this will necessarily take time.

It would also be highly desirable for monitoring organisations to be recognised at an EU rather than member state level – but this is not what the draft regulation envisages. We turn to this topic next.

6. Potential for variable implementation and enforcement

Four key elements of the enforcement of the regulation are left to 'competent authorities' in the member states, i.e. not the Commission itself.

⁵ EU Timber Trade Action Plan (TTAP), *Review of Timber Trade Federations' Purchasing Policies – Update 2008* (draft version, October 2008).

First, recognition of monitoring organisations (Article 5:1). There are obvious dangers in member states, rather than the Commission, recognising monitoring organisations – that some will be recognised in some countries but not in others. Even if all member states adopt a common approach, they are bound to vary in their speed of implementation. And if a common approach is to be adopted – which is obviously desirable – it makes no sense to require all twenty-seven member states to go through the same process of assessment of the same monitoring organisations.

It would make obvious sense for the Commission at the very least to provide clear guidance on which monitoring organisations meet the criteria. Presumably this is what may be meant by Article 5:6 ('The Commission shall adopt measures for the implementation of this Article'), though Q&A 19 seems to envisage a fairly hands-off approach by the Commission:

The recognition of such schemes will be made at national level. The Commission will keep a monitoring role and the responsibility to maintain a well-informed list of all recognised schemes.

The second area where enforcement is left to member states rather than the Commission is monitoring of the monitoring organisations, to ensure they continue to satisfy the requirements of Article 5:1; Article 5:3 provides for the competent authorities to 'carry out checks at regular intervals'.

The third area is monitoring of the operators themselves, under Articles 7 and 8. Inevitably, the degree of oversight exerted by member state authorities will vary.

The fourth area is the level of penalties for any breach of the regulation, which, as usual, will be set by the member states, under Article 13. Again, it seems very likely that these will vary from state to state.

The combination of this potential variability in enforcement, authorising monitoring systems, checking the operators and the monitoring systems and setting penalties, is almost certain to lead to some member states emerging as vulnerable entry points for illegal products – as they have in the past, for example, for CITES-listed products. Once timber products have entered the EU, they will then be able to circulate freely within the EU market – the controls operate only at the point of entry (import or production) and there is no subsequent check on products' legality.

This is potentially a very serious weakness. The Commission itself admits that illegal logging is not unknown within the EU (Q&A 2 mentions Bulgaria and Estonia), implying that the authorities there are already not capable of ensuring legality of production. It is often difficult to assess the legality of imports, and if a member state recognises, say, a trade association with a relatively weak purchasing policy, and then fails to monitor its operation, and sets low penalties for breaching the regulation, it may easily prove attractive to some companies to continue to import cheaper illegal products and to undercut those enterprises that have incurred costs establishing effective due diligence systems.

This is the key difference between this option and Option 4A (Lacey Act equivalent), where the handlers of the illegal products can be prosecuted at whatever stage the products are detected, not just at the point of entry. Under this draft regulation, the whole system will be only as effective as the first entry point in the EU member state which is the weakest at enforcement.

It is also not clear which would be the 'competent authorities' in the member states. If these are to be, for example, trading standards authorities, which currently monitor and enforce compliance with many requirements on market operators, it seems unlikely that they will have the expertise or resources necessary to enforce the regulation adequately. The impact assessment assumes an additional cost of implementation of only €1 million per year for public authorities, including the Commission itself.

7. What happens if the system fails?

The central requirement of the draft regulation is to establish a system of due diligence, not to show that every product introduced to the market is legal. It is not entirely clear, then, what happens if the operator does exercise due diligence but the product is *still* found to be illegal.

Would that imply that the operator's due diligence system by definition failed to meet the criteria set out by the Commission? This would come close to the system being the same as Option 4B, which the Commission criticises for its costly nature. Or would it lead to no action, thus rather throwing into question the effectiveness of the due diligence scheme itself? The Q&A and impact assessment are silent on this issue, though, as noted below (section 9), the impact assessment assumes that the scheme will be as effective as Options 4A and 4B in reducing illegal logging.

This comes back to the question of the guidance the Commission will set for due diligence systems. If an operator sets up a system that does meet the criteria set out by the Commission – or uses a monitoring system recognised by a member state – but still ends up handling illegal products, then presumably it would have a defence in law. Whether the Commission or the member state would then take action to change the criteria, or derecognise the monitoring system, are open questions.

8. Exemptions: CITES, FLEGT and energy products

Any products accompanied by a FLEGT license (Article 3:3) or a CITES permit (Article 3:4) will be assumed to be legal and therefore exempt from any further requirement.

For FLEGT licenses, this is clearly a sensible provision (as long as the definitions of legality in the VPA and the regulation are the same) and should provide an incentive for countries to agree VPAs with the EU – though that may depend on the extent to which due diligence systems for non-FLEGT products are regarded as cheaper and easier to implement than the FLEGT licensing system.

For CITES permits, however, this opens up a potential loophole, as abuse of the CITES permit system certainly exists; unlike the FLEGT system, there is no requirement for third-party auditing of the issue of CITES permits. It would be a good idea if the Commission undertakes to monitor the import of CITES-listed species into the EU after this regulation comes into effect, and investigate further if any signs of abuse (i.e. a sharp increase in imports of (notionally) CITES-listed products) become apparent.

Preambular paragraph 13 of the draft regulation also refers to the intention of exempting timber and timber products subject to mandatory sustainability criteria established by the EU on the promotion of the use of energy from renewable sources. This is not, however, reflected in the main text of the draft regulation, probably because the directive establishing these criteria has not yet been agreed.

However, since the criteria will only apply to some products and not others, depending on their end use, this has the potential to create confusion amongst operators and enforcement authorities. What happens, for example, if a volume of timber is imported or produced ostensibly for energy use and then diverted into production? Will the forthcoming directive establish effective monitoring systems for ensuring that the products do end up where they are supposed to?

9. Impact and cost-effectiveness

The impact assessment published by the Commission summarises the comprehensive assessment performed by Indufor on the original five options (1, 2, 3, 4A and 4B),⁶ and adds new text dealing with the due diligence proposal (option 5).

The *costs* of option 5 are assumed to be almost the same of those of option 2 (private sector voluntary schemes) – €16m/yr on average (€16.5m in option 2) for the private sector, plus €1m/yr for the EU institutions themselves (zero in option 2). The *effectiveness* of option 2, however, is assessed as low – the impact assessment estimates ‘some’ impact on illegal logging, and comments that:

Although these initiatives have merits including their flexibility, powerful motivation and good cost/efficiency balance, their voluntary nature, lack of policing over implementation and lack of sanctions for non-compliance challenged over the years their credibility and sustainability.⁷

The *effectiveness* of option 5 is assessed as high – indeed, it is assumed to be as effective as options 4A and 4B, a 12 per cent reduction in illegal logging globally. The *costs* of these two options are, however, assumed to be much higher (4A: €16.5m/yr on average for the private sector plus unquantified but potentially high costs for public sector law enforcement; 4B: €117.1m/yr on average for the private sector plus €2m/yr for the public sector). The introduction to the draft regulation itself observes that:

[Option 4A] would have significant difficulties in its implementation because demonstrating the underlying illegality would be a difficult task as timber products have complicated supply chains, stretching through several countries ...⁸

[Option 4B] would require presentation of written documentation covering every single shipment and as a consequence the option would risk creating a burdensome, expensive and trade-disruptive system.⁹

It seems distinctly unlikely that option 5 will simultaneously be as cheap as option 2 (which is regarded as ineffective) and as effective as options 4A or 4B (which are regarded as costly).

If it is to be *more* effective than option 2, it must be assumed that certification, legality verification, trade associations’ or similar systems are adopted more widely – indeed, universally – and enforced rigorously. How this can imply no additional costs for the private sector (in fact, €0.5m/yr less) is not explained in the impact assessment.

Similarly, there are a number of reasons to doubt that the system in option 5 will be as effective as that of options 4A or 4B. Indeed, at several points the accompanying documentation to the draft regulation accepts that the due diligence system will not be as effective as other options – for example, Q&A 18 accepts that ‘it is not required that [operators] ensure legality beyond reasonable doubt’, and refers to it being ‘lower as a standard’.

⁶ The full impact assessment is available at http://www.illegal-logging.info/item_single.php?item=document&item_id=690&approach_id=26

⁷ Impact assessment, p.20.

⁸ Draft regulation, introductory notes, p. 6.

⁹ Ibid., p. 7.

It can be understood how the Commission could argue that the due diligence option is more cost-effective than the other options, accepting a lower standard of effectiveness at a significantly lower cost – but this needs to be shown, not simply asserted. As it stands, by simultaneously claiming minimum cost and maximum effectiveness the impact assessment is not credible.

10. Conclusion: can the draft regulation meet the Commission's objectives?

The analysis of due diligence systems in other sectors which accompanies this paper shows how they can work to spread awareness of problems and encourage the development of traceability systems while preserving flexibility and reasonable levels of cost-effectiveness.

In principle, a due diligence system for timber could achieve the same outcomes – though it would also clearly need some of the elements present in other systems, such as clear guidance, support and the opportunities for dialogue between operators and authorities.

However, the analysis of other systems also points out the weaknesses, including the dangers of unclear guidance, particularly over risk assessment, and variable implementation and enforcement across the EU. As it stands, the draft timber regulation suffers from these problems and others. In particular:

- There are too many areas where the draft regulation and accompanying documents are unclear, including definitions of products and operators, how legality can be reasonably assured and what audits are necessary. Although this could be clarified by drafting improvements or the publication of 'statutory' (i.e. legally binding) guidance, it is difficult to assess the impact of the regulation in their absence.
- It is not clear what could qualify as a monitoring organisation. The suggestion in the Q&A that certification schemes or timber federations could act as monitoring organisations does not seem to be borne out by examination of the requirements of regulation itself.
- There are too many potential loopholes, including exemptions, particularly that for energy products.
- Too many implementation and enforcement responsibilities are assigned to member states rather than the Commission, creating a real possibility of variable implementation and the development of favoured entry points for illegal or suspect products. Once illegal products are cleared for entry into the EU, there is no possibility of further interdiction. This is a major flaw in the proposed regulation and risks undermining it completely.