



National
Measurement
Office



EUTR: Plywood imported from China

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Executive Summary

As a result of industry concerns and intelligence in this area, this project focussed on plywood manufactured in China and placed on the market in the UK. Plywood is a product that potentially represents an area of high risk, due to long supply chains and the species used in production, being derived from illegally logged sources, notably Africa.

Sixteen companies were identified as Operators by the National Measurement Office (NMO) and were requested to supply the due diligence system for the Chinese plywood that they place on the market in the EU. Of these, 14 companies submitted due diligence systems that were insufficient when compared to Article 6 of the European Timber Regulation (EUTR) No. 995/2010 that outlines an Operators obligation to implement a due diligence system. The common thread running through these failures was a lack of narrative explaining how the combination of document gathering, risk assessment and mitigation (where necessary) enable the company to reach a conclusion of negligible risk that the timber in the product was sourced illegally. The system must also be maintained.

Alongside engagement with these non-compliant companies, products were purchased from the Operators and subjected to microscopic analysis to ascertain the contents of the product. Of the 13 purchases tested, 9 products did not match the declaration supplied by each company regarding the species contained within the plywood, further indicating the unreliability of the supply chain of these products. In all, only one company was found to be compliant with the EUTR as a result of testing and the submission of their due diligence system. The NMO continues to investigate the remaining cases. Various sanctions will be applied to the companies in question, including the possibility of prosecution based on non-compliance with a Notice of Remedial Action.

The combined value of the imports of the companies in this project amounts to 10% of the plywood imported from China into the UK in the last year, indicating the potential scale of non compliance in the industry. As a result the NMO are likely to conduct a similar project in this product area in the future, drawing from the knowledge gained through this work in terms of industry intelligence and engagement procedures, which are likely to become more robust as the EUTR continues to bed in and companies come to a more complete understanding of their obligations of the EUTR.

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1 Introduction

Originally part of the Forest Law Enforcement, Governance and Trade (FLEGT) Action Plan published in 2003, the European Timber Regulation (EUTR) No. 995/2010 came into force on 3rd March 2013. Article 4 of the EUTR clearly states that Operators (defined as businesses placing timber or timber products on the market for the first time) must not place illegal timber or timber products on the market and must have a due diligence system in place. The aim of the system is to reach a conclusion of negligible risk that of any species used, have been illegally harvested in their country of origin. This system should comprise three elements (information gathering, risk assessment and risk mitigation) prescribed by Article 6 of the EUTR. These obligations apply to timber originating from within the domestic (EU) market, as well as from third (non-EU) countries. Traders (defined as businesses dealing with timber or timber products but not placing it on the market for the first time) have an obligation of traceability.

2 Market Surveillance

Imports from China

This project arose in response to intelligence received and indicators from the trade, as well as concerns raised by trade bodies and NGO groups regarding the importation of tropical timbers into China for processing into plywood. A range of independent background studies¹ have indicated that timber imported into China is likely to be done so illegally and therefore is unlikely to comply with the due diligence requirements of the EUTR.

China is the world's largest plywood producing and exporting country, making up 40% of China's wood-based panel production. In the UK, plywood from China makes up around 50% of tropical plywood imports² and the Chinese product is around 25-30% cheaper than other equivalent products available. The Chinese forestry system and exploitation of domestic forests tend to represent a minor risk due to strong legislation and governance as well as a low risk to the species harvested (poplar, eucalyptus) for plywood manufacturing. However, large volumes of tropical wood are imported into China from high risk areas (e.g. Papua New Guinea³ or Africa⁴) specifically for the face and back veneers.

The supply chain for plywood coming to the UK from China can be varied and complicated, as can be seen in Figure 1. In the countries of origin for both the core and the face veneers there can be a number of forests/plantations and a number of harvesters supplying the constituent parts. In turn there are a number of different suppliers to the peeling mills and manufacturers. A large number of companies take the business decision to be the declarant on the customs C88 form and are therefore considered to be the Operator (as per Commission guidance). They employ an agent to do all of their sourcing and purchasing, but save money by declaring the import in their own name. These agents are in turn using companies that source timber from other agents, resulting in a complicated supply chain.

¹ <http://www.illegal-logging.info/sites/default/files/uploads/CanbyOliver.pdf>

² <http://www.globaltimber.org.uk/UKIllegalTimber.doc>

³

http://www.chathamhouse.org/sites/files/chathamhouse/home/chatham/public_html/sites/default/files/20140400Loggin gPapuaNewGuineaLawson.pdf

⁴ http://www.rem.org.uk/documents/CAGDF_rapport1_Sangha.pdf

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In order to comply with the EUTR, each link in the chain needs to be evidenced by specific documentation, (e.g. felling licence, transit documentation), along with a risk assessment (e.g. prevalence of illegal harvesting in each country) and a mitigation step (e.g. third party verification relating to harvester, testing or other relevant methods) that enables the operator to come to a conclusion that there is negligible risk of the timber having been sourced illegally, or the timber is non negligible, can't be mitigated and therefore cannot be placed on the market.

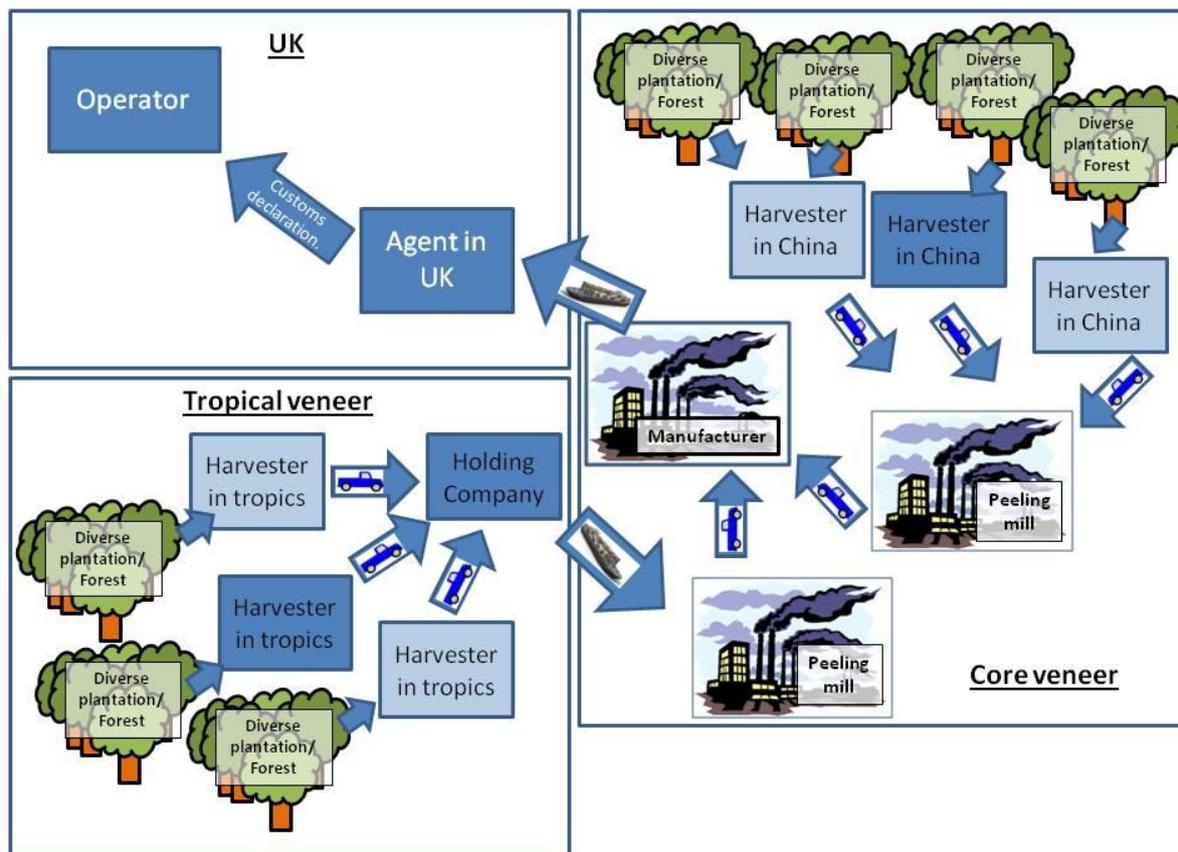


Figure 1: Indicator of potential complexity of supply chain. Light blue boxes indicate alternative parties for each stage.

Methodology

Companies were identified through the HM Revenue and Customs Importer Search website, based on the plywood products commodity code 4412 and focussing on the year March 2013-March 2014. This list was further narrowed down using other sources, including internet searches, NGO reports and concerns from other Operators, outlined in figure 2. These sources also included intelligence gained through previous NMO projects which could identify which companies could be eliminated from the project based on previous satisfactory levels of compliance and identify any that should be included as they were due to be re-visited as a result of previous work. Companies that had successful previous engagement were not included in this project in line with the Hampton Principles.

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A large amount of work has been done between the EUTR team and the large-scale timber retail sector so the majority of the companies identified for this project were small-to-medium enterprises (SMEs). Finally, geographical distribution of companies was also considered based on prior knowledge of the industry and non-Operators were eliminated. Ultimately the model identified 22 companies placing plywood products from China on the EU market.

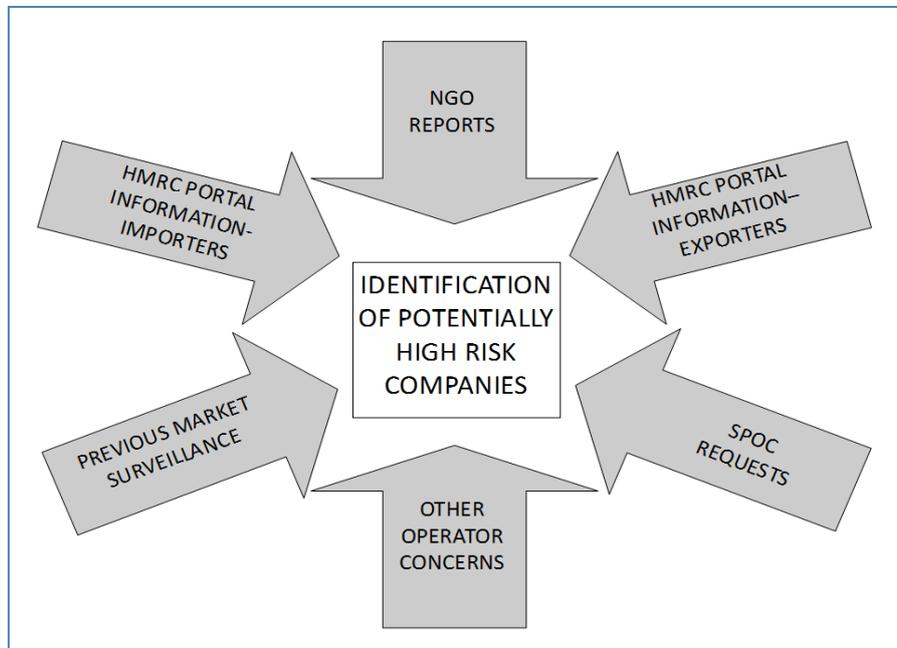


Figure 2: How potentially high risk companies were identified.

Each of the 22 companies was sent a recorded delivery Initiator Letter, requesting that they produce a due diligence system applied to one of their plywood products imported from China and with a tropical face and back veneer. The letter specified that the company had 10 working days to come back to us in whatever format suited them. This response was then audited against the criteria of Article 6 of the regulation.

Testing has become an essential tool in EUTR projects as it allows NMO to establish if a potential offence has been committed under Article 6 of the EUTR with a greater degree of certainty- i.e. a due diligence system cannot be considered appropriate if the product on which it focuses does not contain the species that are researched and risk assessed within it. Following engagement, sample purchases were made wherever possible in order to ascertain the content of the product, which could be compared to a declaration of content obtained from the company in question. Identification is made by microscopic examination of the various veneers of the plywood product, taken from small samples of the products, from which the genus of the wood in each layer can be identified.

3 Results and Outcomes

The response times are shown in Figure 3. Of the 22 companies written to, 16 were found to be considered as Operators under the EUTR and the response time ranged from compliant (within 10 working days as requested) to nonexistent (no submission at all). The locations of these companies around the UK are indicated in Figure 4.

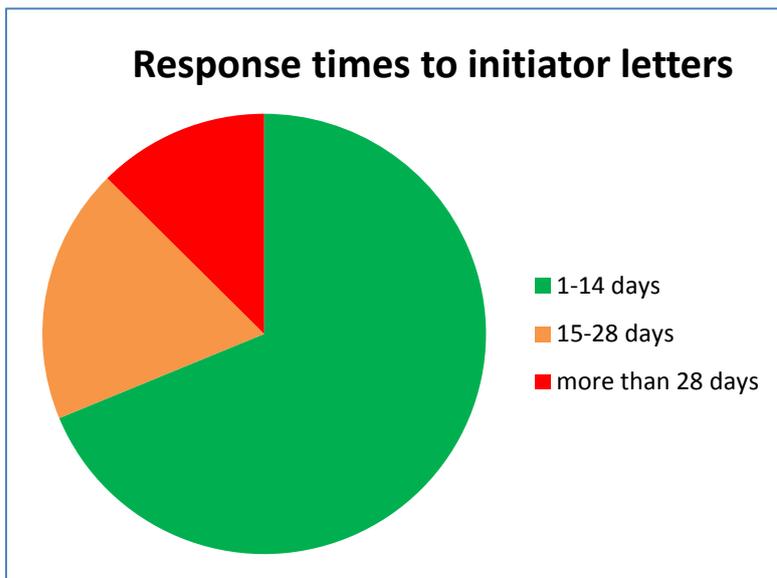


Figure 3: Response times to initiator letters



Figure 4: Company locations

Quality of due diligence procedures

Overall, of the 16 companies that were initiated, 14 initially supplied an insufficient due diligence procedure (88%). Further issues arose with testing (see test results for further details). Two companies supplied satisfactory due diligence systems upon submission. One company was found to be compliant as a result of previous engagement through another project, indicating a positive result to the engagement model. The second company was able to provide a sufficient submission at the first request. These are both large companies with resources and personnel dedicated to compliance.

Four companies' original submission were insufficient but following an enforcement visit from NMO officers' guidance was taken into account and the subsequent submission satisfied the requirements of Article 6 of the EUTR. These engagements will result in administrative sanctions being issued to the business in the form of Warning Letters.

The ten remaining companies failed to meet the requirements of Article 6 of the EUTR, despite guidance and an enforcement visit from NMO officers. These companies were issued a Notice of Remedial Action which outlines the shortcomings of their systems and the action that needs to be taken in order to achieve compliance, along with a timeframe. These companies represent a high risk in the industry and are likely to require re-visiting in the future as part of other projects. One company did not supply a submission upon request fell into this category as their approach was to wait until the meeting stage to discuss their due diligence process, which was then found to be insufficient. Subsequently their re-submission was insufficient and required further action.

Whilst companies showed a willingness to comply with the legislation, very little effort was made to try to understand the EUTR and be proactive in reaching compliance prior to engagement. There were two outstanding contributing factors that accounted for insufficient due diligence.

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The first was an overreliance on certification and trade procedures. In order to comply with Article 6 of the EUTR there needs to be evidence of the steps taken to achieve negligible risk, this means that an overarching policy or a spreadsheet is insufficient without the accompanying paperwork, to demonstrate how decisions are made. For example to state that “websites are checked” indicates part of a risk assessment, but providing no record of what site or when, or no evidence such as a print out of the site does not demonstrate a risk assessment ever being undertaken.

The second contributing factor was the lack of thought process, or narrative through which the Operator demonstrates the proper functioning of the due diligence system and procedures. The normal response was that these are business decisions that the company has made based on their experience in the industry and on agreements with their suppliers. Evidence of a risk assessment and mitigation (if required) alone was not considered sufficient as it does not identify the reasons why the decisions were made.

Common mistakes in the due diligence received
Information gathering
Usually covered by most companies, some information were consistently omitted such as contacts for customers, or essential information indicating compliance with applicable legislation
Risk assessment
When at all approached by the company, many criteria were not covered, most notably the risk of illegal harvesting of the species, in the country of origin, and the associated complexity of the supply chain
Risk Mitigation / Overall
It was found a lack of narrative detailing the business decision and thought processes taken by the company therefore not concluding of reaching negligible risks before placing the product on the market

Microscopic testing

Of the 16 companies, a total of 14 purchases were made. Figure 5 below shows the results of the tests from the 12 samples that had been tested at the time of writing (see Annex 1 for an overview). Match failures occurring in the core were, on the whole, attributed to low-risk species. Non-matching face species represented a much higher risk as a combination of high risk country and high risk species. Aside from the differences in the risk associated with each component of the product a failure of any type highlights a clear unreliability on the company’s supply chain and companies were tasked to explain the difference.

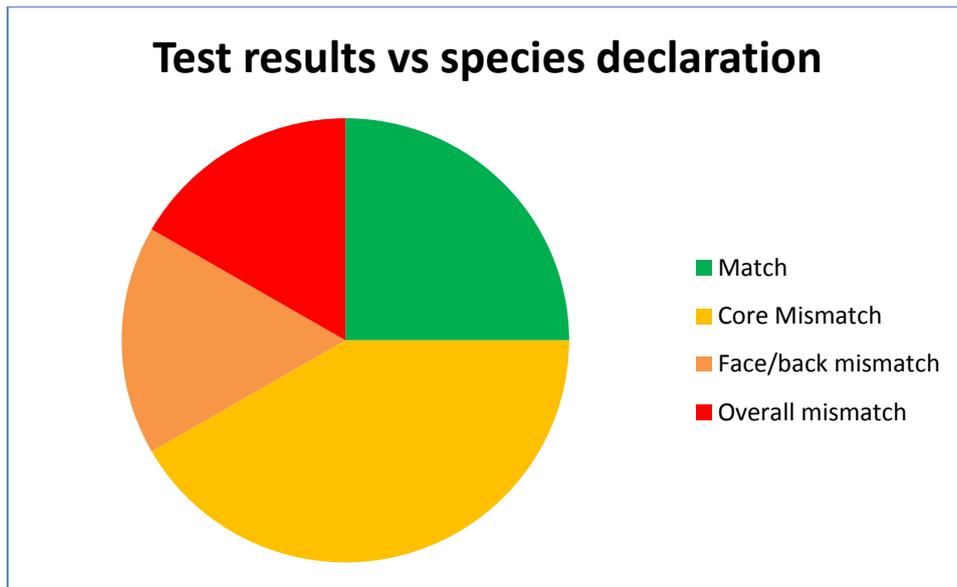


Figure 5: Overview of test results

It should be taken into consideration that the additional species that are found are only able to be identified at a genus level- further testing at the DNA level (if possible) is required to narrow down to a particular species and therefore a particular level of risk. For the company this means that their issue remains that they do not know their product (or their supply chain), whereas for NMO it means that to narrow down the investigation may require further investment.

Engagement outcomes

Given the current status of each case, the outcomes of engagement activities on this project in terms of administrative sanctions and advice given to the 15 non-compliant companies are represented in Figure 6. Nevertheless, it remains an option open to NMO to prosecute companies that continue to be non compliant following engagement and/or testing.

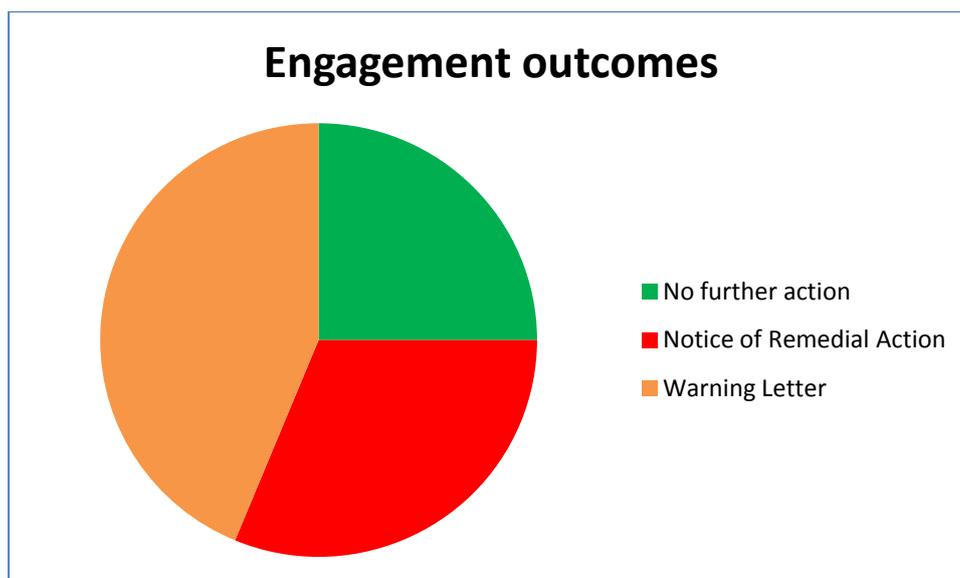


Figure 6: The proportion of outcomes.

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NMO has been able to achieve results through a combination of awareness and enforcement. During the engagements a number of companies took the decision to suspend sale of the timber in question until a suitable outcome was achieved- further evidence of cooperation from the industry.

Positive steps taken by the industry as a result of engagement
<p>Supply chain scrutiny</p> <p>Operators have begun to question the reliability and veracity of the paperwork received from their suppliers when requested.</p> <p>As an example, one company suspended all supply from Papua New Guinea as they didn't feel they could reach negligible risk without investing more time and money than what they had originally budgeted.</p>
<p>Reliance on third party paperwork</p> <p>Through this engagement, companies were able to understand that they then need to assess this paperwork themselves as it is them as the Operator that must reach the conclusion of negligible risk regarding the origin of the timber. As a result of auditing their due diligence process and/or the test results a number of companies were forced to have difficult conversations with their agents.</p>
<p>Third party participation</p> <p>One noticeable outcome was the involvement of third party organisations hired by the targeted companies to help them build their knowledge and due diligence systems (Track Record, TTF, independent consultants). This indicates a strong will from the trade to reach compliance. Whilst this can lead to an over-reliance on frameworks which given no narrative or conclusion, the frameworks provided by these bodies are nevertheless a solid foundation.</p>
<p>Testing, site visits</p> <p>As a result of our engagement, 9 companies have begun to implement testing procedures (generally on an ad-hoc basis) as part of their mitigation procedures. On one occasion, a company director took the decision to fly to China to the supplier to establish the origin of a species found in the core of its plywood sheet.</p>
<p>New company policies</p> <p>A number of companies chose to employ new members of staff/ task current members to establish and maintain due diligence policies within the companies. These policies included novel approaches to the EUTR such as risk matrices and software systems.</p>

Overall as a result of engagement and through working with the industry there is a better understanding of Operators' obligations and there has been a positive industry response to NMO's work. Through the figures obtained from SPOC the value of the imports of plywood from the companies engaged with in this project amounts to approximately 10% of Chinese Plywood Imports.

Whilst two of the companies already had suitable systems in place the project has served to raise awareness across the board in this sector and has resulted in considerable investment in EUTR compliance through the steps indicated above.

Considerations

It was important to take certain factors into consideration when understanding the results and the engagement that followed. Whilst it is concerning for the Operator to find that there is a different species in their product than what was expected, due to the nature of the supply chain and the felling process it is not unlikely. Forest concessions are not always strictly monoculture and some species look the same to the naked eye. From the EUTR point of view whilst the species in the product are not specified in the due diligence or the declaration for testing, which raises a concern, the species that are found may still be covered by the felling licences, phytosanitary certificates and third-party verification certificates. Whilst this is a clearly misapplied due diligence system, the overall risk is low in relation to the possibility of illegal logging in the supply chain. This can be the case with timber both from the country of origin and those further down the supply chain.

4 Conclusions

The level of non-compliance justified the market surveillance activity in this area, with all but one of the 16 companies that were contacted showing either an insufficient due diligence process, a failure in terms of knowledge of their product when tested, or both.

Due diligence non-compliance:

The majority of companies failed to supply sufficient due diligence to cover the product in question. This may be due to a number of factors:

- Insufficient understanding of the legislation in terms of documenting their thought processes.
- An “I’ll wait until I’m audited” approach to regulation.
- Confusing messages from third parties.
- No prior regulation of the legislation in order to understand what is required.
- Reliance on paperwork supplied by other companies in the supply chain when “EUTR compliant” timber is purchased.
- Self declaration accepted at face value
- Making intuitive decisions but not documenting or evidencing them prior to placing products on the market.
- Misunderstanding of the difference between sustainability of a forest vs legality (third party verification may indicate sustainability but not necessarily legality, depending on the country in question).
- Poor search criteria: e.g IUCN red list searched for company name or wrong species.
- Complexity of supply chain.

The reason for non-compliance may be some or all of the factors above. Despite the fact that the regulation was enacted on 20th October 2010, coming into force on the 3rd March 2013, it may be still “bedding in” within the industry and is likely to account for the majority of non-compliance. Following engagement by the regulator a number of companies supplied a more comprehensive

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review on resubmission. The fact that the company that had been engaged with previously supplied sufficient submissions is indicative of positive impact of the enforcement activity.

It is also an offence not to have a due diligence procedure in place prior to placing a product on the market and the majority of companies were clearly non-compliant in these areas. Given the lack of compliance in the industry, accompanied by an apparent will to learn from most companies, the decision was made that it was proportionate not to use further sanctions in some cases (where warning letters were issued). The remainder have yet to be concluded, with further sanctions remaining a possibility. Regardless of the outcome of each case, the results of this project will form a risk matrix for future projects both in this product area and in others that might be covered by the companies that have been investigated.

Testing:

The high failure level when products were tested further justifies the focus on this product area. Overall the failures highlight clear gaps in the supply chain as is understood by each Operator in the UK. Each type of match failure had an associated concern, ranging from a low risk core mismatch where the findings could be easily explained and the necessary paper trail was well established, to high risk face and back veneers where which are of much greater concern when a match does not occur. Overall, unsurprisingly, all test failures resulted in great concern from the Operator in the UK on the basis that their product was not what they thought it was and their supply chains (and the associated due diligence procedure) had been shown to be unreliable.

The greatest concern with the test results was when potential high risk species were found, whether the timbers' source was in the country of manufacture or in the country where face veneer is sourced, further evidence that companies need to consider their supply chain risk and ensure adequate risk assessment of that supply chain is undertaken. *Studying the supply chains as a whole, unreliability of paperwork was ubiquitous, indicating that this is a clear area for concern in due diligence procedures.*

With the manufacturer being closer to the Operator in the supply chain, it is likely that leverage can be used here to ensure that the product matches expectations. It is these areas upon which the EUTR is focussed and where Operators should be the most diligent in not only understanding their supply chain but also in being stringent in their due diligence. Whilst they may be making business decisions based on information supplied by (in most cases) their agents, this in turn relies on paperwork from the manufacturer in China. The onus of the EUTR lies with the Operator- it is their responsibility to achieve negligible risk on the factors outlined in Article 6, not purely on documentation supplied by business partners. Some failures can be easily explained (see considerations below), whilst those that yield further paperwork from another company in the supply chain certainly raise the level of risk.

5 Recommendations

Ongoing

NMO will continue to work with other Competent Authorities throughout the EU and will take these opportunities to highlight this as a potential high risk area, where application of due diligence has been found to be low. With this type of composite product the risk associated will increase with each possible component and its own supply chain, as has been highlighted here.

Ongoing work will also include further engagement with companies in the project to reach a conclusion, continuing to consider all sanctions available. In line with the Notices of Remedial Action that have been issued, future meetings will be arranged to discuss due diligence, identifying the possibility of approaching agents (those that are also Operators) so as to have the greatest impact. NMO will also remain available for advice on future imports.

Future work by NMO

With a number of companies employing agents to source the components of their products, as well as sourcing the paperwork associated with each component, it may be effective to seek agents, or groups of agents to engage with to discuss the obligations of Operators under the legislation. In most cases they are Operators themselves, so for them to understand the legislation would be valuable for both themselves and their customers. Such a meeting could be encouraged to be held by trade bodies or NGOs, with NMO's participation, in order to provide the best value through working with a larger audience. Whilst it is not possible to be prescriptive with this legislation as different products have different supply chains, it may be possible to show some success stories or example cases.

Follow up project in a year / Future project development

Having concluded that there is a high overall level of non compliance in this particular area of the timber trade, it is recommended that a similar project is conducted during the next financial year, targeting other companies, in order to monitor the progress of this sector of the industry. Valuable intelligence from this project as well as those gathered in the interim would be added to highlight possible companies to initiate. This is similar to the model already employed in high risk areas of other markets enforced by NMO. It has shown to be a successful model in the case of this project where a satisfactory submission was received from a company that had been engaged with previously.

Given the level on non-compliance, the number of companies initiated should be considered. Whilst initiating a large number of companies has a large impact, initiating fewer companies would enable NMO to have a more effective impact in terms of engagement timescales. Having identified companies that are high risk from this project, it may be possible to use SPOC to identify future shipments from these companies, with potential for follow up specific to this product area.

Researching the possibility of DNA testing would benefit NMO in future projects by providing the possibility of narrowing the origin of the samples to species level, which would in turn give country of origin specificity (e.g. Red Meranti where some species are at higher risk than others).

6 Annex

Testing overview

Company	Face declaration	Face tested	Core declaration	Core tested
1	Palaquium	Palaquium	Eucalyptus	Eucalyptus
2	Betula	Betula	Eucalyptus	Poplar
				Kedongdong
				Pine
3	Sapeli	Sapeli	Poplar	Poplar
				Elm
4	Palaquium	Palaquium	Poplar	Poplar
			Eucalyptus	Kasai
5	Bitangor	Palaquium	Poplar	Poplar
				Eucalyptus
6	Lotofa	Sapeli	Poplar	Poplar
7	Beech	Beech	Eucalyptus	Eucalyptus
8	Eucalyptus	Ozigo	Eucalyptus	Eucalyptus
				Poplar
9	-	Phenolic resin	Poplar	Poplar
10	Sapeli	Sapeli	Poplar	Poplar
11	Palaquium	Palaquium	Eucalyptus	Poplar
				Pulai
				Red Meranti
12	Eucalyptus	Bitangor	Eucalyptus	Eucalyptus
				Poplar
13	Bitangor	Bitangor	Poplar	Kasai
				Medang
14	Camptosperma	Awaiting result	Poplar	Awaiting result
15	No test purchase- No stock			
16	No test purchase- No stock			