

Sales of timber at negotiated prices by SFMC have not been transparent and have permitted special treatment over the years

TALLINN, 4 July 2024 – The rules for negotiating the long-term contracts and the prices concluded by the State Forest Management Centre (SFMC) do not create the preconditions for selling timber at the market price, which is a requirement under the Forest Act. This also means that the opportunity to earn more money from the sales of timber is not used, the National Audit Office finds in its audit report published today. The National Audit Office maintains that the SFMC should promote competition in the sales of timber and enter into long-term contracts on the basis of public auctions. The system for concluding and amending contracts should be clearer and more transparent than it is now.

Although the Forest Act¹ and the Government of the Republic regulation established on the basis of the Act² require the State Forest Management Centre to ensure that timber is sold at market prices, the audit revealed that the prices agreed in the long-term contracts were significantly lower than the prices at public auctions in the audited period of 2017–2022 – the State Forest Management Centre sold timber under the long-term contracts at prices that were lower by up to 30%. The price difference does not arise from the quantities sold either, as the analysis showed that a customer buying a larger quantity does not generally get a lower price and a customer buying a smaller quantity does not generally get a higher price.

It is positive that the regulation of the Government of the Republic that regulates the sale of timber was updated on 1 October 2023, making the sales of timber more transparent – for example, by establishing the requirement that contracts for sale of timber must be made public according to the Public Information Act. Nevertheless, the National Audit Office finds that the process of timber sales needs to be further improved in order to increase openness and transparency.

The audit indicated that during the audited period of 2017–2022 the State Forest Management Centre did not, and still does not, prefer companies that offer a better price than others when negotiating long-term contracts. Bids that exceed the average weighted price of the bids by more than 15% are either rejected or the Centre reduces the bid price by 15%. In the opinion of the National Audit Office, the process of entering into long-term contracts is also made less transparent by the fact that the State Forest Management Centre does not usually set an initial price for timber during the negotiations of long-term contracts, which would be based on the usual value of timber, i.e. the market price, and would be already known to all bidders at the time when they make their bids.

During the audit, the Ministry of Climate and the State Forest Management Centre presented three contradictory versions of how to calculate the market price of timber when it is sold. The Ministry of Climate and the State Forest Management Centre still do not have a common understanding of how to calculate the market price, i.e. the regular value of timber. At the start of the audit, the Centre considered it impossible to establish the market price of timber, but by the end of the audit it finally reached the conclusion that market price is the price offered in the conditionally guaranteed quantity

¹ Subsection 46 (5) of the Forest Act.

² Government of the Republic Regulation No 1 “Procedure for Sale of Felling Rights to Standing Crop in State Forest and of Timber” of 4 January 2007.

round of the conclusion of the long-term contracts (which is only one component of the price of the long-term contracts and mostly lower than this).

However, the Ministry of Climate stated that a price corresponding to the usual value can be obtained irrespective of the sales method. The audit, however, indicated that the sale price of timber was strongly dependent on whether it was sold under long-term contracts at a negotiated price or by public auction.

The prices in the long-term contracts of customers buying the same timber assortment differ significantly, but there are no convincing reasons for the price differences. Pricing in the negotiation of long-term contracts creates the conditions for very different prices. For example, the prices of pine logs up to six metres in length and with a diameter of 18+ cm in 2022 under long-term contracts ranged from €98 to €130, the price of small logs from €50 to €108, the price of firewood from €28 to €82 and the price of birch blocks from €141 to €252 per m³. The audit indicated that larger quantities or a shorter transport route to the buyer's warehouse are not the reason for lower prices.

In the opinion of the National Audit Office, the State Forest Management Centre has treated its long-term contract partners differently without any justification and entered into preliminary timber sales agreements with at least three companies. The audit indicated that the Centre has entered into three confidential preliminary agreements with two companies from 2011 to 2014 without any legal basis. A number of special conditions were agreed, as well as how much timber would be sold and at what price. The preliminary agreements were later turned into long-term contracts, which guaranteed the companies a stable low price for the contract period, i.e. five years, when compared to other long-term contract customers who bought the same assortment during the same period. A 15-year agreement was also concluded with a company on the basis of a Government of the Republic resolution, and the price mechanism of the agreement made it possible to buy timber at a low price during this period. In addition to unequal treatment, this practice brings about the risk of corruption and prohibited state aid, as well as the possible decrease in profitability.

The audit also indicated that it is difficult to supervise the performance of timber sales contracts on the basis of sales reports. For example, there were prices in sales reports that had not been agreed in the contracts; sales reports showed negative prices in interim storage, i.e. situations where the State Forest Management Centre received a financial loss from timber sales; information on assortments was recognised differently, etc.

Also, data for the sales reports had not been collected in the same way, which makes it difficult to analyse the sales reports and compare the data. As the statistics of the State Forest Management Centre on interim storage prices are used by other market participants as a basis for setting the timber price, and other important decisions are also made on the basis of these statistics (e.g. calculating the price of forest land when transferring land under nature protection to the state), the National Audit Office considers it important to improve the quality of the data.

The National Audit Office advises the Ministry of Climate to instruct the State Forest Management Centre to stop entering into long-term contracts on terms and conditions that restrict competition and to organise the conclusion of long-term contracts through a public auction. This would be the most transparent and competitive way of selling, and

would give the reassurance that timber would be sold at a price that corresponds to the market price.

As an alternative, the National Audit Office recommends the Ministry of Climate to initiate an amendment to the regulation of the Government of the Republic in order to stipulate the obligation of the State Forest Management Centre to determine the starting price of timber sold under long-term contracts and to describe the methodology that would ensure that the market price is obtained when timber is sold.

The National Audit Office recommends the State Forest Management Centre to determine the starting price of timber sold under long-term contracts with negotiated prices and establish a methodology to ensure that timber is sold at the market price.

Background

The National Audit Office audited the long-term contracts of the State Forest Management Centre, which were valid for the period of 2017–2022. In addition, both the earlier and later periods were reviewed to understand the background and circumstances of the conclusion of these contracts, and to assess the changes in the organisation of work at the State Forest Management Centre in relation to the conclusion, amendment and performance of contracts.

The share of the State Forest Management Centre of the total Estonian timber market is *ca* one third. In 2023, the Centre earned €303.5 million from the sale of timber and paid a total of €75 million in dividends to the State Treasury.

The Forest Act and the Government of the Republic Regulation “Procedure for Sale of Felling Rights to Standing Crop in State Forest and of Timber”³ stipulate two important principles for the sale of timber: how and at what price it can be sold. They provide three ways of selling timber, and the condition that timber must not be sold below its usual value (i.e. market price). The State Forest Management Centre may sell the timber felled from state forest

- by a public auction;
- by tender with preliminary negotiations; or
- at negotiated price (hereinafter long-term contract).

According to the sales reports of the State Forest Management Centre, the Centre sold 3.5 million cubic metres of timber (excluding trimmed trunks and cutting waste) in 2022, over 81% of this under long-term contracts at negotiated prices and to 102 customers at the average price of approximately €80 per cubic metre. The average price of timber at the public auctions of the State Forest Management Centre in 2022, in which 91 customers participated (59 of whom also have long-term contracts for buying the same assortments), was €106.76 per cubic metre.

The State Forest Management Centre has *ca* 100 long-term contract partners every year and a small circle of buyers competes for different assortments. The number of buyers of an assortment made be one to a few dozen. In certain cases, one customer buys the majority of an

³ Regulation No 1 of the Government of the Republic of 4 January 2007

entire assortment (e.g. aspen pulpwood and AS Estonian Cell, 99.2% of the quantity). One company may also have several long-term contracts at the same time.

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