



LEGISLATIVE COUNCIL

STANDING COMMITTEE ON  
FINANCE AND PUBLIC ADMINISTRATION

Third Report to the Legislative Council

INQUIRY INTO DEPARTMENTAL AND AGENCY  
PERFORMANCE AND OPERATIONS

REPORT ON VICFORESTS'  
PERFORMANCE FOR 2007-08

FEBRUARY 2009





---

LEGISLATIVE COUNCIL  
STANDING COMMITTEE ON  
FINANCE AND PUBLIC ADMINISTRATION

INQUIRY INTO DEPARTMENTAL AND AGENCY  
PERFORMANCE AND OPERATIONS

**REPORT ON VICFORESTS'  
PERFORMANCE FOR 2007-08**

FEBRUARY 2009

---

*Ordered to be Printed*

---

By Authority  
Government Printer for the State of Victoria



## CONTENTS

STANDING COMMITTEE ON FINANCE AND PUBLIC ADMINISTRATION.....	1
ESTABLISHMENT OF THE STANDING COMMITTEE.....	2
REPORT.....	3
1. Inquiry Background.....	3
2. VicForests Hearing.....	3
2.1 Witnesses .....	3
2.2 Role of VicForests.....	3
2.3 Key matters raised in the hearing.....	4
2.4 Documents tabled at the hearing.....	5
2.5 Questions taken on notice .....	5
APPENDIX 1 – VICFORESTS' PRESENTATION .....	7
APPENDIX 2 – TRANSCRIPT OF EVIDENCE.....	13
APPENDIX 3 – RESPONSE TO QUESTIONS TAKEN ON NOTICE.....	37

STANDING COMMITTEE ON FINANCE AND PUBLIC ADMINISTRATION  
Report on VicForests' Performance 2007-08

---

## **STANDING COMMITTEE ON FINANCE AND PUBLIC ADMINISTRATION**

### **Committee Members**

**Mr Gordon Rich-Phillips – Chairman**  
Member for South Eastern Metropolitan Region

**Mr Matthew Viney – Deputy Chairman**  
Member for Eastern Victoria Region

**Mr Greg Barber**  
Member for Northern Metropolitan Region

**Ms Candy Broad**  
Member for Northern Victoria Region

**Mr Peter Hall**  
Member for Eastern Victoria Region

**Mr Matthew Guy**  
Member for Northern Metropolitan Region

**Mr Peter Kavanagh**  
Member for Western Victoria Region

### **Substituted Members**

Mr Edward O'Donohue substituted for Mr Matthew Guy  
(10 December 2008).

### **Committee Staff**

**Mr Richard Willis – Secretary to the Committee**

**Mr Anthony Walsh – Research Assistant**

Address all correspondence to –

Council Committee Office  
Department of the Legislative Council  
Parliament of Victoria  
Spring Street  
EAST MELBOURNE VIC 3002

Telephone: (03) 9651 8696  
Facsimile: (03) 9651 6799

## **ESTABLISHMENT OF THE STANDING COMMITTEE**

On 21 November 2007, the Legislative Council resolved to appoint a Standing Committee on Finance and Public Administration with a Membership of seven Members. The Council's resolution came into operation on 1 April 2008 and the Committee's inaugural meeting was convened on 7 April 2008.

In accordance with the establishing resolution, the following Members were appointed to the Committee:

- Mr Greg Barber - Australian Greens,
- Ms Candy Broad - Australian Labor Party,
- Mr Peter Hall – Nationals,
- Mr Matthew Guy - Liberal Party,
- Mr Peter Kavanagh - Democratic Labor Party,
- Mr Gordon Rich-Phillips - Liberal Party, and
- Mr Matthew Viney - Australian Labor Party.

At its inaugural meeting the Committee elected Mr Rich-Phillips as Chairman, and Mr Viney as Deputy Chairman.

The establishing resolution provides the Committee with a wide range of powers. Some key features of the Standing Committee include:

- The Standing Committee exists until the Parliament is either prorogued or dissolved.
- Members of the Committee may be substituted by another Member from the same political party.
- The Committee has the power to inquire into any matter or thing relevant to its functions, which is either referred to it by resolution of the Legislative Council, or determined by the Committee.
- The power to appoint sub-committees to inquire into matters.

## **REPORT**

### **1. Inquiry Background**

1. Pursuant to Legislative Council Sessional Order No. 22, the Standing Committee on Finance and Public Administration may inquire into any proposal, matter or thing that is relevant to its functions which is referred to it by resolution of the Council or determined by the Committee.
2. On 28 October 2008, the Committee resolved to inquire into and report on Victorian departmental and agency performance and operations for the previous financial year. It is the Committee's intention for this Inquiry to be ongoing for the life of the Standing Committee.

### **2. VicForests Hearing**

3. On 13 November 2008, the Committee resolved to invite VicForests to give evidence at a public hearing with respect to the agency's performance and operation for the 2007-08 financial year.

#### **2.1 Witnesses**

4. On 10 December 2008, the Committee received evidence from the following VicForests representatives:
  - Mr Paul Barker – Chairman,
  - Dr David Pollard – Chief Executive Officer,
  - Mr Gerhard Hinz – Chief Financial Officer, and
  - Mr Cameron MacDonald – Director Strategy and Corporate Affairs.

#### **2.2 Role of VicForests**

5. VicForests was established as an outcome of the Victorian Government's Our Forests Our Future policy. VicForests is responsible for the sustainable harvest and sale of native forest timbers from the public forest estate in eastern Victoria. As a State owned business corporation, VicForests is an autonomous commercial entity

administered by an independent Board of six Directors and responsible to the Victorian Government through the Treasurer, as shareholder and responsible Minister, and the Minister for Agriculture, who has responsibility for commercial forest policy.<sup>1</sup>

### **2.3 Key matters raised in the hearing**

6. The following issues were discussed during the public hearing with VicForests:

- Reconciliation of timber availability and supply with the Government's timber allocation orders.
- Impact of VicForests' haulage activities on WorkCover performance and premiums.
- Financial matters relating to payment of dividends and borrowings from Treasury Corp.
- Other financial matters relating to VicForests' commercial rate of return, reduction in discount rates from 2007 to 2008, expenses incurred as a result of 'making trees available' and payments to Department of Sustainability and Environment for forest resource data.
- On-going impact of the Great Dividing Ranges fires of 2006-07 in relation to VicForests' commercial activities for 2007-08 and beyond.
- Impact of bush fires on VicForests' ability to meet the objectives of its Salvage Timber Harvesting program.
- Declining supply of timber in East Gippsland.
- VicForests involvement in the Government's new timber strategy.
- Commercial arrangements involving the salvage program and the securing of funding for the bush fire recovery task force.
- Impact to date of new on-line auction system for forward sales.
- Economic impact of competitive procurement for harvest and haul services.
- Increased roading expenses in 2007-08, resulting stakeholders' management and impact on roads.

---

<sup>1</sup> VicForests, *Annual Report 2008*, p.2.

- VicForests' regeneration program and the results of coupe stocking surveys.

## **2.4 Documents tabled at the hearing**

7. VicForests provided an opening presentation at the public hearing. A copy of the slide presentation is provided in Appendix 1.

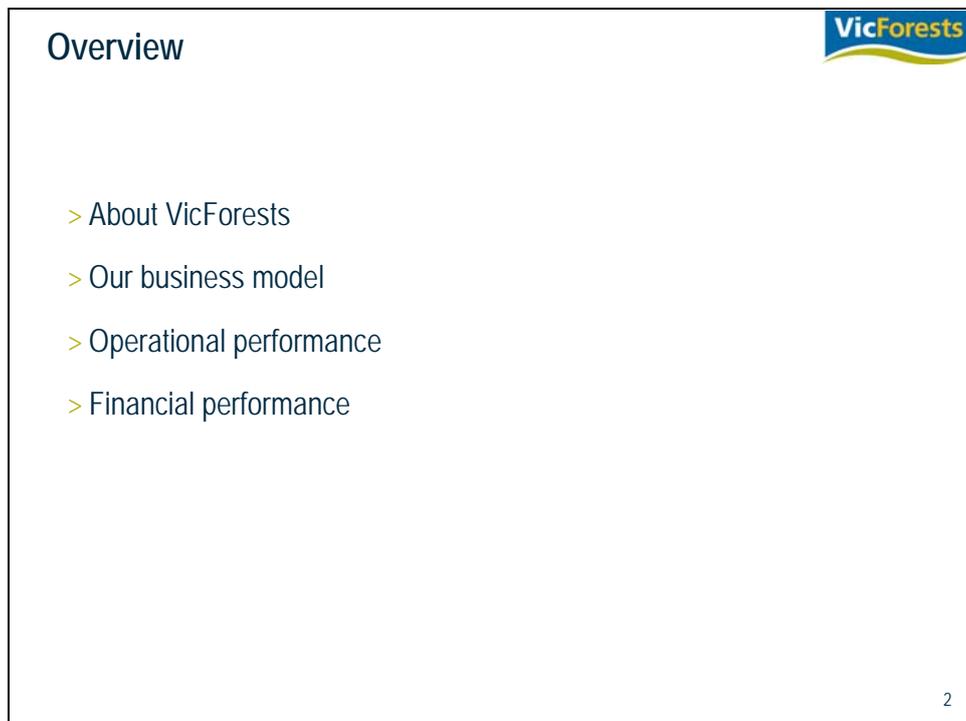
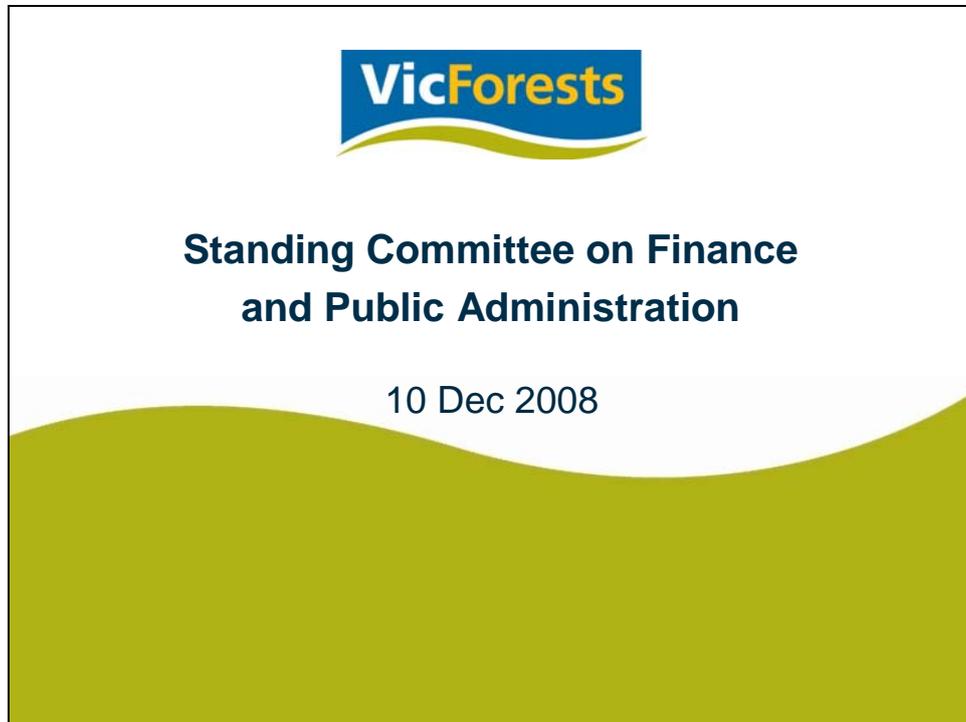
## **2.5 Questions taken on notice**

8. The following questions were taken on notice by VicForests at the public hearing (page references refer to the transcript in Appendix 2):
  - data relating to injury rates and the loss of working time (p. 6);
  - the date of the Treasurer's dividend determination relating to the 2005-06 financial year (p. 7);
  - the quantity of woodchip product sold in 2007-08 (p. 10);
  - the proportion of stumpage for the woodchips to Midway from East Gippsland (p. 12);
  - a copy of the MBAC Consulting Report relating to assessment of VicForests' greenhouse gas emissions associated with harvesting and regeneration of managed native forests (p. 21); and
  - VicForest expenditure to obtain Forest Stewardship Council (FSC) certification (p. 21).
9. A copy of VicForests' response to questions taken on notice is provided in Appendix 3.

Committee Room  
25 February 2009



## APPENDIX 1 – VICFORESTS' PRESENTATION



## Our business



- > Harvest approximately 600,000m<sup>3</sup> of sawlog p.a. (1,900,000m<sup>3</sup> in total including pulp logs).
- > Supply 40 Victorian sawmills, two woodchip exporters and a domestic pulp and paper manufacturer.
- > 145 staff in two regions
- > Three business divisions.
- > Governed by a Board of non-executive Directors.

3

## Current environment



- > Increased competition
  - substitute products
  - imported timber
- > High Australian dollar and surging oil prices through 2007/08
  - Both variables moving in the right direction in recent months
- > Cheap imported copy paper
  - reduced margins for pulpwood to Australian Paper
- > Decreased resource
  - The 2006/07 fires burnt 670,000 hectares of State forest
  - Harvest levels are down from 2003 levels

4

## Price Allocation Model



- > First Australian government organisation to move to open market arrangements for timber sales
- > First to sell timber by on-line auctions
- > At least one major auction per year
- > Price increases of around 40% against previous model
  - Benefits to be reflected in VicForests profit from 2010/11

5

## Harvest and Haul tender



- > Tender completed in September 08
- > Competitive procurement for harvest and haul services
- > Worked with VFHCC and contractors to determine best process
  - Sector not used to competitive arrangements
  - Training provided to contractors to assist them through process
- > Customers expect efficiencies in supply chain, given new competitive arrangements for sale of logs
- > Approx. 86% of incumbents awarded a contract
- > Greater security of tenure to encourage investment

6

## Reorganisation



- > Commenced a review of Business Model in 2006 to reflect changes in business activities (including PAM, MDS and certification)
- > Original structure did not appropriately reflect the new business focus
- > Business imperatives:
  - Dedicated resources for longer term planning and business development
  - Clearer lines of communication with customers and contractors
  - Greater accountability
  - Sustainably profitable
- > 2006/07 fires added impetus for change

7

## Benefits of the reorganisation



- > **For our staff**
  - Better clarity about accountability
  - Better interface with stakeholders, particularly DSE
  - More manageable roles
  - Increased career opportunities
  - Certainty regarding office locations
- > **For our customers and contractors**
  - Better service
- > **For our business**
  - Work functions matched to the creation of value
  - Reduce duplicated and unnecessary work
  - Better planning and operational outcomes
  - Improved focus on business and market development
  - Align office locations with medium-term harvesting activity

8

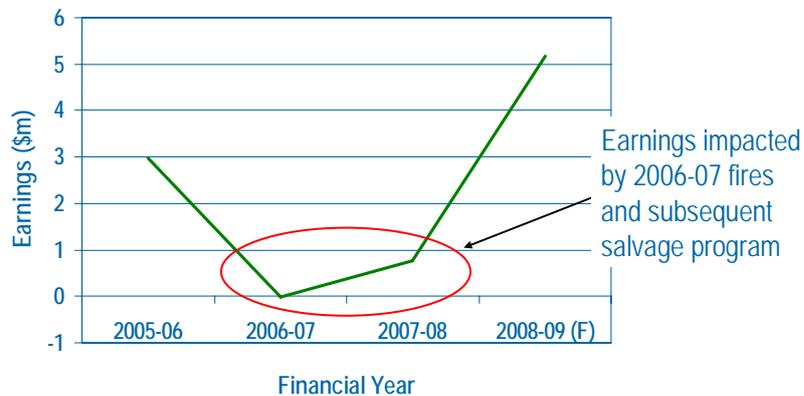
## Joint Sustainable Harvest Levels (JoSHL) Project



- > Joint initiative of DSE and VicForests
- > Aims to provide resource certainty to customers following 06-07 fires
- > Complete overhaul of the process for determining sustainable yield
- > Up to 500,000 m<sup>3</sup> of D+ sawlog per annum over the next 15 years
- > Independently audited by expert advisory panel

9

## Financial performance



10

## Financial performance



### Revenue

in \$'000	Actual 2004/05		Actual 2005/06		Actual 2006/07	Actual 2007/08	Budget 2007/08	% difference Actual/Budget
	)	)	)	)				
Operating Revenue	36,731	37,245	99,117	125,767			116,866	7.6%
Volume m <sup>3</sup>	1,848,000	1,833,923	1,590,520	1,917,701			1,797,431	6.7%

Volume	Actual 2005/06		Actual 2005/06		Actual 2006/07	Actual 2007/08	Budget 2007/08	% difference Actual/Budget
	)	)	)	)				
-Sawlogs m <sup>3</sup>	534,764	580,129	497,970	556,414			610,058	-8.8%
-Pulplogs m <sup>3</sup>	1,313,165	1,253,794	1,092,550	1,361,287			1,187,373	14.6%
<b>Total</b>	<b>1,847,929</b>	<b>1,833,923</b>	<b>1,590,520</b>	<b>1,917,701</b>			<b>1,797,431</b>	<b>6.7%</b>

11

## Financial performance



### Expenses

- Employment expenses decreased by \$669k in 2007/08 compared with the previous year, following the restructure and implementation of the new Business Model.
- This saving was achieved without a decrease in overall staff numbers.

<b>Roading and regeneration expenses</b>	Actual 2008	Actual 2007	% difference 2007/2008
Road access fee	2,491	1,600	55.7%
Road maintenance	4,831	4,406	9.6%
Regeneration expenses	3,183	1,552	105.1%
<b>Total roading and regeneration expenses</b>	<b>10,505</b>	<b>7,558</b>	<b>39.0%</b>

- Roothing and regeneration expenses increased.

12

## **APPENDIX 2 – TRANSCRIPT OF EVIDENCE**



# CORRECTED VERSION

## STANDING COMMITTEE ON FINANCE AND PUBLIC ADMINISTRATION

### Inquiry into Departmental and Agency Performance

Melbourne — 10 December 2008

#### Members

Mr G. Barber  
Ms C. Broad  
Mr M. Guy  
Mr P. Hall

Mr P. Kavanagh  
Mr G. Rich-Phillips  
Mr M. Viney

Chair: Mr G. Rich-Phillips  
Deputy Chair: Mr M. Viney

#### Substituted members

Mr E. O'Donohue for Mr M. Guy

#### Staff

Secretary: Mr R. Willis  
Research Assistant: Mr A. Walsh

#### Witnesses

Mr P. Barker, chair, and  
Dr D. Pollard, chief executive officer, and  
Mr G. Hinz, chief financial officer, and  
Mr C. MacDonald, director strategy and corporate affairs, VicForests.

**The CHAIR** — I declare open the Legislative Council Standing Committee on Finance and Public Administration hearing in relation to the inquiry into departmental and agency performance and operations. Today's hearing is in relation to VicForests. I welcome Mr Paul Barker, chair; Dr David Pollard, chief executive officer; Mr Gerhard Hinz, chief financial officer; and Cameron MacDonald, director strategy and corporate affairs.

All evidence taken at the hearing is protected by parliamentary privilege as provided by the Constitution Act 1975 and further subject to the provisions of the Legislative Council standing orders. Any comments made outside the hearing are not afforded parliamentary privilege. All evidence is being recorded by Hansard, and witnesses will be provided with a proof version of the transcript in the next couple of days. For the purpose of today's hearing with VicForests, Mr Edward O'Donohue is substituting for Mr Matthew Guy. I now invite you to make an opening statement or presentation, and we will then proceed to questions.

**Overheads shown.**

**Dr POLLARD** — Thank you very much for the opportunity to appear. We have a brief opening statement which I think will assist in unpacking the annual report and provide some context for further questioning.

The overview really covers what we are, what our business model is, how operations go, and what our recent financial performance has been. Our mission since being hived off from the Department of Sustainability and Environment is to build a responsible business that generates the best community value from harvesting Victoria's state forests.

As you know, a number of state governments still have native forest harvesting, and we are the Victorian expression of that. Currently we harvest about 600 000 cubic metres of sawlog per annum and about 1.9 million cubic metres in total, the rest being pulp logs. We supply to about 40 Victorian sawmills, down from previous years, two woodchip exporters and a domestic pulp and paper manufacturer. We currently have 145 staff in two regions, all in Eastern Victoria. We have three business divisions, and we are governed by a board of non-executive directors.

We have been in existence now for five years, and we have been fully operational for four and a bit years. The main changes we have implemented since coming into existence — and when you compare our structure and performance to the previous department — are the following: first, we have taken over the sale of logs to mill door. Previously the department allowed responsibility for the harvest and haulage of logs to rest with so-called syndicates, and we have in-sourced the management of that.

We have transitioned the sale of logs to an auction system, which together with a declining and exiting licensing system will be fully operational in a few years time once the auctions have taken over completely from the eroding licences. We have achieved forest management certification, and we have tendered out all harvest and haul work, which has been a very large set of contracts worth about \$83 million per annum to regional Victoria.

There have been a number of benefits from these. There have been some substantial increases in the prices we have received for sawlogs on the auction system. We have been in profit for three of the four years of our operations. The 2006–07 net loss was attributable to the 2006–07 wildfires in Eastern Victoria. But we have worked through the effects of these fires, and the fires of 2002–03 which were almost as catastrophic. The current environment in which the industry in Victoria operates is one of continuously increasing competition from substitute products including concrete, steel, aluminium, plastics and so on and imported timbers which are, of course, freely landed anywhere in Australia.

Up to this year the high value of the Australian dollar and surging oil prices, which are reflected somewhat in this annual report, have affected producers and sawmillers, and indeed anybody who takes our product. That situation is easing at the moment but has been a factor operating up until very recently.

Cheap imported copy paper has affected one of our major customers, Australian Paper. It has also affected us because the price of pulp logs that we sell to them is indexed to their final retail price as well, so we are in the mix with them. Finally, the decreasing resource that we have had to manage

partly as a result of the catastrophic 2006–07 fires, but also the fact that harvest levels are down anyway from when we came into existence in 2003.

The big ticket items for us therefore are the auction system, or as we call it the price allocation model. This was foreshadowed in the government white paper *Our Forests Our Future* in 2002 when the government decided to have an open, transparent and competitive system for disposing of native harvested logs. It began to replace an administered system called licenses whereby existing customers were licensed to exploit the forest themselves, and it is sold via contractual arrangements with the people who win the auctions. They have a contractual relationship with us which is formal and enforceable. The auction system is online, and what people compete for is a future supply of product from us. They win the auction and they sign the contract.

We were the first Australian government organisation to move to open market arrangements for timber sales. We were the first in Australia to sell timber by online auctions, although it is quite common in North America. Currently we have at least one major auction per year, and we would envisage that would be the situation going forward.

There have been a number of benefits to the auction system — one of them being a substantial increase in prices currently of around 40 per cent against the previous model, and we expect the benefits to be reflected in our profit position from 2010–11 going forward once the licensing system, which we still administer, is largely eroded.

Mill door sales was the move from allowing representatives of the final customers, so-called syndicates, to do the harvest and haulage work themselves, so we insourced the management of that in order to get better control over the total supply chain for a number of reasons. It was identified in our early corporate plan, 2004–05. It was consistent with government policy and we introduced it on 1 July 2006.

We regarded it as critical to the success of the auction system. It ensured that we maximised the area harvested and therefore minimised waste. It reduced duplication in the supervision of contractors who actually do the work of harvesting and haul, and it enabled us to standardise systems for occupational health and safety management and environmental compliance — two areas of which for the organisation are of critical importance and which we could not fully have discharged without taking over the management of harvest and haul.

The harvest-and-haul tender which we have recently completed was the next step in the process of change that we introduced to the native forest industry in Victoria. This involved tendering the work of harvest and haul rather than the previous arrangement of allocating it on a basis other than competitive tender, so it represents the marketisation of harvest and haul. It was an attempt, and a successful one, to create competitive procurement for this enormous volume of works — something in the region of about \$85 million per annum.

We worked with the VFHCC and contractors to determine the best process, but the sector at that stage was not used to competitive arrangements. There was a fair amount of fear and uncertainty in what we were doing which we attempted to ameliorate by continuing consultation with the sector, which we did over and over again. We provided training to contractors to assist them in participating in the competitive process, and eventually the contracts were awarded, and some 80 per cent of the then incumbents were awarded a contract, so the vast bulk of the participants in the industry received, by competitive means, the contract or a contract that they had previously held, but it was done through a transparent and competitive process.

We believe that this greater security of tenure because they now have longer contracts with us — typically three to five years rather than the one year that they had with the older arrangements — will assist in encouraging continuing investment or more investment in the industry.

Certification is another milestone that we struggled for and achieved, and all our operations now are certified to the Australian forestry standard and have been since February 2007. This has been maintained through three subsequent maintenance audits and we are some way into gaining the secondary or other forest stewardship council certification. As you may be aware, there are two global forest certification schemes.

We have nailed down one; we are now in the final stages of attempting to achieve the second FSC certification. When that comes to fruition, we will be certified to both global forestry standards

which will be enormously helpful to, among other parties, our principal customers, especially those that export.

Also in the middle of all this in 2006 we began to reflect on the need for a reorganisation in the way we were structured, given that we had taken over the business from the Department of Sustainability and Environment. The original structure we took over was not appropriate for the business focus that we had. There are a number of business imperatives to what we were doing.

We needed dedicated resources for longer term planning and we intended to put a lot more resources into the planning side of the operation for a number of desired outcomes, one of which was better environmental outcomes and the other of which was better occupational health and safety outcomes; and third of which obviously was better commercial outcomes; also greater accountability and a renewed and deepened commitment to sustainability and sustainable profitability.

The 2006-07 fires added some impetus to the need for this reorganisation. That is the business model. You have our handouts in front of you so I will not dwell on this, but if you were interested you could refer to this as a statement of what it is that we were doing when we did the reorganisation. The benefits of the reorganisation as we saw it were for our staff much better clarity about what they were supposed to be doing, so a set of accountability is much more consistent with a commercial environment rather than a departmental environment.

The people we employ, of course, are not public servants. There is better interface with stakeholders, particularly the main department with which we interface, namely the Department of Sustainability and Environment. Roles were more manageable because they were better defined and more accountable. There were increased career opportunities for our staff. There was certainty regarding office locations because we are an organisation somewhat smaller than the previous departmental organisation; hence we integrated around fewer offices and this gave certainty to what those future offices would be.

For our customers and contractors it laid the basis for a more customer-oriented service mode and for business itself we wanted work functions matched to the creation of values. It was a value-adding model to reduce duplication, to plan better, to improve the focus of the business and to align office locations with where we expected harvesting activity would be in the future.

The salvage program, which is somewhat covered in this annual report but which substantially took place the year after, was a 750 000 cubic metre effort to harvest valuable forest stands damaged in the catastrophic wildfires of 2006-07. This operated immediately the wildfires ended, so we began it in February 2007 and we concluded it in November 2008. We received \$6.6 million funding from the bushfire recovery task force. That was there to compensate us for the increased costs of harvest and haul, given the remote location of the salvage operation. In other words, it was to ensure that we were engaging in work on a commercial basis — work that we otherwise would have not done, precisely because it was not fully commercial.

The Department of Sustainability and Environment, I might add, had previously of course done salvage operations but, consistent with this model, it had sought separate ERC funding to do that. Each time they did a salvage operation it approached Treasury, it got a separate advance, it did the work. This is somewhat akin to that.

There is a number of benefits to the salvage program, as there would be to any salvage program after any wildfire. It reduced the harvest of green stands to enable us to put green stands of forest in the bank for future exploitation. It was critical to the continued supply of product to Australian Paper for its work. It had multiply effects on local communities most affected by the wildfires, including Licola and Merrijig.

The Joint Sustainable Harvest Level project (JoShL), which has been a project that we worked on with DSE, was an initiative of both agencies. What it was aiming to do was to provide better resource certainty to our customers following the 06-07 fires. So, the fires concluded, we were proceeding with an auction, and there was a good deal of disquiet among our customers about what availability there would be after the auction.

The uncertainty about future supply prompted us and the department to reach a level of agreement to provide our customers with greater certainty about what the quantum of product would be going forward for them to bid on in future years. The conclusion was that there would be in the future up to

500 000 cubic metres of D+ sawlog available to customers over the next 15 years and, other things being equal, they could profitably bid on those year by year. This process was independently audited by an expert outside advisory panel.

Over 2007–08 there have been a number of issues around timber sales and supply. The salvage program was curtailed from January of this year because of the deteriorating quality of the sawlog that we were extracting, but by then it had been a substantially successful program.

We find that the supply situation in East Gippsland is tightening for us for a number of reasons. Certainly there are low stock levels, and we have responded with additional crews to increase production. But in the long term, we anticipate that we will have to be much more flexible and savvy about how we meet our supply commitments in East Gippsland, given the history that we have inherited of harvesting in that area. Some harvested coupes have yielded insufficient supply of some desired species — for example, yellow stringy-bark. We are having ongoing discussions with customers over changes to the grading system, which, by the way, we inherited from the previous arrangement.

This is a representation on one page of our recent financial performance. Those two down years were years in which earnings were affected by the wildfires of 2006–07. We did make a slight profit in this last financial year. There was a slight profit over an anticipated result of break even, so in a net sense it was a positive result. But we do expect to return to better profitability in all subsequent years, other things being equal.

There are a number of financial indicators and statements that follow this which I will not dwell on, given the shortage of time. But should you wish to go forward in the pages that I have given you, we are happy to answer questions on that as well. Thank you very much, Chair.

**The CHAIR** — Thank you, Dr Pollard. Can I start by asking you about the issue of timber availability, timber supply. You spoke about the assessment project that you have undertaken and had independently audited. Can you reconcile for the committee how that fits with the order made by the minister in the *Government Gazette* in 2004 and updated in 2007 as to timber allocation but set out in the 5-year tranches, particular allocations in particular coupes, and how that allocation of timber reconciles with what you are actually harvesting and what you believe is sustainable?

**Dr POLLARD** — I will defer to my colleague here.

**Mr MacDONALD** — The work that was done last year with DSE, the JoShL project, will actually be the basis for the formation of the next allocation order in 2009. We are still operating under the first allocation order and the areas that were allocated on that basis. The work from JoShL will feed into the new allocation order which is currently being developed now by DSE.

**The CHAIR** — So although the existing allocation order is 15 years in three five-year tranches, the reality is it is not 15 years; it will be at best three or four years and then subject to review?

**Mr MacDONALD** — That is right. There is an ongoing review process. If, and under the Sustainable Forests (Timber) Act there is a requirement for 10-year certainty for VicForests, so in the first two periods of the allocation order. If there are any changes that need to be made, as in this case, to reflect the impact of bushfires, if those changes have an impact on the long term, we would still get 10 years of certainty in the first two periods of the allocation order and the changes would be reflected in the third period.

**The CHAIR** — So the certainty would come from the existing two five-year periods?

**Mr MacDONALD** — That is right.

**The CHAIR** — One of the issues you touched on, Dr Pollard, was OHS and WorkCover performance. What has been the impact of VicForests assuming the haulage activities on your WorkCover, both performance and premium? I assume there would have been an impact?

**Mr BARKER** — Can I just interrupt? I am also a director on the WorkCover board.

**The CHAIR** — You are, yes.

**Mr BARKER** — Do you want me to stay for this question?

**The CHAIR** — I am quite happy for you to stay, Mr Barker.

**Dr POLLARD** — One of the drivers of the organisation in making the change that we have made is to get better control over systems that we have responsibility for. One of them is occupational health and safety and one part of that is the OHS results of haulage contractors. We have experienced recently an increase in incidents among haulage contractors and we have responded by doing a root-cause analysis of where these are coming from and why these recently contracted haulage operators seem to be experiencing greater difficulty in avoiding these situations. We are fairly much down the track now of examining the causes of this, and we are fairly much down the track with our rectification program. We are in the middle of a training program for both harvest and haulier operators. Not only do they need to understand the requirements that we as an organisation have placed on them but they need to understand the results for themselves of failing to observe this. It is a program of bringing them aboard to share our commitment to occupational health and safety.

**Mr MacDONALD** — We engage them as individual contractors so we do not incur any impact on our premiums, for instance, involving contractors and their employees, but we obviously have a responsibility. From an OHS perspective we are deemed to be the employers so we have an obligation to ensure that their work practices are safe, and they have safety management systems in place that we audit.

**The CHAIR** — Do you have any data as to the actual incident rates? I know you report in your annual report the lost time injury frequency rate, but do you have any data on actual injury rates and loss of working time that you can make available to the committee, rather than being expressed as the frequency rate — the raw data, if you like?

**Dr POLLARD** — Yes, we can do that.

**The CHAIR** — Just in general terms, does it show an upward trend as a consequence of taking on board the haulage operations?

**Mr MacDONALD** — For haulage it does.

**The CHAIR** — This gets back to the issue of road transport accidents. Is that where the issues are occurring?

**Mr MacDONALD** — We actually saw a spike last year while we were conducting the salvage operations. Those operations were generally held in more remote locations, so we actually increased our weighted average haulage distance last year. An analysis of the incidents indicated that a lot of the accident resulted from behavioural issues with drivers trying to race to get to particularly Australian Paper. We had some delays at Australian Paper last year in the log yard due to the work that was under way as part of their \$300 million upgrade of the facility. Given the long haulage distances, there was a suggestion that speed may have been an issue in a number of the incidents. We believe that last year may have been an aberration in our performance, given the salvage program that was under way.

**The CHAIR** — Moving to a different area, what has been the situation with dividends for the 2007–08 year? The annual report says it had not been determined at the time the report was published. Has it now been determined whether VicForests will pay a dividend?

**Mr BARKER** — No determination yet.

**The CHAIR** — Isn't it unusual to be six months into the next financial year without knowing the outcome for the previous financial year?

**Mr BARKER** — I suspect, given the performance, the Treasurer will be considering whether or not a dividend is required. We have no determination yet, so I cannot speak for him.

**The CHAIR** — Is that a matter that your board is in consultation with the Treasurer over?

**Mr BARKER** — Not at the moment, no.

**The CHAIR** — So nothing has come from the Treasurer and nothing has gone to the Treasurer?

**Mr BARKER** — Correct.

**The CHAIR** — So you are in the happy situation of not having paid a dividend?

**Mr BARKER** — Correct — yes.

**The CHAIR** — That leads to my next question which relates to the borrowing from Treasury Corp; the \$5.6 million you borrowed last year, which, from reading the annual report I assess as

essentially an overdraft to cover your operations. Was that an issue that was discussed when you paid dividends last year? You paid out roughly \$2 million in dividends last year and then borrowed \$5.6 million to fund operations. I am just wondering what the issues were surrounding those two transactions — why you paid \$2 million out in dividends and then borrowed \$5.6 million to fund operations?

**Mr HINZ** — I was not there last year when the dividend was paid so I do not know whether it was discussed, but I would imagine it was not. I would consider having an overdraft in the vicinity of \$10 million, which VicForests currently maintains, is a normal way of funding our operational cash flow. We pay our contract at more than \$10 million a month, and we pay them 14 days after the closure of the previous month, whereas our terms are 30 days to our customers, so we really have to bridge that period where we pay the contractors and on the other hand have to receive the money. The previous years we have maintained a lower stock holding. We had no salvage operation to that extent, and that obviously has burnt our cash, because if you look into our current accounts for the last financial year, we have actually had a substantial increase in dumps in our stock which was predominantly salvage timber, which obviously has cost us money, thereby also creating cash out which we only recover once we sell.

Financing our receivables as well as our stock holding has obviously burnt some of our cash, and we required some sort of overdraft. I think it is a normal commercial arrangement.

**The CHAIR** — But would it be normal though to pay out \$2 million immediately prior to taking the \$5 million overdraft? Would you not retain that cash rather than pay it as a dividend, given you needed it for operations?

**Mr HINZ** — I think shareholders want to have a certain return, so I do not think the cash flow issue comes into it. But it was not discussed at the time, I would imagine.

**The CHAIR** — That would have been a matter for the board and the Treasurer, I assume?

**Mr BARKER** — The dividend that you are referring to which was paid in cash in the year 2007 relates to the previous year, so it relates to the 2005–06 financial performance. We were not aware at that point in time of the financial impact of natural events that might have occurred subsequently, which has caused exactly the situation that Gerhard is talking about. At the time the dividend determination was made between the board and the Treasurer, the financial affect of the subsequent natural events that took place were not on the horizon.

**Dr POLLARD** — It was made on the basis of the facts as they were at the time.

**The CHAIR** — Can you tell the committee when that dividend determination was made?

**Mr BARKER** — Not off the top of my head. We can give you the date.

**The CHAIR** — Thank you.

**Mr BARKER** — I just have to get the Treasurer's letter.

**The CHAIR** — Obviously for the current year you have not done one yet, so presumably it was a similar time frame last year/

**Mr BARKER** — I would have to go back and find it for you, but we can supply the date.

**The CHAIR** — Thank you.

**Ms BROAD** — Can I refer the Chair to the chairman's foreword to the annual report, particularly the references to the Great Dividing Range fires of 2006–07, which, as you just mentioned, were not on the horizon because these events are not knowable in advance? What is the ongoing impact of those fires in relation to commercial returns, both for the 2007–08 year, which is the year that the committee is particularly examining in these hearings, and what do you expect it to be, going forward — in future years?

**Dr POLLARD** — The fires of 2006–07 following so quickly on the heels of the fires of 2002–03, to get out a cumulative effect on what amounts to our capital stock, it was enormous. But this is a very long-term industry and stocks can be managed into the future on a basis probably that it can be [inaudible].

It is part of the reason why we in our reorganisation put such an emphasis on forward planning and in our discussions with the department put such an emphasis on security of supply. If we have adequate forward planning and certainty of supply, even catastrophic fires like the 2006–07 ones can be successfully managed into the future.

**Mr MacDONALD** — I think the main issue with the fires was that they were in more remote locations, which incurred additional haulage costs over and above what we would normally incur in a year. The mill door prices we set our customers are independent of haulage distance, so those increased costs were something we had to wear, if you like, for that year.

That was combined with the increased harvesting costs due to factors such as the greater amount of dust and charcoal in salvage operations which increase the maintenance costs for contractors. So there were a number of one-off costs associated with that program, some of which were compensated by the funding received from the bushfire recovery task force. Our expectation is that, now we move into areas closer to our customers — where our margins on sawlogs are greater than what we received last year — we will return to profitability this financial year.

**Ms BROAD** — As a member of an earlier bushfire recovery committee — because we unfortunately had these events back in 2003 — I wonder if you can you take us through what form that assistance took and what impact that has had on returns from the bushfire recovery funding that you have referred to?

**Mr MacDONALD** — After the fires we sat down with the contractors and worked through what would be the actual increase in costs that they would incur in conducting harvesting operations. We worked through the increased costs and maintenance, as I indicated. We also had to pay camping allowances, because many of our contractors had to shift from their normal areas up to places like Merrijig and Licola to conduct harvesting operations, and obviously they had to pay additional costs both to their men and also for the accommodation requirements there.

On average we incurred a cost of \$6 a cubic metre more for harvesting than we would normally pay in green stands. Some of those costs that were mentioned were offset by the funding we received from the bushfire recovery task force. Because, as I mentioned, the weighted average haulage distance is higher from salvage areas, our overall margin from salvage operations was significantly lower than what we would normally receive. That margin was not totally compensated for through the bushfire recovery task force. They are the principal costs that we incurred as a result of the operation.

We also had the added impact of the surge in oil prices last year. In our indexation mechanism with our customers we have a six-monthly review where we can adjust our sales prices to reflect increases in diesel but if within the six-month period we have an increase that is greater than 10 per cent in a given month, we then adjust the contractors rates but obviously we then do not recover that amount from our customers until the next review date.

Particularly through April, May, June, when there was a significant spike in oil prices, we had to pass them on to our contractors but we were not able to recover them from our customers. I guess that was a bit of a double whammy in terms of not only the costs of the salvage operation but those external factors around oil prices that also had an impact.

**Ms BROAD** — Just following on this matter of the impact of the fires and the salvage timber program that was set up in response, can you give us an indication of how you have estimated performance against the objectives that were set for that program that was set up particularly in response to those fires? Some objectives were set for that program.

**Mr MacDONALD** — In terms of the sawlog recovery, it was less than we had forecast in the proposal that we put forward to the bushfire recovery task force. What we found in our assessment of the deterioration and the quality of the material was that on the back of a 12-year or prolonged period of drought, the sawlog material deteriorated a lot more rapidly this time than after the 2002–03 fires. So within 12 months we were getting significant barrel checking, where the standing trees were actually drying from the outside in.

Once you get significant checking, it is then not suitable for creating high-value sawn timber products for flooring and joinery, because you get the drying results in checking in the timber. In short, our assessment of our performance against the objectives is that the program was a lot shorter than we had anticipated, due to the rapid drying of the logs.

In terms of our assessment of the impact of the costs, we came in pretty much as expected. In part that was due to our negotiation with our contractors in advance of the submission we put to the

bushfire recovery task force, so we had a reasonable handle on what the costs of that operation would be.

**Mr BARBER** — Dr Pollard, what is the required rate of return or weighted average cost to capital for your organisation? The magic number?

**Mr HINZ** — The magic number would probably be in the vicinity of, I would say, around about 5 per cent, if not even a bit higher. We do not have any targets in that respect. We are planning it in the corporate plan in how much we can actually achieve. We obviously try to achieve a return which is higher than, for instance, the general interest rate in the marketplace.

Our current profit before tax, if you take the SGARA ratios into account, in 2007-08 was only 0.6 per cent. In the previous years: in 2006-07 we had zero because of our marginal loss. In the years before we started with 35 per cent and came down to 8, so there is not a theme in that. We obviously want to improve. The forecast for the coming years is certainly an improvement on that figure.

**Dr POLLARD** — If we are talking about total economic performance the way to evaluate the continuation of native forestry in Victoria is to look at the fact that we pump something like \$130 million into regional economies in Victoria. We are the first part of a very long supply chain of a large industry.

We are in a sense the perfectly competitive part of that, because there is no shortage of logs in the world. We are practically a perfectly competitive globally integrated industry, but what we make available has enormous multiplier effects throughout the whole of the eastern part of Victoria, and particularly in local communities. For example, what we deliver to Australian Paper in Maryvale assists in the maintenance of a thousand jobs in the Latrobe Valley.

If you look at the total performance across the total supply chain in terms not just of the profitability of the starting section of that supply chain but the total industry and its significant multiplier effects, I think you get a better global image, if you like, about the performance of our bit of the total industry.

**Mr BARBER** — But you have got a commercial charter, right?

**Dr POLLARD** — Yes.

**Mr BARBER** — That is the law. The law is that you will operate commercially?

**Dr POLLARD** — Yes.

**Mr BARBER** — But you do not have a view as to what a commercial rate of return would be for your business segment? As you said, you are competing with Gunns Ltd — that would be your nearest competitor, in a similar business. They have got a rate of return — hugely profitable actually?

Let me ask you another way, then. Here in note 8 to your accounts you have got a discount rate, which you used in this instance to look at how you value your standing timber — the bit that has been transferred from DSE to you for that period — and you have dropped the discount rate there from 15 to 10 between the two reporting periods, and there is an explanation for why you do that. It says it:

... reflects VicForests' average costs of funds and the current risk profile of the organisation.

It even says that basically that was on the recommendation of the Department of Treasury and Finance. Can I take it from that that your general discount rate would be something in the range of 10 per cent for the whole business operation, not just for this segment, which note 8 refers to, which is the holding of timber?

**Dr POLLARD** — Yes.

**Mr BARBER** — Okay. Also, at page 45 of the annual report we note there is an item — the third one down — called 'Cost of making trees available'. It has an asterisk down the bottom, where it says:

Agreement for 'Making trees available' with DSE was discontinued and provisions of 2007 were released.

What was the nature of the agreement for making trees available?

**Mr MacDONALD** — The principal results revolve around the work that the forests resources group within DSE does in terms of maintaining datasets that we use for our planning operations, so they maintain data around standing yields, overlays that we use in our planning

process — for instance, for rare and endangered species habitat. Principally it revolves around data that we need to access for our planning processes, and it has subsequently been replaced by a more appropriately named data sharing agreement. It is about paying DSE for access to that data which they use in turn to maintain those datasets.

**Mr BARBER** — So you pay them now as an expense?

**Mr MacDONALD** — We do. What we do now is, rather than a set figure per annum, we have actually got an agreement each year where we look at the work that the resources group within DSE completes each year and what projects we actually might want them to undertake on our behalf, and we come up with a funding model that is agreed in advance of each financial year.

**Mr BARBER** — So last year it was a half-million-dollar expense; this year you wrote off that provision?

**Mr MacDONALD** — No, last year we wrote off that provision. When VicForests was established, the agreement was set at a fixed amount of \$500 000 per annum. We agreed last year to revert to a new data-sharing agreement which was on an actual cost basis. Because we reached that agreement the provision that we had taken up for the previous year was written back.

**Mr BARBER** — So where is it that you pay DSE for the trees?

**Mr MacDONALD** — That relates to the SGARA evaluation.

**Mr BARBER** — But they give you some trees and you sell them. Where do you pay them for the trees?

**Mr HINZ** — The trees are transferred in the form of an allocation order and are transferred as capital to VicForests. As we disclosed, not in the last financial year but in the annual report of the previous year, the trees which were harvested in 2007-08 were actually valued at nil value because of the bushfire effect. In a normal year we amortise the value, which we actually have put into our accounts. You can see in our accounts at the end of 30 June that we actually evaluate the remaining TRPs at approximately \$7 million.

**Mr BARBER** — Is each coupe, or each group of coupes in an area, a profit centre? Do you analyse them like that?

**Mr HINZ** — It is a good question. We have now actually started to implement a management costing system which ultimately should allow us to follow up on a coupe-by-coupe basis what the actual income and expenses are. Unfortunately that has only been implemented in the last few months, and we will probably only see a benefit from that in the next couple of years. But we have actually implemented such a system, yes.

**Mr BARBER** — What quantity of woodchip did you actually sell last year?

**Mr MacDONALD** — To SEFE and Midway, which are the two customers exporting to the Japanese market, an estimate would be in the vicinity of 600 000 to 700 000 tonnes, but we could get those figures for the committee.

**Mr BARBER** — In your previous year's annual report at page 29 you have some little charts which show stumpage revenue by product, total revenue by product and annual log sales volume. That is not in this year's annual report. Last year it was 1.087 million of pulp log. Can you tell me what the figure was for this year?

**Mr MacDONALD** — It would be around 1.3 million. A third of that goes to Australian Paper.

**Mr HINZ** — It was 1.361 million.

**Mr BARBER** — A third of it goes to Australian Paper; okay. Last year it was 502 000 cubic metres of sawlogs. Can you tell me what the figure is for this year?

**Mr MacDONALD** — For 2007-08 it was 566 000 cubic metres.

**Mr BARBER** — So that is a significant increase in your volumes of wood, both sawlog and pulp log, compared to the last financial year?

**Mr MacDONALD** — That is where the bushfires had a dual impact on successive financial years. In 2006-07 our staff and contractors were essentially engaged in the fire suppression efforts from the start of September 2006 until mid-February 2007, and that is our high-production period during the summer months. It is when we harvest the majority of our sawlog and pulpwood, and because a significant proportion of our staff and contractors were engaged in the fire suppression

efforts, we actually sold less than we had planned in that financial year, which resulted in a small loss. Subsequently in this last financial year we have increased our activity back to normal levels but have also incurred additional costs in the salvage programs.

**Mr BARBER** — Beyond normal levels, actually, because in 2005 you only did 1.2 million, and you are saying you did 1.3 million this year. You said a third of that went to Maryvale — 400 and something thousand cubic metres?

**Mr MacDONALD** — Yes.

**Mr BARBER** — Under the forests wood pulp agreement you are required — or the state of Victoria is required — to deliver a minimum of 400 000 cubic metres between 2008 and 2010. The agreement also says that that could fall to 350 000 in 2010. Do you expect that sales will fall in line with the minima under the forest agreement?

**Mr MacDONALD** — We do, in that there is now a second agreement which VicForests has entered into in its own right with Australian Paper, and that was signed as part of the \$300 million expansion program. So Australian Paper will actually take additional wood from VicForests that would normally have gone to the export market, but that is under an agreement specifically with VicForests and not the legislative agreement which is with the Department of Sustainability and Environment.

**Mr BARBER** — The question I want to ask, though, is: do you think the sales to Maryvale will fall over coming years or will they stay static?

**Mr MacDONALD** — No, they will increase under the expansion program, but the volume under the legislative agreement may fall.

**Mr BARBER** — What proportion of your sawlog volume now is still being sold under licence rather than under auction, in cubic metres?

**Mr MacDONALD** — I would estimate in the vicinity of 85 to 90 per cent.

**Mr BARBER** — That is still being sold under licence?

**Mr MacDONALD** — Under timber sales agreements which were entered into. When we moved to the auction system we agreed to a step-down process with our customers where we signed an additional five-year agreement with them under which the volumes would decline by 17 per cent per annum. That surplus volume was then available to go onto the auction market. We are only still in the early stages of that ramp-down, so the majority of our wood is still sold under agreements that were principally involved in the licence system.

**Mr BARBER** — That is what I thought. In a previous document you said you expected to achieve about a 2.5 per cent reduction in the costs of harvesting and haulage as a result of this tendering process; do you think you achieved that?

**Dr POLLARD** — No. We are unlikely to achieve that, for a number of reasons. One of the reasons certainly in East Gippsland is that we have, through the tender process and by taking the most cost-effective bid for each contract, got a situation now where we are paying harvest and haulage contractors a market rate which is somewhat above the rate that they were previously being paid in the old syndicate arrangements.

There are a number of reasons for that, too. One is that they were being substantially put under the hammer by the previous arrangement since they had relatively little market power, I suppose. Now, in this more open arrangement, costs or bids better reflect the economic or financial reality they are operating under locally, so the costs through the bidding process have gone up somewhat.

**Mr BARBER** — There is still only one of you and many of them, so why do they have more market power now?

**Mr MacDONALD** — It is fair to say that if we had our time again, the timing for the tender process was not ideal. We had a significant surge in oil prices, and we were asking contractors to bid at a time when they were concerned about the long-term implications for oil prices. The reality is that the market at that point in time was quite tight for contract or capacity. We have seen a significant number of contractor employees moving to Western Australia to work in the mining industry, so there has been a significant shortage of labour, and our contractors have experienced an increase in the rates they have had to pay their staff.

Similarly with the buoyant market in other states we did not get many external participants in the tender process. So in fact whilst there is only one of us, there certainly was not, I guess, a lot of external interest in the tender process, and our contractors have incurred a significant increase in costs, both for labour and diesel.

**Mr BARBER** — Did you say before that you agreed to wear the upside of the petrol price up to 10 per cent or beyond 10 per cent?

**Mr MacDONALD** — We have a six-monthly indexation review mechanism with our customers and our contractors, so the same indexation mechanism for our contractors is reflected in our agreements with our customers. But within that six-month period we have an agreement with the contractors if there is a significant increase — a movement either up or down greater than 10 per cent — so it can work both against us and for us depending on the way the oil price moves. In fact in the last two months we have actually reduced our rates with our contractors because of the significant fall in the price of oil. But I guess as a protection measure for our contractors we have agreed to that adjustment mechanism within the six-month period, and that is something we had to enforce in April, May and June last year when we had to pass on increases to our contractors because of that surge in the oil price.

**Mr BARBER** — One successful bid that you accepted was to send 50 000 cubic metres of woodchip to Midway; it is mixed species out of East Gippsland at \$62.57. When you say that is an ‘arrangement delivered’, does that mean delivered to the rail head or delivered to Geelong?

**Mr MacDONALD** — For East Gippsland it is the rail head in Bairnsdale.

**Mr BARBER** — And as a proportion of that what would you call stumpage?

**Mr MacDONALD** — I do not have those figures available.

**Mr BARBER** — You do not disclose those figures in your annual reports since you moved to a delivery rather than a stumpage basis, but what I am interested in is: you knew what the average stumpages were then which reflect the part of the value chain which is growing trees. What would be the stumpage on something like that given the distance that it has to be taken before you have delivered it, and allowing for all these other escalations in the harvest and haulage component?

**Mr MacDONALD** — We would have to take that question on notice for that specific lot, because there is a mechanism in putting that wood to auction where we set a reserve price.

**Mr BARBER** — Yes.

**Mr MacDONALD** — I am not familiar with what the reserve price is for that particular lot, but we can find that information.

**Mr BARBER** — It comes back to my question about reserve prices and whether every coupe is a profit centre. But you have already told us that haulage distances are something you wear now that you are delivering it. Were you about to move on to the next one?

**The CHAIR** — We are about to move on, Mr Barber.

**Mr BARBER** — I have a few questions for the end if we still have time, Chair.

**The CHAIR** — We will move on now to Mr Kavanagh.

**Mr KAVANAGH** — Good morning. I know Mr Barber was asking about the net profit rate as a percentage of revenue, and it does seem very low. Mr Barber mentioned Gunns Limited as your competitor. Would you have an idea of what their net profit rate is?

**Mr MacDONALD** — I would suggest that Forestry Tasmania is a closer competitor than Gunns. Gunns is principally a sawmiller and processor much the same as our customers ITC and Midway. I think we would compare favourably with Forestry Tasmania in terms of our return on capital and profitability.

**Mr HINZ** — I actually have the figures here if you want them. The operating profit margins for Forestry Tasmania are: 2003–04, 8 per cent; 2004–05, 5.5 per cent; 2005–06, minus 4.3 per cent; and 2006–07, minus 9.6 per cent. I think we are not too bad in comparison with that.

**Mr KAVANAGH** — Not too bad in comparison with them, but most people would not think that 0.4 per cent was a very desirable outcome, would they? Or 0 per cent or 5.6 per cent or even 22 per cent. I understand that you have said there are a lot of benefits to local communities, but why is the net rate of profit after tax pretty low?

**Dr POLLARD** — Really for all the factors connected with taking one particular year in an industry that is really quite volatile when it is affected by the sorts of global and natural issues that we are affected by. The picture throughout Australia for native forest harvesting and commercial dealing is pretty much the same. For example, our New South Wales counterparts run a double-sided industry of plantations and native forestry.

I think it is fair to say that for a number of reasons their financial performance in native forestry is substantially less than their financial performance in plantation forestry, and that is probably the pattern throughout Australia. There are many reasons for that, but as that picture shows we would expect to come out of the long-term malign influences of the 2002–03 fires and the 2006–07 fires in the next financial year.

But it is also impacted by other issues over which we have no control at all like the previously increasing exchange rate, now declining and the previously exploding oil price, now declining, and our own customers' performance in local markets and in any global markets in which they operate. The factors affecting all of these are extremely volatile. Sometimes they form a perfect storm, and we have a year like we have had — and indeed the previous year. Sometimes they operate in a much more benign manner, and our part of the industry is able to return to commercial profitability.

**Mr KAVANAGH** — Could I ask you about one other thing? You mentioned that in East Gippsland the supply of available timber is likely to decline. Why is that? You said you need to be more savvy and flexible in extracting the timber in East Gippsland. What does that mean for the future?

**Dr POLLARD** — East Gippsland is a complex and particular problem. Obviously we inherited a long history of harvesting from our predecessor organisation. We find that as we move deeper into forest stands, the quality of timber available to us is in a state of long-term decline. It is still commercial, but it is less commercial than we would have preferred. That, in turn, is an outcome of many different factors operating in the past, including the effect of selective logging by previous operators in the forest, and other factors, also the fact that the customers to which we sell in East Gippsland have themselves varying histories and varying performances of their own. There has been a long-term history of lack of investment in that area for all sorts of reasons.

**Mr KAVANAGH** — The previous practices were not sustainable? They have led to a decline in supply?

**Dr POLLARD** — Do you want us to respond to that?

**Mr MacDONALD** — But there have also been changes to land use decisions. If you look at the area available to harvesting over the last 20 years, I think our reserve system has increased from 1.5 million hectares in the late 1980s to over 3.5 million hectares today, so as a result of land use decisions, the area available for harvesting has decreased and some of those reserves have included areas that contain very high proportions of sawlogs.

**Dr POLLARD** — As they are set aside for reserves, the amount of high-quality sawlog available to us to exploit declines.

**Mr KAVANAGH** — The amount that is available now, is that sustainable or not? Is the supply in those areas declining or is it being maintained?

**Dr POLLARD** — Everything we harvest is regenerated, so in that sense it is sustainable. I guess the question for us is: what level of commercial performance is sustainable? The problem of us continuing to encounter into the long term stands of timber that may be less and less commercial is obviously a long-term problem that we are going to have to grapple with.

**Mr KAVANAGH** — And you are going to grapple with that by being 'more savvy and flexible'. What does that mean?

**Dr POLLARD** — It means a number of things. It means that we have to look at stands of timber that have in the past been unmerchantable or less merchantable and to attempt to make them more merchantable. It is an attempt to find better uses for less commercial stands of timber. Now, in principle that is possible, but organisationally we are only now beginning to turn our collective attention to it.

**Mr KAVANAGH** — Should you not have been doing that before?

**Mr VINEY** — Can I take a point of order, Chair? The terms of reference of this committee are to inquire into and report on Victorian departmental and agency performance and operations for the previous financial year. I think Mr Kavanagh is moving into some forward projections. Our terms of reference are clear, and I would expect witnesses to be prepared for that, but we are now asking a range of questions on forward issues that I do not think we should go down unless the committee changes its terms of reference, and if members of the committee want to go down this path, I think they should at least give the courtesy to other members of the committee that that is their intended line of questions.

**The CHAIR** — Thank you, Mr Viney.

**Mr BARBER** — Further on the point of order, Chair, this is a commercial entity, and so the maintainable earnings of the entity are crucial. Any reader of an annual report of a commercial entity wants to know what happened last year for the purposes of knowing what is going to happen next year. If it was a hospital board or some such, fair enough, but this is a commercial entity with a commercial charter.

**Mr KAVANAGH** — Could I also say — —

**Mr VINEY** — ... set this up.

**Mr KAVANAGH** — On a point of order, if there are plans to do things that should be done in the future, it seems to suggest things that should have been done in the past that maybe have not been done.

**The CHAIR** — I take Mr Viney's point of order. The terms of reference are essentially in relation to past operations, but as Mr Barber said, have pointed to future operations, so I will allow your question, but I ask you to be mindful of the terms of reference; we are essentially looking at previous performance and operations.

**Mr KAVANAGH** — Should you not have been more savvy and flexible in the past?

**Dr POLLARD** — We have five years of operating history. Part of the context in which we have operated has been inheriting a lack of adequate knowledge about the nature of the resource, so we have spent a considerable amount of that time putting the systems in place to get a better knowledge of the nature of the resource that we are dealing with.

We now have a better picture of the nature of the resource we are dealing with than we had five years ago. In that time there have been substantial land use decisions made which have affected our operations, obviously, so the facts on the ground have changed. Our knowledge of the operating environment, and hence the commercial environment, has also changed, and those two factors combined mean that we are in a somewhat different environment now than we were five years ago.

**Mr KAVANAGH** — So you could not have been more savvy and flexible in the previous financial year?

**Mr MacDONALD** — One of the initiatives we have currently got under way is the low grade wood project where we are actually looking to see whether there are alternative markets for some of our lower grade products, but in order to take those products to market we need to wait until some of our current agreements expire, which is going to occur over the next few years, so I guess the flexibility is becoming apparent there where we have that ability to seek markets which may deliver higher returns than what we are currently receiving for some of our products.

**Mr KAVANAGH** — Thank you.

**Mr O'DONOHUE** — Dr Pollard, you have given evidence about the impact of the bushfires and the salvage arrangements that have followed. What were the commercial arrangements surrounding the salvage program and the securing of funding for the bushfire recovery task force?

**Mr MacDONALD** — We put forward a business case to the bushfire recovery task force outlining what were the incremental costs that we would incur as a result of going into the salvage program. If we compare ourselves to, say, a commercial forestry organisation in the plantation sector, generally they would take out insurance each year which would protect them in an event like a bushfire where they would be compensated by their insurer, if you like, for the incremental cost of harvesting those stands.

Native forests are almost uninsurable, so in the event of a bushfire such as the 2006–07 fires, you are in effect self-insuring, and we went back to our shareholder, to the bushfire recovery task force, to

seek moneys to meet the incremental cost of the salvage program and that was outlined in that business case.

**Mr O'DONOHUE** — Once all the resource has been sold and realised, will that process be a profitable process or will it in effect have costed VicForests by the time it is all said and done?

**Mr MacDONALD** — We relied on the \$6.6 million funding from the bushfire recovery task force to meet the incremental costs of those operations. That was in effect necessary to make some of those operations profitable.

**Mr BARBER** — So treating that as revenue along with the wood, was it a profitable operation? I think that is what his question was.

**Mr O'DONOHUE** — That is the essence of my question. Given the commercial charter you have, I am trying to ascertain whether that exercise was a profitable exercise. I am trying to establish the difference in roles between yourselves and DSE.

**Mr MacDONALD** — The intent was not necessarily to undertake a profitable exercise. What we were seeking to do was to minimise the long-term impacts of the fires on the resource that we harvest. For example, a significant area of the bush that was affected by the bushfire is within the forest area that forms part of the legislative agreement to Australian Paper, and that agreement runs to 2030. If, over that period of time, we are unable to supply wood to Australian Paper under that agreement, the government itself would be liable for the costs of providing that wood from elsewhere.

We have been able to provide a significant volume of wood to Australian Paper from the salvage efforts, which will minimise or mitigate the potential exposure to the government over time, were we to be unable to meet future supply under that agreement. It was more about mitigating future loss and future impacts from the fire rather than necessarily being a profitable exercise in its own right.

**Mr O'DONOHUE** — Is that future impact on the government or future impact on VicForests?

**Mr MacDONALD** — Future impacts on the industry and the people who are employed. In a sense we have harvested over 250 000 cubic metres of sawlog. That material in the normal course of events has a significant benefit to the local economy in terms of the jobs and the value that that creates. That resource would have been lost otherwise if we do not go in and salvage those stands. I think the benefits are significant in the context of the broader economy rather than focusing on the profitability per se of our operations.

**Dr POLLARD** — If I can just add to that, it also picks up earlier practice when the Department of Sustainability and Environment used to do this — namely, wildfire salvage operation, and it is done essentially on a project basis. Where in the old days it would have been funded by ERC funding, this time it is funded by a project agreement with the Department of Treasury and Finance.

**Mr O'DONOHUE** — Taking page 30, the income statement for the reporting period ended 30 June, from the report, I see there is a significant increase in roading and regeneration expenses between 07–08. Would you like to make the comment, Dr Pollard, on that and the reasons for that?

**Mr MacDONALD** — It is pretty much as a result of the increase in activity levels. We had a subdued year in 2006–07 because we were diverted onto the firefighting efforts so we had lower activity levels. Significant increases in activity levels last year resulted in an increase in roading expense and regeneration, because we shifted a greater volume of wood and we harvested a greater area of forest, so the expenses of both went up accordingly.

**Mr O'DONOHUE** — Would you make comment on the standard of roading in the forest areas that you operate?

**Mr MacDONALD** — We have a road management agreement with DSE where we manage a portion of the road network, and DSE manage a portion of the road network, for which we contribute funding to that. That is based on standards that have been determined by the Australian roading research board. We maintain roads to those standards. From time to time there are areas that may deteriorate due to climatic factors like rain and snow, but generally I believe the standard of the roads is certainly fit for purpose and also provides a safe operating environment for our haulage

operators and the public, because a significant part of these roads are used by a variety of users for recreational and other purposes.

**Mr O'DONOHUE** — I note that the roading agreement you make reference to is detailed on page 12 of your annual report. Does that replace then an existing agreement, or is that a new arrangement that has been agreed between VicForests and DSE?

**Mr MacDONALD** — It did replace a cost-sharing agreement that we had previously, where DSE actually managed the entire network. But we agreed that there were benefits particularly from the coupe where we harvest to a point on the network where there is greater public access. It made sense for VicForests to actually maintain those sections of the road, because we often are required to construct new sections of roads to access coupes.

The road toll network that DSE manages is principally in place now. The management of that is essentially around maintenance. That better suits DSE's operations. The new agreement was something that we both entered into on the basis that it resulted in a better management arrangement for the roads.

**Mr O'DONOHUE** — Minister Helper announced in March this year that a new timber industry strategy would be developed. Have you been involved in the development of that new strategy?

**Dr POLLARD** — We made two submissions to the inquiry.

**Mr O'DONOHUE** — Do you anticipate the release of that strategy in the coming months or coming weeks?

**Dr POLLARD** — I have no knowledge about when the strategy will be released.

**Mr O'DONOHUE** — Do you anticipate any change in direction or operation for VicForests?

**Mr VINEY** — Chair, I draw your attention to the point of order raised before.

**The CHAIR** — Thank you, Mr Viney. I think this question is in order. Questions about the strategy are probably a bit wide of the mark, but in terms of operations of VicForests, I will allow the question.

**Ms BROAD** — Chair, further on the point of order that Mr Viney has raised can I point out that the people appearing before us are essentially being asked to speculate about what is a matter of government policy and determination. That is not a fair position to place them in.

**The CHAIR** — That is certainly the case, Ms Broad. I do not interpret the question as a question about government policy. It is a question about VicForests operations, and a question about government policy would not be in order.

**Dr POLLARD** — I am sorry, could you just rephrase the question then for me?

**Mr O'DONOHUE** — Do you anticipate any change in VicForests practices or direction in the forthcoming period?

**Dr POLLARD** — I have no reason to anticipate any changes.

**Mr O'DONOHUE** — Dr Pollard, there has been lot of criticism from people in the industry about the tender process — about the lack of communication, particularly around the online tenders and concern about achieving access to resource — and perhaps that is reflected in the higher prices you have achieved. Would you like to make any comment with regard to that?

**Dr POLLARD** — Do you mean the tender process for outsourcing and harvest and haul work or the auction system by which we sell logs?

**Mr O'DONOHUE** — The auction system.

**Dr POLLARD** — As I said earlier, we have done a number of major things since we came into existence. The in-sourcing of the management of harvest and haul, the building of the auction system, the placing out to competitive tender of all the harvest and haul work and a number of other changes we have made has involved us in the need to be much more attuned to the requirements of effective communication with our stakeholders.

Largely because we have made so many changes of significant impact on the lives of the stakeholders with whom we work, we have attracted a lot of criticism around how adept we are at communication, and in the instance you raise, around the auction system.

We are very sensitive to those responses because we fully understand the enormous changes that we have brought and attempted to bring to this part of a very large industry in Victoria. We are also very conscious of the fact that we are dealing with people who in many instances have spent a large amount of their life and a considerable amount of their money on surviving in and attempting to build up this industry, so often they are people with long histories in the industry. We are also aware of the fact that there is a somewhat different history of encounter between the department and all these stakeholders than we have been able to have, precisely because we have a commercial remit, not a departmental remit.

In all of this we have attempted to stay in touch with our stakeholders, and in this case our customers, to keep them informed, to bring them into the design of — in this case, the auction system — to speak to their industry association, the Victorian Association of Forest Industries (VAFI), and to speak to the customers direct. In the case of the auction system we not only attempted to communicate thoroughly with them throughout the process but also to train them in how to participate in a successful auction.

My view is that a large amount of the criticism directed at us as not listening, not communicating and so on was actually code for anger at the fact that the system itself was changing. A lot of people, I think, benefited from the system as it was, even as a lot of people failed to benefit from the system as it was because they could not get access to logs. But for all the fact that we have come under a fair amount of criticism over the way we transitioned to the log auction system there has been some countervailing approval of what we have done because a large number of customers now have for the first time access to quantities of logs they did not have before because they were effectively locked out of the system.

So it is true that we have come under a considerable amount of opprobrium from particularly customers and particularly those connected with the auction system. My view is that we have largely come through that and at the moment, having had the last auction, we are having a series of consultations with all customers about their view of the auction system and their view about how it can be amended in the future to make it a more customer-friendly process. When we are finished those negotiations with customers directly and with VAFI, if there is sufficient that we can do, I will take this proposal back to the board for its consideration about how the auction system can continue to evolve over time.

**Mr VINEY** — Mr MacDonald, I want to take you back to the issue of the salvage of logs. What kinds of levels of resource were lost through those bushfires? Have you got any estimate of how much of your available resource was lost?

**Mr MacDONALD** — Over 1 million hectares of public land was burnt during the fires, around 650 000 of which was in state forest. Of that, our estimate was that about 14 000 hectares of high-quality ash commercial stands were destroyed by the fire.

**Mr VINEY** — Am I right in saying then that the subsequent pressure was going to be on the remaining stands that had not been burnt, if you did not go down the path of salvage?

**Mr MacDONALD** — That is correct.

**Mr VINEY** — So in effect the salvage operation was as much about protecting future stands as getting the resource out that had been burnt?

**Mr MacDONALD** — That is right.

**Mr VINEY** — You talked about how much quantity had been taken out in the salvage operation. Can you put that in the context of what that quantity would supply in a given year or future years?

**Mr MacDONALD** — Approximately, in total, it represents about six months of a normal year's supply, but for high-quality ash saw logs it represents close to eight months supply. A lot of the area burnt contained high-quality ash stands which are the most sought-after by our customers for their appearance. They are great products that predominantly get sold into the Melbourne market. That again made it particularly critical for us to salvage those stands. Ash forests are particularly vulnerable to fire; they tend to be killed. Some of our mixed-species stands in East Gippsland will recover from fire, but the ash stands generally do not.

**Mr VINEY** — How much time did you have to get this log out?

**Mr MacDONALD** — We were hoping that we might be able to extend the salvage program out for three years, which happened after the 2002–03 fires. We have one operation still in salvage now, but because of what we estimated was the impact of the prolonged drought the trees were drying out a lot faster and we were getting barrel checking which meant that we were not able to recover as much saw log as we had hoped.

**Mr VINEY** — Can I just go to the harvest-and-haul tender process. Can you give us some advice as to what numbers of contracts there were and what the values were for those tenders?

**Mr MacDONALD** — In total there were 182 contracts, which stretched from between two and five years, in total the value of the work was over \$300 million and there were 87 companies that were successful in the tender.

**Mr VINEY** — Do you know the number of jobs that were involved in those contracts?

**Mr MacDONALD** — Directly we estimate in excess of 500, but that does not include the ancillary services — for instance, the maintenance and diesel suppliers and the equipment manufacturers and suppliers that provide equipment to those contractors. We have seen a significant pick-up in investment by our contractors following the tender. Particularly those who have received five-year contracts have been able to reinvest and buy new plant and equipment because they have greater certainty. So there would be significant flow-on effects to the regional communities.

**Mr VINEY** — How does that compare with the situation beforehand? Do you have any idea of what the values and jobs in the equivalent contracts were before?

**Mr MacDONALD** — We have actually tendered out additional work. For instance, in East Gippsland we have put on an additional three crews over and above what we had previously. That is to enable us to continue to meet our sawlog commitments there. So in total the value would be slightly higher than previously and there would be additional employment there.

**Ms BROAD** — As well as the forests that we have been discussing in great detail, clearly a lot of communities in Gippsland were particularly affected by the Great Dividing Range fires and then the severe flooding that followed, in the great Australian cycle of these things. Can you outline what support or assistance might have been provided to communities affected by those events, because of the impact on the timber industry operations?

**Dr POLLARD** — As you say, native forest timber extraction remains a vitally important industry in some regional communities, especially in eastern Victoria and most especially in East Gippsland. I guess the biggest thing we bring to the table is the provision of long-term employment security. The harvest and haul tenders that we signed allowed a large number of contractors to transition to long-term contracts, which they had not had before.

The jobs that they bring with them, when you put them together, create a great deal more certainty in rural communities than had existed previously. So we would see our principal contribution as being in terms of the multiplier effect caused by the work that we do in East Gippsland and the jobs that that multiplier effect creates.

We also engage in some direct support of community activities, where we believe that that will have a positive effect on community recognition of our contribution to the local economy. So we do some small-scale support of local organisations where we believe we can get some recognition and payback from that.

**Mr MacDONALD** — I think specifically with the fires the township of Licola is a good example. They suffered the impacts of not only the fires but also the subsequent floods. As mentioned, many of the contractors we engaged had to come from other areas. So they were camping up there and using facilities in Licola for both accommodation and also for food. Similarly in Dargo, Swifts Creek and Merrijig. I guess trucks are a great example. Generally your truck driver will stop at the local shops each day and pick up lunch and other supplies.

Woods Point was another case in point. We had contractors based up there, often in commercial accommodation during the week. Certainly the feedback we received from those retailers was that the salvage program did give them a bit of a fillip. Where they had had a dip after the fires and also the floods, we certainly through our contractors injected a significant amount of money into those areas.

**Dr POLLARD** — We began the salvage program fully a year before the previous salvage program had been begun after the 2002–03 fires. The fact that we were able to move very swiftly was an additional benefit to local communities.

**Mr MacDONALD** — It is a bit of a double-edged sword. For example, in the Buckland Valley up near Ovens, where we certainly had an increase in traffic, with the haulage trucks bringing wood out of those areas, it certainly did involve a lot of stakeholder engagement, particularly around ensuring that we did not have log trucks on the road during school bus hours and the like. Certainly that is where at a local level we have tried to invest significant effort in stakeholder engagement. Usually we have some residents in those areas whom we use as a bit of a barometer as to whether we are following through on our commitments. Often they are keen to keep us to our commitments. Certainly on balance they were happy with the performance of VicForests, particularly our truck drivers, in sticking to agreements that were made around curfews in terms of how early in the morning they would operate.

For instance, at Woods Point we had an agreement that trucks were not to go through the town until 7 o'clock each morning. While there might have been a queue of trucks waiting to come through at that time, our contractors did stick to those agreements. I think that was reflected in I guess the goodwill we got from residents in those areas.

**Ms BROAD** — Just on that matter of roading, stakeholder management and impacts on roads, you have referred to a number of stakeholders and agreements with DSE. Can you indicate also how those stakeholder relations are being managed with councils that are affected and are responsible for local roads? I know that has been an issue that many MPs would have received representations about over long periods of time. Can you indicate how those relations are being managed?

**Mr MacDONALD** — With our new business model we have actually got a dedicated planning team in each region. Part of their role is not necessarily to engage in stakeholder management directly, but to create a plan that goes out 18 months and indicates where our operations will take place. Then we have specific staff in areas, such as roading, who then will take that to the various councils that we deal with just to give them an indication of what roads we are likely to use, at what time and what volumes of wood are going to come over.

An example is the Gippsland East shire. We use a significant number of shire roads in that particular region. Then it is a matter of discussing with those local governments and local councils as to what likely impact our use of those roads will be and what maintenance may be required. That is a process that we are actively working at. I think we have got some way to go to really get that embedded in our operations. Part of the reason behind our reorganisation was to get our staff focused on stakeholder engagement.

**Mr BARBER** — In response to Mr Viney's question earlier, I think you said about 15 000 hectares of your more merchantable stands were burnt. Is that right?

**Mr MacDONALD** — Of ash stands.

**Mr BARBER** — Some 15 000 of ash. Did you say that was eight months' supply that had been burnt, or that you had achieved eight months supply by logging it?

**Mr MacDONALD** — That is right. We harvested the equivalent of eight months supply of ash sawlogs.

**Mr BARBER** — How much of the 15 000 hectares was that?

**Mr MacDONALD** — I do not have those figures to hand, but I would estimate we probably harvested about 1500 hectares of those burnt stands.

**Mr BARBER** — In some ways you only recovered 10 per cent of what was burnt with this operation?

**Mr MacDONALD** — Yes.

**Mr BARBER** — Of all the coupes that you have logged over the life of VicForests, how many have been surveyed for stocking?

**Mr MacDONALD** — I would need to take that question on notice. Basically once we conclude harvesting we then go through a process of carrying out regeneration activities. That generally involves putting through a high-intensity burn to remove the residual material. We then

sow seed that has been collected locally. Then under the silviculture guidelines that have been developed by DSE we have to wait for a minimum period of time — generally 18 months — before we can do a final stocking survey to ensure that the regeneration process has met the standard. After that we can survey it and hand that back to DSE. There is a process in place that takes some time to work through before the coupe finalisation process can be completed with DSE.

**Mr BARBER** — Sure, but I am asking about the five-odd years that you have been doing this. Have you regularly surveyed 1 per cent or 100 per cent or half?

**Mr MacDONALD** — We would have surveyed the majority. We would not have surveyed it all.

**Mr BARBER** — How many of those have failed in the sense of stocking? What program do you have in place to go back and remediate that, and have you started to cost that as a liability in the accounts? This is where I am heading.

**Mr MacDONALD** — We do. Regeneration liability in our accounts includes not only current coupes harvested in that financial year but also any additional remedial treatment that we have identified. I will just go back to the process where I have indicated that there is a final stocking survey at 18 months. We also do a preliminary stocking survey.

That is some time in the first 12 months to get an understanding of whether the germination of eucalypt seed has occurred, because any remedial treatment, such as doing some mechanical service and subsequent sowing, is always better to do sooner rather than later. Our silviculture team that manages that process is also monitoring that and factoring that into their subsequent budgets for future expenditure.

**Mr BARBER** — You started to put a bit of a handle on what might be your carbon liabilities, if I can call it that. It comes out of your sustainability report. You started to estimate there — and you talk about all the regulatory changes that are going on — roughly that maybe you are better than carbon neutral, that you are carbon positive. Is that based on an analysis of the coupes that you are given and what you do with them, or is it based on the broader forest area around the actual logging operations?

**Mr MacDONALD** — That is based on the broader forest area.

**Mr BARBER** — If it came down to the legal responsibility for the emissions and that ended up being VicForests for its operations, you have not got any figures on what would be your carbon liability, or do you think it would be carbon negative?

**Mr MacDONALD** — Part of our assessment of our carbon footprint is based on the Department of Climate Change report in 2007 on managed native forests in Australia, which indicates that they are sequestering carbon at a rate of 26 million tonnes of carbon per annum. Our estimates are backed up, if you like, by the work done by the Department of Climate Change.

**Mr BARBER** — If it is based on this MBAC Consulting report that you commissioned last year, would you be able to supply the committee with a copy of that report?

**Mr MacDONALD** — Yes; I think we would be able to supply that to you.

**Mr BARBER** — I have two quick last ones. How many people are employed by your harvest-and-haulage contractors now?

**Mr MacDONALD** — We do not keep a direct tally on the number of staff. We estimate it is in excess of 500.

**Mr BARBER** — Is that 500 EFT or 500 at peak, because we are talking about a harvesting season here? Is it 500 during the peak season, or is it 500 EFT across the financial year?

**Mr MacDONALD** — The season runs for up to nine months in the Central Highlands region. It actually runs for 12 months in East Gippsland, so it is the majority of the year. We put pulp wood into storage dumps for supply to Australian Paper over those three months when we are not operating in the Central Highlands, so that keeps the truck drivers employed during that period.

**Mr BARBER** — But it is proportional wood volume, isn't it? At the end of the day harvest and haulage is proportional to wood volume?

**Mr MacDONALD** — It is. Yes, that is right.

**Mr BARBER** — Your certification for the FSC, what have you spent on that process so far — or during this financial year that we are looking at, if you like — and what progress has been made there?

**Dr POLLARD** — We could supply the figures on those. We would need to dig those out. We have had a preliminary audit, and we are awaiting the written report from the auditors which will, we hope, raise the gaps that we have to meet in order to proceed finally to certification. We are substantially through the process, I would estimate.

**Mr BARBER** — One of your major strategies here — and you have talked about it a couple of times in your testimony — is developing alternative opportunities for selling wood that may currently not be used or may no longer be required by other customers with some of these changes you have referred to. One of those is to sell wood for burning for electricity. Can you tell me what progress you made during that financial year on developing those opportunities?

**Dr POLLARD** — We have been engaged in some experimental work with an outside consultant looking at the possibilities of converting biomass waste into energy.

**Mr BARBER** — It is not like business planning, it is more like asking, ‘How would it work if we burnt it?’ or how to run a burn?

**Dr POLLARD** — The broad picture is that the industry traditionally has been based on sawlog and then more recently pulp log. Both sides of that equation clearly have long-term variables built into them that we are going to have to deal with, so some problems may surface from them. We believe it is in the industry’s interests that we investigate for the long term whether the currently unmerchantable or less merchantable product that we have control of can be turned to account. Really that means a variety of possible alternative uses that we could have for either low-grade logs or unmerchantable logs. One possible future use might be the generation of energy, but there are others as well — for example, manufactured board, which has been hardly looked at for East Gippsland, which is the area where most of the raw material for that would come from were it to be undertaken.

**Mr BARBER** — That is kind of what I am asking. Given that you have held it out in your report and strategy documents as a future growth area of business development, given that you have already told us that it is likely that there will be ongoing variables, as you call them, or difficulties in selling woodchips for pulp, and given that everybody on the Asia Pacific rim has got the same idea as you have about what to do with all this fibre, what steps have you taken that you can report to us that have advanced those possible business opportunities?

**Dr POLLARD** — There is really nothing of a completely concrete nature yet. In terms of woodchip progress we have made resources available where we thought we had them. We regard it as a long-term project, but it is something that will come to fruition in terms of research data in the course of this current financial year rather than the past one.

**Mr O’DONOHUE** — Dr Pollard, as you would be aware firewood is a fuel source or heating source, particularly in East Gippsland and particularly where natural gas and other sources of energy are not as available as in other areas. There has been some disquiet among firewood contractors about access to supply and delivery arrangements, costs et cetera for firewood. Would you like to make any comment on that?

**Dr POLLARD** — We have come in for a good deal of criticism over our involvement in the domestic firewood sector. We have a commercial remit, and we supply commercial quantities of sawlog. The way that ends up in the process is that we auction and hence supply quantities of sawlog to commercial dealers in firewood — in other words, if you are prepared to bid for commercial quantities of firewood, you can have them delivered to your firewood yard and saw them up yourself and onsell them to retailers. In other words, our customer is a firewood wholesaler and not a firewood retailer. In recognition of the fact that that is largely not understood, we have radically reduced the size of the lots that we are prepared to sell to wholesale firewood dealers — and we do sell some firewood to wholesale firewood dealers.

A lot of the criticism of us actually stems from the fact that we do not allow the general public onto coupes that we have ceased to harvest. We do not allow that for reasons connected with occupational health and safety. We do not approve of the public entering coupes with their own machinery,

including chainsaws, and operating in an unsupervised manner for the collection of domestic firewood, especially given that at the retail end there is really no absolute shortage of firewood anyway.

In any regional area you can get on the phone, order it and have firewood delivered to you. That is not the problem. The problem, as we have encountered it, is a widespread misunderstanding among wholesale dealers in firewood about our supply arrangements with them. We want to supply too much and they want to buy too little, and there is something of a gap there.

To the extent that people want to access the forest and get their own firewood, they can do so through buying a \$20 licence from the Department of Sustainability and Environment. That really is a matter of the relationship between the general public and the department rather than the general public and us. We attempt to explain that to people. It is a subject, though, of widespread public misunderstanding which we continue to attempt to bridge.

**Mr O'DONOHUE** — Have you had dialogue with DSE about encouraging it to assist with that communication process?

**Dr POLLARD** — Yes. DSE also recognises the problem, and it is currently engaged in preparing a report on the future of domestic firewood supplied in the whole of Victoria. We are party to those discussions, but they are really the subject of a report of the department. I believe that will be coming out in the course of 2009.

**Mr BARBER** — Can I just ask whether VicForests has any concerns about this report and the PowerPoint presentation being published on our website rather than us having to exchange correspondence later?

**Dr POLLARD** — No, I think it is all public knowledge, in principle.

**The CHAIR** — The committee thanks you for your attendance and your answers this morning. There are a number of matters you have taken on notice, and the secretariat will follow up with you to get those responses. We will also have a draft transcript to you in the next couple of days for any corrections you wish to make.

**Dr POLLARD** — Thank you.

**Committee adjourned.**

## APPENDIX 3 – RESPONSE TO QUESTIONS TAKEN ON NOTICE



Our Ref:  
Your Ref:

19<sup>th</sup> December 2008

Mr Richard Willis  
Secretary, Council Committees  
Legislative Council Standing Committee on Finance and Public Administration  
Parliament of Victoria, Parliament House  
Spring Street  
East Melbourne 3002

Dear Mr Willis

### Corrected Copy of Evidence and Matters Taken On Notice

Thank you for the opportunity to address the Legislative Council Standing Committee on Finance and Public Administration. The purpose of this letter is to provide VicForests' corrected Copy of Evidence and respond to the matters taken on notice.

#### 1. Copy of Evidence

Our marked up response to the record of evidence is attached.

#### 2. Matters Taken On Notice

- a. Data relating to the injury rates and loss of working time: enclosed.
- b. The date the dividend determination was made: the Treasurer proposed a dividend in a letter to VicForests of 9 Oct. 2006. The Board formally agreed to this on 26 Oct. 2006
- c. The quantity of woodchip actually sold last year:

VicForests sells log products, not woodchips. We do sell low quality pulplogs unsuitable for sawmilling to companies whose primary business is the export of wood fibre in the form of wood chips for pulp and paper manufacture. These companies process pulplogs from VicForests, together with significant volumes from plantations and other native forests, to supply pulp and paper manufacturers in Japan, China and Taiwan. The volume of pulplogs sold to these companies in 2007-2008 was **908,080** cubic metres generating revenue for VicForests of **\$ 51,381,370**.



- d. The proportion of stumpage for the woodchips to Midway from East Gippsland:

For that parcel the stumpage for high quality pulpwood was \$6.50 per tonne and \$2.50 per tonne for low quality pulpwood.

- e. A copy of the MBAC Consulting Report:  
attached
- f. The amount spent so far by VicForests to obtain FSC certification is calculated as \$ 121,710.

Yours sincerely

A handwritten signature in black ink, appearing to read "David Pollard".

**David Pollard**  
CEO

STANDING COMMITTEE ON FINANCE AND PUBLIC ADMINISTRATION  
Report on VicForests' Performance 2007-08

22/12/2008

**Listing of VicForests' contractor incidents resulting in injury.**

**2006/07**

Year	Date	Location of Injury	Nature of injury	Work Activity	Class of Injury	Days Lost
2006/07	24/07/2006	Leg	Fracture	Loading	Death	270
2006/07	6/09/2006	Trunk	Fracture	Falling	LTI	100
2006/07	14/02/2007	Arm	Bruise	Falling	LTI	1
2006/07	18/04/2007	Foot	Bruise	Log preparation	LTI	2
2006/07	8/09/2006	Head	Stress	Log transport	LTI	21
2006/07	13/11/2006	Head	Laceration	Loading	MTI	0
2006/07	28/03/2007	Head	Laceration	Log extraction	MTI	0
<b>Total Lost Time</b>						<b>394</b>

**2007/08**

2007/08	16/10/2007	Multiple	Multiple	Log transport	Fatality	270
2007/08	1/08/2007	Head	Bruise, Laceration	Falling	LTI	10
2007/08	22/01/2008	Hand	Laceration	Falling	LTI	14
2007/08	21/04/2008	Head, hand	Fracture, Laceration	Falling	LTI	40
2007/08	4/08/2007	Foot	Sprain	Loading	LTI	188
2007/08	10/10/2007	Leg	Bruise	Log extraction	LTI	1
2007/08	11/07/2007	Foot	Sprain	Log preparation	LTI	2
2007/08	31/10/2007	Multiple	Fracture	Log transport	LTI	44
2007/08	28/11/2007	Leg	Fracture	Log transport	LTI	263
2007/08	12/02/2008	Head, trunk	Bruise, Laceration	Log transport	LTI	21
2007/08	18/02/2008	Trunk	Multiple	Log transport	LTI	168
2007/08	27/02/2008	Leg	Laceration	Log transport	LTI	133
2007/08	27/02/2008	Leg	Poison	Log transport	LTI	2
2007/08	31/03/2008	Trunk	Other	Log transport	LTI	65
2007/08	12/05/2008	Hand	Laceration	Maintenance	LTI	10
2007/08	29/05/2008	Arm	Sprain	Seed collection	LTI	32
2007/08	17/04/2008	Leg	Bruise, Laceration	Log preparation	MTI	0
<b>Total Lost Time</b>						<b>1263</b>

**2008/09 (half year results)**

Year	Date	Location of Injury	Nature of injury	Work Activity	Class of Injury	Days Lost
2008/09	10/11/2008	Trunk	Bruise	Falling	LTI	14
2008/09	8/12/2008	Trunk	Fracture, bruise	Loading	LTI	18
2008/09	16/09/2008	Leg	Sprain	Log extraction	LTI	53
2008/09	15/07/2008	Leg	Sprain, bruise	Log preparation	LTI	12
2008/09	3/11/2008	Leg	Sprain	Seed collection	LTI	19
2008/09	19/08/2008	Head	Laceration	Log transport	Minor Injury	0
2008/09	1/07/2008	Leg	Laceration	Maintenance	Minor Injury	0
2008/09	11/12/2008	Head	Bruise	Driving	MTI	0
<b>Total Lost Time</b>						

LTI = lost time injury

MTI = medical treatment injury