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Dear Beth and Earl,

The Alaska Forest Association requests the opportunity to discuss the following three additional Issues at the Objection meetings in Ketchikan this week. I plan to attend the Juneau meetings next week as well, but as you know, our Annual Convention in Anchorage has been scheduled for nearly a year and I will have to leave Juneau for Anchorage on the morning of October 19 in order to help manage that Convention. If there is insufficient time before October 19 to address these issues, then I request a separate meeting sometime after October 24.

1. Financial Feasibility Issues that were not Addressed in the FEIS

In our February 22, 2016 comments for the DEIS, we explained that the age, size and volume of young growth currently available on the national forest is insufficient to support a viable, competitive young growth manufacturing mill, let alone an industry. Your FEIS Appendix-I dismisses those concerns with assertions that the net present value of the overall timber program is positive and the young growth alone will be profitable after 25 years. Those assertions are not credible.

We were provided a Woodstock data set that included a graph of purported pond log values for young growth hemlock in 2004. In that analysis, young growth trees less than about 32-inches DBH had values ranging from \$120 to \$180 per thousand board feet (mbf), but the trees larger than 32-inches DBH had values ranging from \$200 to \$230. Similarly the spruce young growth tree values ranged from about \$150 for trees with a DBH below 32-inches to about \$400 for trees with a DBH above 32-inches. Only a small percentage of the young growth trees proposed for harvest over the next 25 years will have a DBH at or above 32-inches, so the negative net value for the young growth will likely be *much* greater than the averages presented in the FEIS.

Also, we note that the transportation portion of the Woodstock analysis indicates that the analysis assumes four young growth sawmills will be operating. That assumption artificially lowers the presumed transportation cost and gives a false increase in the net present value calculation because there is not sufficient volume to support four young growth mills at four locations. Further, only one mill currently has sufficient volume to justify barging residual chips to the Pacific Northwest, so the value attributed to sawmill residuals is also grossly overstated.

There is currently one mill making pellets in the region, but that operation appears to be heavily subsidized (as is most pellet manufacturing) and it would be wrong to claim a positive net present value based on a subsidized operation.

The net revenue projections in the FEIS and the appendix acknowledge that young growth will be harvested at a loss. We don't think it is reasonable to expect that anyone would purchase young growth timber sales with the expectation of losing money.

Appendix-I responded to some of our DEIS economic concerns with a remark that Viking can process 8 million board feet (mmbf) of young growth annually. That response overlooks that Viking has made it clear it can only manufacture the 8 mmbf of young growth if it can fully operate its old growth log side at the same time; the old growth operations would offset the losses from the young growth operation, but only if the old growth timber sales are profitable enough. The Forest Service cannot overlook an important aspect of the problem by selectively isolating information that cannot be assessed in a vacuum.

The response to our comments further argues that the Vaagen mill in Eastern Washington manufactures young growth profitably – so why can't we? – but that response also is wrong because it overlooks important aspects of the problem. The Vaagen mill is a high production mill that produces about the same volume in chips and residuals as it does in lumber. Pulp grade chips are shipped to one of two nearby pulp and paper plants and bark and other residuals go to a nearby biomass power plant. Further, the mill only manufactures some of the smaller logs that it acquires; the larger logs (frequently the butt log of the same tree) are sent to a nearby plywood plant for peeling, while other species (cedar in Vaagen's case) go to a nearby cedar sawmill that makes specialty products. So in reality the small logs operation at the Vaagen mill is only viable because there is still a functioning market for large logs, residuals, and other species. The mills in SE Alaska are not high production mills, and they no longer have the economy of scale and manufacturing integration necessary to function like the mill in Eastern Washington. Further, logging conditions and consequently delivered log costs are much lower in Washington State than in Southeast Alaska. Sawmills in Southeast Alaska are also much further from the domestic lumber customers than mills in Washington. The cost of shipping lumber from Southeast Alaska to the markets in Washington State is more than \$55 per mbf. This shipping cost puts Alaska mills at an even greater competitive disadvantage to existing young growth lumber mills in the PNW. That's why the Alaska mills manufacture higher value wood products; and those products cannot be sawn from small diameter trees. All of this has been ignored by the Forest Service.

The 2009 Nature Conservancy/Beck Transitioning to Young Growth in Southeast Alaska report concluded that a small-volume, small-log sawmill in Southeast Alaska would require a logging cost subsidy of about \$140 per mbf in order to be successful. The AFA's own small log sawmill proforma also indicates that a small-volume, small-log sawmill in Southeast Alaska would operate at a loss well in excess of \$100 per mbf. A much larger small-log sawmill in Southeast Alaska would still lose more than \$60 per mbf primarily due to the cost of shipping the lumber some 800+ miles to the PNW for drying, dressing and marketing. Of course a much larger mill would also require more young growth timber than the current young growth timberlands could sustain because they are *too young*.

It is clear that a small log mill in Southeast Alaska will not be profitable until the trees are much larger and until there is a much larger economy of scale in the region. Until then, the only profitable way to harvest young growth trees will be to export them as supplemental volume to China or some other region that already has a large economy of scale and other economic advantages. It is disingenuous to suggest that exporting small logs will help a transition to a small log manufacturing industry.

The FEIS argues that the negative net present value of young growth harvesting will somehow be reversed some 20 to 25 years from now, yet the FEIS also projects that the old growth, which allegedly offsets the young growth losses, will substantially end after 15 years. This future reversal of the young growth negative present value makes no sense. A summary of young growth and old growth net present

values prepared as part of the Woodstock analysis indicates that in the fourth 5-year period of the transition, the young growth harvesting will produce a negative net revenue of \$19,125,370 while the positive net revenue from old growth harvesting will be only \$9,024,908. This means a net loss of more than \$10 million for that 5-year period! How can the Forest Service look at that analysis and still insist on imposing such a financially irresponsible change in its land management plan? And as relevant to the upcoming Objection meetings, why is the Forest Service refusing to discuss this fundamental problems with its analyses?

The Nature Conservancy Beck report, the USFS 2010 report, the AFA proforma and the FEIS net present value analyses all agree - the proposed transition *will not work*.

2. Harvest Constraints Issues that were not Addressed in the FEIS

The 2008 Standards and Guidelines for timber harvesting, along with the land use designations and the old-growth reserve system which placed off limits much of the best timber growing sites, increased the cost of harvesting national forest timber to such an extent that the Forest Service has been unable to prepare economically viable timber sales and thus could implement only about 25% of its planned timber sale projects.

This Transition Amendment does nothing to provide relief from these harvest constraints. Consequently, we can expect that the agency's ability to implement its future old growth timber sale plans will continue the same 25% success rate that has plagued the Forest Service since 2008. Because the young growth lumber is much lower value than the old growth lumber, the implementation success for young growth timber sales will be even worse unless the Forest Service abandons local manufacturing and simply exports the small logs to China or elsewhere.

The MIRF (Model Implementation Reduction Factor) estimates in the FEIS are well below the agency's actual experience of the last eight years, and consequently both the old growth and the young growth volume estimates in the FEIS are grossly overstated. Further, the Standards and Guidelines have not been revised, and there is nothing else in the FEIS to explain how the falldown in volume will be lessened. This is a topic we need to discuss at the Objection meetings.

This failure to address unsuccessful implementation of the timber sale program has already caused the loss of several mills, and it has nothing to do with the demand for timber sales.

3. Demand Analyses Issues that were not addressed in the FEIS

We also reviewed the draft, revised demand analysis that the Forest Service prepared for this TLMP transition effort. The authors of this revised demand analysis state "The Pacific Northwest Research Station has been asked to assist planners in meeting the TTRA requirement for estimating planning cycle demand for timber from the Tongass." Unfortunately, the November 2015 draft EIS for TLMP makes a number of bad assumptions and erroneous conclusions, many of which refer back to this revised demand analysis as the source. Based on personal communication with lead author Jean Daniels, the AFA is not surprised by the flaws in the draft demand analysis on which the Forest Service rests so many of its conclusions. Inexplicably, the draft demand analysis was prepared without input from the State of Alaska or the timber industry in Southeast Alaska, even though the industry and the State are key participants in the market. Further, in a short-sighted effort to meet an arbitrary agency deadline rather than allow for a thorough and accurate analysis, the Forest Service required submission of the draft demand analysis before it was complete. None of these shortcomings in the Daniels' Demand Analysis have been corrected despite our pointing them out repeatedly in both the Draft and Final EIS. Had the Forest Service truly been interested in a factually accurate demand analysis, it would have allowed its

staff to complete their analyses, which might have rectified some of the following shortcomings which permeate the draft demand analysis and render it misleading at best. These issues need to be discussed at the upcoming Objection meetings.

Here are some of the errors and shortcomings in the revised demand analysis:

1. The cost of accessing and harvesting the young growth stands is not assessed.
Other than a few significant blocks of young growth, most of the young growth stands are small and widely scattered and just the mobilization into each of these stands will make the harvest economics difficult. In addition, the current and proposed TLMP standards and guidelines will result in further fragmenting the blocks into even smaller parcels and thus further increasing the cost of harvesting. No significant effort to adequately inventory the young growth and analyze these cost impacts has been made, but it is apparent to those of us who are familiar with timber harvest logistics that most of the young growth proposed for early harvest will be uneconomic. Just the fact that the trees will be cut long before they reach maturity means that the volume of timber per acre will be reduced by more than half. Further, many of the road systems that initially accessed the stands have been closed and will require extensive, costly reconstruction.
2. The value of the young growth on both the domestic and export markets is not addressed.
Export values for logs fluctuate more than domestic lumber prices in part because they are impacted by foreign exchange rates and foreign trade policies. Domestic lumber values for the low grade products that can be produced from small logs vary primarily with the US housing market. Alaskan sawmills can only sell to the domestic lumber market profitably if they manufacture and transport their lumber to market for less than the value of the lumber.

In order to compensate for the low value of construction lumber, new small-log sawmills typically rely on extremely high production rates and a proximity to both their timber supply and their markets. The high production, small-log mills that are currently being constructed in the US are in areas having an abundance of young growth timber available and where the mills are very close to their customers. A high production small-log mill in SE Alaska would have to rely on an inadequate and uncertain timber supply from the current Forest Service timber sale program, and the mill would be at a further competitive disadvantage to small log mills that are some 800 miles closer to their customers.

In 1992, the Irland Report¹ explained *“In SEA, the economics of processing depends on the cost levels of harvesting wood on the level of the uncut volume under contract, on the security of new supplies, and on the ability to obtain enough wood to operate facilities at high operating rates during market peaks. At present, TNF can fulfill none of these requirements.”* This is why the mills in Southeast Alaska have concentrated on higher value products which can only be sawn from the mature, old growth timber.

As one option to utilize a very small volume of small logs from commercial thinning operations, the Viking mill managers suggested that they might be able to ramp up to 8 or 10 million board feet of small logs over a period of years, but only if they could maintain full and profitable operation of their old growth sawmill and sustain their high-value lumber customers. The old growth harvesting under that scenario would allow the Viking sawmill to subsidize the small log operation. Without the old growth timber the Viking mill could not afford to saw the small, 60-year old young growth trees. The two types of operations cannot be divorced from one another.

¹ The Irland Group, 6/23/92, page 49.

3. The projected timber harvest levels are too small to support an adequate economy of scale to support a competitive industry.

The timber industry in Southeast Alaska has lost its economy of scale and much of the infrastructure that once allowed it to be more competitive. We used to have many logging and sawmill operations, but now there are very few and as a result every aspect of the timber business is less efficient and more costly. For instance, the lack of a regional logging equipment dealer in Southeast Alaska was mentioned at one of the Forest Service Tongass Advisory Committee meetings. We spoke with Modern Machinery in Washington State and they explained that they would have to have about \$1.25 million in business each month in order to have a successful dealership located in our region. Working with our loggers, we estimate that roughly 300 million board feet of logging and related road construction would be needed to generate the monthly business level that Modern Machinery says is the minimum necessary to sustain a regional equipment dealership. This is more than double the regional harvest level anticipated by this revised demand analysis. This lack of support businesses for our timber operations puts our local sawmills at a competitive disadvantage to rival mills in the PNW.

The 6/23/92 Irland report explained that *"there is no market demand for Alaska timber or end products. There is a regional and world market for softwood logs of varying levels of quality, for chips, for lumber, and for dissolving pulp. Alaska's share of these markets, even when viewed only in terms of hemlock and spruce, is small. So Alaska is a price-taker on a huge market."* The Irland report further pointed out that *"There is a local demand for logs and for local processing. The future of that demand depends on the local processing industry's competitive position in its end use markets. In turn, that competitive position is strongly affected by the conditions of wood supply."* Without a reliable supply of timber and an adequate economy of scale, the local mills are not able to compete with facilities in other regions that have those advantages, and thus the private timber is economically unavailable to the local mills.

To compensate for the decline in the economy of scale, the surviving mills have been able to remain competitive by manufacturing high value products, but these high value products cannot be sawn from 60-year old hemlock and spruce trees.

4. The assumption that the mills will make investments to enable them to process small volumes of young growth timber is a faulty assumption.

The document assumes that *"existing mills will make any machinery upgrades necessary for the young growth transition, but rates of utilization may fluctuate."* This is a very poor assumption. A competitive small log sawmill will cost upwards of \$100 million and will require more small logs to furnish it than can be sustained on the existing young growth acreage on the Tongass. For instance, a small-log mill in Arkansas is currently being upgraded at a cost of about \$190 million and will have an annual capacity of 387 million board feet. Another new mill being upgraded in Florida will cost about \$130 million and will produce up to 700 million board feet. A similar small-log sawmill is planned for Shelton, Washington. It is expected to employ 150 to 200 workers and will utilize about 200 mmbf of logs annually.

However, the entire 462 thousand acres of Tongass young growth would sustain less than 150 mmbf annually if harvested at about age 60; and that ignores the impossible economics of such an endeavor. Yet, the Forest Service preferred alternative in the draft TLMP amendment proposes to manage only about 260 thousand acres of young growth, which if harvested prematurely as is currently proposed, the agency estimates that the maximum young growth

harvest will be only 9 mmbf during the first ten years and then slowly ramping up to a maximum of 88 mmbf after 23 years! The upper limit of 88 mmbf is less than the volume necessary to sustain even a single competitive small-log sawmill, and the high cost and low value of these small logs will reduce the amount of economically available young growth to a level far below 88 mmbf, making it impossible to ever amortize the investment necessary to construct a new small log sawmill.

5. Private timber is incorrectly assumed to be available to the local sawmills, and the projected level of private timber harvest is overstated.

The revised demand report relies in part on an assumption that private timber harvests are currently about 61 mmbf annually and will increase to about 80 mmbf over the next 15 years. However, the only significant private timberland owner still harvesting timber in the region is Sealaska, and they have explained that their maximum sustainable harvest rate is only about 45 mmbf per year for the next 25 years. Further, Sealaska has indicated they would like the opportunity to bid on an additional 20 mmbf of federal timber annually to improve their own economy of scale. In addition, page 3-267 of the EIS indicates that the Forest Service is in the process of acquiring 22,890 acres of private land at Cube Cove. This action will further reduce the amount of private timber available in the future. Since the two State Forests in Southeast are already selling timber at their maximum sustained yield, the only source of additional timber for Sealaska's operations is the Forest Service.

The future volumes of timber from private lands are greatly overstated. And since the timber from these lands is not subject to export restrictions, that timber will not be economically available to the local mills anyway. Instead the private timber will most likely be sold to mills in regions that have economic advantages like proximity to customers, lower energy costs, larger pools of skilled workers and much larger economies of scale and infrastructure.

6. Wood-based energy products are unlikely to be economic, and the utility log projections in scenario-2 are grossly in error.

The Forest Service analysis states that the efforts to promote biomass energy products invalidates the prior demand assumptions – *“Scenario 2 builds upon Scenario 1 by adding markets for wood energy products based on the assumption that 30 percent of existing heating fuel use in Southeast Alaska would be replaced by wood based fuel over time”*. Actually, it is government subsidies that are driving the demand for biomass energy. Without the subsidies, the biomass businesses will likely not be profitable. Further, these subsidies will not affect the demand for wood products; this is another supply cost issue. *“When the government provides a supply-side subsidy to the producers of a product, the supply curve shifts to the right and the demand curve remains the same.”*²

A good example of the false economy associated with biomass energy subsidies is the collapse of the California biomass to energy industry. About half of the facilities that had been operating in California have closed since the ratepayer subsidies ended. Now the biomass industry is seeking a replacement subsidy from the California cap-and-trade program.

The economics of wood-based energy products in SE Alaska are marginal even with the extensive subsidies and incentives that are available from time to time. Planning a business or a

² The Effects of Subsidies on the Supply & Demand Curve by Forest Time, Demand Media, <http://smallbusiness.chron.com/effects-subsidies-supply-demand-curve-33921.html>.

regional economy that relies on continued subsidies and incentives is a very risky decision. Wood-based energy in the interior Alaska makes more sense primarily because of the low moisture content of the timber in that region. The timber supply constraints in Southeast Alaska effectively limit wood-based energy to the sawmill residuals, and most of those residuals are already being utilized. Also, the document states that higher (heating) fuel costs invalidate the prior demand assumptions, but fuel costs in Southeast Alaska have declined over the last year and a half. This assumption is invalid.

The projected utility log harvest for scenario-2 (Table-18) are grossly in error. Utility spruce and hemlock logs comprise only about 15% of the forests in Southeast; adding cedar utility logs might raise that total to 17%, but even at 17% utility it would take a total harvest level of over 500 mmbf to produce the Table-18 projected volume of utility logs. We had that level of harvest for many years and were able to utilize the utility logs and sawmill chips at our local pulp mills and we did so without any subsidy or incentives. A similar scenario based on real economics rather than federal subsidies would be more likely to succeed.

7. Artificial supply constraints do not lower the demand for timber or timber products.

The document states that this revised demand analysis is needed because the Forest Service decided to restrict the supply of old growth timber. This artificial restriction does not reduce the demand, but rather limits the supply. A reduction in supply shifts the supply curve to the left. It is a shift in price that moves demand left or right along a supply curve. Although the restriction of timber supply has forced the closure of several mills, the revised demand analysis assumption that the demand for timber and timber products is less due to the restrictions on the timber supply is plainly incorrect and flies in the face of existing information.

Prior to a Congressional deficit timber sale prohibition, the agency regularly advertised timber sales that were grossly deficit and would have bankrupt any purchaser that made the mistake of purchasing such a timber sale. Consequently, many of those timber sales received no bids. The Earthjustice graph in Figure 1 of the revised demand analysis compares the various Forest Service demand estimates to the volume of timber harvested. This false allegation that the harvest level is declining due to a lack of demand is one of the primary reasons that Congress enacted the prohibition on advertising deficit timber sales.

The revised demand analysis already explains that environmental groups err when they try to equate timber harvest with timber demand. The revised demand analysis attributes the supply constraints to federal budgets and NEPA issues, but fails to acknowledge that Forest Service self-imposed standards and guidelines for its timber sale program have greatly increased the cost of harvesting timber sales. These high costs are the primary reason the agency has been unable to prepare economic timber sales. As a friend once explained, there is a large demand for \$5 cheeseburgers, but not much demand for \$20 cheeseburgers.

As Irland³ explained, *“the future position of the supply curve is far from certain, as it is subject to influence by the Forest Service, the courts, and the Congress. Indeed, the ASQ and the Standards and Guidelines, and the offering area schedule to be set in the TLMP Revision process, will determine the supply curve in many respects not only as to level but as to costs.”* In 2007 for instance, the agency prepared an economic analysis of the pending TLMP revision. That analysis predicted that the agency would be able to prepare economic timber sales from only about 20% of the so-called suitable, available timber in the revised plan. Inexplicably, the agency adopted

³ The Irland Group, 6/23/92, page 12.

the flawed plan anyway, with the result being the enormous reduction in timber sale volume that could be harvested and manufactured profitably. Until the agency makes changes to correct the economic shortcomings in its land management plan, the economic problem will persist. It has nothing to do with demand.

The revised demand analysis section entitled Changes to Alaska's Forest Sector and Table 3 both point out that the surviving mills in Southeast Alaska are operating well below their capacity. The document does not explain that this is due to the constrained timber supply, not a lack of demand. For instance, Viking lumber managers have repeatedly told the Forest Service that they would like to purchase more timber sales because their customers have additional capacity and Viking wants to more fully utilize their mill. By the way, the document mischaracterizes the Viking sawmill as a "large lumber mill." The Viking mill is a mid-size mill. Large mills typically produce in excess of 100 mmbf of lumber annually.

This section of the revised demand analysis also includes a non sequitur remark about potential monopolistic influence of a single surviving sawmill. The Forest Service manages some 85% of the land in the Southeast region and thus has monopoly power of its own. A decision by the Forest Service to halt old growth timber sales before there is sufficient young growth timber to sustain a viable manufacturing industry demonstrates real monopoly power. The only other significant owners of old growth timber are the State and one private landowner. The best way to avoid these issues is for the Forest Service to provide sufficient timber supply to sustain a viable timber manufacturing industry. That was the intent of the TTRA market demand provision.

8. Log export versus local manufacture policies.

The bulk of the federal timber program has long been dedicated to providing year around manufacturing jobs, but there will not be sufficient volume or value in the young growth stands to support small log manufacturing facilities until these young growth stands reach maturity at about age 90. Even the Nature Conservancy's 2009 Transitioning to Young Growth report⁴ acknowledged that that the Forest Service would have to subsidize the logging in order to enable profitable harvesting of 60-year old trees in Southeast Alaska. While exporting some of the young stands to the Pacific Rim might be economic from time to time, that log export activity will not help the industry transition to young growth manufacturing and will actually delay any economically viable transition to a young growth manufacturing industry because it will postpone the date at which young growth stands in Southeast Alaska start reaching maturity.

The current, temporary policy of allowing up to 50% of the federal timber sale volumes to be exported is a Band-Aid that helps compensate for the high logging costs that result from the 2008 TLMP constraints and thus allows local manufacturers to operate profitably and continue to provide year around jobs.

9. National forest log exports from Alaska are not new and they do not lower demand for timber.

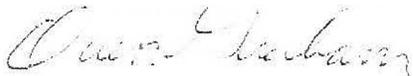
The document states that the entry of Tongass sawlogs into international export markets invalidates prior demand assumptions. Actually, Tongass cedar sawlogs have been sold into international export markets for many decades and from time to time hemlock and spruce

⁴ Transitioning to Young Growth: Prince of Wales Island, Southeast Alaska, The Nature Conservancy Juneau, Alaska, 2009, page 25.

economic analysis of the lands available to support the timber sale program. The analysis indicated that the concerned groups and communities were correct; only about 20% of the suitable, available acres in the plan would support economically viable timber sales. Unfortunately, instead of addressing the issue, the agency adopted the plan with no changes and, as a result, could not implement most of its timber sale plans. Now we find ourselves in a similar situation, but so far the Forest Service has not even looked at the economic impact of its proposed land management plan change. We request that this time the agency perform a credible financial analysis of the proposed plan and then take notice and act upon that analysis. The parties need to discuss this fundamental issue at the upcoming Objection meetings.

If the land management plan is changed to function solely as a small-log wood basket for the Pacific Rim markets, then the plan would no longer match the primary purpose for which the national forest was established – to provide a reliable supply of timber to support local economies. The Forest Service lacks authority to do so, and should not try to foist such an outcome on the stakeholders under the guise of a young growth transition.

Sincerely,

A handwritten signature in cursive script, appearing to read "Owen Graham".

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