ATTORNEY GENERAL'S DRAFT INTERIM REPORT FOR PUBLIC COMMENT RESOLVE, CHAPTER 189

A. Executive Summary.

In April 2008, the 123rd Maine Legislature passed, and Governor John E. Baldacci signed, an emergency Resolve, Chapter 189, to temporarily suspend certain rate-setting procedures for the forest products industry. The suspension expires June 1, 2009.

To ensure reasonable rates of compensation for the many providers of wood harvesting and hauling services in the state, and to assess the impact of Maine Revised Statutes, Title 26, Chapter 18 on these services, the Resolve directed that the Office of the Attorney General conduct a study of the statewide market for forest products harvesting and hauling services.

Since April 2008, staff of the Office of the Attorney General, along with representatives of the Departments of Labor and Conservation and the State Planning Office, examined conditions within the forest products industry to determine what, if any, changes may be necessary to ensure fair competition.[1] The group conducted numerous interviews, reviewed extensive reports and academic material on the forest products industry, and analyzed data collected by the Maine Department of Labor and the Maine Department of Conservation. A summary of our data gathering process is attached as Appendix 1.

The working group's major findings are as follows:

- Over the past 20-30 years, there has been a steady shift away from industrial landowners who employ harvesters and haulers directly, towards landowners who contract with self-employed providers of harvesting and hauling services. Furthermore, the independent contractors engaged by landowners may themselves enter into separate contractual agreements, rather than employment relationships, with those individuals who actually perform harvesting and hauling services.

- The shift has transferred risks and costs from the landowner to the harvesters and haulers. In the past, the costs of health care, disability and workers compensation insurance, and retirement plans were often covered by the landowners. Now, they are the responsibility of the harvesting and hauling contractors and their employees. The risk and expense of equipment and fuel costs have also been shifted to these contractors.

[1] The Office of the Attorney General retained The Irland Group, of Wayne, Maine, to provide consulting services to the state agencies involved in the study.

- While shifting costs to harvesters and haulers as independent contractors, landowners may retain a certain amount of control over various aspects of the harvesting or hauling operations in a manner that is more consistent with an employment relationship at less compensation for services rendered.

- Advances in harvesting technologies have steadily reduced the number of people employed in the industry, replacing labor with capital. While these advances have improved workplace safety and reduced environmental damage, their high cost brings significantly more financial risk to harvesting and hauling contractors and requires more frequent and specialized training for equipment operators.

- Increasing costs have had the expected effect of reducing profitability. Among the results, rates of compensation have reportedly become set by the value of an overloaded truck.

- While facing these rising costs, harvesters are experiencing deteriorating harvesting conditions. Harvesters report that an increase in partial harvesting has reduced per acre harvest volumes, and that average tree size has declined. These changes in operating conditions mean that harvesters must work longer or travel farther to meet their quotas. Fuel, labor, and equipment maintenance costs rise with the additional effort, while yields remain the same.

- Changes in industrial demand for wood have significantly impacted the profitability of the harvesting and hauling industry. Maine's forest products industry has increased its use of low value wood, as evidenced by a significant increase in the harvest of biomass chips.

- Success for harvesters and haulers in an environment of high costs and low equity requires increased business and financial skills.

- There is clear evidence of market concentration among landowners in certain regions of the state. However, due to our inability to obtain rate and other contract information, we were unable to determine whether those levels of concentration result in the landowners paying harvesters and haulers below-market rates.

These evolving market conditions and shifting responsibilities and risks between landowners and harvesting and hauling contractors have created new complexities in assessing the fairness of compensation. As has been discovered in the process of gathering evidence for this study, contract terms and conditions have not been forthcoming and, as a rule, are not transparent.[2] This lack of transparency significantly

[2] The legislation directing the Attorney General to conduct this study did not include the authority to compel information. Thus, we were limited to gathering information on a voluntary basis. While the Attorney General has pre-existing power under state antitrust law (10 M.R.S.A. § 1107) to issue summonses, the Attorney General may only exercise that authority relative to suspected violations of state antitrust laws.

impedes a fair and balanced assessment of how market power is used in setting rates and related contract terms and conditions.

Further compounding the difficulty in assessing and comparing market conditions is the tremendous variability in harvesting conditions and operations, types of equipment used, functions performed, and methods of compensation among contractors and forest landowners. As an example, the recent volatility in energy prices over relatively short time frames, which has presented significant challenges to the financial viability of harvesters and haulers, is not addressed uniformly within contracting relationships. Indeed, it may not be addressed at all under contract terms that are fixed.

This industry is complex and dynamic, and business practices and forest conditions vary across the state. Any compact summary, such as we offer here, will necessary omit details that some may consider important, or make generalizations that have exceptions. Further, we often had to exercise judgment and rely on experience of the working group to develop conclusions where we had conflicting statements from interviewees.

Based upon the findings described above, the working group makes the following recommendations:

- Promote enhanced enforcement of laws that govern the classification of workers. (Misclassification of workers as "independent contractors" when they are actually in employment relationships results in loss of income and benefits to the workers, as well as loss of revenue to the taxing entities.)

- Increase public safety resources, primarily in the form of state commercial vehicle enforcement troopers, to promote more frequent enforcement of highway load limit laws in areas where forest products operations are conducted.

- Provide resources to afford educational opportunities for harvesters and haulers in the business and economics of capital equipment financing and accounting.

B. Changes in Labor Markets for the Harvesting and Hauling Industries.

Technological, demographic, market, and social changes have combined to make the harvesting industry significantly different than it was a generation ago. Gone are the days of chainsaws, lumber camps, and river log drives. Gone, too, are the vertically integrated firms that owned the land, trees, harvesting equipment, and mills, and paid harvesting crews hourly wages, as had been common in many areas of the state.

Today's harvesters and haulers are primarily identified as independent contractors. They are paid for what they produce - by the ton for the harvester, by the mile for the hauler. The challenges of the forest products industry as a whole – globalization, particularly of the pulp and paper sector, rising energy costs, offshore production of value-added products such as furniture, a sharp decline in the housing market, increased competition for forest land from residential and recreational development interests – have acutely affected those in the harvesting and hauling business. These forces present formidable challenges for harvesters and haulers, who are a critical part of the forest products supply chain.

<u>Technological Changes</u>

Increases in technological efficiency and productivity have steadily reduced the number of people employed in the logging industry, while allowing overall harvest levels to remain roughly the same.

- Harvesters with chainsaws and skidders no longer harvest the bulk of Maine's wood; they have been replaced by highly productive feller bunchers, grapple skidders, and cut-to-length harvesting systems that cost $250,000 or more for each piece of equipment.

- While these advances have improved workplace safety and reduced environmental damage, their high cost brings significantly more financial risk to harvesting contractors, and requires more frequent and specialized training of equipment operators.

<u>Changes in the Employment Relationship</u>

In the past 20-30 years, there has been a steady shift away from the common (though by no means exclusive) model of the harvester or hauler as an employee working for a land or mill owner, and towards contracting for harvesting services. Harvesters are now predominantly self-employed, generally getting paid on a contract basis by landowners (under a "Contract for Logging Services" or "CLS"). Moreover, these independent contractors, while hiring workers as employees in some instances, may also contract with individuals themselves rather than actually hire them as employees.

This shift has placed costs traditionally borne by land and mill owners on contractors. To the extent that the costs of health care, workers compensation and disability insurance and retirement plans may have been provided by the employing landowner, these are now the responsibility of the harvesting or hauling contractor. Equipment costs and the burden of making loan payments, even in the event of bad weather or decreased demand, is now on the shoulders of the contractor. Volatility in fuel costs are also borne disproportionately by the contractor.

The result of this change has been a transfer of risk from the landowner to the harvesters and haulers. By itself, this transfer of risk may not necessarily mean lower profits and wages. However, it does mean that success for contractors requires increased business and financial skills and the ability to withstand significant fluctuations in revenues and costs.

Further, there are questions as to whether the landowner/contractor relationship accurately describes the dynamic between landowners and harvesters and haulers in many instances. As discussed above, this is important because a much different set of risks and responsibilities exists for independent contractors, as opposed to those in an employment relationship. Evidence of workers who may be misclassified as independent contractors when they are actually in employment relationships comes anecdotally from harvesters, our own (limited) review of contracts, and previously documented studies (OPLA, 2004). For example, a landowner may actually finance the equipment the contractors must purchase to perform services, with repayment based on the contractors' weekly earnings. Unless and until the equipment is paid off, it is very difficult for the worker to leave the relationship. Moreover, some landowners require contractors to run double shifts. Also, the contractor may have little to no ability to influence the terms of the contract.

Demographic Changes

Maine's logging industry is challenged by the same demographic developments as the Maine economy as a whole, that of an aging population and slow population growth. In the past ten years, the age composition of Maine harvesters and haulers has risen considerably.[3]

- Compared to ten years prior, in 2007 a significantly higher percentage of Maine's harvesting and hauling workforce was age 45 or older (see Figure 1).

- At the same time, the percentage of harvesters and haulers aged 25-34 and 35-44 declined.

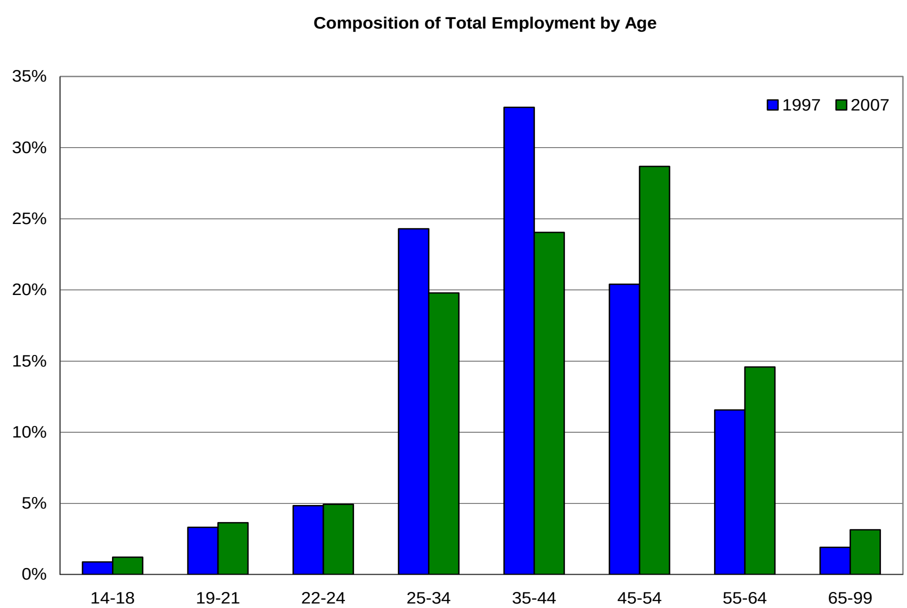

Figure 1

[3] Data was obtained from Local Employment Dynamics, a cooperative program between the State of Maine Department of Labor, Center for Workforce Research and Information and the U.S. Bureau of Census.

- As many of Maine's harvesters and haulers approach retirement age, younger, entry-level workers have not been taking their place.

Social Trends

Trouble recruiting replacement harvesters stems from low wages, long commutes, physically demanding work, and challenging and dangerous working conditions (Egan, 2004). Also, when today's young workers enter the labor force, they may see more alternatives to harvesting than did their predecessors.

- Employment in goods-producing industries such as manufacturing and natural resources has fallen from half of salaried jobs 60 years ago to just 15% today, while jobs in service-providing industries have quadrupled.

- The Maine Department of Labor estimates that 94% of the 48,000 jobs projected to be created from 2004 to 2014 are in service-providing sectors. Forestry and log harvesting/hauling are projected to experience a net loss of jobs.

The Next Generation of Harvesters

All of the forces discussed above are contributing to an erosion of the intergenerational component of harvester recruitment. To illustrate just how critical a role families play in the harvesting workforce, consider that two-thirds of harvesters have relatives in the business and that 62% of Maine harvesters say they log because they came from a logging family (Egan, 2004). This intergenerational supply is at risk. Recent studies indicate that three-fourths of current harvesters would not encourage their children to enter the profession (Goldstein, Irland, 2005, Egan, 2004). Current harvesters whose fathers were also harvesters are even less likely to encourage their children to enter the profession.

Market Changes

Changes in industrial demand for wood, both in total wood processed by sector and types of wood demanded, have significantly impacted the profitability of the harvesting and hauling industries. In the past ten years or so, these changes have been generally towards the processing of more low-value wood.

- Maine paper mill consumption has been falling slowly since 1995 (Figure 2). Pulpwood processing has been volatile due to various mill closures and restarts since about 2000, which have increased the risks borne by harvesters working under a CLS and by haulers. Pulpwood usage is also affected by recycled paper use, which has become a significant part of the fiber mix.

- Total pulpwood use declined by 16% from 1990 to 2006. Consumption rebounded somewhat in 2007, but not to the levels experienced in the 1990s.

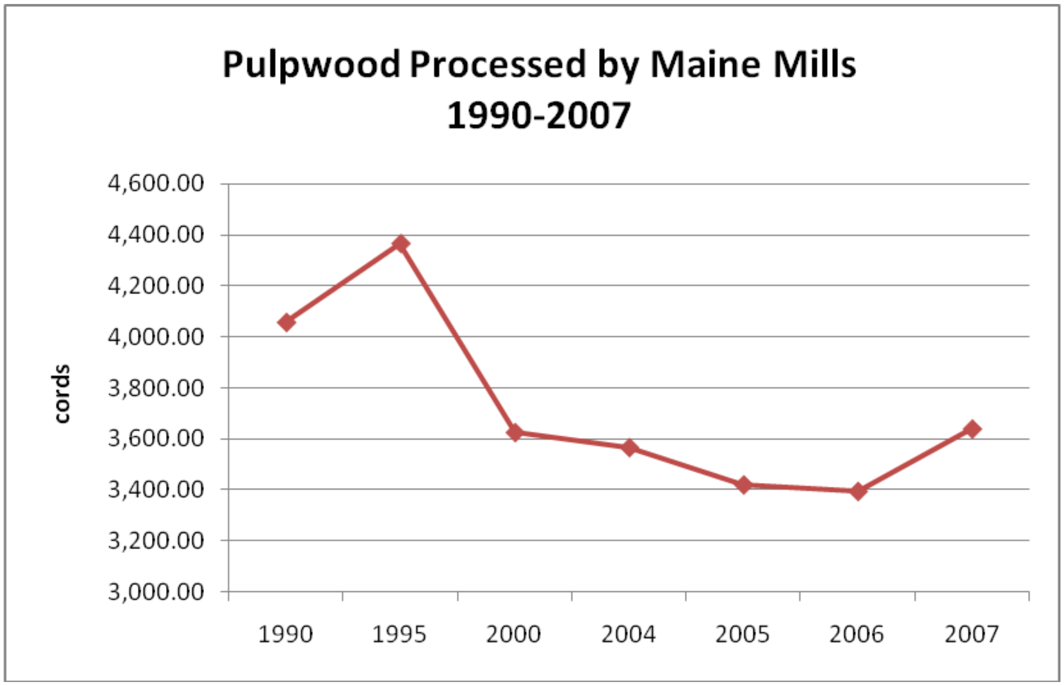

Figure 2

- After a prolonged period of growth, Maine lumber production slipped downward around 2002 following the closure of two major stud mills (Passadumkeag and Costigan) and the near-total loss of the turnery mills. Since sawlogs are a harvester's principal profit source, these losses were a significant blow. The recent closure of the Pinkham sawmill and capacity reductions and temporary closures at other sawmills have exacerbated the situation.

- Perhaps the most significant change in recent years has been the dramatic expansion of biomass markets. The total tonnage of biomass chips processed has tripled since the market bottomed out six years ago (Figure 3). This is an important line of business for the harvesting and hauling sector; however, it provides low profit margins. In the past, biomass was reportedly handled at a loss, which was covered by the margins earned on sawlogs.

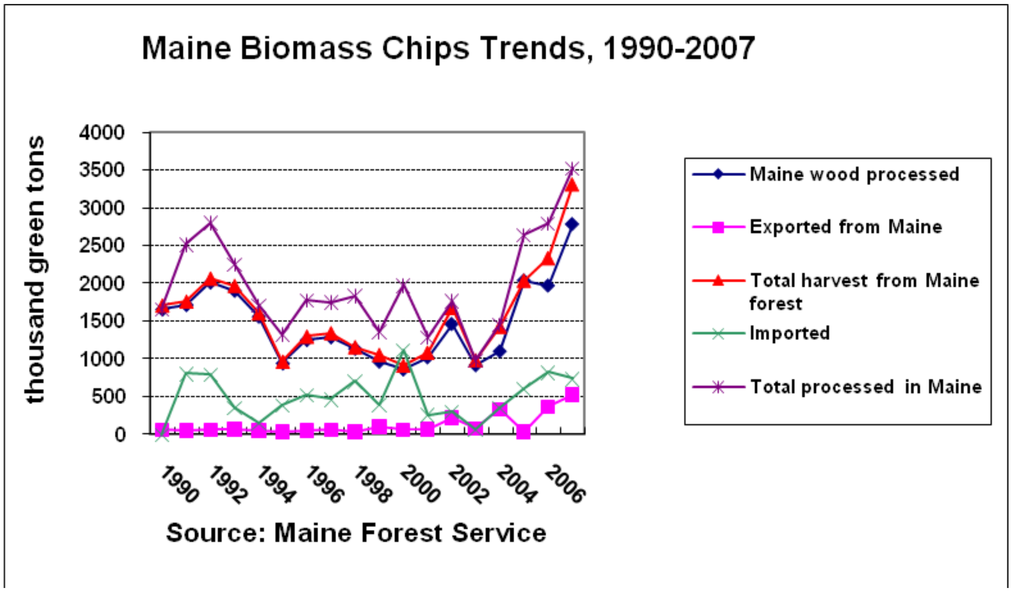

Figure 3

C. Increased Pressures on Logging Harvesters and Haulers.

The major pressures on harvesters today are ever-increasing costs of operation in combination with a decrease in harvesting opportunities (more acres harvested to produce the same volume). These costs adversely affect contractors' profits and the compensation of their employees.

The adverse impact on profitability has also led to frequent violation of state load weight laws. Haulers repeatedly told us that rates of compensation were based on an illegally overloaded truck. They claimed that load compliant haulers were unable to earn enough on each load to cover costs and that overloaded trucks were the norm. They know that comprehensive, continuous enforcement of highway weight limit laws throughout the state's logging areas is impossible due to the shortage of Commercial Vehicle Enforcement resources within the Maine State Police. Many haulers view the risk of getting caught with an overweight load and being fined as a "cost of doing business."

<u>Fuel Costs</u>

The most prominent and contentious single cost category in recent years has been diesel fuel, which costs more in Maine than in other regions. High diesel fuel costs eat away at the bottom line of both harvesting and hauling contractors.

- The rapid increases of the past two years have had major impacts on costs at all levels in the supply chain (Figure 4). Whereas in the past, fluctuations in diesel fuel prices were modest and readily accommodated by six-month contract updates, they now generate major struggles over methods of adjusting payments for fuel costs.

- Further, the risks of high fuel prices seem to be borne predominately by the contractors.[4]

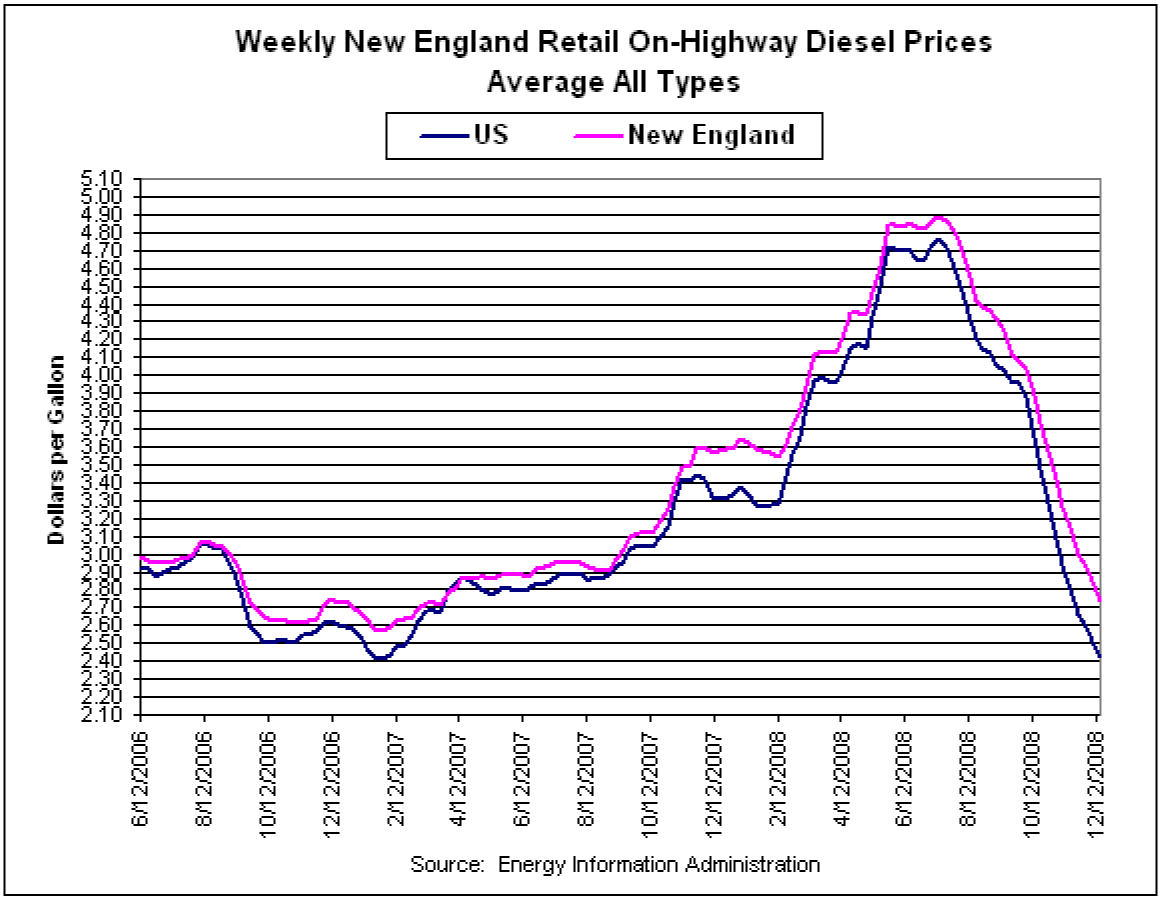

Figure 4

<u>Equipment Costs</u>

The costs of harvesting equipment have risen dramatically in the last 20 years. Both the cost of purchasing and of financing new equipment, as well as replacement items (such as chains and tires), have significantly increased the cost of doing business for harvesters and haulers including the cost of capitalizing a new harvesting or hauling business.

- The high costs of equipment and maintenance reduces efficiency and productivity as it causes many harvesting contractors to operate their equipment past its intended life.

- The high costs of equipment and maintenance also create a barrier to entry to potential new harvesters and haulers.

[4] Not only are adjustments sometimes inadequate to address the full increase in fuel costs, but also there is a lag between the time of the price increase and the adjustments, which results in deficits that may never be fully compensated.

Equipment Cost Trends, 2003 to 2008: Harvesting

EQUIPMENT	Approx. Cost in 2003	Approx. Cost in 2008	Percent Change	Remarks
Grapple skidder	$150,000	$200,000	133%	
set of tires (2)	$2,200	$3,200	145%	New set every year
set of chains	$2,000	$4,500	225%	New set every year
Delimber	$240,000	$340,000	142%	
new boom	$2,200	$4,000	182%	Replace every 3 years
Feller Buncher	$300,000	$400,000	133%	
Forwarder	$300,000	$400,000	133%	16 ton capacity
Processor	$400,000	$550,000	138%	
Loader unit	$135,000	$165,000	122%	Need truck

Source: Equipment dealer interview.

- The intended useful life for major pieces of harvesting equipment is about 4 or 5 years (about 10,000 hours). They should be replaced thereafter. However, due to the high replacement cost, we did not find a single example of an operator who was doing this.

- Many operators are now running machines for 8 to 9 years. Others are using equipment purchased on the used market and already well past normal replacement age, measured either in years or hours.

- Data from the Maine Department of Motor Vehicles point to the same conclusion for haulers.

One consequence of an inability to replace aging equipment is rising maintenance costs. For the individual owner/operator, this usually entails considerable uncompensated time on weekends and evenings, as well as higher losses of revenue due to downtime.

Another consequence is reduced productivity and/or efficiency. Rates for harvesting and contracting services are based on expected performance from up-to-date, efficient machinery. Contractors with older, under-performing equipment are at a distinct disadvantage.

In light of high equipment costs, it is not surprising that down payments in cash are not common, as even 20% down on a $450,000 item would exceed the cash resources of most harvesting and hauling firms. Instead, equipment dealers will often accept a fully owned piece of equipment as collateral in lieu of a down payment.

Succeeding in this environment of high costs and low equity requires increased business and financial skills. At present, there may be insufficient resources to provide assistance to those in the industry in obtaining these skills (see recommendations).

In other capital-intensive industries, return on investment or return on equity are standard criteria for business decisions by both business owners and lending institutions. Surprisingly, this does not seem to be the case in the harvesting industry. Instead, the focus is on "debt service coverage," measured as a ratio between the net revenue a piece of equipment produces and the debt service amount, plus pro-rated owner compensation. Under the latter approach, it is difficult to plan for future capital needs.

<u>Reduced Harvesting Opportunities</u>

In addition to the rising costs harvesters are facing, deteriorating harvesting opportunities put further negative pressure on contactors' bottom lines, in essence adding a further cost to the mix. The increased emphasis on partial harvesting, coupled with a reported decline in average log size mean harvesters have to travel farther or work longer to meet their quotas. Fuel, labor, and equipment maintenance costs rise with the additional effort, while marketable product remains the same.

- Compared to the 1980s and early 1990s, when 20 cords or more per acre were harvested, the trend toward partial harvesting and the reported decline in log size has reduced the harvest per acre.

- Further, several landowners and close observers of the industry suggest that the available timber on the land is growing scarcer. They cite instances of harvesting contractors scouring the landscape to fill contracts, and of large landowners reducing their annual harvests due to increasing scarcity of merchantable stands.

- Several sources in the northern part of the state told us that owners are cutting in more remote corners, sometimes in streamside buffers, and squeezing out remaining bits of biomass to maintain revenues.

- One harvester we interviewed said that he used to get an average of 400 cords per week. Now, he reports, he is lucky to get 300.

Log size is a key component of a "cutting chance" (*i.e.*, yield within a certain area – a good chance can be harvested quickly and easily). For example, cutting 1,000 trees that are 10 inches in diameter yields 100 cords of wood. If the trees are just 7 inches in diameter then the yield is just 50 to 60 cords. While costs remain roughly the same, this is almost a 50% reduction in production. This trend is not reflected in rates. One interviewee stated: "We used to be able to work 55 hours; now we must go 65 hours to get the same amount of wood."

Such reports were not universal, however. Some owners told us this is not happening in their areas. This could be due to regional differences within the state. For example, in southern Maine, merchantable wood has always been hard to source for harvesters and mills but this has been due more to lack of landowner interest in harvesting and parcelization than to any shrinkage in the resource. The Maine Forest Service reports that on a statewide average, new growth is about equal to harvests, but clearly there are regional variations affecting this dynamic. Further, owners who dispute the claim that harvesting opportunities have declined may be speaking of recent years, whereas others are implicitly comparing present conditions to 20 years ago.

To evaluate the extent of declining harvesting opportunities, we asked for long-term trends in such items as skidding distances and removal per acre, but have not been able to obtain sufficient comparable data on these.

D. Competitive Market Considerations.

Economic theory predicts that in concentrated markets, firms may possess "market power"[5] enabling them to influence prices in ways that could not be done in a perfectly competitive market. Objectively evaluating the level of competition, or lack thereof, in the log harvesting and hauling markets statewide proved an insurmountable task, given the limited information we were able to collect and our time constraints. Tight control of information by all market participants is a considerable impediment to determining the presence of market power. We asked for, but were unable to obtain, consistent information on harvesting and hauling contracts and compensation. With limited exceptions, neither harvesters, haulers, nor landowners were willing to reveal this information. More time to complete this study may have enabled us to gather more objective data, although the resistance may have yet been impossible to overcome.

In the harvesting and hauling industry, market power may be derived from two sources: 1) geography, where landowners who own large tracts of land in a region may be able to reduce compensation rates for harvesting services because harvesters wishing to work in the region have limited options for other land to cut; and 2) control of critical information, where the lack of transparency related to contracts provides an uneven playing field for harvesters, haulers and landowners. In addition to making our job of assessing market power difficult, the absence of objective data within this industry is itself a potential source of market influence for those with the most information. We were, at least, able to gain helpful insight into the general level of concentration of landownership in geographic regions of the state, as is discussed below. While helpful in evaluating concentration, it is not enough for a complete economic analysis.

[5] Since we understand that the purpose of the Resolve is to study competition and market power of landowners, and the relationship of any such market power to rates of compensation for harvesters and haulers, we limit our discussion to that dimension of the industry. We do not address competition among contractors or among mills and other buyers.

E. Specific Issues Raised in the Resolve.

The Office of the Attorney General was tasked in Resolve, Chapter 189, to study the following issues on a statewide basis:

1. **Issues of market concentration and horizontal market power.**

While land concentration is fairly straightforward to measure, market power in this industry is much more difficult to measure. In addition to the gaps in data and the general lack of transparency, there are several additional reasons for this.

- The different layers of compensation within the forest products industry – payments from mill owners to landowners, payments from landowners to contractors, and payments from contractors to employees – confound the issue.

- The difficulty in assessing a return appropriate to the risks of owning very expensive pieces of equipment makes assessing what constitutes "fair" compensation very challenging.

- Further complicating the assessment of fair rates and whether market power is present are the difficulties in comparing different types of contracts between landowners and contractors. For example, some include road building and/or snowplowing while others do not.

- The product being sold by landowners is not a uniform commodity. It is a series of differentiated products, varying by species and grade.

We did find evidence of market concentration among some landowners who contract with harvesters and haulers.

- In the Presque Isle Labor Market Area (LMA), which encompasses most of Aroostook County,[6] the largest owner controls 34% and, collectively, the top three owners control 64% of the land.

- In the Skowhegan LMA, the largest owner owns 28% of the land base, and the cumulative share of the top three owners is 54%.

- In the Calais LMA, the largest owner controls 34% of the land, the same as the largest owner in the Presque Isle LMA. The top three owners together control 50% of the timberland.

- In the Rumford LMA, the largest owner holds 19%, and the combined share of the top three is 48%.

[6] The Presque Isle LMA includes Fort Kent to the north, extends west to the Canadian border and reaches south almost to Houlton.

- Several markets show shares of the top three between 22% and 36 %: Dover-Foxcroft, Millinocket, Ellsworth and Farmington.

However, based upon a review of Department of Labor wage data, evidence of compensation below market rates is not readily apparent.

- In all five Rim Counties (Somerset, Aroostook, Washington, Oxford, Franklin) plus Piscataquis, average harvesting wages (for employees) were at or slightly above the county average for wages in all industries. (It is important to note that the DOL wage data compiles wages of *employees.* Compensation of *contractors* could not be evaluated.)

- A comparison of harvesting wages for counties with concentrated land ownership to those in unconcentrated counties was inconclusive.

- Also inconclusive was a comparison of harvesting wages to those of operating engineers, an occupation requiring similar levels of skills and education as harvesters, but external to the forest products industry. If market power is present, we would expect operating engineers to be paid more than their harvesting counterparts.

Thus, the existence of concentrated land ownership does not necessarily translate to market power. While our review of wage data was inconclusive, anecdotes from harvesters that some landowners are using market power to present "take it or leave it" contracts and pay below market compensation are well-documented (OPLA, 2004). As the discussions above illustrate, compensation is unquestionably low enough to present formidable challenges to the viability and solvency of many harvesting and hauling firms. However, we were not able to determine whether this is a result of market power.

2. Issues of vertical market power arising from integrated ownership or control of hauling, harvesting and other related assets.

Integration at the landowner to mill level is now almost gone in Maine.[7] In the past, a single entity generally owned the land, mills and labor force. Today, due to extensive industry land sales, this type of vertical integration is the exception and no longer the rule. Landowners are purchasing labor and selling to mills. The primary vestige of the old vertically integrated patterns is in the pulpwood markets, where longterm wood supply agreements between the old mill landowners and the new landowners preserve a link between the producer of the natural resource and the purchaser of the resource. It is difficult to see how that link confers on the mills market power that negatively impacts harvesting compensation.

The last remaining integrated landowner exists in northern Maine, but the extent to which market power flows from that integration is not entirely clear. In the present market, where hardwood pulpwood is selling at such high prices, it would seem that an advantage may exist

[7] This history has been exhaustively analyzed and is not repeated here (Hagan, Irland, and Whitman, 2006; Irland and Lutz, 2008).

at the mill level – the company as mill owner is able to retain the high earnings rather than pay a different landowner for the enhanced value of the wood. At the landowner and harvesting and hauling levels, however, they are similarly situated to others in the same level of distribution. Thus, any advantage is vis a vis other mills.

Similarly, integration at the landowner to labor level has decreased dramatically in Maine. With limited exceptions, those who own the land contract with harvesters and haulers (as opposed to employing them outright). Some contractors, with the resources and foresight to diversify their operations in recent years, have purchased their own land, affording them opportunities to harvest their own wood to sell when it makes business-sense to do so. These contractors, generally larger and well-established, have been in a much better position to weather the recent storms of escalating costs. Their size, coupled with the ability to harvest their own wood, in some instances has afforded a certain degree of success in bargaining with landowners that small independent contractors have been unable to achieve.

3. The existence of barriers to entry into the harvesting and hauling industry, including required capitalization.

A barrier to entry is any condition that limits the ability of new firms to enter and compete in an industry. The principal barriers to entry for harvesters and haulers today are the availability of capital to finance equipment, and the ability to obtain contracts to cut or haul wood.

The dramatic rise in the costs of equipment and maintenance, as detailed above, explains, in part, why few newcomers are joining the ranks of harvesters and haulers. Not only do would-be harvesters require substantial financial resources, they also need expertise in business accounting and finance, an increasingly indispensable skill in the industry.

Further, since stumpage contracts (where harvesters purchase the wood they cut, as opposed to simply performing services to landowners who themselves sell the products) have become less available, and harvesters are no longer employed by the large mills, they are more dependent on contracts with large landowners. Larger, high-tech equipment has made operations less mobile and harvesters are less willing to travel long distances. The result of these dynamics is that successful harvesting operations have relatively few contracts, but each contract generally involves large volumes. It is difficult for a newcomer to obtain sufficiently large contracts.

4. The extent to which imbalances of supply and demand create opportunities for the unreasonable exercise of market power.

There are different views of the balance in the market for **harvesting** capacity. Some of the demand fundamentals, noted above, are pulling in different directions. On balance, however, we believe that the supply of harvesters and log haulers has continued to decline. (OPLA, 2004). We heard from landowners that it is harder to find good contractors, and we heard from contractors that it is harder to find good labor. This is consistent with well-documented and persistent reports that fewer people are embracing harvesting as a career. There are also different views of the **hauling** market -- some operators tell us that there is a shortage of hauling capacity in the woods, but a surplus in the over the highway business.

Imbalances of supply and demand can exist at any level of the market. Today, production levels for lumber, pulp, and paper, are down from several years ago, a situation likely to create excess capacity. Yet, there is now an extraordinary level of demand for **hardwood pulpwood** due to world pulp market conditions. The demand is at the limit of what the resource can produce in the short term, and of what the supply chain can harvest and deliver. If the mills buying this product possess market power, it does not appear to be doing them much good. They have been forced to pay ever-rising prices to meet their needs, and also to haul wood over longer distances.

In the market for **spruce fir logs**, however, declining lumber prices have driven delivered log prices down. We do not know to what extent the level of harvest has responded during the current year, but it did decline from 2006 to 2007 statewide. This decline in demand has the potential to increase landowner bargaining power over harvesting rates, because it creates excess harvesting capacity. On the other hand, it also cuts landowner gross revenues.

The markets for low-value, bulky products going into the **wood fuels** market have been strong, in both volumes and prices. Production was up significantly in 2007, and will probably increase more into 2008.[8] Rising fuel prices, however, have well offset any contribution increased prices or volumes may have otherwise had on haulers' or harvesters' bottom lines.

Without much more detailed data, it would be impossible to say whether any recent trends in supply and demand have enabled landowners or any other market participants to exercise market power. It does seem clear, however, that any shortage in harvesting capacity within the state has not translated into market power for harvesters and log haulers. While anecdotes suggest that the largest contractors have been able to maintain the financial health of their businesses (*e.g.,* by achieving substantial protection from rising fuel costs), contractors overall, and independent owner-operators in particular, have not enjoyed enhanced bargaining power.

5. The advantages and disadvantages of altering the current market system in the harvesting and hauling of forest products.

The entire woods industry in Maine is struggling in the face of pressures from the global market. The landowners, mills, harvesters and haulers are highly dependent on one another to make a living. Any change in the market that effects one category will necessary have a large impact on the others.

Some believe that the state is growing the same amount of wood as it harvests each year. Others believe the woods have been cut hard. Either way, there seems to be lower product

[8] 2008 data will not be available to the Maine Forest Service until early next year.

value coming out of the woods. The prices are no longer being driven by the pulpwood industry as in the days of the large mills. Markets for new products such as biomass do not pay as much. Biomass harvesting will not employ as many people and it is a lower value product. This situation affects everyone's bottom line.

The reality is that the mills, landowners, harvesters and haulers are tied together in a common fate. Our interviews indicate that they all well recognize their interdependence. Any external influence on market forces, such as legislative action, must be undertaken with extreme care to ensure the longterm viability of the industry as a whole. Smaller, incremental changes would likely prove more successful than a major alteration to the current market system in this fragile industry.

6. The approaches taken in other states to address similar issues.

Recent legislative initiatives have been proposed in the States of both Washington and Oregon that reflect different state regulatory approaches to counterbalance perceived market power in the forest products industry. In both instances, the pending legislation addresses log hauling only, not harvesting. Both states' bills are currently still in committee.

Legislation pending in the Washington State Senate would allow the state Utilities and Transportation Commission, in conjunction with the Northwest Log Truckers Cooperative, to establish advisory rates for log haulers, applicable to landowners owning at least 100,000 acres. A similar house bill would authorize the state's Department of Labor and Industries to establish intrastate compensation rates for log haulers when petitioned by landowners above 100,000 acres in size or qualified unions or cooperative associations (representing at least 50 haulers in a LMA).

The Oregon legislation similarly would authorize the Commissioner of the Bureau of Labor and Industries to establish intrastate compensation rates for log haulers when petitioned by landowners controlling 100,000 acres in a LMA or qualified unions or cooperative associations representing at least 50 haulers in a LMA. Landowners and individual haulers may contract outside of this system, as long as payment is higher than the applicable rate and there are no rates in effect for those parties.

7. The statewide market for such services.

In Maine, there is no statewide market for harvesting or log hauling services. There are, instead, regional markets. The areas where a harvesting contractor or log hauler can effectively work are circumscribed by travel distances (i.e., distance from worksite to their residences and the residences of their employees.) A number of surveys show that workers are not interested in working out of camps or commuting more than 45 or 50 minutes one way to the worksite.

There are regional differences within the state. In **Northern Maine,** Aroostook County alone accounts for 34% of the Maine sawlogs processed in Maine, and 19% of total wood production. Its share of pulpwood is lower as the area is remote from most Maine pulp mills.

The four northernmost counties together account for 61% of all wood processed in Maine in 2007. This is clearly the reason for the concentration of harvesting capacity in this region; it also explains why northern Maine is often the focal point of controversy within the industry. **Southern Maine**, from a line roughly West Paris – Bangor – and then south along the Penobscot River, is characterized by small landownerships and correspondingly small harvesters, often solo workers who work alone in the woods. In this region, there are many highly mechanized machines running, but not typically in the large "systems" as used in the North. Harvesters are often stumpage buyers. **Eastern Maine** is a region with a limited number of sawmills and paper mills competing for wood, characterized by a heavily cut resource and a small workforce. **Western Maine**, including the Jackman region, as well as the entire zone spreading west of Moosehead Lake and up to Fort Kent, is the area in which Canadian contractors and workers have historically been prominent and much of the sawlog harvest is hauled to Canadian mills, exclusively over woods roads.

8. Utility of Title 26, chapter 18, Rates of Compensation for Forest Products Harvesting and Hauling Services.

As of the date of this report, no forestry rate determination proceedings have been held under Maine Revised Statutes, Title 26, chapter 18, as enacted by the 123rd Legislature in 2003. In fact, since the law's enactment, not a single request for a rate determination proceeding has been filed. We cannot be certain why this is. While it may be that the situation has improved in the eyes of harvesters, haulers and landowners, it may also be that would-be petitioners see the law as impracticable because of the data that is required for a petition or because of the time that a rate determination proceeding would require.

As has been stated, all participants in the forest products industry are very reticent to share rate information. This may come from a desire to keep information confidential for purposes of bargaining, or it may be from fear of being labeled a troublemaker in the industry. Further, the length of time from petition to decision interjects uncertainty into a time-sensitive industry.

The utility of the rate determination process in Maine Revised Statutes, Title 26, chapter 18 may appear to be questionable; however, due to our inability to obtain and analyze industry rate and other contract information, we were unable to draw any definitive conclusions about the statute's actual utility.

F. Recommendations.

1. Promote better enforcement of existing laws.

We recommend adoption of mechanisms to ensure better enforcement of existing laws.

a. Labor laws.

Enhanced enforcement of laws governing worker classification could reveal that many workers currently identified as "independent contractors" are, in actuality, working in employment relationships. A number of these contractors appear to be virtually indistinguishable from employees. The "classification" of workers and equipment owners as subcontractors instead of employees is an ongoing public policy issue in many industries. Misclassification of workers in an employment relationship as independent contractors results not only in loss of income and benefits to the worker, but also in loss of income to the taxing entities. Moreover, misclassification also results in an uneven competitive environment. Businesses that classify workers correctly, and therefore pay higher costs for labor, are competing against businesses that misclassify workers and avoid costs associated with having workers on their payrolls. Enhanced enforcement of existing classification laws could provide more equitable compensation for some harvesters and haulers presently providing services as independent contractors.

b. Highway weight limits.

We were told repeatedly that the rates of compensation for log hauling are set by the value of an illegally overloaded truck. Haulers believe that this is the only way to make a profit and that compliance with load limit laws is untenable and unrealistic. Haulers know that, due to the scarcity of State Police commercial vehicle inspection resources, State Police enforcement of weight laws is extremely limited. Comprehensive and continuous enforcement of weight laws should ultimately help to raise the rates paid to haulers, as well as improve the safety of Maine roads. Additionally, the number of overweight trucks would be reduced if mills would only accept and pay for legal weight loads.[9] Finally, more frequent inspection and certification of mill truck scales and their operation should help increase weight accuracy.

2. Education.

Our interviews suggest that business expertise is a key factor in the ability of a harvesting or hauling contractor or owner/operator to bargain effectively and achieve longterm success in the industry. We are convinced that the economic challenges facing contractors, such as equipment loan payments and payroll expenses, leave them disproportionately impacted by changes in the global supply and demand for wood. We strongly recommend that harvesters and haulers be provided opportunities for education in the business and economics of capital equipment financing and accounting.

[9] Mills weigh trucks before and after unloading. They pay based on the weight of the load. If mills limited payment to the weight of a legal load, haulers would have no incentive to overload their trucks.

APPENDIX 1

Methodology of Study

The Attorney General assembled a working group consisting of two Assistant Attorneys General, and representatives from the Maine State Planning Office, the Maine Department of Labor, the Maine Forest Service and the Governor's Office. The Attorney General retained The Irland Group, a Maine consulting firm with considerable experience in forest products industry analysis that previously assisted in preparing the Pan Atlantic Report (1999), which exhaustively reviewed woods labor issues for the Department of Labor. Collectively, we conducted confidential interviews with roughly 50 individuals working in all aspects of the forest products industry, including forest landowners, forest products harvesters, forest products haulers, trade associations representing the interests of these groups, harvesting equipment dealers and financers, as well as private consultants, and former and present state employees with extensive knowledge of the history and workings of this sector of the Maine economy. We assembled state, federal, and private data and literature, and analyzed the information through the prism of microeconomic theories dealing with concentrated markets, as well as relying on practical experience. We distributed questionnaires to forest landowners and forest products harvesters and haulers, soliciting detailed data on phases of work performed, for whom, products harvested, volumes, rates of compensation, to whom the products are sold, how many workers within firms, whether workers are employees or contractors, productivity measures, terms of contracts and equipment expenses. Despite multiple requests, we received completed surveys from only three harvesters, two haulers and one landowner, an insufficient sample of actual data on rates and prices to support a meaningful statistical analysis.