

# Credit System Concerns

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***Prepared by the Sierra Club Forest Certification Committee***

***Highlighted text below written by Scientific Certification Systems***

FSC's Credit System is playing out in ways that challenge the integrity of the FSC system and could result in damage to the FSC brand. The problems are rooted in vague language in the FSC Standard for CoC Certification (FSC-STD-40-004 v. 2-0) and in varying and inconsistent interpretations and application of the Standard on the part of Certification Bodies (CBs).

## **BACKGROUND**

The FSC Credit System is an accounting framework used to track the FSC certified and post-consumer reclaimed material that a company (operating against FSC-STD-40-004) has purchased as well as the FSC products the company has labeled or sold; credit material purchased and FSC products labeled or sold are tracked by each company-defined 'FSC product group'. A company accumulates credits for its account by purchasing FSC Pure, FSC Mixed, FSC Recycled and verified post-consumer reclaimed material and it withdraws credits from the account when it labels or sells products with an FSC claim. A company can sell only as much product with an FSC certified claim as it has credits in its account to do so (by weight or volume). Credits cannot be transferred across product groups so credits must be withdrawn by the product groups associated with each constituent material used in the product; no product group-specific credit balance can be negative. Any non-FSC credit wood/wood fiber (e.g., uncertified virgin wood or pre-consumer reclaimed wood) used in a product carrying a FSC claim must meet FSC Controlled Wood requirements.

Depending on how a company defines its FSC product groups, credit systems can have a very significant impact on the availability of FSC product in the market place and the associated demand for FSC certification of forests and wood products they yield. The current requirement regarding FSC product groups for credit systems are as follows:

Product Group is defined as: A product or group of products specified by the organization, which share basic input and output characteristics and thus can be combined for the purpose of FSC Chain of Custody control, percentage calculations and labeling according to the FSC material categories: FSC Pure, FSC Mixed, FSC Recycled or FSC Controlled Wood.

(2.1.3) For product groups where a credit system is used, the organization shall ensure that all included products share similar specifications in relation to:

- a) quality of inputs,
- b) conversion factors.

Currently, certification bodies are interpreting the Credit System product group requirements differently. This has created an uneven playing field for competing chain of custody certificate holders. Companies that have been approved to combine or substitute species, grades or dimensions, or to include several product lines in a single product group, have a competitive advantage over those that have not.

## **EXAMPLES - MANUFACTURERS**

A few examples of how varying interpretations of “quality of inputs” and “conversion factors” impact the quantity of FSC products on the market will highlight the current threats to the credibility of the FSC chain of custody system:

What does “quality of inputs” mean?

**EXAMPLE # 1:** A mill has a single credit account for high quality hardwood lumber including walnut and cherry. The company purchases walnut logs as FSC Controlled Wood (never as FSC certified), and purchases cherry logs sometimes as FSC certified and otherwise as FSC Controlled Wood. The company considers walnut and cherry logs to “share similar specification in relation to quality of input” and the conversion factor of turning logs to lumber for each of these species is also similar. The company accumulates credit in its hardwood lumber credit account for the volume of FSC certified cherry it purchases, and then sells walnut and cherry lumber as FSC certified upon customer request, up to the available credit.

**EXAMPLE #2:** A large furniture manufacturer with dozens of lines of furniture, including low-end lines that are primarily MDF/plastic laminate and high-end lines that are mostly high-grade hardwood but contain small amounts of MDF, establishes a Product Group and an associated Credit Account for “Office Furniture containing MDF.” FSC-certified MDF is readily available and the company purchases large quantities and builds a

lot of credit in its account -- based on the weight and/or volume of all FSC MDF received into the factory. The company then uses the available credit to fill multiple orders for large quantities of the high-end hardwood furniture for various LEED projects. Because the furniture is FSC Mixed Credit, 100% of the value counts toward achieving the LEED Certified Wood credit -- even though the furniture is mostly high-quality hardwood (Controlled Wood) and the FSC MDF constitutes a tiny fraction of the cost of the wood used.

EXAMPLE #3: An engineered wood flooring manufacturer makes flooring where the wear layer (the part you see and walk on) always represents 25% of the product by volume and is all Controlled high-grade North American oak, cherry, or maple, and the platform or substrate makes up the remaining 75% and is all FSC Pure low-grade plantation pine. The flooring manufacturer can sell up to 75% of their ongoing output as FSC Mixed Credit - regardless of the wear layer species, and irrespective of the fact that the cost of the pine is a fraction of the cost of the high-grade hardwoods used in the wear layers. They can accumulate unused credit in their FSC credit account for up to 12 months and apply it when it suits them.

In this scenario, a large flooring mill in, say, China could manufacture 1,000,000 square meters of flooring a year, then export up to 750,000 sq. m. of relatively high-grade oak, cherry and maple to Europe and North America where there is a market preference for FSC, and dump the remaining 250,000 sq. m. of the lowest grade flooring that accumulates into the Chinese market that doesn't care about FSC and wants only the least expensive product. Or, if the mill has a particularly large ongoing demand for FSC-certified maple and cherry in Europe, then it could sell all of the oak as non-FSC in the Chinese market, and concentrate its FSC credits on maple and cherry for the export market. All this because the mill consumes a lot of low-cost, low-grade FSC-certified pine in my production. Once this practice becomes widespread, flooring mills that operate under Control Systems other than the Credit System will find themselves under competitive pressure to adopt similar practices. Mills that make FSC Pure products under the Transfer System will likely find themselves priced out of the market unless over time the market expresses a preference for FSC Pure.

***The key question that underlies all of the above examples is what attributes define "quality" and thus which products can be included in the same credit account, allowing the products to be bought and sold interchangeably.***

**What does "conversion factor" mean?**

Company A converts logs to lumber using a simple conversion factor of 80% (20% waste) so its log credits are all allocated to a single product group: lumber (e.g. 1500 bd. ft. logs = 1200 bd. ft. lumber). In practice, however, the company makes various grades and dimensions of lumber from each log.

Company B uses a conversion factor that takes into account waste as well as the varying grades and dimensions of lumber that a log produces. This company's log credits are allocated to 3 different product groups: high, medium and low grade lumber (e.g. 1500 bd. Ft. logs = 1200 bd. ft. lumber: 200 high grade, 700 medium grade, and 300 low grade).

The manner by which conversion factors are applied significantly impacts the quantity of FSC certified output available for each product specification. In the above example, Company A has the flexibility to apply its credits from the purchase of FSC certified logs to those products which its customer requests as FSC certified. Company A may apply all of its credit for FSC certified logs to its highest grade of lumber, even though the available quantity of FSC certified logs may not be sufficient to produce the desired amount of highest grade lumber. To meet the demand, Company A is, in effect, transferring low grade credits to the sale of high grade FSC-certified product. Company B has allocated credit to 3 different grades of lumber, which more accurately reflects the availability of product based on available input. If Company B takes a large order for a single grade of lumber, it will require more FSC certified logs to fill the order than Company A will need, and thus drive greater demand for FSC logs. Further, Company B is clearly operating at a competitive disadvantage relative to Company A.

## **EXAMPLES - DISTRIBUTORS**

Practices and problems similar to those in the examples above can occur at the distribution level as well as at the manufacturing level, since distributors of products that are not “finished product” – defined in 40-004 as “product that requires no further transformation in terms of processing or packaging prior to its intended use” – can also operate credit systems

EXAMPLE #1: If construction lumber is not considered a “finished product” (and it is not by most Certification Bodies), then a distributor can establish a Product Group and associated Credit Account for “Construction lumber” and then build credit by buying low-grade green hem/fir 2x4s at a low price and apply the credits to high-grade KD Douglas fir 6x6s at a high price.

EXAMPLE #2: A large wholesale hardwood distributor sets up under the Credit System, establishing a Credit Account for “maple lumber.” The distributor buys

and concentrates large quantities of *hard and soft* maple<sup>1</sup> lumber in a variety of grades and thicknesses, both green and kiln-dried. They operate dry kilns and sort and regrade lumber according to their customers' preferences. Now, suppose this distributor has a significant source of FSC-certified green soft maple lumber (less expensive), good access to Controlled wood hard maple (more expensive), and they concentrate on building credits in their maple Credit Account by purchasing the cheapest FSC material available to them, e.g. #2 common 4/4 green soft maple lumber. Suppose further that they have a guitar manufacturing customer that requires hard maple lumber that has been extensively sorted so that only the whitest material is provided; that is thick and wide, e.g. 12/4, 8" and wider; and that is kiln-dried to a specific moisture content. The distributor uses the credits accumulated in its maple credit account on the basis of cheap, low-grade soft maple to service the customer, selling them what they want, when they want it in expensive, high-grade hard maple as FSC Mixed Credit. In this scenario, they purchase FSC inputs at a small fraction of the value of the FSC outputs that they sell, and they do not have to wait for FSC Pure material to go through dry-kilns or bother with segregating or storing FSC Pure inventories.

Finally, a very significant problem that is beginning to crop up at the distribution level is that credits are being used to sell SFI-certified and labeled product as FSC Mixed Credit. The FSC CoC standard expressly prohibits this practice (FSC-STD-40-004 v. 2-0, 6.2.2 "The organization shall ensure that products sold with an FSC claim do not carry any labels from other forestry conformity assessment schemes."), and yet inadequate policing by CBs and the increase in SFI-labeled product in the marketplace make it a current problem and one that will likely grow if it is not addressed.

## **WHY DO THESE PRACTICES POSE A THREAT TO FSC?**

There are several reasons that these practices threaten the integrity and credibility of FSC and pose risk to the FSC brand.

The practice of "upgrading" or "substitution" at the manufacturing level appears to be increasingly widespread and confers a substantial competitive advantage to those who practice it. Specifically, it will tend to provide companies with a price advantage over companies making products under other control systems, i.e. particularly FSC Pure products made under the Transfer System. If this is true, then over time fewer and fewer manufacturers are likely to use the Transfer system, which means that FSC Pure products will become increasingly rare and expensive. And yet, FSC Pure products are the only products that we can actually guarantee as coming from FSC-certified forests. Allowing a continuing

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<sup>1</sup> two different species that have very different economic value and characteristics, and yet the Credit System as currently interpreted allows them to be used interchangeably

and unfair competitive advantage for FSC Mixed Credit over FSC Pure products threatens to eliminate the direct connection between FSC certified/labeled products and certified well-managed forests.

Another important reason that the practice of upgrading harms FSC is that it breeds cynicism among the manufacturers and distributors who figure out how to “game” the system to their advantage. It opens up a substantial gap between what FSC professes to stand for and how FSC plays out “in the real world.”

Finally, the increasingly common use of the Credit System in combination with the weaknesses of FSC Controlled Wood virtually guarantees that the FSC label will be associated with some of the most controversial forest practices occurring in North America today. With limited exceptions, wood from virtually anywhere in the U.S. and Canada can be controlled per the Controlled Wood standard (FSC-STD-40-005). This includes wood from SFI-certified forest operations whose practices are most strongly criticized by ENGOs. The arguments that are used to attack the credibility of SFI could be turned on FSC, especially where the Credit System makes it easy for SFI-certified products to go to market under the FSC Mix label.