

J. NOUAI R I



**COMMISSION OF INQUIRY INTO
ASPECTS OF THE FORESTRY INDUSTRY**

INTERIM REPORT NO 3

**THE FOREST INDUSTRIES COUNCIL
AS THE STATE MARKETING AUTHORITY**

VOLUME 1

November 1988



COMMISSION OF INQUIRY INTO ASPECTS OF THE FOREST INDUSTRY

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PAPUA NEW GUINEA

The Rt Hon Rabbie Namaliu CMG, MP
Prime Minister
National Parliament
WAIGANI

DATE: 30th November 1988

OUR REF:

YOUR REF:

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My Dear Prime Minister

THIRD INTERIM REPORT

I have the honour to present the Commission's third interim Report. It covers all aspects of my Terms of Reference covering the State Marketing operations of the Forest Industries Council.

Yours faithfully

T E BARNETT OBE
Commissioner

**COMMISSION OF INQUIRY INTO ASPECTS
OF THE
FOREST INDUSTRY**

INTERIM REPORT NO. 3

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I hope that such materials including the detailed analysis of each shipment, will prove useful for whatever authority has the responsibility for State Marketing of timber in future. It should also be a useful guide to methodology for whatever body is given responsibility to audit and supervise the activities of that authority.

Other "raw" data collected together for the purpose of this inquiry and the Commission's own working notes and tables will be placed in the Government Archives.

The main text of the Report is, after a brief introduction, divided into five sections as follows:

SECTION 1: History of FIC Involvement in State Marketing

Here, I have attempted to set down briefly in chronological order how the concept of State involvement in log marketing was approved in 1979 but not implemented until 1985 when the National Executive Council (NEC) decided that FIC would be the State Marketing Authority. Although steps towards implementing the NEC decision were laid down culminating in a formal agreement, the FIC commenced marketing before that formal agreement with NEC was reached. Without government or legal authority it then made 15 shipments between October 1986 and March 1987 to India, Taiwan, Japan and (mostly) to Korea. (No agreement between FIC and NEC was ever concluded).

What happened in these various markets is outlined as an introduction to the detailed shipment by shipment analysis which occurs in Section 2.

In this history the personality and actions of the Chairman and Executive Director are extremely relevant as not only did they direct the marketing operations but, simultaneously, they misused their power as FIC leaders to improperly build up FIC funds at the expense of the PNG producers and then they misused those funds. They also used their power to improperly influence the Minister for Forests and to interfere with the proper functions of the Department of Forests in such matters as the allocation of resources and determination of permit conditions. The historical study outlines these improprieties which went hand in hand with FIC's marketing and were in the end largely responsible for the collapse of those operations in February/March 1987. The history concludes as the Department of Forests steps into the gap left by FIC; and *then itself* commences to market on behalf of the State.

SECTION 2. Forest Industries Council Marketing.

This section examines the Indian, Taiwanese, Japanese and Korean markets and examines the performance of the FIC in selling logs to them. The inefficiency of FIC's operations and its failure to keep separate and proper accounts for its marketing operations are exposed. Each of the 15 shipments is examined in detailed appendices which disclose the administrative and accounting details. The text and the appendices show the crucial importance of S.J. Park as FIC's sole agent in Korea and the various hidden arrangements which existed between he and Cowan.

The various irregular deals which occur during the marketing are disclosed in the text and amplified in the ship by ship analyses set out in appendices.

It is pointed out that though FIC's performance was seriously marred by its inefficiency and by Cowan's improper activities, including the crime of misappropriation, FIC nevertheless did succeed in fulfilling some of the hoped for aims.

SECTION 3. Effect of Marketing on FIC Funds

This section analyses the reports of the Auditor General and of Messrs Coopers and Lybrand and reports on the Commission's own, far more detailed, study of the financial affairs of FIC, as they relate to its State Marketing accounts. It makes serious criticisms of FIC's accounting system and points out that once the situation is correctly analysed, far from making the profit suggested by FIC's own records of K36,329, FIC has made a net loss from its marketing activities in excess of USD 40,000. In addition there are contingent liabilities which could amount to additional losses of over USD500,000.

SECTION 4. The Department of Forests' Role in log Marketing.

The role played by DOF in support of FIC's marketing activities is described in general terms. More importantly this section gives a detailed analysis of how DOF later took over the role of SMA itself and how it has operated as an agent, rather than as a buyer and seller of logs. Its performance is more impressive than that of FIC and was achieved with and far less cost, risk and effort.

SECTION 5. Findings and Comments

INTRODUCTION:

This interim Report No:3 reports on the following terms of reference all of which relate to the Forest Industries Council (FIC).

1. The process by which the Forest Industries Council became involved in the marketing of timber and
 - (a) when, and by whom, a decision was or decisions were made to involve the Council in marketing operations; and
 - (b) the nature and extent of the actual operations; and
 - (c) the nature and extent of any Ministerial involvement in marketing operations; and
 - (d) the role (if any) played by the Department of Forests in the actual marketing operations and resource allocation; and
 - (e) the financial effect of the marketing operations on the funds of the Council.
2. Whether any persons associated with the Council or its marketing operations received any direct or indirect benefits, whether financial or otherwise, as a result of the marketing operations of the Council and whether it was proper or improper for such benefits to be given or received.
7. Ascertain whether and to what extent the functions of each of the Minister for Forests, the Department of Forests and the Forest Industries council under the approved policy for the Forest Industry identified under Term 5 have been interfered with or encroached upon by another or others of such functionaries or any other person.

The FIC was set up by and received its powers and functions from the *Forest Industries Council Act Ch.No:215*. To understand the Report it is important to have a good working knowledge of the Act and for this reason a summary of its provisions is attached as Appendix 1.

The report deals with FIC's role as the State Marketing Authority for PNG logs and it is thus necessary to have a basic working knowledge of how PNG logs are marketed within the wider context of the South Seas Log Market. See Appendix 2 "Log Marketing an Oversimplified Outline".

SECTION 1. HISTORY OF FOREST INDUSTRIES COUNCIL INVOLVEMENT IN MARKETING

A State Marketing Authority for Log Exports

Up until the mid 1970s the official Forestry Policy was focussed on developing a local timber processing industry. The export of timber in log form was officially frowned upon but there were high hopes for chip and pulp mills, plywood mills, sawn timber mills and furniture factories. This was all reflected in the 1974 White Paper National Forestry Policy 1974. (See final Report for discussion on national forestry policy).

In fact however there had been a steady rise in log exports from 1970 onwards and many timber companies were ignoring or breaking the local processing conditions of their permits.

The IMES Report 1978 - a report by International Marketing and Economic Services (UK) Limited entitled "*Establishing a Timber Marketing Bureau in Papua New Guinea*" , made detailed and sensible recommendations aimed at helping the local processing industry to develop. Amongst these was a suggestion that the Forest Industries Council could be adapted to take on an additional role as a Timber Marketing Bureau to promote the sale of *sawn timber*. The report saw the Bureau's role as being to gather data and to promote the product but not to get involved with actual marketing.

As an ancilliary matter it recommended some relaxation of restrictions on log exports to inject funds into the industry and to boost its capacity to handle onshore processing.

National Executive Council Decision No. 72 of 1979

In 1979 an NEC submission was prepared which was to mark a major change of direction in national forestry policy. It did not specifically reject the 1974 Policy of preserving the forests for future generations while developing an efficient onshore processing industry, but it "grafted on" a policy aimed at the rapid promotion of log exports.

The main basis for this policy change was stated to be that *"the policy stressing internal processing has inhibited growth in the forest sector"*. One solution proposed was that: *"restrictions on log exports be relaxed"* so as to *"increase the rate of forest development and to increase the proportion of Papua New Guinea ownership of the timber industry"*.

In an Appendix to the NEC Submission some attempt was made to provide different guidelines for different branches of the industry in separate sections dealing with:

- (a) Papua New Guinea owned Log Export Enterprises (the proposed Forest Development Corporations -F.D.C);
- (b) Combined Log Export/Processing Operations;
- (c) Large scale Foreign Log Export enterprises doing no onshore processing;
- (d) Combined Log Export/Road Making Enterprises;

Support for the submission, as recorded in the submission Ministry by Ministry, was based largely on the national ownership and participation element. (A hope which has never really been achieved).

There is no mention of a State Marketing Authority (SMA) in the body of the submission. It features quite prominently however in the appendices to the submission. In the appendices the purposes for having a SMA were stated to be:

- (a) to assist the F.D.C's to market their products;
- (b) to penetrate new markets in a wider range of overseas countries;

- (c) to promote lesser known species;
- (d) In the case of large scale foreign log export enterprises, to make sales directly to end users rather than through intermediaries;

Throughout the booklets attached as appendices there is an assumption that the State Marketing Authority will be the F.I.C. Its proposed methods of operation were set out in Booklet 2. (which became the basis for the 1979 White Paper) as:

"Promotion and Sale of Logs by the Forest Industries Council or a State Marketing Agent"

A condition will be included in all new or reviewed Timber Permits which include a log export entitlement - along the following lines. In order to fulfil market contracts arranged by the State or a marketing agent appointed by the State for the purpose of:-

- i) promoting the use of Papua New Guinea's lesser known (but widely represented) species;
- ii) diversifying markets for Papua New Guinea's forest product exports;
- iii) selling directly to end-users rather than through intermediaries;

The log exporting enterprise will at the request of the State sell logs to the State, or a marketing agent appointed by the State, or direct to the contracted purchasers, at prices and on terms specified by the State (or it's agent) provided that:-

- (a) the enterprise shall be given reasonable notice of the intended purchase;
- (b) no order will (without the Agreement of the company) exceed 25% of the enterprises's log export allowance over the period during which the order is to be filled;
- (c) the processing operations of the enterprise will not be disrupted;
- (d) the enterprise's existing export commitments are not thereby unduly delayed or unduly disrupted;

- (e) the price for logs paid by the state (or its agent) to the enterprise shall be no less than the contract price arranged with the purchaser less any reasonable handling charges and less any reasonable marketing agency fees.

This measure is necessary because it is often too inconvenient or too costly for an individual company to arrange sales into new markets, or sales of certain species (except as mixed species shipments). The objectives of promoting lesser known species and diversifying markets, and in the longer term (by establishing clear user preferences) forming a market base for the sale of processed forest products, will not be met unless there is some direct selling of logs by a "central marketing authority" (marketing agent) acting in the longer term interest of Papua New Guinea and its timber industry.

It is intended that FIC or a marketing agent created by the State will be the body that acts as the "marketing agent" for this purpose."

On the 22 May 1979, by decision No. 72/79 the NEC endorsed the new policy of promoting log exports and the creation of a State Marketing Authority as recommended in the Submission and it directed that the new policy be presented to Parliament in the form of a White Paper. It specifically directed however that:

"(ii) reference to the Forest Industries Council doing any marketing for the State be deleted."

Records of discussions at the NEC meeting were not available to the Commission but this specific direction implied that mention of FIC should be deleted entirely, even as one of the possible options to be considered later.

As a result of this NEC decision the White Paper entitled Revised National Forestry Policy 1979 was presented to Parliament. It closely followed the provisions of Booklet 2. With regard to State Marketing it refers to "*A marketing agent created by the State*" and, as directed, there was no mention of the FIC at all. Eventually the White Paper received Parliamentary endorsement and consequently the following policy on State Marketing was adopted:

The National Log Export Companies (originally the FDC's) were, if requested, to sell to it up to 25% of log volume which it would sell for the purposes of promoting lesser known species or for the purpose of penetrating or opening new markets in order to achieve market diversification.

Large scale foreign log exporters were to have Permit conditions requiring them to make up to 25% of log export allowance available to the State Agency "*to fulfil market contracts arranged by the State or Agency*" for the limited purposes of promoting lesser known (but widely represented) species; diversifying markets, or selling directly to end users rather than through intermediaries. Quite reasonable protections for the producer were included.

If required, Log Export/Processing operations were to be in the same position as large scale foreign log export operations. Ultimately the Agency could, if appropriate, take over the entire marketing function of National Log Export Companies (F.D.C's) but in the case of foreign companies the maximum which could be sought was to be 25 percent of total exports.

The major thrust of the concept was clearly to promote market diversification and the promotion of lesser known species. The only additional ground for acquisition was for direct sale to end users. There was no broad provision enabling the agency to market so as to obtain market price data or as a tool to combat transfer pricing even though this danger was well recognised.

With the FIC having been eliminated from marketing by the NEC there was no other agency or entity in existence to fulfil that role, so it still had to be "*created by the State*".

1979 - July 1985 Years of Indecision:

Despite the clear NEC direction for the Department of Forests to formulate firm proposals for creating a State Marketing Authority, six long years went by while bureaucrats, politicians and members of the timber industry ineffectually debated the question. The Industry, expressing itself through the Forest Industries Association, was against the whole concept of any State involvement in marketing. The same industry view also came from the F.I.C, expressed through its "*loyal*" Executive Director Gordon Gresham. As the years went on it was becoming increasingly obvious that there were many marketing devices being employed by various timber companies to transfer (or keep) their profits offshore. This enabled them to cheat

the landowners of their rightful share and to reduce or eliminate their tax burden. The industry was clearly aware of this practice but, as many were involved in it themselves, the members were opposed to the establishment of a SMA which might force onshore prices up; thus reducing their offshore illegal profit margin.

So the debate continued:

The Department of Finance was advocating that Inchcape should join in a joint venture with the State as the SMA and perform a wider range of functions, including the management of all the FDC's.

The Department of Forests and its Minister Joseph Aoa, wanted a new Authority to be created with its main aim being to increase prices. There was disagreement whether the Authority should be an independent corporation or an appointed agent.

It was generally believed that the recent entry of Korean log buyers into the market had provided competition which had broken the Japanese stranglehold and forced prices up. D.O.F

Secretary Andrew Yaueib felt that a SMA which dealt on a reasonably large scale could similarly provide competition and force the Japanese and others to increase their purchase offers in order to outbid the SMA's buyer. He felt the SMA should handle 300 000 - 500 000 m³ per annum and be limited solely to matters directly related to marketing.

There were many advocates for appointing the FIC as the SMA and some for appointing the FIA. Both organisations had two major drawbacks in common; firstly they were industry dominated and would therefore be in an acute conflict of interest situation if the State wished the SMA to implement its policy of reducing transfer pricing by forcing up the disclosed onshore price. Secondly neither organisation had staff who were skilled at marketing. The FIC, as a Statutory Corporation, with a minority membership of senior government appointees, at least would carry some authority in the international market place. The FIA on the other hand was merely an unincorporated group of private businessmen.

There were two other serious drawbacks for FIC, both of which were overlooked during the debate. The FIC had been specifically "*deleted*" as the SMA by the NEC in its 1979 decision and secondly, under the *Forest Industry Council Act*, the FIC seems to have no statutory authority, and therefore no power at all, to perform the functions required of the SMA.

Many bodies were consulted during the six year continuing debate. These included the U.N.D.P, the Commonwealth Secretariat, the Malaysian Timber Industries Board, the F.A.O and Mr Phillip Ashenden of the New Zealand Consultancy firm Ashenden and Associates.

In his brief to the Minister dated 11 November 1982, Secretary Yauieb summarised the position clearly (Appendix 3). He listed the options for SMA as:

- (a) Joint venture between the State and an experienced timber company (Inchcape subsidiary Forest Management Services (F.M.S) was one of several being considered);
- (b) State Marketing Corporation - wholly owned and controlled by the State;
- (c) Forest Industries Council. He envisaged it being restructured as a *"quasi government body"*.

Mr Yauieb referred to the attempts to fund a study by Ashenden and Associates which would report on the marketing of PNG logs in Japan and which he believed would include comments on the establishment of a *"Central Marketing Authority"*. He advised delaying the decision pending the arrival of Ashenden's report.

(Ashenden's report did not become available until February 1984. It is an excellent, but unfortunately neglected, document which provides a detailed strategy for marketing PNG logs in Japan effectively. It did not recommend the establishment of a PNG State Marketing Authority).

A discussion paper was prepared in DOF by Mr M.N. Amin (Appendix 4) which sets out the stop-go progression towards establishing a SMA in more historical detail). The paper, which received the backing of senior departmental staff, favoured the establishment of a new State Marketing Corporation rather than a restructured F.I.C or the appointment of an outside "foreign" company as an agent.

Within the DOF there was a growing concern at the increasing rate of foreign currency being lost through transfer pricing (estimated by the Department as K2 million per month and rising). A *"Study Report on Timber Marketing Corporation"* was prepared (Appendix 5). It proposed an Authority which would limit itself to handling all the marketing for the FDC's, which it said would amount to about 300 000 m³ per annum and which it was thought would be sufficient to force prices up.

Having discussed the possibility of appointing one or two foreign companies to act as the government's agent to perform the marketing function for the FDC's, the Report opted for the establishment of a Timber Marketing Corporation to be managed by one overseas marketing expert supported by PNG staff recruited in PNG.

It seems that this sensible but modest proposal was not discussed but rather was swept aside as Secretary Mamalai directed the preparation of an NEC submission. This draft submission was prepared in June 1984 by Mr Kari (Appendix 6) - and a copy was passed on to FIC by the Minister for comment.

The draft submission reflected a change in DOF thinking as it recommended that marketing should be carried out by a State Marketing Agent selected by the Minister, after calling for international tenders, rather than by a State Marketing Corporation. It was also proposed that the Agent would exercise the State's right of refusal of 25% of the export logs of all companies - not just the FDCs.

The apparent firm resolution of DOF to recommend the appointment of an International Marketing Agent was sufficient to galvanise the Executive Director of FIC, Gordon Gresham into rapid and purposeful action. Discussion of the draft NEC submission was put on the agenda for the next FIC meeting and meanwhile Mr Gresham circulated a memorandum to all FIC members calling upon them to accept the unavoidable fact that a State Marketing Agent will definitely be established and, that being the case, he called for members' support for a campaign to ensure that the job is given to FIC.

"Having abandoned the idea of a State Marketing Corporation it is believed the government is now preparing submissions to NEC to make agency arrangements to market the government entitlement of 25% of export logs, as and when the government feels this might be necessary.

It should be made clear to members that the situation is that the government is going to insist on this measure and it is not a question that it will not happen, rather a question of how this operation might be accomplished with the least disruption in the market and in co-operation with the exporters, while achieving the government's aims of checking any 'undesirable trade practices' as these are described in one consultancy report ..."

"It is believed the NEC submission being prepared will suggest that the agency to market the government 25% of export logs should be tendered for internationally. My view is this would be very disruptive in the market, it would no doubt upset almost all PNG log exporters and their existing customers, and it is not clear on what criteria the government could select an agent. Would it be, for example, the agency which charged the least fees?

Bearing clearly in mind that the government intends to bring in and use this power, my opinion is, as it has always been, the government should designate FIC as the agency through which any State Marketing should be directed.

On the grounds that it is not wanted at all - but better through a channel which at least has some input from the PNG industry rather than in a way where there is no input whatsoever from the industry."

On 9 July 1984 Gresham gave his comments to Minister Waka in which he put forward reasons why any form of SMA would fail to control transfer pricing and the disadvantages of an international agent in particular (Appendix 7). On 3 August Mr Gresham informed the Minister that the FIC had instructed him to prepare a brief for the Minister and again pointed out briefly that an agency would not achieve the stated objects and that international tender would be very disruptive.

On 16 August Mr. Gresham prepared a detailed submission in favour of appointing FIC as the agent. It is included in Appendix 7.

As comments on the draft NEC submission came in it seems that DOF began to waiver. The Departments of Finance and Justice were particularly harsh in that they pointed out forcefully the lack of applied thought to practical matters. Those comments, including those of FIC, appear at Appendix 8.

On 24 September 1984 Mr. Mamalai invited FIC to present a submission on it being appointed as the State Marketing Agent. By 2 October 1984 Mr Gresham replied with a detailed outline, specimen contract and letterhead. He summed up the FIC submission as follows:

"7. *Summing up:*

- 7.1 *Appointing FIC will give a very flexible arrangement, the government will be able to exercise its rights only when it is felt necessary.*
- 7.2 *Flexibility also extends to the transactions as FIC will be able to sell directly, or through any of a number of well known agencies - as the market situation dictates.*
- 7.3 *FIC will have the facilities and the interest to encourage smaller producers to sell through the FIC agency, obtaining better and more flexible sales and better prices, particularly in times of difficult market conditions where the wide coverage through several sales channels will break the monopolistic situation which now constrains the small producers.*

- 7.4 *The appointment of a single agency would not have this flexibility nor the same national interests and even if a local office is opened the control will lay - as it does with present sellers and agents - overseas.*
- 7.5 *It is the intention to have one or two FIC national staff members and, if agreed, one staff seconded from Forests HQ to be counterparts to the new FIC Director of Sales, in order that they can learn sales management while acting as assistants in the FIC sales unit.*
- 7.6 *Above all, appointment of FIC as official sales agent will cause the least disruption in the market place and FIC will most certainly have greater goodwill from producers, other agents and end users, not least because FIC is perceived to be independent and impartial.*
- 7.7 *The above transaction and other procedures may sound quite simple and straightforward. In reality there will be very many complications as briefly touched upon in paragraph 1.3.*
- 7.8 *FIC is a Statutory Authority answerable to the Minister for Forests and with very senior government and industry representatives as its Councillors. There can be no other" organisation so well constituted to carry out timber marketing on behalf of the government and people of Papua New Guinea."*

The reply was copied to the Minister and to FIC Council Members. Mr Gresham's telexed response to comments by Stettin Bay Lumber Company is so revealing it bears quoting in part:-

**"MAIN AIM IS TO PERSUADE GOVERNMENT TO
DROP IT'S IDEAS OF ADVERTISING
INTERNATIONALLY FOR AN AGENT TO MARKET 25%
OF ALL EXPORT LOGS.**

AS DISCUSSED LAST FIC (MEETING) WE DO NOT WANT THIS STATE MARKETING AT ALL BUT WOULD BE DISASTROUS IF TAKEN OUT OF HAND BY GOVERNMENT AND GIVEN OUT TO SOME OVERSEAS AGENT IN WHICH CASE NO ONE WOULD HAVE ANY CONTROL AND THE AGENT COULD THEN CALL UPON SBLC AND ALL OTHERS AT ANY TIME FOR 25% OF THEIR LOGS. AM SURE NONE OF INDUSTRY WOULD BE HAPPY AT THIS.

THEREFORE, AM WORKING TO ENSURE GOVERNMENT RIGHTS ARE EXERCISED ONLY THROUGH FIC WHICH GIVES YOU AND ALL COUNCIL MEMBERS AN INPUT INTO HOW WHEN AND WHY RIGHTS MAY BE EXERCISED.

YOU MAY BE SURE WE ARE DOING ALL POSSIBLE TO KEEP SITUATION UNDER CONTROL".

This clearly shows the acute conflict arising out of FIC's structure and constitution which was pointed out earlier but, search as one may, it never appears to have been strongly and clearly drawn to any Minister's attention or to NEC's notice.

1985

During the early months of 1985 the draft NEC submission was being worked into final form.

On 16 May 1985 Mr Gresham circulated FIC members regarding a meeting on June 1 1985. After recounting shortly the history and FIC's fallback position, (If anyone is involved it should be FIC) Mr Gresham goes on to say:-

"It appears matters are now approaching a decision stage and it appears likely FIC may be designated as the agency which would undertake marketing of PNG logs when required on behalf of the government. It is likely this would at first be for production of FDC's particularly the smaller logging companies which are due to start up over the coming years but that it could also take in larger FDC's and other marketing at government direction. Currently thinking is that whichever entity took on the task would be an agency and co-ordinator. That is to say it would not buy and sell logs but would act as an agent by arranging log sales between willing sellers and willing buyers and assisting the producers in supervision, documentation and shipping.

If it eventuates that FIC is to be the organiser and operator of State Marketing requirements this would require a separate unit within FIC which would be self supporting financially by charging expenses to the individual transactions, and which would deal only with this operation. That is to say all other FIC activities would remain completely separate. Much detail would need to be worked out but I am presently just advising members that the possibility exists FIC may be appointed to carry out this function on behalf of the government and on behalf of the industry"

This was Mr Gresham's perception at the time.

FULL CIRCLE

After six to seven years of bureacratic debate and indecision the participants had arrived back to the very same place where the debate began: an NEC proposal for a SMA with FIC being the main contender for the job - the very concept which was deleted by NEC direction in 1979.

In the course of the six or seven year debate however, the earlier objectives of State involvement in marketing appear to have been overwhelmed by concern with using state intervention to ascertain "*true market prices*" and as a weapon to combat transfer pricing and other "*irregularities*".

NEC POLICY SUBMISSION NO. 139/85

The submission refers to the 1979 White Paper recommending a Central Marketing Authority "*to promote the use of Papua New Guinea's lesser known species, diversify markets and sell directly to end users rather than through intermediaries*". It goes on to say that the general feeling is that appointment of FIC is generally regarded as the most appropriate present course.

Under heading "*K. PREVIOUS POLICY REFERENCE*" only Section 4.5 of the 1979 White Paper is mentioned and the earlier purposes of a Central Marketing Authority are repeated. Nowhere in the entire submission is there any mention of NEC

Policy Submission 79/79 or of NEC decision 72/79 which directed deletion of references to FIC as the vehicle for State marketing involvement. In this respect the document is deficient at best and, at worst, dishonest and deceptive.

The main thrust of the submission is the assertion that PNG is not obtaining true value for its logs - the change in emphasis referred to earlier. Factors mentioned are:

- (a) dominance and control of production and sales by foreign companies.;
- (b) a marketing structure involving middlemen;
- (c) use of third country letters of credit to transfer price;
- (d) lack of a strong independent supplier selling directly at competitive prices;
- (e) lack of sorting marketing expertise and shipment co-ordination at the PNG end, particularly for smaller producers;
- (f) lack of an effective Minimum Export Price system occasioned, in part, by lack of market information; obtainable only through practical involvement in trading activities.

In fairness it must be said that, the Commission has found these factors did exist.

The submission said losses in foreign exchange earnings are estimated at a minimum K24 million per year with revenue losses in export duties and corporate taxes as a result of this disorderly marketing system. It said transfer pricing studies were difficult; tax measures by themselves were not effective and that a strong independent marketer is needed to establish reference prices to effectively implement tax measures. No basis for the estimates of foreign exchange losses is given and no estimate of revenue losses is given.

The 1979 White Paper and Ashenden's Report are cited as supporting the need for a strong, independent direct export marketer to achieve indicator prices. Whilst the White Paper saw the solution as a "*centralised Marketing Authority*", what Ashenden clearly envisaged was for the State to work through one or two unlinked private sector independent exporters -not a state agency.

The submission does not consider remedies other than the establishment of a SMA. For instance it does not refer to other solutions which IMES or Ashenden suggested; such as breaking traditional and established links and breaking suspected buying cartels by seeking alternative markets in other countries.

Markets in Western Europe (EEC), the United States, India/Pakistan, the Soviet Union and the Peoples Republic of China were suggested. The NEC Submission proposes, as the only solution, the establishment of a State Marketing Agent. The objectives of the State Marketing Agent (SMA) are said to be:-

- (i) direct sales to end user rather than through intermediaries;
- (ii) marketing assistance to small and local producers;
- (iii) exercise the State's first refusal right to 25% of log export production;
- (iv) obtain a market data base to effectively set Minimum Export Prices;
- (v) diversify markets and promote lesser known species.

It is against these objectives that FIC's marketing endeavours will be assessed later in this Report.

Four alternative forms of centralised market authority are described as options:-

- (1) A state owned Timber Marketing Corporation.
- (2) A joint Venture Marketing company - the State and an overseas timber company.
- (3) A marketing Agent already involved in marketing overseas.
- (4) FIC.

The first three are shortly and inadequately dismissed while the advantages of appointing the FIC are stated at length. It is said of FIC:

- *"(it) has no conflict of interest with the Government"*
- *"there seems to be no constitutional constraints or any disagreements among its members as to its getting involved in the trading activities."*

These very questionable propositions are put as facts to the NEC. No warning is given and FIC is strongly recommended.

The submission then proceeds to list the ten major functions and responsibilities of SMA as:

- i) buy logs and export direct, in competition with other log buyers;
- ii) exercise State's first refusal option to 25% of export volume;
- iii) assist in receiving market data and improving the MEP system;
- iv) operate as an export agent for a sales commission not exceeding 3% of FOB value;
- v) assist small and local producers in marketing;
- vi) assist FDC's in marketing;
- vii) carry out other promotional activities agreed to by Government;
- viii) sell direct to destination country with no third country L/C's;
- ix) bear financial responsibility receiving profits and bearing losses - no financial risk to Government;

- x) be monitored and evaluated by Department of Forests with termination if performance not acceptable.

These are the functions and responsibilities against which FIC's marketing endeavours will be assessed later in this Report.

The submission recommended a number of steps which should be followed leading up to the appointment of FIC as the State Marketing Agent.

The anticipated benefits from the appointment are listed as:

- 1) an increase in current FOB prices of 10-12%;
- 2) reduction in transfer pricing in major markets by direct sales and shipments;
- 3) supply of market data to assist in a more effective MEP system;
- 4) benefits to small national producers through marketing assistance and shipping coordination.

(It can be mentioned at this stage that the Commission has found that all these anticipated benefits, except the last, were achieved during the time of FIC's marketing activity).

NEC DECISION NO 220/85

With this Submission before it on 28 August 1985 NEC proceeded to decision.

(The details of proceedings before Cabinet have neither been sought nor obtained.)

The NEC:-

"Approved the appointment of the Forest Industries Council of Papua New Guinea as the State Marketing Agent through the following steps:-

- i) The calling of detailed offer from Forest Industries Council;*
- ii) Negotiation leading to draft agreement;*
- iii) Approval of the draft agreement by the Minister for Forest; and*
- iv) Appointment of Forests Industries Council as State Marketing Agent by signing the final agreement by the State".*

Quite clearly no immediate appointment was made but a procedure was prescribed whereby FIC would become the State Marketing Agent by virtue of an agreement, and as a result of such agreement, between the State and FIC.

Signing of the Agreement by the State would need to be in conformity with the *Government Contracts Act* and it would require execution by the Head of State acting on NEC advice. Thus, even though any such agreement would be approved by the Minister for Forests it would still be referred to NEC for advice.

The Submission had stated that the views of other Ministries, including Justice, had been included in the submission. That being the case it appears that the legal officers in the Department of Justice, failed to consider whether the FIC was empowered by the *Forest Industries Council Act* to carry out the proposed functions as the State Marketing Agent. In my professional opinion it did not have such statutory authority and, as no amendments to the Act were made or even directed in the NEC decision or later, the FIC's subsequent involvement in marketing was very probably ultra vires its incorporating Act and therefore illegal.

STEPS TO IMPLEMENT NEC DECISION TO APPOINT FIC AS SMA

In preparation for making FIC's detailed offer as called for by the NEC, Gresham circulated a Summary of Operational Guidelines (Appendix 9) and a Background Paper (Appendix 10) to FIC members and asked for comments and suggestions. The documents show the low key approach Gresham proposed in co-operation with industry, stressing quality presentation and eliminating the "poor" image of PNG logs. The summary is consistent with Gresham's previous expressions and in the memo

he sees only an "agent" role with no purchases and resale. He sensibly proposed to deal with voluntary users of SMA first, then thoroughly analyse their operation and product in order to get a data base. He submitted FIC's Outline for the agreement to DOF on 22 October 1985 (Appendix 11). The main points were:

Operations (7.4 (b))

- (i) FIC will not fund purchase itself, but be an agent.
- (ii) First step will be to survey operators and exporters to obtain a data base to establish production and export potentials.
- (iii) Next producers who wish to voluntarily sell through SMA will be identified and production patterns studied.
- (iv) This data can be referred to when deciding whether to exercise the 25% purchase option and it should facilitate co ordination of shipments according to market conditions.

Sales (7.4(C))

- (v) SMA will sell direct and or through agents depending on market structure but will eliminate unnecessary middlemen.
- (vi) Producers who offer to SMA can also offer to other buyers but require SMA approval before closing a sale.
- (vii) SMA will in some cases take a direct contract for small producers and in others act only as an agent, but in all cases on a "back to back" basis.

Finance (7.4(e))

- (viii) Separate bookkeeping will be established so that SMA transactions are properly accounted for and costs apportioned.
- (ix) Costs of SMA will be invoiced between FIC and SMA and accounts consolidated.

- (x) The aim of SMA is not to make "*profits*" or trading surpluses but to match expenditure.

In November 1985 Mr Paias Wingti's government replaced the Somare Government after a successful vote of no confidence in Parliament. Shortly afterwards the FIC circulated a status report on the appointment of FIC as State Marketing Agent (Appendix 12). It is entirely consistent with FIC's previous submission to DOF and the two documents constituted FIC's proposals for the "heads of agreement" and major terms and conditions.

These were forwarded by Secretary Mamalai to the State Solicitor on the 26 February with a request that he prepare the draft agreement which, once approved, would enable the FIC to be formally appointed as the SMA. As Mr Gresham was resigning and intended to leave PNG on the 3 March the State Solicitor was requested to have the Agreement prepared by the 28 February.

Except for the short time given to the State Solicitor for preparing the Agreement, at this stage events seemed to be on course for an orderly entry of FIC into the field of State Marketing.

A sensible and detailed outline had been agreed on between FIC and DOF which would provide for a reorganised FIC to commence operations in a modest way causing little disruption to the industry but leading progressively to more involvement. Very importantly, it was intended to recruit an overseas marketing expert to lead a completely separate and self accounting section of the FIC.

Unfortunately, at an FIC meeting on the 11 February, not only had Gresham announced his imminent resignation but a Council member, Mr Cameron, also resigned. The Chairman, Mr Spillane, announced his intention to resign at the next meeting and the terms of Messrs Gault and Takahashi expired. This was to leave Mr Hirata (of SBLC), Mr Ellis and Mr Maraleu as the only remaining industry representatives. Because of delay in making new appointments, it meant there would be no quorum for a future FIC Council meeting and the next valid meeting was not held until August. Meanwhile Mr Cowan had arrived to take up a position as Executive Officer but was almost immediately to push himself into the Executive Director's seat about to be vacated by Gordon Gresham. Cowan would lead FIC into marketing immediately; before its formal appointment as SMA was completed. The draft FIC/SMA agreement was not prepared by the State Solicitor until January 1987 and, although it was then approved by FIC it was never formally implemented by the State.

The absence of a properly constituted Council created a serious situation as, under the *Forest Industries Council Act*, all powers and functions of the FIC are vested in the Council. There had been no valid delegation of power to the Chairman or Executive Director and thus most of the important acts and decisions of the next six months were unlawful. (See Appendix 1, Clause 2.6 and 2.7).

As a consequence of these circumstances, when Cowan took up his position in February, there was to be a six month period in which he would be free of control by the FIC Council and a period of over 12 months for FIC to (illegally) engage in marketing activities without being bound by the terms and guidelines of an FIC/SMA agreement.

THE COWAN ERA AT FIC

Michael Cowan arrived to take up his middle level administrative position as Executive Officer in January/ February 1986. It is now quite clear that he obtained the position under false pretences, and that many of the claims in his curriculum vitae were not, and could not, be true. It is also clear that he was dishonest in the way he conducted business and accounted for funds to FIC's clients. I have in fact found that he misappropriated at least USD28,892 of FIC funds and on this matter I sought the assistance of the National Fraud Squad for investigation (see Appendix 47).

Cowan must have presented a much more favourable impression than this however for, in a very short space of time he appears to have been accepted by the recently appointed Forestry Minister, Ted Diro as a most influential adviser. He also managed to dominate Miskus Maraleu, the new FIC Acting Chairman and to ingratiate himself with the major participants in the Angus group (with which Mr Diro had undisclosed connections - see Interim Report No 2). He quickly made powerful friends in the industry including David Toms of Wawoi Guavi/Straits, Simon Hirata of Stettin Bay Lumber Co. (SBLC,) Graham Ward of WECO and Francis Sia of MOI. He also made many enemies.

When Minister Diro made his first parliamentary speech on forestry, on the 20 March 1986, he seemed to have no positive plans on the question of SMA. He said:

"Market information is also inadequate. There is need for desperate efforts for promoting the export markets and raising FOB prices to a competitive level. In view of the above circumstances, the Government plans to devote considerable effort in the field of market surveillance and market intelligence for the purpose of assisting the producers to sell directly to end-users, diversifying markets, promoting the use of lesser known species, assisting the small and local producers and finally supplying market information to the Government and the producers for effective implementation of the minimum export price system.

In short, we are being held at ransom by a cartel of overseas buyers who are through, legitimate commercial practice, forcing our timber prices down. We are told that most of our timber species are less known and are of inferior quality, therefore we cannot fetch good prices. My ministry will in the short time ahead, try its hardest to correct these anomalies".

It is not possible from the speech or any other available document to know precisely what Mr Diro intended regarding the State Marketing Agent but his speech suggests surveillance and intelligence rather than active marketing. He does not appear (from the files and running files) to have been briefed in writing on the subject by either the Department of Forests or the FIC until much later.

The next FIC meeting was not held until 20 August 1986 and what occurred between March and August is very relevant to FIC's involvement in State Marketing. During this six months Cowan's endeavours to expand FIC's role were guided only by his inflated ego and his greed for power, influence and money.

1. A previously planned FIC promotional tour to India occurred in April 1986 with Maraleu leading the delegation.

2. Cowan and his wife went on a "*follow-up*" trip to India where he was lavishly "treated" by Hasmuth Vikani of Centaur Exports (who was already doing business with Ron Gibbs and Vanim Forest Products (See Appendix 36.1). Vikani later complained that Cowan was not interested in working during the trip.
3. On the way to PNG from India in June Cowan was the guest of Angus in Singapore and (from Angus' records) he dined with its chairman M.A Ang and Tan Sri Ghazali Shafei.
4. Cowan obviously "cultivated" Miskus Maraleu, the acting chairman of FIC. He put a lot of effort into helping Maraleu to get Francis Sia's Malaysia Overseas Investment Pty Ltd (MOI) safely launched as contractor to Mamirum Timbers Pty Ltd in New Hanover. Maraleu stood to gain handsomely as he was acting as lawyer/consultant for both parties in that deal.

For his part Maraleu, without legal authority, signed on behalf of FIC, a 3 year contract of employment for Cowan whom Maraleu had, again without FIC approval, appointed as Executive Director. Cowan had been recruited by Gordon Gresham as middle level administrator. It is quite clear that Gresham considered Cowan did not have the skills and experience needed to run the marketing operation and Gresham quite explicitly intended that a marketing expert should be recruited for this position. Cowan's contract provided remarkably generous terms - far in excess of those previously enjoyed by Gordon Gresham.

Cowan's contract provided for:

- (a) base salary K50,000.00 per year with indexation and an increase of 8% annually;
- (b) 52 working days paid leave plus four days travelling time (ie: over 11 weeks paid leave) per year;
- (c) 15 working days (3 weeks) per year cumulative sick leave on full pay.;
- (d) 25% gratuity on gross salary.;
- (e) entitlement to long service leave
- (f) annual business class leave fares for Cowan, wife and family;
- (g) cover for Cowan and family by accident and medical insurance;
- (h) provision of furnished housing with FIC to pay electricity, gas, garbage, water and a domestic servant;
- (i) provision of a car for official use;
- (j) repatriation costs for Cowan, family and "household goods";

- (k) reimbursement of (unlimited) entertainment expenses;
- (l) education allowance of up to K4500 per year person;
- (m) superannuation contribution (by FIC) of K2,000 per year.

The contract also tied all remuneration to an exchange rate of K1 = 68 pence.

Cowan's first attempts to take FIC into marketing concerned the Indian market. Having arranged with Vikani that FIC would sell to the Indian market only through Centaur Exports, Cowan stupidly offered a 10000 m³ shipment to Pars Ram Bros of Brisbane. Pars Ram later asserted a contract for this volume. Having signed a long term contract with Pars Ram, Cowan later deceitfully passed on to him confidential market information supplied by his competitor Ron Gibbs (acting for Vanim Forest Products). This was typical of Cowan's double dealing. The contract arrangements with Pars Ram eventually collapsed leaving FIC facing a contingent liability claim which could amount to as much as USD 500,000 (see Indian Market History at Appendix 36.1 and FIC Shipment 2 material Appendix 36.3). Maraleu was also involved in these arrangements.

Preparing for FIC Meeting on 20 August 1986

By early August new appointments had finally been made to the Council of the FIC and there was mounting pressure for the long delayed Council meeting to be called. The Council now consisted of:

Government Members:

Oscar Mamalai (Forests)
Wep Kanawi (Trade and Industry)
Andrew Temu (Works)

Private Members

Miskus Maraleu
Simon Hirata (SBLC)
Fr. Tim O'Neill (Ulamona Catholic Mission)
Mark Grace (Beechwood)
Garth McIlwain (Credit Corporation)
Graham Ward (accountant for WECO and other companies)

By this stage Cowan had taken FIC well and truly into marketing before the NEC approval required by NEC decision 220/85 had been obtained. Some Council members were openly critical of what was happening but, from the documents, it seems that Cowan had been briefing Minister Diro thoroughly on the anticipated successes of FIC's marketing activities and had gained his full support. In preparation for the long delayed meeting Cowan telexed FIC members on the 13 August that the meeting would be held in Rabaul on 20 August. He also briefed

Mr Diro on his forthcoming (14 August) speech to Parliament, to ensure it would be favourable to his FIC activities (Appendix 12A). The speech had three elements:

- (i) Reported export log price increases;
- (ii) Entry into the Indian Market, with plans to market to Europe;
- (iii) Entry of sawn timber to Australia through Cairns.

The speech has many exaggerations and inaccuracies - giving credit to FIC for price rises which were occurring naturally in a rising market, taking the credit due to Gibbs and VFP for developing the Indian Market and untruthfully claiming sales there of 50,000 m³

The hand and manipulations of Cowan are evident in the speech, it seems clear he must have contributed heavily to it, and the inaccuracies and exaggerations in it cannot be blamed entirely on Mr Diro.

Though inaccurate and misleading the speech was well received in Parliament. That evening Cowan and Maraleu met with Mr Diro who was, perhaps, in an expansive mood after his well received speech. It appears, from a letter to Mr. Diro, which

Cowan faxed to Maraleu on the 18 August 1986 (Appendix 13), that they proposed to Mr Diro an expanded role for FIC. They proposed:

- (a) a brief should be prepared with firm proposals enabling the Minister to make an immediate decision, on a solution FIC had already offered. (The language is vague but it seems clearly to relate to FIC marketing).
- (b) authority was sought for FIC *"to approach"* companies paying more than one agent.
- (c) authority was sought for FIC to *"take immediate action"* where a company sells below MEP.
- (d) undergrading of logs was discussed.

Cowan's letter is real *"hard sell"* on these issues. It made a comparison with the projected liquid gas revenue of K3 million in two years :-

"Against this Projected revenue FIC, given suitable authority, is able to commence, within 30/60 days to increase revenue by about USD500,000 building up to about USD 10,000,000 over a period of 12 months. The chairman asks is anyone interested?"

At this stage it seems Mr Diro had not been briefed by DOF or FIC on the 1979 Cabinet decision which had "deleted" FIC; nor about FIC's lack of statutory authority to enter into marketing; nor about the 1985 NEC decision requiring an agreement before FIC could be appointed as SMA; nor that the proposals would cause FIC to trespass into DOF areas of authority over such matters as MEP dispensation, agency arrangements and log grading.

FIC Meeting 20 August 1986

On 20 August the FIC meeting was held in Rabaul. The minutes (which were not typed until the 26 September, (Appendix 14) record that the Minister gave full authority for FIC to be involved in State Marketing as well as in other wider functions:

- (a) Mr Diro is said to have addressed the Council for 35 minutes on the Government's plans and FIC's role in those plans. The following statements are attributed to Mr Diro in the Minutes:

"He stated that FIC was doing an excellent job in monitoring the overseas markets, and marketing into new markets. He also stated his satisfaction in the daily activities of FIC in maintaining and increasing export log prices, which is at present were the highest in the history of industry"

"The Minister stated that it was the intention of the Government to request FIC to work alongside and with the Department of Forests and to fill in on gaps which could not be done, quickly by the Department of Forest, for one reason or another. The Minister continued; he wished FIC to take on more active activities and play a major part in building up the timber industry over the next 5 to 10 years."

FIC would enter into the international log markets and have the powers to negotiate sales and where necessary act as the shipper, this may include the charter of log loading vessels"

"The Minister went onto say that it was the Government intention to make regulations for the compulsory grading of logs for export and FIC would play a major part in this new policy. At this point he again repeated that FIC was needed to obtain markets and ensure our timber was sold at the correct prices. The timber resources of PNG belong to the people of Papua New Guinea and the Government must be ready to help any development in the timber industry and FIC must also help the industry.

The Minister stated that he had formed a top level committee, in which FIC played a major part, to meet every two weeks to discuss various problems in the Trade and at Government Level. The Minister stated that he had also created another powerful committee, of which FIC was a major member. This committee discussed all forest resource problems, existing companies wishing to enlarge their activities and new projects. These were 'action' committees and FIC played a major part within their activities.

The Minister concluded his speech by reminding members that the main functions of the FIC was to promote and develop the forest industry".

After the Minister's address the following is recorded in the Minutes:

(b) On State Marketing

"The Chairman asked the Minister to explain the up to date position of the SMA. The Minister stated that the SMA agreement between the Government and FIC had been approved by the National Executive Council but for the moment had been "put on ice." However present activities of FIC were already taking over most of those included in the SMA agreement. He accepted the fact that FIC was now carrying out functions, which were to be done by SMA. He stated FIC had now become SMA".

(c) On FIC's role in Forestry Policy

Mr Diro is recorded as saying that the Ministry of Forests, Department of Forests and FIC were on the top level committee and he and Cowan are reported as saying that FIC represented the industry and an industry representative was not necessary but that industry would be invited where necessary.

(d) On the position of Chairman FIC

Mr Maraleu's appointment as Chairman was confirmed.

(e) On the proposed Log Grading Rules -

The Minister is recorded as saying:

"There is a possibility that FIC together with Department of Forest (will) be made responsible for enforcing the log grading law".

(f) On Cowans employment contract

Serious questions were raised as to the legality of Cowan's contract and as to the generosity of its terms. Although it was signed by Maraleu as Chairman over the FIC seal he had not been duly authorised by the Board. The question of the terms was referred to Graham Ward a member of the FIC who practised as an accountant and he undertook to report to the next meeting.

The minutes were drawn up more than a month after the meeting and then circulated to FIC members to whom they must have constituted a reassurance that FIC was conducting the State Marketing function with full government approval and authority. Some of the statements attributed to Mr Diro are so completely untrue that one wonders if the minutes accurately recorded what was actually said or, rather, what Cowan *wished* had been said.

For instance when Mr Diro is reported as saying that NEC had approved "*the SMA agreement*" but that had been "*put on ice*", the agreement had not even been drawn up by the State Solicitor (as Mamalai, who was present, well knew) and so had not even been submitted to, let alone approved by, NEC.

Cowan manipulates to influence Diro

Perhaps with the intention of "sweetening" Mr Ward, during his examination of the contract of employment, Cowan immediately commenced to help him to obtain the allocation of the Vudal TRP for WECO, for whom Ward acted. He did this on the 27 August, faxing him copies of two internal DOF memos dealing with inadequacies in WECO's proposals for the VUDAL. Ward promptly used the confidential information to make a supplementary proposal and asked Cowan to obtain Minister Diro's support for WECO. This matter finally came to a head in November when Diro firstly decided to grant the permit to Timbersales but then, under Cowan's influence, reversed the decision. (See details below). In evidence to the Commission Patrick Tay an employee of FIC said that Cowan claimed to have a paid consultancy with Weco. If that is the case Cowan's efforts to help Weco take on a more sinister aspect

These and subsequent activities in this matter clearly demonstrate Cowan's deviousness, the extent to which he was prepared to exceed his proper functions in order to help a "friend" whose support he needed and his basic dishonesty. It also illustrates the influence he had come to exert over Minister Ted Diro.

Meanwhile Cowan continued to manipulate Mr Diro in order to expand FIC's activities into marketing and other activities. Judging with hindsight it is clear that he needed this expansion of FIC functions, not so much to benefit the timber industry as to widen the scope for making personal profit.

Immediately after the FIC meeting of 20 August, Pars Ram came to Port Moresby to persist with his hope to buy Kwila. He succeeded and entered into a memorandum of understanding with FIC on the 26 August enabling him to buy logs, especially Kwila, for the Indian market. At a much publicised ceremony, with the press present and Mr Diro in attendance, the contract with FIC was signed. The ceremony was photographed and the picture appeared on the front page of the Times of PNG.

On the 6 September Cowan signed a letter to Minister Diro over Maraleu's name as FIC Chairman. He faxed a copy of this to Maraleu (in Kavieng) on the 9th September (Appendix 15). It is clear from that fax that three draft letters were attached to the letter so they could be typed under Minister's letterhead.

Cowan was blatantly flattering the Minister and enticing him with the promise of exaggerated results:

"With this support FIC will move on to bigger and better programmes but in the meantime my executive staff expect to have results within the next 30/45 days which will show a major increase in revenue to the government and a lift in the log prices. We intend to put the average FOB prices in the USD60 m³ plus bracket. This will represent an annual revenue increase of about USD 3.5- USD 4 million and we in FIC will call this stage one only. The Department of Forest and the FIC must come together to work as a team, under your leadership to make timber a major industry and revenue earner. This is the moment to act, give us your support and FIC will ensure the job gets done. We have confidence in your leadership"

During the time these letters were being typed up for Mr Diro's signature the Minister found that the Government would not fund his planned trip to Brisbane to attend an Australian/PNG function. The helpful Mr Cowan arranged free tickets. He also arranged for the timber dealer Pars Ram Punj to deliver a parcel containing A.\$ 1500 to Mr Diro in his Brisbane Hotel. (Appendix 36 and Interim Report No:2)

The first two letters were signed and dated the 11th and 12th September just as Diro departed for Brisbane. The first letter (Appendix 16) purported to give powers to FIC over:

- (a) log grading
- (b) MEP enforcement
- (c) scaling (under measurement)
- (d) transfer pricing
- (e) agents and middlemen

The second (Appendix 17) purported to grant FIC authority to:-

"continue in it's present marketing promotion program to find new markets and sales for our round log exports and to maintain it's present market surveillance activities in order to have the best prices for our timbers".

It should be remembered that under the *Forest Industries Council Act*, as it was then worded, the Minister had no power to direct the FIC or to authorise it to take on additional functions (see Appendix 1 clause 9).

The letter goes on to say FIC must be financed and to that end 25% State option rights will be taken up and:

"FIC will step up it's marketing promotions and operate in direct competition with other middlemen agents and traders. I propose that marketing/sale commission be paid to FIC on all sales made. This will provide additional revenue".

These two letters duly signed by the Minister were received on the 15 September which is the very day Mr Diro returned from his FIC-arranged Brisbane trip with the balance of Pars Ram's money in his pocket. A copy of the third letter addressed to Vanimo Forests Products, was received by FIC on the 15 September and had also been signed by Mr Diro. It sought to have Vanimo Forest Products sell Kwila to FIC, which was the

timber that FIC desperately needed in order to fulfill the Pars Ram contract. Assuming that the original was sent to VFP, this letter is a clear example of the Minister getting involved in marketing. The copy received by FIC is attached as Appendix 17A.

A few days later Pars Ram, now favoured man for the Indian market, returned to Port Moresby to discuss problems with the contract because, despite pressure, Vanimo Forest Products refused to sell to FIC and FIC could not obtain the contracted quantities of Kwila elsewhere. In this context a meeting took place in Angus PNG's office "chaired" by Mr Diro at which allocation of the Kwila rich resource adjoining Vanimo was discussed. (It should be remembered that Angus was then experiencing acute liquidity problems). It was proposed to use the allocation to provide Pars Ram with Kwila and to make a benefit for Angus PNG (see Appendix 36 and Interim Report No 2). Cowan, had been playing a key role in these arrangements and was present at the meeting. By having just arranged for him to be "compromised" by receiving Pars Ram's "cash", Cowan was steadily increasing his influence over Mr Diro. (In evidence Mr Diro himself said that he felt uncomfortable about being put in this position).

During this same period in September 1986 Cowan continued his manipulations on other matters. Ward continued to send him faxes of pro Weco material concerning the VUDAL TRP. Cowan was also using his influence to persuade Minister Diro to increase Stettin Bay Timber Company's cut limit and he was actively helping Mr Maraleu to promote Francis Sia's MOI Pty Ltd as contractor for Mamirum Timbers in New Hanover.

On 23 September Cowan faxed to Hirata (SBLC) a letter dated 15 September 1986 giving his account of meetings with Minister Diro to discuss very substantial log export volume increases for SBLC (Appendix 18). There seems to be real conflict and interference in this respect with Departmental functions. Forestry files show Secretary Mamalai only agreed to 30,000 m³ increase and not the further 18,000 m³ which was granted (conditional upon it being offered to FIC).

At the next FIC meeting on 6 October State Marketing was not even discussed. Perhaps because FIC's early marketing endeavours, limited to the Indian market with Centaur Exports and Pars Ram, were not being very successful at that stage. On the 6 October all this changed however when Mamalai announced to all timber companies that the Minister had authorised FIC to operate as the SMA (Appendix 19). From this time Secretary

Mamalai began requiring companies to offer the 25 percent option to DOF which channelled the offers to FIC. Then, between the 10th and 16th October Mr S.J Park emerged to become FIC's agent in Korea, after which the marketing activities boomed. This was largely due to the volume now available for FIC marketing as a result of SPO offers.

During October Cowan was actively involved in helping Maraleu/Sia in the Mamirum Timbers operation and in helping Angus. Cowan was also trying to force Tonolei Development Corporation (T.D.C.) to accept less than best price for an Indian shipment and used Mr Diro to send a "*well timed*" fax intended to induce TDC to sell through FIC at it's lower price.

In early November Cowan was deeply involved trying to help Mr Diro and the ailing Angus PNG Pty Ltd. Cowan met with Angus representatives and their Japanese buyers and agreed for FIC to become Angus' sole agent. Cowan confirmed existing supply arrangements between Angus and Sanko for seven shipments. New contracts were entered in FIC's name as seller with FIC to arrange ship charters and FIC to GUARANTEE supply to Sanko. Letters of Credit were to be established to FIC.

Well aware of Cowan's growing influence with Minister Diro, Graham Ward continued to seek his help over the Vudal TRP by faxing 76 pages of Proposal to Cowan on 13 November with the request to *"PASS THESE TO THE OFFICE OF FORESTS AS OUR COMPLETED SUBMISSION IF NECESSARY"* (Appendix 20 - first two pages only). Clearly Ward considered Cowan to be his ally and wanted him to use his own independent judgement in this matter.

In this same month Cowan was also very heavily involved in negotiating and drafting the permit for Wawoi Guavi Block 2. He did this behind the back of DOF. This will be dealt with in the Commission's final Report.

Cowan, still pushing for FIC expansion, on 13 November faxed C.Itoh in Japan saying:-

"We (FIC) represent the timber industry and Ministry for Forest on all timber matters On 6th October 1986 the Honourable Minister for Forest authorised the Forest Industries council to operate as the State Marketing Agent for export of PNG Logs."

In reality Cowan and Maraleu knew that FIC's unauthorised marketing activities were probably beyond its legal constitutional powers as on 19 November 1986, Maraleu faxed to Cowan draft amendments to the Forest Industries Council Act which would confer the necessary powers (Appendix 20A).

Cowan's activities were, by this stage, openly interfering in the functions of the Department of Forests and the way he was misusing his position as Executive Director of FIC, was rapidly creating a crisis in the timber industry. This is well illustrated by the concluding stages of the VUDAL TRP affair (and Wawoi Guavi which will be dealt with in the final Report).

On 20 November 1986 Secretary Mamalai briefed the Minister on Gazelle forestry matters and recommended the allocation of VUDAL to Timbersales - not to Weco. Hearing of this, Ward telexed Mamalai on 21 November (Appendix 21) seeking to defer the Minister's decision and stated that Weco would accept Maraleu "acting on our behalf". This was faxed to Cowan seeking his help. Mr Diro had already decided the issue in favour of Timbersales however and Mamalai so advised the parties on the 24 November (Appendix 22). Ward then faxed off a number of documents to Cowan seeking his urgent help to have the Minister's decision reversed.

The key document faxed to Cowan was a letter of 25 November to the Minister for Forests in which the East New Britain Premier gave reasons why his government favoured the issue of the Permit to Vudal. Unknown to the Premier, his letter was misused to mount an attack on Secretary Mamalai for failing to consult Provincial Government.

On 27 November there appears on FIC's files a facsimile (Appendix 23) marked "CONFIDENTIAL for M.COWAN" and faxed from Shin Asahigawa's fax machine (previously used by Graham Ward). The author is not shown but the document is of great significance.

Its significance became apparant on 1 December when two letters were drawn up on Minister for Forests' letterhead in virtually the exact terms of this facsimile (there are two "one - word" alterations only). They were signed by Mr Diro and on 4 December were faxed by FIC to the addressees John Dixon (Timbersales) and Graham Ward. (Weco) (Appendix 24).

In the letters Mr Diro revoked his earlier decision and said that the resource allocation:

"is now best resolved by the appointment of an objective third party to make recommendations on the allocation of the resource area concerned. Accordingly I have appointed the Forest Industries Council as the third party".

Obviously Mr Diro was being briefed by Cowan and had accepted from Cowan draft letters prepared by someone using Shin Asahigawa's fax machine - almost certainly Ward. Apparantly Mr.Diro had been led to believe that FIC would be an objective third party in the dispute between Weco and Timbersales; which clearly was not the case. FIC's bias showed on the 13 December when it sent a fax in the name of its chairman Miscus Maraleu to Graham Ward (Appendix 24A).

The fax describes the Minister's direction as being:-

"TO ASSIST IN FINDING A WAY TO FINALLY
DECIDE ON THE RESOURCE IN THE BEST
INTEREST OF YOUR COMPANYS INTEREST
.....NOW I'M IN A POSITION TO DICUSS AND
"LISTEN TO WHAT YOU PROPOSED TO BE
THE BEST WAY TO ADVISE THE
GOVERNMENT TO ALLOCATE THE
RESOURCE."

The man Ward had accepted "*as acting on our behalf*" was now quite apparantly doing so.

On the 10/11th December Mr Diro suddenly ceased to be Minister for Forests and was appointed to the Foreign Affairs portfolio. He was replaced by Paul Torato. Cowan, however, was to continue in operation for another couple of months.

THE TORATO ERA

When Mr Torato became Minister for Forests about the 12 December 1986, FIC's marketing activities were substantial, although still being conducted without formal approval and although they were probably ultra vires the Act.

By the time Minister Torato made his first Parliamentary speech on Forestry, on 15 January 1987, controversies over FIC's marketing role were beginning to emerge publicly. The Minister nevertheless, reading the brief prepared for him, reconfirmed and approved FIC's marketing role.

"I believe the present government through the active marketing efforts of FIC, Forests Department and the Department of Primary Industry, has achieved a significant breakthrough in the prices. But it is not enough. We still have a long way to go and we must establish the most competitive prices for our logs.

Our promotional efforts have got to be continued and intensified further to achieve the highest returns from our log exports".

("FIC) must continue to play its active role in all appropriate areas. FIC, along with Forest Department and the Department of Trade and Industry has recently played a significant role in pushing up the prices and volume of .. log exports. I strongly support FIC to continue to play this active role in its capacity as the State Marketing Agent...."

At last the question of formalising FIC's marketing activities was raised again when, on the 27 January Mr Mamalai renewed contact with the State Solicitor (Appendix 25), sending a draft agreement and seeking approval as:

"The Minister has expressed his desire to get the draft agreement finalised as soon as possible so that it can be signed by the State and the Forest Industries Council in accordance with NEC decision No 220/85 .." .

On 30 January FIC tells DOF it approves the draft (Appendix 26).

On 2 February the State Solicitor advised the Department of Forests that the draft was approved and of the signing procedures (Appendix 27). Still no comment is made about the FIC's powers to carry out the function under the *Forest Industries Council Act*. The same day Mr Amin sent a Minute to Mr Mamalai (Appendix 28) with the draft agreement (Appendix 29) and Policy Submission (Appendix 30) for the Minister's signature.

The draft clearly permits buying and selling of logs (Clause 4); exercise of the State's 25% first refusal rights (Clause 4) and limits FIC's commission to 3% of FOB value (Clauses 3 and 10).

In the submission the 1979 NEC decision is referred to and then it proceeds in these terms:-

"In pursuance (Sic) of the above decision, an offer was received from the Forest Industries Council and a draft agreement was negotiated. The draft agreement was checked and found in order by the Department of Justice.

However, the draft agreement has not yet been formally signed. The Forest Industries Council was asked and authorised by the Minister for Forests to work as the state marketing agent on experimental basis from November, 1986 and the results were found remarkable."

The brief proceeds to expand on the results and to say:

"the informal marketing arrangement has been found highly beneficial to the country and I am convinced that such arrangement should be regularised by signing the draft agreement as soon as possible".

The submission is quite deceptive in its presentation of facts and clearly misleading. It again leads one to be concerned about who was briefing the Minister, how he was being advised or misadvised and what was Cowan's involvement in the preparation of the submission.

Although the submission was clearly put into the hands of the NEC Secretary it is not known whether it was actually considered by Cabinet. It is certain however that no decision on it was made by the NEC and the Agreement was not advised to be signed nor has it ever been signed; possibly because the public controversy was then raging with considerable heat.

Despite the controversy then surrounding FIC, Cowan continued to help Ward over VUDAL (Ward who was due to report to the FIC Council on Cowan's contract conditions in a few days). On 3 February Cowan sent two 49 page facsimiles; one to Maraleu and the other to Ward (Appendices 30A and 30B - first two pages only). These facsimiles consisted of the draft permit and an internal Forestry Minute stating that the Permit which the Minister "*purported to issue*" cannot yet be executed. Ward, apparantly confident of Cowan's ability to influence permit conditions, faxed his requested amendments to the draft to Cowan on the same day (Appendix 30C).

The tumult, conflict and controversy now came to a head however with an FIC meeting on 9 February 1987, coupled with the industry gathering forces at a Forest Industries Association (FIA) meeting on 10 February 1987.

Mr Jack Nouairi of the Prime Minister's Department was present as an observer at the FIC meeting (Minutes are at Appendix 30D).

According to the Minutes:

- (a) It was reported Cowan's contract had been discussed between Ward and Maraleu and with Cowan. The document was produced during the meeting and discussed and debated - Cowan saying *"he was on the same salary and condition as his predecessor with the exception of air travel class which was not first class"*. This was a lie which should have been apparent to Ward and Hirata who did not contradict him. (Hirata had recently requested and had been sent copies of Cowan's and Gresham's contracts)

- (b) There was extensive and vigorous discussion on FIC marketing (Appendix 30D from page 6) touching on:
 - (i) complaints about FIC marketing and ship by ship export licenses;
 - (ii) the legality or vires of FIC involvement in marketing;
 - (iii) lack of NEC approval for FIC to market;
 - (iv) whether FIC was running the Department of Forests - ie role and functions confusion (which Mamalai strenuously denied);
 - (v) FIC's rate of commission (with Mamalai wrongly saying up to 3.5% was allowable);
 - (vi) questions about SJ Park being FIC's agent (where Maraleu was caught telling lies);
 - (vii) questions about pending claims and the Laki Sawmills demurrage claim (where a far less than frank explanation was given);

- (viii) complaints about FIC not keeping up its market reports.

The Minutes show the heat of the Meeting and of the marketing controversy with a 6 to 4 vote for marketing (and only 9 members entitled to vote shown as being present).

Cowan's new contract (Appendix 31) with some marked changes was signed.

By this time animosity was clearly evident, Cowan had completed his misappropriation of FIC funds (See Appendix 47) and with his leave planned for early March he was making "escape" plans. (On 18 February Cowan accepted an offer of a position in Ghana, subject to finalising details in England when on leave - nine days after his three year contract was signed).

The press war then began as did Prime Minister Wingti's concern at what was occurring. The departmental investigation of it by Mr Nouairi commenced.

FIC STOPS MARKETING

On 20 February Miskus Maraleu circulated all log exporters with a telex indicating "FIC will curtail its marketing activities" and predicting immediate price drops.

On 19 February Mr Dike Kari of DOF prepared a report for Mr Nouairi (Appendix 32) discussing state marketing and ship by ship export licenses and outlining what he perceived to be FIC interference in Forestry Department functions such as:

- (a) Allocation of Wawoi Guavi Timber Permit;
- (b) Allocation of the Gazelle Resources particularly VUDAL TRP;
- (c) Additional log export allowances for S.B.L.C.

MR WINGTI AS MINISTER FOR FORESTS

Amidst acrimonious debate, allegations and counter allegations, the appointment of two Council members was terminated and then reinstated. On 8 March Minister Torato made a statement to the Parliament outlining how State Marketing arose (Appendix 33).

Shortly afterwards the Prime Minister Mr Wingti assumed responsibility for the Forests Portfolio. As an early step the Prime Minister asked all FIC Council members to resign. Most did so immediately (Messrs Grace, Kanawi, Hirata, Temu, McIlwain and Father O'Neill) but Messrs Maraleu, Mamalai, Ward and the recently appointed Toms did not do so.

ESTABLISHMENT OF COMMISSION OF INQUIRY

In this context, and amidst a spate of allegations and counter allegations in the press, the Prime Minister established this Commission of Inquiry.

The animosity and division which had arisen is well illustrated in the Minutes of the FIA Meeting of 28 April 1987 (Appendix 34) and Mr Grace's President's Report delivered to that meeting (Appendix 34A).

DEPARTMENT OF FORESTS FILLS THE GAP

The FIC phased itself out of marketing from February/March 1987 but the requirement still existed for producers to offer 25 percent of their exportable logs to the State. To fill the gap left by the discontinuance of FIC's marketing activities the Department of Forests without any formal authority took on the role of defacto State Marketing Agent itself.

How this was achieved and how it worked is described in Section 4 of this Report.

.....

This first section of the Interim Report has studied the long process by which the FIC, after more than six years of debate, became involved in State marketing of logs. The decision to approve the idea of that involvement was made by the NEC during the Somare Government but it was a conditional approval. Before implementation the FIC was to submit detailed proposals which would include its proposed organisational structure and a clear definition of its aims and the role it would play. Only then would the matter be considered in detail by the NEC and a decision made whether or not it should commence marketing.

In the event, a combination of circumstances, largely arising from the unauthorised appointments of Miskus Maraleu as Chairman and Michael Cowan as Executive Director, resulted in an inappropriately structured and unprepared FIC commencing its marketing operations prematurely. It started without government approval of its role, without guidelines for operation, without the required formal agreement with the State and without any legislative authority.

The marketing activities of the FIC into India, Taiwan, Japan and Korea and the devious and dishonest personal manipulations of Cowan and Maraleu have been outlined in chronological order. This provides the continuing theme which linked the various contracts, shipments, wrangles, claims, political machinations and greed driven plots which will be described and analysed in the next section of this Report and its appendices.

SECTION 2: FOREST INDUSTRIES COUNCIL MARKETING

From the foregoing analysis it is apparant that when the FIC embarked on its State Marketing activities there were many drawbacks:

- (a) There were no clear policy objectives for its marketing activities and no approved operational guidelines. It was not clear even whether it was to act as a mere agent or to become involved in buying and selling logs as well.
- (b) Its internal structure and procedures were inappropriate to carry on business as a commercial marketing operation. There was no separate section specialising in marketing and no separate accounting system. It lacked expert and experienced management and staff to run such an operation. Consequently, its records were chaotic and it was inefficient as a business operation.

- (c) There was no formal government approval for its marketing activities as the steps directed by the NEC, which were intended to lead to a formal agreement and NEC approval for FIC to operate as the SMA, were never completed. To the extent that Minister Diro directed FIC to undertake these activities, he was acting beyond his own authority.
- (d) FIC probably lacked legislative authority to buy and sell logs and it definitely lacked legislative authority to enter into contracts and handle its finances in the way in which it did.
- (e) Many of its decisions and actions were taken without the required approval of the FIC Council and were therefore unauthorised as neither the Chairman nor the Executive Director held any delegated authority.
- (f) Many shipping delays, demurrage and other claims, frustrations, ill feeling and financial losses were caused by the inexperience and inefficiency of the Executive Director and his staff.

- (g) It came to be run by Miskus Maraleu as Chairman and Michael Cowan as Executive Director at a time when, for six months, they were not subject to any control by the FIC Council as there was no quorum for it to meet. They were manipulative, dishonest in their "legitimate" dealings and more interested in expanding their own influence and personal profit than in benefitting FIC and the industry. Cowan was busy misusing and even misappropriating FIC funds.
- (h) Cowan persistently diverged from his proper role as Executive Director and became more and more involved in matters of Forestry Policy and administration. The way he openly and secretly influenced and manipulated the Minister amounted to a gross interference with the functions of the Department of Forests.

Nevertheless, the FIC did succeed in marketing 15 log shipments between October 1986 and March 1987. To a large extent it did succeed in raising the price of PNG logs, did gain valuable market data which enabled more rational Minimum Export Prices to be set and it did significantly reduce the seriousness of the transfer pricing problem.

It remains now to look at FIC's marketing endeavours in detail to point out the strengths, expose the weaknesses and see what lessons can be learned for the future.

Details of the fifteen log shipments will be described in Appendices 36 to 46 in which each shipment will be described and analysed. The text of this section will present an overview of the extent of FIC's marketing activities in the Indian, Taiwanese, Korean and Japanese markets; describe and comment on FIC's methods of conducting sales and describe what disclosed and undisclosed deductions were taken from gross sales price, what happened to those deductions and what proportion was passed on to the PNG producers. There will also be a section describing how Cowan used FIC's powerful marketing position to grant improper benefits to several companies and persons in exchange for benefits to himself, and his associates and how he misappropriated FIC funds.

OPERATIONAL ABILITY AND EFFICIENCY

During field inspections and at public hearings the Commission frequently had to examine the office management side of commercial log marketing operations. The following factors were features of all the successful operations studied:

- (a) well qualified trained marketing staff;
- (b) good organisational policies and systems;

- (c) an excellent record keeping system;
- (d) an accurate, efficient bookkeeping and accounting system;
- (e) acute attention to detail and funds control;
- (f) efficient follow up systems regarding payments and claims,

In all these areas FIC management failed spectacularly.

(a) Staff

Gresham envisaged employing a specialist marketing man. He saw Cowan as a technical man. None of the other staff - Tay, Trawa, Aopo had any experience within, let alone as head of a commercial log marketing enterprise. After Gresham left Cowan assumed the role himself and (except for misappropriating funds for his own pocket) made such a mess of it that FIC is yet to feel the full effects of his deficiencies. The whole activity was dominated by Cowan and under his control and direction. In the latter stages Tay displayed signs of efficiency and ability when Cowan was on leave. Cowan appears to have given Tay some measure of responsibility at times but the national officers were relegated to specific tasks such as inspections and loading supervision.

(b) Policies and Systems

There were no positive policies or systems except those which arose from the exigencies of operating. Most producers sell FOB and in all but one case (for Angus) FIC bought its logs FOB. (For explanation of technical marketing terms see Appendix 2)

On all but four shipments however it sold CNF. This practise commenced because Centaur Exports required it for the Indian market. The practice was continued into later shipments however because Cowan had discovered that selling CNF made it easier to build in undisclosed extra margins to be left offshore to pay Park's commission and for the various manipulations which enabled him to misappropriate funds.

There was no standard rate of return for FIC, it was left entirely up to Cowan to decide on a company by company, or even on a ship by ship, basis. Except for Wawoi Guavi Timber Company, which received very special favours, a trend of about 3% return is detectable. FIC would openly seek whatever it could get from the producer up to 3 per cent of disclosed FOB. (3.5 percent for Angus). On top of that there would be an undisclosed extra margin which the buyer would pay.

On the four FOB sales:-

- i) Two to Ataka Lumber were regular - Ataka arranged the vessel (Appendix 42.1 and 42.3);
- ii) One to India seems to have been structured in such a way that very high margins taken offshore could be built into CNF prices (Appendix 36.3);
- iii) On one to Korea Cowan built in a freight "margin" but the producer and buyer, to Cowan's anger, "Trumped" him and arranged a joint shipment with another producer (Appendix 41);

(c) Record Keeping Systems

The FIC filing system is fully described in Appendix 35 where this Commission's work methods are outlined. Suffice it to say here that the filing system was a complete "shambles". To carry out its investigation the Commission had to recreate or, more accurately, to create a filing system for FIC from its own running file. No separate file for each shipment was kept and this must have made it most difficult for staff to keep track of

what was happening at the time. The Commission simply could not compile a filing system using only documents found amongst FIC records and had to fill many gaps by reference to bank and other 'outside' sources. For instance vital banking documents were missing on shipments, 2,3,5, 11A and C and 12A.

(d) Financial Book Keeping and Accounting

FIC's marketing financial records were kept as an integral part of FIC's general business financial records. This has made it most difficult to assess the financial success of the marketing enterprise. It must also have made it most difficult for FIC staff to keep track of the current trading situation during marketing operations.

The financial position of FIC as recorded in its books was not checked sufficiently. For instance there appear to have been no regular bank reconciliations with the cash book and no monthly financial statements were given to the FIC Council. In fact monthly statements were not even prepared. Its cash book for the period is marred by out of place entries, corrections and errors. There are many instances where payments were made by telex transfer directed by a letter rather than by cheque and the amounts were not entered in the cash book, or elsewhere, until the end of the month - perhaps 20 days later. This occurred for instance for Shipments 7A, 10B, 11A and C and 12A. (Thus on one occasion a sum of K639,040.53 was

entered up 18 days after it was actually paid and appears amongst a series of K10 and K12 bank charges entries). Errors in mathematical calculations were also frequent (See shipment 2,3 and 12 for examples (Appendices 36.3, 37 and 45).

In addition to its normal internal accounts FIC made use of its bankers United States Dollar account in America and no records were kept in PNG of transactions in that account (unless some dollars were occasionally converted to Kina). There are sound commercial reasons why a log marketing enterprise may wish to retain some money offshore in this way to facilitate legitimate offshore payments (such as freight charges) without risking the exchange loss which could occur if all funds were routed through the PNG accounts and converted to Kina.

The problem for the FIC using an offshore account arose because:

- i) the FIC Council was never informed of it and certainly never authorised it;
- ii) such a practice is outside the legislative controls imposed on public bodies;
- iii) there were no controls over its use as it was entirely unsupervised and outside FIC's disclosed record system.

(e) Attention to Detail and Funds Control

A careful study of FIC's actual operations disclosed the sort of lack of attention which was to be expected having seen the state of the books. There are frequent errors in vital documents and in instructions given to the bank. For management to have tolerated the long delays in entering up telexed transfers of amounts totalling hundreds of thousands of kina is a fair indication that there was little funds control. Specific examples of inadequate control included several instances where the FIC simply neglected to deduct from the FOB price the commission it had charged (See shipments 2A and B, 11A and C - Appendices 36.3 and 44); one instance where it neglected to even charge any commission at all (shipment 9, Appendix 42.1); an overpayment made to Stettin Bay Lumber Co (Shipment 2C-H Appendix 36.3); probable payment of a freight differential savings to WGTC to which it was not entitled (shipment 13-Appendix 42.2) and, for no apparent reason FIC failed to calculate and record the expenses involved in supervising the loading and inspection of ships.

(f) Efficient Follow up regarding Payment and Claims

Finally there was very little follow up once problems were discovered. Thus, even when it was realised that commission had not been charged to Kumusi and Amazon Bay Timber Company, nothing was done about it; frequently when it was a matter of claiming a refund (as in the case of the Stettin Bay overpayment) nothing was done about it; claims on or by FIC for demurrage, despatch and claims over quantities and defects were often ignored or not pursued by FIC. (These are fully detailed in the comments to Working Table No 3 - Appendix 35.3). The financial consequences of FIC's failure to follow up legitimate claims is fully set out in Section 3 "Effect of Marketing on FIC Funds".

SCOPE OF FIC's MARKETING ACTIVITIES

FIC actually organised and completed only fifteen log shipments, full details of which are given in Appendices 36-46. The positive, and sometimes negative, effects of FIC's marketing endeavours however extended well beyond these actual shipments. FIC frequently bid unsuccessfully for logs and these bids are not recorded as FIC achievements. The fact that an FIC bid was unsuccessful, however, often meant that another buyer (possibly the producer's parent company) had been forced to outbid FIC in order to secure the logs. The "FIC Effect" went even further than that however for, in a very positive way, the mere fact that

FIC was competing in the market and offering "fair market price", and that it was scrutinising the prices being offered by other producers, also had a significant effect in pushing up prices.

There were also some unrecorded "negative" effects of FIC's endeavours such as when, by its own inefficiency or for some other reason, shipments which it had secured failed to eventuate and the overall effect of FIC endeavours on the market was then negative (see Shipment 3 - Woodlark at Appendix 37 and the Kumusi shipment for Pars Ram-Shipment 2A-B at Appendix 36.3) and occasions when disagreement between the producers or buyers and FIC resulted in logs going to alternative buyers. (See Stettin Bay Lumber Co, Kumusi and Open Bay Timber Co. Appendices 36.3,41).

CONCLUDED SALES

The logs for FIC's fifteen shipments were purchased from fourteen producers (from 9 provinces) and sold to 13 buyers (in four countries). All but two of the shipments went to single destination countries, though 8 of them consisted of two or more part shipments for different buyers within the country of destination. Eleven shipments were sold CNF and four were sold on an FOB basis. These details are set out in Table 1. The actual volume sold by each producer to or through FIC is set out in Table 2 which shows the number of shipments and

Table 1

FIC SHIPMENT OUTLINE

(1) SHIP	(2) SUB- SHIP	(3) PRODUCER	(4) BUYER	(5) SALE BASIS
1	A	STETTIN BAY L.C.	CENTAUR EXPORTS	CNF
	B	TONOLEI DEV.	CENTAUR EXPORTS	CNF
2	A-B	KUMUSI TIMBER	PARS RAM GROUP	FOB
	C-H	STETTIN BAY L.C	PARS RAM GROUP	FOB
3		WOODLARK IS DEV.	EAGON IND CO.	CNF
4	A	TONOLEI DEV.	CENTAUR EXPORTS	CNF
	B	KUMUSI TIMBER	CENTAUR EXPORTS	CNF
5		WAWOI GUAVI	SAM WON ENT. CO	CNF
6	A	WAWOI GUAVI	DONG CHANG TIMBER	CNF
	B	ANGUS (PNG)	SANKO CO LTD	CNF
	C	WAWOI GUAVI	SAM WON ENT.CO	CNF
7	A	ULABO	EAGON IND CO	CNF
	B	B.VILLE F.E	EAGON IND CO	CNF
8		OPEN BAY TIM	TAESUNG LUMBER	FOB
9		WAWOI GUAVI	ATAKA LUMBER	FOB
10	A	BISMARK IND	DONG AH ENVIR	CNF
	B	LEYTRAC	DONG AH ENVIR	CNF
11	A	AMAZON BAY S.C	HO SHING WOOD	CNF
	B	ANGUS (PNG)	HO SHING WOOD	CNF
	C	AMAZON BAY S C	SAMSUNG CO	CNF
12	A	LAKI SAWMILLS	EAGON IND CO	CNF
	B	SANTA INV	ORIENTAL CHEM	CNF
	C	SANTA INV	ORIENTAL CHEM	CNF
	D	SANTA INV	SAMSUNG CO	CNF
	E	STETTIN BAY L.C	SAMSUNG CO	CNF
	F	STETTIN BAY L.C	SAM CHANG TIMBER	CNF
13		WAWOI GUAVI	ATAKA LUMBER	CNF
14		ANGUS (PNG)	SAMCHANG TIMBER	CNF
15		WAWOI GUAVI	ATAKA LUMBER	FOB

FIC SHIPMENTS
BY PRODUCER AND PROVINCE (VOLUME)

Table 2

73 b

A BY PRODUCER

PRODUCER	PART SHIP NO	GROSS VOLUME	PROVINCE
STETTIN BAY LUMBER CO	1A 2C-H 12E 12F	2595.097 800.671 2673.590 <u>3055.319</u> 14,124.677	W.N.BRIT W.N.BRIT W.N.BRIT W.N.BRIT
TONOLEI DEVELOPMENT CORP	1B 4A	1620.829 <u>1233.411</u> 2,854.240	N.SOLOMONS N.SOLOMONS
KUMUSI	2A-B 4B	329.391 <u>816.906</u> 1,146.297	ORO ORO
WOODLARK ISL.DEV.	3	<u>5,600.306</u>	MILNE BAY
WAWOI GUAVI TIMBER CO	5 6A 6C 9 13 15	6103.734 3007.925 6359.402 6352.906 6497.751 <u>6514.710</u> 34,836.428	WESTERN WESTERN WESTERN WESTERN WESTERN WESTERN
ANGUS (PNG)	6B 11B 14	5618.143 346.731 <u>3289.255</u> 9254.129	CENTRAL CENTRAL CENTRAL
ULABO	7A	<u>4040.239</u>	MILNE BAY
B.VILLE FOREST ENT	7B	<u>6084 657</u>	N.SOLOMONS
OPEN BAY TIMBER	8	<u>5582.684</u>	E.N.BRIT
BISMARK INDUSTRIES	10A	<u>1500.223</u>	E.N.BRIT
LEYTRAC	10B	<u>4058.356</u>	NEW IRELAND
AMAZON BAY SAWMILLING	11A 11C	458.621 <u>4786.639</u> 5245.260	CENTRAL CENTRAL
LAKI SAWMILLS SANTA INVESTMENTS	12A 12B 12C 12D	2903.323 2588.576 68.827 <u>828.417</u> 5685.820	CENTRAL GULF NEW IRELAND NEW IRELAND

FIC SHIPMENTS

BY PRODUCER AND PROVINCE (VOLUME)

BY PROVINCE

PROVINCE

VOLUME

%

M³

WESTERN (FLY RIVER)

WAWOI GUAVI TIMBER CO

33.85

34,836.428

GULF

SANTA INVESTMENTS

0.25

2,588.576

CENTRAL

DUS (PNG)

9524.129

AMAZON BAY SAWMILLS

5245.260

LAKI SAWMILLS

2903.323

16.91

17,402.712

MILNE BAY

ULABO

4040.239

WOODLARK ISLAND DEV

5600.306

9.37

9,640.545

CEO (NORTHERN)

KUMUSI

1.11

1,146.297

EAST NEW BRITAIN

OPEN BAY TIMBER

5582.684

BISMARCK INDUSTRIES

1500.223

6.88

7,082.907

WEST NEW BRITAIN

STETTIN BAY LUMBER CO.

13.72

14,124.677

NEW IRELAND

LEYTRAC

4058.356

SANTA INVESTMENTS

3097.244

6.95

7155.600

NORTH SOLOMONS

TONOLEI DEVELOPMENT

2854.240

BOUGAINVILLE FOREST ENT

6084.657

8.68

8,938.897

102,916.639

FIC SHIPMENTS
BY BUYER AND COUNTRY OF DESTINATION (VOLUME)

Table 3

73 d

BY BUYER

BUYER	PART SHIP	GROSS VOLUME	COUNTRY
CENTAUR EXPORTS	1A	2595.097	INDIA
	1B	1620.829	INDIA
	4A	1233.411	INDIA
	4B	816.906	INDIA
		<u>6266.243</u>	
PARS RAM GROUP	2A-B	329.391	INDIA
	2C-H	5800.671	INDIA
		<u>6130.062</u>	
EAGON IND CO	3	5600.306	KOREA
	7A	4040.239	KOREA
	7B	6084.657	KOREA
	12A	2903.323	KOREA
		<u>18628.525</u>	
SAM WON ENT. CO	5	6103.734	KOREA
	6C	6359.402	KOREA
		<u>12463.136</u>	KOREA
DONG CHANG TIMBER	6A	3007.925	KOREA
SANKO CO. LTD	6B	5618.143	JAPAN
TAESUNG LUMBER	8	5582.684	KOREA
ATAKA LUMBER	9	6352.906	JAPAN
	13	6497.751	JAPAN
	15	6514.710	JAPAN
		<u>19365.367</u>	
DONG AH. ENVIR. CO	10A	1500.223	KOREA
	10B	4058.356	KOREA
		<u>5558.579</u>	
HO SHING WOOD CO	11A	458.621	TAIWAN
	11B	346.731	TAIWAN
		<u>805.352</u>	
SAMSUNG CO	11C	4786.639	KOREA
	12D	1828.417	KOREA
	12E	2673.590	KOREA
		<u>9288.646</u>	
ORIENTAL CHEMICAL IND	12B	2588.576	KOREA
(FOR CHUNGKOO)	12C	1268.827	KOREA
		<u>3857.403</u>	
SAM CHANG TIMBER CO	12F	3055.319	KOREA
	14	3289.255	KOREA
		<u>6344.574</u>	

WPC SHIPMENTS

BY BUYER AND COUNTRY DESTINATION (VOLUME)

B.	BY COUNTRY OF DESTINATION		VOLUME	
			M ³	%
<u>INDIA</u>				
	CENTAUR EXPORTS	6266.243		
	PARS RAM GROUP	6130.062	12,396.325	(12.04)
<u>KOREA</u>				
	EAGON IND CO	18,528.525		
	SUN WON ENT	12,463.136		
	YONG CHANG TIMBER	3,327.925		
	DAESUNG LUMBER	3,582.684		
	DONG AH ENVIRONMENTAL	3,543.310		
	SAMSUNG CO	3,200.646		
	ORIENTAL CHEMICAL	3,857.103		
	IND			
	SAM CHANG TIMBER CO	<u>6344.570</u>	64,731.472	(62.90)
<u>JAPAN</u>				
	SANKO CO LTD	5618.143		
	ATAKA LUMBER	19,363.357		
<u>TAIWAN</u>				
			24,983.512	(24.28)
	HO SHING WOOD CO		<u>805.552</u>	<u>(0.78)</u>
			<u>102,916.639</u>	

FIC SHIPMENTS

Table 4

BY PRODUCER AND PROVINCE (FOB PRICE TO PRODUCER)

A. BY PRODUCER

PRODUCER	PART/SHIP NO	PRICE TO PRODUCER
1. STETTIN BAY LUMBER CO	1A 2C-H 12E 12F	148,203.88 347,775.05 173,833.36 190,539.77 <u>K860,352.06</u>
2. TONOLEI DEV CORP	1B 4A	95,953.72 72,101.18 <u>K168,054.90</u>
3. KUMUSI	2A-B 4B	25,479.58 55,174.96 <u>K 80,654.54</u>
4. WOODLARK ISL. DEV	3	<u>K295,313.15</u>
5. WAWOI GUAVI TIMBER CO	5 6A 6C 9 13 15	411,066.67 234,252.38 465,748.03 532,777.65 537,624.80 466,472.56 <u>K2,647,942.09</u>
6. ANGUS (PNG)	6B 11B 14	235,795.31 46,872.90 148,350.79 <u>K431,019.00</u>
7. ULABO	7A	<u>K226,835.81</u>
8. BOUGAINVILLE F.E	7B	396,635.68
9. OPEN BAY	8	<u>332,165.22</u>
10. BISMARCK IND	10A	<u>82,305.97</u>
11. LEYTRAC	10B	<u>303,465.32</u>
12. AMAZON BAY S.L	11A 11C	64,185.00 286,138.27 <u>350,323.27</u>
13. LAKI SAWMILLS	12A	<u>43,568.88</u>
14. SANTA INV.	12B 12C 12D	145,098.05 70,961.88 88,947.28 <u>K305,007.21</u>

Con't table 4

FIC SHIPMENTS

BY PRODUCER AND PROVINCE (FOB PRICE TO PRODUCER)B. BY PROVINCE

PROVINCE	TOTAL FOB	
	¢	K
<u>WESTERN (FLY RIVER)</u>		
WAWOI GUAVI TIMBER	(39.98)	2,647,942.09
<u>GULF</u>		
SANTA INVESTMENTS	(2.19)	145,098.05
<u>CENTRAL</u>		
ANGUS PNG		431,019.00
AMAZON BAY S.C		350,323.27
LAKI SAWMILLS	143,568.88 (13.96)	924,911.15
<u>MILNE BAY</u>		
ULABO	226,835.81	
WOODLARK ISL.DEV	295,313.15 (7.88)	522,148.96
<u>ORO (NORTHERN)</u>		
KUMUSI	(1.22)	80,654.54
<u>EAST NEW BRITAIN</u>		
OPEN BAY TIMBER	332,165.22	
BISMARCK IND	82,305.97 (6.26)	414,471.19
<u>WEST NEW BRITAIN</u>		
STETTIN BAY L.C	(12.99)	860,352.06
<u>NEW IRELAND</u>		
LEYTRAC	303,465.32	
SANTA INV	159,909.16 (7.00)	463,374.48
<u>NORTH SOLOMONS</u>		
TONOLEI DEV.	168,054.90	
BOUGAINVILLE F.E	396,635.68 (8.53)	564,690.58
		6,623,643.10

FIC SHIPMENTS

BY BUYER AND COUNTRY OF DESTINATION

(PRICE PAID BY PRODUCER)

A. BY BUYER

BUYER	PART SHIP	PRICE USD	CNF/FOB BASE
CENTAUR EXPORTS	1A	273,888.02	CNF)*
	1B	174,625.08	CNF)*
	4A	127,454.52	CNF)*
	4B	<u>91,323.69</u>	CNF)*
		<u>667,291.31</u>	
PARS RAM GROUP	2A-B	25,961.52	FOB
	2C-H	<u>369,139.92</u>	FOB
		<u>395,101.44</u>	
EAGON IND CO	3	420,022.95	CNF
	7A	323,219.12	CNF
	7B	547,619.13	CNF
	12A	<u>219,872.98</u>	CNF
		<u>1,810,734.18</u>	
SAM WON ENT.CO	5	552,388.01	CNF
	6C	<u>634,668.32</u>	CNF
		<u>1,187,056.33</u>	CNF
DONG CHANG SANKO CO TAESUNG LUMBER ATAKA LUMBER	6A	312,222.61	CNF
	6B	387,023.30	CNF
	8	368,457.14	FOB
	9	565,408.63	FOB
	13	718,001.48	CNF
	15	<u>521,176.80</u>	FOB
		<u>1,804,586.91</u>	
DONG AH ENVIR	10A	143,271.29	CNF
	10B	<u>387,572.99</u>	CNF
		<u>530,844.28</u>	
HO SHING WOOD	11A	77,965.57	CNF
	11B	<u>58,944.27</u>	CNF
		<u>136,909.84</u>	
SAMSUNG CO	11C	397,291.03	CNF
	12D	131,646.02	CNF
	12E	<u>237,949.51</u>	CNF
		<u>766,886.56</u>	
ORIENTAL CHEM	12B	214,851.81	CNF
	12C	<u>105,312.64</u>	CNF
		<u>320,164.45</u>	
SAM CHANG TIMBER	12F	271,923.38	CNF
	14	<u>237,027.70</u>	CNF
		<u>508,951.08</u>	

**B BY COUNTRY OF
DESTINATION**INDIA

CENTAUR EXPORTS	667,291.31
PARS RAM GROUP	<u>395,101.44</u>
	1,062,392.75

KOREA

EAGON IND CO.	1,810,734.18
SAM WON ENT	1,187,056.33
DONG CHANG	312,222.61
TAESUNG LUMBER	368,457.14
DONG AH ENVIR	530,844.28
SAMSUNG CO.	766,886.56
ORIENTAL CHEM	320,164.45
SAM CHANG	<u>508,951.08</u>
	5,805,316.63

JAPAN

SANKO CO	387,023.30
ATAKA LUMBER	<u>1,804,586.91</u>
	2,191,610.21
TAIWAN	
HO SHING	136,909.84

9,196,229.43

Comparisons cannot be made as some sales are FOB and others CNF basis

* Includes Interest

part shipments involved for each producer. Table 2 also shows the volume of timber which FIC took from each Province and what percentage that was of FIC's log sales. It shows that the volume of its total log sales over the fifteen shipments amounted to 102,916.639 m³.

Details of which country each buyer's logs went to on FIC shipments are given in Table 3 which also shows the total volume of FIC logs taken by each of the four countries of destination and expresses that total as a percentage of FIC's total sales.

Table 4 sets out the FOB price received (in kina) by each producer for each numbered shipment or part shipment and receipts on a provincial basis in kina and as a percentage of total receipts. Table 5 shows the price actually paid (in USD) by the buyer for each of those shipments or part shipments.

It must be remembered that no meaningful comparison can be made at this stage between what was paid by the buyer on a CNF basis and what was received by the producer on an FOB basis. It will be necessary to ascertain and deduct the freight and other charges from the CNF price before meaningful comparisons are made. (Some comparisons between what the producer received and what FIC retained are attempted in Table 8-see below);

METHOD OF CONDUCTING SALES

In every case FIC bought from the producer and then sold to the buyer. In no case did it merely act as an agent. This was quite contrary to Gresham's intentions and it meant that, as a principal in each transaction, FIC bore far more risk. It received the gross price shown in Table 5 (in USD) and ultimately paid the producer the net FOB price shown in Table 4 (in Kina). To understand how the producers' shares were calculated requires knowledge of FIC's systems.

The U.S. Dollar Account

At the time of making its claims for the gross price in USD, FIC gave its bankers (BSP) a direction as to what was to be done with the proceeds of the claim. As briefly mentioned above it had arranged with BSP to have BSP hold funds offshore for it in one of the BSP group's foreign currency accounts (a United States dollar account). This is a common, normally available banking service in export transactions involving foreign currency. Such an account is used to retain, offshore in USD, funds to meet offshore payments which are to be made in USD such as freight payments, shipping brokerage and commission payments to overseas agents. The sound commercial rationale for such a practise is to eliminate (or reduce) the risk of loss from unfavourable variation in the foreign exchange rate.

With FIC however, there were three (3) problems in having such a USD account:-

- i) such use of BSP's USD account (though permitted by BSP as a normal customer service) was never sanctioned by the Council of the FIC which appears not to have even been informed of FIC's use of the account;
- ii) retention of FIC funds in BSP's USD account (not an FIC account) was in breach of the spirit and letter of the financial control legislation governing FIC as a Public Body;
- iii) transactions concerning funds retained in USD were not subject to accounting controls and existed outside FIC's systems of financial record keeping; and the funds were only taken up and reflected in FIC's books and accounts if and when funds were drawn off and paid to the credit of FIC's kina account.

These problems never appear to have been addressed by Cowan and Maraleu.

Receiving and passing on the proceeds of CNF sales:

In general terms the CNF price equals the FOB price plus freight on log sales thus one would have expected FIC to develop a system along these lines:-

- i) claim the CNF price in USD;
- ii) calculate freight, shipping brokerage and overseas agents' commission and retain the resulting sum in USD;

- iii) convert the difference (being the FOB price paid less overseas agents commission) to kina and deposit it in FIC's Bank Account in PNG;
- iv) retain FIC standard rate commission less overseas agents' commission (because it is retained in USD and has thus already been deducted) and retain necessary expenses (e.g bank charges);
- iv) account to producer and pay him FOB price less FIC commission and less necessary expenses - such commission and expenses being fully disclosed and particularised;
- vi) pay in USD quantified freight, brokerage and overseas agents' commission against invoices, charter parties or other appropriate evidence acceptable to vouch payment for audit purposes.

This, however, was not the system which FIC used. From its early experience on the Indian market FIC had learned about "contrived" CNF prices where profit results can be manipulated (see comments on the Indian Market in Appendix 36). These

practices were almost a commercial necessity when dealing with the Indian market because of Indian law and long standing market practice. Cowan however carried this type of practice over to almost all of FIC's marketing and he set about contriving prices, parts of which were not disclosed to the producers. He would retain the difference between actual and disclosed prices in the USD account.

For example FIC's Korean agent S.J Park would quote FIC a gross price which would include his commission of USD 1 (plus freight and other charges). When accounting to the producer FIC would omit to mention Park's commission but would wrongly charge the producer a full commission overlooking the fact that Park's commission should have been deducted from the amount retained by FIC.

Sometimes FIC would also manipulate freight and other charges, retaining in the USD account more than was actually charged. In these ways FIC funds were built up at the expense of the PNG producers without their knowledge.

With FIC indulging, almost as a matter of planned routine, in such practices, a different system to that expected was adopted (and there were additional individual variations). Generally it was along these lines:-

- i) claim the CNF price in USD;

- ii) calculate the FOB price which it is intended to disclose to the producer (including disclosed commission and necessary disclosable expenses such as bank charges) and convert that to kina. Sometimes an undisclosed margin was also converted at this time as well in whole or part;
- iii) retain the balance in USD covering freight, shipping brokerage, overseas agents' commission and all or part of the undisclosed freight and/or price margins. The amounts retained were not disclosed to the producers;
- iv) account to the producer for the disclosed FOB price and pay him that price less disclosed commission and necessary expenses (if FIC remembered to deduct the commission and if the producer accepted the expenses);
- v) retain the disclosed commission and necessary expenses and, if it had been converted to kina, the whole or part of any undisclosed margin;

- vi) out of the USD retention funds pay freight and brokerage and sometimes pay Park's commission. In a number of cases Park's commission was accumulated in the USD account and drawn off with Park's concurrence to pay off Francis Sia's loan with BSP Boroko over which Cowan had given an FIC guarantee. (Payments out of the USD fund were almost never vouched to Audit standard);
- vii) work out what to do with the margins and other residues of USD funds. Sometimes these were misappropriated by Cowan; sometimes they were converted to Kina and credited to FIC's Kina account and sometimes the manner of disbursement is just not satisfactorily explicable from FIC's records.

That was what FIC generally did but there were many variations and the full position is only adequately understood by studying the shipment by shipment analyses set out in Appendices 36-46. The variations to this general system include instances where:-

- i) FIC miscalculated the claim and prepared documents wrongly but later corrected them or BSP corrected them;

- ii) FIC made calculation errors in its directions to BSP, in preparing the price to the producer or in preparing freight charges;
- iii) FIC overaccounted to the producer (because undisclosed margins were not considered) and had to seek a refund;
- iv) FIC under accounted to the producer (because of fraudulent false accounting for freight);
- v) FIC rates of commission varied (according to Cowan's whim and other factors). Also FIC sometimes forgot or negelected to deduct or pursue commission in some cases;
- vi) on two occasions Park does not appear to have received his full commission (explicably in one case but inexplicably in another).

Having studied FIC's records it is clear that its methods of conducting sales were disorganised and almost chaotic. Errors and anomalies were an every day fact of life. These were tolerated by Cowan and in fact provided a perfect screen for his carefully calculated misappropriation of funds from the uncontrolled and unsupervised USD residues.