MINUTE ITEM
This Calendar Item No. 35
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only, no action thereon
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INFORMATIONAL
CALENDAR ITEM

35

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Parker

# BIDDING PRACTICES FOR TIMBER SALES

In June 1981, the State Lands Commission awarded a contract for the sale of timber on a parcel of school land in Modoc County. Subsequent to the sale, concern was expressed about the Commission's bidding procedures and whether the practices best served the State's interests.

Currently the Commission utilizes a sealed bid system. This report looks at two issues: 1. sealed v. oral bidding and 2. small business preference in timber sales. For State Lands Commission timber sales it is recommended that:

- The Commission continue utilizing sealed bid practices.

- that no small business preference or "set-aside" program be initiated.

This report examines timber sale bidding practices with the objective of maximization of revenues. A July 23, 1981 memorandum by the Commission's legal staff determined:

"1. There is nothing in the laws of California that mandate a small business preference in the sale of timber from State Lands Commission lands.

2. If the Commission makes a finding that oral bidding in the sale of timber from State Lands Commission lands is in the public interest, it may so order."

SEALED V. ORAL BIDDING:

Oral and sealed bidding are contrasted in the following excerpt from a June 1979 Journal of Forestry article by A. A. Wiener, "Sealed Bids or Oral Auction: Which Yield Higher Prices?":



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"In oral auctions all potential buyers must submit a qualifying bid of not less than the advertised minimum price, together with a bid deposit check. After opening the bids, the auctioneer declares the contract up for oral bidding. Those who submitted qualifying bids can raise their offers orally until no one raises further. Unsuccessful bidders get their deposits back.

In sealed bidding, each bidder submits one written offer which he may not change, and a deposit. The highest bidder is awarded the sale contract.

Under either procedure, a bidder may offer: (a) the maximum amount the timber is worth to him; (b) his judgment of what will probably win the contract for him, but no higher than (a); or (c) a minimal bid that might win the contract if no one else makes an offer.

Under (a) his bid may be even higher than the maximum value of the timber per se, provided that he can average the price with cheaper timber he already has.

In sealed bidding, a buyer who needs the timber is apt to bid a price he judges will win (b), or if he really needs and wants the timber, he will go up to his maximum (a).

In oral auctions, a bidder has no reason to offer more than the maximum (c), initially. If no one else has bid, he will get the timber at the advertised minimum."

The United States Forest Service historically utilized oral bidding procedures in most of its timber sales until Congress, in an effort to curb any possible collusion among bidders, mandated in the 1976 National Forest Management Act (NFMA) that timber sales would be by sealed bid methods, with few exceptions. Strong pressure from the timber industry and arguments that the sealed bidding practices by the



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Forest Service led to closure of some mills and were generally disruptive to timber dependent communities led to the amending of the NFMA to provide for oral auction on major timber sales (generally larger than two million b. f.) and still provide for sealed bidding on smaller sales where collusive activity among bidders and restriction of competition are more likely to occur. Most Commission timber sales are similar in size to this latter classification.

The California Department of Forestry currently utilizes sealed bidding exclusively on its major timber sales. This practice is based on precedence and current managerial preference for the sealed bid system. There are no legislative or administrative mandates that preclude use of either system by the Department.

Current literature (primarily by United States Forest Service economists) contend that there are few significant differences in bid prices generated by oral auction v. sealed bid practices in timber sales - except in situations where competition is reduced (either through lack of need or interest in the timber, or rarely through collusive activity by bidders). In situations with reduced competition sealed bid practices produce significantly higher prices.

In response to the criticism that sealed bidding is disruptive to timber dependent communities, the timber sales by the State Lands Commission are a small proportion of the available timber - relative to the major suppliers - and would have little effect.

Because of the relatively small size of State Lands Commission timber sales, and to generally maximize timber sale receipts it is recommended that the Commission continue to utilize sealed bid procedures.

SMALL BUSINESS PREFERENCE:

There are no legislative or administrative mandates for small business preference in awarding timber sale contracts by the Commission. Neither the Departments of Forestry or General Services currently have a small business "set-aside" or preference provision when awarding timber sale contracts or disposing of surplus/excess property.

The United States Forest Service does have a small business provision in its timber sale program and is described in an excerpt



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[illegible] Service Publication ([illegible]-265) "Competition for National Forest Timber in the Northern, Pacific, Southwest and Pacific Northwest Regions":

"The SBA Set-Aside Program is designed to provide opportunities for small forest product firms to remain viable. The purpose of the program is to help insure that a predetermined share of National Forest Timber harvest is available to qualified small forest products firms. To qualify, firms must be primarily engaged in logging or the manufacture of forest products, must be independently owned and operated, must not dominate in their field of operation, and must not employ more than 500 employees.

Briefly, the intent of the small Business Set-Aside Program is to "aid, counsel, assist, and protect insofar as possible the interests of small business concerns in order to preserve free competitive enterprise." (United States Laws, Statutes, etc. 1958). The program is activated when small business firms are unable to purchase a predetermined percentage of the volume offered. This percentage is based on buying patterns over a five-year period. For example, the current average small business share of the sawtimber volume offered in Washington and Oregon is 31 percent.

If small business firms do not purchase their share of sales during a 12-month period and the accumulated deficit is greater than ten percent of the small business share for the period, a set-aside program is triggered for the following 12 months. During the first six months of this subsequent period, sales containing enough total volume to equal approximately half the accumulated deficit plus the small business share for the period are offered as set-aside sales restricted to qualified small business firms. During the second six-month period, any remaining deficit volume plus the small business share are offered as set-aside sales. These sales may be purchased by large firms only if the USDA Forest Service receives no bids from qualified small firms and if the sale is readvertised."

Current analysis and literature find that bid prices are generally lower on Small Business set-aside sales - that there is an implicit payment to firms awarded Small Business timber sales by the government.

Because the small size, and limited impact on the industry, of the [illegible] Lands Commission Timber Sale program it is recommended that the Commission continue to maximize revenues from its timberlands and not provide for a "Small business Set-Aside" program.

The timber resource under the Commission's jurisdiction is situated on school lands. Maximizing revenue is implied in the trust under which these lands were granted to the State and is consistent with management objectives directed by the Commission for these lands.