

specific mills or mills they own, which limits the ability of tenure holders to rationalize their harvesting operations, log purchase and sale operations, and lumber production in response to changing market conditions.

2. Minimum Cut Requirements

Perhaps the most extreme interference with market forces is in the operation of minimum cut requirements. These requirements, which can be either explicit or implicit, are currently imposed on or perceived by tenure holders to apply to provincial forest land and oblige tenure holders to cut a certain volume of timber during a set period regardless of conditions in downstream product markets that drive the actual demand for timber on the stump. These requirements can be explicitly provided for in provincial regulations or imposed implicitly through the means by which the province implements its policies with respect to the annual allowable cut under tenures and licenses. The result is either a requirement or an incentive to continue harvesting and producing lumber even when market conditions would dictate otherwise.

3. Mill Closure Restrictions

Mill closure restrictions generally dictate the number of days a mill must be in productive operation in order for the operator to maintain access to its tenure. As a result, a mill may be forced to continue to produce lumber even when market conditions would otherwise compel a cut in production or closure of the mill.

4. Minimum Processing Requirements

Minimum processing requirements require the tenure holder or timber buyer to undertake some minimum amount of processing of the timber harvested (or an equivalent volume) before it can be shipped from the province. These requirements have the effect of constraining the impact of market forces in public and private timber markets, as well as limiting the options available to the tenure holder to rationalize harvesting operations, log purchase and sale operations, and lumber production in response to changing market conditions. The elimination or reform of such requirements would reinforce the normal operation of supply and demand in any open and competitive, independently functioning market for timber sales. The Department will, as a consequence, take into account any minimum processing requirements in evaluating the market chosen by a province as a reference point for setting stumpage on provincial lands.

5. Long-Term, Non-Transferable Tenure

Long-term, non-transferable tenures create barriers to entry or exit from the market for provincial timber, which limit competition for the province's timber and the ability of individual firms to adjust to changing conditions in the marketplace.

An important aspect of long-term, non-transferable tenure is the degree to which the security of supply it affords also inhibits the responsiveness of tenure holders to changes in the market. Such inhibition would serve to undermine the overall operation of market forces in the province; which in turn interferes with the market's ability to set

prices. The issues may, however, be most appropriately addressed as a factor affecting the use of reference points in independently functioning markets as a basis for setting stumpage rates on the administered portion of a province's harvest. Adjustments to the observed prices may be required to take into account the differences in the attributes of sales in the independently functioning market and long-term, non-transferable arrangements on provincial lands, including the security of supply associated with a long-term, non-transferable tenures on the administered portion of a province's harvest.

6. Offsetting Provincial Actions

The Department will also examine any evidence that suggests that a province maintains or introduces other requirements or conditions on the sale of provincial timber that would inhibit or undercut the operation of the policy reforms discussed above. The Department will, for example, want to ensure that a province's decisions with respect to the annual allowable cut authorized on provincial lands is consistent with sound forest management and the full rotational economics of the forest, rather than a means of increasing supply and thereby artificially lowering the amount charged on provincial stumpage.

B. Market-Based Pricing

By "market-based pricing," the Department means that a province sets its prices for sales of standing timber on provincial lands either through free and open competition, such as auctions of standing timber or log markets, or a system that ensures the equivalent result. In either instance, to qualify the system must ensure that a province receives adequate remuneration on all provincial timber.

1. Reference Prices

For any portion of a provincial harvest that continues to be sold under prices set administratively the Department will, in general, focus on whether those prices are set by reference to a sufficient range of representative transactions in one or more independently functioning markets for sales of standing timber or logs. Examples of independently functioning markets would include open and competitive auctions of standing timber on provincial lands, competitive log markets, robust and competitive markets for the sale of standing timber or logs harvested from private lands within the province, and, where relevant, similar markets functioning in other jurisdictions.

In assessing whether any reference market is an open, competitive, and functioning independently, the Department will not employ a presumption that a market must represent a specific percentage of the a province's harvest before it could be used as a point of reference for setting prices on the administered portion of the harvest. The Department will, instead, employ a rule of reason—one that is designed to ensure that the market used as a point of reference affords a sufficient basis to establish fair market prices that would then apply to the administered portion of the timber sales system. As reflected in the discussion below with respect to the number of market

participants, all other things being equal, the greater the number of market participants who must participate in the reference market for a sizeable share of the furnish for their mills, the stronger the evidence that the reference market is open, competitive and functioning independently of the administered portion of a province's harvest, and would, as a consequence, serve as an adequate reference point for assessing stumpage on provincial lands.

One reason for adopting that approach is the potentially significant interplay between a province's willingness to undertake the tenure reforms outlined above and the percentage of its harvest that could be used as a reference point for pricing on the administered portion of the province's harvest. To the extent a province has made the reforms outlined above and tenure holders are free to respond to changes in the market, it is easier to identify and evaluate the operation of independent market forces and the size of the reference market per se becomes less significant in ensuring an adequate range of reliable prices that could be used to set stumpage on the administered portion of a province's harvest.

In assessing whether the market-based reference prices provide an adequate basis for setting administered prices that constitute adequate remuneration, the Department will focus on (1) whether the market(s) a province chooses to use as a point of reference ("reference market") actually functions as a market and (2) whether that reference market functions independently of the administered portion of that province's harvest. In determining whether the reference market in fact, "functions" as a truly competitive market, the Department will consider the number of participants, open access to the market, the volume of timber traded on the market (including imports and exports), the lack of restraints on buyers and sellers, access to market information, and other factors listed below. For the Department to determine that the market used as a reference point operates "independently," the Department will want to assure itself, consistent with the discussion below about the direction of the causal link between the reference market and the administered portion of the harvest, that prices observed in the reference market are the result of the free operation of market forces unaffected by any distortions associated with provincial administered timber policies or the effect from stumpage rates charged on the administered portion of the harvest.

More specifically, the Department will examine, *inter alia*, the following characteristics of each reference market chosen by a province for setting the prices for standing timber on the administered portion of a province's harvest, regardless of whether the market chosen involves auctions of the province's own standing timber, auction sales in other jurisdictions, private sales within the province or in other jurisdictions, or any other set of market-based transactions.

a. Number of Participants in the Reference Market. The province must demonstrate that there are sufficient numbers of participants in the reference market to ensure that no individual or group of market participants