

IN THE MATTER OF THE FOREST ACT. R.S.B.C. 1996, c.157,
TIMBER HARVESTING CONTRACT AND SUBCONTRACT REGULATION,
(B.C. Reg. 22/96) AND THE COMMERCIAL ARBITRATION ACT,
R.S.B.C. 1996, c.55

AND

IN THE MATTER OF AN ARBITRATION

BETWEEN:

WESTERN FOREST PRODUCTS INC.

("Western")

AND

HAYES FOREST SERVICES LIMITED

("Hayes")

DATES OF HEARING:

March 29, 30, 31,
April 1, 2005
Vancouver, BC

COUNSEL:

Counsel for Western

Eric J. Harris, Q.C. and
Paul McLean

Counsel for Hayes

Kenneth N. Affleck, Q.C. and
Robert Hrabinsky

COLIN TAYLOR, Q.C.
Arbitrator

[1] This arbitration was initiated by Western Forest Products Inc. ("Western") pursuant to section 25 of the *Timber Harvesting Contract and Subcontract Regulation*, B.C. Reg. 22/96, as amended by B.C. Reg. 278/2004 (the "Regulation"), to determine the 2004 conventional logging rate for timber harvesting services provided by Hayes Forest Services Limited ("Hayes") under a replaceable logging contract at Plumper Harbour. Hayes seeks a rate of \$47.74/m³ while Western has offered a rate of \$44.39/m³.

[2] Section 25(5)(g) of the Regulation provides that the arbitrator must deliver an award within 15 days of the arbitration hearing being completed and the award "must be 5 pages or fewer", a limitation which does not permit an exposition of the evidence and the submissions which the case deserves.

[3] The Regulation underwent substantive amendments in June, 2004 including a more efficient and streamlined dispute resolution process and, of singular significance, the establishment of a new rate test for conventional timber harvesting. The test to be applied under the Regulation now provides:

26.1

(1) *If a rate dispute is referred to arbitration, the arbitrator must determine the rate according to what a willing license holder and a willing contractor acting reasonably and at arm's length in similar circumstances would agree is a fair market rate, on the earlier of*

- (a) *the date the rate proposal was delivered to the contractor, and*
- (b) *the date the timber harvesting operations commenced.*

[4] The Regulation previously required that a conventional logging rate be "competitive by industry standards" and permit the contractor to earn "a reasonable profit". Thus, the requirement to determine a "fair market rate" stands in marked contrast to the previous requirement to permit a contractor "in terms of costs and productivity to earn a reasonable profit".

[5] In its *Backgrounder* released with the amendments to the Regulation on June 21, 2004, the Ministry of Forests said:

[The Regulation] establishes a new method to set contract rates that reflect market conditions ... British Columbia's forest sector must be globally competitive to be sustainable. The amended regulation allows forestry operators to manage their businesses in ways that better reflect the market. For example, the regulation: Introduces a new test to determine market rates, ensuring negotiated rates fairly and reasonably reflect market conditions.

[6] In determining a "fair market rate", an arbitrator "may take into consideration" the comparables identified in section 26.01(2)(a) to (d).¹

Section 26.01(2) then goes on to provide that the arbitrator may have regard to "the impact on fair market rates likely to arise from differences between the timber harvesting operations" in order to make "meaningful comparisons". Those "differences" may include those identified in Section 26.01(e)(i) to (ix).²

[7] Since 1997, Western (and its corporate predecessors) and Hayes have been parties to a full-phase (or "stump to dump") replaceable logging contract for conventional timber harvesting at Plumper Harbour which is situated in an area known as the Nootka Region on the western side of Vancouver Island.

[8] The Nootka Region is comprised of two Western timber harvesting operations and six independent full-phase logging contractor operations³ known as the Nootka Contract Administration ("NCA") which includes the Hayes operation at Plumper Harbour.

[9] Management of the timber resources in the NCA is governed by a fibre basket agreement which sets out the timber allocation available to Hayes and the other five contractors in the NCA.⁴ Hayes is entitled to log 5.77% of the total volume harvested under the fibre basket agreement in each year, or approximately 69,700 /m³ (net) per annum, although this number varies.

[10] By an award dated February 12, 2004 (the "Award"), Arbitrator Frank Borowicz, QC determined conventional timber harvesting logging rates for the Hayes operation at Plumper Harbour as follows: 1998 - \$44.50/m³; 1999 - \$46.90/m³; 2000 - \$45.00/m³; 2001 - \$46.10/m³. Those rates were determined under the former Regulation to allow Hayes to earn a reasonable profit.⁵

[11] The determination of a fair market rate for timber harvesting services at Plumper Harbour on July 2, 2004, the date on which Hayes commenced timber harvesting, is an exercise in discerning timber harvesting market and economic realities. It requires appropriate objective criteria, the best evidence of which is the pattern of rates reached in freely negotiated contracts for similar timber harvesting services performed in similar working conditions. It is a rational matching of like circumstances. The arbitrator's function is not to fashion a settlement based on a reasonable compromise between the negotiating positions of the two parties but to act adjudicatively and base the final result on rational objective criteria. This approach is markedly different from the previous requirement that a rate be sufficient to permit a contractor to earn a "reasonable profit".

[12] The best evidence of a comparable market in this arbitration is the NCA contractors. The similarity of the logging operations in the NCA was

considered and accepted by Arbitrator Borowicz.⁶ Hayes agrees that the contractors in the NCA are substantially similar except for the existence of a camp and mobilization and demobilization costs.

[13] Hayes submits that the fair market rate for 2004 is \$47.74/m³. It derives this figure by taking the rate awarded by Arbitrator Borowicz for 2001 (\$46.10/m³) and rolling it forward by 3.55% (50% of IWA increases; 50% of inflation).

[14] The difficulty with that approach is that the 2001 rate is not a rate "agreed to by the license holder and contractor for prior timber harvesting services" (section 26.01(2)(a) of the Regulation). It is a rate awarded by Arbitrator Borowicz under a different regulatory scheme; one which prescribed a rate test requiring an assessment of the contractor's profitability. The only rate agreed between Western and Hayes is the 1997 rate of \$40.59/m³. No other rates have been agreed between the parties. Moreover, the rates which pre-date the June 2004 amendments to the Regulation were not based on the "fair market" which the Regulation now demands.

[15] In any event, Hayes submits that the 2001 arbitrated rate is objectively reflective of a "proper market rate" when a "meaningful comparison" is made to other timber harvesting operations having regard to the material differences. The material differences between the timber harvesting operations within the NCA in 2001, argues Hayes, were:

- (a) volume of timber processed, and
- (b) the presence or absence of a camp.

Hayes was one of three contractors within the NCA to maintain a camp.

[16] There is evidence to suggest that where rates are freely negotiated, volume does not automatically impact the rate.⁷ Moreover, Hayes has always received its minimum 95% allocation in a five-year cut control period. In any event, Mr. Donald Hayes testified that the logging shows in the NCA are "reasonably similar" except for the existence of a camp and mobilization and demobilization costs.⁸

[17] Hayes quantifies the impact on rates attributable to a camp by taking the agreed camp-man day rate paid by Western to Hayes of \$75.00 and dividing it by Hayes' actual volume per man-day (21/m³) yielding a rate component of \$3.57/m³ attributable to the camp. Hayes then adjusts the 2001 rates for contractors in the NCA by this "material difference" producing a median rate of \$46.47 which compares favourably with the 2001 rate awarded to Hayes of \$46.10 which it uses for the "roll-forward" exercise.

[18] I am unable to accept the argument that the maintenance of a camp by Hayes is a material difference among the timber harvesting contractors within the NCA for these reasons:

- (i) Two other contractors within the NCA maintain camps at rates significantly less than the rate advanced by Hayes.
- (ii) The decision to maintain a camp is one made by a contractor. Western does not require its contractors to operate a camp at Plumper Harbour or at other operations. The contractor negotiates a rate and structures its business, ie. camp or no camp, as it sees fit.
- (iii) Hayes' camp adjustment does not provide an offset for the cost of crew transportation.
- (iv) Mr. Donald Hayes confirmed that the decision to operate a camp rests with the contractor. He testified that a camp was maintained at Plumper for safety reasons. That evidence was rebutted by Mr. John Waring, the Resident Engineer for Western.
- (v) There is no evidence of lost productivity or accidents on the waters of Nootka Sound and I must conclude that the decision to maintain a camp in place of crew transport is a business decision. This conclusion is supported by the decisions of two other contractors in the NCA to operate camps instead of boating crews on a daily basis.
- (vi) There is no satisfactory evidence to support the camp operation cost of \$3.57/m³ advanced by Hayes. It is based upon an occasional day rate paid by Western for its employees to use the camp facilities. There is no evidence of actual cost of operating the camp or the financial impact of the camp on a market logging rate.
- (vii) The operation of a camp is not a "phase" of logging under section 26.01(2) of the Regulation.⁹

[19] Hayes submits that the suspension of work imposed upon it by Western for the 2003 logging year is a material difference among the timber harvesting operations in the NCA that necessarily has an impact on rates within the meaning of paragraph 26.01(2)(e)(iv) of the Regulation. Hayes estimates that the rate component attributable to this suspension of work is \$1.55/m³ having regard to the impact of demobilizing and mobilizing its equipment in 2003. Hayes goes on to argue that if the 2004 rates for other NCA contractors are adjusted to account for the impact on rates attributable to both the presence of a camp (\$3.57/m³) and demobilization and mobilization (\$1.55/m³), the median of these adjusted rates is \$48.74/m³ whereas the Hayes proposed rate for 2004 is \$47.74/m³.

[20] The proposed demobilization/mobilization adjustment is rejected for these reasons:

- (i) Mobilization and demobilization is not a "phase" of logging nor is Plumper Harbour a "new operating area".
- (ii) Hayes was not required by Western to move its equipment nor is there any evidence of the actual cost of doing so. Likewise, there is no evidence of the revenue generated from the use of the equipment in other areas.
- (iii) There is no evidence as to whether such payments are paid on the open market by licensees or in what amount, if any. Western's evidence is that Spirit Lake moved its equipment out of the operating area and did not seek nor was reimbursed by Western.
- (iv) There is no evidence of a historical or contractual entitlement to such payment and no evidence of what a fair market rate might be for such services.
- (v) The 2004 logging plan at Plumper Harbour called for 130,000/m³ comprised of 60,000/m³ (net) from the 2003 logging season and 65,000/m³ (net) for the 2004 season. Hayes was able to log this volume in six months on a continuous shift basis and utilize its

equipment elsewhere for the first half of 2004. No other contractor in the NCA operated on a continuous basis in 2004, a distinct advantage for Hayes.

[21] Following careful consideration of all of the evidence and the thorough submissions of the parties (deserving of a greater exposition than is permitted by the Regulation), I conclude that this case reveals a conflict between the old way of setting rates and the new way required by the amendments to the Regulation. The parties must now adapt to the new market-rate requirement of the Regulation.

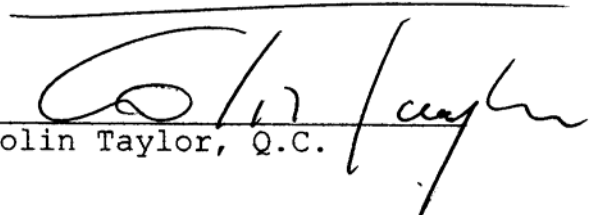
[22] In determining a fair market rate, the NCA contractors represent the most appropriate market upon which to assess the 2004 logging rate at Plumper Harbour. The contractors in the NCA, except for Hayes, have over ten years of freely negotiated rates upon which to ground a fair market rate. Both Western and Hayes agree that operations in the NCA are substantially similar. Hayes submits there are material differences; the existence of its camp and mobilization/demobilization costs. For the reasons I have expressed, that is not a basis upon which to distinguish the logging shows in the NCA

[23] The conventional logging rates negotiated between Western and the NCA contractors reveals that the average blended rate for the contractors in the NCA, for the 2004 logging season, excluding Hayes, was \$43.77m³¹⁰. These rates represent the "fair market" rate for timber harvesting at Plumper Harbour during the 2004 season. Hayes seeks a rate which is \$3.97/m³ above the average market rate in the NCA for a substantially similar logging show. This significant variance has no foundation in fact or in law under the Regulation.

[24] Western has offered Hayes a conventional logging rate of \$44.39/m³ for its operations at Plumper Harbour for 2004 which I determine to be a fair market rate and it is so awarded.

[25] I retain jurisdiction with respect to any issues arising out of the implementation of this award and with respect to costs.

DATED at Vancouver, British Columbia, this 11th day of April, 2005.


Colin Taylor, Q.C.

NOTES:

1 Rate test

26.01(2) In determining a fair market rate under subsection (1), an arbitrator may take into consideration the following:

- (a) rates agreed to by the licence holder and contractor for prior timber harvesting services;
- (b) rates agreed to under another contract by either the licence holder or contractor for similar timber harvesting services;
- (c) rates agreed to under another contract by either the licence holder, the contractor or another person for each phase or component of a similar timber harvesting operation;
- (d) rates agreed to by other persons for similar timber harvesting services;

2 26.01(2) (e) if necessary to make meaningful comparisons to any of the rates agreed to in paragraph (a), (b), (c) and (d) above, the impact on fair market rates likely to arise from differences between the timber harvesting operations that pertain to the rate in dispute, and the timber harvesting operations that pertain to any rate described in paragraphs (a), (b), (c) and (d), including the following:

- (i) differences in operating conditions including, without limitation, differences in terrain, yarding distances, hauling distances, volume of timber per hectare;
- (ii) differences in the total amount of timber processed;
- (iii) differences in the required equipment configuration;
- (iv) differences in required phases;
- (v) differences in operating specifications;
- (vi) differences in law;
- (vii) differences in contractual obligations;
- (viii) differences in the underlying costs of timber harvesting operations in the forest industry generally which would affect fair market rates, including changes in the cost of labour, fuel, parts and supplies;
- (ix) differences in the cost of moving to a new operating area, if any;
- (f) any other similar data or criteria that the arbitrator considers relevant.

3 Onion Lake Logging Ltd.
 Russell & Lilly Ltd.
 Spirit Lake Timber Ltd.
 Friell Lake Logging Ltd.
 Frank Beban Logging Ltd.
 Hayes Forest Services Limited

- 4 Onion Lake Logging Ltd. - 9.446%
 Frank Beban Logging Ltd. - 7.819%
 Friell Lake Logging Ltd. - 6.937%
 Russell & Lilly Ltd. - 6.324%
 Hayes Forest Services Limited - 5.77%
 Spirit Lake Timber Ltd. - 4.89%
- 5 Award - paras. 218-220, 229, 244, 259
- 6 Award - paras. 219-220
- 7 Exhibit 3(18), p.2; Spirit Lake Logging Ltd. has the smallest volume of the NCA contractors and the lowest negotiated market rate.
- 8 Trans. Donald Hayes, March 30, 2005, p.240
- 9 "phase", when used in relation to a timber harvesting operation, means felling, bucking, yarding, skidding, processing, decking, loading, hauling, unloading, non-mill or non-custom dryland sorting or booming, logging road construction, logging road maintenance including temporary road deactivation, logging access road construction and any other phases or combinations or components of them that are aspects of a timber harvesting operation under a license, but does not include catering, cruising, forest engineering, semi-permanent or permanent road deactivation, towing, barging, mill or custom dryland sorting or booming, reforestation, scaling, equipment rental, equipment maintenance or providing support services relating to timber harvesting. (Section 1)
- 10 Exhibit 2 (tabs 9-13)