

IN THE MATTER OF THE *FOREST ACT*, RSBC 1996, C. 157
TIMBER HARVESTING CONTRACT AND SUB-CONTRACT REGULATION,
BC REGULATION 22/96 ("*REGULATION*")
COMMERCIAL ARBITRATION ACT, RSBC 1996, C. 55
A REPLACEABLE LOGGING AGREEMENT IN TREE FARM LICENCE ("TFL") 44
("CONTRACT")

BETWEEN:

HAYES FOREST SERVICES LIMITED

("HAYES")
CLAIMANT

AND:

WESTERN FOREST PRODUCTS INC.

("WESTERN")
RESPONDENT

RATE AWARD

Counsel for the Claimant:

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Arbitrator:

Frank S. Borowicz, QC, CA(Hon)

Background

TFL 44 was obtained by Weyerhaeuser Company Limited in 1999, and transferred to Cascadia Forest Products in 2005. In 2006, Western amalgamated with Cascadia, and continues to hold the Licence.

The last written form of the Contract was dated January 1, 1999. From January 2003 to January 2008, the Contract was suspended while the parties operated under a Timber Supply Execution Agreement ("TSE"). When the TSE expired, the Contract was revived, and Hayes resumed providing conventional stump to dump logging services under the Contract.

The parties have agreed that the amount of work Hayes is entitled to under the Contract is 19.7% of the annual amount of timber processed by Western in TFL 44.

Issues

The issues referred to arbitration relate to:

- (a) **Dry Land Sort Work:** Hayes claims a right under the Contract to do dry land sort work, which Western removed from Hayes on the basis of operational changes it decided to implement. Western does not dispute Hayes' contractual entitlement to the work. It contends, however, that Hayes is only entitled to compensation for loss of the work, and does not have a right to continue to do the work.
- (b) **Helicopter Yarding Work:** Hayes claims a right to perform a percentage of helicopter yarding work. Western contends helicopter yarding is not included in "Work" as defined under the Contract, and that the agreement between Hayes and Weyerhaeuser regarding helicopter work did not form part of the Contract assumed by Western. Western also contends that a collateral agreement regarding helicopter yarding is inconsistent with the "Entire Agreement" clause in the Contract.
- (c) **Set-off:** Western asserts a right to set-off monies it claims are owing to it by Hayes under the TSE against amounts it owes to Hayes for work done under the Contract.
- (d) **Applicable Rates:** Setting the rates to be paid by Western to Hayes for 2008 according to the standard prescribed by the *Regulation* for the logging services performed by Hayes under the Contract.

Division 4 of the *Regulation* establishes a specific procedure for the resolution of rate disputes. Section 25(5) applies to replaceable contracts pertaining to a licence in the coastal area, where TFL 44 is located. It also requires a rate award to be issued within 15 days of the arbitration hearing, and to be limited to no more than 5 pages.

To comply with the statutory time limit imposed by s. 25(5)(g)(ii), this Award relates only to the applicable rates, and jurisdiction is reserved with respect to the other issues in the arbitration, which will be determined in a supplementary award.

RATE AWARD

1. At issue are the 2008 rates to be paid by Western to Hayes for logging services under the Contract. The parties agree that the operative date for the rate determination is January 25, 2008.
2. Hayes proposes a rate of \$58.67/m³ for conventional stump to dump logging services; and \$4.75/m³ for related dump and boom work.
3. Western proposes a rate of \$49.57/m³, as an all-inclusive blended rate for all phases of the work performed by Hayes.

Regulatory Context

4. In 2004, the *Regulation* was amended to establish a new approach to determining rates by reference to what "a willing licence holder and a willing contractor acting reasonably and at arm's length in similar circumstances would agree is a fair market rate".¹ This more objective fair market approach is a marked departure from the previous standard, which was essentially cost based and contemplated a rate that was "competitive by industry standards" and would permit a contractor to earn "a reasonable profit."
5. The *Regulation* prescribes factors that may be considered in comparing other contracts to determine a fair market rate,² and also differences in circumstances and other criteria that may be used to adjust comparable contracts to make meaningful comparisons.³
6. As noted by Arbitrator Colin Gibson, QC,⁴ the five page award limit imposed by the *Regulation* does not allow much exposition of the evidence, submissions and analysis that inform the arbitrated rate. Of necessity, therefore, the Award is conclusory in nature.

Former Rates

7. Section 26.01(2)(a) provides for consideration of the rates agreed to by the licence holder and contractor for prior timber harvesting services. In this case, however, the last agreed upon rates under the Contract were for 2001 and 2002, and were settled in the context of the prior regulatory scheme.
8. Hayes maintains that, for purposes of section 26.01(2)(a), the "agreed" rates for 2001 and 2002 are the rates it contends were agreed to as "rates of record". Western contends that the "agreed" rates for 2001 and 2002 should be the amounts the parties

¹ Section 26.01(1)

² Section 26.01(2)(a) to (d)

³ Section 26.01(2)(e) and (f)

⁴ *Western Forest Products Inc. and Hayes Forest Services Limited (Plumper Harbour)* (April 11, 2005), par. 2

actually agreed would be paid. The former are higher than the latter, as in both years Hayes agreed to accept the amount advanced by Western in settlement of its outstanding accounts, with a stipulation that an adjusted rate be accepted as the "rate of record".

9. While there may be a lack of evidentiary certainty as to the proof of whether Weyerhaeuser had accepted Hayes' stipulated 2002 "rate of record", there is no real reason to doubt it did, or that the purpose of setting the rate of record was to establish a baseline for future rate negotiations. Accordingly, it can be reasonably concluded that the agreed rate under the Contract for 2001 was \$49.07/m³, delivered to the Cayuse sort; \$51.60/m³, delivered to the more distant China Creek and Sarita sorts; and \$7.36/m³ for the dry land sort phase. For 2002, the agreed rate of record was \$52.63/m³ for conventional stump to dump harvesting to the China Creek and Sarita sorts; and \$7.51/m³ for the dry land sort phase.

10. Hayes contends it is a common practice in the industry to establish new rates by rolling forward the prior year's rate with an adjustment formula for some standard inflation factors. On Hayes' calculations, the 2001 rate of record rolled forward on that basis would amount to \$57.91/m³ for conventional stump to dump work in 2008, and rolling forward the 2002 rate of record would amount to \$59.07/m³ in 2008.

Comparable Contracts

11. Western presents various rates in contracts it contends relate to similar timber harvesting services performed in similar working conditions, including a number of contracts that are not replaceable contracts under Bill 13. In that regard, Hayes contends that Bill 13 contracts are to be preferred as comparables when they are available. While there may be merit to that, it is not decisive, as the *Regulation* contemplates non-Bill 13 contracts being used as comparables. More significantly, in this case all but one of the contracts presented necessitate so many adjustments and extrapolations that they are not practically meaningful as comparables.

12. The most useful current comparable is the contract between Western and Island Pacific Logging ("IPL"). Western based its proposed rate for the Contract on the IPL rate, and Hayes agrees that the IPL contract is the best comparable available. Under the TSE, Hayes had also worked in both of the adjacent Walbran and Franklin areas of TFL 44. IPL is now harvesting in the Franklin, while Hayes is harvesting in the Walbran.

IPL Contract Adjustments

13. Nonetheless, Hayes contends that a number of adjustments need to be made to the IPL contract rate to reflect similar circumstances and make it more accurately comparable to the Contract.

14. For example, Western pays IPL a blended rate of \$49.71/m³ for all of its work, including dry land sorting. Hayes contends that adjustments are needed because of major differences between the work being done. For example:

- (a) hauling distance - IPL had estimated an average haul distance of 30 km, compared to Hayes' average haul distance of 71 km;
- (b) volume - IPL has a total contract volume of 426,200 /m³, some of which is yarded by helicopter, compared to Hayes' contract volume of 186,809/m³; and
- (c) phase work -
 - (i) IPL does dry land sort work; whereas
 - (ii) Hayes is doing dump and boom work.

15. The volume differences are generally significant. The BC Court of Appeal has recognized that volume has a global impact on operating costs. It is "*a generally accepted fact that harvesting costs per unit diminish as the volume of harvest increases.*"⁵ The volume differences between the Contract and the IPL contract are indeed substantial. In addition to the overall volume differences, Hayes also has a smaller volume per block ratio. These differences impact the fair market rate of the Contract, and need to be considered as a factor in appropriate adjustments.

16. IPL's anticipated hauling phase cost was \$8.59/m³, based on an average distance of 30 km. Hayes' average hauling distance is 71 km. This is also a significant and self-evident difference in an important industry metric. Hayes proposes to adjust for the difference by doubling the hauling distance cost allocation in the IPL contract. Western contends an appropriate adjustment is not as simple as a doubling of costs for a doubling of distance. In these circumstances, however, doubling is not an inappropriate way to account for vital factors like fuel use and driving time. It is also likely that IPL's cost estimate would have included consideration of its ability to use the same trucks to perform both its Western work and hourly contract work for TD Carter, as well as the ameliorative impact its overall work volume would have on its hauling costs. On the whole, therefore, Hayes' proposed hauling adjustment to the IPL rate is reasonable. Both parties also analyzed actual load per day truck utilization in the Hayes and IPL operations, which tend to be more illustrative of operational business decisions than fair market value, and do not detract from the simple utility of the hauling adjustment proposed by Hayes.

Dump and Boom Rate

17. Since recommencing work under the Contract, Hayes at the direction of Western has been performing only dump and boom work, and not dry land sort work. Hayes therefore proposes the IPL rate be adjusted by removing the dry land sort component

⁵ *Hayes Forest Services Limited v. Pacific Forest Products Limited*, 2000 BCCA 66, par. 21

and by adding a fair market value for the dump and boom work, as a simple adjustment to reflect a significant difference consistent with actual circumstances.

18. In reference to extrapolated costs for its own dump and boom work, and dump and boom rate information received from other operations, Western contends that an average adjusted rate for dump and boom work would be \$2.11/m³.

19. Hayes proposes an average of dump and boom rates obtained from several other companies, as well as the rates Hayes has paid to other companies to do dump and boom work, adjusted for related wire and infrastructure costs, and the addition of \$0.72/m³ for "travel and crummy" time to the Coleman dump, resulting in an adjusted average rate of \$4.60/m³.

20. The travel and crummy time, however, is dependent on Hayes' agreement with its union-sub local. Using its own particular union costs as a basis for adjustment is in essence a return to the former "costs plus" approach to rate determination, and should therefore be discouraged, although travel time to the Coleman dump for the crew involved is an objective factor that can be appropriately taken into consideration in determining a fair market rate. Western's assessment of the actual travel cost to the Coleman dump is that it would objectively be no more than \$0.25/m³. Using an adjustment of that amount, instead of \$0.72/m³, results in a dump and boom rate of \$4.13/m³ in reference to the comparables offered by Hayes, which overall seem to better reflect rates available on the open market under similar operating conditions and specifications as pertain at the Coleman dump.

Other Adjustments

21. Hayes contends that other adjustments should be made to the IPL rate in light of what Hayes considers to be errors made by IPL in calculating its costs. While it may be appropriate to make adjustments in some circumstances where, like here, there is a single comparable contract for consideration, it would be presumptuous to conclude without compelling evidence that IPL had not reconciled for itself a comprehensive assessment of all the factors it chose to integrate into its rate proposal. Comparables are not required to be identical to each other to be reasonable comparators, and only those adjustments that are material need be made.

22. Hayes also contends that some adjustments should be made to the IPL rate to reflect certain fixed costs that had to be incurred by Hayes but not incurred by IPL, like stand-by and mobilization costs. These, however, are similarly not necessary for the IPL contract to be a reasonable comparator, and also tend to be of an operational and accounting nature more compatible with the former "costs plus" regulatory scheme than the new fair market rate scheme.

Conclusion

23. Rolling forward the 2001 and 2002 rates of record in accord with common industry practice would ordinarily produce a persuasive comparable rate. In this case, however, the previous rates need to be rolled ahead not just one or two years, but six or seven years. A roll forward of that magnitude is arguably less reliable, and the 2001 and 2002 rates of record also pre-date the new regulatory rate setting scheme.

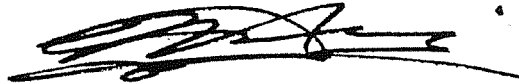
24. It is notable, however, that the TSE included a mechanism whereby the parties made an annual inflation adjustment. And, in the circumstances of this case, there is only one current, meaningful comparable, which itself required adjustments to account for differences in operations. The breadth of comparables contemplated by s.26.01(2) of the *Regulation* suggests an intent to reference enough comparables to create a market context. A larger number of comparables generates a higher degree of substantive confidence in the resulting data, as it is inevitable that each contract will contain idiosyncrasies. For example, Hayes observed that IPL has indicated an intention to approach Western with a view to seeking some adjustments to its contract. The existence of multiple comparables minimizes the impact of idiosyncrasies on the determination of a market rate.

25. In the result, I am drawn to the conclusion that the rolled forward rate of record and the adjusted IPL rate, when blended, provide a more objective indication of a fair market rate in this case. The comparable IPL rate, adjusted for hauling distance, and excluding dry land sort, is \$52.38/m³. The 2002 rolled forward rate is \$59.07/m³. The average of the adjusted IPL rate and the 2002 rolled forward rate is \$55.73/m³.

26. Accordingly, the fair market rate for the Contract is \$55.73/m³ for conventional stump to dump work. In the circumstances of this case, it is also appropriate to provide for a separate rate for dump and boom work, and the fair market dump and boom rate for the Contract is \$4.13/m³. It is so awarded, and Western is to pay Hayes the difference between the amounts paid for the related services performed by Hayes to date and the amount payable in accordance with these awarded rates.

27. Jurisdiction is reserved with respect to the remaining issues in the arbitration, interest, costs, and any issues arising out of the implementation of this Award.

DATED in Vancouver, British Columbia on the 7th day of October, 2008.



Frank S. Borowicz, QC, CA(Hon)
Arbitrator