

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:

TRUE NORTH HOLDINGS LTD. dba  
TRUE NORTH TIMBER HARVESTING AND  
THUNDERBOLT ENTERPRISES LTD.

("Logging Contractors")

AND

TOLKO INDUSTRIES LTD.

("License Holder")

DATES OF HEARING: March 20, 21, 22, 2006  
Williams Lake, BC

COUNSEL:

Counsel for Logging  
Contractors

Counsel for License Holder

John Drayton

Daniel Bennett

COLIN TAYLOR, Q.C.  
Arbitrator

[1] This arbitration was initiated by the Logging Contractors 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 2005 logging rates for timber harvesting services provided by the Logging Contractors under three replaceable logging contracts.

[2] The Logging Contractors are related companies. There are three rate disputes which the parties, for convenience, have chosen to consolidate for purposes of this arbitration. In all cases, the blocks have been logged. In their chronological order of logging, the blocks may be described as:

- (a) EG6002 and EG6009 (referred to by the parties and hereafter called "108 North Package");
- (b) FT8497 (referred to by the parties and hereafter called "CP497"); and
- (c) FR3498 (referred to by the parties and hereafter called "CP498").

[3] The rate dispute logging areas are located in the Moffat Lake area, generally south-east of Williams Lake and north-east of Lac La Hache. The terrain is characterized by flat to rolling topography. Timber stands are primarily composed of lodgepole pine with minor amounts of Douglas fir and Engelmann spruce. The mountain pine beetle has heavily attacked the mature pine trees in this area resulting in a priority effort to salvage the remaining economic value of the forest stands.

[4] Section 25(6)(i) of the *Regulation* provides that the arbitrator must deliver an award within 7 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 voluminous evidence and the submissions which the case deserves.

[5] The *Regulation* underwent substantive amendments in June 2004 including a more efficient and streamlined dispute resolution process and, of most significance, the establishment of a new rate test for timber harvesting:

*Rate Test*

26.01(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.*

[6] The *Regulation* previously required that a 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."

[7] In *Western Forest Products Inc. v. Hayes Forest Services Limited*, April 11, 2005, the only decision under the new *Regulation*

provided to me by the parties, the determination of a fair market rate is described at para.11 as:

... 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".

[8] The concept of a "fair market rate" is similar to that of fair market value described in *Minister of National Revenue v. Northwood Country Club*, (1989), 89 D.T.C. 173 at 176 in the familiar phraseology of the "willing seller" and "willing buyer" acting at "arms length". It will be observed that section 26.01 of the *Regulation* borrows from this well-established concept with its reference to the "willing license holder" and "willing contractor", "acting reasonably and at arm's length". Thus, in considering the concept of a fair market rate under the *Regulation* assistance may be obtained from the principles developed in determining the fair market value of land.

[9] With reference to the determination of fair market value of land by the use of comparable properties, one finds the following principles in Todd, *Law of Expropriation*, 2nd. Ed:

- (a) Comparables should be closer in time to the valuation date. The nearer in time of the comparable sales, the greater the weight attached to them (p.191, p.193);
- (b) The validity of the comparables depends upon the comparison of like with like (p.191);
- (c) No two properties are exactly alike which might necessitate adjustments to take account of differences between the property being evaluated and the comparable property. As a general rule, the more adjustments required, the less reliable is the resultant estimate of value (p.193);
- (d) Relative proximity in time is of primary importance (p.193);
- (e) Adjustments for time are usually derived from evidence of sales and resales of comparables (p.194).

Thus, the land comparison approach is to consider relevant, objective comparables requiring as few adjustments as possible. The fewer adjustments, the more relevant the comparable. Adjustments for time should not be made measuring inflation rates but by comparing like properties to determine whether the market value has changed over time. It is not a consideration of price increases in construction materials and labour.

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

[11] Section 25(6)(h) of the Regulation requires the parties to deliver final offers for the rates in dispute. Section 25(6)(i)(v) requires the arbitrator to select the final offer which best reflects the fair market rate test set out in section 26.01(1).

[12] The 108 North Package comprises 12 disconnected salvage blocks having a total volume of 31,987m<sup>3</sup>. The Logging Contractors' final rate is \$18.35/m<sup>3</sup> plus fuel as per the License Holder's current fuel clause which, for purposes of this arbitration, is not in dispute. The License Holder's final rate is \$17.00/m<sup>3</sup> plus fuel.

[13] With respect to CP497, the volume is 62,463m<sup>3</sup>. The final rate offered by the Logging Contractors is \$17.25/m<sup>3</sup> plus fuel; the License Holder's final rate is \$15.75/m<sup>3</sup> plus fuel.

[14] The volume in CP498 is 42,782m<sup>3</sup>. The final rate offered by the Logging Contractors is \$16.75/m<sup>3</sup> plus fuel. The License Holder's final rate is \$14.99/m<sup>3</sup> plus fuel.

[15] The Logging Contractors rely upon the expert report of Mr. John Neels. His approach involved the deconstruction of historical market rates provided by the Logging Contractors to establish "Adjusted Base logging Rates" (ABRs). Mr. Neels examined the total population of all projects harvested by the Logging Contractors since the 2001-2002 logging season from which he selected those which he considered to most closely compare to the timber blocks in dispute. Those finally selected by Mr. Neels as comparables were comprised of timber blocks harvested by the Logging Contractors for the License Holder, West Fraser Mills, Pinnacle Pellet and Timber Sales owned by the Logging Contractors under the BC Timber Sales ("BCTS") program.

[16] The methodology employed by Mr. Neels in arriving at the ABRs involved making the following adjustments to the gross payment rates of the comparables:

- Estimated road construction costs;
- Estimated lowbedding (mobilization and demobilization) expenses
- Log-processing adjustment for net piece size
- Costs of long vs. short logs and the number of sorts;
- Cost of specialized equipment to handle expected wet ground conditions;
- Other quantifiable costs to adjust for unique situations;
- A CPI adjustment based on the year of operations.

[17] The result was described by Mr. Neels as a benchmark ABR defined as:

*... a simplified rate that would be paid to harvest a standard project with no road construction or lowbedding costs, one sort of short logs, 0.36m<sup>3</sup> stem net piece size, no specialized equipment to handle wet ground, and a 2005 operating season. The ABR of this hypothetical project (\$15.24/m<sup>3</sup>) is simply the arithmetic average of all the projects utilized in the study that met the criteria of market payment rates. This benchmark ABR allows for a balanced comparison with the dispute projects.*

[18] The approach taken by the License Holder was to consider rates freely negotiated for operations with similar general parameters as the dispute blocks, i.e. piece size .25 to .55, volume per ha greater than 200m<sup>3</sup>, east of the River, volume greater than 10,000m<sup>3</sup> and slope less than 25%. From that data, the License Holder submitted what it considered to be the "best comparables" based on location and piece size with the most recent rates. A range of contractors was selected as

representative of the market, focusing mainly on contractors in size similar to the Logging Contractors.

[19] With respect to the relative logging chance, the License Holder relied on the expert report of Mr. Dennis Anderson.

[20] The comparables relied upon by the Logging Contractors include British Columbia Timber Sales. The difficulty with this is that these are not "rates" within the meaning of the *Regulation*. The Logging Contractors are the owners of the logs and sell them to companies pursuant to purchase contracts. Arriving at a so-called rate is a calculation working back from the selling price to a notional "rate" which does not account for the additional risks and costs involved with being the owner of the Timber Sale license. There may be an element of subjectivity inherent in BCTS comparables since any "higher" rate may reflect profit to the owner of the timber. I do not say that BCTS should never be considered but they are not, in this arbitration, the most reliable comparables.

[21] The West Fraser comparables relied upon by the Logging Contractors are not the most reliable comparables because they are for long logs and therefore require adjustment whereas there are relevant West Fraser comparables available for short logs. A further difficulty is encountered when the short log rate for CP428 is compared to CP598 and CP448 and adjusted for the different piece size. The result is a lower rate for the short logs. The Anderson report concludes that CP428 and CP598 have a similar logging chance. It follows that the calculation of the adjustment for long logs is inconsistent with the assertion that short logs should have higher rates. Consistent with the principle that the fewer adjustments, the better the comparable (all things being considered) and the fact that relevant comparables of short log rates from West Fraser are available, one must conclude that the West Fraser comparables relied upon by the Logging Contractors are not to be preferred.

[22] A number of the comparables relied upon by the Logging Contractors are rates in the 2001 and 2002 logging seasons. The preferred approach is to use comparables closer in time to the logging season in dispute. The older rates call for another adjustment which further erodes reliability. 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. It is arguable that time adjustments made by employing the CPI index are not the preferred approach. This adjustment might more reliably be considered by comparing similar timber harvesting operations over the time period to see if the market has been rising. Simply considering inflation ignores productivity gains from new and innovative procedures and focuses on costs which is no longer the test.

[23] The Pinnacle comparable used by the Logging Contractors is of lesser relevance because it is a small licensee in Quesnel whereas there are numerous rates for contractors with large licenses in Williams Lake, the market of significance. Moreover, the logging rate was derived from the Canfor-Quesnel logging rate schedule. There is a hearsay aspect to this, in addition to which there is no evidence on whether the rates applied to long or short logs, the number of sorts or other similar factors. More to the point, however, is that the Pinnacle rate relates to a different market and given the comparisons available in the Williams Lake market can not be considered as a preferred comparable.

[24] Analysis reveals that of the comparables submitted by the Logging Contractors, those which are current rates for short logs in the same general location as the dispute blocks are CPs 494, 404, 402 and 436. However, the consistent evidence throughout was that the 2004 logging

season was exceptionally wet and the weather was considerably more adverse in the 2004 logging season when compared to the 2005 logging season. Even blocks harvested in October 2004 were not typical winter blocks. All contractors were faced with the same challenging wet conditions. Indeed, the License Holder allowed significant rate adjustments for the exceptional wet weather. The extraordinary weather conditions and adjustments are a point of distinction for these comparables. It must also be observed, as it was in *Western Forest Products Inc. v. Hayes, supra*, the Logging Contractors structure their business as they see fit. There are many different ways which allow a contractor to deal with wet ground conditions and the method or methods chosen and equipment utilized is for the contractor to decide. The contractor negotiates a rate and structures its business, e.g., six wheel skidder or single grip with forwarding, in its discretion.

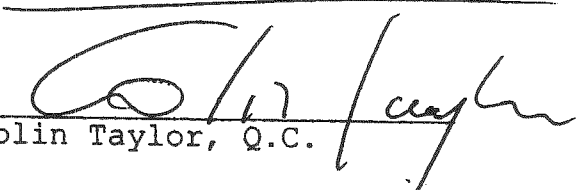
[25] The comparables submitted by the License Holder are, in the main, the best evidence of the pattern of rates reached in freely negotiated contracts for similar timber harvesting services performed in similar working conditions. They generally, by no means exclusively or perfectly, meet the test of like to like. The relevant date for 108 North Package is May 2005. There are twelve relevant comparables with an average logging rate of \$15.22/m<sup>3</sup> compared to the final offered logging rate of \$16.20/m<sup>3</sup>. The most notable is the June 2005 San Jose rate for CP2 and CP9. This contractor worked side by side with the Logging Contractors in like conditions. In fact, the Anderson report rated the San Jose blocks as a little more difficult logging chance. The San Jose rate is \$14.94/m<sup>3</sup> whereas the logging rate offered to the Logging Contractors is \$16.20/m<sup>3</sup>. There was rate recognition for wet ground for the Logging Contractors in 108 North in October 2004 and January 2005 and for San Jose in February 2005. If the San Jose rate of \$14.94/m<sup>3</sup> is adjusted for piece size and assume San Jose had no wet conditions, the total adjusted rate is \$16.16/m<sup>3</sup> compared to the License Holder's final logging rate offer of \$16.20/m<sup>3</sup>. The R & D June 2005 comparable reveals a logging rate of \$16.17/m<sup>3</sup> with a slightly more difficult logging chance. The May 2005 R & D comparable is \$15.25/m<sup>3</sup> with a slightly more difficult logging chance.

[26] The six relevant comparables submitted by the License Holder for CP497 reveal an average logging rate of \$15.06/m<sup>3</sup> compared to the final offered logging rate of \$15.00/m<sup>3</sup>. The deletion of Ecolink (a related company to the License Holder) does not disturb the analysis.

[27] The relevant comparables for CP498 indicate an average logging rate of \$14.16/m<sup>3</sup> compared to a final offered logging rate of \$14.73/m<sup>3</sup>. Two of those comparables are CP800 and CP803 for which there is historical evidence going to the rate differential between the Logging Contractors and others. The Logging Contractors and Westline both harvested in CP800. The Logging Contractors' rate was \$17.25/m<sup>3</sup> and Westline \$15.94/m<sup>3</sup>. Similarly, in CP803, the Logging Contractors began harvesting the block at a requested rate of \$19.00/m<sup>3</sup>. Hytest logged it at the same rate offered to the Logging Contractors, i.e., \$16.50/m<sup>3</sup>.

28. My task under the Regulation is to select the final offer which best reflects the fair market rate test set out in section 26.01(1). I have determined that the final offers for the rates in dispute made by the License Holder come closest to the mark and they are awarded.

DATED at Vancouver, British Columbia, this 31st day of March, 2006.

  
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.