IN THE MATTER OF THE *FOREST ACT*, R.S.B.C. 1996, c. 157,
TIMBER HARVESTING CONTRACT AND SUB-CONTRACT REGULATION,
B.C. REGULATION 22/96 AND THE
COMMERCIAL ARBITRATION ACT, R.S.B.C. 1996, c. 55

AND

A DIFFERENCE CONCERNING 1996 LOGGING VOLUME IN TFL 19

BETWEEN:

HAYES FOREST SERVICES LIMITED

CLAIMANT

AND:

WESTERN FOREST PRODUCTS LIMITED

RESPONDENT

A W A R D

Counsel for the Claimant:
D. Geoffrey Cowper, Q.C.

Counsel for the Respondent:
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Arbitrator:
Frank S. Borowicz, Q.C.

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I. BACKGROUND

[1] Hayes Forest Services Limited ("Hayes") is a logging contractor. Western Forest Products Limited ("Western")[1] holds a licence under the *Forest Act*[2] to cut timber in the area defined by Tree Farm License ("TFL") 19 on the west side of Vancouver Island.

[2] Hayes and Western were successors to a five-year replaceable logging contract in respect of TFL 19 (the "Contract").

[3] Hayes contends that, during 1996, Western prevented it from logging the volume it was entitled to under the Contract. It claims damages under Section 5 of the *Timber Harvesting Contract and Subcontract Regulation* (the "Regulation")[3].

[4] Section 5 of the Regulation provides:

> Every contract or subcontract must provide that all disputes that have arisen or may arise between the parties to the contract or subcontract under or in connection with the contract or subcontract will be referred to mediation and, if not resolved by the parties through mediation, will be referred to arbitration.

[5] In a prior arbitration under Section 25 of the Regulation, W.J. Wallace, Q.C. set the logging rate under the Contract for 1996.

[6] The test for a rate arbitration under Section 25 is what the parties would reasonably have agreed to as a logging rate as on first day of the year in question. In his Award, Arbitrator Wallace decided that Hayes' contention that it had been deprived by Western of an amount of logging volume could not be factored into the rate, because it could not have

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[1] Formerly known as Canadian Pacific Forest Products Limited.

[2] R.S.B.C. 1996, c.157.

[3] B.C. Reg. 22/96.

been in the contemplation of the parties on the first day of the year. It therefore had to be resolved in another forum. His decision was affirmed in appeals to the British Columbia Supreme Court and Court of Appeal.

[7] As a result, Arbitrator Wallace awarded a rate based on the estimated volume set out in the Contract, not the actual amount harvested in 1996. Hayes contends that caused its fixed costs and profit to be determined over a larger volume, resulting in less revenue than it should have earned under the Contract.

[8] Arbitrator Wallace based his Award on an annual volume of 128,500 m^3. The logging plan prepared by Western for 1996 projected a volume of 132,500 m^3. The volume actually harvested by Hayes was only 105,300 m^3.

[9] Since this arbitration involves the same contract and the same logging year considered by Arbitrator Wallace, the parties agreed to rely on the transcripts of the testimony and the documentary evidence from that arbitration.

II. CONTENTIONS

[10] Hayes contends that Arbitrator Wallace in effect determined, explicitly or implicitly, that it was entitled under the Contract to harvest a volume of at least 128,500 m^3. It claims Western was negligent and breached the Contract by not:

(a) making its contractual entitlement reasonably available;

(b) preparing a logging plan that was reasonably capable of providing its contractual entitlement;

(c) obtaining the cut block permits and approvals required to achieve its contractual entitlement; and

(d) acting fairly and in good faith to allocate the permitted and developed work available between Hayes and Western's own logging crews.

[11] Western denies it was obligated under the Contract to provide a specified annual volume, and contends Arbitrator Wallace's Award does not compel that conclusion. It contends that the Contract expressly contemplated an "estimated average annual volume", so that whether the expected amount was 128,500 m^3 or 132,500 m^3, it was only an estimate and not an obligation.

[12] If it was obligated under the Contract to provide the volume claimed by Hayes, Western purports to have provided a reasonable plan and taken all reasonable steps it could, and invokes protection from liability under the "Force Majeure" and "Curtailment of Production" provisions of the Contract.

[13] Western also contends that, under the Regulation, a licensee is not liable for a shortfall if it is less than five percent over the five-year cut control period of the licence and, since Hayes achieved 97% of its total estimated average annual volumes calculated over the entire five-year period, the standard of the Regulation was met.[4]

III. THE CONTRACT

[14] The term of the Contract was January 1, 1992 to December 31, 1996.

A. Volume

[15] Paragraph 2.3 of the Contract provided:

> Based on information available at the date hereof, the parties estimate that the average annual volume to be logged by the Contractor during the term of this Agreement will be as set out in Schedule "A".

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[4] Both the 5-year cut control period under Western's licence and the term of the Contract happen to have spanned the period between January 1, 1992 and December 31, 1996.

[16] Schedule "A" set out the "Estimated Average Annual Volume" as 165,000 m^3. But, that figure was changed by the parties as a result of changes to the allowable annual cut allocated to Western under TFL 19. The volume substituted for 1996 was either 128,500 m^3 or 132,400 m^3.

[17] Arbitrator Wallace referred to 128,500 m^3 as the "contract volume" for the purpose of determining the logging rate for 1996.[5]

[18] Western contends that Arbitrator Wallace's use of the figure 128,500 m^3 does not establish that Hayes was guaranteed an annual volume of 128,500 m^3 in 1996. Since his purpose was limited to setting a rate for 1996, knowing there was a dispute between the parties about whether the volume for 1996 should be the contract volume or the actual volume harvested, his Award should be confined to its limited purpose.

[19] In a chart prepared by Western for the rate arbitration (Exhibit 12), the estimated "quota gross" for 1996 was shown as 132,400m^3.

[20] In support of the 132,400 m^3 amount, Hayes notes that Otto Schulte, Woodlands Manager for Western's Gold River Division, testified that 132,400 m^3 was the "actual contractual obligation" of Western to Hayes for the 1996 logging year.[6] Since Western argued in the rate arbitration that the logging rate for 1996 should be determined by

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[5] Award, p. 19, par. 11.5. The source of that figure, however, is not clear from the documents tendered to Arbitrator Wallace, or the transcript of the testimony at the hearing. It may be that 128,500 m^3 was a "net volume" derived from a larger "gross volume" reduced for an estimated amount of "waste". Otto Schulte of Western testified (p. 313, lns. 16-23) that 125,500 m^3, which appeared in Ex. 6 ("Hayes Forest Services Estimated Logging Rate", prepared by Western), was an approximation of the planned volume for Hayes for 1996, using "roughly five per cent net down for waste from gross quota". It is also possible that 128,500 m^3 was a misrecording of the number obtained when 5% is subtracted from 132,400 m^3. 95% of 132,400 m^3 is 125,800 m^3, and perhaps the "8" and the "5" were inadvertently transposed. At one point in Arbitrator Wallace's Award (par. 11.14), 125,800 m^3 is referred to as the logging contract volume.

[6] P. 85, ll. 14-18, referring to Ex. 12.

reference to that volume rather than the lower volume actually logged, Hayes contends Western cannot now maintain it was not the contractual volume.

[21] Hayes also contends that the practice of the parties under the Contract was that, if the contractor was unable to log its complete quota, the licensee allowed the shortfalls to be carried forward. It points to Exhibit 83 before Arbitrator Wallace, a letter from Western's predecessor (Pacific) to Hayes' predecessor (P.C.B.)[7] titled "Volume to complete 1995 contractual obligations", which shows the "budgeted quotas" for the years 1992 through 1994, the actual production, the shortfall in each year, with a total shortfall of 30,000 m^3, and says:

> "Adding the total shortfall volume with your quota of 127,000 m^3 requires Pacific to provide 157,000 m^3 for P.C.B. to log in 1995. At June month end P.C.B.'s year-to-date production was 58,000 m^3. Please find attached a logging plan which provides the required 99,000 m^3."

[22] Hayes contends that Exhibit 83 reflects the real agreement and expectation of the parties, the effect of which was that, after providing the agreed upon 1995 volume to Hayes[8], there was no surplus (or shortfall) left to be carried forward, so that there was no "averaging" available to Western in regard to the acknowledged 1966 gross quota of 132,400 m^3.

[23] Western's basic contention is that the plain and ordinary meaning of the term "estimated average annual volume" in the Contract is that "estimated" implies an approximate expectation, and "average annual volume" implies consideration of more than one year. In

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[7] Pat Carson Bulldozing Ltd.

[8] Exhibit 12 shows that the actual gross cut by Hayes in 1995 was 156,500 m^3, reasonably close to the agreed upon amount of 157,000 m^3. Hayes therefore contends that the years before 1996 are irrelevant since Exs. 12 and 83 show that Hayes achieved 100% over the first four years of the Contract. The position presumes that the Contract entitles Hayes to specified volume and that the Regulation does not apply.

some years, the volume may equal the estimated amount, in other years it may exceed or fall below the estimate, as long as the volumes balance out, over the term of the Contract.[9]

[24] Accordingly, Western contends the 132,500 m^3 volume referred to in the logging plan, and adopted by Hayes, was simply a prediction by its engineers of the amount that would be produced by logging all of the cut blocks assigned to Hayes, and neither does that number create or reflect a contractual obligation. To the contrary, Hayes contends that the annual volume under the Contract was contractually determined each year when the licensee allocated a particular volume to the contractor in preparing the logging plan. That interpretation, however, would seem to deprive the specified "estimated average annual volume" in Schedule "A" of meaning, and does not appear to be contemplated by anything else in the Contract.

[25] If it was necessary to decide, I would be inclined to conclude that 132,400 m^3 is most likely the "estimated average annual volume" contemplated by the parties under the Contract in 1996. It is the amount Western referred to in Exhibit 12 as the 1996 "quota gross", and is likely a modified estimated annual average volume figure provided to Hayes for the year 1996 reflecting changes to the allowable annual cut of TFL 19 in accordance with paragraph 28 of the Contract, which dealt with reductions in allowable annual cut.[10] It seems likely that the use of the figure 132,500 m^3 by Hayes and 132,400 m^3 by Western was an incident of the way in which they each rounded off the volume in Western's proposal.

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[9] Western notes that in the rate arbitration (transcript pgs. 1207-08), Donald Hayes agreed that the contractual gross quota during the five-year cut control period was 681,600 m^3 (as set out in Ex. 12).

[10] Although there was no evidence of a specific proposal or agreement reducing Hayes' estimated average annual volume to 132,400 m^3, Ex. 84 contains the proposal made by Western relating to the first year of the Contract. There the "estimated average annual volume" for the year 1992 is changed from 165,000 m^3 (the number which appears in Schedule "A") to 140,000 m^3. In Ex. 12 that volume of 140,000 m^3 appears as the 1992 gross quota, while 132,400 m^3 appears as the 1996 gross quota. Hayes did not contest the accuracy of those numbers, and the origin of the 132,400 m^3 figure for 1996 was likely similar to that of the 140,000 m^3 for 1992.

B. Contingencies

[26] Paragraph 2.2 of the Contract provided that each year Western was to give Hayes a logging plan, that Western determined at its discretion and that was subject to approvals for cutting rights having been obtained:

> 2.2 In each successive year of this Agreement prior to the re-negotiation of the compensation as set out in paragraph 1.2 hereof, the Company will deliver to the Contractor maps and plans outlining the areas within the said lands which are approved for logging during the following 12-month period. The precise logging area in any year of this Agreement shall be determined by the Company with reference to the maps and plans so delivered. It is understood and agreed that all logging is subject to the Company's having obtained approval for cutting rights from the British Columbia Forest Service.

[27] Other provisions of the Contract dealt with related and other contingencies. Paragraph 25.1, for example, titled "Force Majeure", said:

> 25.1 If either party shall fail to perform any term hereof and such failure is due to flood, fire, explosion, strike, lockout or other labour disturbance or due to any cause whatsoever beyond its control, then the party shall not be deemed to be in default. ...

[28] Paragraph 28 dealt with a reduction, outside the control of the parties, in the allowable annual cut under the licence that was the subject of the Contract. Paragraph 29 provided for changes in harvesting methods, and Paragraph 30 dealt with the curtailment of operations:

> 30.2 Notwithstanding any other term hereof and for greater certainty, if the Company shall for any reason not obtain cutting rights sufficient for the purposes of the operations of the Contractor, the Company shall not be liable in any manner whatsoever for any loss, costs, damages, or expenses in connection with the curtailment of the operations of the Contractor as a result thereof.

[29] Western relies on Paragraphs 25.1 and 30.2[11] for its contention that even if Hayes was entitled to specified volume under the Contract in 1996, Western is not liable for the shortfall. As long as the cause was beyond Western's control, it claims protection under Paragraph 25.1 from liability for a breach of the Contract, that might otherwise result from events like poor weather, government failure to issue cutting permits, and delays in granting road building permits. And, it contends Paragraph 30.2 specifically excused it from liability for not obtaining timber approvals.

[30] Hayes contests the application of the force majeure provision of the Contract. It contends Western should have foreseen any weather conditions that may have prevented it from supplying Hayes with timber, and taken them into account in designing the logging plan. In regard to Paragraph 30.2, Hayes contends the phrase "cutting rights sufficient for the purposes of the operations of the Contractor" refers to the cutting rights available to Western generally, and not specifically to the blocks assigned to Hayes. It supports that interpretation by reference to Paragraph 2.1 of the Contract, which it contends gave it access to all of TFL 19 and did not restrict its access to the cut blocks allocated in any logging year. It contends any contrary interpretation would have allowed Western to assign it volumes that were undeveloped and unpermitted, without any penalty or obligation to compensate, while it held approvals in other blocks within the area of logging contemplated by the Contract.

IV. THE REGULATION

[31] The Regulation was first enacted in 1991. It had a revolutionary effect on the forest industry by introducing the concept of replaceable contracts. Soon after, both licensees and contractors called for substantial reform, and the Ministry of Forests asked representative stakeholder groups to recommend changes. Their recommendations led to the repeal of the

[11] In combination with Section 22 of the Regulation, which is also a "force majeure" provision.

Regulation, and its replacement in 1996 by a significantly amended Regulation with a similar name.[12]

A. Amount of Work

[32] Sections 17 to 22 of the Regulation deal with "Amount of Work". They were new in 1996, and endeavour to strike a balance between the respective rights and interests of contractors and licensees.

[33] Section 17 requires replaceable contracts to specify an amount of work to be performed by a contractor in each year of a contract, that can only be reduced as allowed by the Regulation. Section 18 sets out formulas for calculating the amount of work guaranteed to a contractor in any year. For stump to dump agreements like the Contract, the amount of work is to be expressed as a percentage of the total amount of timber processed by the licence holder in that year.[13] The calculation is adjustable for fairness, for example if there is a significant disparity between the calculated percentage and the historical levels of service provided by the contractor, or if the parties agreed on a different amount of work in a replacement contract entered into after August, 1991.

[34] Section 18(8) also provides that a licence holder and its contractors under a licence may agree, on or after April 1, 1996, to specify the amount of work in a different manner, presumably, for example, as a fixed volume. Neither party proposed that a possible approach to the resolution of this dispute was to make the calculation set out in Section 18 and

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[12] Eg. Coastal Joint Review Report and Recommendations to the Ministry of Forests, January 1994, and the Joint Review for Interior Region Report and Recommendations, March, 1994.

[13] The percentage is set with regard to the amount of timber processed by the contractor in either 1991 or the year in which the contractor first became entitled to a replaceable contract, as compared to the amount of timber processed by the licence holder under the licence in the same year. In this case, the applicable year is 1991, since the parties were engaged in a contractual relationship prior to the 1992-1996 logging contract. This entitled Hayes to a replaceable contract in 1991, although the replaceable contract which is the subject of this dispute did not take effect until 1992.

determine if the resulting percentage was met in 1996, which suggests they both continued to have regard to the estimated volume contemplated by the Contract.

B. Five Year Averaging

[35] Section 21 of the Regulation, on which Western does rely, requires a replacement contract to provide that the amount of work allocated to a contractor in any year may differ from the amount of work specified in the contract if the difference is attributable to *bona fide* business and operational reasons, and the contractor receives at least 95% of the aggregate amount specified in the contract over a five-year cut control period:

> 21 A replaceable contract must provide that the amount of work that the licence holder allocates to the contractor and that the contractor is required to perform in any year during the term of the contract may differ from the amount of work specified in the contract, provided that
>
> (a) the difference is attributable to bona fide business and operational reasons on the part of the licence holder, and
>
> (b) the amount of work that the licence holder allocates to the contractor under each replaceable contract over each 5 year cut control period of the licence to which the contract relates is equal to or greater than 95% of the aggregate of the specific amount of work provided for under that contract during that 5 year cut control period ...

[36] Western contends that Hayes received about 97% of the volume provided for in the Contract over a five-year cut control period. However, Hayes contends that the Regulation does not apply and that the percentages achieved in the years before 1996 are therefore irrelevant. It relies on Exhibit 83 as demonstrating that Hayes achieved 100% of its total cut over the first four years of the contract, leaving Western no room for averaging under the Contract.

[37] Like many sections in the Regulation, Section 21 begins with the words: "A replaceable contract must provide...". Section 2 of the Regulation says it applies to all contracts still in force on April 1, 1996, and to all contracts made after that date. It would therefore appear at first glance that Section 21 applies to the Contract.

[38] However, in another arbitration award involving Hayes, Arbitrator George Macintosh, Q.C. reached the opposite conclusion.[14] Hayes and Western differ about whether his Award was correct.

[39] The background legislative scheme provides the context for the parties' disagreement.

C. Required and Standard Provisions

[40] Part 7 of the Regulation is entitled "Required Provisions". Under that heading, Section 48 requires that all contracts must contain certain provisions set out as Schedules to the Regulation, or equivalent provisions agreed to by the parties, to comply with the requirements of certain listed sections of the Regulation.[15] Section 21 is one of the listed sections. And, Schedule 12 of the Regulation contains the model wording to reflect the requirements of Section 21.

[41] However, that does not end the matter. Section 160 of the *Forest Act* provides that the Regulation may specify a deadline for the amendment of contracts in regard to certain

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[14] *International Forest Products Limited* - and - *Hayes,* March 25, 1999.

[15] "Required" provisions (those referred to in Part 7 of the Regulation) all contain the phrase "a replaceable contract must provide that..."; they are clearly intended to be mandatory and contracts must deal with the subject matter as directed. Sections which are not categorized as "required" are those which describe provisions which may or may not be included in contracts depending on the choice of the parties or various external factors (for example, s. 18(8)); those that provide explanatory details or calculations related to mandatory contract provisions (for example, s. 18(2)); those that provide for a basic requirement to be contained in a contract that cannot be standardized (for example, s. 17(1)); and those that direct the parties whether and in what circumstances they must enter into various types of contracts in the first place (for example, s. 34)).

"standard provisions" of the Regulation, and deems contracts to be amended to include those provisions if the parties do not make the amendments by the prescribed deadline. In turn, Section 50 of the Regulation specifies which Schedules to the Regulation "are standard provisions for the purpose of section 160 of the Act". Schedule 12 is not identified as a "standard provision".[16]

[42] Hayes contends that those provisions of the Regulation which are not designated as "standard" are not applicable to contracts which were made before April 1, 1996. Western contends that all "required" provisions, whether standard or not, were deemed by operation of law to be automatically incorporated into all contracts in effect on April 1, 1996.

[43] Hayes contends that, by subjecting only certain Schedules, and thereby only certain corresponding sections of the Regulation, to specific deadlines for incorporation into existing contracts, the Regulation intended only the standard provisions to be mandatory for continuing contracts. It adopts the reasoning of Arbitrator Macintosh, that Sections 48 to 51 of the Regulation and Section 160 of the *Forest Act* do not require the provisions referenced in Section 21 of the Regulation to be part of the Contract.

[44] For the opposing view, Western relies on the Award of Arbitrator Pearlman in *Little Mountain Contracting Ltd.* - and - *Ross Fillion Trucking Ltd.*[17] The question considered in that case was whether a subcontractor was entitled to a replaceable subcontract. The contractor contended that Section 35 of the Regulation, which deals with replacement contracts and is a "required", but not a "standard", provision, and its corresponding schedule, Schedule 17, should not be incorporated into the agreement between the parties, because they were not standard provisions. Arbitrator Pearlman concluded that in the absence of an

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[16] Neither are any of the sections dealing with "amount of work", except Section 22, the "force majeure" section.

[17] August, 2001.

agreement between the parties on different language to the same effect, Schedule 17 was automatically incorporated into the subcontract by operation of Sections 48 and 35 of the Regulation.[18]

[45] Hayes contends that Western's reliance on the analysis in the *Little Mountain* case is misplaced, because it concerned a situation where the contract and subcontract were entered into after April 1, 1996, when the Regulation came into force, and not a contract made before, which simply continued past the introduction of the Regulation. It suggests the significance of the distinction is that prior contracts generally expressed negotiated volumes of work as a fixed volume rather than a percentage of the licensee's total holdings.

[46] Hayes also contends that the *Little Mountain* and *International Forest Products* awards can be reconciled, if the latter is taken to stand for the proposition that, in contracts which pre-date the Regulation, only the "standard" provisions which have been expressly deemed to be retroactively part of those contracts by Sections 50 and 51 are mandatory, while the former confirms that contracts made after the Regulation must contain all the "required" provisions in Section 48.

[47] I am inclined to think, however, that if it was intended that only contracts entered into after April 1, 1996 would be subject to the key "required" provisions of the Regulation, it could have easily been made clear in the Regulation. Sections 48, 50 and 51 do not seem to me to reflect such a distinction or a basis for the notion that priority should be given to the

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[18] He also specifically observed that the omission of Schedule 17 from the standard provisions included in Section 50 did not defeat the subcontractor's entitlement to a replaceable contract. The Award turned not only on Section 35, but also on Section 34, which Arbitrator Pearlman considered the source of the obligation to provide a replaceable subcontract, with Section 35 setting out the provisions that the subcontract must contain.

recommendations relating to the "standard" provisions over those relating to the "required" provisions.[19]

[48] Instead, both Section 2 of the Regulation, as well as the introductory words of Section 21 and the other required provisions, together with the use of the terminology "Required Provisions" in Part 7 of the Regulation, suggest they were intended apply to all contracts equally and automatically:

> 2 (1) This regulation applies to
> (a) contracts, and
> (b) subcontracts
> that were made before April 1, 1996 and that are still in effect on that date as well as to
> (c) contracts and
> (d) subcontracts
> that are made after that time.

[49] The 1996 amendments to the Regulation were intended to change the way timber harvesting contracts and subcontracts worked. Having been developed in response to concerns expressed by representatives of all stakeholders' interests also suggests the new provisions of the Regulation were intended to come into force with equal application to contracts in existence at the time the Regulation took effect as well as to contracts to be made in the future.

[50] The primary purpose of the "Required Provisions" portion of the Regulation appears clearly to provide model language for all the mandatory provisions of the Regulation. The subordinate purpose of the "standard provisions" appears simply to provide time frames for some of the required provisions to be included and reconciled with existing contractual

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[19] Neither can I find it in the Reports and Recommendations of either the Interior or the Coastal Joint Review Committees.

provisions, especially those that related to the same subject matter the standard provisions mandated in the 1991 Regulation. Under the 1991 Regulation, parties to timber harvesting contracts were required to incorporate standard provisions into their contracts dealing, for example, with assignability, mediation and arbitration, replacement offers, reductions in volume due to changes in allowable annual cut, and changes in harvesting methods. The "standard provisions" in the 1996 Regulation relate to the same subjects, although they changed some substance and introduced some new standards.[20] To harmonize the amendment of contracts which already incorporated standard provisions based on the existing legislative framework, it was perhaps sensible to include specific incorporation deadlines for the related standard provisions of the 1996 Regulation.

[51] The Regulation was also limited in the scope of its authority under Section 160 of the *Forest Act*, which only provides for the enactment of incorporation deadlines for provisions relating to certain topics. As these topics do not include amount of work provisions, the only portions of the Regulation which could properly be assigned postponed incorporation dates under Section 160 of the Act were those included in the "standard provisions" sections of the Regulation.

[52] From an effective policy perspective, if only the "standard provisions" were required to be read into existing contracts, then parties to contracts entered into before April 1, 1996 could perhaps sidestep the other "required provisions" of the Regulation indefinitely by avoiding new contracts, and thereby avoiding the new amount-of-work provisions of the

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[20] For example, Schedule 13 of the 1996 Regulation requires parties to incorporate the concept of force majeure into contracts, which is broader than the contingency provisions made standard by the 1991 Regulation (ie. reductions in annual allowable cut or changes in harvesting methods), but still relates to contingencies affecting contract volume. Also, Schedule 15, which deals with proposals for changes to amount of work resulting from allowable annual cut reductions, is much abbreviated from the corresponding provision in Schedule 9 of the 1991 Regulation.

1996 Regulation.[21] I am doubtful that could have been the intent of revising the Regulation, which seems oriented to correcting problems relating to amounts of work, since it would have the effect of the "required provisions" of the Regulation serving no purpose with existing contracts.

D. Effective Date

[53] Section 2 of the Regulation is clear that the Regulation applies to the Contract, and therefore the 1996 logging year. If the five-year averaging provision of Section 21 applied to contracts in existence on April 1, 1996, it follows that the other required provisions of the Regulation dealing with amount of work under the Contract also applied.

[54] In particular, Western relies on Section 22 of the Regulation, which complements Paragraph 25 of the Contract (Force Majeure):

> 22 (1) A replaceable contract must provide that the licence holder is not liable to the contractor for any failure to allocate to the contractor in any year the amount of work specified in the contract, as adjusted under section 20 or 21, if the failure results from changes in law, natural disasters, interference by a person who is not a party to the contract or any other event beyond the reasonable control of the licence holder other than a change in the market price of logs. ...

[55] Western also contends that, if the Regulation was applicable to the Contract, then Hayes' claim ought to be dismissed as unenforceable because the amount of work is not expressed in the Contract as a percentage of the total amount of timber processed by Western, as required by Section 18 of the Regulation. That, however, seems hardly reasonable. If a five-year average could be imposed on the parties, so could a formula for deciding what the appropriate amount of work should have been, and there is no reason in

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[21] Although Section 5 of the Regulation might allow for an "interest arbitration" to settle the terms or establish the content of a contract, it so far does not appear to have been invoked for that purpose.

principle that a volume specified in a contract could not be verified or corrected by applying the calculation set out in Section 18.

[56] Hayes agrees that a regulatory requirement that the volume of work be expressed as a percentage is not inconsistent with an agreement about how that percentage translates into a specific volume in a given year. It acknowledges, in theory, that if a proportionate analysis results in a volume less than specified in a contract, the resulting amount could be read into the contract, but observes that would not be fair if the parties had already agreed to and logged a different amount.

[57] Indeed, the new provisions of the Regulation had the effect of imposing on the parties a new set of amount-of-work rules when they were eight months from the end of a five-year contract and the five year cut control period of TFL 19, four months into the last year of that contract, and several months into negotiations about the proper rate to be applied and the areas to be logged in that year.

[58] Those negotiations were premised on the estimated annual volume contained in the Contract having some significance. Exhibits 12 and 83 confirm the parties were acting on the expectation that Western would attempt to provide Hayes with a particular fixed volume of timber for each year of the Contract. By April 1, 1996, they had completed significant negotiations in regard to the appropriateness of the logging plan and the rate to be paid to Hayes, based on the "contractual quota" for 1996.

[59] Unless it was absolutely necessary to impose on them a completely new method of calculating the amount of work for the 1996 year, I would not be inclined to do so. And it seems to me it is not, since Section 18(8) of the Regulation allowed the parties to specify the contract volume for 1996 in a manner different than otherwise required in Section 18. Neither party calculated the amount of work under Section 18 because it was clear they had

at least impliedly agreed to specify the contract volume for 1996 as a fixed volume, rather than a percentage of the total timber processed by Western that year, as permitted by Section 18(8).

V. LIABILITY

[60] There is no doubt there was a discrepancy between the estimated average annual volume contemplated in the Contract for 1996 and the amount actually harvested by Hayes. Depending on which volume is correct and how waste is factored in, the discrepancy for the year is somewhere between 13 and 21%. Over the five years of the Contract, and the five year cut control period of the TFL 19, the discrepancy between the total amounts harvested by Hayes and the estimated average annual volumes is approximately 3%.[22]

[61] The question is whether in consideration of all the circumstances surrounding the formation of the Contract, the parties' agreement as expressed in the Contract, the conduct of the parties during the term of the Contract, the regulatory and industry context in which it operated, and the applicable principles of the general law, the shortfall constitutes a breach of contract entitling Hayes to compensation from Western.

[62] In my view, the "required provisions" of the Regulation apply to the Contract, and the shortfall over the five year cut control period of TFL 19 was less than 5%. The short and simple answer, therefore, is that under Section 21 of the Regulation, Western would only be liable to Hayes if the reasons for the shortfall were not "bona fide business and operational reasons".

[63] The result, it seems to me, would also be the same if Section 21 did not apply and the answer had to be derived from the Contract.

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[22] Assuming Exhibit 12 sets them out correctly and the 5% increase for waste which was added to the actual net figures there is appropriate.

[64] The volume contemplated by the Contract is described as an estimated average annual volume. Implicit in the phrase "average annual" is flexibility to vary amounts from year to year over the term of the contract, which is historically what the parties did. If production in a particular year was low, the undercut could be made up in a subsequent year. Exhibit 83 confirms that Western allocated extra volume to Hayes in 1995 to make up for previous years, in effect averaging the volume harvested by Hayes over the term of the Contract.

[65] The word "estimated" also suggests some flexibility in permitting variation from the specified volume. But, there appears to be no industry standard of an accepted range of deviation from contractual estimates. Section 21 of the 1996 Regulation incorporated a 5% cap on the amount of variation from the amount of work specified in a contract for bona fide business and operational reasons over a five year period. That may well have been a codification of a shortfall amount acceptable to the industry and reflective of the desire of stakeholders for a balance of fairness and certainty in their contractual relationships.[23]

[66] Other industry related factors also suggest that reasonable variation over the term of a contract was understood and expected in the industry. There is, for instance, a paucity of arbitration decisions awarding damages for shortfall, unless the work contracted for was substantially not provided at all.[24]

[67] Rate determinations under Section 25 of the Regulation also include an assessment of "profit and risk", with reference to such factors as adverse weather and difficulties in obtaining permits, as a contingency incorporated into the logging rate. That component of the

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[23] It was probably not a mere coincidence that the five year period reflected in Section 21 is the cut control period for the licence. Licensees must achieve within 10% of the aggregate allowable annual cut over the cut control period or face potential penalty.

[24] The Award of Arbitrator Macintosh in *Hayes* - and - *International Forest Products Limited,* is an example of a remedy directed at a complete failure to comply with contractual promises of work, which is different from the circumstances of this dispute.

assessment is a form of recognition that there is risk inherent in the business, which may or may not be fully compensated for by the logging rate.

[68] Indeed, there are many contingencies in the forestry industry that tend to defy accurate prediction, and that affect the operations and profits of both licence holders and contractors. The 1996 Regulation was framed to expressly recognize many of those contingencies, and to exempt a licence holder or a contractor from any notion of strict liability. Section 22, for example, provides that in any year, a shortfall by either party, regardless of magnitude, will not be compensable if it results from "changes in law, natural disasters, interference by a person who is not a party to the contract or any other event beyond the reasonable control of the licence holder ...". Section 21 gives even broader flexibility to licensees to provide less than the amount of work specified in a contract for "bona fide business and operational reasons", so long as the difference does not exceed 5% of the aggregate contract volume over a 5-year cut control period.

[69] Just like the Regulation attempts to balance the contingencies, so that only acts or omissions reasonably within the control of a licensee are compensable, Paragraph 25 of the Contract was complementary and protected either party from a breach of contract where the cause of their failure to perform is beyond their control.

[70] There is also the flexibility inherent in satisfying the annual harvest requirements of a tree farm licence. Section 64 of the *Forest Act*, for example, provides that a licencee must ensure:

> (a) the volume of timber harvested during a calendar year under the licence is not less than 50% nor more than 150% of the allowable annual cut available to the holder during that calendar year, and
>
> (b) the volume of timber harvested during a 5 year cut control period under the licence is not less than 90% nor more than

> 110% of the total allowable annual cut available to the holder during that 5 year period.

The use of the word "estimated" in the Contract in relation to annual volume is more indicative of tracking that statutory flexibility than promising contractual certainty.

[71] It also highlights an important distinction from the contract considered by Arbitrator Macintosh. Although his Award does not quote the exact language of the contract, he notes that it obligated the licensee to provide an "Annual Volume" of a particular amount, without any qualifiers like "estimated" or "average".

[72] The same result is also consistent with the jurisprudence of the general law relating to tortious conduct.

[73] Arbitrator Wallace's determination of the logging rate under the Contract for 1996 was appealed to the Courts, which confirmed that adjustments to logging rates cannot properly include a claim for "licensee-caused" damage from alleged misfeasance or nonfeasance.[25] Arbitrators would otherwise have to wait until the logging year was complete to include the actual volume logged in the assessment, which would be contrary to the purpose of Section 25. It might also encourage contractors to delay reaching agreement on logging rates until after the year is complete, which would also counteract the efficiency goals of the regulatory scheme.

[74] The Supreme Court and Court of Appeal decisions that flowed from the rate arbitration also directed that a contractor's proper remedy for reduced harvests due to the

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[25] *Hayes Forest Services Ltd. v. Pacific Forest Products Ltd.*, [1998] B.C.J. No. 2368 (S.C.), pars. 26-28, 32.

conduct or misconduct of the licensee would likely be a claim of damages for breach of contract, "which might possibly be advanced under s. 5 of the Regulation".[26]

[75] Indeed, a remedy must be available to contractors who are subjected to tortious conduct or breach of contract by a licence holder to whom they have contracted their services.

[76] Hayes also contends that regard must be had to duties implied into the Contract by the general law, for example, the principle that a party to a contract may not act in such a way as to nullify it, expressed in the recent Court cases of *Schluessel* v. *Maier*[27] and *Mannpar Enterprises Ltd.* v. *Canada*[28]. Those cases confirmed that while a general duty of good faith needs to be expressed in the terms of the contract or derived by implication from the reasonable expectations of the parties, the law does imply a duty on each contracting party not to act in a manner that deprives another party of the objective or benefit of their agreement.

[77] Put positively, the general law recognizes the natural expectation of the parties to a logging contract, implicit in the language of the Contract and Section 22 of the Regulation, that licence holders have a duty not to act in a manner that would deprive contractors of the agreed amount of work, and contractors have a duty not to act in a manner that would prevent them from delivering the agreed amount of work. So the actions of both Western and Hayes are relevant to determining if Western is liable in damages to Hayes.

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[26] *Hayes Forest Services Ltd. v. Pacific Forest Products Ltd.* (2000), 133 B.C.A.C. 291 (C.A.), par. 55.

[27] (2001), 85 B.C.L.R. (3d) 239 (S.C.)

[28] (1999), 173 D.L.R. (4th) 243 (B.C.C.A.)

VI. CONDUCT

A. Logging Plan

[78] Hayes contends that Western failed to provide a logging plan which was reasonably capable of providing Hayes with the volume to which it was contractually entitled in 1996. Hayes' Summary of Argument focuses its claim:

> Hayes testified that it objected to the logging plan on the basis that the permits and approvals required for cut blocks specific logging were not in place and that accordingly the cut blocks were not sufficiently developed and engineered to enable Hayes to obtain its volume for the year. Discussions continued with respect to cut blocks from the fall of 1995 through to the completion of logging in 1996. A number of alterations were made by Pacific in consultation and agreement with Hayes to seek to enable Hayes to log its contract volume in spite of the difficulties presented by the logging plan and the unavailability of permits and shortfall from estimates presented by the plan prepared by Pacific's engineers. In particular:
>
> (a) a major cut block was deleted without explanation;
>
> (b) certain cut blocks were substituted for some originally added to make up for the short fall and estimated volume in other cut blocks;
>
> (c) certain cut blocks were taken away as a result of an agreement that a different form of logging would be most appropriate to that cut blocks.

[79] Western's answer is that it tried to respond to concerns expressed by Hayes that the plan did not provide for enough logging in the early months of the year. It made attempts to increase the volume available early in the year, but winter blocks were sparse. One particular block (J95) had been slotted for road building in 1995 and for logging in 1996, but Hayes chose to log it in 1995 . Hayes, on the other hand, asserts that this block was included in the logging plan for 1995 as part of the amount meant to compensate Hayes for previous shortfalls, and that it was not logged by Hayes earlier than it should have been.

[80] Western also claims that Hayes agreed to a compressed logging season for 1996, so no logging would be done in January and February. This, however, seems somewhat incongruous with an intention to provide for more winter logging, and the supporting evidence relied on by Western, in particular Exhibit 25, does not show that Hayes knew in advance of the 1996 season that the logging year would be compressed. Exhibit 25 is a letter, dated February 15, 1996. While it refers to an intent expressed in another letter, Exhibit 24, about an earlier logging settlement, that settlement related to the 1995 logging year, and Exhibit 24 does not refer to any future intention by Western. If Hayes knew that Western intended to compress the 1996 logging season, there is no indication Hayes agreed with that course of action. To the contrary, Hayes went ahead and logged blocks in January and February, which suggests it did not.

[81] Western, however, did attempt to obtain early logging shows. Between September, 1995, and February, 1996, Western purports to have increased the amount available for logging by Hayes in March, April and May of 1996.[29] It did so in response to Hayes' concerns and the logging plan dated February 6, 1966 projected providing Hayes with 132,500 m^3 in 1966. After the logging plan was finalized, Western purports to have continued to substitute blocks where necessary and at the times cutting permits became available. Hayes claims Western might have acted faster in communicating approvals while Western claims Hayes did not always act immediately when approvals were delivered. Neither claim is surprising and timing was likely affected by the transfer of equipment and crews from one cut block to another. And, there is no indication that the delays experienced in the process were attributable to anything other than the usual practicalities of doing business in the forest industry.

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[29] Donald Hayes' cross-examination, pgs. 1224-27.

[82] Western purports to base its obligations with regard to the logging plan on Paragraph 2.2 of the Contract, which it notes specifically allowed it to unilaterally determine a plan for the areas to be logged. It also observes that the logging plan provided for a harvest of 132,500 m^3, which it contends was patently reasonable, and that it made changes to the logging plan in response to requests from Hayes.

[83] While the provisions of Paragraph 2.2 alone would not exempt from liability a licensee who did not provide plans over the course of a contract which were capable of providing the expected contract volume, or reasonably close to it, without operational factors beyond its control, they are not sufficient to impose an obligation on Western to ensure the logging plan met the yearly quota.

[84] The process of creating a logging plan also involves an element of negotiation. While Hayes acknowledges that Western had sole responsibility for preparing the logging plan, it also acknowledges that Western made changes to the logging plan "in consultation and agreement with Hayes to seek to enable Hayes to log its contract volume".[30]

B. Access

[85] Hayes also contends that since the Contract gave it a right to access any developed cut blocks anywhere in TFL 19, there is an onus on Western to prove it did not have other properly engineered, developed and permitted cut blocks that it could have substituted when it became clear that Hayes' blocks might not be as productive as originally predicted.

[86] Western says that, in fact, all of the available cut in TFL 19 was otherwise allocated not and available to be substituted for blocks allocated to Hayes which did not turn out to

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[30] Hayes Summary of Argument, pgs. 5-6; cross-examination of Mr. Hayes pgs. 1224-1227.

be productive.[31] In this regard, Hayes contends that not only did Western have a duty to reallocate cut blocks as necessary, but it also had a duty to act in good faith in allocating available cut blocks as between Hayes' and Western's own logging crews. Western's answer is that it satisfied all of its obligations to Hayes, and was not obligated to prove it had no other blocks which it could possibly have transferred to Hayes.

[87] In regard to particular cut blocks:

(a) Hayes complains that Block K502A was scheduled by Western for road building in February, 1996, but Hayes did not receive the road building permit until February 26, 1996. And, that although the block was permitted by the Ministry of Forests for falling, Hayes never received the falling permit. Western explains that when cut block M26 was removed from the logging plan, it advised Hayes that K502A and M26 were linked, so if M26 was deleted, K502A would be as well to balance the logging plan, and that Hayes agreed that M26 and K502A would be removed from the plan and that K11 and K46 would be substituted. There is no dispute that Western substituted K11 and K46 for Block M26 at Hayes' request, due to the difficulty of logging M26, and that Hayes logged some 1,500 m^3 from K502A during the road building.

(b) Hayes complains Western did not give it the road building permit for Block Q40 until March 25, 1996, and that the volume available from this block was negligently overestimated by about 6,000 m^3. Western denies any negligence just because less timber was harvested than the volume estimated. Since there

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[31] Transcript, pg. 542, lns. 3-19.

is no industry standard of an acceptable range of error for estimates, both under-estimates and over-estimates are common. Western also observes there was nearly a month's delay by Hayes between the delivery of the road building permit to Hayes, which Western says occurred on March 19, 1996, and the beginning of road building, which Hayes acknowledged was not Western's fault. Hayes also acknowledged that a further delay of nearly a month between the delivery of the logging permit and the start of logging was not caused by Western.

(c) Block N87 was a high elevation block suitable for logging in the summer. Hayes logged only 2,484 m^3 of a planned 22,000 m^3 in this block. It received the road building permit from Western in mid-August and the logging permit on October 21, and says, because of the lateness of the permits, it was unable to complete the logging due to snow. Western says that, according to the logging plan, N87 was not to be logged until October and November and, if Hayes thought that was too late because it might snow in November, it could have flagged the problem when it reviewed the logging plan in February. Western also notes that road building was complete by September 9, in time to start logging according to the logging plan. A subsequent government delay in providing the cutting permit caused a logging delay of approximately five weeks, while early snow caused the loss of another two weeks of logging time. Western contends that if those two events had not happened, Hayes would have been able to log the full volume. It adds that, when the cutting permit was not forthcoming by September 15, it was not able to substitute another block for N87, because it was not feasible to start road building into another area and then fall that area before the end of November. Instead, the most appropriate course of action was to get approval as soon as possible and log as much as possible before the end of November.

(d) Block K80, another high elevation block, was also not completed because of snow. Hayes says it did not receive the falling permit until August 7, 1996. Western says the block was not part of the original logging plan, and was substituted in May to provide additional volume to Hayes. It says that the reason the full volume on K80 was not logged was because of a summer shutdown for heat and an early snowfall. It notes the road permit was given to Hayes on May 3, that it started the road on June 3, but did not complete it until October 24. Since logging commenced only after the road was completed, the lateness of the falling permit made no difference.

(e) Hayes complains that Block P17 was never made available to it, without explanation or excuse. Western says the government never granted a permit for the block due to concerns about terrain stability, which is why K80, a block with almost exactly the same volume, was made available to Hayes as a replacement block as soon as Western realized that P17 was not going to provide June logging as planned.

[88] In essence, Western says that it substituted K11 and K46 for K502A and M26 when Hayes said it preferred not to log M26, and that it substituted K80 for P17 when it became apparent approvals for P17 would not be granted in time. In regard to N87, it says by the time it became apparent the cutting permit would not be granted, it was too late to substitute in another block.

C. Cutting Permits

[89] Between June 15, 1995 and June 15, 1997, which was the phase-in period for the new *Forest Practices Code*, the Ministry of Forests delayed a substantial number of cutting permits. During the phase-in period, the *Code* required "substantial compliance" with its

requirements, and the Ministry often required additional information to ensure that cutting permits were in substantial compliance.

[90] Exhibit 67 is a week-by-week summary of the approvals Western obtained in the latter half the 1996 year. Western purports to have prepared it for the purpose of demonstrating to the Ministry of Forests that the number of approvals being granted was not satisfactory. Mr. Schulte testified that it was followed up with tours of Western's operations for district and regional managers of the Ministry.[32] While these actions were perhaps taken only after Western knew that the 1996 rate for Hayes was to be submitted to arbitration, in an attempt to demonstrate Western's diligence with respect to obtaining approvals, the table does appear to indicate that many of the requested approvals were not granted in a timely way during the latter half of 1996.

[91] In this regard, Donald Hayes testified:[33]

> Q: You would agree that Pacific was trying to provide you with as much information as was available about the logging for '96?
>
> A: Yes.
>
> Q: And you would agree that Pacific was attempting to obtain as much of the approvals as possible for 1996?
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> A: I would agree at that time they were. I'm not sure that they shouldn't have started earlier.
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> • • •
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> Q: Yes. But again you would agree that the company was sharing all of the information it had available on the cut permit situation?

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[32] At pg. 174.

[33] At pgs. 1223-1226.

> A: Well, we kept asking them about the permits and they kept saying that they thought they would come, so they were sharing what they knew but it was very - - everyone knew at that point that the permits had to come exactly when they hoped for them for the plan to work. Everyone acknowledged that it was very tight.

VII. RESULT

[92] Western originally provided Hayes with a logging plan that projected the amount of work available to Hayes in 1996 would be 132,500m^3. Although, in hindsight, the modifications made by Western to the logging plan over the course of the year may not have been the best choices, in that they did not result in Hayes achieving the intended volume, they nonetheless appear to have been a reasonable attempt to meet that goal. Mr. Harold Hayes himself acknowledged "the company did its best during the course of the year...".

[93] It seems to me there is little else Western could reasonably have been expected to do to give Hayes alternate cut blocks. Transferring cut blocks is inherently disruptive to other crews and has collective agreement implications in regard to unionized workers, which affect any licensee's ability to simply make changes to logging plans. The proximity of one block to another, elevation, weather patterns, the harvesting method involved with a block and its particular suitability to the equipment available to a particular crew at the time, and the general "ripple effect" of a change on all of the other blocks planned for crews affected by the change, also affect a licensee's ability to move blocks around.

[94] If Western had assigned different blocks to Hayes, it may have been able to log its target volume. The substitutions made to the plan also gave it the potential to provide Hayes with its target volume, although that potential may have been contingent on government approvals coming when expected, and weather conditions being favourable. The timber harvesting business, however, is inherently difficult and unpredictable. Given the lateness

of permits issued by government, the vagaries of the weather, union considerations, and the domino effect of making changes on other logging plans in circumstances that did not become clear until late in the logging year, it would have been difficult for Western to evenly balance the achievement of its crews and Hayes' crews. In any event, I am doubtful that it actually had an obligation to do so. And, in the absence of demonstrable bad faith in the allocation of cut blocks to Hayes, or deliberate manipulation of the allocations so as to benefit Western at the expense of Hayes, I am unable to conclude that Western breached its obligations of good faith to Hayes.

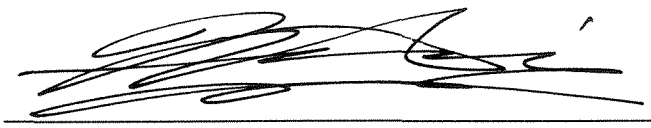
[95] It also seems to me there is little else Western could reasonably have been expected to do to induce the government to grant approvals more quickly, and the speed with which the government chose to grant approvals was a circumstance outside Western's control.

[96] In all the circumstances, I am drawn to conclude that what occurred was substantially beyond Western's control, and otherwise attributable to bona fide business and operational reasons, so that the 1996 logging volume shortfall was within the difference permitted by Sections 21 and 22 of the Regulation.

[97] If the Regulation did not apply, I would have been drawn to conclude that the shortfall was similarly caused by factors beyond Western's control, as contemplated by Paragraph 25.1 of the Contract, and that the Contract did not guarantee Hayes a specific amount of work. I would also have been unable to conclude that Western's conduct in the circumstances constituted a breach of contract, or that it was negligent, in bad faith or unreasonable so as to be tortious under the general law.

[98] For these reasons, I am unable to conclude that Hayes is entitled to compensation from Western.

DATED in Vancouver, British Columbia on the 17th day of July, 2002.



Frank S. Borowicz, Q.C.
Arbitrator