BEFORE M.R. TAYLOR, Q.C.

Arbitrator

IN THE MATTER OF THE *FOREST ACT, R.S.B.C. 1996, CHAPTER 157, TIMBER HARVESTING CONTRACT AND SUB-CONTRACT REGULATION*, B.C. REGULATION 259-91 (REVISED 22-96) AND *COMMERCIAL ARBITRATION ACT*, R.S.B.C. 1996, CHAPTER 55

AND

IN THE MATTER OF A DISPUTE CONCERNING THE RATE TO BE PAID BY INTERNATIONAL FOREST PRODUCTS LIMITED TO LINEHAM LOGGING LTD. IN RESPECT OF 1999 LOGGING IN THE SOO T.S.A.

AWARD OF THE ARBITRATOR

December 3, 1999

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DATES OF HEARING:	**June 21-25, 28 & 30, July 2, 5 & 6, and October 27, 1999**

AWARD OF THE ARBITRATOR

This arbitration is for setting the rate to be paid by International Forest Products Limited ("Interfor") to Lineham Logging Ltd. ("Lineham") for logging during 1999 on five blocks within Interfor's Forest Licence in the Soo Timber Supply Area, north of Harrison Lake, pursuant to the implied terms of a "replaceable" logging contract which is deemed to exist between them under the provisions of the *Timber Harvesting Contract and Sub-Contract Regulation*, B.C. Regulation 25991 (Revised 22-96).

While there is in fact no written contract between the parties they are agreed that the volume to be handled by Lineham in its "stump to dump" operation for Interfor during 1999 in the Gowan Creek area -- that is to say felled, logged, yarded, loaded, hauled some 39 kilometres to Spring Creek on Harrison Lake, and there dumped, sorted, bundled and boomed -- is 55,800 cubic metres of approximately 194,000 cubic metres

which Lineham is entitled to the opportunity to harvest for Interfor from this area during a five-year period commencing in 1997. No attempt was made to define the terms under which Lineham is to perform this work; I presume they are to be implied from past practice, written or oral communications between them, and the provisions of the Regulation with respect to "deemed" contracts.

The parties started the arbitration more than 60% apart, with Interfor offering a rate of $36.70 per cubic metre and Lineham seeking $59.58. By the end of the hearing the gap had narrowed only marginally, Interfor proposing $36.75 per cubic metre as a reasonable rate and Lineham proposing $56.30.

I. THE CONTRACT REGULATION

The effect of the Regulation, which was introduced in 1991 and to some extent revised in 1996, is to give security of tenure to logging contractors working for companies holding Crown timber cutting rights, by guaranteeing to the contractor, subject to satisfactory performance, a perpetually renewable right to log a prescribed proportion of the licensee's allowable cut over each five-year allowable-cut period at annual rates which, if not mutually agreed, are to be established by *ad hoc* arbitration under the *Commercial Arbitration Act*, now R.S.B.C. 1996, c. 55.

(a) Requirements of Section 25

The arbitrator's task is described in s. 25 of the Regulation as the establishment of a level of compensation which is *both* "competitive" and "reasonable", on the basis of criteria some of which are specifically enumerated:

> 25(1) A replaceable contract must provide that if a rate dispute is referred to arbitration, the arbitrator must determine the rate according to what a licence holder and a contractor acting reasonably in similar circumstances *would agree* is a rate that
>
> (a) is *competitive* by industry standards, and
> (b) would *permit* a contractor operating in a manner that is reasonably efficient in the circumstances in terms of costs and productivity to earn a *reasonable profit*.
>
> (2) In determining a 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) the costs and productivity of *the* contractor for prior timber harvesting services carried out by *the* contractor;
> (c) relative to prior timber harvesting services, the impact on costs and productivity likely to arise from:
>
> (i) changes in operating conditions including, without limitation, changes to terrain, yarding distances, hauling distances, volume of timber per hectare;
> (ii) changes in the total amount of timber processed;
> (iii) changes in the required equipment configuration;
> (iv) changes in the law if the changes affect costs or productivity of the timber harvesting operation;
> (v) changes in the underlying costs of timber harvesting operation including, without limitation, the cost of labour and the impact of inflation on wages, fuel, parts and supplies;
>
> (d) the *costs* in the logging industry for each phase or component of a *similar* timber harvesting operation;
> (e) the *rates* in the logging industry for *similar* timber harvesting operations;

> (f) any other data or criteria that the arbitrator considers relevant in ascertaining the rate that *a* licence holder and *a* contractor acting reasonably *in similar circumstances* would *agree* to.
>
> (3) In determining a rate under subsection (1), an arbitrator must not take into account any consideration or goodwill associated with purchasing a replaceable contract or otherwise acquiring the right to provide timber harvesting services pursuant to a replaceable contract. [Emphasis added]

Thus the general intent of the regulation appears to be: (i) that the rate set be one to which a reasonable licence holder and contractor *would agree*; (ii) that it be both *competitive* and *such as to permit* the contractor a reasonable profit *when operating efficiently*; (iii) that the *first* source of guidance is to be sought from rates previously *agreed to* by the *same* parties, adjusted for relevant differences between the nature, cost and productivity of the prior work and economic circumstances relevant to that work, on the one hand, and those pertaining to the work for which the rate is to be set, and circumstances relevant to it, on the other; (iv) that a *second* source of guidance is to be sought in costs and rates paid in *similar* operations; (v) that other information may be considered which is relevant to ascertaining the rate that *a* licence holder and *a* contractor acting reasonably *would agree to* in *similar circumstances*; and (vi) that in setting the rate no regard is to be had to the special value conferred by the regulatory scheme on contracts which enjoy its protection.

It is of course necessary to have in mind that the criteria listed in sub-section (2) above can be relevant only insofar as they assist in achieving the objectives stated in sub-

section (1), that is to say, in arriving at a rate which *would be agreed to* for the work in question by parties acting reasonably, that is to say as being competitive by industry standards and offering the contractor a reasonable profit opportunity.

It is in my view apparent that the most useful guide in arriving at such a rate is likely to be those rates agreed to in recent years under the Regulation by the same or other parties for the same or truly *similar* operations.

(b) Legislative Purpose and Effect

The broad legislative purpose of the Regulation was described by the Minister of Forests in the Legislature on June 24, 1991, during first reading of the enabling amendment to the *Forest Act* (Hansard p. 21985):

> Independent contractors and subcontractors who harvest timber for larger forest companies are extremely important to British Columbia's forest sector. The stability of many families and, indeed, many communities is dependent on contractors maintaining *secure and fair* contracts with the holders of timber rights in their vicinity. This amendment will enable us to improve the balance in these contractual relationships. It will also provide a quick and inexpensive system for resolving contract disputes. This will ensure *security and fairness* for all parties involved in timber-harvesting in British Columbia. [Emphasis added]

At second reading, on the same day, the Minister added (Hansard p. 13039):

> The British Columbia forest industry can be roughly grouped into two sectors: the manufacturing sector and the logging sector. The manufacturing sector has the benefit of long-term replaceable and transferable licences. This tenure security is necessary collateral for the very significant capital financing requirements associated with forest products manufacturing.
>
> By contrast, the logging sector, which is largely composed of contract operators, generally has limited tenure security. Yet - and this is a central point - the investment in the provincial logging sector is about equal to that of the sawmilling sector.
>
> Clearly, logging contractors and subcontractors need improved tenure security as a basis for financing their considerable equipment and operating costs. *Greater contract certainty* will mean improved stability not only for the contractors themselves but also for their many employees and the communities in which they live.
>
> This bill will enable us to write regulations to provide for written and replaceable contracts, contracts that may be transferred to third parties, and access to quick and inexpensive mediation and arbitration to resolve contract disputes. [Emphasis added]

The Minister's statement was followed by an assurance of support from the Opposition, whose spokesman indicated that the measure was supported by the industry generally, and who observed (Hansard p. 13039):

> I can only say that when we extend the kind of protection a major licence offers the holder, and provisions for renewal of that contract and some provisions for appeal, it only makes sense that the same right be extended to the contractors. The reason we as government would do that is that it's all based on a resource owned by the Crown.

This, for practical purposes, is the extent to which legislative intention can be discovered from the brief debate in the Legislature.

The present proceedings, involving 11 days of complex technical evidence and submission of written and oral argument over a period of four months, suggest that the confidence expressed by the Minister in *ad hoc* arbitration, without more, as a "quick and inexpensive" process for settlement of rate disputes, may have been misplaced.

Mr. Verne Wells, President of Lineham and a Director of the British Columbia Truck Loggers Association, stated in evidence that prior to introduction of the Regulation Crown timber licensees, by virtue of their control of harvestable timber, were often able to dictate contract terms to logging contractors, and that the Regulation provided contractors with a better chance of a fair deal. He did not see the legislation as intended to prevent licensees from taking over the logging, yarding, hauling, sorting and booming functions themselves, but rather as giving contractors long-term assurance of a reasonable return in the face of declining timber supply under the control of a limited number of the Crown timber licensees. Mr. Wells emphasized also the importance of assured long-term contractual rights in obtaining the credit necessary today for a contractor to be able to finance an efficient logging operation.

Mr. Otto Schulte, Manager of Interfor operations in the Campbell River area who

has previously served in managerial capacities for both contractors and licensees on the Coast and in the Interior, described difficulties which the Regulation -- referred to in the industry as "Bill 13"-- has created for licensees and contractors, including loss of opportunity for contractors to move between logging areas when economic or other conditions constrain logging in a particular area, the barrier which it creates to efficient contractors increasing their business and the elimination of any market for establishing rates "competitive by industry standards" as the Regulation requires. He commented on a tendency under the Regulation for rates to be set on a “cost-plus” basis for the particular operation, and observed that rates established by agreement for logging privately-owned timber, which accounts for less than 5% of the Province’s timberland and is not subject to the Regulation, have been significantly lower.

It must be assumed that the government and industry foresaw that some difficulties would flow from creation of a statutory monopoly regime without any accompanying regulatory system to establish accounting standards, audit expenses, review capital programs, assess service and productivity levels, record rate settlements and set rates on an equitable basis, even as in the present case between co-users of the same monopoly service. While these must have been regarded as a price worth paying to avoid government involvement in the process, it is difficult to believe that the problems illustrated by this case were fully anticipated, and it may be that the time has come for a review of the practicality of the present system.

The introduction of the Regulation has had the effect of eliminating freedom of contract on much of the Province's forest land in favour of fixed local monopolies. As Mr. Schulte observed, there is no market within which rates can be established which might be considered "competitive by industry standards" as required by s. 25(1)(a). It was not suggested that rates for logging on private timberland can be looked to for this purpose, although failure of Lineham to obtain a small volume of "non-Bill 13" work was cited by Interfor as evidence of Lineham's inability to complete. There is no requirement for disclosure of rates settled under the Regulation, leave alone the basis on which they were arrived at, such settlements often being regarded as confidential. In the present case the most important settlements, those reached between Lineham and Interfor in the same area, have been withheld even from the arbitrator. It is curious, to say the least, that arbitrated rates are required to be published, yet agreed rates to which arbitrators must look in order to make their decisions can be secret.

The unique nature of each operation makes comparison with those elsewhere possible only to persons with extensive expertise and full knowledge of all the relevant factors. The evidence shows that such judgment differs widely as between one expert and another, creating large difficulties, no doubt, even for arbitrators with expertise in the industry who have not themselves examined and compared the operations "on the ground". Making such comparisons has been described by other arbitrators as a "nebulous exercise", and this is certainly so in the present case.

I cannot believe that the Regulation seeks to establish a "cost-plus" pricing regime, -- one in which rates are established simply on the basis of a contractor's actual costs with a percentage addition for "profit and risk". Such a regime would provide no incentive for efficiency, but the very reverse -- the promise of increased profit as costs increase. If, as seems often the case, the rate is set after the work has been done, reduction of expected costs through increased productivity will under such a system be directly penalized by lower profit. Where the rate is set while work is in progress, subsequent efficiencies may result in increased profit for the current year, but almost inevitably lead to reduced profit in the following and later years.

Thus in deciding whether a rate is "competitive", and such as to permit a reasonably efficient contractor to earn a reasonable profit, as required by s. 25(1)(a) and (b), it seems, as I have said, that the most valuable guidance will be found in rates actually agreed to by the same parties for recent work as part of the same operation -- the criterion mentioned in s. 25(2)(a) -- in association with adjustment for the factors listed in clauses (b) and (c), and rates agreed between contractor and other licensees involved in the same operation. Because of the lack of any requirement for disclosure of rates and costs, agreed to or incurred under the Regulation, as well as the unique nature of each operation and the wide variation in expert opinion as to the adjustments which should be

made between them, less assistance is likely to be found in costs and rates agreed to in *other* harvesting operations under clauses (d) and (e). While actual or "historic" costs of the particular contractor are obviously relevant under s. 25(2)(b) and (f), a determination based on such cost data, with the addition of profit and risk markup, must for the reasons mentioned be regarded as less likely to result in the "competitive" rate required by s. 25(1), and more likely instead to accelerate the familiar, perhaps inevitable, tendency under monopoly conditions for prices to rise from those "which competition will permit" to those "which the traffic will bear".

In considering rates arrived at through negotiation for work done for the same licensee or others as part of the same operation, it seems that one may well draw on the best evidence of the judgment of those in the industry most knowledgeable with respect to all considerations listed in s. 25, and thus be most likely to achieve the result contemplated by the opening words of s. 25(1).

(c) The Evidence

I am faced with the difficulty that the parties have agreed between themselves that they will not disclose in these proceedings either the rates under which Lineham has cut a substantial volume for Interfor during the last four years in Gowan Creek, where this year's work is in progress, nor the interim rate now in effect there.

While the task has as a result been rendered more difficult than it might have been had I been given what could have been the "best evidence", there is some guidance along the same lines to be found: (i) in an offer made to Lineham by Interfor for logging in Gowan Creek for 19967, which surprisingly falls outside the non-disclosure agreement; (ii) in the rates agreed between them for logging in Rogers Creek, to the north of Gowan Creek, for 1995-6; and (iii) particularly, in rates agreed to between Lineham and Canadian Forest Products ("Canfor") for work carried out both in 1999 and during the previous eight years as part of the same operation on the other side of the Lillooet River, including that in the Chief Paul Creek directly across the river from Gowan Creek. I have benefit also of the arbitration decision which set rates between Lineham and Interfor for the Rogers Creek for 1992 and 1993, but this, like the opinions of expert witnesses, cannot have the same evidentiary value as rates negotiated by those in the business, to which the Regulation first looks, and which in my view are most likely, certainly in the present case, to lead to the correct result.

I shall have particular reference to this evidence of the course and result of prior rate negotiations (summarized hereafter in Table I, page 65), but my conclusion will necessarily be flawed by the decision of the parties to withhold evidence of prior rates in Gowan Creek itself. Although Lineham indicated during the hearings its willingness to disclose such evidence if Interfor would waive the confidentiality agreement and Interfor

declined that invitation, no inference can in my view properly be drawn against Interfor in this regard, that is to say for holding to the bargain they had made, the legality and enforceability of the agreement not being questioned by Lineham.

II. LINEHAM OPERATIONS

(a) Lineham's History

Lineham is a "stump to dump" logging contractor operating under the "Bill 13" Regulation for three licence-holders, Interfor, Canfor and Western Forest Products Limited ("Western"), its operations for Interfor and Canfor being centred at Spring Creek, at the north end of Harrison Lake, and those for Western at Silver River, to the south and on the east side of the Lake. (See Map I: next page).

The company has been operating in the Hope-Harrison Lake area for many years, and was at one time involved in logging its own timber, as well as that of its present customers or their predecessors and of other forest companies.

Lineham's Interfor and Canfor operations are integrated in that they share the same equipment, manpower and facility at Spring Creek, but its Western operation is almost completely separate. The three operations are controlled from Lineham's head office in Chilliwack, but there is said to be very little sharing of manpower or equipment between the operation for Western and that for Interfor and Canfor.

[Insert Map I here]

(see LIT:61736 and LIT:62202)

Under the Regulation, Lineham is entitled to a guaranteed percentage of the allowable cut of each licensee, to be delivered over the same five-year period for which the allowable cut is set by the Ministry of Forests. Its current entitlement within the allowable cut of each for the period 1997-2002 is: (i) for Interfor, an average of 40,830 cubic metres per year; (ii) for Canfor, an average of 40,420 cubic metres a year; and (iii) for Western, an average of 33,366 cubic metres per year.

But Lineham is not entitled to any minimum cut in any year, and during 1998 had little work because of the downturn in the province's lumber production, a factor which considerably complicates the *ad hoc* rate-setting task.

The hub of the combined operation for Interfor and Canfor is the somewhat dated Spring Creek Camp, owned by Canfor and maintained and operated by Lineham to house and feed Lineham's crews for both operations. Despite its proximity to the Fraser Valley, the camp is isolated by the lack of usable road access along Harrison Lake and crew and supplies have to be brought in by air. At the nearby "dry land sort" the timber from each operation is separately graded and bundled before booming in the lake. This is a complicating factor, since the two licensees require that Lineham handle their production at the same time but that the wood handled for each be processed separately.

While the present arbitration is concerned only with Interfor rates, it will be

obvious that the work being done for Canfor necessarily plays a very large role in the economics of the operation, and that lack of any regulatory machinery for establishment of equitable rates even as between co-users of the same monopoly service is but one of several obvious problems associated with the regime. Canfor appears in recent years to have paid Lineham markedly higher rates than those offered by Interfor, the recently-agreed 1999 Canfor rates being on any view at least 30 per-cent higher than Interfor's proposed rate, and possibly as much as 50 per-cent higher.

(b) 1999 Canfor and Interfor Work

Lineham is employed this year on five Canfor blocks west of the Lillooet River, as well as on the five Interfor blocks in Gowan Creek on the eastern side of the river (see Map II: next page), transporting logs from each to the Spring Creek facility by different logging roads, one on each side of the river.

While many Canfor Blocks are relatively close to the Spring Creek Camp, others such as Block 4874 are in the Chief Paul area, a similar distance from the Spring Creek to the Gowan Creek blocks in which Lineham is now cutting for Interfor. Under its 1999 logging plan, Lineham is cutting its 55,800 cubic metres for Interfor in Blocks 402, 404,

[Insert Map II here]

(see LIT:61736 and LIT:62202)

406, 409 and 415 in Gowan Creek, having a distance of close to 40 kilometres from Spring Creek. This is almost three times as much as the total volume logged by Lineham last year for Interfor and Canfor combined. Lineham is cutting its 36,000 cubic metres this year for Canfor in Blocks 3562, 3564, 3566, 1550 and 1551, approximately half the distance of Gowan blocks from Spring Creek. The total cut of 91,800 cubic metres is its largest for the combined operation in seven years.

As already noted, Lineham cannot work for one licensee at a time, but has to log contemporaneously for both while handling their wood separately, greatly reducing the benefit of an integrated operation.

(c) The Phases

The Lineham "stump-to-dump" operation was generally broken down in evidence into a series of so-called "phases", said to be recognized in the industry.

These include (i) falling, including cutting and logging; (ii) yarding, in which logs are gathered and moved to the roadside using machines such as backspar hoe, swing yarder in grapple configuration and tower yarder; (iii) loading, in which log loaders and possibly backspar hoe are used to load logs for onto trucks; (iv) travel time, covering wages paid to the crew during the time it takes to get from camp to the cut site, and back

at the end of the day; (v) hauling, a particularly expensive phase in which logs are transported to dry land sort; (vi) dry land sort, in which the logs are unloaded, scaled, graded, bundled, dumped and boomed; (vii) road maintenance and deactivation; (viii) camp expenses, covering crew board and lodging; (ix) crew transportation, being the cost of getting the crew in and out of camp at beginning and end of the season and during fire season; (x) overhead, which includes costs of supervision, contract administration and other head office expenses; (xi) depreciation of equipment; and (xii) profit and risk.

Unfortunately, all witnesses did not break the operation down in the same way. Dennis Bendickson, an expert called by Lineham, included depreciation, for instance, within the cost of each phase; Dr. Andrew Howard, an expert called by Interfor, included travel time in calculating "benefit loading". While the witnesses agreed in their identification of some of the phases involved they disagreed, sometimes very widely, on the cost or value properly to be placed on each. The resulting array of conflicting cost figures will be found on Table II (see pages 71-73).

The significance of any "phase cost" breakdown of rates said to have been used during rate negotiations is subject to the qualification that where the end result is a rate for all phases the parties may in fact have quite different views with respect to reasonableness of each component -- that is to say, a contractor may accept a low rate for one phase if the rate for another phase is generous enough to render the overall rate

sufficiently attractive. Any comparison of individual so-called "phase" rate components as between one operation and another, if such a breakdown is available, must for this reason be treated with considerable caution -- for practical purposes the figure of consequence to the parties is the final unit price per cubic metre.

As might be expected, the appropriate "profit and risk" mark-up, while said to be "standard" in the industry at 15%, in fact varies from one settlement to another and one expert to another -- Lineham's expert contending for 17½%, almost three times the 6% allowance which has in fact been accepted by Lineham in dealings with Canfor -- and there is a continuing disagreement as to whether this allowance, whatever it is, should be applied "before" or "after" depreciation.

I think it fair to say that the per-centage allowance acceptable to the parties will depend largely on the level at which costs are calculated, and the extent to which these allow for variation from "optimum" or "target" conditions and productivities, as part of the "give-and-take" which leads to an agreed rate.

(d) Spring Creek Rate Settlements

Previous arbitrators under the Regulation appear to have had the benefit of full disclosure of rates earlier agreed to between the parties, and, as might be expected, have generally treated these as an important guide to the appropriate result.

As has been mentioned, the parties in the present case agreed to withhold much relevant evidence of prior rates, and have largely based their cases either on differing expert opinions adapting figures from other operations, or "cost-plus" approaches. Having in mind that s. 25(1) requires determination of rates on which it can be said that reasonable licensees and contractors in the same circumstances *would agree*, the value of other evidence must, in my view, be assessed in light also of the past rates offered and agreed to for the operation involved.

There is evidence of rates paid by Interfor to Lineham for work in Rogers Creek, north of Gowan Creek, for 1991-1997. The 1991 rate was the product of a "market logging contract", and for that reason is not useful in the present context; the 1992 and 1993 rates were set by an Arbitration Panel under the 1991 Regulation at $43.53 for 1992 and $44.90 for 1993. Interfor agreed to pay Lineham $45.79 per cubic metre for 23,127 cubic metres cut in Rogers Creek in 1994, $50.50 per cubic metre for 41,303 cubic metres cut there in 1995, and $51.50 per cubic metre for 20,688 cubic metres cut there in 1996. It was said in evidence for Lineham that this last rate was considered by Lineham to be too low, a feeling no doubt commonly held by contractors while the opposite may at

the same time be the view of licensees. In agreeing to $51.50 per cubic metre three years ago for more than 20,000 cubic metres Lineham must be taken to have reached an agreement of the sort contemplated by s. 25(l). Yet it cannot be denied that the costly and uncertain prospect of arbitration is likely to be most daunting for the party least able to bear the potential expense, and there is evidence in the rates paid by Canfor to support Lineham's view that the Rogers Creek rate was low.

Evidence of prior rates agreed to by Lineham and Interfor for Gowan Creek itself has been withheld with the exception of a rate of $61.12 per cubic metre for a very small volume of 667 cubic metres cut in November of 1998, which is plainly unrepresentative but which the parties have agreed to disclose. The total Gowan Creek cut in the years for which agreed rates have been withheld amounts to some 45,000 cubic metres. I have, however, evidence of an offer made by Interfor to Lineham in August, 1997, for work in Gowan Creek between June, 1996, and June, 1997, of $45.96 per cubic metre for approximately 23,806 cubic metres. This was rejected by Lineham, and the parties eventually settled on a rate not disclosed.

There is significant evidence of rates established by negotiation between Canfor and Lineham for logging on the other side of the Lillooet River, from 1990 to 1999, mainly in Sloquet, Chief Paul and Smith Creeks. The weighted average rate for 1997 logging in Blocks 1254, 3560, 1341, 4446, 4874, 4880 and 4380, was $54.12 per cubic

metre for a volume of 24,502 cubic metres. Rates for Chief Paul Creek, directly across the Lillooet River from Gowan Creek, varied between 1994 and 1997 from $42.58 to $60.70 per cubic metre. The recently-agreed weighted average Canfor rate for 1999 logging, well to the south, amounts to $47.91 per cubic metre.

In utilizing rates agreed to by the parties regard must be had for differences in volume, operating conditions, yarding and hauling distances, labour and regulatory costs, required equipment configuration and such important factors particularly affecting the yarding phase as estimates of "piece size" and the amount of relatively lower-cost "cherry-picking" and "hoe-chucking". The most important difference between Lineham's 1995-96 work in Rogers Creek and that to be done by it this year in Gowan Creek, however, is that the work in Rogers Creek was substantially further from Spring Creek Camp than the 1999 Gowan Creek blocks.

The parties disputed the issue of average "piece size" with respect to the wood taken out of Rogers Creek in 1996 for Interfor and that to be removed for Interfor from Gowan Creek in 1999. Piece size is an important factor in the present context because yarding and loading costs are only marginally increased by larger log size, while the volume to which the logging rate is applied is significantly increased by minor increases in average log size. Interfor's principal witness, Mr. Meyer, described piece size in the two cases as similar. Mr. Wells, for Lineham, responded that piece size in Rogers Creek

was significantly larger than that anticipated in the 1999 Gowan Creek blocks, indicating lower productivity in Gowan Creek and making 1999 Gowan Creek logging less economic. An Interfor printout summarizing actual piece size for 199697 (Exhibit 39) seemed to support the testimony of Mr. Wells, but Interfor denies that it does, demonstrating the potential for dispute in the present context as to interpretation of both to qualitative and quantitative evidence.

Not only is Rogers Creek significantly further from the Spring Creek Camp than the 1999 Gowan Creek blocks, but the percentage of road to Gowan Creek which is "mainline", and therefore of higher quality, is obviously higher than in the case of the 1996 Rogers Creek blocks. Lineham contended that the difference is not substantial, and that there are features which make the journeys more comparable, but there is obviously a significant difference in this component -- one which looms large because of the importance of travel and haul time, to which I shall later refer.

Notwithstanding these difficulties, the limited information disclosed in these proceedings regarding prior rates proposed or agreed to between the present parties, and more particularly that with respect to rates agreed between Interfor and Canfor for the same operation, in my view constitutes by far the most useful evidence before me. The figure of $36.70 put forward by Interfor, albeit for a greater volume, seems questionable when set beside the company's offer two years ago of $45.96 -- 25% more -- for a

substantial, though smaller, volume in the same area, and beside rates agreed to by Canfor for comparable work between 1996 and 1999, to which I shall later return. Similarly, Lineham's claim for $56.30 for Gowan Creek this year cannot be equated with the rate of $51.50 on which it agreed with Interfor for logging a smaller volume three years ago in Rogers Creek -- work involving greater haulage and travel-time expense.

The figures put forward by each party, while they may very well be those for which licensees and contractors respectively *might argue* in the course of rate negotiations, seem to me less helpful than evidence of previous settlements actually reached between them, in determining rates on which reasonable parties *would agree* -- the standard required by s. 25(1).

III. THE CASE FOR INTERFOR

Interfor employed four approaches to arriving at a rate on a basis other than Lineham's highly subjective "cost-plus" method.

The first two approaches were explained by Mr. Meyer, Area Engineer for Interfor in the Soo Timber Supply Area: (i) breakdown of costs and productivities which would in his opinion be incurred and realized by a reasonably efficient contractor, with a 10% allowance for profit and risk based on costs excluding depreciation, which he believes to

be “competitive by industry standards” as required by the Regulations; and (ii) a “rate comparison” by which he compares his calculated rate and Lineham’s proposed rate with rates paid to other contractors. Mr. Meyer characterized this second study as a “reasonableness check” which in his opinion demonstrates that Interfor's proposed rate is within the “range of reason” while Lineham's proposed rate is not. Mr. Meyer did not as part of his report attempt a “reasonableness check” comparing his proposed rate with those previously agreed between his company and Lineham for cutting in Rogers Creek, to the north of Gowan Creek, nor that offered by his company in 1997, but rejected by Lineham, for 1997 work in Gowan Creek itself, nor the rates paid to Lineham by Canfor in this or past years for what is obviously quite similar work.

Interfor’s third approach is an analysis prepared by Dr. Andrew Howard of the consulting firm KPMG of costs and productivities which would in his opinion be incurred and realized by a reasonably efficient contractor in Lineham's position, and what he believes to be an appropriate profit allowance.

The fourth approach applies costs in Interfor's Hope Division for 1999 to Lineham's 1999 Gowan Creek operation.

(a) The Meyer Approaches

The Meyer Report lays out a "model" Lineham operation adopting what Mr. Meyer considers the physical conditions of the blocks in which Lineham will be cutting for Interfor in 1999 and building up, phase-by-phase, the costs which he believes the "average efficient operator" in Lineham's position would incur.

Mr. Meyer makes two major assumptions: first, that Lineham can fulfil its contract with less equipment than it is in fact using; and, second, that greater productivities can be achieved for each phase, based on his experience and judgment, than those for which Lineham contends. The Meyer report combines machine and labour costs with expected production per day and develops a phase-by-phase rate. His "tree to truck" rate is $16.68, with other phases (including depreciation but excluding profit) totalling $16.89. He adds 10% profit to costs excluding depreciation, which he acknowledged to be somewhat low, but which he justifies by the fact that the contractor is more secure under the Regulation than it would have been in the past, and that many of the necessary regulatory approvals for 1999 are in place. He thus arrives at Interfor's proposed rate of $36.75.

The second aspect of the Meyer report is his comparison between his conclusion, the Lineham submission and contract rates of three other contractors for Interfor in the Soo TSA, identified as "1", "2" and "3", and two contractors in Campbell River, identified as "A" and "B", and Interfor's own costs in its Hope operation. To achieve his comparison, Mr. Meyer had to adjust the applicable rates to reflect often large differences

in conditions affecting each operation. Soo contractors "1", "2" and "3" have no dry land sort or camp costs; contractor "1" has no haul phase and contractors "1" and "2" have selective logging. There are substantial differences in travel time and road maintenance costs, factors of substantial significance in that minor differences in travel time have a major effect when applied to costs through various phases. Mr. Meyer excluded those phases not common to all contractors -- such as dry land sort, camp, haul and selective logging -- and made corrections for differences in travel time and road maintenance, in order to produce a "base rate" which he said compared, albeit obviously on a highly judgmental basis, "apples to apples."

With respect to contractors "1", "2" and "3", and to "A" and "B", Mr. Meyer had only "signed rates" - - that is rates for the completed job - - and no phase-by-phase breakdown of costs. He estimated costs of each phase which he excluded, and then deducted 8% for overhead and an amount for profit and risk. Travel time and road maintenance ingredients were corrected by using travel time and road maintenance figures submitted by Lineham as a base, and then adjusting up or down for difference in distances involved in the various other operations.

It is apparent that both in his "cost plus" study and in his comparison with agreed rates elsewhere Mr. Meyer has of necessity had to rely on professional judgment in very important respects. In so doing, as I have mentioned, he has arrived at a rate $9.20 below that which his company previously offered, and therefore presumably regarded as

reasonable, in its 1996-97 negotiations with Lineham for a substantial albeit smaller volume in the same area, but which Lineham rejected.

As I have said, this 25% difference between a necessarily opinion-influenced comparative analysis, on the one hand, and evidence from the negotiating table of the company's offer -- albeit not its final position -- two years ago, casts doubt in my mind on the appropriateness of the former figure; this doubt is confirmed by comparison of Mr. Meyer's proposed rate with very much higher rates paid to Lineham by Canfor in recent years, and those recently agreed-to for 1999.

(b) The Howard Study

Dr. Andrew Howard of the consulting firm of KPMG, produced by Interfor as its second expert witness, presented a study (Exhibit 13) based on his inspection of the conditions in which Lineham will work in Gowan Creek this year and the application to them of cost assumptions entirely independent of the contractor's actual costs, historical productivity and complement of equipment.

The Howard study is designed to reflect what it should cost the average efficient operator to log the area, and what allowance for profit and risk should be made to arrive at a rate "competitive by industry standards." Although similar in approach to the Meyer

report, the Howard study differs in that its costs are generated on a block-by-block basis to make the model sensitive to the diversity of conditions to be experienced. Dr. Howard described his report as more "empirical" and less "theoretical" than that of others. He agreed, however, that this approach, while used in other countries, has yet to be generally accepted in the forest industry in Canada.

At the core of Dr. Howard's study is his use of predictive equations generated from data collected and reported in forest scientific literature to predict actual productivities for falling, yarding and other phases on a block-by-block basis. Through the use of these sophisticated averages, Dr. Howard predicted productivities for 1999 in Gowan Creek. Counsel for Lineham challenged the efficacy of these predictive equations, suggesting that the data on which they are based were collected in areas significantly dissimilar from Gowan Creek, and that they do not take into account costs imposed on Lineham by the *Forest Practices Code*.

Like Mr. Meyer, Dr. Howard assumed a theoretical complement of equipment in determining machine and labour costs for each phase, and had no regard to actual equipment used by Lineham. His model made no allowance for fluctuations in volume which Lineham has experienced in recent years and the impact which these would have on the contractor's ability to develop an optimum equipment complement, nor for the

impact which demands of the Canfor operation necessarily have on an optimum equipment complement for the Lineham operation.

The basic Howard study assumes a cut of 51,078 cubic metres, higher than the average contract volume but lower than the expected volume for 1999. In his "sensitivity analysis", however, Dr. Howard calculates rate changes given different volumes, and concludes that a rate of $40.17 per cubic metre would be competitive for a reasonably efficient operator logging a volume of 56,000 cubic metres under conditions relevant to Lineham's 1999 work in Gowan Creek.

Dr. Howard's approach arrives at a rate which is $5.79, or approximately 12.6% lower than that which Interfor offered, and must have regarded as reasonable, for 1997 logging of a smaller volume by Lineham in the same area.

(c) Owen Trumper

Interfor's fourth approach to the calculation of an appropriate rate was provided by Owen Trumper, Operations Manager for its Hope Logging Division, a relatively large Interfor operation whose 1999 annual cut is 200,000 cubic metres, of which it will cut 180,000 cubic metres, the remaining 20,000 cubic metres being cut by a contractor. As of the date of Mr. Trumper's testimony, Interfor had cut 55,028 cubic metres. Mr. Trumper

produced (Exhibit 9) a cost breakdown for that volume in which he arrived at a cost of $39.59 per cubic metre before 10% profit and risk which he would apply to costs excluding depreciation, for a total of $43.21.

Mr. Trumper's duties for Interfor in Hope go beyond merely log production. He is responsible for road building, log sales, and forestry and engineering planning. As such, the figures in Exhibit 9 represent costs which Mr. Trumper "narrowed" so as to reflect log production only. Mr. Trumper testified, using the "Overhead Matrix" (Exhibit 1, Tab 2), that Hope uses a similar number of vehicles, just over half the labour and the same number of shops as Lineham, even though Hope's volume, at 180,000 cubic metres, far exceeds Lineham's three contracts combined. Mr. Trumper suggested that Interfor's Hope operation is, in effect, doing more with less.

Mr. Trumper conceded, however, that relying on "year to date" figures is less reliable than looking at figures for a complete year, such as 1997, and that he had not produced any such figures. He was also unable to provide details with respect to costs actually incurred by the contractor which he uses.

It is evident, both from the "Contract Matrix" which Mr. Trumper adopted in his testimony and from his cross-examination, that the Hope Division has a longer season

than Lineham and better "cull factor" (and therefore less waste), that it is less remote than Lineham's 1999 Gowan Creek operation and has more favourable yarding conditions than Lineham's 1999 Gowan Creek operation, and also that Lineham's average block slope this year is greater, and that it must contend with greater haul distances and travel time than the Hope Division.

It was quite apparent that the comparison of these two operations calls for a large element of judgmental adjustment, and that not all factors could be accounted for.

(d) Submissions

Interfor argues that s. 25 of the Regulation requires the arbitrator to first apply a threshold test of competitiveness, that is to say that it is a condition precedent to a contractor receiving a reasonable profit that the contractor establish that it is reasonably efficient, and that the evidence shows Lineham to be an inefficient company, with the proof of its inefficiency being found in its poor productivity.

Interfor argues that the productivity figures presented by Lineham are so far from the norm as to be plainly unreasonable, and urges that I accept the evidence of Mr. Meyer and Dr. Howard over that of the Lineham witnesses. That evidence, as already discussed, includes opinions of these witnesses that in their experience Lineham should achieve a

certain level of productivity, and has not done so. Interfor led evidence that Mr. Trumper was able to agree with his crew to pay them for less travel time, and that Lizzie Bay, an unrelated contractor, pays less than half of its crews' actual travel time. This latter evidence was adduced by way of hearsay and I cannot accord it a high degree of trustworthiness, while the former evidence renders little assistance, since under the IWA contracts contractors and licensees are legally obliged to pay for full travel time and Lineham's evidence was that its crews will not agree to any reduction. While Interfor suggests that Lineham has not tried hard enough, and that it is in Lineham's interest to have high travel time if "cost plus" pricing is to prevail, Lineham's position that it has no choice in the matter is difficult to answer.

Interfor argues that Lineham is not only passing along inefficient costs to Interfor, but seeking a profit and risk allowance upon those costs, and that this is unconscionable. The passing along of overhead and administrative costs including full salaries of Lineham's principals and its timekeeper, a member of the family of one of them, together with a profit over-ride on such payments is specifically challenged by Interfor, which notes that some of the time of Lineham's principals is spent negotiating contracts. Interfor argues that *Ray Savidan Enterprises Ltd. v. Weldwood of Canada Ltd.* [Unreported 22 March 1999 Arbitration award] stands for the proposition that a distinction must be made between work done by a contractor's principals to produce logs and work done in the capacity of owner.

Interfor also argues that Lineham's profit and risk allowance should be lower than "normal" because of its favourable 1999 logging chance, above average expected volume, readiness of roads, early approval of permits, IWA contract stability and the lack of any reason to expect unfavourable weather. Interfor also argues that the unhappy recent state of the forest industry is relevant -- that when the rest of the industry is trying to cut costs, contractors should be expected to do the same.

Interfor makes no attempt to adjust Lineham's cost projections to reflect its objections -- it simply rejects the Lineham approach *in toto* in favour of its own, using individual items to characterize Lineham's as unreasonable.

With respect to rates agreed with or offered to Lineham by Interfor and Canfor, Interfor argues that rates in 1997 reached a "high watermark", from which they should be adjusted downwards. Interfor suggests that the rates paid by Canfor to Lineham cannot be generalized in a "weighted average" as Lineham seeks to do (Exhibit 14, Schedule Q) because of the range in block-by-block rates (see Table 1). Interfor argues that Canfor has paid non-competitive rates to Lineham, and that Interfor should not be penalized on this account. Counsel notes that the difference between the 1996 Interfor rate of $51.50 per cubic metre for Rogers Creek and Canfor's nearby Chief Paul rate of $61.83 cannot be accounted for by differences in travel time and piece size, and that "the rest of the

logging chance is average" in both cases, yet Canfor paid a "premium" of more than $10.00. Counsel asserts that Interfor "should not be prejudiced" by what he describes as "non-competitive" Canfor rates.

Interfor argues that the failure of Lineham to win from Canfor a "non-Bill13" contract in its own area, even after dropping its proposed rate from $43.00 per cubic metre to $35.00, demonstrates its want of efficiency. The parties dispute whether the winning contractor was a union contractor or not, but if I accept Interfor's evidence that it was, there are factors not canvassed in evidence which would have to be considered in order to determine whether this incident has any significance.

Interfor argues that I should accept the expert evidence of Dr. Howard over that of Mr. Dennis Bendickson. It attacks Mr. Bendickson's credibility and argues that certain of Mr. Bendickson's important underlying assumptions were unsubstantiated.

As already indicated, I have difficulty with all the expert evidence. While undoubtedly sincere in their testimony, the experts justified their opinions by reference to much less persuasive criteria than *agreedto* or *offered* past and present rates for the area and operation in question, evidence which seems to me more pertinent.

IV. THE CASE FOR LINEHAM

Lineham put forward evidence from three witnesses, Verne Wells and Herb Nickel, its co-owners -- who together produced a “cost-plus” “Contractor Program” based on the company's own “historical” costs (Exhibit 14(c)) -- and Dennis Bendickson, an expert in forestry economics who produced a cost study developed independently of Lineham's actual, or “historical”, costs and provided assistance in adapting earlier arbitrated and agreed rates for the Spring Creek operation for the present purpose.

(a) The ‘Contractor Program’

The contractor program generally adheres to the form and methodology of the cost-based Meyer report, permitting some comparison to be made between Lineham and Interfor assumptions and conclusions on a phase-by-phase basis.

An important difference between them is the calculation of fixed costs per cubic metre including overhead, supervision and depreciation of equipment, which will not change significantly with changes in volume, as do wages. equipment operating costs, labour costs, camp costs, and other operational expenses. For the present purposes Interfor calculates costs per cubic metre by dividing the total by 55,800 cubic metres, the expected actual cut according to the 1999 logging plan. While Lineham calculates its variable costs in the same general way as Interfor, it divides its fixed costs by the average

annual amount of wood which it is entitled under the Regulation to cut - - 40,830 cubic metres. Mr. Wells testified that this is the only way to maintain stability in the contract rate, and ensure that Lineham is properly compensated for the cost of having equipment ready to perform its obligation when required to do so. Interfor complains that to "amortize" fixed costs over the smaller volume 40,830 cubic metres artificially inflates the contract rate in 1999 when the actual cut is 55,800 cubic metres. Lineham responds that in "lean" years, such as last year, when it only cut 2,725 cubic metres, Interfor is obviously the beneficiary of Lineham's proposed practice, and that Lineham's approach ensures that over the five year period, costs will be fairly recovered.

To Mr. Meyer's contention that in "lean years", like last year, it would be prudent for Lineham to sell off almost all its equipment, and when conditions improve, as in 1999, to buy a new complement of equipment, Mr. Wells replied that lean years are lean for everyone, and there will be an excess of equipment on the market over demand, which depresses prices, while when conditions improve there tends to be a shortage of equipment, and prices inevitably rise, while commission will in any event have to be paid on the transactions involved. "It's just a losing proposition, both ways", said Mr. Wells, a position which seems to me to make good sense, and leaves me with considerable doubt as to the practicality of Mr. Meyer's contention.

This last aspect emphasizes the danger involved, in my view, in adopting analytical approaches, however well-based from a theoretical point of view, as opposed to judgment based on business realities which actually face contractors and are most likely to influence the parties in rate-settlement negotiations. Interfor does not seek to revise Lineham's cost-based approach by elimination, reduction or adjustment of specific ingredients, but suggests rather that its own approach is more reasonable.

The "contractor program" arrives at a proposed rate of $56.69, adjusted at the hearing to $56.30, approximately $5.00 less than Lineham's calculation of actual cost of its operations in Gowan Creek in 1997.

(b) Verne Wells and Herb Nickel

Mr. Wells handles the logging and operational side of the Lineham, including supervision of operations in the forest, while Mr. Nickel handles the financial side - - including managing the Chilliwack head office, dealing with suppliers and interviewing job applicants - - and the Lineham "cost plus" approach employs historical productivities and costs as a base, with judgment as to these being made by Mr. Wells from his more than 25 years of experience in logging in the area, and the company's actual present complement of logging equipment.

In answer to Interfor's contention that there is no reason for Lineham to utilize a "tower yarder" which - - while less expensive to purchase and maintain than a swing yarder in grapple configuration - - is less productive, needs the constant accompaniment of a loader and is typically used in areas of poor deflection in which a swing grapple yarder cannot adequately function, Mr. Wells concedes that there is no topographical reasons for employment of the tower this year for Interfor, but says that Canfor will from time to time require a tower yarder and that instead of purchasing in addition an expensive new swing yarder, Lineham is acting prudently in using the tower yarder which it must in any event have available. While the matter is by no means a simple one, and no effort was made to provide quantitative evidence by which the alternatives might be compared, I cannot say that Lineham has acted imprudently in this regard; its explanation certainly seems to me to make practical sense.

The Lineham evidence that it cannot rent and operate saws for less than $42.15 per day per saw was met by Interfor's claim that this can be done for $30 per day. Interfor objected to being required to pay for Lineham's sponsorship of a children's hockey team, asserted that Lineham wastes money by utilizing woods foremen when it could utilize charge hands whose wages are lower, and challenged Lineham's evidence that it needs both watchman and a handyman at Spring Creek Camp. Interfor asserted that Lineham's complement of generators is inefficient, its supervision structure wasteful, and its Chilliwack head office unwarranted. These are examples of what Interfor describes as a

general “attitude” towards costs and productivity which, it says, demonstrates lack of concern for efficiency.

To some of these challenges Lineham offered no plausible answer - - such as saws and hockey sponsorship. As to others Lineham claimed, for instance, that safety and *Forest Practices Code* requirements dictate the use of woods foremen over charge hands, that the aged Spring Creek Camp, which it is obliged to use, requires heavier maintenance, and involves greater heating and catering costs, than would be the case with more modern facilities, that the generator complement and other camp costs are as economical as alternatives suggested by Interfor, and that because it serves three operations, and for other reasons, a central head office in Chilliwack is justified.

As to these last four issues, it is apparent that only a person with extensive experience in the industry and personal knowledge of the operation concerned would be able to reach a confident conclusion, but it seems to me, as with the tower yarder, that Lineham’s position is based on operational realities, and generally to be preferred over what seem to me to be more theoretical considerations.

Lineham characterizes supervision as a fixed cost, while Interfor argues that as volume drops, supervisors should be laid off. Interfor treats depreciation as a variable cost, in the sense that under-utilization of equipment should be reflected in reduced

depreciation. Mr. Nickel conceded that supervision could be characterized as partially variable, but said that because of their scarcity able supervisors are prudently kept on by Lineham in lean years so as to ensure their availability when volumes recover, and contended that under-utilization of equipment in lean years should be offset with increased volumes in subsequent years.

(c) The Bendickson Report

Lineham's expert witness, Dennis Bendickson, produced a report (Exhibits 29 and 30) derived from productivity and costs in operations which in his view indicate those of a reasonably efficient contractor in Lineham's position.

Mr. Bendickson inspected the physical conditions in Gowan Creek and obtained a list of Lineham's equipment, but did not receive any information on Lineham's "historical" costs or productivity. He rated the 1999 "logging chance" in Gowan Creek as average, but said there are factors which have an adverse impact on Lineham's efficiency, including relatively small average annual contract volume, restricted working year due to annual closure of Harrison Lake, fluctuation in actual volume and a practice called "stumpage setting", which results in Interfor instructing Lineham to load only certain types of trees after it has finished logging an area , something designed to take a

advantage for Interfor of the technicalities of government stumpage rules which appears to be entirely unrelated to efficient logging practice.

Mr. Bendickson estimated productivity for each phase of the 1999 Gowan Creek operation substantially lower than Mr. Meyer and Dr. Howard. Mr. Bendickson applied a profit and risk allowance to costs, including depreciation, of 17.5%, in part to account for what he regarded as unusual adverse factors. In Mr. Bendickson's opinion, adopting costs of a reasonably efficient operator with the 17.5% profit and risk allowance produces a reasonable rate of $57.70 per cubic metre - - representing a return on Lineham's invested capital of between 40 and 60%, depending on how calculated. As I have mentioned, this 17 ½% allowance must be compared with the 6% profit and risk allowance which Lineham has accepted in dealings with Canfor.

As already noted, Mr. Bendickson's proposed figure of $59.42 for Gowan Creek is more than 15%, *higher* than that agreed to by Lineham for 1995-96 logging of a much *lower* volume in Rogers Creek, an area involving substantially greater haul distance and travel time than Gowan Creek; Mr. Bendickson stated that he did not take 199596 Rogers Creek rates into account in forming his opinion as to a reasonable 1999 Gowan Creek rate because this was not within his terms of reference.

At the request of the arbitrator, however, Mr. Bendickson did make some calculations adjusting Lineham's Rogers Creek and Canfor rates for distance differences only, to which reference will be made later.

(d) Submissions

Counsel for Lineham submits a spirited defence of the company's performance, rejecting Interfor's allegations of "chronic inefficiency", pointing to Canfor's acceptance of its higher level of costs caused by factors such as isolation, the ageing Canfor camp which it is obliged to operate for both licensees, the choice of the licensees not to improve hauling conditions by building a larger bridge over the Lillooet River and their unwillingness to co-ordinate their operation so as to avoid concurrent use for both of the Spring Creek dry land sort and bundling and dumping facility.

Lineham says that the real issue in this arbitration is whether Lineham deserves to be "driven out of business" by acceptance of a rate such as Interfor proposes.

Counsel for Lineham points out that Lineham has never had to arbitrate a rate dispute with any party other than Interfor, that Interfor has in the past challenged Lineham's claim to the protection of the Regulation and has been obliged to pay Lineham compensation for failure to provide it with the work to which it is entitled. Counsel says that arbitration is too expensive for most contractors to undertake, and that it was Interfor,

and not Lineham, that initiated the present proceeding. Counsel says that Interfor has forced it to arbitration without any real effort to negotiate, and is seeking in these proceedings to "rid itself of Lineham permanently".

Lineham takes the position that the process laid down by s. 25(1) "is analogous to, or contains components of, a cost plus approach" in that: "Once it is determined that the contractor is reasonably efficient, and that the rate sought is competitive, the rate must permit the contractor to earn a reasonable profit".

While I do not in any way criticize this statement as a paraphrase of the language of the Regulation, I would question whether it makes the task simpler. The Regulation seeks "competitive" rates while at the same time eliminating freedom of contract so as to prevent competition, but nevertheless requires that rates ensure that a contractor operating in a reasonably efficient manner will be able to earn a reasonable profit. It seems to me that Lineham's position reflects the difficulties inherent in the wording of Section 25(1), and cannot assist in resolving them. In a later reference counsel seems to abandon concern for the requirement that rates be "competitive", and states simply that the Regulation should be "liberally interpreted to ensure that a reasonably efficient contractor has a reasonable prospect of covering his costs of performing timber harvesting operations, and realizing a fair profit".

With respect to the relevance of the general "economic health" of the industry, Lineham takes the position that licensees are not entitled in "hard times" to lower their rates to "Bill 13" contractors on that account, but must instead "seek more efficient means of operating, or cease production until prices improve".

In his overview of the evidence counsel for Lineham refers to five factors peculiar to the present operation which are not present in the other operations referred to by Interfor witnesses: (i) the particular overhead, head office, administration and equipment costs involved for Lineham in servicing three relatively small cuts for separate licensees; (ii) the isolation, small volume, limited load size and adverse hauls involved; (iii) the age, inefficient layout and isolation of Canfor's Spring Creek Camp, which Lineham is required to operate; (iv) the inefficiencies resulting from failure of Interfor and Canfor to assist in integrating the Spring Creek operation, and their insistence that Lineham log concurrently on both sides of the river yet keep production separate while being handled at the log sort; and (v) Interfor's unusual requirements, including short season, its selective "stumpage setting" of smaller wood only, and its significant volume variations and tendency to shortfall in its volume allocation.

With respect to Mr. Meyer's evidence, on which Interfor bases its figure of $36.75, counsel for Lineham says that this rests on assumptions which have no connection with

Lineham's actual circumstances, that it is inconsistent with evidence of Lineham's actual costs and "would in short order bankrupt Lineham". Of the KPMG rate of $41.54, counsel says that this is related to "idealized costs" rather than actual costs currently incurred in the area. Counsel emphasizes that Lineham's "Contractor Program" is based on productivities higher than those in fact achieved by the contractor in recent years. He asserts that Interfor has in past based rates on contract volumes rather than actual volumes -- in this regard, I would observe that Interfor does not appear in 1998 to have paid rates sufficient to cover fixed costs, while low volumes were harvested. As to profit and risk, counsel offers no explanation for the acceptance by Lineham of a 6% allowance in its dealings with Canfor. Counsel asserts that 15% has "consistently" been awarded as an "industry standard" and ought to be awarded on costs after depreciation, making the point that Mr. Meyer allowed 15% for profit and risk in his assumptions with respect to rates paid by Interfor to other contractors.

With respect to depreciation, counsel for Lineham points out that Dr. Howard allowed for greater depreciation than does Lineham -- based, perhaps, on the assumption of more expensive but more productive equipment.

(e) New Evidence

When the matter came on last month for oral argument, Lineham offered as new evidence: (i) its 1999 rate settlement with Canfor; (ii) its 1999 settlement with Western in

respect of the Silver River operation; and (iii) information requested by the arbitrator regarding comparative "logging chance" as between various blocks referred to and factors affecting logging costs since 1992.

This new evidence was admitted over the objection of Interfor. It was my view that the new evidence of consequence was that of the 1999 settlement with Canfor. This indicated agreement on a rate very close to the figure put in evidence by Interfor in cross-examination as that being discussed in negotiations between Lineham and Canfor at the time of the July hearing. It seemed to me that this new evidence met the traditional requirements applied in the courts for re-opening of a case before judgment, and it proved in the end merely confirmatory of less reliable information already in evidence. The 1999 Canfor-Lineham rates seem to be at a level lower than that agreed between them for logging in 19967, but markedly higher than rates proposed in these proceedings by Interfor. The Canfor rates amount, on a weighted-average basis, to $47.91 per cubic metre, as opposed to $54.12 in 1997. While "logging chance", including 'piece size' as well as 'cherry picking', 'hoe-chucking' and other aspects relevant to logging economics, play a part in explaining the differences in logging cost as between different blocks, the most important will generally be distance from the Spring Creek 'dry land sort' and booming ground, which affects 'travel time' and 'haul distance' costs through several phases. The importance of this factor was emphasized by the earlier evidence of

Mr. Wells that every additional *10 minutes* of additional road time amounts, on his costing basis, to *$50,000* for the year's work.

As will be later discussed, the 1999 Canfor blocks logged by Lineham for a weighted average rate of $47.91 are about *half* the distance from Spring Creek of the 1999 Interfor Gowan Creek blocks, yet Interfor offers the very much *lower* rate of $36.75. Interfor does not suggest that this marked difference can be justified by differences in 'logging chance', or anything else having to do with logging economics, but attributes it instead to Canfor's willingness, for some reason, to pay what Interfor regards as excessive rates.

The new evidence shows that Lineham's 1999 agreed weighted average rate for Western at Silver River is $50.70 per cubic metre. While, as already indicated, this operation is quite separate from the Spring Creek Interfor-Canfor operation, and comparisons between the two are difficult to make, it is clear that the rate agreed between Western and Lineham is much higher than would be justified on the basis of costs said to be applicable to the vicinity of Silver River used by Interfor in constructing its proposed Lineham costs out of Spring Creek. Counsel for Interfor contends again that, as in the case of Canfor, Western is paying an unjustifiable "premium" rate, and argues that Interfor should not be "penalized" on this account.

V. PREVIOUS AWARDS

Although the Regulation has now been in effect for eight years, only six arbitration awards given under the Regulation have been located by counsel, four of these being under the Regulation as amended in 1996.

The following is a brief summary of some salient features of these awards and of decisions of the Supreme Court of British Columbia on appeal from two of them.

(a) *Timfor v. Fletcher Challenge* (1993)

In this case, heard by a three-arbitrator panel, the contractor argued that the Board should rely on its actual costs, on trends in the industry over time, and on costs in similar operations, and that decrease in volume should lead to an increased rate; it contended also for a profit and risk allowance of 15% on costs inclusive of depreciation. The licensee argued that the Board should conduct the proceedings as an "interest arbitration", and seek to replicate the agreement the parties would eventually have come to, without undue regard for the contractor's actual costs, and that the rate should be set from the perspective of the parties prior to the contractor embarking on the work.

The Board agreed that the process constituted "interest arbitration" and that the perspective from which the rate should be set was the time at which the parties agreed to the interim rate which, like all agreed rates since 1986, had been disclosed to the Board. The Board placed reliance on the 1991 agreed rate, finding that the evidence did not show this to be inadequate from the contractor's perspective. The Board held the agreed interim rate, which was higher than the 1991 rate, to be a reliable starting point. It accepted that as volume goes down the rate should go up, found there was little or no change in logging chance and took into account that more expensive equipment was to be used than previously, and also length of the logging season.

The Board set the rate for the first 120,000 m^3 at a level almost precisely half way between the opposing submissions, and the rate for the remainder of the cut essentially on the basis of the contractor's calculation.

(b) *Lineham v. Fletcher Challenge and Interfor* (1994)

This arbitration involved the present parties and raised issues which included the jurisdiction of the Board and the position of the prior licensee, Fletcher Challenge, as well as the applicable rate; Lineham argued that in setting the rate the Board should start with the 1991 rate as agreed between itself and Fletcher Challenge, which had subsequently transferred the licence to Interfor.

Lineham's expert referred to what he contended were prevailing rates, costs and productivities in the industry for similar operations, as well as rates agreed to between the parties in the past, changes in logging chance, volume, equipment configuration, regulations and inflation, arriving in this way at a proposed rate base to which he added 15 % before depreciation for profit. The licensee argued that past rates and actual costs were largely irrelevant, and that the Arbitrator ought to rely on its own expert's analysis of cost figures for the 1992, 1993 and 1994 years derived from a Ministry of Forests Stumpage Appraisal Manual, a cost evaluation based on labour costs and average efficiencies, and comparisons with agreed rates paid by Canfor and in two other Interfor operations with various adjustments.

The Board rejected the use of the 1991 rates because these had been paid under a "market contract" arrangement and were not comparable; it referred to the licensee's expert report, with adjustment for what it found to be errors in travel time, overtime and hauling capacity, overly-liberal estimates for yarding and overly-conservative estimates for overhead, depreciation, profit and risk.

The Board stated its resulting rate finding without detailed explanation.

(c) *Hayes v. TimberWest* (1997)

The Arbitrator in this case had agreed rates for 1994 and 1995 and evidence of proposals made by the parties in 1996 negotiations.

The contractor argued that it had been put in a position of accepting for past years unreasonably and unfairly low rates. The Arbitrator rejected this proposition, finding that the evidence did not warrant the conclusion that rates which proved acceptable to the contractor should nevertheless be regarded as unreasonable.

The parties disagreed as to overhead costs and supervision, with the Arbitrator ruling on both in favour of the contractor. As to the profit allowance, the Arbitrator concluded that it should be applied to costs *excluding* depreciation, as this appeared consistent with the prior practice at least as between these parties. As to the claim for an allowance for "extra risk", the Arbitrator rejected the contractor's position. He accepted the contractor's submissions on costs over those of the licensee.

The Arbitrator's award fell almost at the centre-point between positions taken by the parties in their last negotiations.

(d) *Pacific Forest Products v. Hayes* (1997)

The Arbitrator in this case had evidence of agreed rates for 1990 to 1995 and the rate proposed by the licensee to the contractor for 1996; he rejected the proposition that rates should be set without reference to data from the year in question, and declined to characterize the process as either "interest" or "rights" arbitration.

The Arbitrator again rejected the argument that previous rates were unfair, observing that the parties had been represented by able officers and counsel, but declined to consider evidence of 1996 negotiations as indicating what the parties believed to be fair or reasonable. He relied on prior rates adjusted upward for inflation and costs grossed up for profit and risk, rejected certain components, and for phases subcontracted out, such as falling and yarding labour, accepted the rate paid to a sub-contractor representing as cost including profit and risk. The Arbitrator used a list submitted by the contractor for assessment of depreciation, although expressing dissatisfaction with it as unaudited and produced for internal purposes, this being in the end the only evidence available.

In supplemental reasons the Arbitrator found certain capital acquisitions to be reasonable and legitimate costs reasonably and properly spread over time, and held that the profit and risk allowance should be based on costs *including* depreciation. There is no discussion as to the selection of a profit-and-risk allowance of 15%.

The Arbitrator in this case observed that comparison between rates for the operation in question and other operations was "at best, a nebulous exercise."

(e) *Savidan Enterprises v. Weldwood* (1999)

This arbitration dealt with a replaceable contract in which the contractor was paid on an hourly basis, rather than by volume produced. The submissions of the parties revolved around hourly machine and labour cost by phase, circumstances in which productivities and logging chance have no relevance. The Arbitrator held that an hourly-paid operation is less risky to the contractor, and should therefore be subject to 10% profit and risk allowance, as opposed to the 18% claimed.

(f) *Western Forest Products v. Hayes* (1999)

In this arbitration the contractor had taken over replaceable contracts from a former contractor, but the Arbitrator had details of agreed rates over past years, as well as the interim rate currently being paid.

The contractor argued that the Arbitrator ought to look at its actual audited costs of volumes logged, and add 15% for profit and risk, while the licensee argued that the rate ought to be at about the level of the agreed interim rates. The licensee argued that the

Arbitrator ought to make his ruling in respect of anticipated rather than actual volume. The contractor had taken out less than the volume anticipated, but the Arbitrator used actual volume logged. The Arbitrator looked at the actual costs of the previous contractor, and at logging chance, which he said was poorer for the current contractor than it had been for the previous contractor. He rejected the opinions of two experts, on the ground they relied on incorrect logging plans, failed to conduct site visits, were not well-informed as to actual conditions in the blocks and on the roads, and used coastal averages instead of data specific to the blocks. He accepted as a solid starting point the evidence of the contractor's expert who had used actual logging plans and logging costs, had conducted site visits and had put together a phase-by-phase analysis, but went through each phase and adjusted the expert's figures in certain respects.

The Arbitrator ruled that profit ought to be added to costs inclusive of depreciation, and accepted as "industry standard" a profit allowance of 15%. While finding, again, that rate comparisons with other operations were at best nebulous, he noted that adding 15% profit to the actual costs of the previous contractor produced a figure very close to the rate on which he had settled.

(g) Decisions of Madam Justice Baker

In *Hayes Forest Services Ltd.* v. *Pacific Forest Products Limited* (Unreported 9

October, 1998 Vancouver Registry A972671) (B.C.S.C.) (*Hayes No. 1*) and *Hayes Forest Services Ltd.* v. *TimberWest Forest Limited* (Unreported 2 December, 1998 Vancouver Registry A971531) (B.C.S.C.) (*Hayes No. 2*), Madam Justice Baker considered the arbitration decisions summarized under (c) and (d) above.

The first issue of relevance in the present context in *Hayes No. 1* was the decision of the Arbitrator not to consider the effect of shortfalls in volume which Hayes had argued should result in upward adjustment of the rate. Madam Justice Baker upheld the decision of the Arbitrator to ignore the shortfall on the ground that to take it into account would be to award Hayes damages for the licensee's failure to provide the promised cut under their contract, relief which fell outside the scope of the arbitration. In the present case Interfor relies on this reasoning in urging that I reject Lineham's proposal for averaging fixed costs over a five-year period. Interfor argues that I should have regard only to this year's agreed 55,800-cubic-metre cut in arriving at the fixed cost component of the rate, and not take into account that last year's cut was much lower and too low to enable Lineham to recover its fixed costs. I do not believe that Lineham led evidence in this regard for the same reason, or to achieve the same result, as did the contractor in *Hayes No. 1*. Lineham's position is that because of the fluctuation which it has faced in yearly contract volume the most reasonable way to distribute fixed costs each year is on the *average* annual cut for the five-year period.

In her decision in *Hayes No. 1*, Madam Justice Baker upheld the Arbitrator's decision to not accept evidence as to the "fairness" of past agreed rates, characterizing this as a matter of the arbitrator declining to give that evidence weight, which she held to be both permissible and proper in the circumstances.

In upholding the decision of the Arbitrator in *Hayes No. 2*, Madam Justice Baker rejected criticism of the Arbitrator's approach as that of a "surrogate negotiator". The judge held that while the decision must ultimately be "objectively capable of being tested against the standard imposed by the legislation", the arbitrator may nevertheless take into account the actual positions of the parties in negotiation leading up to the impasse which made the arbitration necessary.

VI. COMPARATIVE DATA

(a) Points of Divergence

As will by now be evident, the parties disagree on a vast number of issues, resulting in a dramatic difference in proposed rates; the following are some of the significant points of divergence.

They disagree as to expected productivities in virtually every phase of production

falling, yarding, loading, hauling and sorting. In the falling phase, for instance, Interfor submits as reasonable a productivity level of 138 cubic metres per-man day, while Lineham contends for 125. There are similar divergences in other phases. The disagreement over equipment addressed above is highlighted by Interfor deleting equipment which it considers unnecessary for performance of the contract, the most notable difference revolving around the necessity for the tower yarder.

The parties disagree as to the proper allowance for travel time, a particularly sensitive cost component. Mr. Miller for Interfor and Mr. Wells for Lineham drove the route together, and there is no disagreement as to the time it actually took - - the weighted average was 1.72 hours. Interfor submits that the time taken should be decreased to reflect the fact that the roads were not by then fully up to standard and they had to stop at one point for an empty log truck. Lineham denies that the roads were in unusually poor conditions, asserts that stopping for traffic is not uncommon and points out that the weather was unusually good.

Lineham increases travel times to reflect its practice of allowing its crews an extra ten minutes per day to don their boots and get machines operating. Interfor says that this is unwarranted. Lineham responds that if not included in travel time this would have to be paid for as working time. Simply put, Interfor's submission is that travel time equals the amount of time it takes to get from camp to the cut site plus the amount of time it

takes to get from the cut site back to camp, while Lineham says that travel time equals the time it takes the crew to get from camp in the morning till they arrive back in camp at night, minus the working day. Lineham says that if one does not count the preparation time in the morning and afternoon as travel time, then one must adjust daily productivities to reflect ten fewer minutes of production, which seems to make sense.

The parties disagree on the proper level of payroll loading - - the amount by which base wage is increased to reflect the cost of statutory benefits and holidays. Interfor uses a figure of 48% derived from Mr. Meyer's experience and from Forest Industrial Relations figures; Lineham calculates its actual payroll load at 51.9%. They disagree as to the "cycle time", or amount of time it takes to load trucks at the cut site, transport the logs to the sort, unload them, and return to the cut site, Interfor calculating the cycle time at 3.5 hours, while Lineham says that its actual cycle time is 4.45 hours, and that this is reasonable. Interfor argues that it is inefficient for Lineham to maintain a central office in Chilliwack for its three operations, and contends that Lineham could cut costs significantly by closing that office, while Lineham argues that working cuts in two separated areas requires a central office and that proximity to banking services, suppliers and labour markets necessitates "a town presence". The disagreement as to the proper calculation of fixed and variable costs has been outlined above.

The parties disagree as to whether the profit and risk allowance ought to be calculated on costs including or excluding depreciation, as well as with respect to the appropriate level -- Interfor arguing for 10% and Lineham's expert submitting 17½%, yet Lineham conceding that it has in fact agreed to 6% in dealings with Canfor, while some prior arbitration decisions adopt 15% as an "industry standard", and Mr. Meyer has used this figure in some calculations.

(b) Other Spring Creek Rates

As I have mentioned, it is my view that the most valuable evidence in these proceedings is that of past rates which Interfor and Canfor have offered and paid to Lineham by agreement in respect of the operation conducted out of Spring Creek; from these figures I believe I have in this case the best prospect of arriving at a result which reflects the criteria mentioned in s. 25.

Table I (see next page) summarizes the available rate data in tabular form together with relevant explanatory information. In considering this data one must, however, be

[insert Table I]

(LIT:65928)

cognizant of differences between the areas to which the rates apply and the area in question in this arbitration. Differences in volume, logging chance, hauling distance and travel time, piece size and other variables can have a significant impact, even though these variables obviously have less significance than do those involved in comparisons with other, quite different, operations.

Toward the end of the main hearing, perhaps in answer to the arbitrator's questions, the parties addressed differences between the 1999 Gowan operation and past contracts which Lineham has performed for Interfor in respect of which data was disclosed -- Lineham's 1996 Rogers Creek work, for which Interfor paid Lineham $51.50 per cubic metre, and Lineham's 1997 Gowan Creek work, in respect of which we know that Interfor offered Lineham $45.96 per cubic metre. These operations were both within reasonable proximity of the 1999 Gowan Creek operation, suggesting similarity in most but not all aspects. Not surprisingly, the parties disagreed as to differences between the cost of work in each situation. These differences, as I have said, while significant, are obviously more susceptible to adjustment than those between Lineham's operations out of Spring Creek and quite different operations.

Mr. Bendickson prepared calculations (Exhibit 33) applying adjustments for haul and travel time difference to Lineham's 1997 Canfor rates on a weighted-average basis, and Lineham's 1996 Interfor rates for Rogers Creek, so as to render these in his view

comparable in that respect to this year's Lineham work for Interfor in Gowan Creek. On the basis of adjustment for this factor, Mr. Bendickson arrived at figures of $55.18 and $48.58 respectively. Mr. Bendickson said he was unable to explain these prior Lineham rates for the same operation in relation to costs derived from different operations elsewhere and the Coast Appraisal Manual because he had not inspected Lineham's Canfor and Rogers Creek working areas. In cross-examination Mr. Bendickson said he did not look at these operations in the vicinity because that was not within his terms of reference. He said he did a work-up of costs based on his experience and the physical circumstances at Gowan Creek and the Spring Creek camp service area and compared it to the Forest Service manual, but did not test the competitiveness of the calculated rate, because he was not asked to do this.

Mr. Meyer testified for Interfor that 1996 Rogers Creek costs were higher not only because, as is obvious, they involved greater haul distance, but also because a tower yarder was required for topographical reasons, and because Lineham had to deal with a logging road whose "mainline percentage", and therefore average quality, was lower than that involved in 1999 in Gowan Creek, and also because there was less cherry-picked wood in Rogers Creek than in the 1999 Gowan Creek blocks. Mr. Meyer also said that Rogers Creek in 199697 had a higher "cull factor", which reduced Lineham's efficiency and increased its costs, and he pointed out that Lineham had a smaller volume to log in Rogers Creek than it does in 1999 in Gowan Creek.

Mr. Meyer suggested that "piece size" in Rogers Creek in 199697 and Gowan Creek in 1999 are comparable. As I have mentioned, Mr. Wells testified in rebuttal that the piece size in Rogers Creek was in fact larger, making that operation more efficient than the 1999 Gowan Creek operation, and produced (Exhibit 39) an Interfor analysis of piece size in the 199697 Rogers Creek operation which corroborated his testimony. Mr. Wells testified that piece size not only increases yarding efficiency, but efficiency also in the dry land sort, and I accept that this is so.

Mr. Wells testified that while Lineham logged a smaller volume in Rogers Creek than it will this year in Gowan Creek, it was also logging in Gowan Creek, which reduced the impact of volume on rate. Mr. Wells testified that while the haul from Rogers Creek in 19967 was greater than in the case of 1999 Gowan Creek, road conditions were better in Rogers Creek, a mitigating factor.

In response to Lineham's evidence Mr. Meyer compared Lineham's 1997 Gowan Creek work to the 1999 Gowan Creek operation, emphasizing the factors which increased Lineham's costs, such as the necessity of a tower yarder in 1997 Gowan Creek work, the lack of "hoe-forwarding" and "hoe-chucking", which reduces yarding costs, smaller piece size in the 1997 Gowan Creek blocks, which reduces efficiency, more rugged terrain and the smaller volume involved in the 1997 Gowan Creek work. Mr. Wells testified in reply

that the 1997 Gowan Creek haul was shorter, that the use of a tower yarder in 1999 in Gowan Creek is justified, and that costs in 1997 and 1999 Gowan Creek work are actually quite similar, any cost savings in the 1999 Gowan Creek yarding work being offset by a greater haul distance as compared with 1997.

While some of the factors referred to are related in objective and quantitative terms, the analysis is in other respects subjective or judgmental -- or qualitative rather than quantitative -- but here, again, I find the Lineham evidence on the whole preferable to that offered by Interfor. As I have repeatedly said, these past rates to which the parties themselves have agreed, or which they have offered, seem to me more reliable as evidence of rates on which reasonable parties would be likely to agree than evidence of rates or costs derived from other operations with opinion-based adjustments, or "historic" Lineham costs with added risk and profit margin.

Without an independent regulatory body having the expertise and authority to gather, verify and evaluate cost and rate data throughout the industry, it seems unlikely that reliable comparisons can be made between different operations, a difficulty recognized by other arbitrators. On the evidence I have heard I am unable to share the view expressed by some arbitrators that there is such a thing as a generally applied profit and risk allowance. Only with an industry-wide rate-setting mechanism, involving full and frank disclosure of rate settlements and the basis on which they have been reached, it

seems to me, can a "standard" costing system and associated profit allowance properly be applied, and with respect to risk, the allowance must obviously relate to each individual operation, recognizing the hazards actually involved and the extent to which costs allowed for each "phase" take account of the potential for variation between anticipated conditions and any more adverse conditions that may actually be encountered.

(c) 'Phase' Cost Data

Table II (see next pages) shows comparative figures for each "phase", so far as comparison is possible, as disclosed in expert evidence and Lineham's own figures, and what is said to be the "phase-by-phase" breakdown of agreed rates for 1997 work done by Lineham for Canfor as part of the same operation.

Like the rate comparisons demonstrated by Table I, the Lineham-Canfor 1997 figures must be viewed with caution. Where cost-based rates for different blocks are agreed as part of a "package", it may well be that the parties in fact have quite different

[Insert Table II (page 1) here]

(LIT:65935)

[Insert Table II (page 2) here]

[Insert Table II (page 3) here]

views with respect to costs appropriate to each. The fact that in this case the Canfor wood is handled in the same manner, and for the most part under the same conditions as that cut for Interfor, however, makes these figures far more relevant, in my view, than costs said to have been incurred or agreed to in respect of different operations which can only be adapted by the exercise of a large measure of judgment.

Interfor concedes the significant point that the level of Canfor rates has been higher than that of rates paid or proposed by Interfor, and ascribes this to over-generosity on Canfor's part, a matter to which I shall return.

(di A General Overview

The differences between the opinion evidence in these proceedings and other figures offered as relevant to Lineham's dealings with Canfor and Interfor are shown on Table III (next page), and demonstrate quite dramatically the difficulty involved in applying the s. 25 criteria to the present circumstances except on what is frankly conceded to be a broadly judgmental basis.

[Insert Table III here]

(LIT:69494)

These (Table III) figures are necessarily incompletely explained in the accompanying text, and provide no more than a rough comparative overview of the general range of the data presented.

VII. THE LEGISLATIVE CRITERIA

I have concluded that the two objectives mentioned in s. 25(1) are to be considered together in arriving at the rate there stipulated on which reasonable parties *would agree* -- one must consider what would be "competitive by industry standards" *and* permit a reasonably efficient operator "to earn a reasonable profit", no matter how difficult either may be under the present regime, and try to achieve a rate embodying both.

As I have said, I do not accept that the Regulation seeks to establish a "cost-plus" pricing system. The rate to be settled is, of course, a "fixed price" unit rate, arrived at on the combined basis of whatever evidence there is as to reasonable costs, profit-and-risk allowances and rates "competitive by industry standards".

My general conclusions with respect to specific factors enumerated in s. 25(2) of the Regulation include the following:

(a) "Rates agreed to by the licence holder and contractor for prior timber

harvesting services". The most significant such rates, those for logging some 45,000 cubic metres in Gowan Creek itself over the last four years, have been withheld from use in these proceedings, by agreement between the parties. There is, however, evidence of an offer made by Interfor of $45.96 per cubic metre for 23,806 cubic metres in 1997, a year in which Lineham logged a total of 48,308 cubic metres for Interfor and Canfor combined, and which Lineham rejected. This offer is to be compared with the rates in excess of $60.00 per cubic metre paid to Lineham by Canfor for logging in 19967 in Chief Paul Creek, approximately the same distance from camp on the other side of the river, and processed as part of the same operation, and with the rates of $50.50 and $51.50 agreed to between Lineham and Interfor for logging a total of some 62,000 cubic metres in Rogers Creek to the north of Gowan Creek during 19956. The only other agreed rate between these parties disclosed to me is the 1994 rate of $45.79 for cutting some 23,127 cubic metres in Rogers Creek.

(b) "The costs and productivity of the contractor for prior timber harvesting services carried out by the contractor". There is evidence from Lineham that costs of harvesting services carried out in Gowan Creek in 1997 exceeded $61.00 per cubic metre on the basis of actual productivity achieved; these costs relate to a cut of 23,800 cubic metres, are unaudited and essentially unexplained. Without a proper audit of costs and productivity, independently conducted by someone having the necessary expertise and knowledge of the operation, it is impossible to say whether these figures are reliable. The

"contractor program" produced by Lineham, which arrives at a lower figure, is said to be predictive, based on unexplained "historic" data.

(c) "Relative to prior timber harvesting services, the impact on costs and productivity likely to arise from":

(iA "Changes in operating conditions including, without limitation, changes to terrain, yarding distances, hauling distances, volume of timber per hectare". While there is evidence of differences between "logging chance" and other factors affecting the falling and yarding phases, the large difference for purposes of adapting 19967 Interfor-Lineham rates is the extra hauling and travel-time as between Gowan Creek and Rogers Creek. According to the evidence of Mr. Bendickson an appropriate adjustment would bring the 1996 Rogers Rate of $51.50 to $48.58 and would bring 1997 Canfor rates, as a weighted average, to $55.18. The evidence with respect to other differences between Lineham's 19967 and 1999 logging conditions does not suggest that Lineham would be significantly better situated this year than in its 19967 operations for Interfor.

(iiA "Changes in the required equipment configuration". The attack by Interfor on Lineham's equipment configuration was not, in my view, persuasive. In particular, use of the tower seems to me to be justified by the fact that a third piece of yarding equipment is required, and in some circumstances (albeit not this year in Gowan Creek) a tower is necessary. I accept that it does not make economic sense in these circumstances to purchase a third grapple yarder rather than to use the tower which is already necessarily available. So far as purchasing highway trucks or other new equipment is concerned, no figures were produced to demonstrate that the extra capital cost involved would be offset by savings through increased efficiency.

(iiiA "Changes in the law, if the changes affect costs or productivity of the timber harvesting operation". The evidence was that following a period of regulation-driven cost increases, changes in logging regulations have reduced the cost of certain aspects of timber harvesting since 1996, but it is not clear to me to what extent these decreases affect work carried out by the licensee itself in the planning and engineering stage prior to the contractor's involvement, rather than the work of the contractor itself.

(ivA "Changes in the underlying costs of timber harvesting operations including, without limitation, the cost of labour and the impact of inflation on wages, fuel, parts and supplies". The evidence was less than precise with respect to the impact of inflation since 1996. To the extent that other costs have increased this increase may have been offset by reduced regulatory costs, but, as noted above, the latter may have benefited the licensee more than the contractor. I am left with the impression that contractor's overall costs have probably to some extent increased since 1997.

(d) "The costs in the logging industry for each phase or component of a similar harvesting operation". The evidence suggests that only in the falling and yarding (or "stump to truck") phases can it be said that operations elsewhere may be truly *similar* to those with which the arbitration is concerned, but even as to these there will be differences between blocks due to variations in such factors as "piece size", deflection and the extent of lower-cost "hoe-chucking" and "cherry picking" opportunities in the yarding phase. The only harvesting operation which could be considered similar on an over-all basis is that conducted by Lineham out of Spring Creek for Canfor, the costs for which must be relatively similar to those involved in Lineham's work for Interfor. The evidence presented by Interfor suggests that Lineham's anticipated level of costs is higher

than those anticipated or incurred in other harvesting operations elsewhere, but this conclusion is inevitably highly judgment-influenced.

(e) "The rates in the logging industry for similar timber harvesting operations". The only truly similar operation, as I have said, is that conducted by Lineham out of Spring Creek for Canfor. Adjusted for haulage and travel time differences, the 19967 Lineham-Canfor rate is said to amount to about $55.00 when adapted to Gowan Creek -- $7.00 higher than the 1996 Lineham-Interfor rate for Rogers Creek after similar adjustment for haulage and travel time. According to the new evidence of Mr. Wells, recently-agreed 1999 Lineham-Canfor rates indicate a rate of at least $54.00 when adapted to 1999 Gowan Creek conditions. Difference in opinion as to physical and forest characteristics inevitably come into play in accounting for the disparity, but this is by no means a complete explanation. Rates paid to Lineham by Canfor in 1996, 1997 and 1999 for essentially the same harvesting operations show Interfor's single disclosed rate and one disclosed offer during this period to be markedly lower and indicate that Interfor's proposed 1999 figure must be regarded as quite unreasonably low. This is the most persuasive evidence I have.

(f) "Any other data or criteria that the arbitrator considers relevant in ascertaining the rate that a license holder and a contractor acting reasonably in similar

circumstances would agree to". The most significant such data, in my view, is the volume to be harvested. This factor is nowhere mentioned in the foregoing s. 25(2) enumeration of relevant criteria, perhaps for the reason that framers of the Regulation anticipated a steady annual rate of logging, based on allowable cut. While rates per cubic metre can be expected to rise as annual volume falls, there appears to be no direct relationship between the two. Certainly Lineham's 1998 rate did not reflect the greatly reduced cut in that year. I agree with the evidence of Mr. Bendickson that the fixed cost ingredient in rates under the conditions created by the Regulation ought to be recovered over the five-year allowable cut volume rather than on an actual annual volume basis. I believe that faced even in a free market with greatly fluctuating volumes, contractors would expect in high volume years to recover fixed costs unrecovered during leaner years, and that this would be reflected in agreed rates. This is not a matter of using varied volume figures for the current year's cut, which has been judicially criticised, but rather of assuring economic survival over the longer run to efficient contractors -- the basic purpose of the Regulation. I do not, however, believe that an exact recovery is to be expected under either system. With respect to the financial "state of the industry", this is not, in my view a factor which can be expected to impact as significantly on the "Bill 13" contractor as it might on licensees and others in the business. While contractors are now protected, they are also "locked in", and have little opportunity to benefit in what may be "good times" for the licensees. Reasonable profit margins may, however, be lower for contractors in times when the industry as a whole is incurring losses.

VIII. CONCLUSION

(ai The Canfor Rates

As I have indicated, a factor which seems highly relevant in determining an appropriate rate in this case is the willingness of Canfor during and after 1996 up to and including this year to pay rates at a level significantly higher than those proposed by Interfor, a factor of significance because Lineham's work for Canfor is part of the same operation -- the only truly *similar* service.

Interfor attributes the admitted marked difference to a willingness on the part of Canfor to pay uneconomically high rates, and asserts that this is not something for which Interfor should be "penalized." A more likely explanation, in my view, is that there is a difference in the view of Lineham's services taken by each licensee. It is apparent, for instance, that Interfor is able through the services of another contractor ('Soo No. 3') to truck wood from this same area north to Pemberton and then south to Squamish, and deliver it directly to Interfor's log storage and manufacturing facility at Squamish (see Map III, next page). Plainly the Lineham operation, involving movement of the wood south through Spring Creek, Harrison Lake and the Harrison river to the Fraser is but one part of a complex timber supply system for each of the two licensees served by Lineham, and each may well take a different view of its value. Such larger questions were not gone

into in evidence, but it seems to me that I cannot ignore the fact that there may be far more logical reasons than lack of bargaining skill or indifference to cost control -- reasons, that is to say, based on different timber supply systems, different cost data and the use of different contractors -- which account for Canfor agreeing to much higher rates than those offered by Interfor. I am unable in the circumstances to accept the explanation advanced by Interfor for the disparity.

A comparison of previous and current Canfor rates with those paid or offered by Interfor can conveniently be made in association with Map II, which is reproduced again hereafter (page 87) and which may be folded out so as to be examined in combination with consideration of the following observations.

[Insert Map III]

(see LIT:61736 and LIT:62202)

I accept Lineham's submission that Interfor's proposed 1999 rate of $36.75 for logging the Gowan Creek (blue) blocks is one which could well put Lineham out of business. I accept Lineham's evidence that the rate of $51.50 which it agreed to accept in 1996 for logging the Rogers Creek (green) blocks was, in relation to the weighted average rate of $52.01 for logging Canfor's 1996 blocks, unduly low, even when differences in timber quality and "logging chance" are considered. Lineham seems to have accepted a modest rate for that work, even if it were assumed that some of the 1996 Canfor blocks were more costly to log than the Interfor 1996 Rogers Creek blocks. The 1997 Interfor offer of $45.96 for the Gowan Creek (yellow) blocks is impossible to equate with rates in excess of $60.00 paid to Lineham for logging Canfor's Chief Paul (pink) blocks on the opposite side of the river, despite differences in the timber qualities. Interfor's proposal in these proceedings of $36.75 for 1999 logging in the Gowan Creek (blue) blocks has to be set beside the weighted average rate of $47.91 being paid by Canfor this year for logging the (orange) Sloquet and 11 Mile blocks, which are approximately half the distance from Spring Creek. It does not seem to me reasonable that essentially the same operation should include such a marked disparity in rates.

This is not to criticize Interfor, whose management is entitled, and indeed bound, to do its best to improve the company's financial position, and it may well be that the Regulation has in this case unfairly impacted on the economic position of Interfor, as it

[Insert Map II here]

(see LIT:61736 and LIT:62202)

must from time to time on that of licensees and contractors, whose opportunities for innovation, expansion and diversity are constrained by the static monopoly structure which the Regulation inevitably creates.

(bi Other Evidence

I am of the view that Lineham's "contractor program" represents an unduly cautious approach to anticipated productivities, and includes an overstatement of depreciation cost by using increased appraisal values in place of depreciated book values -- an inappropriate change where this cannot be justified by proven "rebuild costs" and could result in recovery through extension of useful life, from "captive" customers, of more than the true cost of the depreciated asset.

In regard to matters such as cost of saws, failure to use highway trucks and the suitability of generators in use, it seems to me that Interfor should assist Lineham with information available which would enable Lineham to avail itself of alleged potential cost savings, or at least demonstrate in the latter cases that savings can in fact be achieved when the necessary investment cost is taken into account. I am not persuaded that Lineham could markedly decrease its camp costs or that the quote obtained by Interfor for providing catering services there represents a firm offer or thorough appraisal of the total cost of providing such services rather than an initial rough estimate.

There may be some overstatement of supervision costs through inclusion of salaries of owners and what may be “ownership” expenses and the charging of a “profit and risk” margin on such items. Interfor did not seek, however, to perform any sort of “audit”, or recalculation or re-statement of Lineham’s “cost-plus” approach, and I have no means of doing so, nor do I have any basis on which to set a precise profit-and-risk allowance, something which appears to vary greatly according to the level at which the costs themselves are calculated, or the extent to which cost estimates include allowance for variation from productivity assumptions.

I place little weight in Lineham’s claimed 1997 costs in excess of $60.00 per cubic metre, which are essentially unexplained.

Dr. Howard’s work is the result of careful, systematic analysis of industry figures applied to the actual timber to be harvested, but I cannot say that it takes into account the peculiar circumstances under which Lineham is obliged to operate for Interfor and Canfor, as opposed to those of "average" operators. Like Mr. Meyer, Dr. Howard assumes an equipment mix different from that which Lineham has acquired, and I do not accept that a contractor can be expected always to have the precise equipment mix best suited for the work undertaken in a particular year.

I regard Mr. Meyer's proposed figure and that of Dr. Howard as below the "range of reasonableness" established by negotiated rates. Mr. Bendickson's proposal, while closer to the mark, is also necessarily highly judgmental and it, too, does not consider prior rates for the operation, either those of Interfor or Canfor.

While the most reliable information before me as to the criteria listed in the Regulation seems to be that of rates agreed to between Lineham and Canfor during the years 1996-1999 for similar services provided under the Regulation, and I believe that these rates arrived at by negotiation represent a consensus between those most knowledgeable with respect to the relevant criteria, on which I can properly rely, I have in mind the observations made above regarding the Lineham cost-based approach, which I believe to result in an unduly high estimate of costs, and it is my conclusion that a 15 per-cent profit-and-risk allowance after depreciation could not be justified on the costing level which is proposed by Lineham.

I also take into account the rate of $51.50 agreed to by Lineham and Interfor for 1996 logging in Rogers Creek, a rate which appears significantly lower than rates paid by Canfor that year, but which Lineham for whatever reason *did* accept. Having in mind what I believe to be a modest over-all increase in contractor costs since that date, but also that there is a significantly lower distance and travel time involved in servicing Gowan Creek, and also the relative "logging chance", volume and other differences affecting

operating economics, I am of the view that a rate for Gowan Creek this year equal to that last agreed by the parties for work in Rogers Creek could not be justified.

(ci The Rate

Taking all of the considerations I have mentioned into account, and giving such weight as seems appropriate particularly to the evidence summarized on Tables I and II, having regard particularly but by no means solely to rates paid for work during and since 1996 to Lineham by Canfor, a licensee for whom Lineham performs harvesting operations similar to those to be performed this year for Interfor, I conclude that an appropriate rate for Lineham's 1999 work for Interfor is $50.50 per cubic metre, to be further adjusted for I.W.A. wage increases as at June 15, 1999.

(di Costs

To require, as Interfor suggests, that Lineham pay part of its costs, thereby presumably reducing the "profit and risk" portion of its rate, does not in the present circumstances appear consistent with the spirit of the Regulation.

Where the contractor has been substantially successful but has been submitted to a

sufficiently protracted and expensive arbitration proceeding, the result of requiring the contractor to bear part of the costs of the arbitration could well be to defeat the primary purpose of the Regulation, by denying the contractor a proper return. While in a case in which a licensee makes a reasonable proposal it may be proper that the contractor, even though successful in obtaining more, bear a portion of the costs involved, that does not appear to be the case here. The proposed rate of $36.70 at which Interfor opened the arbitration is in my view well below the "range of reasonableness"; one would, indeed, have to go back some nine years to find such a rate paid for work at an equivalent distance from the Spring Creek Camp (see Table I, p. 65), and during this period there have, of course, been very substantial increases in logging costs. It seems to me that this arbitration was not caused by reasonable difference of opinion between the parties, but that Lineham was obliged to incur the expense of the arbitration in order to resist an unreasonable proposal, and, indeed, to stay in business. The costs so incurred should, in my view, be recoverable under s. 11 of the *Commercial Arbitration Act.*

Counsel for Interfor points out, of course, that Lineham's position was not fully accepted, and for this reason argues that Lineham should bear its own costs and 50% of those of the arbitration, referring particularly to the decision to that effect in *Pacific Forest Products Ltd. v. Hayes Forest Services Ltd.* [August 15, 1997], in which the Arbitrator noted (at page 32) that "each party has been successful in part in advancing their claim and defending their respective positions". While that can, of course, also be said here, I do not think that this should, in the present case, be the dominant

consideration. Faced with the unrealistically low proposal advanced by Interfor, it seems to me natural, having in mind the highly judgmental manner in which the matter would have to be resolved under the present system, that Lineham would feel obliged to put forward the highest figure for which it could honestly contend. It seems to me that Interfor "set the pace" in the proceedings.

In the circumstances I view the fact that Lineham obtained less than it sought as no more significant than would a court in a case in which a generally successful plaintiff obtains a somewhat lower award than sought.

Lineham will therefore have the costs of the arbitration as specified in s. 11(2) of the *Commercial Arbitration Act*, that is to say "actual reasonable legal fees" and "disbursements, including the arbitrator's fees, expert witness fees and the expenses incurred for holding the hearings", such costs are to be assessed, if necessary, by a Master or Registrar of the Supreme Court of British Columbia, pursuant to s. 11(3).

Should further directions with respect to costs be required, these may be sought under s. 27(4) of the *Commercial Arbitration Act*.

IX. A LAST WORD

I am profoundly aware that this decision cannot be taken to resolve all of the questions raised by the parties.

Only with the establishment of a proper rate-making authority having benefit of knowledge of costs incurred and rates agreed throughout the industry, uniform classification and independent audit of accounts, established productivity standards and profit and risk allowances, and independent expert guidance with respect to issues involving logging economics, would it be possible, in my view, that the unanswered questions be properly addressed and fairly resolved.

I wish, in conclusion, to thank counsel and the witnesses for their patience in explaining the issues and their painstaking work in wrestling with the difficult problem of presenting a case within what must be recognized as a particularly challenging alternative to the free market system -- their task has been in every sense as trying as that of finding a proper resolution to the problem. I am indebted also to my colleague, Emmet Duncan, whose assistance throughout the proceedings has been invaluable.

This is my award.

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Arbitrator

December 3, 1999 Vancouver, B.C.