# H. ALLAN HOPE, Q.C.

**ARBITRATOR/MEDIATOR**
**P.O. Box 728**
**Prince George, B.C.**
**V2L 4T3**

**Telephone** (250)964-2771 **Fax** (250)964-3477
**Email** allan_hope@telus.net


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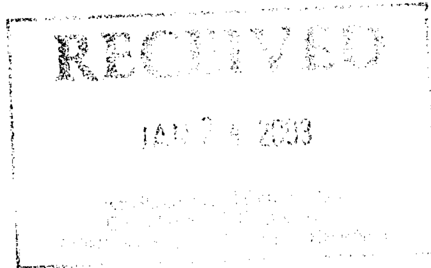
File 5020

January 17, 2003

Mr. Brad Harris,
P.O. Box 9510,
Stn. Prov Gov't,
Victoria, B.C.
V8W 9C2



Dear Mr. Harris:

**RE: International Forest Products Limited –and- Bear Creek Contracting Limited**

Enclosed please find a signed copy of the Award as requested.

Yours truly,

H. ALLAN HOPE, Q.C.

HAH/gm

Enclosure

IN AN ARBITRATION

BETWEEN

INTERNATIONAL FOREST PRODUCTS LIMITED

-AND-

BEAR CREEK CONTRACTING LIMITED

AND CONCERNING THE
TIMBER HARVESTING CONTRACT AND SUBCONTRACT REGULATION,
B.C. REG. 22/96

AND CONCERNING THE
COMMERCIAL ARBITRATION ACT, R.S.B.C. 1996, C.55, S.7

# AWARD

| | |
|---|---|
| Arbitrator: | H. Allan Hope, Q.C. |
| Counsel for Bear Creek: | Charles Willms and Brook Greenberg |
| Counsel for Interfor: | Eric Harris and Jennifer Lamont |

## AWARD

### The Disputes

[1] This arbitration involves two rate disputes and shortfall claims arising under a full phase contract, (the Contract), entered into between the parties under the Timber Harvesting Contract and Subcontract Regulation, B.C. Reg. 22/96 (the Regulation) for a five-year term between January 1, 1997 and December 31, 2001. The rate disputes were initiated under s. 25 of the 1996 Regulation in separate letters sent respectively on October 25, 2000 and June 12, 2001. The Contract applied to Forest Licence No. A16841 (the Licence).

[2] The parties did not designate which provision governed the adjudication of the shortfall claims. The circumstances giving rise to the claims are addressed in s. 17(2) of the Regulation. It prohibits a reduction in the amount of work specified in a contract unless the reduction can be brought within force majeure exceptions set out in s. 22(1), but the Regulation does not address what remedy is available to contractors where a compensable shortfall occurs. Presumably they are claims for compensation that fall within s. 5 of the Regulation, being an omnibus provision which embraces "all disputes that have arisen or may arise between the parties" to a full phase contract.

[3] Resolution of both the rate disputes and the shortfall claims involve the interpretation of s. 1(5) of the Contract as a primary issue. It reads as follows:

> Specified Amount of Work: 100 percent (%) of the total amount of timber harvested from the Licence each year.

[4] The position of Bear Creek was that s. 1(5) required Interfor to allocate timber to it equal to Interfor's Annual Allowable Cut (AAC) under its

Licence in each year of the five-year Contract. Interfor's position was that the provision required it to provide Bear Creek with an annual volume equal to 100 percent of the timber it elected to harvest under the Licence in a given year.

[5] The rate disputes relate to the last two years of the five-year term. The shortfall claims relate to all five years and were based, in the main, on the difference between the AAC and actual volumes harvested each year and cumulatively over the five years of the Contract. The rate positions of the parties are set out in Appendix I of this Award.

[6] In these proceedings the particulars given with respect to the shortfall claim included the five years of the Contract. See para. 62 and Appendix A of Bear Creek's submission. I concluded from those facts that the October 25, 2000 shortfall notice related to the first four years of the Contract and the June 12, 2001 notice extended the claim to include 2001.

[7] In order for Bear Creek to succeed in the shortfall claims it was necessary to conclude that its interpretation of s. 1(5) of the Contract was correct in law. I concluded on the basis of the facts and the governing principles that the interpretation put forward by Interfor was to be preferred and that the shortfall claims failed, thus requiring that the rate disputes be addressed on the presumption in law that the parties had fixed the contract volume as equivalent to the actual volume harvested in a given year.

[8] It is useful to provide a brief outline of the contractual and regulatory history of the dispute. The first version of the current Regulation was introduced in 1991. The current Regulation was introduced on April 1, 1996. The parties have entered into three contracts under the Regulations. The first was for a five-year period commencing January 1, 1990 and ending December 31, 1994. It was executed by the parties on October 24, 1991. The second was for a term from

January 1, 1995 ending on December 31, 1999. It was executed by Bear Creek on April 25, 1995 and by Interfor on May 15, 1995. The current Contract, which was for a term from January 1, 1997 to December 31, 2001, was introduced during the currency of the 1995-99 contract. It was executed by Bear Creek on September 7, 1999 and by Interfor on October 21, 1999.

[9] There was no direct evidence, but the inference to be drawn from the facts and submissions is that the introduction of the new Regulation on April 1, 1996 required the parties to negotiate a new volume provision and that they addressed that requirement in the form of a new contract. I concluded that the provisions of the 1996 Regulation governing volume had the effect of requiring parties to either negotiate provisions that restricted contractors to actual volumes harvested or to negotiate separate provisions under discretionary language which permitted them to craft a unique arrangement. There was no indication that these parties invoked that discretionary right.

[10] Acceptance of Interfor's interpretation served to deny Bear Creek access to protection against shortfalls introduced in the 1996 Regulation despite the fact that the shortfall protection has been seen by the Courts, at least by implication, as a policy objective of the Regulation.

[11] The rates claimed by the parties evolved over the course of the proceedings. That evolution is recorded in Appendix I. For convenience, the following table compares the final proposals advanced in February, 2002:

| 2000 | | Bear Creek | Interfor | Difference |
|---|---|---|---|---|
| (1) | Surf Heli Lake | $89.67 | $85.09 | $ 4.58 |
| (2) | Surf Heli Ocean | $89.67 | $70.83 | $18.84 |
| (3) | Kumealon Conventional | $73.30(+$2.50) | $45.89 | $29.91 |
| (4) | Chapple Conventional | $70.75(+$2.50) | $42.39 | $30.86 |

| | | | | |
|---|---|---|---|---|
| (5) | Surf Heli Lake (dewatering (performed in 2001) | $15.23 | | |

| 2001 | | Bear Creek | Interfor | Difference |
|---|---|---|---|---|
| (1) | Surf Heli Lake | $97.93 | $86.32 | $11.61 |
| (2) | Scotia Conventional | $43.33(+$2.50) | $42.21 | $ 3.62 |
| (3) | Cedar/Dam Conventional no dryland sort | $43.33(+2.50) | $36.95 | $ 8.88 |
| (4) | Kumealon Heli Ocean | $91.88 | $74.72 | $17.16 |

[12] As stated, the current Contract was executed in September and October of 1999, just short of three years after its retroactive term commenced. The contractual relationship in the three years prior to the execution of the current Contract was not addressed by the parties. It was not clear when and in what terms the decision to renegotiate the 1995-99 contract was made and what contractual relationship existed in the interim between the April 1, 1996 introduction of the Regulation and the execution of the current Contract in September and October of 1999.

[13] In seeking to put those observations in context, I note that there was a lack of clear evidence of the events surrounding the negotiation process that gave rise to the current Contract. The inference I drew was that the introduction of s. 18 of the 1996 Regulation required the parties to negotiate an "amount of work" provision to replace the volume provision in the 1995-99 contract. The prior provision read, "Estimated Volume: 180,000$m^3$". S. 18(1) required, inter alia, that volume provisions in contracts governed by its terms be expressed in the form of a percentage. Hence, the volume provision in the 1995-99 contract would have fallen into breach of s. 18(1) when the 1996 Regulation became effective.

[14] It was apparent in the limited evidence available that the negotiations for the current Contract left the parties with a fundamentally different

understanding of the meaning of the volume provision they had agreed to introduce. That misunderstanding was complicated by a coincidental decline in the annual volume of wood that Interfor allocated to Bear Creek. The decline began in 1996 and, after a partial recovery in 1997, continued in a steepening decline through to 2000 before achieving a second partial recovery in 2001.

[15] In my view, those discrete factors compelled the parties to adopt a process in this dispute which was a distortion of the process contemplated in the Regulation as interpreted in the arbitral and Court authorities. That conclusion is less pompously critical than it sounds. For Bear Creek, there was little alternative if it wanted to achieve a medium in which it could recover fixed costs placed at risk by declining volumes. For Interfor the challenge was to maintain rates it viewed as competitive in the context of the rate history of the parties and rates in operations it viewed as similar to those at issue.

[16] It is convenient to record at this early stage that, in addition to finding that Bear Creek's interpretation of s. 1(5) of the Contract cannot be supported, I concluded that its approach in the rate dispute cannot be reconciled with s. 25 of the Regulation as it has been interpreted by arbitrators and by the Courts.

[17] Interfor's interpretation of the Contract had the effect of restricting Bear Creek's right to recover costs seen as arising reasonably with respect to preparations to harvest its understanding of its volume entitlement. However, that result is compelled by the circumstances despite the fact that it is inconsistent with the policy of the 1996 Regulation as it has been viewed by the Courts and is contrary to shortfall guarantees incorporated in both the Regulation and the Contract.

[18] The deliberations giving rise to those conclusions have been protracted unduly by their consequence and a desire to find a compromise which would better balance the interests of the parties. In the final analysis, it has been necessary to reject Bear Creek's position on the shortfall claim and in the rates disputes.

[19] Turning to the reasoning that gave rise to those conclusions, I note that the parties, in advancing their competing positions, engaged in a simulated cost accounting process in which they parsed every detail of the direct and fixed costs involved in the two years in question. That process included a detailed examination of the logging chance phases found in blocks and areas that made up Bear Creek's operations.

[20] In the case of Bear Creek, that process involved a complex analysis and distribution of costs extracted from the accounting records of various companies that make up the Bear Creek group. See Exhibits 11, 12 and 13. In the case of Interfor, it involved massive evidence and analysis directed at reconstructing and comparing Bear Creek's cost base with operations it saw as being similar within the meaning of s. 25 of the Regulation.

[21] After multiple attempts to place that body of evidence into an adjudicative framework which would provide a basis for resolving the dispute, I concluded, not without trepidation, that the evidence was largely unhelpful. In the case of Bear Creek, its reconstruction and presentation of its costs went well beyond the use of "actual costs" in the fixing of rates which is endorsed in the authorities. I accept the submission of Interfor on p. 15 of its submission where it wrote:

> 3.7 As outlined in section 25(2) of the Regulation, there are a number of factors that may be relevant

> to the determination of the rate. Bear Creek has put forward a cost based claim for a rate. The contractor's actual costs are not among the factors in section 25(2). Bear Creek's approach essentially ignores the relevant factors outlined in the Regulation and in particular contains no check on the competitiveness of the rates.
>
> 3.8 Bear Creek's approach to determining the rate is to break down the logging operations into its constituent phases, determine what costs are reasonably associated with those phases, add them up and add a factor for profit and risk. This approach leads to many difficulties, such as allocating fixed costs, depreciating assets, determining fuel consumption rates and finding the appropriate factor for profit and risk. Moreover, there is a critical flaw with this approach; namely, that it fails entirely to consider the broader context of the industry to ensure that the rate is competitive by industry standards.

**[22]** Conversely, Interfor's reconstruction of the logging chance and resulting costs went well beyond what could be seen as helpful in fixing rates in an adjudicative environment dominated by the rate history of the parties. Undoubtedly there will be cases where there is no rate history that can be relied on to predict what reasonable parties would agree to if they took direction from the criteria defined in s. 25 of the Regulation. In this dispute, however, these parties have a history dating back to 1985 during which time they routinely negotiated rates in the same general areas and with respect to a logging chance which was roughly recurring in terms of its predictability in the exercise of calculating rates. See Interfor, paras. 1.1 to 1.17. That history is a reliable resource that, at least by implication, was routinely accessed by the parties in fixing rates until the stresses of underproduction drove them apart.

**[23]** It is useful at this early stage to express the view that, despite the absence of detail, the rate history of the parties, particularly the facts relating to

1996 and to the first three years of the current Contract, (1997-99), provided the only reliable base upon which to calculate rates for 2000 and 2001 and to resolve the related issues. What is clear is that the parties were able to negotiate rates for 1996 and in those three years despite the apparent absence of an agreement on a contract volume and during a period of instability with respect to actual volumes harvested that must have made it difficult for Bear Creek to adjust its fixed cost base to the volumes Interfor allocated to it.

[24] As stated, Bear Creek's interpretation was that the volume provision agreed to by the parties obligated Interfor to provide it with an annual volume equal to Interfor's AAC entitlement under its Licence. In support of that interpretation, Bear Creek submitted that the volume provision in the two previous contracts, (1990-95 and 1995-99), constituted a contractual commitment to provide it with an annual contract volume of 180,000m$^3$. I have not been able to find support for that submission.

[25] Bear Creek's position was that the negotiations for the current Contract involved it exchanging a contract volume of 180,000m$^3$ for 100 percent of Interfor's AAC. That view of the previous volume provision was thematic in Bear Creek's submission on the interpretation of the Contract. In para. 26, of its submission, for example, Bear Creek referred to "its existing contract of 180,000 cubic metres per year". In para. 44 it wrote that it "had a contract for 180,000 cubic metres of wood per year".

[26] Bear Creek's point was that Interfor's interpretation would involve exchanging a secure contract volume of 180,000m$^3$ for a formula which would leave it without any volume commitment upon which it could rely. On that basis alone, said Bear Creek, Interfor's interpretation must be rejected as improbable.

[27] However, I concluded on the authorities that Bear Creek's "estimated volume" was not the equivalent of a "contract volume". The significance of the difference between an "estimated" and a "contract" volume is found with respect to whether Bear Creek was entitled to compel an allocation of 180,000m$^3$, either annually or as a five-year average. On my reading of the authorities, Bear Creek was not in a contractual position to require Interfor to allocate the estimated volume.

[28] Turning back to the significance of the three-year hiatus, the relationship between the Contract, the Licence and the Regulation changed when the new Regulation was introduced on April 1, 1996. The Licence is issued for 15-year terms which incorporate cut control periods that coincide with the five-year contracts negotiated between the parties. The introduction of the 1996 Regulation overlapped an existing term of the Licence and the existing term of the 1995-99 contract.

[29] The AAC under the Licence was 226,617m$^3$. The Licence was "replaced" in a Forest Service letter dated September 3, 1998 for a 15-year term commencing September 1, 1998. (See Exhibit 123). As stated, the 1995-99 Contract was renegotiated for a five-year term commencing January 1, 1997 but was not executed until October of 1999. Prior to those events, the five-year period between 1992 and 1996 had been designated retroactively as the five-year cut control period under the Licence. That designation was communicated in a Forest Service letter dated June 26, 1997. See Exhibit 85(a)(1).

[30] In addition to its AAC, Interfor is governed by an Allowable Annual Rate of Cut (AARC) which may vary from the AAC and which applies during each cut control period. The Forest Service letter of June 26, 1997 fixed the AARC at the same level as the AAC for the 1992-96 cut control period. The AARC for the next five-year term, which coincided with the term of the current Contract, was

fixed in a Forest Service letter dated April 30, 2001. That letter confirmed that the cut control period under the current Contract was for a five-year term coincidental with term of the current Contract. The letter also confirmed that the AAC for the cut control period remained unchanged at 226,617m$^3$ but with an AARC which was reduced to 219,708m$^3$ in response to over cutting in the prior cut control period.

[31] The negotiation of the current Contract took place in the wake of the changes brought about by the introduction of the 1996 Regulation. The evidence does not support the position of Bear Creek that the volume provision in the first two Contracts amounted to a volume guarantee to Bear Creek of 180,000m$^3$. The conclusion I drew on the available facts was that those volume provisions, in effect, gave to Bear Creek entitlement to a maximum of 180,000m$^3$ of Interfor's harvest in a given year and cumulatively over five years.

[32] Bear Creek was the only full-phase contractor working under the Licence and was routinely allocated volumes in excess of 180,000m$^3$. However, on my reading of the Contract and the authorities, Bear Creek could not compel Interfor to allocate in excess of 180,000m$^3$.

[33] In my view, Interfor was free to allocate logging rights to another contractor with respect to volumes above 180,000m$^3$. Bear Creek's contrary position can be measured against the fact that another contractor was assigned to log a portion of the AAC in 1996 and 1997. See Transcript, January 31, 2002, p. 1837, l. 10 to p. 1838, l. 25.

[34] It was implicit in the evidence that the question of whether Bear Creek was entitled to all volumes harvested under the Licence arose with respect to helicopter logging and the potentially competing rights of Helifor Industries, a wholly-owned subsidiary of Interfor to which Interfor routinely allocated all

helicopter yarding done under the Licence. The question arose in the negotiations triggered by the introduction of the 1996 Regulation.

[35] The issue was resolved between the parties when they agreed that Bear Creek would enter into a subcontract with Helifor entitling it to perform all helicopter yarding. See Exhibits 4(4); 23 and 21(1). Flowing out of those exchanges was the agreement that Bear Creek would enter into a subcontract granting Helifor the exclusive right to perform all helicopter yarding allocated by Interfor under the Licence.

[36] In summary, I conclude that when the parties commenced their negotiations for the current Contract, the estimated volume in the prior two contracts did not represent a right in Bear Creek to compel Interfor to allocate that volume to it in a given year or as an average over the five years of the cut control period.

[37] As stated, Interfor allocated all harvesting under the Licence to Bear Creek over the years. However, it is important to commence a consideration of the interpretation of the volume provision in the current Contract with a clear understanding of Bear Creek's rights under the equivalent provision in the first two contracts. In terms of the issues raised in this dispute, Bear Creek was entitled to an annual allocation of all of the timber harvested up to 180,000$m^3$. The entitlement could be averaged out over the five years of the cut control period to accommodate production that fell above or below the 180,000$m^3$ in a given year.

[38] As stated, Bear Creek's interpretation of the disputed language was that, subject to the force majeure provisions in the Regulation and the Contract, Interfor was required to allocate to it a volume equal to 100 percent of the AAC in a given year or cumulatively over the five years. Interfor's interpretation of s. 1(5)

was that Bear Creek was restricted to 100 percent of whatever "amount of timber [was] harvested from the Licence each year".

[39] S. 1(5) was negotiated by the parties pursuant to s. 17(1) of the Regulation. It required them to introduce "an amount of work" provision in their contract. S. 18(1) required, inter alia, that the amount of work provision be expressed in percentage terms. S. 18(8) permitted the parties to fashion a provision in which volume was expressed in alternative terms agreed to by the parties. That provision was not raised in this dispute.

[40] It would appear that the parties intended to draft a provision that met the requirements of s. 17(1). That section provides in part that; "a replaceable contract must specify an amount of work to be performed in each year during the term of the contract". S. 18(1) requires, inter alia, that a provision under s. 17(1):

> [M]ust be expressed as the amount of work required to process an amount of timber where the amount of timber is expressed as a specified percentage of the total amount of timber processed by the licence holder under the licence in that year. (emphasis added)

[41] Interfor's position was that the key phrase, "the total amount of timber processed", is unambiguous when the words are given their ordinary meaning. The phrase, said Interfor, means 100 percent of the timber it elects to process in a given year. Its interpretation is summarized in para. 12.14 of its submission as follows:

> To equate the phrase "total amount of timber harvested from the Licence in each year" with the 100% of the AAC is to go beyond the words which the parties have written down. It is submitted that [...] the phrase means exactly what it says; that is, 100% of the total amount of timber

harvested" whatever that volume may be. (emphasis added)

[42] It was not clear when and in what circumstances the parties became aware of their differing interpretations. On the facts, that discovery came at an unstated time between October 21, 1999, when Interfor executed the Contract, and October 25, 2000, when Bear Creek issued its first dispute notice.

[43] The interpretation dispute was brought forward under the common law of contract. My jurisdiction to adjudicate the claim was not addressed by the parties. Presumably it arises under s. 5 of the Regulation as a claim for breach of contract.

[44] I note in that context that there is an alternative process for the resolution of volume disputes set out in s. 23 of the Regulation. The parties did not avail themselves of that process and did not address it in these proceedings. However, consideration of the provision assists in placing this dispute in perspective.

[45] The shortfall issue, stripped to its essentials, was a dispute about the "amount of work" provision the parties had introduced. It seems apparent that it was in anticipation of such disputes that s. 23 was introduced. That provision established a third party process for the resolution of volume issues. It gave the parties access to a flexible process for compromising volume disputes, including jurisdiction in an arbitrator to impose a s. 18(8) formula that balances the interests of the parties. By way of contrast, the jurisdiction in these proceedings was limited by the positions of the parties to selecting between what proved to be two extreme interpretations.

[46] As I will detail later in dealing with the rate disputes, I read s. 17(1) and s. 18(1) as combining to require parties to negotiate volume provisions which, when adopted, are difficult to reconcile with the policy implications of the 1996 Regulation as they have been addressed in the governing authorities.

[47] If that conclusion is correct, and it is a conclusion which is presumptuous in view of the fact that it is one of first impression, then the discretion vested in the parties under s. 18(8) and the volume dispute resolution process in s. 23 and s. 24 become significant. In particular, they provide alternative frameworks in which parties can sidestep the limitations I find to be inherent in volume provisions negotiated under s. 18(1).

[48] Bear Creek's position on the interpretation issue is extreme because it would effectively deprive Interfor of its ability to adjust its harvest to changing conditions unless it could bring itself within the force majeure exceptions set out in the Regulation and the Contract. The interpretation would render Interfor liable in damages for any shortfall below its full AAC in any year in which it could not justify its production decisions in the context of those provisions. Expressly excluded from the force majeure provision in s. 22 is "a change in the market price of logs". In short, Bear Creek's interpretation would leave Interfor vulnerable to shortfall claims which are market driven.

[49] I agree with the submission of Bear Creek that, where the shortfall provisions are seen to apply, it is for the licence holder to prove facts that bring it within s. 22. Hence, on Bear Creek's interpretation, Interfor would have to allocate to it a volume equivalent to the AAC unless it could prove facts which justified a lesser volume. In fact, the position taken by Bear Creek in this dispute was that Interfor had failed to meet that imperative and thus could not take advantage of the force majeure exceptions.

**[50] Interfor's interpretation is also extreme. It denies Bear Creek any contractual commitment to a volume of work that can be measured under s. 25 at the effective date for the projection of rates for the upcoming year of production. The interpretation also denies Bear Creek access to the shortfall guarantees set out in the Regulation and the Contract.**

**[51] That is so because the contract volume and the actual volume are the same under Interfor's interpretation and no shortfall can occur. On that interpretation, Bear Creek is left vulnerable to potentially extreme fluctuations in its earnings. That potential was realized to varying degrees in each of the five years of the Contract. See: para. 57 and Appendix "A" of Bear Creek's submission.**

**[52] In general terms, Interfor's interpretation appears to be inconsistent with the general policy of the new Regulation as it has been defined by the Courts. The general principles having application to rate disputes and, indirectly, to those governing volume disputes, were addressed in a series of decisions that began with Pacific Forest Products Limited and Hayes Forest Services Limited, August 15, 1997, unreported, a decision by Arbitrator W.J. Wallace, Q.C. The award of Arbitrator Wallace was reviewed by Baker, J. in the Supreme Court of B.C. in a decision published on December 2, 1998. That decision was reviewed in the British Columbia Court of Appeal in a decision written by Finch J.A., as he then was, on February 4, 2000.**

**[53] The decisions in Hayes led to further proceedings and an award which was published after submissions were complete in this dispute. That award led to additional written submissions by these parties which were filed in July and August of 2002. The award was published by Arbitrator Frank S. Borowicz, Q.C. in Hayes Forest Services Limited and Western Forest Products**

Limited, July 17, 2002, unreported (Hayes). (Western was the successor to Pacific). Copies of those submissions appear in Appendix II of this Award.

[54] The issues of law raised in the Hayes decisions are sufficiently similar to accept the decisions as the primary source of the principles that govern the issues raised in this dispute. That is particularly so in light of the decision of Baker, J., upheld by Finch J.A., that the correctness test applies in the review of arbitral decisions made under the Regulation.

[55] The regulatory environment contemplated in the 1996 Regulation was addressed by Finch J.A. in para. 17 of his decision. He adopted the analysis of John Forstrom in a paper Mr. Forstrom delivered in May of 1997. In his paper Mr. Forstrom wrote in part:

> The underlying policy of the [1996] Regulation is to protect and promote the interests of the independent contract logging community.

[56] Mr. Forstrom went on to write that; "The evolving policy ... has been directed at: (1) Protecting the contract logging community generally by preserving its source of work" (emphasis added). Accepting that analysis as reflective of the policy goals of the Regulation, the interpretation advanced by Interfor is antithetical to it. It leaves Bear Creek with a "source of work" which is in the discretion of the Licence Holder.

[57] The regulatory medium in which the issues in this dispute arose has a relatively short history. It is reviewed in the decision of Finch J.A. in Hayes commencing on p. 3. The old Regulation was enacted on January 12, 1991. The current version arose in part from perceived deficiencies in the 1991 Regulation. The new Regulation was introduced on April 1, 1996. Included were the volume of work provisions that gave rise to the interpretation issue raised in this dispute.

[58] In particular, s. 18(1) of the new Regulation, which governs the negotiation of volume provisions in contracts, requires a formula that can only be applied retrospectively. In the result, the only fixed volume that can be calculated under s. 18(1) is the actual volume. In terms of the authorities, the result , as stated, is that the "contract volume" and the "actual volume" will always be the same.

[59] That result is inconsistent with the policy of the new Regulation as it was defined by Finch J.A. That is not to say that the parties are prevented from negotiating a volume formula that can be applied prospectively. As stated, that option is contemplated in s. 18(8). See Borowicz Award, para. 34. It is to say that s. 18(1), which cannot trigger a prospective formula, appears to be out of step with the policy of the Regulation as it was construed by the Court in Hayes.

[60] It is clear that the relationship between volume and rates is such that higher volumes can be expected to trigger higher income and higher gross profits. That relationship is achieved when rates operate to defray all direct and fixed costs and provide a profit consistent with the standard in the industry. That relationship was described by Arbitrator Munroe in Hayes and Timberwest, April 10, 1997, unreported. He wrote as follows on p. 5:

> The 1994 negotiations were relatively speedy, occupying only a few meetings and being concluded by April of that year. A major reason for the ease of negotiations was the parties' expectation at the time that Hayes' 1994 logging volume would likely exceed the usual 160,000 m3 by as much as 50,000 m3. (As it turned out, that expectation was fully realized). That is significant because the greater the logging volume, the lower the fixed costs per m3. Thus, an apparently lesser rate per m3 for a higher-than-normal annual volume can produce not only greater gross revenues, but also greater profitability than a seemingly higher rate applied to the usual annual volume. (emphasis added)

[61] The existence of a relationship between volume, fixed and overhead costs, rates and profits is thematic in the authorities cited by the parties. The decisions in Hayes provide insight into what can occur when the regulatory scheme for fixing volumes and the imposition of rates cannot be applied consistent with what Finch J.A. identified as the underlying policy of the new Regulation. In particular, the Hayes decisions illustrate the results that can occur if parties do not adopt an "amount of work" formula which serves to balance their interests.

[62] In Hayes the volume provision was negotiated under the 1991 Regulation, as was the case in the first two contracts between these parties. It incorporated a formula based on an estimated volume. In the proceedings, the estimated volume was ruled to be the contract volume for purposes of projecting 1996 rates. The actual volume, being the volume upon which Hayes was paid, was significantly less. In the result, Hayes was caught in a process in which a unit rate was fixed on the basis of an imposed contract volume of 128,500$m^3$ but was at the lower rate paid on the basis of an actual volume of 105,300$m^3$, resulting in a significant reduction in both gross and net earnings.

[63] The direct and fixed costs in Hayes were spread over the larger "contract volume", thus triggering a lower rate than would have been triggered on the lower actual volume. The result was a drop in rate income. It was that result that led to the proceedings before Arbitrator Borowicz. The volume discrepancy in Hayes arose, at least in part, from the fact that the volume provision was negotiated under the 1991 Regulation, thus leaving Hayes without a volume it could enforce in the context of the shortfall provision later introduced in s. 17(2) of the 1996 Regulation.

[64] According to the authorities, the expectation in the industry is that, the higher the volume, the lower the rate. That is so because there are obvious

synergies when fixed and overhead costs are divided by a higher volume. In terms of the contractor's earning power, however, lower rates are offset by the increased income generated by a higher volume. That did not occur in Hayes because the higher "contract volume" generated a lower rate which was then applied to the lower "actual volume" and Hayes was left without a remedy in the form of access to the shortfall provisions of the new Regulation.

[65] Interfor's interpretation gives rise to a similar result in the fixing of rates in this dispute. The potential would not arise if Bear Creek's interpretation were to be accepted as correct. The result would be a contract volume equal to the AAC that Interfor would be required to deliver, subject only to Interfor's force majeure rights under the 1996 Regulation and the Contract. However, if Interfor's interpretation is accepted, not only does Bear Creek's shortfall claim fail, but it is left without a contract volume upon which it can rely in fixing prospective rates.

[66] That conclusion is based upon a consideration of the provisions of the 1996 Regulation which gave rise to the volume provision in the Contract. Leaving aside s. 18(8), the Regulation compels parties to negotiate a volume provision in the form in which it appears in the Contract. S. 48 provides in part as follows:

> To comply with the requirements of each of the sections listed below, a contract or subcontract must contain either the provision set out in the Schedule listed beside the section below, or a provision agreed to by the parties that is consistent in all material ways with the requirement represented by that section. (emphasis added)

[67] Included in that list of required provisions are s. 17(2) and s. 18(1). Those provisions read:

17(2) A replacement contract must provide that the specified amount of work to be performed in each year of the replaceable contract may not be reduced by a licence holder except as expressly provided for in the regulation or in a clause required, or permitted to be in the contract by this regulation.

. . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . .

18(1) Except as otherwise provided in this Part, the amount of work specified in a replaceable contract that pertains to a licence for the coastal area, other than a dedicated phase contract or a volume independent contract, must be expressed as the amount of work required to process an amount of timber where the amount of timber is expressed as a specified percentage of the total amount of timber processed by the licence holder under the licence in that year. (emphasis added)

[68] The introduction of the 1996 Regulation had the effect of compelling the parties to renegotiate their 1995 contract in order to introduce a volume formula that met the s. 18(1) guideline, or to negotiate a separate formula under the discretion vested in parties in s. 18(8). There was no evidence that dealt expressly with that issue, but the conclusions I reached are consistent with the facts. In particular, there was no indication that the s. 1(5) of the Contract was negotiated pursuant to s. 18(8) and no other option was available under the Regulation.

[69] In considering the competing interpretations, I first acknowledge that Interfor's interpretation effectively nullifies the volume guarantee contemplated in s. 17(2) of the Regulation and in the Contract. That guarantee is expressed in the Contract in para. 5(2) of Other Special Terms. Further, in paras. 2.2 and 2.3 of the

General Terms and Conditions, Interfor agrees that it "will not reduce the Specified Amount of Work" except in accordance with the Regulation and enabling provisions of the Contract. Similarly, para. 2.7 introduces a force majeure protection which imitates s. 22(1) of the Regulation.

[70] Those provisions are meaningless under Interfor's interpretation. The "Specified Amount of Work" becomes whatever Interfor elects to harvest in a given year. On that interpretation, there can never be a "failure to allocate to the Contractor in any year the Specified Amount of Work" because the amount "allocated" will always be whatever Interfor elects to harvest and that amount, ipso facto, will always be equal to the "specified amount of work".

[71] As stated, Interfor's interpretation also poses problems with respect to rate disputes and the application of s. 25. That provision has been interpreted by the Courts as contemplating an objective and prospective application of defined criteria. On the interpretation of Interfor, the prospective aspect of that process would have to be applied without reference to a contract volume that can be projected forward.

[72] As recorded earlier, in practical terms, if not as a matter of law, volume is a major factor in both the negotiation and the adjudication of logging rates. In para. 21 of his Reasons, Finch J.A. wrote:

> It appears to be generally accepted as a fact in the forest industry that harvesting costs per unit diminish as the volume of harvest increases. Fixed costs are spread over a larger volume. Conversely, as [the] volume cut diminishes, costs per unit may be expected to rise.

[73] The volume contemplated in any formula that meets the s. 18(1) criteria cannot be determined prospectively. The volume must be determined

retrospectively because it does not become known until after harvesting for the year is complete. That aspect of the Regulation and its application was not raised in the hearing and was not addressed directly by the parties in their submissions.

[74] If I have stressed the resulting anomaly repeatedly, and I have, it is because I am frustrated by my continuing inability to find a medium in which the language of the Contract with respect to volume can be brought into harmony with the balancing of interests goal of the Regulation. Repetition has proven necessary to achieve satisfactory expression of a conclusion that I view as perverse but inescapable.

[75] Interfor's interpretation gives a literal meaning to s. 18(1) and thus proposes a formula under which no shortfall claim can ever arise and no breach of s. 17(2) can ever occur. Despite a repeated review of the facts and the arbitral authorities, I have not been able to reconcile that apparent incongruity. Nevertheless, I am not aware of any principle of law which prohibits the interpretation advanced by Interfor. I repeat my earlier conclusion that Interfor's interpretation is correct despite its disparity in terms of the policy implications of the 1996 Regulation.

[76] I pause to note that Interfor, at least by implication, read the 1996 Regulation as reflecting a policy objective that recognizes an absolute discretion in licence holders to determine what volume will be harvested in a given year. Interfor's submission with respect to s. 18(1) was that it did not contemplate the fixing of a volume. On p. 69 Interfor wrote:

> 12.24 It is submitted that the objective of this provision, [s. 18(1)], is <u>not to provide the contractor with a fixed amount of work in each year</u> of the contract. Instead, the objective is to divide <u>the work between the</u>

> various contractors and the licence holder's crews. This allows for flexibility for the licence holder to manage its operations and proportionate fairness to the contractors working within the licence. (emphasis added)
>
> 12.25 The Regulation also provides flexibility to licence holders with respect to the volume of timber harvested in each year by allowing compliance with the amount of work provisions over a period greater than one year ... (emphasis added)

[77] Interfor addressed the issue further in its July 30, 2002 submission with respect to the decision of Arbitrator Borowicz in Hayes. The following extract puts its position in perspective:

> 14. The Regulation prescribes that the amount of work, unless specifically otherwise agreed by the parties, must be described as a percentage of the total volume harvested in the licence. This specification of work as a percentage necessarily leaves to the licence holder the discretion to determine the amount of work harvested in each year.
>
> 15. In addition to the flexibility in determining the amount of work to be harvested from the license in any given year, the Regulation provides relief to the licence holder if it varies from the proportion assigned to the contractor in any given year through sections 21 and 22 of the Regulation.
>
> 16. Clear contractual language would be required to vary from the underlying policy in the Regulation which provides flexibility to the licence holder to determine the annual volume harvested. It would be an exceptional circumstance to have a fixed volume contract under the Regulation. (emphasis added)

**[78] Interfor made that latter submission with respect to Bear Creek's shortfall claim, but it also applies to the fixing of a "contract volume" in the rate dispute. I agree that the volume provision of the Contract gives Interfor the right to determine the annual volume, but I am not able to accept that it is a result that reflects "the underlying policy in the Regulation". Quite the contrary, I conclude that it is a result that confounds the Regulation's underlying policy and arises because s. 18(1) is anomalous.**

**[79] The language selected by the parties, while its meaning is in dispute, imitates the language of s. 18(1) and, if Interfor's submission were to be accepted as to its underlying policy, it would mean that no access to a volume guarantee was intended in the new Regulation other than under s. 18(8). If that were so, why would the shortfall provisions be included? It seems improbable that they would be enacted solely to support a volume negotiated by the parties under s. 18(8).**

**[80] I pause to note that the formula set out in s. 18(2) appears to have been fashioned to have application to licences where there is more than one full-phase contractor. When applied to a single contractor, the formula will always give the contractor 100 percent of "the amount of timber processed" in a given year.**

**[81] In my reading, that section can fairly be regarded as meaningless in terms of a s. 18(1) volume provision negotiated with respect to a single contractor. Rather, as stated, it appears to have application where there is more than one contractor holding rights under the particular licence. However, neither the language in s. 18(1) nor the formula in s. 18(2) compels the conclusion that s. 18(1) is restricted to licences where there is more than one full-phase contractor involved. If that were so, what provisions would govern volume provisions in disputes such as this one?**

[82] It is presumptuous to conclude that the drafters of the Regulation failed to appreciate that s. 18(1) would compel a volume formula tied to actual production and would therefore render the shortfall provisions redundant. For that reason, I resisted that conclusion with tenacity and procrastination until I was compelled to accept that the language could not be reconciled with a less contradictory result.

[83] Bear Creek, as stated, urged that a proper interpretation of the 1996 Regulation was that it was intended to require licence holders to provide contractors with a percentage of the AAC. Bear Creek relied in part on the decision of Arbitrator Taylor in Interfor and Lineham, December 3, 1999, unreported. On p. 3 he wrote:

> 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 licencee'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. (emphasis added)

[84] However, that observation appears to have been made in passing. A close reading of the facts does not indicate that Arbitrator Taylor was required to interpret the 1996 Regulation in the context in which the issue arose in this dispute. His comment was addressed specifically to the 1991 Regulation and only "to some extent" to the 1996 revision. In any event, Bear Creek's reading of the decision produced a conclusion which is inconsistent with the language of the 1996 Regulation.

[85] Turning to the reasoning that led to acceptance of Interfor's interpretation, I begin by agreeing with Bear Creek that the principles of interpretation do not require that words be given their literal meaning. Lambert, J.A., writing for the Court in Jacobsen et al v. Bergman, 2002 BCCA 102, wrote as follows in para. 4:

> [4] Just as in statutory interpretation, so also in contract interpretation, [the] fact that the section or clause seems to have a plain enough meaning when viewed in isolation does not preclude, but indeed requires, an examination of the whole text of the statute or agreement, and a consideration of the section or clause in their place in the whole text and in the factual matrix in which they were intended to operate. That process is required in every case of interpretation of either a statute or an agreement.

[86] But here there is no alternative interpretation that meets the issue. Interfor's interpretation is extreme in its consequences but is not in breach of either the Regulation or the Contract as opposed to being out of harmony with the policy objectives of the Regulation. Bear Creek's interpretation is also extreme but is contrary to s. 18(1) when the words used in that section are given their ordinary meaning.

[87] I digress to note that it would be presumptuous to assume that the parties were unaware of the difficulty inherent in the language of the Regulation and the Contract relating to the volume issue. In that context, I struggled with but was unable to fashion a question or questions which would justify resuming the hearing for further submissions.

[88] Bear Creek called evidence intended to support its understanding that, while the contract negotiations were protracted, they were directed by both parties at achieving a formula calculated as a percentage of the AAC granted to

Interfor under the Licence. It was in that context that Bear Creek claimed an entitlement of 100 percent of the AAC.

[89] The evidence given on behalf of Interfor was that the discussions with respect to volume involved a percentage of the total volume harvested in a given year. Interfor asserted that an entitlement to 100 percent of the volume harvested in a given year was the result of those discussions.

[90] There was no evidence which would support the conclusion that the parties were aware of their differing positions at any time prior to the execution of their contract. They were represented by lawyers in their negotiations but the evidence with respect to the selection of the language in dispute was confined in the main to what each of the parties understood the meaning of the words to be and their recollections with respect to discussions and written exchanges between them that preceded and followed the execution of the Contract. Those exchanges were not presented as verbatim and, in the case of Bear Creek, they did not support its interpretation in any express sense. To be persuasive, extrinsic evidence must speak in clear support of the interpretation advanced. The evidence adduced by Bear Creek did not meet that test.

[91] In that context, Bear Creek relied in its submission on exchanges of correspondence, extracts from the evidence and recollections of the discussions that took place before and after execution of the Contract. However, the documentary evidence relied on did not relate directly to the negotiation of the disputed language and the evidence viva voce was confined in the main to the understanding of the witnesses. For example, the written exchanges involved related but collateral volume issues which were interpreted by Bear Creek as implicit support for its understanding of the meaning of the language ultimately selected.

[92] The extrinsic evidence relied on by Bear Creek is set out in paras. 26 through 45. Those references do not include express exchanges, either written or verbal, in which the interpretation proposed by Bear Creek in these proceedings was advanced by it or acknowledged by Interfor.

[93] An example of the difference between the evidence and the meaning read into to it by Bear Creek can be seen in paras. 26 and 27 of its submission. In para. 26, Bear Creek recited an extract of evidence given by Interfor with respect to the early negotiations directed at finding an acceptable formula. The evidence recited in Bear Creek's submission is an extract from the evidence of Don McMillan, one of the officials negotiating on behalf of Interfor. It reads:

> The original offer that Interfor put forward to Bear Creek for replacement contracts at the beginning of negotiations was for <u>79.4% of the amount of work</u>, utilized the estimated volume of 180,000 cubic metres per year, <u>and divided it by 226,617, the annual allowable cut</u>, to come up with 79.4 percent.
>
> (Transcript, January 25, 2002, p. 17533, lines 5-11) (emphasis added)

[94] Read in context, Mr. McMillan was describing a process in which Interfor was proposing an "amount of work" figure calculated as a percentage of the AAC but representing "the amount of harvest done under the licence". The extract cited by Bear Creek in its submission continues as follows commencing at line 12 on p. 1753:

> Q And do you recall specifically putting the percentage 79.4 forward in any discussion with --
>
> A It was put forward in discussion. It was also put forward in a draft contract to Bear Creek.
>
> Q What was the reaction to Bear Creek?

A Bear Creek rejected our proposal on the basis they felt they were entitled to 100 percent of the amount of work.

Q And what is it that happened that resulted in the resolution, in the words that are found in the contract now?

A There was, I would say, another two steps to get to the final statement. Interfor put forward a second proposal, which was that Bear Creek would have 79.4 percent as a full phase, and the remaining 20.6 percent would be as a subcontractor to Helifor Industries while Helifor would hold the contract. Bear Creek also rejected that proposal.

So I believe it was December of '97 Interfor sent a letter as per the regulation stating that 79.4 percent would be the amount of work, and Bear Creek had 30 days to respond. Bear Creek responded within the 30-day period stating that they claimed a hundred percent of the amount of work. In, I believe it was early January or February of 98, we put forward a proposal of a hundred percent of the amount of work on a condition that Helifor Industries would be given a subcontract for 100 percent of the helicopter subcontract work. So that was agreed to in February of '98, I believe. And that formed the basis for this contract.

Q In any meeting that you had with Bear Creek was there any reference to the AAC as representing a relationship to the amount of work? In any meeting that you had with Bear Creek was there any reference to the AAC as representing a relationship to the amount of work?

A No.

Q Can you explain your answer?

> A We propose amount of work on the basis of the regulation. It's the amount of harvest done under the licence. We did not state in any way that the AAC was equivalent to 100 percent of the amount of work. (emphasis added)

[95] The exchange in that extract made it clear that the comments relied on by Bear Creek do not support the conclusion it reached. It negates rather than supports the conclusion that Interfor was adopting a negotiating posture directed at a volume formula expressed as a percentage of its AAC as opposed to a percentage of the annual harvest.

[96] Mr. McMillan addressed the evolution of the negotiations that gave rise to the s. 1(5) language. As noted in the extract cited from his evidence, the difference between 79.4 percent and 100 percent turned initially on the proposal to grant 20.6 percent of the "amount of work" to Helifor Industries. Ultimately that issue was resolved by Bear Creek agreeing to grant Helifor a replaceable subcontract right to perform all helicopter yarding done under the licence.

[97] It was clear in Mr. McMillan's evidence that Interfor understood and intended that the negotiations would result in a formula based on a percentage of the volume harvested. That understanding is also expressed in a further extract cited by Bear Creek in para. 27 of its submission. Included in the passage extracted from the evidence of Otto Schulte was the following:

> The specific issue was that Bear Creek wanted a 100 percent contract, meaning they wanted a contract that covered 100 percent of the volume harvested. And the Contractor Regulations [the new Regulation] specifies that a replacement contract had to be a percentage of the volume harvested as opposed to a specific volume. (emphasis added)

[98] Read in context, that evidence is inconsistent with the assertion that Bear Creek and Interfor had a mutual understanding that they were negotiating for a formula that involved a percentage of the AAC.

[99] The reference to 100 percent and 79 percent related to the volume harvested, not the AAC. Interfor was concerned about preserving Helifor's right to all helicopter yarding. The prelude to those discussions is found in an exchange of correspondence recorded in Exhibits 4(4), 23 and 21(1) respectively. Those exchanges place in perspective the discussions with respect to helicopter yarding and Interfor's desire to secure Helifor's rights in the context of the volume provisions introduced in the new Regulation.

[100] I note by way of aside that if the mutual intent was as described by Bear Creek, it could easily have been expressed in clear language. That is, "100 percent of the AAC" is a precise term. Its insertion in the volume formula in s. 1(5) would have left no doubt as to the mutual intention of the parties.

[101] The inference I draw from all of the evidence is that the introduction of the 1996 Regulation and the requirement to express volume entitlements in percentage terms caused concern to both parties with respect to the role that helicopter logging would play in the transition. The negotiations with respect to that issue gave rise to the proposal of the 79 percent figure.

[102] That evolution led ultimately to the resolution recorded in the current Contract in which Bear Creek is entitled to the full volume of wood harvested annually; Interfor is entitled to designate the method of harvest as between conventional yarding and helicopter yarding; and Helifor is entitled to perform all helicopter yarding under a replaceable subcontract. In reviewing the extensive viva voce and documentary evidence adduced with respect to that evolution, I was unable to find anything to confirm that Interfor had contemplated or agreed

to an "amount of work" formula based upon a percentage of the AAC as opposed to a percentage of the volume of wood harvested.

[103] In particular, absent from the exchanges between the parties and the evidence they adduced was evidence in which Interfor can be taken to have agreed that "100 percent of the total amount of timber harvested from the Licence each year" was intended to mean "l00 percent of the AAC" granted to Interfor each year. There was no extrinsic evidence adduced of oral or written exchanges in which Interfor acknowledged that the words selected were mutually intended to reflect a volume guarantee of 100 percent of the AAC.

[104] Returning to the principles that govern the interpretation of disputed language in the law of contract, Lambert J.A. in Jacobsen et al v. Bergman et al wrote in part in para. 2 that:

> In my opinion [this proceeding] raises no disputed general principles of law. It involves the application of well-understood principles to the particular facts.

[105] That analysis applies in this dispute. The particular facts are complex and raise unique issues with respect to what mutual intention is to be imputed to the parties with respect to the singular aspect of their Contract which is in dispute. However, it is the facts that are complicated, not the legal principles that govern the interpretation of the disputed language. In addition to para. 4 of his reasons with respect to reliance on plain language, Lambert J.A. wrote:

> [3] The applicable principles may be stated in this way. It is not sufficient in interpreting a clause in an agreement to look only at the wording of the clause in order to decide on its meaning and application; instead the clause must be examined in its place in the agreement as a whole. Further, the agreement as a whole, and the clause in particular, must be examined in

the context of the factual matrix which gave rise to the agreement and against which the agreement and the clause were intended to operate. (emphasis added)

[106] Bear Creek relied heavily on the extrinsic evidence adduced in these proceedings to support its interpretation. As stated, that evidence included exchanges between the parties preceding and following the adoption of the disputed language. However, those exchanges did not disclose any expression of intention by Interfor that it was prepared to accept a formula that would see it obligated to provide Bear Creek with a volume equal to its AAC.

[107] Bear Creek's understanding of those exchanges was based on inference, not the exchanges themselves. In evidentiary terms, that difference can be seen in a review of one letter Bear Creek saw as confirmation that the volume formula was based on a percentage of the AAC. See Bear Creek's submission, para. 35. The exchange was recorded in a letter dated May 6, 1998 from Mr. McMillan on behalf of Interfor to George Munson of Bear Creek. It reads:

> Re: FLA16841 – Long Term Harvest Plans
>
> In the fall of 1997, the Ministry of Forests allocated new Forest License Chart Areas to all licensees in the North Coast TSA. Our Forestry and Land Use group has analyzed all charts (new and old) to determine the [full AAC] percentages of conventional, helicopter land, and helicopter water (lake and ocean) harvesting systems. Please find attached a copy of the analysis. The percentages are as follows:

| | | | |
|---|---|---|---|
| Conventional | 31% | = | 70,251$m^3$/yr |
| Heli – land drop | 36% | = | 81,582$m^3$/yr |
| Heli – water drop | 33% | = | 74,784$m^3$/yr |
| Total | | = | 226,617$m^3$/yr |

> The FLU report was also stratified by species to reflect what the harvest systems percent would be based on

> market conditions. The volumes by system are averages and will vary from year to year.
>
> Based on the above numbers, we should discuss the necessary equipment complements and optimum operating periods to minimize both fixed and variable costs. This applies to both logging and road construction. For roads we should plan on an average of 12 km/yr (based on 6,000m$^3$ per km).
>
> We would like to sit down and discuss a 3 year harvest plan (with alternatives) and ensure that all operational issues are incorporated into the Forest Development Plan before completion in August. Please let us know of any operational issues which should be addressed during planning which will assist in lowering costs. (emphasis added)

[108] In its submission, Bear Creek read that letter as confirmation that its volume entitlement under the Contract, which was executed approximately 17 months later, would be based upon a fixed percentage of the AAC and that 100 percent was the figure upon which they ultimately agreed. However, the letter does not express that meaning.

[109] The fact that the parties spoke of planning to log the full AAC was to be expected. Interfor's License carries with it defined production goals expressed in the form of its AAC. Discussions with Bear Creek in the context of the AAC could be expected to occur routinely. It is difficult to visualize planning that did not include annual harvesting of the full AAC as a starting point. Fixing a volume guarantee was a different issue and was not addressed in the letter.

[110] In summary, the evidence of the exchanges between the parties, by itself, would not serve to deprive the words used in s. 1(5) of their ordinary meaning. Lambert, J.A. made reference to that aspect of contractual interpretation as follows:

> [5] Of course the process I have described does not detract in any measure from the importance of the words chosen to express the mutual intention of the parties. It merely underlines the view that it is the mutual intention of the parties that is being sought and not simply the lexical possibilities inherent in the words chosen to express that mutual intention, perhaps by a third party advisor.

[111] I repeat in that context that there were "third party advisors" in these proceedings in the sense that the parties were receiving legal advice during the negotiation of the Contract. In any event, the meaning of the words is clear enough, and, by themselves, they carry the meaning given to them by Interfor. Thus the question, at it highest, is whether the extrinsic evidence compelled the meaning asserted by Bear Creek.

[112] As indicated earlier, included in "the factual matrix which gave rise to the agreement and against which the agreement and the clause were intended to operate", is the complex history of the introduction and application of the new Regulation and the impact Interfor's interpretation has on the application of the Regulation and the Contract to the calculation of rates. Those facts fall within the extrinsic evidence that must be weighed.

[113] I concluded in that context that Interfor's interpretation raised a question about how the volume provision was intended to operate when read in conjunction with the shortfall provisions of the Contract. Those provisions imitate the shortfall provisions in the 1996 Regulation and Interfor's interpretation renders them meaningless in an application of a volume provision under s. 18(1). However, it was open to the parties to negotiate a different volume provision and, while significant weight must be given to the application problem dictated by Interfor's interpretation, the fact that they could have negotiated another

provision served to defeat the conclusion that the Regulation could not be reconciled with the shortfall rights incorporated in it.

[114] Extrinsic evidence represents a resource that can be relied on to assist in the interpretation of the Contract. See Gilchrist v. Western Star Trucks. However, the extrinsic evidence given in this dispute offered no assistance because it is inconclusive and, in any event, because the language in dispute does not support more than one meaning. That is, the disputed words, "viewed objectively", are not capable of bearing "two or more reasonable interpretations" in terms of defining the volume of work under the Contract.

[115] The words, "100 percent of the total amount of timber harvested from the licence each year", cannot be given the meaning assigned to them by Bear Creek. The term, "timber harvested", cannot be seen as the equivalent of the AAC granted under the Licence. AAC is defined in Part 1 of the Regulation and is further defined in a context in s. 27 where "AAC Reductions" are addressed. The term, "AAC" is used in that section in a context which distinguishes it from the "amount of work specified" in a contract.

[116] Further, the interpretation offered by Bear Creek is not compatible with the governing language in s. 18(1). It requires that the amount of work be defined as "an amount of timber where the amount of timber is expressed as a specified percentage of the total amount of timber processed by the Licence holder under the Licence in that year". On all of the facts and the structure of the Regulation, "the total amount of timber processed" cannot be read as being equivalent to the "total amount of the AAC".

[117] The words used in s. 1(5) of the Contract are a nearly literal imitation of s. 18(1). The phrase, "timber processed by the Licence holder" used in s. 18(1), and the phrase, "timber harvested from the Licence" used in the Contract,

convey the same meaning. On the facts, the phrases are interchangeable in the sense that "timber processed" and "timber harvested" appear equivalent, at least in the context of the interpretive issue raised. Nor is there any apparent difference in terms of the competing interpretations between "timber processed by the licence holder", as provided in s. 18(1) of the Regulation, and "timber harvested from the licence", as provided in the "specified amount of work" provision of the Contract.

[118] If the disputed language is given the meaning assigned to it by Interfor, the provision meets the literal requirements of s. 18(1). By contrast, the interpretation advanced by Bear Creek, when read in the context of s. 18(1), cannot be seen as the equivalent of "a specified percentage of the total amount of timber processed by the Licence holder ... that year". Rather, 100 percent of the AAC means the total amount of timber Interfor is entitled to process in a given year, not the amount actually processed.

[119] The conduct of the parties after the contract was executed is inconsistent with Bear Creek's interpretation. In particular, Bear Creek's interpretation would create a retroactive claim for shortfalls that occurred in the first two years of the Contract and would also set up a shortfall claim for 1999 if one were to occur. On Bear Creek's interpretation, the execution of the Contract in October of 1999 would have triggered a shortfall claim for 1997 and 1998 and, upon completion of logging in 1999, would have triggered a further claim. No claim was filed until October 25, 2000.

[120] An inference inconsistent with Bear Creek's interpretation can be drawn from the execution of the Contract. In the July 19 fax transmission in Exhibit 20A(36), Interfor attached a proposed schedule of rates dated June 28, 1999 in which volumes were divided as between conventional logging and

helicopter logging and as between areas. The volume estimates ranged between 216,000m$^3$ and 243,000m$^3$.

[121] That memorandum formed the basis of the August 23, 1999 letter which addressed "1999 Rate & Contract Settlement". The letter contained the following extract:

> You will find below a summary of our agreements, as I understand them to be. If you have any further questions or comments please contact me as soon as possible. If not, then I would appreciate you executing the Logging Contract document by signing the copies you should have and initialing the attached Schedule "C" of rates attached.

[122] Presumably it was that request that led to the execution of the Contract by Bear Creek on September 7, 1999 and by Interfor on October 21, 1999. On Bear Creek's interpretation, execution of the Contract by Interfor would constitute an acknowledgement of a shortfall entitlement for underproduction in 1997 and 1998 totalling in excess of 45,000m$^3$.

[123] By the end of the production year in 1999, the accumulated shortfall entitlement of Bear Creek under its interpretation would be 102,413.5m$^3$. The failure to advance a shortfall claim for those three years, while not conclusive, is inconsistent with Bear Creek's interpretation and its assertion that it was entitled to compensation for any shortfall below the AAC. Accepting that the language of the 1996 Regulation can be read as contemplating the averaging of production for purposes of shortfall claims, the language also supports an entitlement year by year.

[124] The interpretation advanced by Bear Creek can be measured against its impact in terms of the rate history between the parties. A crude comparison

can be made by calculating the gross revenue which would be generated by its proposals in 2000 as compared with the result that would have been triggered if the rates agreed to by the parties in 1999 were substituted. Using the actual volume in 2000 and the 1999 rates as recorded in Exhibit 20(A)(1), the result is as follows:

Conventional

$44,000m^3$ x $41 = $1,804,000

Helicopter

$73,398m^3$ x $41 = $3,009,318

Total $4,813,318

[125] If the same volumes are applied to Bear Creek's rate proposals for 2000, the following result is triggered:

Conventional

$43,000m^3$ x (combined) $72.00 = $3,168,000.00

Helicopter

$73,398m^3$ x $89.67 = $6,581,598.66

Total $9,749,598.66

[126] There was no evidence as to actual costs in 1999, but, on the evidence, it can be presumed that Bear Creek invested fixed costs in each year sufficient to harvest the full AAC. On balance, Bear Creek's approach to the volume provision introduced in October of 1999 was the only explanation emerging for the extraordinary increase it proposed for rates in 2000. That extreme difference in a contractual relationship which had endured for many

years was only explained in these proceedings by Bear Creek's interpretation of s. 1(5) of the Contract.

[127] I conclude that the interpretation advanced by Interfor is consistent with the language, the relevant evidence surrounding its adoption by the parties, and the terms used in s. 18(1) of the Regulation. I further conclude that, while Interfor's interpretation is difficult to reconcile with the policy of the Regulation and certain of its terms, and with certain of the provisions of the Contract, those factors cannot overwhelm the plain meaning of the language used and the context in which it is used.

[128] In the result, I concluded that Interfor's interpretation was binding upon Bear Creek in terms of its volume entitlement for purposes of the volume guarantees contained in the Regulation. In particular, Interfor's interpretation compelled the finding that the contract volume for purposes of calculating whether a shortfall has occurred was the actual volume harvested. On that basis, the shortfall claim must fail. In the same vein, the interpretation fixes the actual volume as the only contract volume upon which Bear Creek can rely in the calculation of rates.

## The Rate Proposals

[129] The rate proposals of the parties are summarized in their submissions. See: Bear Creek at p. 5, p. 29 and p.47 and Interfor at p. 7, and see Appendix I of this Award.

[130] As indicated, "actual volumes" fell significantly below the AAC in 1996 and over the first three years of the Contract, leaving Bear Creek with fixed and overhead costs that it may not have been able to fully recover. Bear Creek's response with respect to 2000 and 2001, while not expressed in overt terms,

amounted to an assertion that it was entitled to rates which would compensate it in full for all of its costs for both years and a profit of 15 percent, regardless of the volume harvested and regardless of the interpretation of the volume provision of the Contract.

[131] That position amounted to a cost plus claim. Bear Creek acknowledged that a cost plus approach is not consistent with the governing principles of the 1996 Regulation and asserted that it was not taking that position. It defended its claim on the basis that its costs were reasonable in the circumstances and that rates based on reasonable costs and a 15 percent profit are consistent with the Regulation and are not equivalent to a cost plus claim. Its position was expressed in paras. 174 and 175 as follows:

> 174. Although Bear Creek relies on its actual costs and a mark up of the industry standard 15% to arrive at a logging rate, this is not simply an exercise in establishing a "cost-plus" rate.
>
> 175. Justice Finch noted in the Court of Appeal's decision of Pacific that it is only a cost plus approach where the costs are determinative of a rate. The costs presented under Arbitrator Wallace's approach, however, are not determinative of a rate. Labelling this a cost plus approach confuses the role of costs with the relevance of costs in setting a rate. (emphasis in text)

[132] In my view, Bear Creek's proposal did meet the definition of Finch J.A. in the sense that its reconstruction of costs was relied on as determinative of rates for 2000 conventional logging and figured to a lesser extent in fixing helicopter rates and 2001 conventional rates. See Bear Creek's para. 200 where it proposes the "Previous Rate Approach" for all 2001 logging operations. But also

see para. 202 where Bear Creek tied that approach to the "Reasonable Costs Plus 15%" approach.

[133] Bear Creek presented what amounted to alternative positions in support of its rate proposals, both of which were driven by its costs. The first position was that if it was correct that the volume provision of the Contract it had negotiated set its entitlement at 100 percent of Interfor's AAC, it was entitled to recover damages in the form of costs and profits lost when the actual volume harvested fell below the AAC. In that case, Bear Creek acknowledged that its claim in the rate disputes should be adjusted to avoid the double compensation which would result if no adjustment were made for the fixed cost component of its rate calculations.

[134] Bear Creek's alternative submission was to the effect that if its interpretation was not accepted, it was nevertheless entitled to rates which would compensate it for all of its fixed and overhead costs with a 15 percent profit added. That claim was tied to Bear Creek's assertion that its fixed and overhead costs were reasonable in the circumstances even though they were incurred in anticipation of logging the full AAC rather than the "actual volume".

[135] Before considering those conclusions further, it is instructive to outline the regulatory criteria that applies to rate disputes. The criteria are set out in s. 25(1) and (2) of the Regulation. Those provisions read as follows:

> 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.

25(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 hectare;

(ii) changes in the total amount of timber processed;

(iii) changes in the required equipment configuration;

(iv) changes in 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 license holder and a contractor acting reasonably in similar circumstances would agree to.

[136] Those criteria have been the subject of considerable scrutiny in the arbitral and Court authorities. They are seen as contemplating a prospective application in which the arbitrator is to be guided by the objective principles set out in s. 25(1). In para. 45 of Hayes, Finch J.A. wrote as follows:

> The result is that the arbitrator is required to take an objective-prospective approach in setting the year's rate, but he or she will be doing so either during the contract year or after the logging operations for that year have concluded, and when actual volumes logged, and hence unit costs, will be known either in whole or in part. The question is whether the arbitrator is required by the language of the Regulation to ignore, or permitted by its language to consider, evidence of how much timber has in fact been harvested and how much it cost per unit to do so.

[137] In s. 25(2)(a), (b) and (c), the arbitrator is given direction with respect to historical factors unique to the parties. The arbitrator is then directed to consider the industry-wide factors defined in s. 25(2)(d), (e) and (f). No reference is made to actual volumes or actual costs as a medium for projecting rates. The role those factors play in the s. 25 process was addressed by Finch J.A. in Hayes as follows:

> [49] I agree with Pacific that treating actual volumes and costs as "determinative" of the rate would not accord with the apparent intent of the Regulation, to have the rates fixed objectively. Neither party could know at the beginning of the contract year what volume

> will actually be harvested. Reasonable parties would attempt to make a realistic estimate of what might be cut, having regard for the contract volume and the risks inherent in the particular "logging chance" which the contractor has the opportunity to exploit. It is an exercise in risk assessment of future events.
>
> [50] But evidence of actual volumes and rates may be relevant and admissible without treating that evidence as determinative of the rate. Actual logging harvest volumes are some indicia of whether the licencee's volume expectations, as expressed in the contract, will be realized. Actual volumes are after the fact evidence of a previous risk or chance. They show what is within the range of the possible. There is no "one-to-one" relationship between the actual and the previous contingency. The latter is a matter of prior judgment, which if exercised reasonably, takes into account those matters falling within the range of that which is possible in practice. (emphasis added)

[138] The question arising on the unique facts was, how are the factors identified in s. 25, and the principles identified by Finch J.A., to be applied where the only "contract volume" is an "actual volume" that cannot be applied prospectively? More particularly, what should substitute in this dispute for the process described by Finch J.A.?

[139] In that process, actual volume is employed as a means of measuring whether the parties, in their projections, made "a realistic estimate of what might be cut, having regard for the contract volume". The efficacy of that "realistic estimate" is then measured against the actual volume. In these circumstances, where the contract volume and the actual volume are the same, there is no basis I can discern for "a realistic estimate of what might be cut" in terms contractually binding on Interfor. I conclude on the basis of that analysis that Bear Creek is confined, with respect to both the shortfall claim and the calculation of rates, to the "actual volume" harvested.

**[140]** It is well settled that the role of an arbitrator under the Regulation, while it is somewhat reminiscent of the role of an interest arbitrator employed to fashion an agreement between parties, is objective. In my view the role is restricted to the application of the statutory criteria to the Contract, including the "contract volume", negotiated by the parties.

**[141]** The arbitral role was addressed by Finch J.A. in Pacific Forest Products and Hayes, February 4, 2000, C.A. 025241, unreported, as follows:

> [23] In my view, the arbitrator was free to take into account subjective information about the actual practices of these parties as long as the end result conformed to the objective stipulations found in s. 25(1). Similarly, in the companion appeal, in my view the arbitrator was permitted to consider the actual volume of wood harvested and the costs incurred, as long as such considerations were not ultimately determinative of the appeal. In this case, the arbitrator did not err at p. 24 by labeling the process a combination of the "interest-arbitration" model "with the objective adjudicative model". As quoted above at paragraph 13 of these reasons, the key passage in the award is found at paragraph 24: (emphasis added)
>
>> My appraisal and re-appraisal of the document aforesaid has also included an element of surrogate negotiations. Regulations 25(1) and (2) combine the replication model of interest arbitration with the objective adjudicative model. That is, the overall purpose of a rate arbitration under Regulation 25 is to replicate what the parties themselves would have done, acting reasonably in the given circumstances. However, the exercise in replication assumes that the parties would take account of certain things. Thus, the ultimate conclusion is objectively anchored, but reflects as well a measure of subjective judgment. Interestingly, that mix between objective appraisal and some concluding give-and-take is precisely how these

> **parties have conducted themselves in their past negotiations. It is a mix which reflects reasonable business realities. (emphasis in text and added).**
>
> **[24] If the underlined sentence were read in isolation one might conclude that the arbitrator had fallen into error. However, in the next two sentences the arbitrator illustrates that he remains aware that s. 25(1) mandates an objective approach. I am not persuaded that the arbitrator has erred in his interpretation of the Regulation or has used an incorrect approach to his resolution of this dispute.**

**[142] As I read that decision, there is no jurisdiction in an arbitrator to act on a perception of inequity in the bargain made between the licence holder and the contractor. In particular, the "contract volume" in this dispute, as that term is used by Finch J.A. in Hayes, is the volume agreed to by the parties in their Contract.**

**[143] That distinction was not acknowledged by Bear Creek in the sense that it assumed that if its interpretation of the volume provision was rejected, the result would be equivalent to the circumstances addressed in Western v. Hayes where Arbitrator Pearlman addressed circumstances in which the parties had not reached agreement on a contract volume. See Bear Creek, paras. 77-79.**

**[144] But here the parties did reach an agreement on a volume provision. Their disagreement related to its effect. It is not open to me in those circumstances to treat their disputed interpretations as equivalent to an absence of agreement for purposes of the application of the Contract.**

**[145] The fact that the interpretation of the amount of work provision, (which differed from Bear Creek's understanding), operated to the disadvantage of Bear Creek does not make it correct in law to impose a different volume**

agreement in order to achieve a different result. Bear Creek's claim to be entitled to rates based on the costs associated with logging a much larger volume has no contractual support and is the rough equivalent of the standby costs claimed and rejected in the decision of Arbitrator Wallace in Hayes. See Part 8, p. 9.

[146] Having acknowledged the primacy of previous rates and other historical facts, Bear Creek set that approach aside in favour of a reconstruction of its actual costs. On p. 3 of its submission, Bear Creek wrote in part:

> (b) the best evidence of costs of logging and the adjustments to be made to the previous rates are found in Bear Creek's actual costs of performing the logging and other admitted cost increases such as labour, fuel and inflation ... (emphasis added)

[147] Bear Creek's submission that "actual costs" are the "best evidence" available for the calculation of rates is contrary to the prospective approach in which actual costs are limited in their use to assessing the efficacy of rates derived from historical facts, particularly prior rates freely negotiated and the cost projections that gave rise to those rates.

[148] In presenting its proposal, Bear Creek rejected the traditional approach with respect to conventional logging rates for 2000. In para. 102 Bear Creek wrote:

> The conventional logging rates for the year 2000 are anomalous because of the very low volume assigned by Interfor to Bear Creek and therefore, the previous rate agreed in 1999 for a conventional logging is too far removed from the circumstances of 2000 to be of assistance in setting the conventional rates for 2000. Bear Creek submits that in the absence of a helpful previous agreed to rate, Bear Creek's reasonable costs

> are the best starting point in setting conventional rates for 2000. There is no prior agreed rate for Surf Lake dewatering, heli dump and boom that took place in 2001 with respect to the wood yarded into the lake and scaled in 1999 and 2000, and thus, actual costs are the only basis for setting this dewatering rate. (emphasis added)

[149] In context, the submission of Bear Creek is that actual costs, including fixed costs incurred in operations designed to log the full AAC, should be divided by actual production in order to calculate an applicable rate. In para. 104 Bear Creek wrote:

> The approach applied by Arbitrator Wallace in Pacific is to rely on actual costs, tested for reasonableness through cross-examination and adjusted as required, and add the industry standard 15% profit margin.

[150] That is not my understanding of the reasoning of Arbitrator Wallace as it was reviewed by the Courts. Actual costs afford a medium in which rates that are being fixed prospectively under s. 25 can be tested with respect to the projections and contingencies incorporated in them. They were not seen by Finch J.A. as a factual base from which rates can be calculated in the first instance. He wrote:

> [56] I would conclude that evidence of the actual volume of timber harvested in the contract year in question is not generally relevant to the arbitrator's task of fixing a rate for that year, nor is evidence as to the cause of volume shortfalls generally admissible. However, evidence of actual volumes harvested may be relevant to the issue of contingencies reasonably within the contemplation of the contracting parties prior to commencement of logging operations, and a consideration to be factored into the rate to the extent that reasonably contracting parties would consider it realistic to do so. (emphasis added)

[151] Those limitations can be seen in para. 48 as extending by necessary implication to actual costs. In those extracts Finch J.A. made it clear that the reasoning with respect to actual volume also extended to actual costs. He wrote as follows:

> [48] Pacific says that if actual logging volume and unit costs were to be determinative of rate disputes there would be no incentive for the contractor to run an efficient logging operation, and the contract would simply become one of "cost-plus". (emphasis in text)
>
> [49] I agree with Pacific that treating actual volumes and costs as "determinative" of the rate would not accord with the apparent intent of the Regulation, to have the rates fixed objectively. Neither party could know at the beginning of the contract year what volume will actually be harvested. Reasonable parties would attempt to make a realistic estimate of what might be cut, having regard for the contract volume and the risks inherent in the particular "logging chance" which the contractor has the opportunity to exploit. It is an exercise in risk assessment of future events. (emphasis added)

[152] In my view, the submission of Bear Creek with respect to the decision of Arbitrator Wallace failed to acknowledge the distinction between the use of actual costs to fix rates in the first instance and their use to test the contingencies employed in forecasting rates. Arbitrator Wallace elected to accept the evidence of actual costs in that case rather than seeking to forecast them on the basis of evidentiary projections. In any event, Finch J.A. in Hayes did not suggest that actual costs plus profit was a separate approach to calculating rates or one that could substitute for a forecasting of rates based on prospective facts known or discoverable at the material time.

[153] I note in that context that Bear Creek identified separate approaches to the calculation of rates that it saw as having been approved in the authorities,

one, of which was identified in para. 110 of Bear Creek's submission as "the reasonable costs plus 15% profit approach". A second was identified in para. 206 as the "previous agreed rate approach". I am not able to agree that the authorities contemplate more than one approach to the application of the s. 25 criteria in facts similar to those found in this dispute.

[154] In my view, what Bear Creek described as "the previous agreed rate approach" embraces the principles contemplated in the authorities for the resolution of rate disputes. It is discussed in paras. 187 to 233 of Bear Creek's submission. It represents what I take to be the approach required by s. 25, particularly where there is a well-established contractual relationship and a history of rate agreements over a number of years.

[155] The difficulty in the application of s. 25 is that, while it provides an analytical medium in which to fix rates, the "amount of work" provisions of the 1996 Regulation cannot be fully reconciled with the criteria unless the parties have elected to fix a volume formula, presumably under s. 18(8), which triggers a "contract volume" that can be enforced under the shortfall provisions, and which, coincidentally, can facilitate the application of the s. 25 criteria to the fixing of rates in the context contemplated by the Court in Hayes.

[156] The "previous rate approach" requires development of the recent history of rates negotiated between the parties and the application of projections and contingencies required to adapt those rates to the two years in dispute. Shaping that surrogate bargaining process in this dispute must accommodate the absence of a contract volume that can be projected in fixing rates.

[157] In that context, I return to my earlier conclusion that the rate history in 1996 and the first three years of the current Contract provides the only reliable factual base for the simulation of rate negotiations between the parties. Both

parties appeared to accept that approach. In particular, they expressed themselves as agreeing with the proposition that rates should be fixed in the first instance on the basis of prior rates freely negotiated between them and other relevant facts that are capable of prospective application. In its submission, Bear Creek wrote in part as follows:

> Applying [the applicable] principles, Bear Creek submits that the best approach to setting logging rates is as follows:
>
> (a) a rate should be based on the previous rate agreed between the parties for similar harvesting operations on the same licence, with adjustments for changes in volume, costs and operating conditions ...

[158] Interfor adopted that same general approach. It wrote as follows:

> It is submitted that the better approach, and the approach more consistent with the Regulation, is to consider prior rates agreed to by the parties, any adjustments that arise as a result of changes in logging chance, underlying costs, and operational differences (for example, additional or fewer phases).

[159] The approach defined in those extracts is in accord with my reading of the Regulation and the authorities, subject to the understanding that the "changes" referred to in the submissions relates to factors that can be applied prospectively in the form of projections and contingencies that are relevant in terms of the contractual rights of the parties.

[160] In applying the "previous rate approach", it is convenient to review the history of the parties with respect to the fixing of rates. The contractual relationship began in 1984 between Bear Creek and a predecessor to Interfor. It continued in existence through when the 1991 Regulation was introduced and

through introduction of the 1996 Regulation. Over that period the parties appear to have acted out their relationship in the posture of "commercial self-interest" contemplated by Baker, J., in para. 44 of Hayes.

[161] The inference invited on the evidence is that the parties developed an approach to rate negotiations which, while it was informal, was marked by an ability to isolate, quantify and project the phase cost factors and volume estimates involved in Bear Creek's stump to dump operations. The approach to rate negotiations usually taken by these parties was defined by Interfor and adopted by Bear Creek at para. 207 of its submission as follows:

> Mr. Schulte for Interfor, testified:
>
> I think in getting to know George [Munson], his method of negotiating rates is sort of like the industry standard of what I'm accustomed to. Basically the two parties sit down and go from where you left off in prior years. You try and determine any kind of major differences that may occur that you want to pay more or less money for. That's the type of negotiating that I'm accustomed to and I think George was, too. (emphasis added)
>
> (Transcript, February 12, 2002, p. 2275 lines 8 – 17).

[162] As stated, the inference I drew was that the failure to negotiate rates in 2000 was attributable to the steepening decline in the volume of timber Interfor allocated to Bear Creek. That decline bottomed out in 2000.

[163] The contractual process for rate negotiations agreed to by these parties in the current Contract is set out in para. 2 of the Schedule of Rates. Memoranda recording the rates for the first three years were incorporated in para. 1 of the Schedule of Rates. The memoranda read as follows:

**1. Logging Rates**

**For merchantable logs that meet the Company's log sort specifications as may be amended by the Company from time to time, produced and delivered by the Contractor to the Company pursuant to the terms hereof between the Effective Date and the day before the first Adjustment Date inclusive, the Company shall pay the Contractor the following rates per cubic metre of logs:**

| **Species** | **Grade/Sort** | **Rate** |
|---|---|---|

**Notwithstanding anything else in this Contract, the rates payable by the Company to the Contractor from the Effective Date to June 15, 1999 are as set out in the agreements on rates dated August 6, 1996; April 2, 1997; July 30, 1997; August 20, 1997; July 7, 1998; September 30, 1998; October 19, 1998; and November 6, 1998 between the Company and the Contractor, as evidenced by the letter dated August 6, 1996 from Dave Callas to G. Munson; the rate sheet and work description for 1997 signed by the Contractor and Don McMillan; the memorandum dated April 2, 1997 from Don McMillan to George Munson; the letter dated July 30, 1997 from Don McMillan to George Munson; the letter dated August 20, 1997 from Don McMillan to George Munson; the memorandum dated July 7, 1998 from Don McMillan to George Munson; the memorandum dated September 30, 1998 from Don McMillan to George and Ian Munson and Gary Laidlaw; the memorandum dated October 19, 1998 from Don McMillan to Ian Munson; and the memorandum dated November 6, 1998 from Don McMillan to George Munson. (emphasis added)**

**[164]** **Copies of the memoranda cited in that provision were filed in evidence. Only two made any reference to volume. The September 30, 1998 memorandum referred to a "profit share" project in which direct costs were designated as actual costs and indirect costs were to be "allocated based on volume [percentage] through sort". In context, that is a reference to actual volumes as opposed to contract volumes.**

[165] The November 6, 1998 memorandum covered "all rates applicable from June 15, 1998 to June 15, 1999". The agreement as to volume included the agreement that; "the overhead costs utilized in these negotiations [were] based on a total volume of 201,000m$^3$ produced between June 15, 1998 and June 15, 1999". In short, the reference amounted to an estimate of the volume to be harvested in future operations. (On the facts, the actual volume was less). Aside from those references, the memoranda recorded in the Contract made no express or implied reference to either a contract volume or an actual volume.

[166] That same practice prevailed in the rate memoranda filed with respect to rate agreements reached prior to August of 1996. Copies of those memoranda were filed in Exhibit 20(A) for a period between August 20, 1990 and July 9, 1996. Those memoranda recorded a recurring practice in which the parties fixed an all inclusive rate separated only as to area and as between conventional yarding and helicopter yarding.

[167] The introduction of helicopter logging into the operation is recorded in Exhibit 20(A)(1). Helicopter yarding was done in 1993 and 1994. No further helicopter yarding was done until 1997. Helicopter yarding rates were negotiated separately between Interfor and Helifor prior to October of 1999, after which Helifor entered into the subcontract for helicopter yarding with Bear Creek. Interfor and Bear Creek negotiated support rates. After the subcontract was executed, helicopter yarding rates were negotiated between Bear Creek and Helifor.

[168] The parties were successful in negotiating a combined rate for helicopter logging in their August 23, 1999 agreement on rates. They also agreed, that "Bear Creek will sub-contract heli-yarding directly with Helifor Industries".

**[169]** It can be seen from the history of rates set out in the memoranda incorporated in the Contract that the earliest date upon which rates were settled in any year was April 2. The latest was November 6. That pattern was followed with respect to the 1999 rate agreement, being the last agreement negotiated between the parties. Those rates, as indicated, were agreed to on August 23, 1999. The inference I drew was that rates were negotiated closer to mid-year than the start of the year to afford the parties an opportunity to react to production decisions as opposed to production estimates.

**[170]** The 1999 rates grew out of discussions recorded by Interfor in a handwritten memorandum dated June 28, 1999 relating to "1999 logging rates". The memorandum, which was sent in a fax transmission dated July 19, 1999, appears in Exhibit 20(A)(36). The rates were formalized in an August 23, 1999 letter. See Exhibit 20(A)(37). To place the rate negotiations and the execution of the current Contract in context, it is useful to reproduce the August 23 letter. It reads:

> Re: 1999 Rate & Contract Settlement
>
> I would like to thank Ian [Munson] for the trip into Kumealon Camp last week and for your co-operation in putting together what should be a successful export-logging program. During our meeting we reached agreement on the majority of the rate negotiations for this year. The delay in concluding negotiations was understandable due to the lengthy delay we encountered early this year with the FDP, waiting for the export approvals and the resultant lack of a defined logging plan.
>
> You will find below a summary of our agreements, as I understand them to be. If you have any further questions or comments please contact me as soon as possible. If not, then <u>I would appreciate you executing the Logging Contract document by signing the copies</u>

**you should have and initialing the attached Schedule "C" of rates to be attached.**

**Logging Rates**

**Conventional Logging;**

| | |
|---|---|
| **Kumealon Inlet stump-to-dump** | **$41.00/m$^3$** |
| **Scotia River stump-to-dump** | **$41,00/m$^3$** |

**Helicopter Logging;**

| | |
|---|---|
| **Surf Inlet Rep stump-to-lake** | **as per D. Mackay** |
| **Kumealon Inlet stump-to-dump** | **$80.68/m$^3$** |

**Export Handling Conventional & Heli;**

| | |
|---|---|
| **Kumealon export blocks only** | **$ 2.50/m$^3$** |
| **Scotia export blocks only** | **$ 2.50/m$^3$** |

**Conditions**

- **Logging rates above include camp payment of $1.34/m$^3$.**
- **Logging rates above are all-found.**
- **Export handling rate includes all costs to be incurred by Bear Creek to ensure that export logs are maximized for volume and quality at all stages of the logging process including falling, bucking, loading, sorting, booming, and handling.**
- **Bear Creek will ensure all efforts are taken to run a successful export logging program on a timely basis.**
- **Logging rates include payment for solid wood trimmed from export logs which otherwise would stay on a domestic log. Broken ends and XX will not be paid.**
- **Y's will be paid for conventional logging and heli-support only. The heli-logging portion of the heli rate**

**will not be paid for full length Y's. The heli-support will be paid at $29.50 + .81 = $30.31/m$^3$.**

- **Bear Creek will take steps to ensure X's and Y's are left on the hill where X and Y exceptions exist, and Y's are left on areas with no exceptions.**
- **Bear Creek will be responsible for dry short patching.**
- **Interfor will compensate Bear Creek for dry sort debris removal.**
- **Interfor will compensate Bear Creek for debris removal from the heli load-out sites.**
- **Bear Creek will be responsible for road maintenance.**
- **Bear Creek will be responsible for culvert cleaning, ditch cleaning and piling in active logging areas.**
- **Bear Creek will sub-contract heli-yarding directly with Helifor Industries.**
- **Bear Creek will supervise and coordinate Helifor activities.**
- **Bear Creek will follow Logging Plans as directed by Interfor supervisors.**

**(emphasis added)**

**[171]** **The "attached Schedule "C" of rates" included the following:**

**Logging Rates**

**For merchantable logs that meet the Company's log sort specifications as may be amended by the Company from time to time, produced and delivered by the Contractor to the Company pursuant to the terms hereof between the Effective Date and the day before the first Adjustment Date inclusive, the Company shall pay the Contractor the following rates per cubic metre of logs ...**

**Conventional Logging;**

| | | |
|---|---|---|
| **Kumealon Inlet stump-to-dump** | **all except XX** | **$41.00/m$^3$** |
| **Scotia River stump-to-dump** | **all except XX** | **$41.00/m$^3$** |

Helicopter Logging;

| | | |
|---|---|---|
| Surf Inlet stump-to-lake | separate agreement | |
| Kumealon Inlet stump-to-dump all except Y & XX | | $80.68/m$^3$ |
| Note: heli Y's paid at ... | | $30.31/m$^3$ |
| | | |
| Export Handling | N/A | $ 2.50/m$^3$ |

Other rates:

The rates per cubic metre of logs payable by the Company to the Conractor on and after the first Adjustment Date shall be determined in accordance with paragraph 2.

[172] The body of Schedule "C" attached to the August 23, 1999 letter differs from Schedule "C" as it appears in the current Contract. As recorded earlier, that Contract was executed by Bear Creek on September 7, 1999. The inference I drew was that the Schedule "C" attached to the letter two weeks earlier was intended by Interfor to be incorporated as an addendum to Schedule "C" as it appears in the current Contract but that its inclusion was overlooked.

[173] The Surf Inlet reference in the Schedule applies to a statement of account from Bear Creek to Mr. Mackay of Interfor on August 6, 1999 which he accepted. It reads:

<u>Re: Surf Inlet</u>

Invoice for production at Surf Inlet. Final invoice will follow.

| | | |
|---|---|---|
| Falling | $83 days @ $550.00 per day | $ 45,650.00 |
| Helicopter | (Hughes 500 – support for fallers | 20,000.00 |
| Fuel | | 9,000.00 |
| Fuel delivery | | 9,500.00 |
| | | |
| Moving to Surf Inlet (camp) | | 4,100.00 |
| Boom on lake | | 6,000.00 |

| | | |
|---|---|---|
| **Miscellaneous** | | **10,000.00** |
| **Total** | | **104,250.00** |
| **Total Volume Yarded** | **2,482.29m$^3$ @ $56.18** | **139,455.16** |
| | **Total** | **$243,705.16** |

**[174] Copies of rate agreements dating back to 1990 were filed, the first of which consisted of the rates recorded in the "Logging Rates" set out in the Schedule of Rates in the 1990 contract. Those rates were effective January 1, 1990. Thereafter, sequential rate memoranda, commencing with August 20, 1990, were filed. Similar memoranda were filed with respect to rates agreed to on July 28, 1992; August 27, 1993; August 29, 1994; November 9, 1994, and a new schedule of rates effective January 1, 1995 which was incorporated in the Schedule of Rates in the 1995-99 agreement. An adjustment to those rates was recorded on August 3, 1995. That rate history was summarized by Interfor in Exhibit 20(A)(1).**

**[175] Bear Creek filed a partial rate history in Exhibit 4 that commenced with the August 29, 1994 memorandum. Both parties included other documents in the rate history relating to specific arrangements.**

**[176] As recorded, the rate memoranda filed in evidence did not customarily include references to volume considerations, although it was clear on the evidence that volume figured in the negotiations themselves. That fact was made clear in the June 28, 1999 handwritten memorandum that recorded Interfor's 1999 rate proposal. It lists projected volumes broken down as between conventional and helicopter yarding and as between areas. The volumes totaled 243,000m$^3$. The actual volume for 1999 fell significantly below that estimate.**

[177] Evidence with respect to the exchanges between the parties that gave rise to their rate agreements, particularly those in the years immediately preceding the two years in dispute, would have been helpful. In particular, evidence of past costs would have assisted.

[178] In the absence of evidence of exchanges in negotiations, the inference I drew was that the parties would discuss projected volume as a prelude to fixing rates for the upcoming year. Those discussions would take place in the context of logging plans filed in advance of each logging season and other projections. For example, see: Exhibits 5 and 6. Those projections would be revisited as the start of logging approached and the opportunity for volume projections became more practical.

[179] However, there was no direct evidence with respect to how the parties progressed from volume projections to rates. Some insight is offered by Interfor's June 28, 1999 memorandum, but it is evidence that, like much of the evidence, required the drawing of inferences. In any event, there was no indication in the evidence that, whatever volume expectations were discussed between the parties, there was an agreement between them that permitted Bear Creek to recover compensation for any shortfall in projected volumes.

[180] The relationship between "contract volume" and rates was addressed indirectly by Finch J.A. in Hayes at para. 51 where he wrote:

> I am therefore of the view, taking all of these considerations into account, that evidence of actual volume harvested may be admissible as relevant to the contingency of the contract volume not being achieved. That contingency is a factor which reasonable parties would take into account in setting a rate in advance of the logging taking place. (emphasis added)

[181] Here that factor cannot be measured because, as noted repeatedly, there is no distinction to be made under this Contract between the "contract volume" and the "actual volume". In the interpretation of the "amount of work" provision dictated by the facts and applicable legal principles, the "contract volume" and the "actual volume" are the same.

[182] I repeat my earlier observation that the only reliable facts upon which to apply the s. 25 criteria are those relating to the rates freely negotiated between the parties, particularly those in 1996 and in the first three years of the current Contract. Insight into the approach the parties took to negotiating rates can be gleaned from that rate history. I include 1996 because it was the first year in the pattern of declining volumes.

[183] In paras. 4.3 to 4.16 Interfor raised the assertion that a camp barge premium agreement had expired. The "agreement" is in two parts recorded in Exhibit 20(A)(9) and (16) respectively. The date upon which those arrangements expire appears on their face. I did not find it necessary to address the agreement in fixing the rates.

[184] Before addressing specific rates, it is helpful to consider various other issues raised by the parties. I begin with a submission by Interfor in para. 2.13 that a "composite rate" approach should be adopted to assist in "establishing new rates for the future". I have not been able to fit that proposal within s. 25.

[185] I turn next to Helifor. Its history is set out in Interfor's submission commencing in para. 1.18. The primary issue involved the calculation of rates for helicopter yarding. However, a second issue was addressed by Bear Creek at para. 191 of its submission. It relates to an outstanding rate dispute between Bear Creek and Helifor under Helifor's subcontract. The parties agreed on interim

helicopter rates pending a resolution of that rate dispute. Those rates are set out in para. 1.23 of Interfor's submission. They were incorporated by Bear Creek in its proposal. I will set them out later.

[186] Bear Creek proposed that I retain jurisdiction to afford it an opportunity to "substitute the final Helifor rate for the interim rate in setting the all found helicopter logging rates". Bear Creek's concern is that any increase in Helifor's rates imposed in a subsequent arbitration would have the effect of reducing its return on the rates fixed in these proceedings. That is an appropriate request and I reserve jurisdiction for that purpose.

[187] The next issue relates to profit and risk in helicopter yarding. Bear Creek's initial position was that it was entitled to claim 15% profit on its helicopter costs because a 15% profit on all costs is standard in the industry. Bear Creek's alternative position was that there was an onus on Interfor to establish that the Helifor's interim rates included profit and that it had failed to meet that onus.

[188] It was not necessary to address that submission because I am in agreement in this dispute with Bear Creek's initial submission. However, I wish to record the view that if a subcontractor's costs are to be excluded from a contractor's profit entitlement on the basis that the subcontractor's rate can be taken to include profit, it does not follow that the licence holder must prove that a profit was in fact earned or the amount of that profit.

[189] To agree with Bear Creek's submission would be to extend the process into yet another area of factual inquiry which would serve to render it more cumbersome than it is. It was Bear Creek's position that proof of an actual profit and its amount was a condition precedent to excluding profit on Helifor's

**rates and that Interfor had failed to meet that requirement. I do not agree with that submission.**

**[190] If a discretion to exclude a profit allowance is consistent with s. 25 in particular circumstances, it does not follow that the licence holder must call evidence to prove the fact or amount of the profit. In <u>Hayes</u>, Arbitrator Wallace presumed that subcontractors would claim a standard 15 percent profit without requiring proof of an actual profit. See: paras. 11.0 to 11.11. It was a reasonable presumption in the sense that subcontractors would be expected to negotiate rates that provided for a profit based on the industry standard. Whether or not they achieved that level of profit would depend on their performance.**

**[191] In any event, Bear Creek's approach would require a detailed factual inquiry into the financial affairs of the subcontractor to determine whether a profit was actually achieved. But how could a licence holder compel an arms length subcontractor to divulge its cost base and profit ratio in order to counter a claim for profit on a particular phase which is being advanced by the full phase contractor? In this dispute, Helifor was deemed compellable with respect to its profit performance but that relationship would not routinely exist.**

**[192] The question became academic in these proceedings, however, because I was unable to accept the submission of Interfor that profits should not be allowed on helicopter yarding costs or other component costs performed by subcontractors in this dispute. I found the decisions relied on by Interfor, (see: paras. 10.1 through 10.19), to be difficult to place in context on the facts established in this dispute. Reasons were not given for the exclusion of profit in those cases. My presumption was that the exclusion related to some factor affecting the level of risk of the contractor in those cases or on the basis that allowing a contractor's profit on a subcontractor's rates would constitute some form of double counting.**

[193] Assuming that an absence of risk or double counting was the basis upon which subcontractor costs were excluded in the authorities relied on by Interfor, that reasoning does not apply in this dispute. Here the risk with respect to subcontracting costs remained with Bear Creek. In that context, I agree with Bear Creek's characterization of "risk" as an element in fixing rates. Following is an extract from para 181:

> Therefore, even in a rate arbitration after the fact, the contractor bears a risk that it will not recover all of the costs it has incurred if they are deemed to be unreasonable, unwarranted or excessive in some way.

[194] In short, risk is the possibility that a contractor will not recover its costs, including costs incurred in engaging and paying a subcontractor. It is a risk bourne by a subcontractor in its dealings with the contractor and is equally a risk bourne by the contractor in its dealings with the licence holder.

[195] In evaluating the risk factor with respect to Helifor, I begin with its relationship with Bear Creek. As noted by Interfor at para. 10.17, prior to the execution of the subcontract between Helifor and Bear Creek, Interfor determined the rate to be paid to Helifor for helicopter yarding and paid that rate directly. Bear Creek received a rate for supporting helicopter yarding but was not subject to the risk associated with the fixing of the helicopter yarding rate.

[196] That arrangement changed when the Contract was executed by Bear Creek on September 7, 1999 and by Interfor on October 21, 1999 and, coincidentally, the Helifor subcontract was executed by Bear Creek on September 7, 1999 and by Helifor on October 22, 1999. Interfor sought that contractual relationship to protect Helifor's right to all helicopter yarding, a right which was at risk in recognizing Bear Creek's right to 100 percent of all wood harvested.

[197] The execution of the Contract activated the following provision dealing with Helifor:

> Other Special Terms and Conditions:
>
> 4.1 Simultaneously with the execution of this Contract, the Contractor will enter into a replaceable subcontract (the "Replaceable Heli-Subcontract") with Helifor Industries Limited ("Helifor") whereby Helifor is entitled to 100% of the yarding, support and chasing required in connection with any and all helicopter logging operations to be performed by the Contractor within the Licence pursuant to this Contract. Subject to the provisions of the Replaceable Heli-Subcontract, the Contractor will negotiate the rates payable on the helicopter yarding, support and chasing portion of the Replaceable Heli-Subcontract directly with Helifor and pay the rates payable by the Contractor to Helifor within ten days of the payment by the Company to the Contractor for the Work provided pursuant to this Contract. If payment is not made by the Contractor to Helifor within that ten days, the amount owing to Helifor may be paid by Interfor to Helifor and deducted by Interfor from amounts owing by Interfor to the Contractor under this Contract. (emphasis added)

[198] Thereafter, the cost of helicopter yarding became one of the phase costs for which Bear Creek was responsible under the Contract. It involved the same factor of risk that arose with respect to other phase costs for which Bear Creek had assumed responsibility. Bear Creek was required to incorporate helicopter costs in the rate it sought to negotiate with Interfor and thus became subject to the risk of imprudence in the context of the overall rate it achieved, either in negotiation or in arbitration.

[199] The level of risk is manifest in this dispute in light of the pending rate arbitration between Bear Creek and Helifor. Helifor's rate may be increased in the pending rate review and Bear Creek may or may not succeed in the reserved jurisdiction in having the rates imposed in this process adjusted to reflect any

increase. A similar risk relationship existed between Bear Creek and other subcontractors it employed.

[200] In my respectful view, a full phase logging contractor performs a role similar to a head contractor in any enterprise employing subcontractors where the head contractor earns a profit based on the risk associated with fixing and accepting responsibility for the costs of the project and supervision and coordination of the work. Those are factors that fall outside the support services required for helicopter yarding. A full phase logging contractor who employs subcontractors bears the ultimate responsibility and the ultimate risk for the costs associated with the work of the subcontractors and of the work itself. In my view, it is that assumption of risk that the industry recognizes as justifying a profit.

[201] In any event, the fact that contractors are acknowledged as having a right to claim a profit allowance on all of their costs does not mean it is entitled to recover those costs from the Licence Holder. The entitlement of contractors to recover costs and profits is limited to what can be seen in an industry context as reasonable costs.

[202] I conclude that nothing in s. 25 of the Regulation, as its application has been interpreted by the Courts, requires contractors to forego the standard industry premium of 15 percent profit on any of the components that make up a full-phase operation. Whether they recover the profit allowance is subject to the exigencies that make up the factor of reasonableness measured on an industry standard. The question raised is whether the fact that a profit factor is added to a subcontractor's rates renders the rate unreasonable by that fact alone. The answer is, no.

[203] A further submission by Interfor with respect to profit and risk relates to opinion evidence that it should be based on a return on invested capital. I agree with Bear Creek's response to that position which appears in paras. 166 through 173 of its submission. The question raised in the context of s. 25 and the authorities does not involve what approach to profit is deemed appropriate in the investment community. The question is, what approach is consistent with logging industry practice. When considering what reasonable parties will agree to with respect to profit and risk, the prevailing industry practice is persuasive.

[204] Interfor next submitted that contractors should be expected to respond to the economic vagaries of the industry. That expectation was expressed as follows:

> 10.2 The profit must be a reasonable one. What is reasonable must necessarily depend on a consideration, not simply of rates of return and reasonableness of costs, but also the state of the industry. Indeed, it would be inconsistent with the objective of fairness to require one company, party to a timber harvesting contract, to earn a profit when the industry as a whole, and in particular in the north coast, is experiencing challenging economic hardship and the other party to the contract will increase its losses as a result of the legislative requirement for a contractor to earn a profit. It is submitted that in some cases, reasonable can be interpreted to mean "no" profit. (emphasis added)

[205] There is no support for that position in the Regulation or the authorities. Licence holders are not obligated to share their profits with contractors and cannot be seen as entitled to a waiver of the profits of contractors or to insist on cost reductions from contractors on the basis that the profit rights of the licence holder are at risk.

[206] The obligations and rights of these parties are defined in the Regulation and the contracts they negotiate. The submission of Interfor would introduce a further variable which is not recognized in s. 25 and which would require proof of facts upon which to make the findings necessary about whether a waiver of profits and an enforced reduction in costs is justified in particular circumstances. That factual inquiry, once again, would further complicate an already burdened process.

[207] Turning to Interfor's proposal of the $300,000 "bridging amount", I note that s. 25 of the Regulation does not confer a jurisdiction to impose such a premium on Interfor, any more than it contemplates a right in Interfor to compel a contractor to restructure its operations to reduce its costs. The rights of both parties in that context are addressed in terms of what rates are reasonable in the context of the industry.

[208] However, on the unique facts in this dispute, Interfor's proposal can be seen as an acknowledgement that Bear Creek's fixed cost base has been adversely affected by the reduced volumes Interfor allocated to it. Acceptance of Interfor's interpretation has the effect of limiting the fixed costs Bear Creek can recover in the fixing of rates and Interfor's goal was achieved, albeit indirectly.

[209] In that context, nothing in the Regulation or the authorities prevents Interfor from extending an ex gratia payment to Bear Creek in response to circumstances as they arise. The rate history between the parties reveals a well-established practice in which Interfor compensates Bear Creek for increases in its cost base, such as labour costs, which arise after rates have been fixed for a particular year.

[210] In para. 2.8, Interfor expressed the "bridging amount" as being subject to facts disclosing that Bear Creek had incurred additional expense in the

course of restructuring its operations. In argument, Bear Creek acknowledged that it had not initiated any restructuring. However, the finding that Interfor's interpretation with respect to volume is correct triggers what amounts to the imposition of "restructuring costs" on Bear Creek. The result has been an increase in productivity in terms of Bear Creek's costs base. On those facts I find that Bear Creek, in effect, has been forced to meet Interfor's criteria and is entitled to receive the restructuring premium of $300,000.

[211] I turn next to the issue raised by Bear Creek on p. 67 with respect to "Volumes Not Paid". The claim was based on Interfor's introduction of a practice of dividing XX waste into separate categories designated as X1 and X2. The volumes for which Bear Creek was entitled to claim compensation were set out in the Contract. See Interfor, para. 11.3. The history of Interfor's introduction of the sub-categories of X1 and X2 was described in Section 11 of its submission.

[212] In order to claim compensation for additional volumes, it was necessary for Bear Creek to bring its claim within the Schedule of Rates in the Contract. On the evidence, Bear Creek failed to establish that the logs in question "[met] the Company's log sort specifications". On that basis, the claim for additional volumes is disallowed.

[213] I now return to the rate history of the parties. In measuring its significance, guidance can be found in the pattern implicit in the relationship between actual production and rates during the years immediately preceding the rate dispute, commencing with 1996. That relationship discloses that, while volumes over the four years fluctuated and fell significantly below both the AAC and the AARC, the corresponding rates remained relatively stable. The following table illustrates the rate and volume relationship:

1996

| Rates | | Actual Volume |
|---|---|---|
| Kumealon | $\$41.85/m^3$ | |
| Scotia | $\$41.19/m^3$ | $147,791 m^3$ |

1997

| | | |
|---|---|---|
| Scotia | $\$41.40/m^3$ | |
| Kumealon | $\$42.06/m^3$ | |
| Kumealon Heli | $\$81.86/m^3$ | $214,689 m^3$ |

1998

| | | |
|---|---|---|
| Kumealon | $\$39.50/m^3$ | |
| Marion | $\$35.10/m^3$ | $178,857 m^3$ |

1999

| | | |
|---|---|---|
| Scotia | $\$41.00/m^3$ | |
| Kumealon | $\$41.00/m^3$ | |
| Kumealon Heli | $\$80.68/m^3$ | $158,788 m^3$ |

[214] I conclude that it is probable that these parties, were it not for the intervention of the 1996 Regulation and the dispute with respect to the "amount of work" provision, would have fixed rates in a continuation of the same pattern, beginning with the existing rates and adding "any kind of major differences that may occur" that would cause Interfor to "want to pay more or less money". See Bear Creek para. 207.

[215] Bear Creek took the position that it was entitled to rates based on recovery of its full costs in both years, either in its shortfall claim or in the significantly higher rates it was proposing. It wrote as follows in its submission:

> 107. Again, the conventional rates for 2000 are anomalous because of the extremely low volume assigned to Bear Creek by Interfor. In 2000, Bear

> **Creek was required to defray its repair and maintenance, overhead and depreciation over a relatively small volume, which resulted in vastly higher per unit costs. <u>To the extent these fixed costs are recovered in Bear Creek's Shortfall claim, the rates may be correspondingly lower</u>. (emphasis added)**

**[216] It can be seen in that submission that Bear Creek was of the view that even if its interpretation failed, it was nevertheless entitled to rates calculated on the basis of fixed costs and overhead expended in anticipation of a timber allocation equal to or greater than the AAC. Thematic in its submission was the proposition that its fixed costs were reasonable when measured in the context of the facts. It wrote as follows:**

> **58. There was some suggestion in the evidence led by Interfor that Bear Creek ought to have restructured its equipment complement to reduce fixed costs. A more detailed response to this submission will be provided in reply. However, in summary Bear Creek submits it was not reasonable to suggest it ought to have reduced its equipment complement in 2000 and 2001 given that:**
>
> **(a) Interfor did not say, and could not say as late as February, 2002 at this arbitration, what volume Bear Creek could expect to harvest this year or for the next three years;**
>
> **(b) the initial logging plans that were given to Bear Creek by Interfor indicated a range of relatively large conventional volumes in both 2000 and 2001; and**
>
> **(c) Bear Creek was instructed to complete its logging programs in a very short time frame, for which they required all of their equipment.**

[217] Bear Creek's submission with respect to reduced volumes introduced a factor that I was not able to relate to s. 25. It was based on the assertion that it had incurred fixed costs required to log a volume equal to the AAC of 226,000m$^3$ and was entitled to recover those costs plus a margin for lost profit regardless of the actual volume and regardless of whether its costs substantially exceeded those required to log the contract volume, being the actual volume.

[218] Bear Creek's submission was developed further in paras. 115 through 133. However, accepting that Bear Creek held itself ready to log the full AAC or greater, missing from the equation was support in law for the proposition that it was entitled to recover all costs lost in what it viewed as reduced volumes. Bear Creek tied its submission to the assumption that the concept of "reasonable costs" under s. 25 included costs incurred in preparing to log estimated volumes that subsequently fell below expectations. That right could only arise by contract.

[219] The imbalance between "estimated' and "actual" volumes posed a problem for contractors under the 1991 Regulation. A reasonable inference is that it was one of the factors that led to the introduction of the volume provisions in the 1996 Regulation. In particular, the contractual right to claim compensation for projected volumes not harvested did not appear to exist under the 1991 Regulation and was found only under any contractual provisions that recognized a "contract volume" as opposed to an "estimated volume. Volume protection under the 1996 Regulation only arises under the shortfall provisions of the 1996 Regulation and the Contract. That aspect of the Regulation was reviewed by Arbitrator Borowicz in Hayes.

[220] The inference invited by the facts is that Bear Creek invested fixed and overhead costs in each of the years from 1996 through 2001 which were

sufficient to log a volume at or above the AAC. The pattern of erratic and sagging volumes thus exposed Bear Creek to fixed overhead costs that it could not recover under whatever volume provision existed from 1996 through rate negotiations in 1999. That pattern challenges the existence of an obligation in Interfor to meet volume expectations that are not secured in the Contract.

[221] I digress in that context to reiterate that the status of the contract between the parties in the period between April 1, 1996, when the 1996 Regulation came into force, and the execution of the current Contract by the parties, was not clear in the evidence. Some of the documentary evidence of exchanges between the parties during that period invites the speculation that they reached the conclusion at some stage subsequent to the introduction of the new Regulation that it would be necessary to negotiate a new volume provision to bring it into compliance with the Regulation's terms, but that they were unable to reach agreement on that issue until the Fall of 1999.

[222] In any event, the parties continued to negotiate rates which did not appear to be tied to any agreement on volume. If it is presumed that the 1995-99 contract continued in force until October 21, 1999 when Interfor executed the current Contract, the volume provision governing the negotiation of rates would be, "Estimated Volume: 180,000$m^3$". As stated previously, that provision did not constitute a guarantee that Bear Creek would receive that volume annually or cumulatively.

[223] If, on the other hand, one or the other or both of the parties elected to terminate the 1995-99 contract coincidental with the introduction of the volume provisions of the 1996 Regulation, there would be no volume agreement in force between the parties during the negotiation of the 1996, 1997, 1998 and 1999 rates. (The 1996 rates were negotiated after the introduction of the 1996 Regulation and the 1999 rates were negotiated before the execution of the current Contract).

**Hence, the rate history does not support recognition by the parties of an entitlement by Bear Creek to costs based on volumes other than the actual volume.**

**[224] In turning to the task of fixing the rates, I start by confirming my conclusion that, for the most part, the approach taken by Bear Creek is not consistent with the s. 25 criteria as it has been interpreted in the authorities. That position was summarized by Bear Creek as follows:**

> **298. Bear Creek is an extremely efficient contractor. It has been able to harvest the volumes requested by Interfor using the harvesting methods requested by Interfor at the times requested by Interfor. The volumes, methods and the timing of the harvest requests suited Interfor's needs but were contrary to any sensible planning schedule that a contractor expects a licensee to have. Bear Creek is entitled to be, and should be, compensated for its achievements for Interfor. The rates and shortfall award sought are more than fair in the circumstances. (emphasis added)**

**[225] The claim advanced by Bear Creek is reminiscent of the claim for standby rates which was reviewed and rejected by Arbitrator Wallace at para. 8.1 - 8.5. Bear Creek's claim for compensation for costs incurred with respect to volumes not harvested is not recognized in the Contract and cannot be supported.**

**Fixing the Rates**

**[226] In addressing the question of rates, the approach dictated by the authorities and s. 25 begins with an imitation of the practice described by Mr. Schulte in his evidence. See Bear Creek, para. 207. That approach should be taken subject to the following direction given by Finch J.A. in para. 43 of Hayes:**

**[43] The language of s. 25(1) indicates clearly that an arbitrator is required to take an objective approach in determining a rate. Section 25(1) refers to what "a licence" and "a contractor" would agree to. It does not refer to the actual parties to the dispute. The section also refers to what a licencee and a contractor "acting reasonably ... would agree". The conduct of reasonable persons is an objective test. The words "would agree" also suggests a prospective, and therefore objective approach. Section 25(1) postulates a hypothetical scenario for the arbitrator, one in which the arbitrator places himself or herself in the position of the parties, acting reasonably, at the commencement of the contract year in the circumstances then known to both of them. Then, the task is to determine what such parties at that time and in those circumstances would have agreed to, bearing in mind the two criteria for such an agreement mandated by s. 25(1). Those criteria are (a) a rate that is "competitive by industry standards", and (b) a rate which will permit the contractor to earn "a reasonable profit". (emphasis in text and emphasis added)**

**[44] However, the statutory scheme also clearly contemplates that the arbitration process will commence after logging operations for the contract year have begun, and quite possibly, as in this case, after the year's logging operation has concluded. After the fact arbitration must have been in the contemplation of the Regulation drafters given: the history of contract negotiations in the industry; the length and complexity of, and the preparation required for, such arbitration proceedings, including the practice of adducing expert evidence; and most importantly, the regulatory provision for payment of a provisional rate pending resolution of a rate dispute. The requirement for a provisional rate clearly contemplates commencement of logging for the contract year in dispute, before the rate for that year is set. (emphasis added)**

**[227] I do not read the references in para. 44 to lengthy and complex preparation to require the preparation of such a case in all disputes. When read in context, those observations do not detract from the conclusion reflected generally in the Court's decision in Hayes that actual costs and actual production can be of assistance in the fixing of rates in a dispute where an imbalance is seen to arise between actual costs and actual production and the costs and production estimates that are projected for the purpose of fixing rates.**

**[228] After lengthy deliberation, I concluded that the underlying issue in this dispute did not respond, in the main, to an analysis of the actual costs incurred in the two years in question. I note first that the reconstruction process adopted by Bear Creek raised a number of questions about its reasonableness. Those questions included some of the issues raised by Interfor in s. 9 of its submission. The questions related to whether the reconstruction process could be seen as reflecting reasonableness in the context of industry standards. In any event, I concluded in general terms that the evidence of the parties with respect to actual costs was not helpful.**

**[229] The issues in this dispute arose in the context of Bear Creek's assertion that it was entitled to a contract volume of 226,917m$^3$/year, being Interfor's AAC under the Licence. Bear Creek's reconstruction of its actual costs was based on that presumption. But, the only "contract volume" was the actual volume of 120,807m$^3$ in 2000 and 212,430m$^3$ in 2001. (Those figures are from Appendix A to Bear Creek's submission. Volume figures vary in the evidence). In terms of the prospective process of fixing rates, those contract volumes could not have been projected in the sense contemplated in para. 50 of the decision of Finch J.A. in Hayes.**

**[230] The conclusion I drew after an extensive review of the evidence, the authorities and the submissions was that there was little benefit beyond**

background to be derived from the mass of evidence accumulated by the parties. In my view, the parties failed to establish that the costing process in which they engaged produced facts which were relevant to the fundamental issues raised in the dispute. That conclusion was based primarily on the absence of a contract volume other than the actual volume that could be applied in the manner contemplated in s. 25(2) and the reasons of Finch J.A. in Hayes.

[231] In considering the retrospective facts developed by the parties I note that the use of such evidence is not contemplated in any express sense in s. 25. However, in commenting on the admissibility of retrospective facts, Finch J.A. wrote in Hayes in para. 46 that it was not necessary in terms of the admissibility of such evidence to find express reference to it in s. 25(2). Finch J.A. wrote in part:

> Absence of an item from such an inclusive list of factors does not lead to the conclusion that matters not mentioned may not be considered. I think the language of s. 25(2)(f) supports Hayes' argument that evidence of actual volumes cut and unit costs may properly be considered in fixing a rate.

[232] That analysis, as I read it, permits but does not require the parties to introduce evidence of actual costs and volumes in a rate dispute and does not stand for the proposition that such evidence should be seen as supplanting the criteria set out in s. 25(2).

[233] On my reading of the decision of Finch J.A., an arbitrator should look first to the criteria defined in s. 25(2) and should weigh it under s. 25(2)(f) in the context of factors that may support or refute rates generated under the defined criteria, including evidence of actual costs and actual volumes.

[234] In the extensive deliberations that gave rise to this Award, I concluded that the prospective criteria offered the only reliable approach to fixing rates in these unique circumstances. In expressing that conclusion, it is advisable to make a clear distinction between the approach taken by the parties in this dispute and the approach contemplated under s. 25 of the Regulation. The test the rates must meet is defined in s. 25(1) as follows:

> 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.

[235] Applying the reasonableness test to the unique facts in this dispute, it was necessary to assume that the volume agreed to in the current Contract was 100 percent of what is harvested. That assumption did not arise from any agreement or acknowledgement by Bear Creek, but it does arise from the interpretation of the Contract. Its effect is to require the fixing of rates with no contingency with respect to future volumes. The significance of that conclusion can be evaluated in the context of the following comments of Finch J.A. in Hayes:

> [49] I agree with Pacific that treating actual volumes and costs as "determinative" of the rate would not accord with the apparent intent of the Regulation, to have the rates fixed objectively. Neither party could know at the beginning of the contract year what volume will actually be harvested. Reasonable parties would attempt to make a realistic estimate of what might be cut, having

> regard for the contract volume and the risks inherent in the particular "logging chance" which the contractor has the opportunity to exploit. It is an exercise in risk assessment of future events.
>
> [50] But evidence of actual volumes and rates may be relevant and admissible without treating that evidence as determinative of the rate. Actual logging harvest volumes are some indicia of whether the licencee's volume expectations, as expressed in the contract, will be realized. Actual volumes are after the fact evidence of a previous risk or chance. They show what is within the range of the possible. There is no "one-to-one" relationship between the actual and the previous contingency. The latter is a matter of prior judgment, which if exercises reasonably, takes into account those matters falling within the range of that which is possible in practice. (emphasis added)

[236] I conclude, with deference, that the phrase, "actual volumes and rates" in para. 50, when read in context, was intended to read, "actual volumes and costs". The question in this dispute is, how should rates be calculated in the absence of "volume expectations ... expressed in the contract". My conclusion is that the answer lies in having resort to the rate history of the parties as contemplated in s. 25(2)(a) and projecting the rates forward as contemplated in s. 25(2)(c).

[237] In the context of this dispute, the distinction between projected costs and actual costs is fundamental. It is the difference between establishing a cost base for forecasting rates and a detailed and retroactive process directed at establishing actual costs. As stated, actual costs may or may not assist in fixing rates, but are limited in any event to measuring the efficacy of costs developed in accordance with s. 25(2). That provision contemplates that parties will consider prior rates they have agreed to and the other following factors:

**25(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 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 ...**

**[238] Bear Creek did not call evidence under s. 25(2)(b) of the Regulation of its "costs and productivity" in prior years when the parties were successful in negotiating rates in similar conditions. But, evidence under s. 25(2)(a) of the Regulation with respect to rates agreed to by the parties was made available and,**

by necessary inference, those rates incorporated the costs upon which they were based. On the unique facts in this dispute, that body of evidence provided the factual base upon which to project the rates in issue and that factual base did not require evidence of actual costs to give them meaning or to measure their reliability.

[239] As noted in the decision of Finch J.A., the use of actual costs to test the projections made on the basis of prior rates is an option available in appropriate circumstances. In particular, where one or the other of the parties is of the view that rates derived in accordance with s. 25 are flawed on the basis of the projections from which they were derived, it is open to them to adduce evidence of actual costs and volumes to test their validity.

[240] As indicated, I concluded that the evidence developed by the parties with respect to actual costs was not relevant to the fundamental issue raised in this dispute because there is no contract volume which would assist in defining the rate equation. The only contract volume available for the fixing of rates was the actual volume and the cost figures developed by Bear Creek were not developed with respect to that volume. One exception, as I will detail later, related to support rates for ocean drop helicopter logging.

[241] On the facts, I conclude that reasonable parties acting in accordance with the principles defined in s. 25 would confront the unique circumstances in this dispute, in which no contract volume can be projected, by reaching back to the approach they had taken to the negotiation of rates in what amounted to equivalent circumstances. That is, the years from 1996 through 1999 when no apparent agreement on volume was available to assist the parties.

[242] No direct evidence was called about the negotiations that gave rise to those rates, but the inference to be drawn is that, whatever volume estimates

were made to facilitate operations, there was no contract volume upon which Bear Creek could rely in fixing rates for the upcoming year. Nevertheless, the parties were able to negotiate rates for logging in the same general areas with no substantial change in logging chance.

[243] The inference to be drawn from the evidence was that, in the negotiations in the four years prior to 2000, the parties adopted an averaging approach to the calculation of rates in the various areas rather than attempting the phase by phase and block by block analysis adopted for the reconstruction of actual costs by Bear Creek and opinions with respect to what actual costs should be by Interfor.

Conventional Rates – 2000

[244] I conclude on the evidence that Interfor's proposal for conventional logging rates in Kumealon for 2000 reflects the test contemplated in s. 25(1). The rate of $\$45.89/m^3$ for Kumealon represented an increase of $\$4.89/m^3$ over the 1999 rate. That increase was sufficient to accommodate the relevant factors identified by Bear Creek in the "previous agreed rate approach". See Bear Creek: paras. 199 - 218.

[245] I note in that context that I treated the $\$2.50/m^3$ for export blocks as a separate premium payable in any export block in any of the areas in both years.

[246] Returning to the Kumealon rate, the rate pattern supports the conclusion that the parties would not have agreed on a higher rate. The $\$41.00/m^3$ rate had persisted over the years from 1996 through 1999 despite sagging volumes, the introduction of the $\$2.50/m^3$ export premium and the influence of inflation, fuel costs, wages and similar factors. Hence, an increase of

**$4.89/m$^3$ in 2000 constituted a significant increase with no apparent explanation other than Bear Creek's approach to the volume issue.**

**[247] A different conclusion is invited on the rate history in Chapple. Interfor's proposal was not consistent with the history, either in isolation or when measured in the context of the overall rate structure. It can be seen that when logging occurred in both Kumealon and Chapple over the years, there was a gap of approximately $1.00/m$^3$ between rates in the two areas. The Interfor proposal of $42.39/m$^3$ results in a difference of $3.50. The last rates negotiated between "Chapple/Cedar/Dam/Surf" before 2000 was in 1995. In 1993, 1994 and 1995 the relationship, while not precise, was constant. See Exhibit 20(A)(1).**

**[248] Applying the test in s. 25(1), it can be expected that a licence holder, acting reasonably, would maintain internal rate relationships unless it was able to identify a factor that justified a change. Nothing in the evidence indicated why the relationship between Kumealon and Chapple changed in the terms implicit in Interfor's proposal.**

**[249] The evidence of both parties invites the inference that the logging chance in Bear Creek's operations remained relatively constant over the years. Obviously logging chance, and the direct costs associated with it, can vary from phase to phase, block to block and area to area. However, the rate fixing process contemplated in s. 25 of the Regulation, while contemplating an objective approach, must adapt itself to the particular parties and the approaches they have taken in the fixing of rates in the past.**

**[250] Where parties have followed a practice of negotiating omnibus rates that, by necessary implication, average out the cost factors relating to blocks within an area and as between areas, that same broad-based averaging and internal relationships should be continued under s. 25 as reflective of how**

reasonable parties would approach the calculation of rates in the unique circumstances. My conclusion with respect to the rate history relating to Kumealon and Chapple is that it supports a continuation of the relative relationship between the two. I conclude on that basis that the rate for Chapple in 2000 should be fixed at $\$44.90/m^3$.

Conventional Rates – 2001

[251] Turning to the rates for conventional logging in 2001, I note first that Bear Creek proposed a combined "conventional" rate of $\$43.33/m^3$. Interfor divided its submission between Scotia at \$42.21 and Cedar/Dam/Push/Dump at \$36.95. Once again, that latter proposal constituted a significant change in the relationship between rates.

[252] The history of rates at Scotia disclosed that they advanced over the years from 1992, when it was $\$34.63/m^3$, to 1996 when it was $\$41.19/m^3$. From 1996 through to 1999 it remained at \$41.00. Hence, Bear Creek's combined rate of $\$43.33/m^3$ represented an increase in two years of $\$2.33/m^3$ in Scotia compared with Interfor's proposal of $\$42.21/m^3$, which was $\$1.21/m^3$ above the 1999 rate. I conclude that the combined rate proposed by Bear Creek is within a reasonable range for Scotia.

[253] Interfor's rate for Cedar/Dam was not consistent with its history from 1993, when it was \$35.89, to 1995 when it had advanced to $\$38.48/m^3$. There was no rate history rationale for the reduction from $\$38.48/m^3$ in 1995 to \$36.95 in 2001. Taking into account factors that invite an increase, I conclude that a rate of \$40.00 would not be inconsistent in Cedar/Dam. The relevant factors are those identified by the parties as including labour costs, inflation, fuel prices and similar factors. Over the course of two years, an increase to $\$40.00/m^3$ is well within reach.

**Helicopter Rates - 2000**

[254] As stated previously, in the wake of the Helifor subcontract and the inability of Bear Creek and Helifor to agree on rates, these parties agreed on the following interim rates:

> 1.23 During the course of the proceeding, Interfor agreed that the heli yarding rates for 2000 and 2001 agreed upon between Helifor and Bear Creek would be acceptable to Interfor as a basis of negotiating an overall rate. Those rates were as follows:
>
> 2000
>
> | | |
> |---|---|
> | Surf Heli Lake | \$53.75/$m^3$ on 31,587$m^3$. |
> | Surf Heli Ocean Blocks 6101, 6102 | \$51.70/$m^3$ on 25,766$m^3$. |
> | Surf Heli Ocean Blocks 6102A, 6103, 6105, 6107 and 6108 | \$56.50 on 16,045$m^3$. |
>
> 2001
>
> | | |
> |---|---|
> | Surf Heli Lake | \$54.40/$m^3$ on 55,380$m^3$. |
> | Kumealon Heli Ocean | \$58.60/$m^3$ on 28,945$m^3$. |
>
> Interfor's position is that it will only pay the rates agreed between Bear Creek and Helifor for heli-yarding to the maximum set out above.

[255] In that agreement, Surf Heli-Ocean is divided into two rates having application to different blocks. However, both parties elected in their proposals to propose a single rate for Surf Heli-Ocean. In terms of calculating rates for Surf Heli-Ocean, I propose to use a yarding rate of \$53.60/$m^3$ as reflective of a combined rate for all blocks.

[256] The parties adopted various approaches in fixing helicopter rates, including projections based upon prior rates, being the approach I consider appropriate in the circumstances. That approach was complicated to some extent by issues relating to what Bear Creek characterized as "Surf Heli-Lake Dewatering and Support". See Bear Creek, para. 102 which reads in part as follows:

> There is no prior agreed rate for the Surf Lake dewatering, haul, dump and boom that took place in 2001 with respect to the wood yarded into the lake and scaled in 1999 and 2000, and thus, actual costs are the only basis for setting this dewatering rate. (emphasis added)

[257] Interfor took a different approach to the calculation of rates for those volumes. In its submission it wrote as follows:

> 2.12 Interfor takes a prospective approach to the 2000 surf heli-lake support rate. The logs were water scaled in 2000 and contribute to Interfor's forest licence annual allowable cut for that year. Interfor's 2000 surf heli-lake support rate reflects the work that would have been required in total for that year if the wood had been loaded and hauled etc.

[258] The volume at issue was recorded by Bear Creek in Exhibit 12(1) and Appendix A to its submission and at 35,970m$^3$. It appears to be surplus to the Surf Heli-Lake volumes in 2000 and 2001.

[259] The circumstances surrounding Bear Creek's claim were addressed in the evidence of Mr. Rife as follows:

**Mr. Willms:**

**640 Q This will go a little faster.**

**If you turn to tab one [of Exhibit 12] you have done the same thing here that you did for 2000?**

**A That's correct.**

**641 Q There are two columns for Surf Heli Lake. Can you just explain why there are two columns for Surf Heli Lake?**

**A Yes.**

**Because Bear Creek was paid separately for the 2000 wood – There was wood in the lake at the end of 2000 boomed, and that wood in 2001 was dewatered and processed and eventually dumped into the ocean. And that has a separate costing – that has separate costing attributes than wood you are going the whole stump to dump route on.**

**(Transcript, October 16, 2001, p. 351).**

**[260] Exhibits 12(1) and (6) record the direct and fixed costing relied on by Bear Creek in support of its claim. The calculations were not challenged by Interfor. As I will record later, costing of helicopter logging is less vulnerable to the volume issue than conventional logging. I conclude that Bear Creek has established its entitlement to the dewatering rate claimed.**

**[261] The issue raised with respect to those differing positions relates to support rates. Helicopter rates are made up of yarding costs and support costs. The parties agreed upon interim yarding costs which can be applied in the calculation of rates. Support services can be projected from the prior support rates negotiated between the parties. In its submission, Interfor wrote as follows:**

> 4.4 For land and lake drop helicopter logging, the support rate (for the services provided by Bear Creek) for 1997, 1998 and 1999 was fairly constant at approximately $30.00. For heli-ocean, in 1998, Bear Creek only provided falling services, at an all found rate of $9.25/m^3$.

[262] That summary reflects the fact that there is no rate history between the parties which would assist in distinguishing between support services for land/lake drops and ocean drops. Interfor assumed a difference in its rate proposals when it assigned a support service rate in ocean drops of $15.95/m^3$ in 2000 and $14.97m^3$ in 2001 as compared with a support rate for lake and land drops of $29.55/m^3$ in 2000 and $30.13/m^3$ in 2001.

[263] Turning to the 2000 rates, Bear Creek proposed the same rate of $89.67/m^3$ for Surf Heli-Lake and Surf Heli-Ocean. Bear Creek's approach consisted of taking costs recorded in the statement it sent to Interfor on August 6, 1999 relating to yarding and support services performed in conjunction with the 1999 rep scale in Surf Inlet and dividing them by the volume. The result was a presumed rate of $98.18/m^3$. Bear Creek proposed adjustments which are summarized in para. 196 and which resulted in the rate of $89.67/m^3$ which Bear Creek then proposed for both Surf Heli-Lake and Surf Heli-Ocean.

[264] Interfor agreed in evidence that the invoice presented in the letter of August 6, 1999 was approved for payment for what was described as the "Surf rep scale". See Exhibit 20(A)(34) and Transcript, January 31, 2002, p. 1844, l. 21 to p. 1845, l. 19. That invoicing was addressed in the rate agreement recorded between the parties on August 23, 1999 with the reference under helicopter logging to "Surf Inlet Rep stump-to-lake" and the rate designated, "as per D. Mackay". That rate proposal was accepted by Bear Creek.

[265] For Surf Heli-Lake, Bear Creek's rate is well within what can be projected. The assumption on the basis of the interim rates agreed to by the parties is that the yarding portion would amount to $\$53.75/m^3$. Added to that is a 15% allowance for profit which equals $\$8.06/m^3$ for a combined yarding rate of $\$61.81/m^3$. On the basis of the yarding rate, the rate proposed by Bear Creek would include a support rate of $\$89.67/m^3 - \$61.81/m^3 = \$27.86/m^3$. Based on the rate history, that support rate falls well within the range for support services seen historically in lake drops.

[266] In seeking to project a rate for Surf Heli-Ocean, I commence with the combined yarding rate of $\$53.60/m^3$. An allowance for 15% profit brings the yarding rate up to $\$61.64/m^3$. The support rate and camp barge allowance proposed by Interfor is $\$17.29/m^3$ for a total of $\$78.93/m^3$. If the rate accepted by Interfor in 1999 is applied, allowing for a 15% profit on the $\$51.70/m^3$ yarding rate, it results in a support rate of $\$30.21/m^3$.

[267] Applying the same analysis to Bear Creek's proposal of $\$89.67/m^3$, and assuming a yarding rate plus profit of $\$61.64/m^3$, the support rate equals $\$89.67/m^3 - \$61.64/m^3 = \$28.03/m^3$. If it were to be accepted that support rates for lake/land drops are roughly equivalent to support rates for ocean drops, Bear Creek's proposal triggers an effective support rate of $\$30.21/m^3$. The support rate of $\$28.03/m^3$ calculated by projecting the 1999 rate forward falls comfortably within the range experienced by the parties.

[268] However, as indicated, Interfor places ocean drop support rates substantially below those of lake/land drops. The rate history does not include support rates for ocean drops other than a falling rate of $\$9.25/m^3$ in 1998. Bear Creek, as stated, relied on the 1999 rate agreement with respect to Surf Inlet to support both rate proposals.

**[269] In addition, Bear Creek's rate reconstruction in Exhibit 11(2) fixed support services for Surf Heli-Ocean in 2000 at a slightly higher rate than Surf Heli-Lake. There were difficulties with Bear Creek's costing generally, but helicopter costing was less affected by the volume issue than conventional costing. Hence, the costing of support services for Surf Heli-Ocean in 2000 is a factor to at least consider when simulating a rate that would be acceptable to reasonable parties in the absence of a defined rate history.**

**[270] As a matter of impression, I conclude that ocean drop support rates are generally lower than lake/land drops. That impression is consistent with the expert opinion on helicopter support rates. But that impression is not sufficient to overcome the 1999 helicopter rate agreement and Bear Creek's costing. In the absence of facts inviting a distinction, Bear Creek's proposal is not inconsistent with the helicopter rates agreed to by the parties in 1999 and it is imposed.**

**[271] Turning finally to the helicopter rates for 2001, I note first that Bear Creek's proposal of $97.93/m^3$ for Surf Heli-Lake Land is not consistent with the rate history regarding helicopter logging. Applying the same approach to projecting historical rates, I commence with the interim yarding rate agreed to by the parties at $54.40/m^3$. The profit allowance is $8.16/m^3$ for a total yarding rate of $62.56/m^3$. If the standard support rate of $30/m^3$ is assumed, the resulting rate is $92.56/m^3$.**

**[272] I was not able to find support for the lower rate proposed by Interfor or the higher rate proposed by Bear Creek. The rate arising from a projection from prior rates is $92.56/m^3$. No basis was established for presuming that the parties, acting reasonably, would have negotiated a rate different from the one triggered by historical support rates coupled with the interim yarding rates they agreed to for purposes of having rates fixed in this process.**

**[273]** **The wild card in that analysis is the inclusion of 15 percent profit. As indicated earlier, Interfor strongly opposed an allowance for profit on yarding rates, including an alternative submission that the rate should be something less than 15 percent. Hence, in projecting what reasonable parties would agree to in fixing helicopter rates, there is no basis for concluding that Interfor would agree to a 15 percent profit allowance. However, the question is not whether Interfor would agree, but whether Interfor, acting reasonably in the sense contemplated in the authorities, would be presumed to have agreed. My conclusion on the basis of the relevant facts is that reasonable parties considering the projection of historical helicopter rates to the year 2000 would agree to a helicopter rate of $\$92.56/m^3$ for Surf Heli-Ocean in 2000.**

**[274]** **Turning to Kumealon Heli-Ocean and applying the same analysis, the yarding rate agreed to by the parties was $\$58.60/m^3$ to which I apply the profit calculation of $\$8.79/m^3$ for a total yarding rate of $\$67.39/m^3$. Adding a support rate of $30 would bring the rate to $\$97.39/m^3$. Bear Creek has proposed a rate of $\$91.88/m^3$. Once again, absent a history of support rates for ocean drops, Bear Creek's costing and the 1999 rate agreement are an indication of the actual support costs incurred. Those costs, coupled with the interim costs of yarding agreed to, support Bear Creek's claim of $\$91.88/m^3$.**

**[275]** **On the basis of the reasoning set out in the Award, the following rates are imposed:**

**(a) 2000**

| | |
|---|---|
| **Kumealon** | **$\$45.89/m^3$** |
| **Chapple** | **$\$44.90/m^3$** |
| **Surf Heli-Lake** | **$\$89.67/m^3$** |
| **Surf Heli-Ocean** | **$\$89.67/m^3$** |

**(b) 2001**

| | |
|---|---|
| **Scotia** | **$42.21/m$^3$** |
| **Cedar/Dam** | **$40.00/m$^3$** |
| **Surf Heli-Lake Land** | **$92.56/m$^3$** |
| **Kumealon Heli-Ocean** | **$91.88/m$^3$** |
| **Dewatering** | **$15.23/m$^3$** |

**(c) Bridging Amount $300,000**

**[276] Those rates, of necessity, are rough-hewn. There is no reliable basis for refining them. The process involves assumptions with respect to the projection of previous rates and their adaptation to circumstances in 2000 and 2001. The accuracy of those assumptions is subject to question. However, the evidence invites the view that the parties took a similar broad-based approach to the calculation of rates.**

**[277] A review of Bear Creek's submission in paras. 206 to 233 demonstrates that its principal assumption is that global changes in the factors identified in para. 231 can be expected to translate into higher rates. That assumption can be challenged on the rate history itself where some rates remained stable even though it can be expected that the factors identified by Bear Creek would have invited an increase.**

**[278] Both parties demonstrated that rates, quite properly, could be manipulated up or down on the basis of assumptions that arise in an examination of the evidence which, itself, included significant assumptions in Bear Creek's cost reconstruction and Interfor's body of expert opinion. However, the assumption underlining the s. 25 process is that parties, barring evidence to the contrary, can be expected to project future rates on the basis of past rates. Here the broad brush approach to projecting past rates forward is consistent with the equally broad brush approach that arises by implication from the evidence with**

respect to past rates negotiated freely by the parties. Within the limitations of the evidence, that is the approach I took in addressing the rate disputes.

[279] On the question of interests and costs, I adopt the proposal of Bear Creek at para. 294 of its submission.

## Conclusion

[280] The dispute generated a highly complex process that evolved over a period commencing on November 23, 2000 and ending with oral submissions which were completed on March 1, 2002. Brief written submissions were exchanged in July and August of 2002 on the newly published Award of Arbitrator Borowicz.

[281] Between preliminary proceedings on March 10, 2001 and the presentation of argument in March of 2002, the hearing occupied 18 days. Evidence viva voce was given by 25 witnesses, many of whom gave expert evidence supported by detailed reports. Documentary evidence was presented in 126 exhibits, a significant number of which contained multiple documents. Detailed written submissions were augmented in oral argument.

[282] Deliberations have been overlong. They involved a painstaking review of labyrinthine evidence and submissions which was necessitated in large part by the problems associated with the interpretation issue and its impact upon Bear Creek. I speculate on the facts that Bear Creek failed over the five years of the Contract to achieve the goal expressed in s. 25(1)(b) of earning a reasonable profit in operations where it saw itself as required to maintain the capacity to log to the full AARC of 219,708m$^3$ but was limited in its recovery to increasingly lesser volumes. I express that conclusion as being speculative because no evidence was adduced with respect to Bear Creek's financial performance over

those years and, in any event, such evidence may or may not have been relevant to the issues in dispute.

[283] In that same posture of speculation, I did not conclude that Interfor profited from the contractual arrangement at the expense of Bear Creek. There was sufficient evidence introduced to support the conclusion that Interfor, as with the industry generally, was experiencing difficult times. See Interfor, para. 10.2 and Exhibits 21(F)(2) and (10).

[284] My observation with respect to Bear Creek's apparent financial plight is simply to offer some explanation to account for extremely protracted deliberations which, in the final analysis, served only to confirm that the dispute would not yield to a more refined balancing of the interests of the parties.

[285] In that vein, it is convenient to observe that this Award does not fully reflect the detailed review of the evidence and submissions necessitated by the hard positions taken by the parties and the complexity of the issues raised. Early drafts incorporated a detailed review of various of the issues raised by the parties which served only to make a cumbersome and overlong Award longer and more cumbersome. Included in that review was the cost reconstruction undertaken by Bear Creek and the numerous expert reports and viva voce evidence adduced by Interfor. In the final analysis, I sought to confine the Award to conclusions with respect to what I considered to be the issues that had to be addressed in order to resolve the dispute.

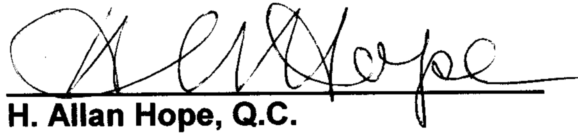
[286] An illustration of the distinction can be found with respect to the "volumes not paid" issue raised by Bear Creek at para. 289 of its submission. That issue involved an extensive review of the evidence which was detailed in initial drafts of the Award and then deleted on the basis that it was not necessary in order to express a conclusion with respect to Bear Creek's claim.

[287] A similar pattern occurred with respect to the complex facts relating to the relationship between costs, rates and volumes in the costing processes undertaken by the parties. It is trite to observe that a rate is made up of costs and profits divided by volume. Initially I undertook a detailed examination of the figures expressed by the parties in the phase and area costing. Almost invariably, the evidence expressed costs, including phase costs, as a unit calculated in the context of a particular volume. In early drafts I recorded an analysis of the interaction of those components, but then deleted it when I concluded that the absence of a volume relationship in the historical rates, and the absence of a contract volume, made it unnecessary to make or record findings on those hotly disputed facts.

[288] In a similar vein, I noted, quite apart from the "volumes not paid" issue, that there were somewhat different figures given for various volumes, including actual volumes for the years in question and volumes employed in the calculation of phase and area costs. Once again, after noting and recording those differences in the Award, I concluded that the analysis was unnecessary because no issue was raised that required resolution in order to resolve the dispute.

[289] These concluding comments are made by way of assurance to the parties that I recognized their entitlement to have every issue addressed and considered. That requirement was particularly important in this dispute. My observations are by way of assurance that all issues raised in their submissions and in the evidence, and all of the authorities upon which they relied, were addressed in detail in deliberations. However, in preparing the final Award, I limited the reasoning and conclusions to those issues I deemed necessary to address and resolve the dispute.

**DATED at Prince George, British Columbia, this 21st day of December, 2002.**



**H. Allan Hope, Q.C.**
**Arbitrator**

# APPENDIX I

## RATE PROPOSALS

### Bear Creek

**October, 2001**

**2000 Rates**

| | |
|---|---|
| Kumealon | $73.39/m^3$ |
| Chappel | $70.85/m^3$ |
| Surf Heli-Lake | $87.88/m^3$ |
| Surf Heli-Ocean | $89.58/m^3$ |

**2001 Rates**

| | |
|---|---|
| Surf Heli-Lake | $98.33/m^3$ |
| Surf Dam Creek | $39.13/m^3$ |
| Surf Cedar Creek | $41.30/m^3$ |
| Kumealon Heli-Ocean | $90.68/m^3$ |
| Scotia | $43.35/m^3$ |
| Surf Heli-Lake Dewatering and Support | $15.44/m^3$ |

**February, 2002**

Bear Creek requests the following rate for **2000 logging** (subject to reduction if overhead, depreciation and repair and maintenance costs are awarded under the Shortfall Claim rather than in the logging rates): (emphasis added)

| | | |
|---|---|---|
| (a) | Surf-Heli Lake | $89.67/m^3$ |
| (b) | Surf-Heli Ocean | $89.67/m^3$ |

(c) Kumealon Conventional $73.30/m³(+$2.50/m³ for export)

(d) Chappel Conventional $70.75/m³(+$2.50/m³ for export)

(e) Surf-Heli Lake Dewatering (performed in 2001) $15.23/m³

Bear Creek requests the following rates for **2001 logging**:

(a) Surf-Heli Lake Land $97.93/m³

(b) Conventional $43.33/m³(+$2.50/m³ for export)

(c) Kumealon Heli-Ocean $91.88/m³

Bear Creek requests an award in the amount of $2,004, 181 for the shortfall in the cut to which it was contractually entitled.

## Interfor

**October, 2001**

| 2000 | Rate | Camp Barge | Fuel Adjustment | Total |
|---|---|---|---|---|
| Kumealon Conventional DLS | 43.95 | 1.34 | .60 | 45.89 |
| Chapple Conventional DLS | 40.45 | 1.34 | .60 | 42.39 |

| 2000 | Heli Yard | Support | Camp Barge | Fuel Adjustment | Total |
|---|---|---|---|---|---|
| Surf Heli Lake | 53.75 | 29.55 | 1.34 | .45 | 85.09 |
| Surf Heli Ocean | 53.54 | 15.18 | | | 68.72 |

| 2001 | Rate | Camp Barge | Fuel Adjustment | Total |
|---|---|---|---|---|
| Scotia Conventional DLS | 41.61 | | .60 | 42.21 |
| Cedar/Dam Push Dump | 35.11 | 1.34 | .50 | 36.95 |

| 2001 | Heli Yard | Support | Camp Barge | Fuel Adjustment | Total |
|---|---|---|---|---|---|
| Surf Heli Lake DLS | 54.40 | 30.13 | 1.34 | .45 | 86.32 |
| Kumealon Heil Ocean | 58.60 | 13.74 | | | 72.34 |

**BRIDGING AMOUNT: $600,000**

## February, 2002

| 2000 | Rate | Camp Barge | Fuel Adjustment | Total | $m^3$ |
|---|---|---|---|---|---|
| Kumealon Conventional DLS | 43.95 | 1.34 | .60 | 45.89 | 19,962 |
| Chapple Conventional DLS | 40.45 | 1.34 | .60 | 42.39 | 24,038 |

| 2000 | Heli Yard | Support | Camp Barge | Fuel Adjustment | Total | $m^3$ |
|---|---|---|---|---|---|---|
| Surf Heli Lake | 53.75 | 29.55 | 1.34 | .45 | 85.09 | 31,587 |
| Surf Heli Ocean | 53.54 | 15.95 | 1.34 | | 70.83 | 41,811 |

| 2001 | Rate | Camp Barge | Fuel Adjustment | Total | $m^3$ |
|---|---|---|---|---|---|
| Scotia Conventional DLS | 41.61 | | .60 | 42.21 | 56,022 |
| Cedar/Dam Push Dump | 35.11 | 1.34 | .50 | 36.95 | 69,477 |

| 2001 | Heli Yard | Support | Camp Barge | Fuel Adjustment | Total | $m^3$ |
|---|---|---|---|---|---|---|
| Surf Heli Lake DLS | 54.40 | 30.13 | 1.34 | .45 | 86.32 | 55,380 |
| Kumealon Heil Ocean | 58.60 | 14.97 | 1.15 | | 74.72 | 28,945 |

**BRIDGING AMOUNT: $300,000**

**APPENDIX II**

# In the Matter of an Arbitration under the *Timber Harvesting Contract and Subcontract Regulation*, BC Reg. 22/96

**Between:**

**International Forest Products Limited**

**("Interfor")**

**And:**

**Bear Creek Contracting Limited**

**("Bear Creek")**

## Supplemental Submission of Interfor

1. On July 17, 2002, Arbitrator Borowicz issued his decision in an arbitration between Western Forest Products Limited ("Western") and Hayes Forest Services Limited ("Hayes").

2. This award is relevant to the dispute between Interfor and Bear Creek with respect to liability for an alleged shortfall.

## The Western and Hayes Decision

3. The dispute between Western and Hayes concerned logging in 1996. In a rate dispute before Arbitrator Wallace, Hayes contended that Western had prevented it from logging the volume it was entitled to under the Contract and claimed an increment to the rate for logging in 1996 as compensation for the "shortfall".

Arbitrator Wallace rejected the claim for a rate increment, which was upheld on appeal to the Supreme Court and Court of Appeal.

4. Hayes then initiated a second dispute claiming damages for an alleged shortfall. This dispute was heard before Arbitrator Borowicz on the basis of the transcripts and exhibits from the first arbitration.

5. In that case, the Contract, which had been negotiated prior to the Regulation coming into force, provided for an "estimated average annual volume". Hayes argued that it was entitled to damages because it had actually harvested a volume less than the estimated volume for 1996. Western denied that it was obligated to provide a specific annual volume. It also relied upon sections 21 and 22 of the Regulation, as well as the contractual force majeure.

6. In the course of his reasons, Arbitrator Borowicz described the part of the Regulation that addresses amount of work (at pp. 9 – 10) and explained that the Regulation requires the Contract to specify an amount of work "expressed as a percentage of the total amount of timber processed by the licence holder in that year", unless the parties agree to specify the amount in a different manner: paras 33 - 34.

7. Arbitrator Borowicz discussed the absence of certainty in the volumes harvested each year. He opined that (at para 68):

> Indeed, there are many contingencies in the forest industry that tend to defy accurate prediction, and that affect the operations and profits of both licence holders and Contractors.

8. In that case, the evidence established that during 1996 the volume of logging was impacted by many factors including: the timing of receiving permits from the government; weather; and the allocation of blocks as between contractors and company crews.

9. In the result, the Arbitrator found that Western was not liable to Hayes for any compensation for the shortfall (if any), because of circumstances substantially

outside the control of Western and otherwise attributable to bona fide business and operational reasons. Accordingly, any shortfall was within the variation permitted by sections 21 and 22 of the Regulation.

## Bear Creek's Shortfall Claim

10. Bear Creek seeks compensation for an alleged shortfall. This claim rests on an interpretation of the contractual language concerning amount of work.

11. In summary, Bear Creek says that the amount of work language obliges Interfor to harvest the AAC volume in each year. Interfor says that the language entitles Bear Creek to 100% of the work in Licence in each year, but that there is no specific annual volume.

12. As illustrated in the Western and Hayes case, there are innumerable factors which can affect the ability of a licence holder to provide a specified volume of work in any year. Herein, the evidence also showed that Interfor was impacted by many factors including, *inter alia*, the weather, matters involving first nations, government approvals of permits and plans, and depressed markets.

13. The Regulation reflects the flexibility needed by a licence holder to respond to these (and other) factors in the amount of work provisions.

14. The Regulation prescribes that the amount of work, unless specifically otherwise agreed by the parties, must be described as a percentage of the total volume harvested in the licence. This specification of work as a percentage necessarily leaves to the licence holder the discretion to determine the amount of work harvested in each year.

15. In addition to the flexibility in determining the amount of work to be harvested from the licence in any given year, the Regulation provides relief to the licence holder if it varies from the proportion assigned to the contractor in any given year through sections 21 and 22 of the Regulation.

16. Clear contractual language would be required to vary from the underlying policy in the Regulation which provides flexibility to the licence holder to determine the annual volume harvested. It would be an exceptional circumstance to have a fixed volume contract under the Regulation.

17. Interfor maintains that the language of the Contract is clear and that the volume of work which is allocated to Bear Creek in any year is not tied to the AAC. Such an interpretation is also consistent with the practicalities of the industry that were identified and illustrated in the Western decision and in the evidence in this case, and that are reflected in the Regulation.

18. In summary, the Western and Hayes case provides a useful illustration and discussion of both the factors that impact in a very practical way the volumes of timber that are harvested and the associated principles and policy underlying the amount of work provisions in the Regulation.

All of which is respectfully submitted.

____________________________________

Eric J. Harris
Counsel for Interfor

Dated: July 30, 2002

**IN AN ARBITRATION**

**BETWEEN**

**INTERNATIONAL FOREST PRODUCTS LIMITED**

**-AND-**

**BEAR CREEK CONTRACTING LIMITED**

**AND CONCERNING THE**
***TIMBER HARVESTING CONTRACT AND SUBCONTRACT REGULATION,***
**B.C. REG. 22/96**

**AND CONCERNING THE**
***COMMERCIAL ARBITRATION ACT, R.S.B.C. 1996, C.55, S.7***

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# SUPPLEMENTAL SUBMISSIONS OF BEAR CREEK CONTRACTING LIMITED

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Fasken Martineau DuMoulin LLP
Barristers and Solicitors
2100 - 1075 West Georgia Street
Vancouver, British Columbia V6E 3G2
Phone: 631-3131
Fax: 631-3232
COUNSEL FOR BEAR CREEK
CONTRACTING LIMITED

CHARLES F. WILLMS
BROOK GREENBERG

Harris & Company
Barristers and Solicitors
2200 - 1111 West Georgia Street
Vancouver, British Columbia V6E 4M3
Phone: 684-6633
Fax: 684-6632
COUNSEL FOR INTERNATIONAL
FOREST PRODUCTS LIMITED

ERIC J. HARRIS, Q.C.
JENNIFER A. LAMONT

## I. INTRODUCTION

1. Bear Creek Contracting Limited ("Bear Creek") agrees that the recent decision in *Hayes Forest Services Limited v. Western Forest Products Limited* is a useful illustration of the proper approach to a claim for shortfall in volume assigned.

## II. THE AWARD

2. The analytical approach to liability for a volume shortfall which Arbitrator Borowicz applied at p. 18 of his award (the "Award") is the same as that found in Bear Creek's principal Submissions in this matter:

   (a) is there a shortfall in the contractual volume in the year in question (Award, paragraph 60);

   (b) is the shortfall the result of bona fide business and operational reasons, if not s. 21 of the Regulation does not assist the licensee (Award, paragraph 62); and

   (c) did the licensee provide at least 95% of the volume over five years, if not s. 21 of the Regulation does not assist the licensee.

3. Significantly, Arbitrator Borowicz held that there is a general duty on a licensee to deliver to the contractor the agreed amount of work under the contract:

> Put positively, the general law recognizes the natural expectation of the parties to a logging contract, implicit in the language of the Contract and Section 22 of the Regulation, that licence holders have a duty not to act in a manner that would deprive contractors of the agreed amount of work, and contractors have a duty not to act in a manner that would prevent them from delivering the agreed amount of work. (emphasis added)
>
> (at p. 22, para. 77)

4. In *Hayes v. Western,* the amount of work Arbitrator Borowicz held that the licensee was obligated to provide was a fixed volume rather than a percentage of the work based on his finding of an implied agreement between the Parties arising out of their conduct. Such an agreement, Arbitrator Borowicz found was permitted under s. 18(8) of the Regulation. (Award, at pp. 17-18) In any event, the Arbitrator certainly did not find that with the introduction of the Regulation and the requirement to express the amount of work as a percentage, that the licensee had been granted full discretion to assign any amount of work it wished in a given year or over the five year cut control period.

5. With respect to the application of s. 21 of the Regulation, the Arbitrator held at p. 19, paragraph 65, that s. 21 had effectively limited the permissible variation in the amount of work a licensee assigns to a contractor:

> Section 21 of the 1996 Regulation incorporated a 5% cap on the amount of variation from the amount of work specified in a contract for bona fide business and operational reasons over a five year period. That may well have been a codification of a shortfall amount acceptable to the industry and reflective of the desire of stakeholders for a balance of fairness and certainty in their contractual relationships.
>
> (emphasis added)

6. In the footnote to this paragraph the Arbitrator noted:

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

7. Arbitrator Borowicz recognized that the provisions of the Regulation were intended to introduce a measure of certainty to the harvest volume, while still

providing some level of flexibility in the annual harvest. The Arbitrator's conclusions with respect to the application of the volume requirements and s. 21 and 22 of the Regulation are on all fours with the approach set out in paragraph 47 of Bear Creek's principal submissions in which Bear Creek submitted:

> 47. The Contract and Regulation both clearly provide some flexibility for a licensee in complying with the Amount of Work Requirements. However, to obtain this relief, a licensee must:
>
> (a) show a bona fide business and operational reason for the shortfall in a given year; and
>
> (b) provide 95% of the aggregate work over five years.

8. Arbitrator Borowicz held that there was some flexibility in the volumes assigned, but that the allowable variation in volume over five years had been "capped" at 5%.

9. The Arbitrator then reviewed the detailed evidence with respect to the availability of cut blocks to provide sufficient volume to satisfy the contract requirements. At p. 30 the Arbitrator held:

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

> It seems to me there is little else Western could reasonably have been expected to do to give Hayes alternate cut blocks.

10. At p. 31, the Arbitrator concluded:

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

11. Arbitrator Borowicz held that there is an obligation on a licensee not to do anything which deprives the contractor of its full volume entitlement. That obligation is tempered by s. 21, which allows a licensee to assign a lesser volume in a given year, provided that it has a bona fide reason for doings so <u>and</u> assigns 95% of the volume over the five year cut period.

## III. APPLICATION TO THE CASE AT HAND

12. Bear Creek submits that the approach applied by Arbitrator Borowicz ought to be adopted in the case at hand.

13. In paragraphs 26 to 42 of its principal submission, Bear Creek reviewed the evidence of the parties with respect to the volume entitlement under the contract. Both Bear Creek and Interfor treated the volume of work in terms of the annual allowable cut for the Forest Licence. The evidence established that the parties agreed that Bear Creek would be entitled to 100% of the AAC, not 100% of whatever Interfor decided to cut.

14. As in the *Hayes v. Western* case, there was a clear shortfall in the amount of work assigned to Bear Creek.

15. Over the five year period Interfor assigned only 889,948 $m^3$ of the 1,098,540 $m^3$ aggregate AAC (81%), including an assignment of only 120,807.4 $m^3$ of the 219,708 $m^3$ AAC in 2000.

16. As submitted in paragraphs 48 and 49 of Bear Creek's principal submission, Interfor has provided no evidence whatsoever of a bona fide business and operational reason which caused the shortfall. Moreover, Interfor refused to disclose the documents requested which would have been the best evidence of such a reason, and would have allowed Bear Creek to cross-examine the Interfor witnesses with respect to the bona fides of the alleged reasons for the shortfall.

17. Furthermore, as submitted previously, Interfor failed to provide 95% of the volume required over the 5 year period in any event, and therefore, it does not fall within the provisions of s. 21 which would provide relief from liability.

## IV. REPLY TO INTERFOR SUBMISSIONS

18. Bear Creek makes the following submissions in specific reply to the supplemental submissions of Interfor (all paragraph references are to Interfor's Supplemental Submissions unless stated otherwise).

19. In reply to Paragraph 6, Arbitrator Borowicz referred to the requirement that the amount of work be expressed as a percentage, but also examined the parties' conduct and expectations and concluded that both parties had treated the contractual volume as an estimated annual volume. This was sufficient to find the parties had agreed to that volume of work pursuant to s. 18(8) of the Regulation. In the case at hand, the evidence is clear that both Bear Creek and Interfor agreed their contract volume was an expression of percentage of the annual allowable cut. (See Bear Creek Principal Submissions paragraphs 26-42)

20. In reply to Paragraph 7, Arbitrator Borowicz's discussion of uncertainty with respect to volumes was in respect of the volumes in any given year, not over the five year period. The Arbitrator held that s. 21, which may excuse a licensee from a shortfall in a given year provided there is a bona fide reason and provided that the contractor receives 95% of the work over five years, was intended to strike a balance between the need for flexibility and certainty in their contractual relationships. The Arbitrator described s. 21 as incorporating "a 5% cap on the amount of variation from the amount of work specified in a contract for bona fide business and operational reasons over a five year period." (See *Hayes v. Western* Award Paragraph 65)

21. In reply to Paragraph 8, Bear Creek agrees that in *Hayes v. Western* it appears the licensee disclosed a great deal of evidence as to the factors which made volume unavailable to assign to the contractor, as well as a great deal of evidence as to the licensee's attempts to remedy the shortfall. Evidence of either the reason for the shortfall or Interfor's attempts to fulfill its obligation to provide the work to Bear Creek, is entirely lacking here.

22. In reply to Paragraph 12, the fact that Western disclosed documents and led significant evidence of the reason for the shortfall stands in stark contrast to Interfor's evidence in this case. Interfor's failure to disclose documents or lead evidence of a bona fide business and operational reason for the shortfall, or of Interfor's efforts to ensure Bear Creek was assigned sufficient work should give rise to a negative inference against Interfor that there was no such bona fide business and operational reason for the shortfall, nor any effort to prevent it.

23. In reply to Paragraph 13, the Regulation provides the flexibility needed by a licence holder, but only where that flexibility is <u>genuinely</u> required for bona fide business and operational reasons. Moreover, the licensee's need for flexibility is balanced against that its obligation to provide a consistent volume of work over time.

24. In reply to Paragraph 17, Arbitrator Borowicz did not find that the volume of work allocated to the contractor was divorced from the annual cut requirements. To the contrary, he concluded it was no coincidence that the five year period reflected in Section 21 is the also the cut control period for the licence.

## V. CONCLUSION

25. Bear Creek submits that the decision of Arbitrator Borowicz is entirely supportive of the approach set out in its principal submissions. The decision in *Hayes v. Western* reinforces Bear Creek's submission with respect to entitlement to damages for the shortfall in volume over the five year period at issue in these proceedings.

RESPECTFULLY SUBMITTED,

Charles F. Willms

July 31, 2002