

IN THE MATTER OF THE *FOREST ACT*, R.S.B.C. 1979, C. 140, AS AMENDED;  
IN THE MATTER OF THE TIMBER HARVESTING CONTRACT AND  
SUBCONTRACT REGULATION, B.C. REG. 22/96; AS AMENDED; AND IN THE  
MATTER OF A DISPUTE

BETWEEN:

**GORMAC DEVELOPMENTS LTD.**

CLAIMANT

AND:

**J.S. JONES HOLDING LTD., J.S. JONES TIMBER LTD.,  
TEAL CEDAR PRODUCTS LTD.**

RESPONDENTS

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**AMOUNT OF WORK SHORTFALL AWARD**

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SOLE ARBITRATOR:

Paul J. Pearlman, Q.C.

DATE OF AWARD:

November 25, 2002

COUNSEL FOR GORMAC  
DEVELOPMENTS LTD.:

Mr. Stephen R. Ross  
Miller Thomson LLP

COUNSEL FOR TEAL CEDAR  
PRODUCTS LTD.:

Mr. Peter G. Voith  
Hunter Voith Litigation Counsel

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**AMOUNT OF WORK SHORTFALL AWARD**

1. This is a dispute under the *Timber Harvesting Contract and Subcontract Regulation, BC Reg 22/96* (the *Regulation*). The central issue in this case is whether, in 2002, when the licence holder reduced the amount of new road construction work it was otherwise obliged to allocate to the holder of a replaceable contract, it did so for bona fide business and operational reasons within the meaning of s. 21 of the *Regulation*.

2. Throughout this award, I refer to the Respondents collectively as Teal Cedar Products Ltd., or Teal.

**BACKGROUND**

3. The following facts are not in dispute between the parties:

- a. Gormac Developments Ltd. (Gormac) is the holder of a road construction agreement with Teal, which is a replaceable contract under the *Regulation*. Teal holds Forest Licence A19201, in the Fraser

Timber Supply Area (TSA) and is the successor to the previous holder of that replaceable forest licence, Fletcher Challenge Canada Limited.

- b. In 1993, Gormac acquired its replaceable road construction contract by assignment of an agreement originally made between Fletcher Challenge Canada Limited and Interline Construction Ltd. dated April 7, 1992 (Exhibit 1, Tab 1). That contract did not contain an amount of work provision.
- c. However, Gormac's amount of work entitlement was determined as a consequence of the award of Arbitrator Alvarez in *Fraser Canyon Transport Ltd. v. Fletcher Challenge Canada Limited* dated May 30, 1995. At that time, there were two holders of replaceable contracts for road construction work in the Fraser TSA pertaining to FL A19201, namely Gormac and Fraser Canyon Transport Ltd. Arbitrator Alvarez found that Fraser Canyon Transport Ltd. was entitled to construct up to 49% of the new road built for Fletcher Challenge Canada Limited under FL A19201. As a result, Gormac, had an entitlement to the remaining 51% of the new road construction work.
- d. In 1997, Teal purchased Fraser Canyon Transport Ltd.'s replaceable contract. Since then, it has put that work up for bid, and has had the work performed by various road construction contractors who do not have replaceable contracts.
- e. For the purposes of this arbitration, the quality of Gormac's road construction work is not in dispute.
- f. Similarly, for the purposes of this arbitration, the parties agree that Gormac's replaceable contract entitles it to 51% of all new road construction work which Teal requires in relation to its Boston Bar logging operations in the Fraser TSA under FL A19201. Pursuant to its

replaceable contract, Gormac has performed road construction work for Teal at West Harrison, Tipella Creek and Boston Bar, all of which are part of Teal's Boston Bar logging division.

- g. Although Gormac also claims to be entitled to an allocation of 51% of the reconstruction and rehabilitation of roads and landings done each year in the licence area, the parties have agreed to restrict this hearing to new road construction work, and to defer any dispute with respect to rehabilitation and reconstruction work to a later date.
- h. In 2002, Teal allocated to Gormac 3,440 metres out of a total of 21,949 metres of new road construction work in the licence area. Thus, this year, Gormac has performed only 15.67% of the new road construction work, while the remaining 84.33% of the work was allocated by Teal to other road builders, who do not hold replaceable contracts, through a competitive bidding process.

4. By agreement of the parties, this arbitration award deals with the question of whether Teal is liable to Gormac for an amount of work shortfall for 2002. The parties have agreed that the assessment of any damages suffered by Gormac will be the subject of a further arbitration hearing, if liability is established.

5. There is also a rate dispute with respect to work performed by Gormac for Teal in 2001. That dispute will also be the subject of a separate hearing. During the course of this hearing, I heard some evidence, from both parties, concerning the circumstances giving rise to the rate dispute, and the impact of Teal's failure to pay all of the invoices rendered by Gormac for road construction work performed in 2001 on Gormac's financial position. However, it is neither necessary, nor prudent, where I have heard only a very small part of the evidence relating to the rate dispute, to make any findings with respect to the merits of that dispute in order to resolve the 2002 amount of work dispute, and I decline to do so.

6. This dispute arises at a time when the forest industry in British Columbia, particularly in the coastal area, is depressed. Brian Taylor, the logging manager for Teal's Boston Bar logging operation, gave evidence, by reference to Exhibit 2, Tab 24, about the decline in the volume of timber harvested in 2000-2002. In 2000, Teal's Boston Bar logging operation harvested 238,113 m<sup>3</sup> from the Fraser TSA. In 2001, that volume had fallen to 111,746 m<sup>3</sup>. To August 31, 2002, the most recent date for which Teal had figures available, the volume harvested was only 76,961 m<sup>3</sup>. Mr. Taylor expected that Teal would harvest a total of approximately 140,000 m<sup>3</sup> from the Fraser TSA this year. All of these figures are exclusive of the company operation at Pitt Lake. Mr. Taylor anticipated that the company would meet the 50% minimum annual cut control requirement under FL 19201, and pointed out that 2002 was the first year of the current five year cut control period. Teal has four years to make up the shortfall.

7. Notwithstanding the decline in volumes of timber harvested in recent years, over the previous 1997-2001 five year cut control period, Teal did allocate to Gormac sufficient work to substantially satisfy its 51% entitlement over that five year cut control period. I reproduce below Exhibit 2, Tab 4A, a table prepared by Teal and showing for each year the total amount of new road constructed, in lineal metres, 51% of that amount, and the amount actually allocated to Gormac and constructed by it in each year.

<u>YEAR</u>	<u>FRASER TOTAL</u>	<u>FRASER 51%</u>	<u>GORMAC TOTAL</u>
1997	40,250	20,528	18,998
1998	44,686	22,790	19,463
1999	40,865	20,841	19,594
2000	12,152	6,198	4,269
2001	14,408	7,348	11,191
<b>5 year total:</b>	<b>152,361</b>	<b>77,704</b>	<b>73,515</b>

<b>Entitlement</b>	95% x 77,074	=	73,819
<b>Total Built by Gormac</b>		=	<u>73,515</u>
	<b>Shortfall</b>	=	<b>304</b>

8. As is apparent from the table, in 2001, Teal was able to allocate sufficient new road construction to Teal to substantially make up the previous shortfall.

### **Positions of the Parties**

9. Gormac maintains that Teal's failure to allocate to it 51% of the new road construction work for 2002 is not attributable to bona fide business and operational reasons. The Claimant asserts that Teal breached its contractual and statutory obligations under the *Regulation* by putting all of the new road construction work out for tender through a competitive bidding process, by insisting that Gormac perform work at prices which matched or were very close to the lowest two or three bids which Teal obtained from non-replaceable contractors, without regard to Gormac's productivities and efficiencies, and by insisting, as a condition for the allocation of road construction work, that Gormac agree to a price before the work commenced, and waive its right to arbitrate the rate.

10. According to Gormac, the only new road construction work which Teal allocated to it in 2002 under its replaceable road construction contract consisted of 1.08k in Block CC-3, and an additional 2.36k in Block B100 Upper Spurs. Teal allocated the latter work after Gormac had given notice of its intention to take the amount of work dispute to arbitration. Gormac complains that while Teal initially invited it to bid on the full 3.36k of new road construction work on Block B100 Upper Spurs, it subsequently advised Gormac that one kilometre of that work was to be assigned to another road builder, Darwin Friesen, in order to enable him to repay a debt he owed to one of the principals of Teal.

11. Gormac also asserts that in March 2002, Teal offered Gormac roadwork in Block WH-8, and set a price of \$36,000.00 for the work. The Claimant says that

when it agreed to \$36,000.00 as a provisional rate, subject to its right to arbitrate, Teal refused to allocate the work unless Gormac agreed not to arbitrate the rate. Teal took the position that it was not prepared to live with the uncertainty of an interim rate.

12. Mr. Gordon McDonald, the principal of Gormac, testified that Brian Taylor of Teal told him, in or about August 2002, that the reason why Teal was reluctant to give any work to Gormac was because of the rate dispute arbitration then pending in September. Mr. Taylor did not recall making that comment. He testified that during a meeting with Mr. McDonald at Teal's Boston Bar office, both he and Mr. McDonald acknowledged that the rate arbitration was causing some tension between them, and that both parties left the meeting with an understanding that they would deal with each in a forthright manner, despite the rate dispute.

13. Gormac says that Teal has failed to demonstrate that the financial losses it suffered in its Boston Bar logging division constitute a bona fide business reason justifying the reduced allocation of work in 2002. The Claimant submits that the refusal of Teal, a private company, to disclose its financial statements for its consolidated operations should result in no weight being given to its claim that it is currently in a financial "survival mode".

14. For its part, Teal relies on s. 21 of the *Regulation* to maintain that it is entitled to vary the amount of work it provides to Gormac from the 51% entitlement in any given year, provided that over the five year cut control period, it allocates, in aggregate, at least 95% of Gormac's entitlement for the five years.

15. Hanif Karmally, the Chief Financial Officer for Teal, described the operations of the Teal Group, and its recently adopted financial policies. He testified that Teal has seven business segments, three in logging and four in manufacturing. The three logging operations are Boston Bar, Pitt Lake, a company operation, and Sandspit, in the Queen Charlottes. The company's four manufacturing divisions include Boston Bar Sawmill, which is currently shut down, the Stag Timber Mill at Surrey, which

focuses on the Japanese market, Teal Shake & Shingle, and Inland Cedar, located at Salmon Arm.

16. The Boston Bar logging operations make up slightly less than 20% of Teal's revenues.

17. Teal currently operates on the basis that each operation has to stand alone, and has to break even. According to Mr. Karmally, each business segment is evaluated as a separate entity. That philosophy has been in place since the beginning of 2001. Mr. Karmally testified that because of the depressed state of the forest industry, one operation cannot cross subsidize another. Teal shut down its largest sawmill, at Boston Bar, because, on a stand alone basis, it could not break even. That mill had operated on a single shift through 2001, and was shut down in December of that year.

18. The Boston Bar logging operation, since the closure of the mill, has had to operate as a market logger.

19. Mr. Karmally testified that Teal's markets have continuously deteriorated over the past three years.

20. With respect to the Boston Bar logging operation, Mr. Taylor described the various cost saving measures that Teal implemented in 2001, and continued in 2002, including reduction of management professional staff by almost half, the consolidation of office space, reducing the level of cut, and focusing on logging operations on the best timber in the easiest harvesting terrain.

21. In 2002, Teal implemented a requirement that all rates or prices had to be established and fixed before any work could commence. It applied this policy on a block by block basis. Teal called for competitive bids on all of its road construction work. Whereas in the past, Teal and Gormac had negotiated rates either while the work was under way, or, frequently, after it was completed, Teal was no longer



prepared to follow that practice. Teal maintains that for most of the new road construction performed in 2002, it gave Gormac the opportunity to bid for the work, subject to two conditions:

- a. that the parties agree upon rates before Gormac commenced the work;  
and
- b. that Gormac offer rates comparable to those Teal could otherwise obtain from non-replaceable contractors in the market place.

22. Teal says that, in most cases, Gormac failed to provide Teal with a rate, and that although Teal provided Gormac with the opportunity to negotiate a rate, Gormac did not avail itself of that opportunity. The licence holder maintains that when Gormac did submit rates, they were frequently substantially higher than those which Teal could obtain through the competitive bidding process (Exhibit 2, Tab 10).

23. Teal says that when Gormac did offer rates that were comparable to bids it had received from non-replaceable contractors for the same work, it allocated the work to Gormac. That, according to Teal, was the case with respect to Block CC-3 and the Block B100 Upper Spurs.

24. In short, Teal maintains that it was entitled to adopt financial policies it implemented in 2001 and 2002 in furtherance of its own financial survival, and that it has the contractual right, by virtue of s. 21 of the *Regulation*, to vary the amount of work it provides to Gormac from the 51% entitlement so long as it does so for bona fide business and operational reasons and so long as it makes up the difference over the course of the current five year cut control period.

### **THE REGULATION**

25. The critical issue arising on this arbitration is whether it can be said, in the particular circumstances of this case, that Teal reduced the amount of work that it

allocated to Gormac in 2002 for bona fide business and operational reasons within the meaning of s. 21 of the *Regulation*.

26. Section 21 of the *Regulation* provides:

21. A replaceable contract must provide that the amount of work that the licence holder allocates to the contractor and that the contractor is required to perform in any year during the term of the contract may differ from the amount of work specified in the contract, provided that

- (a) the difference is attributable to bona fide business and operational reasons on the part of the licence holder, and
- (b) the amount of work that the licence holder allocates to the contractor under each replaceable contract over each 5 year cut control period of the licence to which the contract relates is equal to or greater than 95% of the aggregate of the specific amount of work provided for under that contract during that 5 year cut control period, or such other cut control period as may be substituted for the licence by the regional manager, less the aggregate of any reductions in the amount of work imposed during that cut control period as permitted by sections 20 and 22.

27. The starting point for the interpretation of s. 21 of the *Regulation* is the principle that the provisions of an enactment are to be given their plain and ordinary grammatical meaning:

Today, there is only one principle or approach, namely the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of parliament.

*Huor Chieu v. The Minister of Citizenship and Immigration* 2002 SCC 3 at para. 27.

28. Broadly stated, the legislative scheme of the *Regulation* provides for replaceable contracts and subcontracts, prescribes standard provisions for those contracts and establishes a mandatory dispute resolution scheme.

29. As Arbitrator Borowicz observed in *Hayes Forest Services Limited v. Western Forest Products Limited* (July 17, 2002), at para. 32, sections 17 to 22 of the *Regulation*, which were introduced in 1996, endeavour to strike a balance between the respective rights and interests of contractors and licensees.

30. Section 17 provides, inter alia:

17. (1) A replaceable contract must specify an amount of work to be performed in each year during the term of the contract.
- (2) A replaceable 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.

(emphasis added)

31. Section 18 provides formulas for calculating the amount of work which must be specified in various types of replaceable contracts in the coastal area.

32. Sections 20, 21 and 22 of the *Regulation* expressly provide for circumstances in which the specified amount of work to be performed in any given year of the replaceable contract may be reduced by a licence holder. Sections 20 and 22 provide:

20. (1) A replaceable contract must provide that the licence holder may allocate to the contractor and the contractor must perform, in any given year of the term of the contract, an amount of work that is less than the amount of work specified in the contract to enable the licence holder to experiment with timber harvesting methods, technology or silviculture systems different from those historically used by the licence holder on the licence to which the contract relates, provided that
- (a) the contractor receives reasonable notice,
- (b) the experiment is for bona fide business and operational reasons,

- (c) it is not practicable for the contractor to perform the work required to conduct the experiment, and
  - (d) the licence holder has used reasonable efforts to fairly distribute among company operations and other contractors carrying out timber harvesting operations under the licence the reduction of work associated with any experiments.
- (2) In an arbitration of a dispute arising from or in relation to a reduction in the amount of work under subsection (1) the onus lies on the licence holder to establish that the conditions entitling the licence holder to reduce the amount of work have been satisfied.
- 22.** (1) A replaceable contract must provide that the licence holder is not liable to the contractor for any failure to allocate to the contractor in any year the amount of work specified in the contract, as adjusted under section 20 or 21, if the failure results from changes in law, natural disasters, interference by a person who is not a party to the contract or any other event beyond the reasonable control of the licence holder other than a change in the market price of logs.
- (2) A replaceable contract must provide that the contractor is not liable to the licence holder for any failure to perform the amount of work allocated by the licence holder in any year if the failure results from changes in law, natural disasters, interference by a person who is not a party to the contract or any other event beyond the reasonable control of the contractor other than a change in the market price of logs.

33. Section 21, which I have set out above at paragraph 26 of this award, requires the replacement contract to provide that the amount of work that the licence holder allocates to the contractor and that the contractor is required to perform in any year may differ from the amount of work specified in the contract, if the difference is attributable to bona fide business and operational reasons, and if the amount of work that the licence holder allocates to the contractor over each five year cut control period is at least 95% of the aggregate amount of work provided for under the contract for that five year cut control period.

34. Another component of the legislative scheme relevant to this case is s. 26 of the *Regulation*, which provides:

- 26.** A replaceable contract must provide that if a rate dispute arises,
- (a) except as otherwise provided for under this section, the parties must continue to observe their respective rights and obligations under the contract unless both parties agree otherwise,
  - (b) if the parties to a rate dispute are unable to agree upon the amount to be paid for timber harvesting services provided from the beginning of the rate dispute until it is resolved, the contractor must be paid a provisional rate equal to the rate in effect for prior timber harvesting services,
  - (c) a party to a rate dispute may apply to an arbitrator to increase or decrease the provisional rate as determined by paragraph (b) to reflect any significant change in operating conditions or operating costs relative to those encountered for prior timber harvesting services, and
  - (d) the rate determined by an arbitrator in a rate dispute is retroactive to the beginning of the commencement of the work in respect of which the rate dispute arose, and the award by the arbitrator must provide for repayment of any difference between the rate awarded and the provisional rate agreed to by the parties or determined by this section.

(emphasis added)

35. Thus, the *Regulation* contemplates that where the parties are unable to agree upon a rate, the parties will continue to perform their obligations, the contractor will be paid a provisional rate pursuant to s. 26(b) and, ultimately, the rate dispute will be resolved by arbitration.

36. One of the legislative objects of the *Regulation* is to provide security of tenure to the holders of replaceable contracts.

37. In *R.G. Daines Contracting Co. Ltd. v. Pacific Forest Products Ltd.* (November 23, 1994) Arbitrator Johnston, in considering the 1991 *Regulation*, stated, at p. 13 of his award:

... The general legislative intent of the Regulation, is, inter alia, to protect contractors in dealings with licensees from any inequities arising out of an inequality of bargaining power and to provide certain contractors, being those entitled to replaceable contracts, with "security of tenure" similar to that enjoyed by licensees.

38. After observing that the aspect of security of tenure most relevant to licensees is certainty with respect to the amount of timber that the licensees are entitled to harvest in any given year, Arbitrator Johnston concluded, at p. 14:

Based on this, I have concluded that in enacting the Regulation, it was intended that those contractors entitled to replaceable contract should have certainty with respect to the amount of work that they would receive on an ongoing basis in a manner which most closely resembles the certainty of timber volume enjoyed by a licensee under the licence to which the replaceable contract pertains.

39. In *Daines*, Arbitrator Johnston determined that "amount of work" should be expressed as a percentage of the type of work performed under the licence, which meant that the contractor effectively shared any risk a licensee had in obtaining cutting permits or meeting regulatory requirements.

40. When the Lieutenant Governor in Council promulgated the *Regulation* in 1996, it adopted, in s. 18 of the *Regulation*, percentage of work formulae as the standard means of specifying replaceable contractors' entitlements to an amount of work in any given year.

41. Counsel for Gormac submits that the *Daines* decision equates the legislative intent of the *Regulation* to provide a contractor with "security of tenure" with certainty with respect to the amount of work that contractor will receive. Mr. Ross argues that the degree of certainty enjoyed by the holder of a replaceable contract should parallel that enjoyed by the licensee. He submits that s. 21 of the *Regulation* should be interpreted in light of this legislative intent, and that this provision is necessary to relieve licensees from liability for work they cannot perform, but not for work which they can and do perform.

42. Mr. Voith, for Teal, points out that the security of tenure provided to replaceable contractors under the *Regulation* is not absolute and argues that a licensee is not required to operate at a loss in order to provide the holder of the replaceable contract with work.

43. Mr. Voith is correct in his submission that the *Regulation* does not confer absolute security of tenure on the holders of replaceable contracts and that it does place limits on their security of tenure. It does so in a number of ways. First, by defining under s. 18 that the holder of a replaceable contract is entitled to either a specified percentage of the total amount of timber processed by the licence holder under the licence in a given year, or a specified percentage of the total amount of work of the type provided for in the contract, the *Regulation* does not guarantee the contractor a fixed volume or quantity of work in every year of the contract. To take an extreme example, if the licensee does not require any work of the type provided for in the contract in a given year, then the holder of the replaceable contract is not entitled to any work in that year: see *R.W. Saunders and Sons Ltd. v. McMillan Bloedel Limited* (December 1, 1999), para. 49.

44. The *Regulation* contains other limits on the security of tenure otherwise enjoyed by the holders of replaceable contracts. Sections 27 to 32 of the *Regulation* provide for the termination by a licence holder of a replaceable contract pursuant to an AAC reduction proposal. Under section 20, a licence holder may provide the holder of a replaceable contract with an amount of work which is less than the amount of work specified in the contract if the lesser amount is required to enable the licence holder to experiment with different timber harvesting methods. Section 22 of the *Regulation* provides that a licence holder is not liable to the holder of a replaceable contract for any failure to allocate to the contractor in any year the amount of work otherwise specified in the contract for events beyond the licensee's control, such as changes in law, natural disasters or other such events, other than changes in the market price of logs. Finally, s. 21 of the *Regulation* permits a licensee to vary the amount of work otherwise specified in a replaceable contract in

any given year provided the difference is attributable to bona fide business and operational reasons and provided the shortfall is made up within the cut control period.

45. In *Hayes Forest Services Limited v. Western Forest Products Limited* (July 17, 2002), Arbitrator Borowicz, after finding that s. 21 of the *Regulation* applies to replaceable contracts, considered the flexibility which s. 21 provides to licensees 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. The 1996 Regulation was framed to expressly recognize many of those contingencies, and to exempt the licence holder or a contractor from any notion of strict liability. Section 22, for example, provides that in any year, a shortfall by either party, regardless of magnitude, will be compensable if it results from “changes in law, natural disasters, interference by a person who is not a party to the contract or any other event beyond the reasonable control of the licence holder ...” . Section 21 gives even broader flexibility to licensees to provide less than the amount of work specified in a contract for “bona fide business and operational reasons”, so long as the difference does not exceed 5% of the aggregate contract volume over a five year cut control period.

46. At para. 94 of his award, Arbitrator Borowicz set out the test he applied to determine whether the licensee in that case might rely on s. 21 to justify a shortfall in the amount of work it provided to Hayes in a year:

And, in the absence of demonstrable bad faith in the allocation of cut blocks to Hayes, or deliberate manipulation of the allocation so as to benefit Western at the expense of Hayes, I am unable to conclude that Western breached its obligation of good faith to Hayes.

47. Teal argues that it has not acted in bad faith with respect to the assignment of road work to Gormac, and that it has not manipulated the allocation of work in a deliberate effort to harm Gormac. It invites me to find that it is therefore not liable to Gormac for any amount of work shortfall.



48. Before I consider the application of s. 21 of the *Regulation* to the facts of this case, it is necessary to consider the plain and ordinary meaning of the words used in that section. The relevant words are “allocates” and “bona fide business and operational reasons”.

49. In the Compact Edition of the Oxford English Dictionary, “allocate” is defined as:

**allocate:** to set or lay apart for a special purpose, to apportion, assign, to give one as his special portion or share.

50. “Allocation” is defined as:

**allocation:** the action of apportioning or assigning to a special person or purpose; apportionment, assignment, allotment.

51. In Black’s Law Dictionary, 7th edition, the following definition of allocation appears:

**allocation**, n. a designation or apportionment for a specific purpose; esp., the crediting of a receipt or the charging of a disbursement to an account (allocation of funds). – **allocate**, vb. – **allocable**, adj. – **allocator**, n.

52. Mr. Taylor acknowledged in cross examination that he understood that “allocate” meant to assign to somebody his share of something.

53. I find that on its plain meaning, the term “allocate”, as it is used in the *Regulation*, means that the licensee will assign to the holder of that replaceable contract its portion of the work of the type pertaining to the replaceable contract. In order to allocate the work, the licence holder must identify to the contractor the portion of the work which that contractor is to perform.

54. There must be a bona fide business and operational reason on the part of the licence holder for allocating to the contractor an amount of work which differs from the amount of work specified in the contract.

55. The following dictionary definitions from Black's Law Dictionary, 7th edition, provide guidance in interpreting the phrase "bona fide business and operational reasons".

**Bona fide.** In or with good faith; honestly, openly, and sincerely; without deceit or fraud. *Merril v. Dept. of Motor Vehicles*, 71Cal.2d 907,80 Cal. Rptr. 89, 458 P.2d 33. Truly; actual; without simulation or pretence. Innocently; in the attitude of trust and confidence; without notice of fraud, etc. Real, actual, genuine, and not feigned. *Bridgeport Mortgage & Realty Corporation v. Whitlock*, 128 Conn. 57, 20 A.2d 414, 416.

***Bona fide business purpose.*** In tax law, this term is often used in determining whether *real business purpose* in fact existed for carrying out a particular transaction. [emphasis added]

***Business.*** Employment, occupation, profession, or commercial activity engaged in *for gain or livelihood*. Activity or enterprise for *gain, benefit, advantage or livelihood*. *Union League Club v. Johnson*, 18Cal.2d 275, 108 P.2d 487, 490. Enterprise in which person engaged shows willingness to invest time and capital *on future outcome*. *Doggett v. Burnet*, 62 App.D.C. 103, 65 F.2d 191, 194. That which habitually busies or occupies or engages the time, attention, labor, and efforts of persons as *principal serious concern of interest or for livelihood or profit*. [emphasis added]

***Business Purpose.*** Used on occasion to describe the use to which property may be put or not, as in a deeds restricted covenant. *A justifiable business reason for carrying out a transaction*. ... [emphasis added]

56. In addition, Mr. Voith referred to me the following definitions from *Webster's 3rd New International Dictionary*:

**operational** ...: of or relating to operation or an operation ... .

**operation** ...: ... the whole process of planning for and operating a business or other organized unit ... phase of a business or of business activity ... .

**operating** ...: ... of or dealing with profit and loss or income and expenses ... used for or in operations ... .

57. Giving these words their plain and ordinary meaning, I must consider whether the difference between the amount of work that Teal allocated to Gormac in 2002, and the amount of work specified in Gormac's contract, i.e. the 51% entitlement, is attributable to real business or operational purposes, that is whether Teal had justifiable business or operational reasons for the failure to allocate to Gormac its 51% entitlement in 2002.

58. It is also necessary to consider s. 21 in the context of the legislative scheme of the *Regulation* as a whole, including, in this case, s. 26, which requires that, in the event that the parties are unable to agree on rates, they must continue to observe the respective rights and obligations under the contract unless both parties agree otherwise.

59. In determining whether Teal had bona fide financial and operational reasons for reducing the amount of work it allocated to Teal in 2002, it is necessary to consider both the evidence relating to Teal's financial position and financial policies, and the specific decisions it made respecting the allocation of work, particularly with respect to Block WH-8 and the B100 Upper Spurs.

### **Teal's Financial Position and Financial Policies**

60. On the basis of Mr. Karmally's testimony, and the financial statements which Teal did produce relating to its Boston Bar logging division (Exhibit 2, Tab 28), I have no hesitation in finding that Teal's Boston Bar logging division essentially broke even in 2000, but sustained losses in the order of \$1 million in 2001. For the eight months ending August 31, 2002, Teal's Boston Bar logging division lost about \$1.2 million on harvesting operations in the Fraser Canyon, earned approximately \$108,000.00 at Tipella, and was breaking even on the West Harrison segment of its Boston Bar operation. Mr. Karmally testified that when Teal made its plans for 2002, it had expected to do better at West Harrison, which offered the best timber, and the most favourable logging conditions. However, timber in some of the blocks

harvested turned out to be of lower quality than anticipated, and the company experienced delays in obtaining cutting authorities from the Ministry of Forests.

61. It is also true that as the volume of timber harvested by Teal in the Fraser TSA declined from 2000 to 2002, there was a decline in road construction, and that this affected the financial positions of both Teal and Gormac.

62. Although Teal produced financial records relating to its Boston Bar logging division for the period 1999 to August 31, 2002, it refused Gormac's request to produce consolidated financial statements for all of its operations. Counsel for Gormac requested disclosure by Teal of its consolidated financial statements shortly before the commencement of this arbitration, which came on for hearing on an expedited basis, and reiterated that request during the course of the hearing.

63. Teal is a private company and declined to produce financial records showing the overall performance of the company for reasons of commercial confidentiality. Because of the urgency, particularly from Gormac's perspective, in having the amount of work dispute decided, Mr. Ross, upon instructions from his client, declined to make an application to compel the production of Teal's consolidated financial statements. That application, if successful, would have resulted in further delay in these proceedings.

64. Mr. Ross invites me, in light of Teal's refusal to produce its consolidated financial statements, to attach no weight to its assertion that the company is in financial "survival mode".

65. While Teal has not produced consolidated financial statements which would show the state of the licence holder's balance sheet for the period of time relevant to this arbitration, Mr. Karmally, Teal's Chief Financial Officer, has testified at some length concerning Teal's motivation in implementing the policy that each of its divisions must, on a stand alone basis, break even if it is to continue to operate. In December 2001, Teal closed down its largest sawmill at Boston Bar after that

operation suffered significant losses. Both Mr. Karmally and Mr. Taylor described, at some length, the restructuring of Teal's Boston Bar logging operation, following the closure of the mill, as a market logging operation, and the measures which Teal took to reduce costs in 2001 and in 2002. On the basis of this evidence, I am satisfied that Teal adopted a policy of requiring each of its divisions to break even for bona fide business and operational reasons. It is clear from the testimony of Teal's Chief Financial Officer, and its logging manager, that the decision to close the Boston Bar mill, the refocusing of the logging division to a market logging operation, and the substantial reductions to the work force were all taken because the company regarded them as necessary to maintain its financial viability.

66. However, that is not the end of the matter. It was not Teal's adoption of a corporate policy requiring each of its divisions to break even on a stand alone basis which gave rise to difficulties in this case. Rather, it is the manner in which Teal chose to implement that policy in its dealings with Gormac which must be considered in this proceeding.

67. Up to and including the year 2000, Teal assigned to Gormac the road construction work it required the Claimant to perform. The parties then negotiated a rate. Those negotiations frequently occurred while Gormac was performing the work, or even after Gormac had completed the work. During this period, Teal clearly allocated to Gormac the specific road construction work it wished the Claimant to perform.

68. Beginning in 1997, when Fraser Canyon Transport Ltd. relinquished its replaceable contract to Teal, and until 2001, Teal restricted the new road work that it put out to tender to the 49% of that work that it was not obliged to allocate to Gormac. According to Mr. Taylor, Teal's purpose in tendering a portion of the new road construction work was to obtain competitive prices, and to gather information to assist it in pricing road construction work. There is no question that Teal was entitled to assign that work as it saw fit, and to use the information it received from

putting 49% of the road construction work out to tender to assist it in negotiating rates with Gormac.

69. In 2001, Teal put all of its new road construction work out to bid. Mr. Taylor testified that it did so for two purposes. One was to obtain the lowest price possible for road construction work, and the other was to establish competitive prices.

70. It is apparent from Exhibit 2, Tab 4A, which I have reproduced at paragraph 7 of this award, that notwithstanding the fact that Teal sought competitive bids for all of the new road construction work in 2001, Gormac nevertheless received sufficient work that year to not only meet its 51% entitlement, but also to make up almost all of the shortfall over the previous five year cut control period. However, the result was different this year.

71. Mr. Taylor described how, following the shutdown of the Boston Bar sawmill in December 2001, the Boston Bar logging division had to market all of the logs it harvested. Whereas the West Harrison area has some of the best timber and easiest operating conditions, timber in the vicinity of Boston Bar itself produces lower grade lumber and is more difficult to market than better quality lumber. Mr. Taylor testified that in these circumstances, in order to ensure that Teal could harvest profitably, it had to establish, as precisely as possible, production costs and product values.

72. In its initial planning for the 2002 logging season, Teal anticipated that it would harvest approximately 145,000 metres from the Harrison area and approximately 190,000 metres in the Boston Bar area under both FL A19201 and its interior forest licence. Subsequently, there were reductions in those volumes after Teal determined that some blocks would not be profitable. Teal's initial projections are set out in Exhibit 2, Tab 23A, which was an assessment prepared in December 2001 of the profitability of each of the blocks planned for harvesting in the West Harrison area. At the time, Teal was anticipating an 18% increase in stumpage, which would have rendered many of the blocks unprofitable.

73. According to Mr. Taylor, road construction costs are one of the most variable logging costs, due to the different conditions which pertain from block to block.

74. Mr. Taylor testified that in projecting road building costs for 2002, he used bids received in 2001 from three non-replaceable contractors, whose bids were fairly close to each other. He also testified that for the Boston Bar area, Teal was looking for a \$10 a metre difference between logging costs and log values, in order to allow for uncertainties regarding wood quality, and unanticipated extra costs.

75. When stumpage rates did not increase by the 18% which Teal had anticipated, and after the company took a number of other measures intended to minimize its operating costs, it decided to proceed with some of its harvesting plans for the Boston Bar logging division for 2002. Those measures included persuading Teal's logging contractors to continue a \$2 to \$3 per cubic metre reduction in their logging rates which Teal had negotiated in 2001. In addition, for 2002, Teal's senior management implemented the policy whereby rates had to be determined and prices had to be established before any work would proceed. The company put this policy into effect on a block by block basis.

76. In 2002, Teal put all of its new road construction work out to competitive bid in several, separate road packages. Typically, it sought bids from six to eight road builders.

77. Exhibit 2, Tab 5 is an example of the tender packages put out by 539197 British Columbia Ltd., a numbered company affiliated with Teal. It is dated February 4, 2002, and is an invitation to bid for road construction work in the West Harrison area. Paragraph 3 of the tender conditions provides:

3. No tenders will be considered which stipulate qualifying clauses, and lowest or any tender will not necessarily be accepted. Some of the road will be awarded to a Bill 13 road construction contractor.

78. The notice to road construction contractors also provides that the successful contractor will be required to sign a road construction sub subcontract.

79. Mr. Taylor testified that Teal wished to make it abundantly clear that some of the road construction work might be awarded to a Bill 13 contractor, and that the successful bidder might therefore only obtain part of the work.

80. Mr. Taylor testified that Teal gave Gormac the opportunity to bid, through this competitive bidding process, on almost all of the new road construction work for 2002. Teal's logging manager either called Mr. McDonald to let him know a road package was available, or actually delivered the package to Gormac. Mr. Taylor testified that Gormac never responded to the bid packages within the time stipulated for the receipt of bids and, in some cases, did not submit bids at all.

81. In a number of cases, Mr. Taylor followed up with Mr. McDonald and specifically requested that he submit a proposal for particular roads. Mr. McDonald testified that he never made any proposal to Teal until Mr. Taylor had contacted him and requested that Gormac make a proposal. Gormac submitted proposals for Blocks WH-8, CC-3, B100 Lower Spurs and B100 Upper Spurs.

82. Whenever Teal solicited proposals from Gormac, it did so on the basis that the rate had to be competitive, and that no work would commence until Teal and Gormac had agreed upon the rate.

83. Mr. Taylor acknowledged that when Teal adopted the practice of tendering all of the road building work, it no longer had discussions with Gormac about its costs and productivities. Rather, Mr. Taylor's measure of competitiveness was the price he obtained through the open market bidding process. In the case of Blocks WH-8 and CC-3, Teal let Gormac know some of the prices it had obtained through the competitive bidding process, and that it expected Gormac to put in a proposal that came close to those prices.



84. Mr. Taylor never provided Mr. McDonald with any assurance that if Gormac bid on the road construction packages, Teal would negotiate a rate with Gormac to the exclusion of other road builders who did not hold replaceable contracts.

85. In cross examination, Mr. Taylor agreed that Gormac's replaceable contract did not oblige the Claimant to bid for work against other contractors. Mr. Taylor said that Teal expected Gormac to provide some prices in response to the invitations to bid as a basis for negotiation. However, Teal's insistence that Gormac's prices must either meet, or be very close to bids at the lower end of the spectrum that Teal received through the competitive bidding process, limited the scope for any negotiations.

86. As I describe in more detail below, Gormac obtained work in Block CC-3, and some, but not all of the road construction for Block 100 Upper Spurs. Gormac also made a proposal for Block 100 Lower Spurs. That proposal was not acceptable to Teal because the licence holder did not regard the rates submitted by Gormac as competitive with bids received from other contractors. Teal assigned the Block B100 Lower Spurs work to two non-replaceable contractors. Later in this award, I address the circumstances relating to Block WH-8, which Teal also ultimately assigned to one of its non-replaceable contractors.

87. As Mr. Taylor testified, in 2002, Teal attempted to determine production costs and log values with as much precision as possible. However, as Mr. Taylor also testified, at least at Boston Bar, it built into its estimates a spread between costs and log values to allow for uncertainties, including unanticipated extra costs. Furthermore, and despite some evidence suggesting that Teal would not run its Boston Bar logging division if it sustained any loss at all, Mr. Karmally, on cross examination, acknowledged that Teal would not make a decision to shut down its Boston Bar logging operations solely on the differential cost between what it might have cost to have Gormac construct 51% of the new roads and what it would have cost to have other contractors perform that work. He agreed that road and bridge construction made up about 8.5% of the total production costs for the Boston Bar

logging division. As a corollary to this evidence, Mr. Karmally also agreed with Mr. Ross that the vast majority of production costs which contributed to the Boston Bar logging division's loss during the first eight months of 2002 were not related to road construction costs.

88. I refer to this evidence not to suggest that road construction costs were an insignificant factor in the company's calculations, but rather to put those costs into perspective. On the evidence I have received, I am not persuaded that Teal, as a matter of economic necessity in 2002, could not assign to Gormac its share of the new road construction work and then negotiate and, if necessary, arbitrate rates for particular road headings. However, that is not the real issue in this case.

89. Teal did not allocate work to Gormac when it put out road packages and invited Gormac to compete for the work by bidding against a variety of other road builders. That process did not, in any sense, constitute an assignment to Gormac of its share or portion of the work.

90. Teal knew that Gormac, as the holder of a replaceable contract, was not obliged to participate in the competitive bidding process.

91. Teal also knew that Gormac had the right to be paid a provisional rate, and to arbitrate in the event of a rate dispute. However, in 2002, it insisted that Gormac agree to a firm rate determined by reference to rates which Teal selected from those it received through the competitive bidding process, and without regard to Gormac's efficiencies and productivity, before it would authorize Gormac to work.

92. It was certainly within Teal's purview to decide whether or not to proceed with the construction of new roads in 2002, and to determine which roads it wished to have built. However, once it had decided to have the work performed it was obliged to allocate that work as required by the *Regulation* and its contract with Gormac. It failed to do that in 2002 when it put all of the new road construction

work out for competitive bid and insisted that Gormac forego its right to have rates resolved in accordance with sections 25 and 26 of the *Regulation*.

93. By adopting these measures as a means of achieving its financial objectives, Teal disregarded its statutory and contractual obligations to Gormac. While I am satisfied that Teal did not take these measures with the intention of inflicting economic harm upon Gormac, the licence holder does appear, at least for much of the 2002 logging season, to have been somewhat indifferent to the impact of these measures on the Claimant. Teal was certainly aware that aside from the 1.08k in Block CC-3 allocated to Gormac in early April, the Claimant received no further new road construction work until September. Even then, it assigned to Gormac only a portion of the Block B100 Upper Spurs work in circumstances which I consider in more detail below.

94. To summarize, Teal knew, or ought to have known, that its invitation to Gormac to participate in the competitive bidding process did not satisfy its obligations to allocate work to Gormac. Teal knew that Gormac, as the holder of a replaceable contract, was not obliged to participate in that process. Teal knew that Gormac had a contractual and statutory right to arbitrate a rate dispute, and to receive a provisional rate in the interim, yet it insisted that Gormac agree to competitive rates derived through its bidding process and waive its right to arbitrate.

95. In these circumstances, I am unable to find that these measures are justifiable for bona fide business or operational reasons within the meaning of s. 21 of the *Regulation*. They do not justify the difference between the amount of work which Teal allocated to Gormac this year, and Gormac's 51% entitlement. The flexibility that s. 21 affords to licence holders does not extend to permitting them to disregard their obligation to allocate work to the holders of replaceable contracts, by putting all of their work out to competitive bid, and to disregard their obligation to resolve and pay rates as provided by s. 26 of the *Regulation*.

96. I turn now to the specific circumstances relating to Blocks WH-8 and B100 Upper Spurs.

### **Block WH-8**

97. On March 9, 2002, Mr. Taylor sent a memorandum to Gormac inviting it to submit a proposal for road construction for West Harrison Blocks WH-8 and CC-3 (Exhibit 1, Tab 17). He stipulated that there would be “no construction prior to agreeing on a price for the work”. Teal had previously put this work up for competition and it had received bids from various non-replaceable contractors. Before Mr. Taylor contacted Gormac on March 9th, Gormac had not made a proposal for this work.

98. Gormac initially proposed to perform the Block WH-8 work for a price of \$64,825.00. Teal responded by advising that Gormac’s price for the road construction on Block WH-8 was higher than anticipated and that unless there was a substantial adjustment, Teal would award the road to another contractor. Gormac made a second offer in the amount of \$53,380.00, to which Teal responded by advising that this offer was considerably higher than bids received from other contractors and that, accordingly, Gormac’s offer was rejected.

99. On March 14, 2002, Mr. Taylor wrote to Mr. McDonald informing him that three of the other bids it had received for roads and landings in Block WH-8 were in the \$30,000.00 - \$38,000.00 range, excluding falling, and that Teal was looking for a price in that range.

100. Mr. McDonald then offered to do the work for an interim amount of \$45,000.00, including the remaining falling. He testified that by an “interim amount” he meant an amount which Gormac would agree to start the work, and then negotiate to finalize a price. Mr. Taylor testified when Gormac offered an interim rate of \$45,000.00, he understood that to mean that if the parties agreed,

Gormac could start the work while they continued to negotiate to “fine tune” the rate.

101. On March 14, 2002, Mr. Taylor, on behalf of Teal, responded by proposing an interim rate of \$36,000.00, with the remaining falling extra.

102. On March 15, 2002, Mr. McDonald, with the assistance of his solicitor, wrote to Teal stating that Gormac would commence the work on Block WH-8 at the provisional rate of \$36,000.00 proposed by Teal, provided that Teal agreed that Gormac would have the right to apply to an arbitrator to increase the provisional rate, and to set a final rate. Mr. McDonald said that when he made this offer, which was only slightly more than half his original price for Block WH-8, he did so because he was desperate to get some cash flow.

103. On the same date, Teal made a final offer on terms that it would pay Gormac \$36,000.00 for the completion of all construction for the WH-8 roads and landings, Teal would complete the right of way falling, and Gormac would agree not to pursue rate arbitration.

104. Mr. McDonald rejected the final condition because he was not prepared to waive his right to arbitrate the rate. As a consequence, Gormac did not get the WH-8 work, which was assigned to one of Teal’s non-replaceable contractors.

105. I find that Teal insisted that as a condition for allocating the Block WH-8 work that Gormac relinquish its right to arbitrate. The position taken by Teal contravenes s. 26 of the *Regulation* and the rate dispute provision incorporated in Gormac’s replaceable contract by operation of the *Regulation*, both of which contemplate that unless both parties agree otherwise, the contractor will perform work for the licensee at a provisional rate, and that the rate dispute will be resolved by arbitration.

106. Mr. Taylor and Mr. Karmally both acknowledged that they understood that Gormac had a contractual right to arbitrate its rate. Teal's logging manager also agreed in cross examination that he understood the difference between setting aside work for someone and negotiating a rate, and that allocating the work and negotiating a rate were two separate and distinct obligations. I find that Teal's insistence that Gormac waive its right to arbitrate cannot be characterized as a bona fide business or operational reason for not allocating the Block WH-8 work to the Claimant. While Teal maintains that it took this position out of a desire for absolute certainty regarding the rate, and its road construction costs, this cannot be characterized as a bona fide or real business or operational reason when it flies in the face of the *Regulation*, and its mandatory dispute resolution process.

### **Block B100 Upper Spurs**

107. In early September 2002, at a time when, according to Mr. Taylor, Teal was concerned that Gormac had received only a small portion of its entitlement, Teal wrote to Mr. McDonald, inviting him to submit prices for all 3.36 km of the B100 Upper Spurs (Exhibit 1, Tab 22, p. 14). Up to that point, the only new road construction work that Teal had allocated to Gormac in 2002 was approximately 1.08k in Block CC-3. Teal allocated that work to Gormac in early April, after Gormac had submitted a price which approximated bids received by Teal through its competitive bidding process from other road builders. Mr. Taylor testified that Teal was concerned about the limited amount of work that Gormac had obtained. In cross-examination, Mr. Taylor agreed with Mr. Ross that when he invited Gormac to provide prices for the B100 Upper Spurs, it was his intent that Gormac would get the work.

108. On September 10, 2002, Gormac submitted a bid for all of the Block B100 Upper Spur work, in the amount of \$157,146.00 (Exhibit 1, Tab 22, p. 19).

109. However, Mr. Taylor received instructions from Mr. Jones, one the principals of Teal, to assign one kilometre of the Block B100 Upper Spurs to Darwin Friesen, in order to provide Mr. Friesen with means to repay a debt he owed to Mr. Jones. Mr. Taylor then contacted Mr. McDonald to adjust Gormac's proposal by deleting the road spurs assigned to Mr. Friesen. Ultimately, Teal and Gormac agreed upon a price of \$126,571.00 for the remaining Block B100 Upper Spurs work (Exhibit 1, Tab 22, p. 25).

110. Mr. Taylor agreed in cross examination that the fact that Teal directed one kilometre of the B100 Upper Spurs to Mr. Friesen had nothing to do with Gormac's price. He went on to say that the fact that Teal had obtained prices from Gormac did not mean that Gormac would get the work. However, this evidence has to be assessed against Mr. Taylor's repeated assertions during his testimony that Teal wanted to provide work to Gormac and was concerned by this time that it was not getting its entitlement in 2002.

111. I find that had Mr. Jones not directed that one kilometre of the Block B100 Upper Spurs work be provided to Mr. Friesen, Mr. Taylor, on behalf of Teal, would have allocated all of the Block B100 Upper Spurs work to Gormac, rather than the approximately 2.36k that it ultimately received. Mr. Taylor's acknowledgement in cross examination that Gormac's price was not the issue, and the fact that Teal had invited Gormac to make a proposal for all of the road construction work in Block B100 Upper Spurs at a time when Gormac had received only a fraction of its 51% entitlement, lead me to that conclusion.

112. Teal led some evidence concerning Mr. Friesen's competence as a road builder. That is of no consequence in this case. I find that the decision to assign some of the Block B100 Upper Spurs to Mr. Friesen was made to accommodate the financial interests of one of the principals of Teal. It had nothing to do with any real business or operational consideration of Teal itself. It therefore was not a bona fide business or operational reason for not allocating that work to Gormac.

**CONCLUSION**

113. I find that Teal is liable to Gormac for an amount of work shortfall for 2002. There are differences between the amount of work which Teal allocated to Gormac and the amount of work specified in Gormac's replaceable contract, which are not attributable to bona fide business and operational reasons on the part of Teal. The assessment of damages will be the subject of a separate hearing. I invite counsel to contact me to set a date for that hearing.

**COSTS**

114. Because neither counsel made full submissions on costs during the hearing, I am prepared to receive submissions in writing on costs from both parties before making any order as to costs.

It is so awarded.

DATED at the City of Victoria, in the Province of British Columbia, this 25th day of November, 2002.



**PAUL J. PEARLMAN, Q.C.**  
Arbitrator