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THE TIMBER HARVESTING CONTRACT AND SUBCONTRACT REGULATION: IS IT ADDRESSING ITS INTENDED OBJECTIVE?

TLA Editorial

Background

As part of the 2003 *BC Forest Revitalization Act,* a new rate dispute resolution mechanism was created as part of the Timber Harvesting Contract and Subcontract Regulation (Part 26.01 of the Regulation).

Prior to 2003, arbitrators who sought to resolve rate disputes between contractors and licence holders under replaceable contracts (aka Bill 13 contracts) were guided by regulation that required a contractor who was "competitive by industry standards" to earn a "reasonable" profit. In this regard, contractors in arbitration had to prove that they were competitive in their operations by "market standards" and, if so, the regulation provided for a profit and risk allowance over and above the market competitive costs that a contractor could demonstrate in completing harvesting services.

After several arbitrations where a tenure holder challenged the contractors' efficiency or rates that they were asking for in the market place, most failed to demonstrate that the contractors were not competitive by market standards and contractors were awarded settlements. In essence, the rate test worked. It included a market test for efficiency and contractors who chose to arbitrate demonstrated their efficiency and the rates required to do the work being asked of them and the courts agreed.

26.01 (1) of the current Regulation states: If a rate dispute is referred to arbitration, the arbitrator must determine the rate according to what a willing licence holder and a willing contractor acting reasonably and at arm's length in similar circumstances would agree is a fair market rate…

This fair market rate paradigm eliminated any relevance of the costs borne by a contractor to do the work they were contracted to do.

The major licence holders then took the position that the notion of a "profit guarantee" under the Regulation was not consistent with the free market performance of the industry as a whole and sought changes to the Regulation.

A new paradigm was subsequently engrained in the Regulation whereby rate disputes between parties to replaceable contracts would be settled by an arbitrator who would consider comparable rates agreed to by others doing similar work. More specifically the term "fair market rates" was introduced as the underlying theme of the regulation as seen in Part 26.01.

This fair market rate paradigm eliminated any relevance of the costs borne by a contractor to do the work they were being contracted to do when setting rates and went so far as to eliminate any notion that contractors needed to be sustainable at all.

The new regulation focuses on "comparable" rates and "lowest last bid" rates but unfortunately does not define a "fair market rate." It does, however, provide the criteria that the arbitrator may consider in his determination including:

(a) rates agreed to by the licence hold-

er and contractor for prior timber harvesting services;

(b) rates agreed to under another contract by either the licence holder or contractor for similar timber harvesting services;

(c) rates agreed to under another contract by either the licence holder, the contractor or another person for each phase or component of a similar timber harvesting operation;

(d) rates agreed to by other persons for similar timber harvesting services;

(e) if necessary to make meaningful comparisons to any of the rates agreed to in paragraphs (a), (b), (c) and (d) above, the impact on fair market rates likely to arise from differences between the timber harvesting operations that pertain to the rate in dispute, and the timber harvesting operations that pertain to any rate described in paragraphs (a), (b), (c) and (d), including the following:

(i) differences in operating conditions including, without limitation, differences in terrain, yarding distances, hauling distances, volume of timber per hectare;

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

(iii) differences in the required equipment configuration;

(iv) differences in required phases;

(v) differences in operating specifications;

(vi) differences in law;

(vii) differences in contractual obligations;

(viii) differences in the underlying costs of timber harvesting operations in the forest industry generally which would affect fair market rates, including changes in the cost of labour, fuel, parts and supplies;

(ix) differences in the cost of moving to a new operating area, if any;

(f) any other similar data or criteria that the arbitrator considers relevant.

The Regulation has resulted in other changes within the industry that have effectively undermined the intended application.

Two additional clauses in the Regulation provide some comfort to contractors who face arbitration knowing that the new market rate paradigm would be used as the basis of arbitration.

Section 25.1 of the Regulation requires: that at the request of a mediator or arbitrator, each party to a rate dispute must do all of the following:

(a) disclose all rates known to it and described in section 26.01 (2) (a), (b), (c) and (d);

(b) disclose any relevant information known to it that, having regard to the considerations in section 26.01 (2) (e), may be reasonably necessary to make meaningful comparisons between those rates disclosed under paragraph (a) and the rate that is subject to the rate dispute;

(c) not disclose to any third party any confidential information received under paragraph (a) or (b);

(d) not use any information received under paragraph (a) or (b) for any purpose other than the rate dispute.

This section of the Regulation notionally allows contractors involved in

the rate dispute to solicit and obtain rates paid to other contractors for similar work that they could then use in the arbitration.

tended application of the Regulation to the general detriment of contractors.

Most notably is the general inclusion in all logging contracts of a confidentiality clause preventing individual contractors from disclosing their rates to others. This clause effectively mitigates contractor's potential to use either peers or comparable market rates since divulging of the rates to one another would contravene the contracts signed by each.

In effect, the entire contractor segment of the forest products supply chain has been undermined.

Section 25.5 (c) allows for the use of peers (i.e. other contractors) to provide perspective and assist the mediator in their deliberation of the rates being arbitrated.

At the request of a mediator or arbitrator, each party to a rate dispute must do all of the following: if requested by the mediator, or if agreed to by the parties, each party must appoint one peer to assist the mediator during the mediation process.

Effects

Since implementation of the current Regulation, there have been no arbitrations brought to completion.

The Regulation has, however, resulted in other changes within the industry that have effectively undermined the in-

What this means is that as a result of the widespread use of contractor confidentiality clauses in replaceable logging contractors across BC, all but two of the criteria that the arbitrator may consider in his determination are available to contractors, those being: (a) rates agreed to by the licence holder and contractor for prior timber harvesting services, and (f) any other similar data or criteria that the arbitrator considers relevant, since every other criteria requires knowledge of rates prohibited by confidentiality clauses.

In essence, contractors no longer have any fundamental data with which to demonstrate "market comparability." At the same time, their costs, desired rate or specific circumstances have no bearing on the discussion. All that is typically considered is "industry average data" which no contractors would have. Conversely, each licensee has the privilege of knowing what each of their contractors are willing to operate for—a clear advantage in negotiations bestowed upon them by the Regulations.

As a result, the regulation has effectively undermined any notion of contractor sustainability. Under this regime, the efficient contractors are at risk since they are systematically being forced to accept lower and lower "market rates" based upon the lowest last bid. In effect, the entire contractor segment of the forest products supply chain has been undermined.

What has been the effect of these actions?

Very simply, rates have stagnated and in some cases fallen since the only credible rates that a contractor can bring to the table to justify a fair market rate

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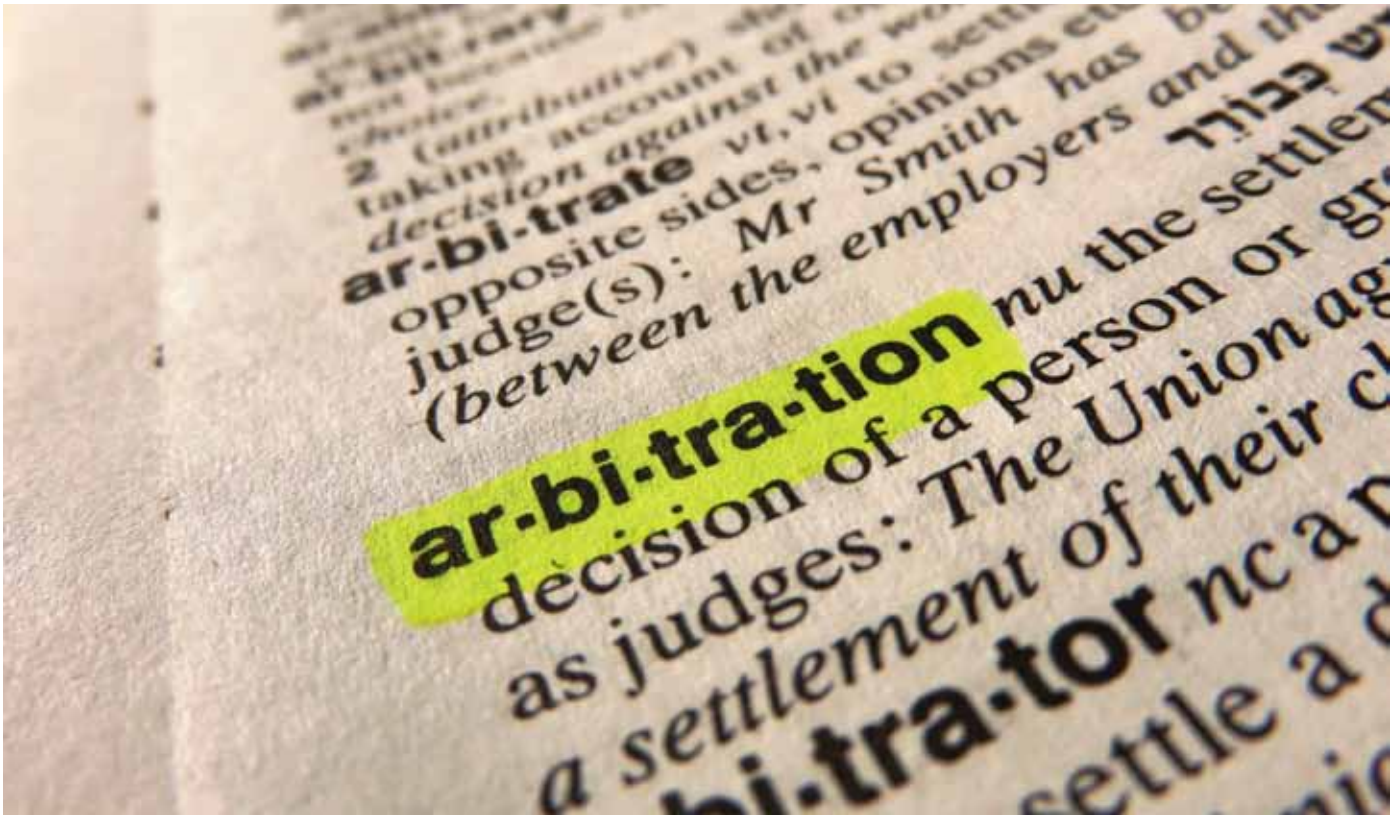

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are rates previously agreed to with the licensee. Ironically, it is these very rates that lead to arbitration.

For the licence holders, the benefits of the Regulation have been many.

Beyond the obvious (no completed arbitrations since the new regulations took effect and stagnated rates for harvesting services), the term "standard industry rate" has evolved which exemplifies the essence of the market rate test…that no one contractor should be paid more than the next contractor for the work they do regardless of their efficiency of operations or difficulty of work. This is despite the fact that the Regulation itself contains provisions to allow for the adjustment of comparable market rates in order to "make meaningful comparisons to the rate dispute in question".

Further, it is generally recognized that "market rates" set the bar for all contractors whether they hold replaceable contractors or not. In essence, rates for harvesting services across BC are no longer negotiated, but rather, they are determined by the licence holder alone based on their perspectives on what a "fair market" reflects without ever considering the differences in conditions or contractor efficiencies required to make meaningful comparisons to any of the rates agreed to. And all of this is engrained in Regulation.

The impacts are clear in the market place. The contractor community has been undermined through application of the new regulation by the majors. The evidence is seen in ongoing contractor insolvencies that have resulted in many small community businesses paying the price for low rates, exits from the industry of many otherwise well capitalized and market competitive contractors, sales of logging equipment at auction as contractors downsize and an ongoing difficulty in attracting new workers to the logging sector.

The lumber supply chain is now at risk as a result of a lack of contractor sustainability resulting from the imposition of a flawed and unworkable market rate test within Bill 13.

Solution

For its part, the TLA has embarked on a number of initiatives working together with financial analysts, investors and industry associations to find solutions to the underlying rate versus cost and efficiency issues. Given that this Regulation is now ten years old, and times have changed, it would be prudent to conduct a review of the Regulation as well.

What is needed, however, is an empirical database of contractor costs and efficiencies that can be used to demonstrate the dilemma. With the data in hand, an update of the market rate test and related sections within the Timber Harvesting Contract and Subcontract Regulation would then be proposed that reflects the reality of the business today. The reality being that the current regulation ignores contractor sustainability to the detriment of the industry as a whole.

This update may eventually extend to a review of the legality of placing confidentiality restrictions within harvesting contracts as an act of bad faith on the part of the licensees as it relates to rate negotiations and the market rate test within the Regulation.

If you are interested in participating in an initiative to update the Timber Harvesting Contract and Subcontract Regulation so that the rate dispute mechanism reflects what was intended and, if needed, reviewing the legality of placing confidentiality restrictions within harvesting contracts, please contact David Elstone, TLA Executive Director, at david@tla.ca or 604.684.4291 ext. 1.