

90, 1933

No 42 of 1933.



APPELLANTS' CASE.

## In the Privy Council

ON APPEAL FROM THE COURT OF APPEAL FOR  
BRITISH COLUMBIA

BETWEEN:

THE MOUNT ROYAL ASSURANCE COMPANY, et al,  
(Defendants) Appellants,

AND:

CAMERON LUMBER COMPANY LIMITED,  
(Plaintiff) Respondent.

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(AND SIX CONSOLIDATED ACTIONS)

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## CASE FOR THE APPELLANTS

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1. This is an appeal by the Defendants from a decision of the Court of Appeal of British Columbia whereby an appeal from D. A. McDonald, J., was dismissed, the Chief Justice of British Columbia, and M. A. Macdonald, J.A., dissenting; the former would have directed a new trial, and the latter would have dismissed the Plaintiff's action. RECORD

2. The appeal is concerned with contracts of use and occupancy insurance, whereby each of the Appellants insured the Respondent against actual loss sustained in respect of such fixed charges and expenses as must necessarily continue during a total or partial suspension of business caused by fire to the extent only that such fixed charges and expenses would have been earned had no fire occurred. p. 244.

3. The Respondent carried on business as a manufacturer of lumber on Garbally Road in the City of Victoria, the site being adjacent to tide water. p. 7.

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p. 8.

4. On the 25th February, 1931, a fire occurred at the plant which destroyed the Respondent's sawmill, lath mill, wharf and other buildings, but did not result in a total loss, as there remained the power plant, planing mill and other buildings. The physical loss resulting from the fire, was adjusted at \$136,000 and was duly paid.

p. 40,  
ll. 23-25.

p. 217,  
ll. 30-42.  
p. 218,  
ll. 1-10.  
p. 219.

5. The actions having been consolidated for trial, were tried before D. A. McDonald, J. and a special jury at Victoria; the jury answered all questions put to them and supplemented their answers by a written memorandum or rider showing in detail the calculations whereby they arrived at their verdict of \$24,269.07 in the Respondent's favour. 10

p. 244.

6. The material portions of the policy are:

#### BUSINESS INTERRUPTION

##### ON FIXED CHARGES, as hereinafter defined.

1. The conditions of this contract are that if the buildings situate on the west side of Garbally Road in the City of Victoria, Province of British Columbia, Insurance Plan Sheet 60, Block 1601, and occupied as a Lumber Manufacturing Plant by the CAMERON LUMBER COMPANY, LIMITED, and/or machinery and/or equipment contained therein, be destroyed or damaged by fire occurring during the term of this policy so as to necessitate a total or partial suspension of business, this Company shall be liable under this policy for the actual loss sustained consisting of: 20

- (I) Such Fixed Charges and expenses as must necessarily continue during a total or partial suspension of business, to the extent only that such Fixed Charges and expenses would have been earned had no fire occurred;
- (II) Such expenses as are necessarily incurred for the purpose of reducing the loss under this policy; for not exceeding such length of time, commencing with the date of the fire and not limited by the date of expiration of this policy, as shall be required with the exercise of due diligence and despatch to rebuild, repair or replace such part of said buildings and machinery and equipment as may be destroyed or damaged subject to the following conditions and limits to wit: 30

2. TOTAL SUSPENSION CLAUSE: The per diem liability under this policy during the time of total suspension of business of all the properties described herein shall be limited to the "Actual Loss Sustained," not exceeding 1/300 of the amount of this Policy for each business day of such suspension, except that in the case of business being operated on Sunday and/or holidays, in which event the said per diem liability shall not exceed 1/365 of the amount of this Policy for each business day of such suspension, due consideration in either case being given to the experience of the business before the fire and the probable experience thereafter.

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3. PARTIAL SUSPENSION CLAUSE: The per diem liability under this Policy during the time of a partial suspension of business shall be limited to the "Actual Loss Sustained" not exceeding that proportion of the per diem liability that would have been incurred by a total suspension of business which the actual per diem loss sustained during the time of such partial suspension bears to the per diem loss which would have been sustained by a total suspension of business, for the same time, of all properties described herein, due consideration being given to the experience of the business before the fire and the probable experience thereafter.

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7. As the Respondent had not reconstructed the Mill, one of the issues at the trial, which is absent in this appeal, was "the length of time commencing with the date of the fire . . . as shall be required with the exercise of due diligence and despatch . . . to rebuild" which the jury on a conflict of evidence found to be 221 days. For all purposes of this appeal the period of suspension therefore ran from February 25th, 1931 for 221 working days, or roughly ten months. It was in respect of the fixed charges, necessarily continuing during that period, that indemnity was claimed.

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p. 217,  
ll. 34-36.

8. It is common ground that the fixed charges insured against amounted to \$115.56 per diem.

9. The Respondent after the fire leased and operated for the remainder of the year a mill known as Wilfert Mill. By particulars delivered of the actual loss alleged in the Statement of Claim, and by evidence adduced at the trial, the Respondents attempted to demonstrate their right to indemnity under the policies by proving the result of its operations at the Wilfert Mill; such operation resulted in a loss of \$51,891.63; but they subtracted therefrom what were said to be expenses incurred in excess of

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pp. 10-14.

RECORD

customary costs, leaving \$29,674.91 as the loss which would have occurred in its main operation; then they took into account extra revenue consisting of the sale of surplus power and by-products lost by reason of the fire of \$32,930.20, and thereby showed an estimated profit of \$3,255.29. This method did not involve any allowance for depreciation as part of the cost of production.

p. 10,  
ll. 10-21.

p. 20,  
ll. 20-46.  
p. 21,  
ll. 1-20.

10. The Appellants challenged such method of proof at the outset by objecting to any evidence of actual loss which did not have regard to the term of the contract which provided that "due 10 consideration be given to the experience of the business before the fire and the probable experience thereafter."

p. 48,  
ll. 20-44.  
p. 49,  
ll. 1-38.  
pp. 282-285.

11. The experience of Respondent's business before the fire shows by the Company's books that for the year 1930 they suffered a loss of \$7181.45, but having made a profit of \$18,279.82 in the first seven months of that year it is apparent that the company lost \$28,098.94 in the last five months of 1930 without making any allowance for depreciation as an item in the cost of production.

p. 125,  
ll. 20-31.  
p. 178,  
ll. 15-45.  
p. 179,  
ll. 1-4.  
p. 115,  
ll. 40-46.

12. The evidence of Appellants' witnesses, concurred in by some of Respondent's witnesses, and so found by the jury, shows 20 that a proper allowance for depreciation of the plant must be considered as part of the cost of production.

p. 219, l. 6.  
p. 141,  
ll. 11-23.

13. The Respondent's method of proof did not commend itself to the jury, who adopted in principle the method put forward by the Appellants through their witness Barrett-Lennard, a chartered accountant.

p. 8, l. 13.  
p. 19, l. 9.  
p. 122,  
ll. 20-40.

14. As the trial did not take place until fifteen months after the fire, Mr. Barrett-Lennard not only had full access to the books of the Respondent, which showed the experience of the business before the fire, but he also had accurate information as to the 30 change in conditions in the industry generally, and particularly as to the fluctuation in prices of the finished product and in the cost of raw material and labour.

p. 124,  
p. 292.

p. 292.

p. 71,  
ll. 12-22.

15. During the year prior to the fire the trend of selling prices was steadily downward continuing so for the relevant period of 221 days after the fire. Exhibit 12 was agreed upon by Counsel as correctly setting forth the prices. The products of the

Respondent were of a higher class than the average of other mills which accounts for their relatively higher prices but even so they suffered a corresponding fall in price. RECORD

16. From all sources of information available Mr. Barrett-Lennard prepared and produced at the trial three statements which were projected five, six and eight months after the fire, being Exhibits 23, 24 and 25 respectively. As the period of reconstruction would not be ascertained until the jury had passed on that issue it was necessary to cover alternate periods. p. 137, ll. 3-10.

10 17. The general plan of each of such statements was to charge on the debit side the opening inventory on hand at the cost of production, the labour, supplies, logs and lumber purchased, then to deduct the amount of the closing inventory at the then cost of production. He then added depreciation and taking into account as a credit the amount realized from sales during the period he arrived at the net result as regards profit or loss. p. 137, ll. 19-46. pp. 138-139. p. 140. p. 141, ll. 1-23.

20 18. The compilation of these statements was strictly in accord with the provisions of the contract requiring due consideration to be given to the experience of the business before the fire, and the probable experience thereafter. The quantity of the opening inventory as of March 1st was shown on the Respondent's books; likewise was the cost of production; selling prices over the projected period represented the actual experience of Respondent at the Wilfert Mill; the reduced prices of logs, labour, and costs generally were a matter of record. The only figures supplied by Mr. Barrett-Lennard were the quantities cut and sold by the mill, and for these he took the quantities shown on Respondent's books over the corresponding period before the fire. p. 34, ll. 1-9. p. 29, ll. 20-26. pp. 272-279. p. 83, ll. 6-23. p. 34, ll. 14-44. p. 35, ll. 1-46. p. 36, ll. 1-38. p. 65, ll. 40-44. p. 67, ll. 18-24.

30 19. The Respondent did not question such statements either as to form or the accuracy of their contents, except with regard to the amount charged for depreciation and the basis of pricing the opening and the closing inventories. The jury accepted Exhibit 25, being the 8-months' statement as the basis of their calculation, and therefore as being correct in principle as the proper method of determining the question in issue, viz: whether or not the Respondent would have earned its fixed charges during the period p. 219, l. 5.

RECORD  
p. 219,  
ll. 9 and 21,  
l. 24.

of reconstruction; but the jury took a different view than that of the Appellants as to the amount of depreciation and the pricing of inventories.

p. 218, l. 39,  
p. 290, l. 49.

20. The issue as to the amount of depreciation not being present in this appeal, there remains only the question of whether the Appellants were right in pricing the opening and closing inventories at the cost of production as ascertained at the respective dates of such inventories. If that question is determined in the Appellants' favour, the net loss which Respondent would have suffered in the period of 8 months instead of being \$778.81 as found by the jury, would have been approximately \$34,000, and in such case the Respondent would have lost the whole of its fixed charges for the period, and more than \$10,000 in addition. 10

p. 137,  
ll. 19-30,  
p. 139,  
ll. 14-18.  
p. 219, l. 7.

21. Exhibit 25 and the jury's memorandum or rider are set forth in parallel columns on the opposite page of this case; apart from depreciation allowed the only differences consist of inventory valuations; the Appellants priced the opening inventory at \$20 per thousand, and the closing inventory at \$17 per thousand, both based on the average cost of production; the jury altered these prices to \$15 per thousand in both cases. 20

p. 87,  
ll. 30-44.

p. 28,  
ll. 27-39.

22. The reason for this change was that the Respondent had for some years past been in the habit of pricing all its inventories at an arbitrary valuation of \$15 per thousand; the practice arose by reason of an arrangement made by Respondent with the Canadian Income Tax authorities, and no doubt for the purpose of taxation worked out fairly over a period of years. Inventories were so priced in the annual statements of the Company prepared by the auditor for the information of the shareholders, but it is a noteworthy fact that the Respondent annually made up a supplementary statement for the information of the directors showing the inventories priced at the actual value. It was only by reference to such supplementary statement that the true position of the company could be ascertained at the end of any financial year. 30

			Jury's Memorandum or Rider		Exhibit 25
	10,991,340'	15.00	164,870.10	20.00	219,826.80
	Output Log Cost				
	Less 12%				
		234,485.84			
		28,138.30			
			206,347.54		206,347.54
	Purchases		61,098.88		61,098.88
10					
			432,316.52		487,273.22
	Labour Net		98,370.02		98,370.02
	Supplies "		32,371.19		32,371.19
	Taxes & Licences		4,751.79		4,751.79
	General Expenses		3,057.53		3,057.33
			570,867.05		625,823.55
	10502455'	15.00	157,536.83	17.00	178,541.74
20			413,330.22		447,281.81
	Depreciation 13120	200 da.	8,746.66		19,456.11
			422,076.88		466,737.92
	Sales, less disc. allces. & 9%		460,316.97		460,316.97
			38,240.09		6,420.95
	Profit from Rents		2,399.41		2,399.41
	Gross Profit		40,639.50		4,021.54
30	Selling and Office Expenses	17%	13,946.60		13,946.60
			26,692.90		17,968.14
	Insurance, int. deb. exp. and adm. ex. less 17%		27,471.71		27,471.71
	Net loss 200 days which is 3.894 per day of amount required to cover stated overhead of	115.56	778.81		45,439.85
		3.89	3.89		
		115.56	115.56		
40		3.89			
		111.67	111.67		
	for 221 days	24,269.07			

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23. As an illustration, the balance sheet for 1929 showed a hidden reserve of \$61,022.26, by a comparison of the inventories valued at the arbitrary price of \$15 per thousand and at their actual value. And it may be said in passing that owing to the decline in lumber prices the whole of such hidden reserve was lost in 1930 except \$10,161.04.

p. 135,  
ll. 19-45.  
p. 108.  
p. 91,  
ll. 1-14,  
ll. 32-39.

24. The price of \$15 per thousand was admittedly an arbitrary valuation having no relation to the cost of production or market value: Respondent's Accountant, Campbell admitted that for the purpose of ascertaining actual profit or loss it would not be proper to use an arbitrary valuation: their sales manager, Miller, in effect says the same: and their Auditor, Grogan, in cross-examination says: 10

p. 28,  
ll. 10-26.  
p. 38,  
ll. 27-44.  
p. 68,  
ll. 44-45,  
p. 69, ll. 1-9.

“Q. In order to ascertain the true position you must “take the inventory at cost of production or market price, “whichever is lower? A. Yes, provided—if the market “price is lower than cost.

“Q. I put it to you as a general principle, according to “proper accounting, that it is the only fair method. Do you “agree or not? A. Provided your selling price—provided “the actual selling price—if your selling price is lower than “your cost you must do it to be conservative. 20

“Q. Whichever is the lower—you agree? A. Yes.”

p. 105,  
ll. 19-28.

p. 89,  
ll. 29-32.

Respondent's Vice-President, D. O. Cameron, said, also in cross-examination:

“Q. So that illustrates the point that I have been trying “to demonstrate in the last two days that the \$15.00 valuation “bears no relation whatever to the actual cost of production? “A. Certainly it don't.”

25. The Appellants contend that while the use of an arbitrary valuation may be justified as a matter of policy over a period of years as part of the internal economy of a company and for the information of shareholders it cannot be justified when the company is called upon to show the “true position” or to prove “actual loss” or “actual profit” in a given period. The Respondent's witness, Taylor, an accountant for the Puget Sound Lumber Company, in cross-examination said that if a Lumber Company applied to a Bank for credit the Bank would not be satisfied with an arbitrary valuation of inventories but would demand that they 30

p. 77,  
ll. 29-38.

p. 79,  
ll. 25-47.  
p. 80,  
ll. 1-16.



be valued at the cost of production or market value, whichever might be lower; that in order to ascertain the true position during a fixed period that method must be adopted. RECORD

26. The Appellants' contention was upheld by Barrett-Lennard and Scollard, both chartered accountants, having special qualifications in the lumber manufacturing industry. Their view was supported by leading text writers on the subject, and Respondent's witness, Grogan, agreed not only that such writers were authorities on the subject, but also that their opinions were correct. p. 123, ll. 36-45. p. 177, ll. 9-46. p. 178, ll. 1-15. p. 105, ll. 36-45. p. 106. p. 107, ll. 1-38.
- 10 27. The cost of production at the beginning of the period in question as shown in Exhibit 25, viz.; \$20 per thousand, is the average cost over the four months preceding the fire. Mr. Barrett-Lennard took that average rather than the cost in Feb. 1931, because the inventory on hand at the time of the fire represented the normal cut of the mill for four months. The actual average for the four months was \$20.34 per thousand, so that the Respondent was given the benefit of 34 cents per thousand. The costs were taken from the books and records of the Company; their monthly operating statements showing in great detail the average cost per month. The figures were confirmed by Respondent's witnesses in the box. p. 34, ll. 1-8. p. 137, ll. 19-46. p. 138, ll. 1-14. pp. 272-279.
- 20 28. The cost of production at the close of the period referred to obtained in the same way, and likewise confirmed by Respondent's Accountant, was actually \$16.56 per thousand, the Respondent again having the benefit of the difference between that figure and \$17. The cost of production fell by reason of the drop in the cost of logs, labour and supplies. p. 139, ll. 15-18. p. 34, ll. 14-45. p. 35. p. 36, ll. 1-34.
- 30 29. Reference to Exhibit 12 being a comparison of lumber average sales prices, will show an even greater reduction in sales or market prices during the period; the Cameron prices were \$22.01 per thousand in March, 1931, as against \$17.33 in November; the average for the year 1931 was \$21 per thousand in March and \$18.77 in November. The month of December showed a much higher average of \$25.73, but this is not a fair criterion because, as explained by Mr. Barrett-Lennard, and agreed to by Miller, there was an unusual proportion of high grade product shipped or sold in that month. p. 292, l. 28. p. 292, l. 36. p. 292, l. 28. p. 292, l. 36. p. 71, l. 45. p. 72, ll. 1-2.

RECORD

p. 59,  
ll. 7-24.

pp. 272-279.

30. Some criticism was directed to the valuation on the basis of cost by witnesses for Respondent on the ground that the "total cost of manufacturing (including logs)" as shown by their statements is incorrect to the extent that the figures include the labour and other incidental expenses in connection with the handling of lumber purchased as distinguished from lumber manufactured from logs. But this is answered by taking the figures in the operating statements for four months prior to the fire and combining lumber purchased with lumber cut, thus arriving at an average price for all lumber manufactured. The average is \$20.64, a 10 higher valuation than shown in Exhibit 25.

p. 57,  
ll. 23-25.

31. Notwithstanding the elaborate bookkeeping system employed by the Respondent and the monthly operating statement designed to show the cost of production, the Respondent contended that it was impossible to calculate the cost of production. This feature was dealt with by M. A. Macdonald, J.A. (dissenting) in the Court of Appeal as follows:

"They said it was impossible to estimate the actual cost  
 "of production of stock in the yard at any particular time;  
 "that lumber may be in stock for several years and that it 20  
 "accumulates during the year (it appreciates in value the  
 "longer it is stored); if manufactured it may be stored for  
 "future orders; it consists of lumber of different dimensions  
 "differing in size and quality; it is not like goods on a mer-  
 "chant's shelves and it is impossible to estimate separate  
 "costs; about 25 per cent of it would be lumber, part of it  
 "purchased to supplement their own production, the balance  
 "or about 80 per cent would be shiplap, timbers, cross-arms,  
 "etc. (all these products, however, are 'sold by the thousand  
 "'feet primarily; even cross-arms'); different classes of 30  
 "articles are manufactured at different costs, the smaller  
 "items costing more, the larger less; cost of production of  
 "lumber varies from \$6.00 to \$40.00; some operations are  
 "cheap, others more expensive. Hence it was impossible to  
 "put any cost production price on specific items in stock.

"Yet their books show the average cost of production  
 "from month to month from the total stock, and also, taking  
 "March 1st, 1931, at \$19.00, going back over a considerable  
 "period higher costs are shown. This attempt to show account-  
 "ing difficulties does not of course demonstrate that in taking 40  
 "an arbitrary valuation results approximately correct will  
 "be shown. That it is not an easy task may be conceded:  
 "not however that it is impossible. One can visualize a small  
 "operation with all the factors referred to included and no

10 “special book-keeping difficulty would be encountered. The RECORD  
 “same methods and principles would be applied on a larger  
 “scale. Modern accountancy I hope it quite equal to the task.  
 “Respondent knew at the time of the fire what its logs cost,  
 “the cost of labour and the general costs entering into manu-  
 “facture of the products. It would naturally assume that the  
 “business would go along after the fire (had it not occurred)  
 “very much as it did before with any variation that might  
 “arise from a drop in labour costs and a drop in log costs.  
 “The reductions in the labour scale were known. It could  
 “estimate the cost of any new material required by the condi-  
 “tion of the supply market. It could also assume sales of a  
 “corresponding amount. Any exceptional facts would be  
 “taken into consideration.”

20 32. At the conclusion of the evidence Counsel for Appellants  
 asked the learned Trial Judge to direct the jury that as a matter  
 of law inventory valuations must be based on cost of production.  
 The learned Judge’s charge leaves no doubt as to his own opinion;  
 in fact after the jury brought in their verdict the Trial Judge  
 said he would not have decided the case as they did. But the  
 Chief Justice in the Court of Appeal thought that the Trial Judge  
 should have gone farther “and instructed them that they should  
 not adopt any other mode of finding the cost production,” mean-  
 ing any mode other than that put forward by Appellants.

30 33. The learned Chief Justice thought there should be a new  
 trial, so that the jury properly directed could proceed on the basis  
 of pricing inventories at cost; presumably the Chief Justice  
 thought that the jury might find such cost to be \$15 per thousand.  
 In this, however, he apparently did not appreciate the fact that  
 the costs of production were fixed or calculated by the Respondent  
 himself and a new trial would for that reason be merely a matter of  
 form.

34. Mr. Justice Macdonald in the Court of Appeal was of  
 opinion that Respondent’s action should be dismissed; after a  
 comprehensive review of the evidence and the rival views pre-  
 sented by both parties as to the proper basis of valuation of inven-  
 tories he said that “a basis of computation therefore was taken by  
 the jury disclosing earnings that did not exist, and as there was  
 no reasonable evidence to justify it in accepting that basis and as

on the other hand, having regard to Respondent's records and proper methods of accounting, it is evident that fixed charges and expenses were not partly earned" he would allow the appeal and dismiss the action.

35. No reasons for judgment have been delivered by Martin and Galliher, J.J.A., of the majority of the Court of Appeal, who would have dismissed the appeal.

36. The Appellants humbly submit that the judgment of the Court of Appeal should be reversed and the action dismissed or alternately that a new trial be directed for the following amongst other 10

### REASONS

1. That the jury having in all other respects accepted Exhibit 25 were not justified in calculating the value of inventories at an arbitrary value, having no relation to cost and substituting such arbitrary valuation for the cost of production as shown in the said exhibit.

2. That the computation of the jury did not show an "actual loss" by the Respondent which would entitle it to indemnity from the Appellants. 20

3. That the Jury erred in principle in not accepting the valuations of Inventory based on the cost of production as shown in Exhibit 25.

4. That if the valuations used in Exhibit 25 are right the Respondent would not have earned any part of its fixed charges during the period of re-construction.

5. That the learned Trial Judge should have been more explicit in directing the jury to disregard an arbitrary valuation and to apply the principle of cost.

6. That the learned trial judge should have granted the 30 Appellant's motion for judgment dismissing the action after the jury's verdict because it was apparent from the jury's memorandum that they had proceeded on a wrong principle.

7. That the jury's verdict was perverse and was not supported by any proper or legal evidence.

ALFRED BULL.

REGINALD SYMES.

No 42 of 1933.

## In the Privy Council

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On Appeal from the Court of Appeal for  
British Columbia

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BETWEEN:

THE MOUNT ROYAL ASSURANCE  
COMPANY, et al  
(Defendants) Appellants,

AND:

CAMERON LUMBER COMPANY  
LIMITED  
(Plaintiff) Respondents.

(AND SIX CONSOLIDATED ACTIONS)

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## Case for Appellants

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