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LORNEX MINING LTD.

v.

ASSESSOR OF AREA 23 - KAMLOOPS

Supreme Court of British Columbia (A863217) Vancouver Registry

Before: MR. JUSTICE A.G. MacKINNON (in chambers)

Vancouver, December 8, 1987

W.R. Ellison for the appellant
John E.D. Savage for the Respondent

Reasons for Judgment December 30, 1987

Pursuant to s. 74 (2) of the *Assessment Act*, R.S.B.C. 1979, c. 21, the Board seeks the opinion of the Court in respect of the following questions:

1. Was there any evidence before the Board on which it could reasonably have held that the value of the properties could be determined by the method it used, namely, a calculation of the ratio of 1984 net operating income to 1981 net operating income, and the application of that ratio to the depreciated values placed on the Assessment Roll?

2. Did the Board, in adopting the approach that it used to determine economic obsolescence, and hence actual value, act in disregard of appraisal principles and hence err in law?

3. Was there any expert appraisal opinion evidence before the Board to justify the approach used by the Board for the calculation of economic obsolescence, and hence actual value, and if not, did the Board err in law in adopting this approach?

4. Did the Board breach the principles of Natural Justice and thereby err in law in adopting an approach to the calculation of economic obsolescence, and hence to the calculation of actual value, which was not advocated by any party or witness before it, nor by any appraisal authority cited to it, and without giving the parties any opportunity to comment on the correctness of such an approach?

5. Did the Board err in purporting to adopt a method of calculating economic obsolescence referred to only in counsel's argument, and not in evidence before it?

6. Did the Board, in deducting its calculation of economic obsolescence from a measure of depreciated replacement cost, assume that depreciated replacement cost represents an upper limit of value, a concept not supported by any appraisal authority cited before it, and thereby err in principle and in law?

7. Did the Board disregard the statutory requirements of the *Assessment Act*, in particular Section 69 (1) (e), in adopting a method of calculation of value different from that used for any other mining property of which testimony was taken by the Board, and without

inquiring into, or giving the parties any opportunity to demonstrate whether the result would affect equity with other mining properties?

8. Was there any evidence on which the Board could have reasonably determined that the U.S./Canada exchange rate in 1981 was 1.033, and hence that the net operating income for that year was the figure it found?

The appellant has abandoned Question No. 7.

The material facts are:

1. The Lornex Mining Corp. Ltd. owns lands and improvements making up a copper, molybdenum and silver mining complex near Logan Lake in the Highland Valley of British Columbia. The property includes an open pit mine site and a mill, which produces copper concentrate as its primary product.

2. Initial construction of the mill began in 1970. There was a subsequent addition of the third production line in 1981, bringing the mill to its present capacity of 87,000 tons per day. A 1981 expansion was performed after an economic analysis of cash flow expectations by the owner, Lornex, and the cost of the expansion was approximately $150,000,000. At the time of the decision to expand, the price of copper was approximately 90 cents per pound.

3. The Assessor valued the mill on a cost approach using the capital cost and current replacement cost new for the improvements. There is no disagreement between the parties on the amount of physical obsolescence applied by the Assessor and there was no functional obsolescence present.

4. The Assessor gave a 5% allowance for general economic conditions and a further 5% allowance specific to the mining industry to account for economic or external obsolescence. No evidence was presented to support the determination of those allowances. The Board found that they were arbitrary.

5. There was agreement that some adjustment to value should be made for economic (external) obsolescence, and only the appellant made an attempt to provide market evidence from which such a deduction could be quantified.

6. Mrs. Dianna Manson, a Mineral Economist, was called by the appellant. Her evidence was accepted by the Board.

7. It was Mrs. Manson's evidence that metal prices had declined substantially since 1981 and there have been unprecedented levels of mine closures - in British Columbia, eight out of fourteen copper/molybdenum mines had closed since 1981.

8. It was further the evidence of Mrs. Manson, again accepted by the Board, that the current production/supply situation is more than a mere low point in a cyclical market, but is a basic dislocation and restructuring which might never return to a market of the type experienced when the mine expansion was undertaken in 1981.

9. The Board found that a significant level of external (economic) obsolescence had occurred.

10. The appellant led expert appraisal evidence from William M. Anderson, B. Comm., A.A.C.I., F.R.I., R.I. (B.C.) of International Assessment Appeals Inc. Mr. Anderson's appraisal attempted to develop a value for improvements based on an income approach.

The Board perceived the appraisal as an attempt to value the remaining income stream rather than the income loss.

11. The Board considered the appropriateness of the life of ore body approach to the determination of depreciation in the evidence of both parties and found that it was not an appropriate method for use in the valuation of the subject.

12. The Board accepted that the appellant's appraisal may well be considered as a business valuation, but that it could not be accepted as good evidence of the value of the assets which are the subject of the appeal.

13. The Board found that a determination of the income loss due to the factors causing the economic obsolescence must be made, and the Board found that neither party had adequately addressed this issue in its evidence.

14. In argument, the respondent put forward a method of calculation of economic obsolescence, which it advocated as being preferable to the calculation put forward by the appellant's appraiser, and from which the Board derived its approach to the findings made on economic obsolescence.

15. The Board did not find that depreciated replacement cost represents an upper limit of value.

16. In seeking a (normal) base from which the income loss demonstrative of economic obsolescence could be calculated, the Board determined that the year 1981 , the year in which the new production expansion was realized, was the most appropriate.

17. The Board calculated the income loss due to economic obsolescence by taking the net revenue obtainable at normal (1981) price levels and then at the levels prevailing in July 1984 (the effective date of the assessment, adjusted for the existing exchange rate on each date).

18. This comparison indicated a level of earnings in 1984 at 37.6% of the "normal" level of 1981. In other words, income loss due to economic obsolescence was found to be 62.4% at the date of the assessment.

19. The Board was satisfied that this drop of net revenue resulting from the market prices for minerals was the best measure available from the market of the economic obsolescence suffered by the improvements under appeal at July 1, 1984.

20. In making its calculations on revenue loss, the Board used a U.S./Canadian dollar conversion factor of 1.033 in 1981 and 1.343 in 1984. These were the trade weighted values of the U .S. dollar with its ten largest trading partners, not the Canadian/U .S. dollar conversion rate which was 1.199 and 1.319 respectively.

21. The evidence as to the comparability of all mining properties indicated a wide range of mineralization ranging from significant gold content in one mine to varying combinations of silver, copper and molybdenum in others. The Board found that the effect of economic conditions in the long term is such that the determination of economic obsolescence might require a unique approach in the case of each mining property, and specifically, distinct approaches in the case of the subject and the adjacent Highmont property which were both heard and determined in this same assessment year. The Board concluded that the most appropriate way to ensure equity is to determine correct actual value for each property under appeal.

In these Reasons I will refer to the appellant as "Lornex" and to the respondent as "the Assessor".

On the hearing before the Board the sole issue was the amount of the allowance to be made for "economic obsolescence". There was no dispute as to the cost of the mill and its improvements nor as to the existence of "economic obsolescence".

The Board was presented with two different methods for calculating "economic obsolescence":

> 1. The Assessor made a 10% reduction across the industry and applied that to depreciated cost. It arrived at a value of $188,000,000.00.
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> 2. Lornex contended that economic obsolescence may only be measured by the income approach. It adduced undisputed evidence there was a reduction of 62.4% in net revenue between 1981 and 1984. An expert opinion was rendered on the basis of that reduction. The actual value of the mill site would be $78,442,000.00.

The Board rejected both methods. It found the Assessor's method arbitrary and the appellant's income approach inappropriate. It then adopted its own method and arrived at a value of $46,425,480.00.

THE ISSUE

The issue on this Stated Case is whether the Board committed an error in law when it used its own method to determine the amount of "economic obsolescence".

It is the submission of counsel for the appellant that the court should not interfere with the findings of the Board. It is argued that the Board used a method of arriving at value by giving consideration to those matters set out in s. 26 (3) of the *Assessment Act*, R.S.B.C. 1979, c. 21, which provides:

> In determining actual value, the assessor may, except where this Act has a different requirement, give consideration to present use, location, original cost, replacement cost, revenue or rental value, market value of the land and improvements and comparable land and improvements, economic and functional obsolescence and any other circumstances affecting the value of the land and improvements.

Accordingly, the appellant contends that the Board considered cost, revenue and economic obsolescence being matters within s. 26 (3), supra. It looked at the cost of the improvements, applied undisputed depreciation, calculated income losses at 52.5% which it attributed to economic obsolescence, and then made a reduction allowance and arrived at actual value. It is submitted there was evidence before the Board from which they could arrive at value and that their method is, therefore, not open to review. Lornex relies upon *Provincial Assessors of Comox, Cowichan and Nanaimo* v. *Crown Zellerbach Canada Limited* (1963), 42 WWR. (N.S.) 449 (B.C.C.A.), where Davey J. stated at pp. 455-56:

> The statutory duty of the Assessor is to find the "actual value" of the taxable property, but section 37 permits him to use several different methods and to consider many different elements in finding actual value. I do not think that the use of any specifically mentioned method of finding actual value, or the inclusion or exclusion of any enumerated element, provided there is evidence to support the reasoning, can be said to raise a question of law appealable to the Courts on a stated case, for those matters lie in the judgment of the Assessor and the Assessment Equalization Board: *Reg.* v. *Penticton Sawmills Ltd.* (1954) 11 W.W.R. (N.S.) 351 at 353, 356.

Here, the issue is whether the method of assessment adopted by the Board is wrong in principle. It is, therefore, a matter of law and not fact: see *Swan Valley Foods Limited* v. *Assessment Appeal Board* (1979), 13 B.C.L.R. 304, Meredith J.; *Western Indoor Tennis Association* v. *Assessor of Area 11, Richmond-Delta* (1981), 29 B.C.L.R. 285; *Crown Forest Industries Limited* v. *Assessor of Area 6 - Courtenay* (1985), Case 210, B.C.S.C.

ECONOMIC OBSOLESCENCE

Lett C.J.B.C. considered "economic obsolescence" in *Re Assessment Equalization Act Re Royalite Oil Company Limited* (1957), 23 W.W.R. 328 at pp. 336-37:

> There is no definition of economic obsolescence in the *Assessment Equalization Act*. In a manual issued by the Assessment Commissioner appointed pursuant to the *Assessment Equalization Act* for the guidance only of Assessors, obsolescence is stated to be 'a loss in value caused by functional inadequacy, obsolete design, shifting land use, public nuisance, migration and many other factors which influence value.'

I was referred by counsel to a volume published by the American Institute of Real Estate Appraisers in 1953. While statements contained in this volume cannot be taken as binding, I found helpful the statement as to the nature of economic obsolescence contained in an article designated "The Theory of Depreciation" at p. 544. The statement reads as follows:

> *Economic Obsolescence*
>
> 'Loss of value through economic obsolescence is apparent if the neighbourhood has changed through racial encroachment, through a change in the use of the land, by reason of zoning restrictions, or by the imposition of some other economic law of change. It cannot be estimated as a percentage of reproduction cost new. It has nothing in common with reproduction cost - nothing to do with cost in any analysis. Its measurement must be otherwise if it is to be estimated reasonably or intelligently. The estimate of economic loss is economic inutility. It may best be estimated dollar-wise by capitalization of the money loss through estimated comparative failure to produce normal income.' [Italics added.]

An appraiser, Mr. Anderson, testifying on behalf of Lornex, said:

> Economic obsolescence can only be measured on an income basis and has nothing to do with cost in any way. . . therefore, all properties must be valued on an income basis if there is any suspicion that economic obsolescence exists.

The Assessor submits the Board was in error when it devised a method of determining the value of economic obsolescence that is unknown to the law and contrary to recognized and accepted methods of valuation. In those circumstances, it is argued that the Board misdirected itself on the proper principles of valuation. Furthermore, there was no evidence before the Board upon which it could reach the conclusion it did.

Royalite, supra, is authority for the proposition that economic obsolescence should be estimated by the income approach. Lornex also took that position before the Board.

The Board took the revenue losses between 1981 and 1984 as the criterion of economic obsolescence and applied the percentage reduction to age-depreciated replacement cost. Indeed, it did not capitalize the income loss. Its decision was based on a hybrid method that is contrary to *Royalite* and to accepted appraisal methods of valuation. The method used was created by the Board. There was no evidence to support the reasoning of the Board.

In *Marathon Realty Company* v. *The Regional Assessment Commissioner, Region Number 7 and The Corporation of the City of Peterborough*, S.C.O. Div. Ct., October 10, 1979 (unreported), Craig J. for the Court stated at pp. 22-23:

> In conducting the hearing of an assessment appeal it is my opinion that the Board functions in a judicial capacity; The *Assessment Act*, s. 57 (2); and *Peterkin* v. *Hydro-Electric Power Commission of Ontario*, 12 D.L.R. (2d) 791. It is required to hear and determine the case on the evidence adduced. No doubt the members of the Board do have a certain degree of expertise in assessment matters which assists in understanding, assessing and weighing evidence. In deciding assessment appeals, if the Board were permitted to act on its own expertise in complex matters and substitute its unsupported opinions for those expressed in evidence, then the exercise ceases to be judicial in character. The members of the Board would be their own experts not subject to cross-examination; their opinions would remain unknown until after delivery of the decision and therefore not open to contradiction or challenge. The parties would not know what case had to be met. There is no right of appeal on a question of fact. It would be quite unacceptable in our adversarial system where the parties, and not the court, decide what evidence to adduce.

It is my opinion that the Board erred in law in failing to determine the amount of economic obsolescence on the basis of the income approach and in using the method it did to determine economic obsolescence. There was no evidence before it that such a method could properly be used in determining value.

I remit the matter to the Board to determine economic obsolescence and direct it to receive further evidence on this issue.

As to the questions raised, I find as follows:

1. The answer to Question No. 1 is no.

2. The answer to Questions Nos. 2 to 6 is yes.

3. As to Question No. 8, the evidence is clear that there was no basis upon which the Board could have reached the conclusion it did. The Board used the incorrect exchange rate.

The answer to Question No. 8 is no.

These reasons will be remitted to the Board as the opinion of the Court.