BRITISH COLUMBIA

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DELIVERED BY EMAIL

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RE: QUOTA ASSESSMENT TOOLS EVALUATION (QATE) FOLLOW-UP QUESTIONS

This letter is in follow-up to the Milk Marketing Board (Milk Board) June 30, 2017 QATE submission and August 17, 2017 board to board meeting with the BC Farm Industry Review Board (BCFIRB). It sets out a number of questions related to the Milk Board's rationale and proposed changes to BCFIRB's 2005 Specialty Review directions.

QATE (initiated by BCFIRB on November 22, 2016) is intended to determine whether, and to what extent, industry and public interest policy outcomes are still being achieved by specific BCFIRB 2005 Specialty Review[1] directions, and whether those directions may have had unintended or adverse consequences that need to be addressed as a matter of sound marketing policy in the public interest. As stated in BCFIRB's February 28, 2017 Letter of Expectations[2] to all supply management commodity boards, a sound evaluation process providing substantive information and rationale is required before BCFIRB will act on any proposed changes.

BCFIRB requests that the Milk Board provide a written response to the following questions prior to the QATE board to board meeting scheduled for September 28, 2017. This letter and the Milk Board's responses will be posted to BCFIRB's website. These responses are intended to support the discussions at the September 28, 2017 meeting as well as to generally inform BCFIRB's deliberations. Given the short timeframe, summary answers are acceptable at this time.

BCFIRB's questions currently focus on three of the Milk Board's proposed changes. Specifically:

1) Eliminate LIFO and 10/10/10 transfer assessment on quotas issued after 2005 to established producers (excluding new entrant and specialty incentive quotas).

[1] BCFIRB 2005 Specialty Review Webpage; BCFIRB 2005 Specialty Review Directions
[2] 2017 February 28. BCFIRB. Quota Assessment Tools Evaluation-BCFIRB Expectations and Looking Forward.

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2) 0% Transferability of all new entrant, specialty incentive and quota issued for the Cottage Industry program non-transferrable for 10 years (100% of quota retracted by the Milk Board if transferred within 10 years after being received). The 0% transferability would also apply to any growth issued based on the aforementioned quotas. After 10 years, these quotas would be transferable and subject to the rules governing transfer, for example, the proposed market responsive assessment.
3) Lower and freeze quota price by approximately 15%, for a temporary period of time (e.g., one year should LIFO 10/10/10 be removed).

BCFIRB may have further questions for the Milk Board at the September 28 meeting or subsequently regarding the proposals to establish a market responsive assessment and to include farm workers as persons exempt from transfer assessments.

Overall, BCFIRB asks that the Milk Board focus its additional rationale for its proposed changes on areas that show how the changes will benefit the industry as a whole, and the overall public interest. The following criteria are provided as a guide to help draw out how the proposed changes benefit the industry and the public interest:

- Greater operating efficiencies for producers and other industry members throughout the entire system – enhancing value in the marketplace over the long-term.
- Promotion and/or continued overall industry growth and competitiveness.
- Responsiveness to the needs not only of producers, but also processors, consumers and other participants in the British Columbia food system.
- Contributions to the ongoing development of new and specialty markets (e.g., Cottage Industry, organic production, others).
- Reduction of barriers to entry and promotion of growth and sustainability for new entrants and specialty markets.
- Economic activity and stability in all regions of British Columbia.

Follow-up Questions

Proposed MMB Change #1 - Eliminate LIFO and 10/10/10 Transfer Assessment on all Quotas Issued after 2005

In September 2005, BCFIRB issued directions to all supply managed commodity boards concerning programs for new entrants and specialty production and marketing in the regulated marketing system. BCFIRB directed the terms and conditions for the transfer of new entrant and specialty quotas, including the establishment of a declining transfer assessment schedule. This schedule requires an automatic retraction of 100% of quota issued by boards in the first year after issuance, should a producer transfer or sell it. Subsequently, the amount retracted declines by 10% per year until it reaches a minimum assessment of 10% in year 10. This declining transfer assessment is known in industry as “10/10/10”. A further condition of transfer established by BCFIRB at that time was that the last quota issued by the board to a producer would be the first quota authorized for transfer out. This principle is known in the industry as “Last in / First Out” or LIFO.

The declining transfer assessment 10/10/10 and LIFO was extended by BCFIRB in 2005 to apply to all quota (growth) allocated by boards in all classes, including mainstream and base quota.

The BCFIRB 2005 Specialty Review established several policies that reflect federal and provincial legislation and regulations. LIFO and 10/10/10 was designed to balance the transferability of quota with the following policy objectives established by BCFIRB as part of sound marketing policy:

- Quota is intended to be produced
- Producers are actively engaged and committed to the industry
- Quota is available to commodity boards to support policy objectives, including development of specialty markets and providing for new entrants in the supply management system.

The BCFIRB 2005 Specialty Review noted that if quota issued by a commodity board becomes instantly transferable, there is a real possibility of windfall gains. The report stated that it is a basic principle of the commodity boards that producers should be actively engaged and committed to being in the industry. If a producer simply applied to transfer (i.e., sold or flipped) their quota immediately upon receiving it from a commodity board, this would not seem to indicate engagement or commitment.

In its June 30, 2017 submission, the Milk Board stated that the current transfer assessment structure, as established in 2005, is not market responsive and impacts a growth market very differently than one that is stagnant or in decline. It reported that producers have seen a 22% increase in quota allocations from the Milk board over the last 3 years, resulting in challenges to the efficiencies of the system.

In essence, the submission states that LIFO and 10/10/10 are hindering quota transfers and hence raising “quota prices”, thus creating barriers to entry. In addition, the current quota transfer assessment structure limits producer flexibility and doesn’t support the need to “right size” farms, creating challenges for the industry.

The submission goes on to state that producers “earn” their quota allocations through paying advertising and promotion levies. Similar statements are made with respect to quota being “earned” through capital and labour investments and through participation in national promotion programs.

Finally, the submission states that the argument of a guaranteed price for product, in a guaranteed market, is weak in today’s industry.

Further information is requested on the following points:

1. Part of the Milk Board’s justification for eliminating LIFO and 10/10/10 is on the basis of a point in time situation and various side effects – a growth market and a rapidly changing industry environment. Please address how the elimination of LIFO and 10/10/10 would benefit the industry strategically in the long run and how this measure would tie into the Milk Board’s long term strategic goals and vision for the industry - including how the industry would benefit in growth, neutral and declining markets.

2. The Milk Board reports that the ability to freely transfer quota without assessment is important for producers to be able to afford to "right size" their farms, particularly in the face of increasing public expectations surrounding traceability, food safety, biosecurity, animal care, and the environment. Please expand on:

    a. Why transferring quota (the licence to produce) is necessary to finance investments, as opposed to using operating profits and/or loans based on cash flow, as would be the case with non-supply managed businesses?

    b. How does transferring growth quota received for free from a commodity board – as opposed to existing quota traded or sold between producers in the marketplace – align with the principle that quota is a right to produce, that it is intended to be produced and that it is not property?

    c. How the Milk Board's rationale aligns with the two legal principles guiding quota management in BC. Please see Appendix A for a Milk Board document that BCFIRB finds adequately outlines BC's legal framework:

        i. The Board is not to assign monetary value to quota, even though it acquires value in the market place when traded between producers; and,
        ii. Quota remains under the exclusive control of the Milk Board at all points, meaning that a transfer of quota between two producers does not imply a change in ownership of that quota. Quota is a revocable license and is not property.

3. The prohibition against commodity boards in BC assigning monetary value to quota, per the discussion in Appendix A, raises the question as to what role, if any, the Milk Board properly has in seeking to address quota values in the marketplace. The prohibition against attaching a monetary value is inextricably bound with the notion that quota must remain the property of the board. Please expand on the role the Milk Board should play with respect to quota values given the discussion in Appendix A and how you see that role working to the benefit of the industry and the overall public interest.

4. If LIFO and 10/10/10 are removed, how does the Milk Board intend to achieve the following policy objectives set out in 2005, namely:
    a. Quota is intended to be produced
    b. Producers are actively engaged and committed to the industry
    c. Quota is available to commodity boards to support policy objectives, including development of specialty markets and providing for new entrants in the supply management system.

5. Whether or to what extent do any of the Milk Board's quota management policies and rules (for example, issuing continuous daily quota on a monthly basis, allocating growth pro rata and the ability to lease quota credits) play a role in the 'quota liquidity' and the ability to "right size a farm" issues reported around LIFO and 10/10/10?

Proposed MMB Change #2 - 0% Transferability (non-transferability) of New Entrant and Specialty Incentive quotas (e.g. Cottage Industry Program Quota) for 10 years

Under this proposal, all quota issued to a new entrant or specialty incentive quotas (e.g. Cottage Industry Program), including any growth, would be 100% retractable by the Milk Board if any portion of the quota is sold in the first 10 years. Essentially quota would become non-transferable for 10 years.

The Milk Board is proposing that this would apply to all Graduated Entry Program (GEP) quota issued between 2004 and 2019 (thus it would be retroactive). After 10 years the GEP quota would be considered as 'basic' quota and subject to the market responsive assessment. 100% retraction would include any pro-rata growth issued on GEP quota.

The Milk Board submission states that this change will provide production accountability to the Milk Board which in turn supports supplying milk to market while supporting new entrants in both the mainstream and specialty markets.

1. How does 0% transferability for 10 years square with the policy objective that quota should be transferable?

2. Imposing non-transferability on new entrant quota could discourage new producers who discover the industry isn't a good fit, from exiting. Is this something the Milk Board considered? Does it agree? If not, why? Are there sound marketing concerns with this approach? Is there a risk that a change to 0% transferability could potentially motivate 'poor fits' to stay for the 10 years, possibly creating a health or safety risk to animals or the industry overall? Is this something the Milk Board considered, does it agree?

3. The prevention of quota flipping/windfall gains is stated by the Milk Board as one of the key reasons behind moving to a 0% quota transfer scheme for new entrants. It is noted that this factor is not emphasized in the proposal to eliminate 10/10/10 and LIFO for existing producers. What is the overall industry/public interest rationale for proposing to treat this risk so differently between new entrants and established producers?

4. How will the proposed 0% transferability affect the ability of new entrants to "right size" their farms within their first decade of business?

Proposed MMB Change #3 – Lower Quota Price by approximately 15% and Freeze Quota Price for some temporary Period of Time

Under this proposal, the Milk Board would cap and freeze quota price on the Quota Exchange for one year at $36,000 CDQ. Should the target price of $36,000 kg/day be reached during the QATE review (prior to any potential policy changes, the Milk Board would freeze at target price to maintain industry stability while BCFIRB deliberates. No price adjustment would be applied if LIFO and 10/10/10 or some form of the policy remains.

The Milk Board has provided a legal opinion on this matter to BCFIRB. BCFIRB is in the process of reviewing this opinion. It looks forward to further discussion at the September 28 meeting on the alignment between the Milk Board proposal and the current legislative framework in British Columbia.

In closing, I would like to thank the Milk Board on behalf of BCFIRB for your assistance and efforts in answering these questions and for meeting again with BCFIRB to discuss them on September 28, 2017. In the meantime, should you have any questions or wish to discuss any of these items further, please call me at 250-387-3915.

Yours truly,

Kirsten Pedersen
Executive Director

Cc: BC Farm Industry Review Board
BC Milk Marketing Board
Zahra Abdalla, Director, Policy, BC Milk Marketing Board
BCFIRB Website

Appendix A

Milk Marketing Board's "Quota Policy and Governance Consultation" document published January 28, 2014 – "Summary Discussion of the Principle that Quota has no Value".

Under the *British Columbia Milk Marketing Board Regulation* (a regulation made under the *Natural Products Marketing (BC) Act*), the Milk Board has broad powers to "establish, allot, alter, suspend, or cancel a quota" and "to establish terms on which quotas may be allotted, held, transferred, altered, suspended or cancelled".

Subsection 7(2) of the *Regulation* vests the following specific powers in the Milk Board:

> 7. (2) The board is authorized
>
> (a) to establish, allot, alter, suspend or cancel a quota, <u>to which no monetary value is to be attached by the board</u>, that applies to any person, [*emphasis added*]
>
> (b) to establish terms on which quotas may be allotted, held, transferred, altered, suspended or cancelled,

These provisions must be understood in light of the nature of quota itself.

In *Sanders v. British Columbia (Milk Board)* (1991), 53 B.C.L.R. (2d) 167 (B.C.C.A.). In that case, the appellant producer took issue with the surrender assessment imposed by the Milk Board. The issue before the Court of Appeal was whether quota could be considered "property" as against the Milk Board itself. The Court of Appeal answered in the negative, stating:

> The Milk Board may prescribe the terms and conditions on which quotas may be issued, held, transferred or cancelled. The word "cancelled" is particularly significant as indicating the powers intended to be conferred. A quota, a license to produce, which may be issued on prescribed terms and conditions may be cancelled, that is annulled or abolished, also on prescribed terms and conditions. In summary the situation is "the Board giveth and the Board taketh away"; others may in the meantime buy and sell the licence which the Board issues, but they do so knowing that the Board has the right not to approve its further sale.
>
> In addition, the Court of Appeal quoted with approval from the reasons of Hinds J. in these terms:
>
> > I therefore conclude that the appellant's quota should not be characterized as property. In essence, it was a revocable license to

> produce and ship fluid milk to a dairy plant. As quota has not been characterized as property, the foundation for the appellant's argument that the board cannot expropriate property without compensation has crumbled and has ceased to exist.

The governance of quota in BC is thus guided by two overarching legal principles. The first is that the Milk Board is not permitted to attach monetary value to quota, despite the fact that it acquires value in the market place when traded amongst producers. The second principle is that quota remains under the exclusive control of the Milk Board at all points, meaning that a transfer of quota between two producers does not imply a change in the 'ownership' of that quota.

In short, the expression "quota has no value" is a term of art in regulated marketing. It speaks to both the Milk Board and the producer. To the Milk Board, it states that when the Milk Board is issuing quota and making other regulatory decisions regarding quota, it may not attach value to that quota. To the producer, it says that the producer may not assert that quota as property against its regulator, the Milk Board, regardless of its treatment in other contexts.

<u>The legal principle that Quota has no Value may be summarized as follows:</u>

1. Quota is a revocable license which provides a conditional entitlement to produce milk, but with no right to renew or retain the quota allotted.
2. Quota is issued from the CDC to the Province with no value (free).
3. BCMMB under the regulations are stewards of quota for the Province.
4. BCMMB issues (allocates) quota with no monetary value (free) to produce milk.
5. Quota remains under the exclusive control of BCMMB at all points.
6. Quota is not owned by producers or the BCMMB.
7. Producers may trade (sell) quota with permission of BCMMB to produce milk and create value from cash flow of milk production from the quota.
8. Producers trading (selling) quota use the Quota Exchange "clearing price" based upon the cash flow of the quota but the quota itself still has no value since it is a revocable license and not property.

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