1/13/2014

BC Dairy Quota Policy and Governance

Stage 2 “Finding Solutions”

Zahra Abdalla-Shamji
DIRECTOR OF POLICY

The BC Milk Marketing Board is conducting a consultation with the support of the BC Farm Industry Review Board (BCFIRB) that will be used to develop an effective long term quota allocation and governance policy. The Milk Board developed a Discussion Paper in support of the consultation, and invited all industry stakeholders and interested members of the public to participate. Following a series of regional consultations, the Board provided a summary of findings report that identified key issues that were identified during these sessions.

The objective of the review is the development of an effective quota policy that will preserve, build and transition the British Columbia dairy industry for future generations. **The key principles for such a policy are to provide equitable quota allocation, sustain current producers, facilitate renewal of the dairy industry with new producers, enable flexibility to manage quota for milk production, and support innovation and adoption of value added opportunities across the entire market.**

The Board completed Stage 1 of the consultation “Identifying Issues and Ideas” at the fall producer meeting held in Vancouver on November 29, 2013. The summary provided included key themes that surfaced through the face to face sessions and any written comments within scope of the consultation.

The Board is currently in the process of Stage 2 of the consultation “Finding Solutions” from producers and the dairy industry input with respect to quota policy and provides the paper that follows which outlines the quota policy considerations that surfaced from the analysis stage of the consultation. The Board will continue to gather input through this process that will be used to evaluate current policy, and, where necessary, propose policy changes or develop new policy to BCFIRB for prior approval.

The Board is requesting all industry stakeholders review the following summary of key themes and policy considerations and provide comments with respect to the quota policies that are outlined in this discussion paper. <u>The deadline for submission will be January 31st, 2014.</u> Comments can be provided by mail, fax, or email. All written submissions will be shared publicly on the Milk Board website (with identifying features removed) once the submission period closes.

The Board has been asked to submit an overall review of all quota policies to the FIRB and to identify whether policies are working or require change. Input within the scope of the consultation, from all stakeholders will be used to develop the final review paper.

Identified Theme and Current Policy

Distribution of General Allotments

Farm size and the concentration of quota on the farms in British Columbia is an issue that constantly surfaces in the world of policy. Small, medium and large farms all have unique needs with respect to quota, adding in regional considerations creates a broad discussion with respect to the distribution of general allotments.

The current policy (C.O. September 2013; Section III 13(2)) for BC dairy producers is to distribute quota on a pro-rata basis to all qualifying producers.

Objective of Current Policy

The current policy applies a percentage (as determined by the BCMMB) to the existing quota on all qualifying farms in British Columbia. The policy provides an equitable distribution of quota and a reasonable growth allocation for all farms. The policy also allows for quota to be allocated and retracted using the same policy with minimal impact on the farm.

Comments during the analysis stage of this consultation encouraged the Board to develop a differential allocation policy for dissimilar sized farms in order to support the challenges of smaller farms, regionally challenged locations and underproduction on farms.

Key Principle(s) Applied to Policy

a) Equitable Quota Allocation:
b) Sustain current producers;
c) Facilitate renewal of the dairy industry with new producers

Significant Shareholder Inputs and Analysis

1. <u>50/50 Allocation Policy</u>
   Contributors to this discussion suggested the current distribution of general allotments policy could be changed to a 50/50 distribution of quota, a policy that was applied in the past. This policy would distribute 50% of any general allocations by an equal quota share to all producers in British Columbia. The remaining quota (50%) would be distributed on a pro-rata basis as it is today.

   The theory behind this type of policy is that it will allow smaller farms to grow at a faster pace than allocating all quota on a pro-rata basis. However, this type of policy also becomes unequitable during a quota reduction and becomes challenging for on farm management if several quota allocations or retractions occur in the same calendar year.

   In order to assess the impact of the suggested policy, the following examples have been provided for review, using the following information;

   Current Producers = 511

   CDQ = 71,127 kg/day for the province

   January 1, 2014 Quota Allocation = 1% which equates to 711 kg/day

50/50 Scenario

- 355.50 kilograms allocated to 511 farms on equal share= 0.70 kg/day
- 355.50 kilograms allocated to 511 farms @ 0.5% based on farm CDQ

Pro-Rata (Current Policy)

- 711 kg/day allocated to 511 farms @ 1% based on farm CDQ

Example 1 – Smaller than average Farm in BC (100 kg/day)

Using the 50/50 allocation method the 100 kg/day producer would receive 1.20 kg/day (0.7 $^{50/50}$ + 0.5 $^{\text{Pro-Rata}}$) instead of 1.00 kg/day under the current methodology.

Example 2 – Average farm in BC (140 kg/day)

Using the 50/50 allocation method the 140 kg/day producer would receive 1.40 kg/day (0.7 $^{50/50}$ + 0.7 $^{\text{Pro-Rata}}$) under either methodology.

Example 3 – Larger than average farm in BC (180 kg/day)

Using the 50/50 allocation method the 180 kg/day producer would receive 1.6 kg/day (0.7 $^{50/50}$ + 0.9 $^{\text{Pro-Rata}}$) instead of 1.80 kg/day under the current methodology.

2. Sleeve Allocation
   Another suggestion provided during discussions was to consider a sleeve allocation instead of a permanent allocation during times of uncertain growth in the market. This practice is currently used in the organic industry due to constant processor commitment changes in the market. A sleeve allocation would result in a temporary allocation of quota for a period of time, quota would then be allocated based on utilization of the allocation, i.e. if 90% of the allocation is produced, and the producer would then earn 90% of the allocation. Although a sleeve allocation has been used in the past under the TPQ system, the current national continuous quota system could be a difficult system to coordinate the sleeve and allocations as Canadian Requirements occur on a bi-monthly schedule. In the past, when a sleeve was used, an allocation occurred at the end of the dairy year which complemented the national “dairy year” system.

3. Allocate to Those Who Can Produce Quota
   Many producers suggested a policy that would allocate quota strictly to producers willing to produce it. There was significant concern with respect to producers holding on to quota due to the current 10/10/10 and LIFO retraction policies and either using the credit transfer system to profit off a regular transfer or simply holding on to quota rather than producing it. Suggestions included creating a policy that would limit allocations only to producers who have produced a minimum percentage of quota on a twelve month rolling basis; only to producers who have not lost underproduction credits on a twelve month rolling basis; and only to producers who have not lost deemed kilograms of quota on a twelve month rolling basis. Although these types of policies are administratively challenging, the punitive nature of losing kilograms for production and then losing a quota allocation would likely be seen as being penalized twice for the same infraction.

The long term impact of this type of policy would prevent a producer from the opportunity to receive allocations, plan for future production through the use of credit transfers to acquire cash flow to have the relevant resources to produce allocations.

4. Hold Allocations Back to Fund Programs
   The Board currently reconciles quota on a bi-monthly basis to coordinate with the notification of change to Canadian Requirements. The reconciliation includes accounting for quota that is required for all Board funded quota programs (i.e. GEP, specialty sleeve etc.). This practice has been applied by the Board administratively for years in order to manage quota production with the national system. This practice has ensured programs that require quota have never been short of resources to start producers.

   Another consideration of holding back quota is the global assessment strategy. This type of policy would require the Board to take an assessment from all producers currently in the industry in order to fund Board quota programs. This type of policy would be to the benefit of producers selling out of the industry and not to producers staying in for the long term.

5. Sell Allocations on the Exchange
   Another policy consideration is the idea to apply all quota allocations on the quota exchange and provide an opportunity to all producers to purchase quota. The Board would face challenges with respect to managing this type of system as it would be recognizing a monetary value on quota that is allocated to the province. However, the province of BC recognizes no value for quota, value is defined through transfers between producers. The other challenge would be the management of funds collected from the sale of quota as these funds would likely need to be restricted fund strictly used to administer the quota exchange and could not be applied to the producer pool as producers would receive financial benefits from quota they didn't produce.

6. Regional Allocations
   Differential quota allocations have been applied in the specialty industry to encourage growth and support innovation in the province. Producers in outlying areas suggested a differential quota policy that ensures the long term viability of farms outside of the Fraser Valley.

   Although no differential quota policy exists to support farms in regions outside the lower mainland, there are policies that exist today that support the production of quota in these areas. For example, the shared freight costs for all quota in the province is a policy that encourages producers to produce milk outside of the Fraser Valley; the Board has policies that support the expansion of production in the specialty industry in outlying areas; and the opportunity for all producers in outlying areas to purchase quota.

   The Board encourages and supports the production of quota in the entire province through its policies.

7. Status Quo
   The current policy of general allocations on a pro-rata system is a fair, equitable system that is simple. The primary benefit of this policy is that allocations, retractions and producer levies are all applied in the same manner. A farm with 300 kg/day of quota receives a proportionate share

of quota and pays its proportionate share of levies and in turn receives a proportionate share of retractions. This policy allows for effective farm management in the industry.

Preliminary Policy Recommendation(s)

Following a review of all comments including those provided during the regional input sessions, the Board is considering the distribution of general allocations remain on a pro-rata basis as the distribution is fair and equitable and complements the national allocation process under a CDQ system.

The Board explored penalizing producers for low production practices but had concerns with respect to creating a system that determines the eligibility of a producer receiving allocations could not justify a system of dual penalties while maintaining the principles of sound quota governance.

Holding back quota to fund programs is already a process that is practiced and selling allocations on the quota exchange would likely require changes in legislative policy.

The Board is confident the current policies of allocations for all producers support regional production in the province.

Identified Theme and Current Policy:

Graduated Entrant Program

A global concern within all commodity Boards is the true opportunity to sustain the industry in its current state and provide mechanisms to encourage long term growth.

Commodities tend to experience swings in participation due to cost of entry and greater efficiencies within the market. As part of the BCMMB's strategic plan, the Board is committed to provide effective and efficient quota management policy and address the future consolidation of farming.

The current graduated entry program (GEP) was introduced in 2004 which allocated 13.7kg/day of non-transferable restricted CDQ plus 5.5kg/day of matching non-transferable restricted CDQ. The program length is 10 years and children of producers were permitted to add their names to the program wait list. The Board currently commits to starting three producers annually from the wait list. Details of this program can be found in the September 2013 Consolidated Order – Schedule 1.

Objective of Current Policy

The intention of the GEP was to address future consolidation and to mitigate challenges faced by new entrants trying to enter the industry. The program was designed to provide some financial support to new farmers and in return new entrants were to commit to farming for a minimum of 10 years.

However, concerns from the analysis stage of the consultation strongly emphasized the need to exhaust the existing GEP waitlist as the length of the list creates substantial waiting periods which in turn forms barriers to entry into the dairy industry.

Although significant support for the program is evident through industry comments and sessions, participants encouraged the Board to consider a new program with a lottery system for quick entry, an allocation amount that is economically viable, allocation of non-transferable quota and a longer commitment term in the program.

Key Principle(s) Applied to Policy

a) Facilitate renewal of the dairy industry with new producers

Significant Shareholder Inputs and Analysis

Discussions at regional sessions focussed on four key areas of the program;

1. <u>Waitlist</u>

   Generally all industry participants agreed 42 potential wait list candidates is a list that is too long and will require approximately 14 years (3 entrants per year) to complete. Contributors to this discussion emphasized the need to exhaust the current list and create a new program that could be run under a lottery system. This would allow interested new entrants the opportunity to start farming right away and deter any need to secure other careers in the interim.

   Over the last three years the Board has invited 15 waitlist participants (5/year) to start producing milk through the increase of national allocations and available quota from retractions and assessments. The Board must ensure there is a market for the production and availability of quota allocations that does not create detriment to the general producer body.

2. Program Length

   Participants expressed concerns on the ability for a producer to participate in the dairy industry for 10 years and then selling out allocated quota with minimal investment requirements and in some cases retaining other employment. Suggestions for a longer program length i.e. 15 or 20 years before any quota can be sold was strongly suggested.

   Since 1998, 63 graduated entrant producers have started under the program. Statistics over the last five years indicate that 8 GEP producers have left the program.

3. Quota Allocation

   Many participants (primarily producers) voiced concern on the allocation of quota (maximum 19.2kg/day) being economically challenging for any new entrant. The Board was encouraged to allocate more quota but restrict its transferability in order to ensure the success of the new operation. Other proponents of this discussion suggested it is not the Boards responsibility to create a viable farm, viability is the responsibility of the investor.

   Allocations in the cottage industry program are a maximum of 27.4kg/day and the specialty industry can be as high as 13.7 kg/day on a 68.5 kg/day base.

4. Family Transfers

   Family transfers are currently permitted and popular for those children of producers currently still in the industry. Participants were split in this discussion, some requested the Board to consider no family transfers should be permitted to any new participants within the industry and others suggested the current policy is supportive of growth and succession.

   Exempt transfers are permitted as per the consolidated order (C.O. September 2013; Section I (3)). Currently there is not policy that prevents exempt transfers from occurring to a GEP producer.

Preliminary Policy Recommendation(s)

The Board reviewed the comments from the industry with respect to the concerns on the current graduated entry program. Due to the list that currently exists and the length of time some people have been waiting , the Board is considering that the current wait list be completed within five years and a future new entrant program be developed that encompasses suggested changes during this period. The Board could start 8 to 10 producers a year to exhaust the list or advise all producers on the wait list that they must start production in the next five years contingent on potential program changes with respect to quota allocation.

The Board recognizes a new program would require an evaluation of the investment of time (i.e. 10, 15 20 years) in the program; the value of the quota allocation; and the opportunity of family transfers under the program.

Identified Theme and Current Policy:

Farm Succession – Intergenerational Transfers

In British Columbia, dairy farming today contains various levels of organization unlike 50 years ago when the farm was organized as a "mom and dad" entity. Many farms have a very complex structure which includes corporations, many limited companies and several family trusts. The farms have gone through succession and brothers, cousins, aunts, uncles are all intertwined as shareholders of quota.

Intergenerational transfers under this premise become challenging and the exempt transfer provision is not a policy option for many farms.

Over the past several years' policies have directed the flow of quota but some find the logic questionable and are challenging the sustainability of these policies in the long term.

Objective of Current Policy

The current policy as defined by FIRB (C.O. September 2013; Section I (3)) for exempt transfers allows parents to transfer quota to children (as defined under the law) without assessment. The scope of exempt persons was intentionally limited to a small group in order to allow for the majority of transfers to occur on the quota exchange.

Key Principle(s) Applied to Policy

a) Equitable quota allocation;
b) Sustain current producers;
c) Facilitate renewal of the dairy industry with new producers

Significant Shareholder Inputs and Analysis

Four key inputs surfaced during discussions on intergeneration succession;

1. <u>Exempt Persons</u>
   It was clear that the producer body is asking the Board to review the exempt person criteria and allow the list to reflect today's modern family farm. As mentioned earlier, a level of succession has already occurred in the industry which has created the family corporate farm which may not complement a direct transfer (parent to child) of quota.

   However by expanding the exempt persons list, less assessments would be taken creating a need to retain quota for Board programs from another source.

2. <u>Corporate Family Farms</u>
   In order to maximize benefits of running a business, over 50% of farms today are corporations. However the Board has no specific provisions to support corporate family transfers. Therefore it becomes challenging to coordinate the transfer of quota with the corporate family structure and benefits through taxable benefits, etc.

3. Non-Family Exemptions
   Although the nature of farming supports a family structure, there are situations in which the farm is run by employees or extended family. In these types of scenarios, the owner of the quota is unable to transfer quota to key employees or extended family to secure their commitment for the long term on the farm.

   The Board did not hear a viable basis or support to exempt non-family members to an undetermined limit of employees, friends, or private treaty.

4. Limited Board Involvement
   Comments from some producers indicated that current policies were working effectively and the Board should not be involved in farm succession plans.

Preliminary Policy Recommendation(s)

The Board reviewed all industry comments and is considering a change to extend the exempt persons list to include nieces, nephews and grandchildren in order to facilitate family transfers especially within a corporate family structure.

Identified Theme and Current Policy:

Declining Transfer Assessment

The declining transfer assessment was applied to all commodity Boards following the specialty review in 2005.

The current policy as directed by FIRB (C.O. September 2013; Section IV 23(B) allows a producer to earn 10% of his/her quota allocation over a 10 year period resulting in a 10% assessment after 10 years.

Objective of Current Policy

The declining transfer assessment is designed to ensure producers “produce milk”, quota is equitably transferred and windfall profits are prevented.

This assessment was intended to support long-term farming, innovation, specialty and market development and penalise those producers wanting to sell some quota or all quota in a short period of time.

Key Principle(s) Applied to Policy

a) Equitable quota allocation;
b) Sustain current producers;
c) Facilitate renewal of the dairy industry with new producers;
d) Enable flexibility to manage quota for milk production;
e) Support innovation and adoption of value added opportunities across the entire market

Significant Shareholder Inputs and Analysis

Comments with respect to the declining transfer assessment though never complementary advised the Board that the assessment schedule works as long as policies like credit transfers, flexibility days and the quota exchange continue to be an option for producers.

Sessions and written inputs are summarised in the following points;

1. Change LIFO to FIFO
   Participants of this discussion recognised the need for an assessment to support Board programs and innovation to sustain the industry. The challenge in the discussion surfaced through various regions and producers individual needs. LIFO is a policy that will not impact a producer as long as he/she has cash flow and plans to stay in the industry for a long period of time. FIFO has benefits to producers who are trying to manage a farm with limited cash flow and have very different needs in their stage of farming.

2. Change 10/10/10 to 10/10/5
   Changing the assessment rate to 5% at the end of the 10 year earning period provides consistency in policies on a standard surrender assessment of 5% (C.O. September 2013; Section IV 23(1(A))).

3. Remove 10/10/10 and LIFO
   Some proponents of this discussion were adamant this policy is unfair to the dairy industry in today's time. The policy is not flexible and creates challenges for on farm management especially for downsizing purposes. Others felt this policy creates an inflated market value for quota on the quota exchange which was not the original intention of the policy when applied, as it benefits sellers and not producers. Lastly the producers require a tool that can offer stability on their farm instead of relying on overpriced credits to manage over or under production.

4. Flat Rate Assessments
   Non-supporters of the declining transfer assessment suggested a flat rate assessment on all quota, for example 10%. This type of assessment would allow producers to sell and buy quota as required and still allow the Board to collect the quota needed to fund Board programs and support the industry.

   This type of policy is similar to what existed before 2006 with a 5% assessment on all quota.

5. Status Quo
   Lastly some producers expressed the policy is working and changes were not required. Producers have credit transfers, 20 days of flexibility and the quota exchange to manage their affairs.

Preliminary Policy Recommendation(s)

The Board is considering a policy change from 10/10/10 LIFO to 10/10/5 LIFO in order to administratively have the same assessment practice as purchased (non-allocated) quota at the end of the 10 year cycle and extend the exempt persons list for industry growth and renewal with corporate family farms.

The Board is also considering no change to 10/10/10 LIFO with extension of the exempt list for renewal of the industry through farm investments or expansion.

Identified Theme and Current Policy:

Whole Farm Transfers and Quota Exchange

In April 2010, the Board issued a Notice to Producers that advised no whole farm transfers would take place until such time a new policy could be applied. The policy that was cancelled afforded buyers and sellers significant amounts of flexibility to move quota outside of the quota exchange. This practice did not allow all producers equal access to quota. The current whole farm transfer policy was applied in November 2011 (C.O. September 2013; Section IV 18(2)) following a yearlong discussion and then recommendation from the Quota Exchange Committee to the Board.

The conventional quota exchange (C.O. September 2013; Schedule 3) was applied in February 2010. The Board developed this model with consultation through regional associations and the Quota Exchange Committee through the fall of 2009.

Objective of Current Policy

The intent of the quota exchange was to remove the ability to manipulate price and settlement on the exchange. The exchange was meant to be a tool that was fair, equitable and transparent to all producers within the industry. The Board applied a model with one clearing price for all producers and a pro-rata application of settlement to sellers. Following the initial application of the model, the Quota Exchange Committee monitored the model and recommended the application of a purchase limit and mechanisms to slow down the climbing clearing price of quota. These policies were applied as recommended.

The whole farm transfer policy was intended to support producers purchasing farms for long term succession and to ensure the availability of quota on the quota exchange. The policy was designed to support renewal and to sustain efficient farming.

Key Principle(s) Applied to Policy

a) Support industry to sustain current producers;
b) Provide equitable quota allocation;
c) Facilitate renewal of the dairy industry with new producers;
d) Enable flexibility to manage quota for milk production

Significant Shareholder Inputs and Analysis

Whole Farm Transfer

1. <u>Keep 100% of the quota on the Farm</u>
   A consistent input from many stakeholders with respect to the current whole farm transfer policy, was the inefficiency of transferring 50% of quota off the farm. The policy impacts small and mid-size farms significantly different from larger operations. The requirement to transfer 50% of the quota on the quota exchange immediately devalues the sale especially if the producer planned to purchase the farm and run it independently. This policy only becomes efficient in the case of a merging the newly acquired farm and quota with the producers existing

farm and quota. Many producers argued that in order for a whole transfer to be effective 100% of the quota should be allowed to transfer.

The previous policy allowed a 100% transfer of quota with the farm, but producers argued at that time that the policy was unfair as quota was being transferred off the exchange and there was no transparency or equity in the industry.

2. Allow the merging of the newly acquired farm and quota with the producers existing farm and quota, after a period of time
   Another option that was contributed through discussion was to allow 100% transfer of quota with the whole farm and restrict any mergers for a period of time. For example, it could be mirrored similar to the declining assessment policy that is after 10 years a merger could occur without any assessment. An issue with this type of policy is that it interferes with efficiency. The Board must consider whether it's more important to have 500 farms or 450 efficient farms.

3. Change the 50/50 policy to 25/75
   Producers that supported the current policy but agreed in certain situations a 50/50 split on the quota was detrimental suggested a change to the ratio of 25% of the quota would revert to the exchange and 75% would remain with the farm. All mergers could continue as the policy allows today. However less quota would be available on the exchange.

4. Use 50/50 if merging of the newly acquired farm and quota with the producers existing farm and quota occurs
   Lastly, suggestions to apply the 50/50 provision only if a merger occurs. Concerns regarding this type of policy provision are more administrative and would require an expiry clause to be functional.

Quota Exchange

5. Not Enough Quota on the Exchange
   A significant concern in the industry appeared to be the lack of quota on the exchange. Suggestions from stakeholders to secure more quota on the exchange included changing the declining transfer assessment LIFO to FIFO which would allow producers to sell quota and manage operations without penalty and keeping the whole farm transfer policy and its current 50/50 requirement.

   With respect to quota availability, if a producer had CDQ of 100 kg/day on January 1, 2013 and submitted the max bid of 30kg/day on each quota exchange in 2013, the producers new CDQ at December 31, 2013 including Feb 1 General Reduction of 0.6% and September 1 general allocation of 1.5% would have been 121.32 kg/day. This would be a 21% increase in quota on the farm over one calendar year.

6. Change how bids are filled
   The current exchange is filled on a pro-rata basis satisfying all sellers. Comments regarding this model were favourable as the exchange appears fair, transparent and equitable. However some

producers vocalised the disparity in the model for smaller producers and the need to fill a higher percentage of smaller bids through a bottom up system. This type of system would ensure an equal portion of quota available to all bidders and provide a true reflection of demand on the exchange as max bids would not be required.

Preliminary Policy Recommendation(s)

The Board is considering no changes be applied to the Quota Exchange at this time as the current model is fair, equitable, and transparent and meets the current objectives of quota transfers in the province. Although the claim is there is limited availability of quota, based on the example of a 100 kg/day dairy there appears to be opportunity to increase production through consistent bids on the quota exchange.

With respect to whole farm transfers the Board is considering maintaining the status quo and maintaining the 50/50 application during a transfer. An alternative would be to create a declining scale to allow merging of the newly acquired farm and quota with the producers existing farm and quota at the point of sale or thereafter, however this policy would require limitations to exempt family transfers and significant administrative tracking in order to be effective.

The Board is considering the following change in policy for whole farm transfers:

1. Allow 100% transfer of quota if the farm is not merged;
2. If merging of the newly acquired farm and quota with the producers existing farm and quota occurs in the first 5 years – 50% of the quota is sold on the exchange, 50% can transfer
3. If merging of the newly acquired farm and quota with the producers existing farm and quota occurs following Five Years:
   - Year 6 40% on the exchange
   - Year 7 30% on the exchange
   - Year 8 20% on the exchange
   - Year 9 10% on the exchange
   - Year 10 0% on the exchange