

Supervisory Review of Proposed Amendments to the CFC Operating Agreement (Federal Provincial Agreement for Chicken)

SUBMISSIONS OF THE PRIMARY POULTRY PROCESSORS ASSOCIATION OF BC

APRIL 27, 2016

Overview

1. This submission of the Primary Poultry Processors Association of BC (“PPPABC”) responds to the submissions of the BC Chicken Marketing Board (“BCCMB”), received by FIRB on March 31, 2016. PPPABC relies on its submissions filed April 4, 2016, supplemented by the within submissions and affidavits.
2. The BCCMB has to advance positions which support the BC processing and further processing industry. It is a fact that processors and further processors must sell to a regional and national market. These markets do not exist solely within the borders of BC, nor are the BC borders closed to processed products coming in from the East. Fifteen years ago the chicken industry in BC was enjoying robust growth. A strong further processing industry had developed and was thriving. The growth in BC that created these substantial plant investments arose during the period BC was out of the national agreement for chicken.
3. The re-entry of BC into the national system was predicated on an assurance that BC would be able to continue to grow and meet the needs of its industry stakeholders. Without adequate supply, there was a real risk that the further processing sector would not be able to continue to grow and compete on the national stage. The new Federal Provincial Agreement had a satisfactory method for allowing differential growth, and worked for a period of time. When CFC stopped using the differential growth allocation method and began issuing allocations *pro rata*, the processing and further processing sectors in BC were adversely affected. Without access to adequate product to allow them to fully compete on regional and national contracts, BC processors and further processors have watched processors from Central Canada displace them and fill the retail markets in the West. This has great significance for the sustainability of the BC processing and further processing sectors. The further processing industry is significantly impacted by its inability to meet its product needs. Two major processors in

BC have additional further processing facilities in Ontario. These two companies will continue to make investment and production sourcing decisions based on where they can access sufficient chicken to meet the demands of their customers and on where that chicken is competitively priced.

4. The submissions of BCCMB focus on the period 2014 to the present. However, 2014 to the present is not the relevant time frame. More importantly from the perspective of the BC processors is the timeframe of approximately 2004 to 2016. Over these 12 years the supply share of BC significantly diminished as against processors in Central Canada. The impact of this cannot be overstated. The impact can be seen in the loss of market share on Western retail shelves, in Western food service restaurants, and in the supply imbalance demonstrated in the table at page 37 of the Processors' Documents filed on April 4, 2016 ("PD"). The chronic shortage of product in BC, coupled with high costs of bringing product into BC from other regions to meet production needs, high live prices, and an export program that has become less economically viable, have brought the BC further processing industry to a critical place. The continued existence of the BC further processing industry is at risk, and the industry is no longer able to grow. Investment in further processing is moving to Ontario.

Affidavit of Scott Cummings, para. 7 - 8
Affidavit of Blair Shier, para. 6 - 7

5. Similarly, the BCCMB focusses on domestic allocations. From the perspective of the BC processors, the entire supply share available to Canadian processors must be considered, not just domestic allocations. Central Canada has a distinct advantage over the West. It is able to easily access TRQ and spent fowl to increase its volume of raw materials. The additional product available to processors in Central Canada must be considered when FIRB assesses the impact of proposed amendments to the Operating Agreement. In other words, do the proposed amendments allow sufficient flexibility for BC to meet the needs unique to this province? Because BC does not have access to the same volume of imports as Central Canada, it requires a higher percentage of domestic production in order to meet its markets.

Supply imbalance

6. The supply imbalance between Central Canada and the West is critical when understanding the opposition of the BC processors to the proposed amendments to the Operating Agreement.

7. When the domestic allocation alone is considered, Central Canada receives 60% of the total national allocation. However, Central Canada has access to significant amounts of product coming in through TRQ and spent fowl. When the total production is considered, the share of Central Canada increases to 65%. In contrast, the production in the West drops from a 32% share (domestic alone) to 28% (total production). Under the TPP, if TRQ is allocated on a *pro rata* basis, the numbers will become even worse.

Excerpt from December 6, 2013 presentation, [PD page 37]

8. Access to significant amounts of product over and above the domestic allocation provides Central Canada with a distinct competitive advantage over the West.

Affidavit of Ron Kilmury, para. 3

9. The share of total production in Central Canada exceeds its percentage of the population, while the West has a lesser share than its percentage of population.

Excerpt from December 3, 2014 presentation, [PD page 75]

10. BC has previously enjoyed a strong share of the further processing category in Canada. As the largest province in Western Canada, and the third largest province in the country, it would be expected for B.C. to remain an active and competitive player in this category. Based on the investments that have been made, B.C. has facilities that are as good as any in Central Canada. In order to maintain a viable position in the further processing category, BC needs fair access to supply for further processing. The concentration of fowl and TRQ in Eastern Canada, which is processed there and shipped into Western markets, combined with the lack of domestic supply available to us in BC, means that B.C. does not have enough chicken to supply the growing needs of B.C.'s consumers.

Affidavit of Blair Shier, para. 9

11. The differential growth allocation method in the current Operating Agreement was designed to allow the Western processors to determine their own market needs, and obtain the product they needed, independent of the market needs of Central Canada. It was a workable method that allowed Western provinces to receive allocations which reflected their needs, and were different from the allocations made for Central Canada. However, when CFC ceased allocating for differential growth, the supply imbalance arose and was further exacerbated with large increases in fowl imports.

Affidavit of Ron Kilmury, para. 6
Affidavit of Scott Cummings, para. 16-18, Exhibit "A"

12. At para. 32 - 38 and 53 – 54 of its submission, the BCCMB asserts that the current Operating Agreement was not allowed to operate as it was intended due to the failure of the processors to supply their market needs. This assertion is factually incorrect. The processors in fact have supported the use of the current Operating Agreement, and its differential growth methodology, throughout. The complaint of the processors is that CFC stopped using the differential growth formula and moved to a *pro rata* allocation. It is this decision of CFC to ignore the differential growth method and instead allocate *pro rata* which gave rise to the supply imbalance which is the basis for the processors' opposition to the proposed amendments to the Operating Agreement.

Affidavit of R. Kilmury, para. 3, 6
Affidavit of Scott Cummings, para. 4
Affidavit of Ken Huttema, para. 3

13. In early allocations under the current Operating Agreement, the provinces received allocations at differentiated rates, which were recorded as averages per region. For example, in A-43 (December 2001), the West received 4.2% over base, while Central Canada received 1% over base. In A-45 (April 2002), the West received 2.2% over base, while Central Canada received no increase over base. In A-49 (November 2002) the West received 1.4% over base, while Central Canada received 1% over base.

Affidavit of Scott Cummings, Exhibit "A"

14. By A-62 (November 2004), CFC was making allocations on a *pro rata* basis. This situation has continued to the present.

Affidavit of Scott Cummings, Exhibit "A"

15. In or about 2006-2007, the BC processors generally stopped providing their market requirements to the BCCMB in writing. This was done out of frustration with the national allocation process, and the failure of CFC to issue allocations on anything other than a *pro rata* basis.

Affidavit of Scott Cummings, para. 4
Affidavit of Jeff McDowell at para. 2
Affidavit of Ken Thorpe at para. 3

16. Even though the B.C. processors chose to protest the failure of CFC and the BCCMB to allocate production in accordance with the regional responsiveness provisions of the

Operating Agreement, the BCCMB was made aware of the market needs of the B.C. processors. In most periods either the CFC rep or the General Manager of the BCCMB would talk to processors to discuss their requirements. The BCCMB would aggregate these numbers, and together with other relevant information, and send the aggregate number to the Pricing and Production Advisory Committee (“PPAC”) for comment.

Affidavit of Scott Cummings, para. 5
Affidavit of Ken Thorpe at para. 3

17. The BCCMB was aware of the requirements of the BC processors, but still the allocation to BC came back *pro rata*.

Affidavit of Scott Cummings, para. 6
Affidavit of Jeff McDowell at para. 2
Affidavit of Ken Thorpe at para. 3

18. Contrary to the submissions of the BCCMB at para. 38, the inflexibility of the *pro rata* allocation methodology is what drove Alberta to leave the national system. There was no effective way for it to obtain the differentiated growth which it required. If the current Operating Agreement had been allowed to operate as it was intended, Alberta would have obtained the growth it required **and would not have exited the national system.**

19. At para. 54 of its submission, the BCCMB states that TRQ are held by all processors and can be used in any province, plus all processors are eligible for TRQ based on previous year’s production. This statement is simply not a reflection of reality. As confirmed by CFC, the vast majority of TRQ in fact is available for processors in Central Canada. According to CFC, in 2011 Ontario received imports of 48.3 Mkg, Quebec received 22.2 Mkg (total of 70.5 Mkg for Central Canada), and BC received only 2.8 Mkg. The remaining provinces received negligible amounts.

Excerpt from CFC presentation, [PD page 26]

20. Further, while a Western further processor could theoretically purchase TRQ and use it in its Western operations, it is not practical to do so because it is extremely complex, risky and unsustainable due to distances and shipping timelines. It is far easier and less expensive to have U.S.-based product simply shipped to Ontario facilities, as the materials are almost always sourced from the Southeastern United States.

Affidavit of Blair Shier, para. 8

21. When British Columbia re-entered the national system in 2001, part of the agreement was that it could continue its export program. Because BC processors did not have access to TRQ to bring white meat into BC for further processing requirements, BC processors developed a way to obtain white meat for their processing operations that became known as the export program. For every 1 kg of dark meat exported, BC processors could grow an equivalency of 1.5kg live weight. This allowed a disproportionate amount of white meat to be grown under the domestic allocation and to remain in BC for the further processing sector.

Affidavit of Scott Cummings, para. 9

22. When BC signed on to the new agreement in 2001, the processors compromised on the co-efficient of 1.5kg. They agreed to reduce the re-grow co-efficient to 1.25kg. While this substantially reduced the economic value of the program, the 1.25 co-efficient still provided BC processors with an economically viable program at the time. However, as pricing on the export market has fallen, the co-efficient of 1.25kg is no longer profitable. The processors have substantially reduced their export production in light of the current pricing. Instead of CFC looking at ways to increase the volume of exports back to previous levels, by increasing co-efficients to higher levels, the only changes that have been proposed are ones that would have further reduced the co-efficient and further compromised the economic viability of the program. This creates another competitive advantage for processors in Central Canada who continue to access TRQ and increase their spent fowl imports without the supply disruption experienced by Western processors.

Affidavit of Scott Cummings, para. 10

23. As noted by the BCCMB at para. 37, the Farm Products Council of Canada has expressed concerns about the incompatibility of the *pro rata* allocation methodology to appropriately address the statutory requirement to consider comparative advantage. The proposed amendments will effectively lock in the current shares of the domestic allocation with no ability to obtain a differentiated result in the future. The criticism expressed by FPCC will not be addressed.

Affidavit of Ron Kilmury, para. 7

24. The BCCMB retained Ference & Co. to prepare an analysis of the differential growth formula contained in the MOU (and to be implemented in the proposed amendments to

the Operating Agreement) against the *pro rata* allocation method employed by CFC since 2004. The Ference report states its key finding as follows:

Our key finding is that there does not exist a significant difference between the future estimated volumes of allocation growth in BC using the current differential growth formula to that using pro-rata (i.e. BC's share of the national base). ... During this ten year period, BC's share of the national allocation is projected to be 14.16% based on the current differential growth formula which is slightly less than BC share of 14.21% base on pro rata.

Comparison of Projected Allocation Growth Using
Current Differential Growth Formula to Pro Rata
Allocation, Ference & Co., March 21, 2016, page 1,
6, 7

25. In the result, the proposed amendments to the Operating Agreement do absolutely nothing to address differential growth or the current supply imbalance. Over the course of 10 years, under the proposed model, BC will be in exactly the same place it is today, or maybe it will be slightly worse off than it would have been under *pro rata* allocations. This is a completely unacceptable outcome. The further processing sector is struggling with the current supply share. It cannot be sustained at the current level for 10 more years.

Affidavit of Ron Kilmury, para. 7
Affidavit of Scott Cummings, para. 12
Affidavit of Jeff McDowell, para. 4
Affidavit of Ken Huttema, para. 7

26. In its submissions at para 59-60, 62 the BCCMB suggests that there is no evidence to support the impacts on the BC processing and further processing industry asserted by the PPPABC, or the assertion that Central Canada had no need for additional production. There is clear evidence that shows the supply advantage of Central Canadian processors vs. their Western counterparts and that the supply advantage has translated into Central Canadian processors displacing Western processors from Western retail and food service markets. The PPPABC relies on the following evidence in support of its position:
- (a) A retail survey conducted in retail stores in Ontario, Alberta and BC. This survey demonstrated that in BC and Alberta 75% of the frozen and further processed chicken products originated with processors in Central Canada, and only 4% of the frozen further processed product in Ontario originated with processors in Western Canada.

Retail Audit Report, March 2016 [PD page 115-131]

- (b) Sunrise and the Hallmark Group have had to import significant volumes of third party product into their BC production facilities to meet current needs. These volumes represent 6-9% of the total domestic allocation for BC.

Affidavit of Ron Kilmury para. 8 & 9

- (c) Of the top ten restaurant chains in terms of market size, six are supplied either 100% or 90% from processors outside of BC, one is supplied 50% from processors outside of BC, two are supplied with fresh product within the regions, and only one national restaurant chain is supplied by BC processors.

Poultry Supply to Top Restaurant Chains in
Canada [PD page 105]

- (d) The total supply share has been amply demonstrated to disproportionately favour Central Canada at the expense of Western Canada.

Excerpt from December 6, 2013 presentation, [PD
page 37]

Excerpt from December 3, 2014 presentation, [PD
page 75]

- (e) Central Canada consistently requests lower allocations than the West.

Affidavit of J. McDowell para. 16-17, Ex. "E"

- (f) Ontario takes the position that any additional allocation that it wants should come at the expense of the other provinces. Ontario is not growing the market, rather it is using the allocation process to take markets from other provinces.

Affidavit of Ron Kilmury para. 4-5

27. Further, as stated above, the BC processors did provide the BCCMB with their market requirements throughout, and had meetings with the BCCMB where they explained all of the impacts described above.

Impact of MOU and proposed amendments to the Operating Agreement

28. The MOU and the proposed amendments to the Operating Agreement do not address the rigid and inflexible allocation method employed by CFC since 2004. The proposed amendments will do nothing to grow the industry in the West, or address the supply imbalance which has arisen since 2004.

Affidavit of Scott Cummings, para. 12, 16, 18

29. In para. 49 of its submissions, the BCCMB says that the processors were satisfied with the allocations since 2014 under the MOU. The quote set out by the BCCMB does not support the position articulated by the BCCMB. As stated by the processors in earlier

submissions, the point to be taken from the allocations since 2014 is not that the MOU created a favourable environment for allocations across the country, as the BCCMB seems to suggest. Rather, the position of the processors was, and is, that 2014 and 2015 were anomalies for the chicken sector.

30. The high demand in those years was artificial, and will soon return to much lower levels. The concern of the processors is that the artificially high volumes in 2014 and 2015 masked the true effect of the MOU. In periods of low or normal growth, BC will again suffer disproportionately as its allocations will decrease in line with Central Canada notwithstanding the fact that BC cannot afford such decreases. As predicted, the most current data from CFC is showing storage stocks far higher than the healthy range, and a significant drop in wholesale pricing.

Affidavit of Jeff McDowell, para 14-15, Ex. "C" and "D"

Processors' Differentiated Regional Allocation model

31. In its submission at para 39-47 the BCCMB is critical of the processors' efforts to advance the Differentiated Regional Allocation proposal ("DRA").
32. The processors developed the DRA as a conciliatory attempt to work with the MOU, and to amend that agreement to allow for differential growth. However, it is not the role of the PPPABC to develop regulatory solutions. That is the role of the BCCMB, in response to and in consultation with industry. The PPPABC attempted to develop this proposal because of the failure of the BCCMB to advance their interests at the national table.

Affidavit of Ron Kilmury, para. 18
Affidavit of Jeff McDowell, para. 8

33. The Western processors do not have a seat at the CFC table. The Western processors rely on their provincial boards to represent their interests at the national table. At a May 29, 2015 meeting of the Western boards and processors, the Western processors presented the DRA. The Western boards agreed to present this proposal to the other provinces.

Affidavit of Ron Kilmury, para. 10, 17

34. On September 2, 2015 at a CFC meeting in Ottawa the Western processors' proposal was introduced. The processors did not attend because they did not know that the proposal was on the agenda.

Affidavit of Ron Kilmury, para. 11
Affidavit of Jeff McDowell, para. 9-10

35. Ron Kilmury, the representative of the PPPABC who had presented the DRA to the Western boards, was not notified that the Western processors were expected to attend the meeting, nor was he asked to present the DRA proposal to the CFC. He only found out the night before the CFC meeting that the DRA proposal was going to be discussed. At the time, he was in BC and could not make last-minute preparations to attend the meeting.

Affidavit of Ron Kilmury, para. 12

36. Jeff McDowell, an alternate to CFC, was also not notified that the DRA proposal would be discussed at the September 2, 2015 CFC meeting. The agenda did not disclose that the DRA would be discussed. Mr. McDowell was not able to attend the meeting. If he had known the DRA was going to be discussed, he would have attended.

Affidavit of Jeff McDowell, para. 9-12, Exhibit "A"

37. The minutes of the September 2, 2015 meeting state that the Western provincial board managers would address feedback on the DRA proposal. However, such follow up did not occur with the BCCMB. The only follow-up came from the Alberta Chicken Producers Board (the "**Alberta Board**") and the Further Poultry Processors Association of Canada ("**FPPAC**").

Affidavit of Ron Kilmury, para. 13-15, Ex. "A" and
"B"
Affidavit of Jeff McDowell, para. 13, Ex. "B"

38. After the September 2, 2015 CFC meeting, Western processors did not pursue the DRA proposal further because of reports that the majority of the other provinces did not have an appetite to renegotiate the MOU. Western processors were left with a sense that the MOU was set in stone by that point.

Affidavit of Ron Kilmury, para. 16

Consultation

39. At para. 21-25 of its submission, the BCCMB states that the consultation with the processors was sufficient and meaningful. The PPPABC disputes this assessment.

40. At times the representatives of the BCCMB did update PPAC members about discussions at the national level regarding proposed amendments to the Operating Agreement. However, these were very general updates only. The processors expressed their concerns regarding allocations in several meetings, but those concerns were not addressed in the MOU.

Affidavit of Ken Huttema, para. 5
Affidavit of Jeff McDowell, para. 2
Affidavit of Scott Cummings, para. 2
Affidavit of Ken Thorpe, para. 3

41. On May 15, 2014 the processors met with the BCCMB and raised several concerns, as outlined in the April 4, 2016 submissions of the PPPABC (at paras. 35-36). Those concerns, however, have not been addressed in the proposal currently before FIRB.

Affidavit of Ken Huttema, para. 6
Affidavit of Jeff McDowell, para. 2
Affidavit of Scott Cummings, para. 2
Affidavit of Ken Thorpe, para. 3

42. The MOU and proposed amendments to the Operating Agreement do not address the fundamental concerns of the processors, namely that the West is experiencing a significant supply imbalance which is affecting the processors' ability to maintain and grow their markets. The MOU and proposed changes to the Operating Agreement do nothing to ensure that the domestic allocation is being distributed across the country in a manner responsive to the actual market needs of the processors.

Affidavit of Ken Huttema, para. 7
Affidavit of Jeff McDowell, para. 2
Affidavit of Scott Cummings, para. 2
Affidavit of Ken Thorpe, para. 3

43. At no point did the BCCMB meet with the BC processors to discuss how the supply imbalance could be corrected in a new agreement. And at no point did the BCCMB respond to the concerns raised by the processors.

Affidavit of Ken Huttema, para. 8
Affidavit of Jeff McDowell, para. 2

Affidavit of Scott Cummings, para. 2

Affidavit of Ken Thorpe, para. 3

44. The processors were not shown a copy of the draft MOU before it was signed, and no meetings were held with individual processors before it was signed.

Affidavit of Ken Huttema, para. 9

Affidavit of Ken Thorpe, para. 4

Affidavit of Scott Cummings, para. 14

Affidavit of Jeff McDowell, para. 6

45. Mr. Smith, the Chair of the BCCMB, and Mr. Janzen, the BCCMB's delegate to CFC, requested a meeting with the owners of Superior Poultry Processors Ltd., Murdie and Ron Pollon, only following the execution of the MOU.

Affidavit of Ken Thorpe, para. 5

Non-compliance with Operating Agreement, FPA and relevant legislation

46. The PPPABC generally relies on its submissions made earlier in this review to address the positions taken by the BCCMB.
47. The PPPABC does respond specifically to the statement made by the BCCMB at para 55, to the effect that the actions of CFC under the MOU were legal because they were approved by the FPCC. To the extent the FPCC became engaged in prior approvals of allocations made under the MOU, the FPCC put itself in a very difficult position. The allocations made outside of the current Operating Agreement are not permitted under the FPA. The FPCC has no authority to amend the FPA or permit activities which contravene the FPA.

Is a differentiated regional growth mechanism required in the proposed Operating Agreement?

48. FIRB has asked that the following question be answered through a demonstrated, substantiated SAFETI analysis:

Is a differentiated regional growth mechanism required in the proposed Operating Agreement in order to address concerns raised by the Primary Poultry Processors Association of BC (PPPABC) that the proposed Operating Agreement, including the Chicken Farmers of Canada (CFC) decision-making structure, leaves them at a competitive disadvantage?

49. The PPPABC strongly submits that any Operating Agreement must have a mechanism to allow for differentiated regional growth. This could be the method

outlined in the current Operating Agreement provided it was complied with. This could also be a mechanism along the lines of the DRA proposal prepared by the Western processors. But there must be something in the agreement that will give BC the ability to grow out of lock step with Central Canada. The PPPABC relies on all of its submissions in this review when setting out its summary SAFETI analysis below.

Strategic

50. If the BC processing and further processing industry is to survive and flourish, it must have an ability to grow to meet its markets. A strategic decision for BC is a decision which provides flexibility for the industry, and which allows BC processors to plan and invest in the future. Given the size of Central Canada relative to BC and the West, every time a *pro rata* allocation is made to both regions, Central Canada receives more than twice as much new product as the West. The new product is then processed by Central Canada and sold in the West. If BC further processors cannot get access to enough product to compete head to head with companies from Central Canada, the further processing industry in BC will not survive.
51. Strong processing and further processing industries drive growth at all levels of the production and supply chain in BC. Improving the domestic supply allocation process is particularly critical for BC processors if they are to overcome the existing structural advantage currently enjoyed by Central Canada as a result of TRQ and the importation of fowl. Any loss of markets at the processing and further processing level has significant negative impacts down the supply chain, as less chicken is required to be grown in the province.

Accountable

52. A differential growth mechanism which responds to the market needs of the processors allows the BCCMB to be accountable to the industry in BC, and the consumers of BC products. If the mechanism is mandatory it will eliminate the ability of CFC to avoid implementing the differential growth mechanism, which again addresses accountability.
53. Accountability requires the BCCMB and CFC to comply with agreements to which they are parties. Agreements are important and foundational to the exercise of good governance. If CFC and the BCCMB act as though compliance with agreements is optional, or merely a discretionary obligation, the accountability of the system is undermined.

Fair

54. The effect of the proposed amendments to the Operating Agreement will be to create and exacerbate an unfair, inefficient system with embedded competitive advantages favouring Central Canada over the West.
55. If a non-discretionary differential growth mechanism is included in the Operating Agreement, it will allow BC processors to begin to regain a supply share more in line with their market needs. This is required to ensure a fair outcome for the BC processing and further processing industry.

Effective

56. Adding a differential growth mechanism to the current proposed amendments will allow Alberta to re-enter the national system, without detrimentally impacting the whole of the Western region.


Transparent

57. Basing allocations requests on the market requirements of the processors allows the allocation setting process to be transparent. Allocations can be evaluated against the requests made, and a coherent approach to the allocations should be evident.
58. All product available to processors in Canada must be taken into account in making allocation decisions. Imports (TRQ, spent fowl, and TPP) must be taken into account in determining the appropriate level of allocation to be made to a region or province. **Domestic allocations cannot be considered in isolation from other product available to processors.**

Inclusive

59. The BCCMB must involve the processors in the development of a proposal before it is complete. Further, it is not adequate to receive information from the processors without acting upon it. The BCCMB must accommodate the concerns of the processors in the development of any proposed new amendments to address differential growth.

Dated: April 27, 2016



Wendy A. Baker, QC
Counsel for the Primary Poultry
Processors Association of BC