

BRITISH COLUMBIA FARM INDUSTRY REVIEW BOARD

IN THE MATTER OF THE *NATURAL PRODUCTS MARKETING (BC) ACT* AND

SUPERVISORY REPORT:

A REVIEW OF THE BC MILK MARKETING BOARD'S MANAGEMENT OF THE BUSINESS
REORGANIZATION OF A QUOTA HOLDER FROM 2011 TO 2016

April 21, 2017

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INTRODUCTION

This report pertains to the British Columbia Milk Marketing Board's management of the business reorganization of a quota holder covering a period of time from late 2011 to October 2016.

On January 26, 2015, BCFIRB approved amendments to the Milk Board's consolidated order (CO) to expand the list of family members eligible to receive transfers of interest in quota without a requirement of continuous daily quota (quota) being surrendered to the exchange and without assessment on the interest in quota being transferred. These changes are now incorporated into section 23 of the CO (refer to CO dated September 1, 2013, as amended May 14, 2015 and effective June 1, 2015).

BCFIRB approved changes to the order on the condition that the new provisions not be applied to business transactions retroactively. BCFIRB requested information from the Milk Board on December 18, 2015 to follow up with its direction of January 26, 2015 and to confirm the Milk Board's assertion that there was no compliance issue with the approvals provided to a quota holder to add partners to its main shareholder partnership.

BCFIRB requested documents on two additional dates, April 19, 2016 and June 20, 2016. On receipt of documentation provided June 24, 2016 from the Milk Board, with follow up to address technical access matters, the Vice-Chair of BCFIRB struck a supervisory panel to review the documents to determine if the Milk Board complied with BCFIRB's January 26, 2015 direction.

KEY INFORMATION

BCFIRB required documents from the Milk Board for the follow-up and confirmation of compliance with its January 26, 2015 direction. This report provides a synopsis of the key documents evaluated and refers to information provided by the Milk Board in its November 9, 2016 meeting with the panel.

The quota holder is a corporation; its owners (shareholders) are a managing partnership which owns the voting common shares, and three other groupings (a family trust, a numbered corporation and another group) which own three classes of non-voting preferred shares. The managing partnership is the decision-making shareholder of the quota holder. It consists of partner corporations.

The principals of the original seven partner corporations are brothers and the principals of the additional four partners are sons of one of the principals of the "brother" corporations. These sons are nephews to the principals of the other "brother" corporations. The organization of the business of the quota holder appears to reflect a range of objectives, such as the minimization income tax liability and a means to achieve family succession for the business. The quota holder adopted this business organization in the fall of 2010.

BCFIRB's Vice-Chair struck a supervisory panel on July 30, 2016 to review the Milk Board's governance of issues arising from changes made within the business organization of the quota holder based on the record of documents the Milk Board provided to that time, with a view to ensuring that BCFIRB's direction of January 26, 2015 had been met.

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The panel reviewed the Milk Board's early records (late 2011 to September 2013) pertaining to the quota holder. The factual ambiguity in the information from this period gave rise to questions as whether any retroactive transfer, without the payment of a transfer assessment, had occurred.

The Milk Board wrote to the quota holder in August and September 2013 advising that additions to the partners of its managing partnerships, which additions were corporations of whose principals were the children of one partner, but nephews to other individuals of the partnership, would result in "deemed transfers". Any deemed transfer would trigger assessment on the interest in quota being transferred to the new partners, and result in subsequent surrenders of the assessed quota to the Milk Board.

The quota holder wrote to the Milk Board in September 2013 seeking a "ruling" on whether there would be an assessment if changes were sequenced so that interests were transferred from the "brother" partner corporations before transferring an interest in quota to one of that partner's son's corporations. The Milk Board sought advice from BCFIRB at that time and then advised the quota holder that this sequencing would not be acceptable to avoid application of quota transfer assessment. The quota holder referred to the transfers at that time as proposals.

The Milk Board went on to investigate "strategic options" in September 2013.

In October 2013, the Milk Board wrote to BCFIRB advising it had ruled that proposals to add partners were not "allowed" without an assessment on the interest of quota to be transferred. The Milk Board advised, however, that it wished to change its orders to broaden the list of exempted family members to accommodate business succession planning within family farms and to avoid assessment on the associated quota transfers. This led to the inclusion of consideration of this further policy change in a governance review already underway at that time by the Milk Board.

Over the next two years, the Milk Board communicated with the quota holder and BCFIRB several times, and ultimately made a recommendation to expand the list of exempted entities. BCFIRB provided its approval in January 26, 2015, based on conditions, notably

The expansion of the transfer assessment exemption list is not to be applied retroactively. BCFIRB expects the Milk Board will address any quota transfer compliance issues previous to this decision as appropriate in a transparent, fair and accountable manner. [emphasis added]

The change to the CO made on May 14, 2015 and becoming effective June 1, 2015, included adding nieces and nephews to the list exempt from quota transfer assessment.

After the Milk Board received BCFIRB approval regarding changes to the exemption list, it determined that further due diligence on its part was required with regard to the quota holder in light of information in its possession. In May 2015, the Milk Board determined a third party should undertake an assessment of the business structure changes raised by the quota holder.

The Milk Board advised the quota holder:

The purpose of this letter is to notify you that KPMG will be reviewing both the corporate and LLP structures on behalf of the Board.

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On June 22, 2015 the quota holder wrote the Milk Board indicating it was "not yet in a position to advise as to what proposed changes" would be made to the corporate structure, but provided the Milk Board:

- (a) The Partnership Agreement,
- (b) A Partners' Resolution re conditions of admittance of new partners (the Resolution), dated effective December 17, 2010; and
- (c) Instrument of Admission form which will be used to admit any new partner.

In the June 22, 2015 correspondence, the quota holder's counsel advised unequivocally:

We confirm that the current partners of the Partnership are the original seven partners named in the Partnership Agreement. No partners have been added since the date the Partnership was established, as none may be added with the condition precedent of the requisite Board approval have been met.

At this stage it is proposed that corporations controlled by children of the principals of Existing Partners may be added as partners in the future. If it meets with the Board's approval, the Partnership would propose to add [listed partners] as partners in 2015. [emphasis added]

KPMG undertook its review in July 2015, and reported its results to the Milk Board. The Milk Board summarized these results to the quota holder's counsel:

The Board is satisfied that the ... shareholder structure review conducted by KPMG confirmed the information provided to the Board on June 22, 2015 by legal counsel for [the quota holder]. KPMG reported that at all times during the period under review, the quota was directly held by the quota holder; and at all times during the period under review, the partners of the partnership were the original seven family members are noted by [the quota holder's] legal counsel and here below....

The Board noted that the KPMG Report of July 8, 2015 stated "Nothing has been brought to our attention to indicate otherwise or cause us to refute the representation made by legal counsel....".

The Board has accepted the KPMG review and the legal counsel ... representation that there has been no change in the partner group ... since inception and thus no direct or indirect transfer of quota.

The quota holder wrote to the Milk Board in August 2015 advising that "the Partnership would now like to admit new partners" and sought the Milk Board's approval that four new partners be added, on an exempt basis under the Board's orders, "effective immediately, on receipt of Board approval". This is the first and only written request for Milk Board approval by the quota holder, or notice of organization change, that the panel finds in the records.

On October 23, 2015, the Milk Board responded with its approval for the addition of the proposed new partners and requested that the quota holder provide updated documents listing an updated Central Securities Register (CSR) reflecting the changes; CSR for each of the new partner's Partner Co. Ltd.; CSR for each of the new partner's Holding Ltd. and a copy of each of the new partner's "Family Trust".

In response to this letter, the Milk Board received, from counsel for the quota holder:

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the draft copy of the amended Central Securities Register (CSR) ... for the board's review and records." And "...an updated register for [the managing partnership] " [emphasis added]

On January 26, 2016, BCFIRB wrote to the Milk Board directing the production of documents from which BCFIRB would determine if the Milk Board had met the compliance obligation. The Milk Board responded on January 28, 2016 explaining how in its view it had done so, but not providing all documents as directed.

BCFIRB followed up with this request on April 19, 2016 directing production of the documents. BCFIRB followed up again on June 20, 2016 to remove any ambiguity as to its direction by providing a particularized list of the documents it expected from the Milk Board and clarifying the direction. The Milk Board responded in full to this direction on June 24, 2016 providing copies of many of the documents not previously provided and information as to how to access some documents electronically. The Milk Board later remedied the ineffective electronic link to documentation.

On July 30, 2016 the Vice-Chair established a three person supervisory panel (Chair D. Stancil, Members A. Sakalauskas and C. Wendell) to review the record and make a determination as to compliance. After the panel evaluated the documents, it determined it required further information to fully understand how the Milk Board came to the conclusion it was in compliance with the January 26, 2015 direction.

The panel met with representatives of the Milk Board on November 9, 2016 who advised the panel that it relied on the June 22, 2015 advice of counsel for the quota holder as follows:

We confirm that the current partners of the Partnership are the original seven partners named in the Partnership Agreement. No partners have been added since the date the Partnership was established.

The Milk Board indicated it relied on that advice since it was the advice of an expert legal professional. Based on that advice, in the opinion of the Milk Board there were no transfers made before the changes to the CO, that would have attracted assessments.

The panel subsequently considered this information and determined that "the documents requested by the Milk Board on October 23, 2015...do not appear to answer the question as to the effective dates that the four new partners became partners...", but that in all likelihood records must exist that demonstrate the effective dates the four new partners were added.

The panel requested the information from the Milk Board on January 10, 2017. On January 26, 2017 the Milk Board provided the information from the quota holder dated January 20, 2017.

Counsel for the quota holder advised the Milk Board of the effective dates of admission of four new partners to KMS and provided a copy of the Register of Partners. The effective dates for admission are as follows:

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1. Partner Corporation (Corp.) 1– December 16, 2015
2. Partner Corp. 2 – December 16, 2015
3. Partner Corp. 3 – December 16, 2015
4. Partner Corp. 4 – February 4, 2016.

The panel accepts the information in these final documents to be conclusive evidence that the interests in quota were transferred on dates that post-dated the effective date of the changes to the CO and following the October 23, 2015 approval of the Milk Board.

CONCLUSION

Based on the findings above, and subject to the comments and recommendations contained in the cover letter to this report, the panel is satisfied that there are no outstanding regulatory matters concerning the subject matter of this report that the Milk Board is required to address. The panel concludes that the Milk Board complied with the January 26, 2015 direction of BCFIRB.



Daphne Stancil, Presiding Member



Chris K. Wendell, Member



Al Sakalauskas, Member