

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

SUBMISSIONS OF THE PRIMARY POULTRY PROCESSORS ASSOCIATION OF BC

May 11, 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") and the Chicken Farmers of Canada ("CFC"), received by FIRB on April 27, 2016. PPPABC relies on its submissions and affidavits filed April 4, 2016 and April 27, 2016, supplemented by the within submissions and affidavits.
2. CFC asserts in para. 2 of its April 27, 2016 submissions that a differentiated regional growth mechanism is not required to address PPPABC's concerns. However, such a mechanism is fundamental to the continued health and growth of the processing and further processing sectors in the West. Only through a regional market responsive mechanism can the needs of the processors in the West be adequately addressed without simultaneously oversupplying and unfairly advantaging processors in Central Canada.
3. The CFC and BCCMB incorrectly assert that PPPABC has not proved the supply imbalance it claims. The processors have substantiated the disadvantage they currently experience. The vast majority of TRQ is held in Central Canada, while government data shows that almost 100% of fowl is imported to Central Canada. Further, the supply imbalance is acutely demonstrated by the displacement of BC products on Western retail and restaurant markets where Western consumers are increasingly being supplied by Central Canadian processors.

Total Supply Imbalance

4. When total supply—domestic, TRQ and fowl—is considered, the West suffers a significant supply imbalance as against Central Canada. The submissions of CFC and the BCCMB focus on technical arguments relating to TRQ and fowl imports. In doing so, they fail to appreciate PPPABC's position. It is the processor's position that BC must

receive domestic production sufficient to meet the market needs of its processors. Pro-rata domestic allocations, combined with a growing TRQ and fowl supply advantage for Central Canadian processors, means Western processors have been significantly undersupplied in meeting their customers' needs. The West needs to receive allocations that allow them to compete against processors from Central Canada and to supply their customers, at minimum, within their own regional markets. This can only be achieved through an effective regional differential growth mechanism.

5. CFC and BCCMB submit that it is impossible to consider the impact of TRQ and fowl when setting domestic allocations because they do not know where the imported product eventually ends up after it is brought into Canada. The CFC also claims that the processors have failed to substantiate their claims that BC processors lack access to fowl imports. The processors have demonstrated that the supply imbalance overwhelmingly favours Central Canada, and that TRQ and fowl significantly contribute to this imbalance.
6. The vast majority of TRQ is available in Ontario and Quebec. 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 [PPPABC April 27, 2016 submissions at para. 19].
7. In addition to TRQ, Central Canada receives the bulk of the fowl imports. Government data demonstrates that 99% of spent fowl is imported into Central Canada.

Affidavit #2 of Blair Shier, Ex. A

8. Fowl is used, for the most part, in further processed products. One of Western Canada's two largest further processors, JD Sweid, does not import fowl into its BC plant. JD Sweid's Ontario and BC operations are separate. Only a small amount of fowl is brought into the JD Sweid plant in Ontario.

Affidavit #2 of Blair Shier, para. 11.

9. In the near future processors will also have to contend with the impact of the TPP. The TPP agreement will add 2.1% imports to Canada. It is anticipated that TPP imports, like TRQ, will be allocated mainly to Central Canada. As such, the supply imbalance is expected to be further worsened following the implementation of the TPP, with further negative impacts on the ability of Western processors to compete with processors in Central Canada.

10. The processors' retail and food service surveys show that product from Central Canada has significantly displaced Western processors from Western retail and food service markets [PPPABC April 27, 2016 Submissions, para. 2] and dominates sales in Western Canada. This is proof of the supply imbalance. Central Canada is only able to dominate the Western sales of frozen and further processed products because it has excess supply. Western processors have been and continue to be increasingly displaced from their own regional markets, and Western consumers do not have sufficient access to locally produced further processed and frozen products. This displacement has worsened under the MOU, and will continue to worsen if the amendments to the operating agreement are approved without a differential regional allocation methodology.
11. At para. 58 of its April 27, 2016 Submissions, BCCMB questions where BC further processed products are sold. For the most part BC further processors supply BC and the Western region, although they strive to sell their products to provincial, regional and national markets. The fact that the overwhelming sales in the Western region originate in Central Canada does not mean that BC processors are choosing to sell their out of the Western region to allow Central Canadian processors to take over the Western market. This was proven by the sales survey of Ontario retail stores which showed only 4% of BC product was listed on their store shelves. BC processors are being displaced from Western markets due to a supply imbalance which favours Central Canada.

Affidavit #2 of Blair Shier, para. 13

12. TRQ and fowl are not a practical solution for Western processors as importation is not viable from an economic standpoint. TRQ is owned primarily by parties in Central Canada. For BC to utilize extra TRQ, it must purchase and pay the economic rent associated with TRQ from other parties. In many cases TRQ is not available, and in many instances it is not economic to pay for it. Fowl, on the other hand, can be sourced, but it originates primarily from the Southeastern U.S. Transportation cost and time are significant negative factors to bringing fowl to BC for use in processing. By the time product makes its way to BC further processing plants, its quality is significantly diminished. Given the economics and logistics involved with bringing in TRQ and fowl to the West, the only reliable source of product for Western processors and further processors is domestic production.
13. If purchasing additional TRQ paper and fowl imports were feasible alternatives to Western processors, the two major further processors in the region—JD Sweid and

Sunwest—would use them. But neither JD Sweid nor Sunwest have found it feasible to do so in their Western operations.

14. At para. 13 of his affidavit, William Vanderspek attests that TRQ is considered when setting the national allocation. It is true that when CFC sets allocations it takes TRQ into account. However, this has a negative consequence for Western processors. The national allocation is traditionally adjusted downwards at various times of the year to account for TRQ imports. Virtually all the TRQ comes into Central Canada. Therefore, the national system is adjusted to account for a benefit that flows only to Central Canada, thereby shorting the Western provinces.
15. Access to product to supply their customers is critical, and if sufficient supply is not available to BC processors and further processors, their ability to serve their markets is limited.
16. In the past Western processors were able to use market development quota to assist in obtaining additional further processing product. However market development production is not currently cost effective, as set out in PPPABC's April 27, 2016 Submissions, paras. 21 - 22.
17. The processors submit that one part of the solution to the current supply shortage in BC would be to increase the coefficient from 1.25kg to 1.5kg. An increase in the coefficient would allow the export program (market development program) to be economically viable and this might address to some degree the ability of BC to grow more white meat for further processing in BC.
18. There are a number of other solutions available, but to develop them the BCCMB must constructively engage the processors. The BCCMB needed to understand the challenges faced by the BC processors, and work with them to find solutions to the supply imbalance. The BCCMB's failure to effectively engage the processors has led to the current proposed amendments which are detrimental to the processing industry and, as a result, the long term health of the whole industry.

Compliance with Governing Legislation and Agreements

Special Vote Provisions

19. In paras. 13-16 of its April 4, 2016 submissions, PPPABC outlined its concerns that in the proposed amendments to the operating agreement, several key sections—including sections 3.27 and 3.28—could be amended by special vote without the level of oversight required by the Federal Provincial Agreement for Chicken (the “FPA”).
20. The BCCMB asserts in para. 43 of its April 27, 2016 submissions, that the processors’ concerns regarding the special vote provisions of the proposed amendments have been addressed by the agreement of the provincial boards to hold a special vote only if all ten provincial boards are present. The processors, however, remain concerned.
21. First, the outcome of this supervisory review will be based on the proposed amendments that are currently before FIRB, which do not include the new terms of the agreement asserted by the BCCMB. Should the proposed amendments be adopted, decisions must be made pursuant to the amended operating agreement. As the amended operating agreement would not contain the new terms, there is no way to ensure that those terms would be followed.
22. Second, changes could still be made to fundamental provisions of the operating agreement in the absence of downstream stakeholders and supervisory boards. Alterations to the further processing component and future adjustments to allocation under the new proposed changes to sections 3.27 and 3.28 of the operating agreement should not be made without the input and consent of the processors and the supervisory bodies. The fundamental change to current governance contained in the proposed amendments to the operating agreement is contrary to section 9.03 of the FPA, which requires amendments to be made only with the unanimous consent of the Provincial Supervisory Boards, the Provincial Commodity Boards and the CFC. CFC is attempting to bypass these current statutory requirements in advancing these proposed amendments to the operating agreement.
23. The concern the processors have with CFC’s discretion to change the allocation method going forward is demonstrated by the late addition of a further processing component, which CFC states is being developed for implementation in 2019 [Dungate affidavit, para. 29]. The potential implementation of the MOU, increasing fowl imports, and the

threat of the allocation of TPP and TRQ to Central Canada means that BC's further processing position will be significantly compromised by the time of implementation. This negative impact will be compounded by the operation of the further processing component and will result in reductions to BC's allocation.

Differentiated Regional Allocation Proposal

24. The Western provinces must receive allocations reflective of their needs. The DRA is but one method of achieving the market responsive differential growth necessary to respond to regional supply requirements. While PPPABC stands by the DRA as a workable model, other mechanisms are available. As noted in the processors' previous submissions, the current agreement provides a method for allowing differential growth that worked until CFC stopped using it in favour of issuing allocations *pro rata* [PPPABC April 27 submissions, para. 3 & 11]. The current operating agreement, which does allow for regional ranges, could be modified to be more responsive to the needs of other provinces. Another solution is to add a regional differential growth overlay to the proposed amendments.
25. In paras. 36 – 37 of its April 27 submissions, CFC contends that one reason why the DRA was not workable is that it did not have the support of the other industry stakeholders. If the processors had been consulted before the MOU was developed and agreed to, there would have been a much better chance of obtaining the consensus necessary to include a regional differential growth component. After the MOU was signed, the processors did what they could to present a regional differential growth model that would work for the West. However, at that point, there was no appetite from other Central and Eastern provinces to make any substantive changes to the MOU.
26. Regional differential growth is already in place and works well in other supply managed industries, notably the dairy and turkey industries.
27. The dairy industry permits regions to take additional quota for industrial milk—i.e. to vary the allocation upwards by region. Certain conditions adhere to this arrangement. For example, there must be agreement between the provinces in each region as to how the additional allocation will be distributed. This has not been an issue for the Western region in dairy, and there is no reason why regional agreement could not be reached in chicken as it was initially under the current operating agreement, and as was demonstrated by the Western chicken boards' support for the proposed DRA.

28. Similarly, the further processing sector of the turkey industry functions with differential growth based on regions. The processors drive that differential growth by submitting allocation numbers to CPEPC, which forwards the numbers after vetting them. As with the dairy example above, the provinces within a region decide how to share the allocation.
29. The BCCMB says at para. 41 of its April 27 submissions that that it would be unfair at this point in the process for BC to withhold its consent from the consensus proposal that has been developed. There is no merit to this submission. The operating agreement can only be amended with the consent of the supervisory boards. The consensus of the commodity boards is not determinative of whether the supervisory boards will also agree. FIRB must independently assess whether the proposed amendments are in the best interests of all components of the BC industry, not just the interests of the growers. FIRB must also assess whether it is in the public interest for BC to enter into the long term agreement as presented.
30. It is the submission of the processors that the proposed amendments are short sighted and will negatively impact the stakeholders which actually drive the industry in BC – namely the processors, further processors and consumers. It is in the best interest of all stakeholders that the industry be given the tools it needs to grow and flourish. Access to supply and fair pricing are the two most important drivers of the success of the processing and further processing sectors. The proposed amendments to the operating agreement create a severe obstacle to the ability of BC processors to obtain sufficient supply to allow them to respond to their markets, remain competitive and allow them to try to regain the market share they have already lost to processors in Central Canada. The combined effect of the proposed amendments, TPP, TRQ and increasing fowl have the potential to seriously undermine the viability of the BC further processing industry.

Other Issues

31. **Comparative Advantage Factors.** In para. 21 of their April 27, 2016 submissions, BCCMB asserts that the proposed amendments expressly permit consideration of comparative advantage factors, which BCCMB considers to be in the interests of BC. However, as the Ference & Co. report shows that using those factors produces the same result as allocations made *pro rata* [PPPABC April 27, 2016 Submissions, para. 24 – 25]. The amendments thus do not promote differential growth or address the current supply imbalance issue.

32. **Consultation on Further Processing Component.** In para. 55 of its April 27, 2016 submissions, the BCCMB states that it consulted with Blair Shier regarding a further processing component to be included in the proposed amendments to the operating agreement. The PPPABC raises the issue of the further processing component as an example of how the BCCMB has failed to adequately consult with critical stakeholders. Decisions have been made by the BCCMB without having a fully informed understanding of key components of the industry. Because the BCCMB does not understand the processing and further processing aspects of the industry, the BCCMB has taken positions at CFC which result in serious negative consequences for those sectors in BC.

Affidavit #2 of Blair Shier, paras. 3-10

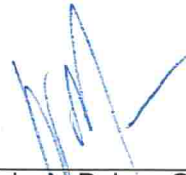
33. The PPPABC submits that the positions taken by the BCCMB at the time of signing the MOU in relation to further processing illustrate how the BCCMB's lack of understanding led to problems which the BCCMB is attempting to fix after the fact. At the time of the MOU, the BCCMB tabled a further processing component under the assumption that it would give BC more production. It did so without consulting the further processors, and as such the BCCMB was completely unaware of the impact of the MOU on the further processing industry. The BCCMB sought to understand the effects on further processing only after the deal was completed by approaching Mr. Shier and Scott Cummings. Both told BCCMB that including a further processing component would be a mistake.

Affidavit #2 of Blair Shier, paras. 3-10

34. Further, it is no answer to agree to proposed amendments which are deficient in the hopes of correcting any problems later. While unforeseen issues may arise which require amendments in the future, it is not good policy to sign a defective agreement, knowing that it has significant problems at the time it is entered into.
35. The supply imbalance has arisen over the past 10 years by CFC failing to implement the current operating agreement as drafted and approved. Making non-market responsive allocations led to Alberta's withdrawal and the dissatisfaction of the Western processors and cost to Western consumers. CFC's efforts to create a new allocation system simply has the effect of locking in the current unbalanced and inequitable supply share. This issue must be addressed before the existing supply share imbalance is locked in for

another 10 years with devastating consequences to the processing industry in BC and, in the end, to their customers.

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