IN THE MATTER OF THE
*NATURAL PRODUCTS MARKETING (BC) ACT*
AND AN APPEAL FROM A DECISION
CONCERNING MARKETING COSTS & LOSSES LEVIES

**BETWEEN:**

ISLAND FARMS DAIRIES CO-OPERATIVE ASSOCIATION

**APPELLANT**

**AND:**

BRITISH COLUMBIA MILK MARKETING BOARD

**RESPONDENT**

**AND:**

ISLAND MILK PRODUCERS ORGANIZATION
BC MILK PRODUCERS ASSOCIATION
HERITAGE DAIRYFARM ASSOCIATION

**INTERVENORS**

# DECISION

**APPEARANCES:**

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| For the British Columbia Farm Industry Review Board | Christine J. Elsaesser, Vice Chair<br>Karen Webster, Member<br>Wayne Wickens, Member |
| For the Appellant | Eric Erikson, Chief Financial Officer<br>Peter Vaartnou, Counsel<br>Dave Pendray, Director |
| For the Respondent | John Jansen, Chair<br>Tom Demma, General Manager<br>Scott Miles, Program Manager |

For the Intervenors

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| Island Milk Producers Organization | Chris Groenendijk, President<br>Dave Lestock-Kay |
| BC Milk Producers Association | Len Bouwman, Director<br>Stan Van Keulen, Director<br>Ben Brandsema, Past President<br>Heather Douglas, Executive Director |
| Heritage Dairyfarm Association | By written submission |
| Date of Hearing | January 27, 2004 |
| Place of Hearing | Victoria, British Columbia |

## INTRODUCTION

1. This is a policy appeal, pursuant to s. 8(1) of the *Natural Products Marketing (BC) Act*, by Island Farms Dairies Co-operative Association ("Island Farms") from a November 20, 2003 decision of the British Columbia Milk Marketing Board (the "Milk Board") to increase the Marketing Costs & Losses Levy ("MCL Levy").

2. Island Farms submits that the Milk Board erred in increasing the MCL Levy by $1.96/HL when none of the other western provinces acted to implement a similar levy. Island Farms argues that the effect of this levy is to make processors who have plants only in BC less competitive than their counterparts with plants in other provinces, especially Alberta. The MCL Levy increases the cost of a litre of milk by $0.02 over the Alberta price and as such makes BC-only processors non-competitive and vulnerable to losing market share to Alberta processors.

3. On December 24, 2003, Island Farms filed its appeal to the British Columbia Farm Industry Review Board (the "Provincial board"), and requested a stay of the announced increase. On December 31, 2003, the Provincial board conducted a telephone conference call to hear the application for a stay. The Provincial board dismissed the application and scheduled the appeal hearing for January 27, 2004. Administratively, Milk Board action to begin collecting the levy is to commence in mid-February 2004.

4. Given that this appeal challenges a policy or legislative decision that pertains to the industry at large, three producer associations were granted Intervenor status. The BC Milk Producers Association ("BCMPA") and the Heritage Dairyfarm Association intervened in support of the Milk Board. The Island Milk Producers Organization ("IMPO") intervened in support of the Appellant.

## BACKGROUND

5. The dairy industry in Canada is supply managed nationally. Each province receives an allocation, distributed amongst producers through a quota system. In addition, BC participates along with the three other western provinces in an agreement known as the Western Milk Pool (the "WMP"). The WMP is an agreement under which prices paid by processors to producers of milk are pooled from the four western provinces so as to provide an equitable return among producers within each province. There is a similar agreement for the eastern provinces. Although BC is a member of the WMP, the Milk Board retains the authority to establish fluid milk prices independent of milk prices in other jurisdictions.

6. The Milk Board's pricing and production authority is subject to the procedural safeguard that it must consult with the Milk Industry Advisory Committee ("MIAC") before making any decision relating to pricing or production (s. 8 of the *British Columbia Milk Marketing Board Regulation* (the "*Scheme*")). MIAC is

comprised of producer and processor members.[1] While obliged to consult with MIAC, the Milk Board must make its own decisions.

7. On November 19, 2003, MIAC met to discuss, among other things, a proposal to simultaneously decrease the published price for fluid milk subclasses 1 (a), 1(b)(i) and 1(c) by $1.96/HL effective January 1, 2004, and to increase the prevailing MCL Levy by $1.96/HL for sales reported by Vendors in the same subclasses of fluid milk. The $1.96 decrease was consistent with a proposed decrease, across the western provinces, in the price that processors would have to pay producers for their milk. However, the purpose of the proposed increase in levy was to offset the significant loss of income to producers due to the consequences of bovine spongiform encephalopathy (BSE), and to partially recover some of the cost associated with the disposal of cull cows (cows sold for meat by milk producers after outliving their usefulness in producing milk). MIAC could not reach a consensus and as such did not forward a recommendation to the Milk Board.

8. According to a chart prepared by the Appellant, in August 2003 the total cost of raw milk for Alberta processors was $74.01 (including a $0.40 levy) compared to $74.68 (including a $1.07 levy) for BC processors. The price differential between the Alberta and BC raw milk price was $0.67. Effective January 1, 2004, the price of raw milk was decreased so that the Alberta processor paid $67.15; the BC price was also decreased but a further levy increase of $1.96 was added so that the total cost to BC processors was $69.78. The resulting differential amounts to $2.63. It should also be noted that according to the Appellant's chart, in BC there are additional levies (Accommodation = $0.30, Admin = $0.11) of $0.41 bringing the total cost to the BC processor at January 1, 2004 to $70.19. On November 20, 2003 the Milk Board met and considered the deliberations of the MIAC. Following discussion, the Milk Board made the following motion:

> that effective January 1, 2004, the price of milk reported as being used in Class 1(a), Class 1(b)(i) and Class 1(c) is reduced by $1.96 per hectolitre and furthermore, in recognition of the on-farm costs related to the BSE issue, the Marketing Costs & Losses Levy is increased by $1.96 per hectolitre which will be fully distributed to producers based on their in-quota litres.

9. On November 26, 2003, the Milk Board issued a Notice to Processors, the relevant portion of which is set out below:

> This notice serves as a reminder that effective December 1, 2003 processors receiving raw milk for use in Classes 1(a), 1(b)(i) and 1(c) will pay $70.19 per hectolitre on a 3.6 kilogram per hectolitre basis. This amount is $2.94 less that the November 2003 price.
>
> Effective January 1, 2004 there will be no change to the above stated December 2003 cost for milk used in Classes 1(a), 1(b)(i) and 1(c).
>
> Commencing January 1, 2004 the Vendor marketing costs and losses levy fixed and imposed on Vendors reporting sales in Classes 1(a), 1(b)(i) and 1(c) will be increased by $1.96 to $3.03 per

[1] The Appellant, Island Farms, is a processor member of MIAC.

> hectolitre. This levy increase is accompanied by an equivalent decrease in the published milk component prices for Classes 1(a), 1(b)(i) and 1(c). As a result, the cost of milk procured by British Columbia processors for use in the aforementioned milk classes remains unchanged from December 2003.

10. In December 2003, the federal and provincial governments implemented a national compensation program for dairy producers whereby producers receive approximately $1/HL (split $0.66 Federal Government, $0.34 BC Government) to offset the depressed cull cow price.

11. As noted above, the $1.96 milk price reduction implemented by the Milk Board was consistent with action taken by regulators in other western provinces. However, the $1.96 MCL Levy increase has not, to date, been implemented in any other western province. The result is that while the cost of BC milk to BC milk processors is, in absolute terms, the same today as it was before the November 20, 2003 decision, the relative cost is now higher because the MCL Levy is unique to BC. It is this relative cost differential that gives rise to the Island Farms appeal.

**ISSUE**

12. Did the Milk Board err in policy in increasing the MCL Levy by $l. 96/HL?

**DECISION**

13. Island Farms strenuously opposes the $1.96/HL increase in the MCL Levy. Given that the other western provinces have not implemented a similar levy, the effect of the $1.96/HL increase is to effectively raise the price of BC milk by $0.02/L or $0.08/4 L jug. This leaves BC-only processors at a competitive disadvantage to their counterparts with processing plants in Alberta and creates an uneven playing field. Even before this levy increase, "massive amounts" of Alberta milk were trucked through the Rockies into BC stores as a result of the advantage of Alberta's lower labour, taxes, land and capital costs. To give a further two cents a liter advantage to Alberta processors makes BC only processors uncompetitive.

14. To support this argument, Island Farms presented a large display of milk products purchased in various retail outlets including grocery, big box and convenience stores located in the Lower Mainland and Victoria area. Milk products from Parmalat (processed in Ontario and Quebec), Saputo labelled "Dairyland" (produced in Edmonton) and "Milk to Go" (processed in Alberta) were readily available in local stores. Island Farms argues that with the increased MCL Levy, the influx of Alberta milk will only increase.

15. Island Farms' General Sales Manager, Art Paulo, estimates that approximately 8% of all milk consumed in BC is currently from Alberta. Island Farms' witness Robyn Smith, Executive Director of the British Columbia Dairy Foundation, confirmed this position and gave evidence on sales of product in BC vs.

consumption. According to a report prepared by the Prairie Milk Marketing Partnership, approximately 10% of milk consumed in BC is produced and packaged in the Prairies.

16. With the added MCL Levy, BC processors are now paying $70.19/HL for milk as opposed to $67.15 paid by Alberta processors, amounting to a $3.04 difference, the bulk of which is made up by the $1.96 increase. We were given evidence that prior to this increase, the differential between BC and Alberta milk has ranged from $0.47- $1.45 made up of levies and bonuses imposed with the support of MIAC over the past 5 years.

17. Island Farms argues that with respect to overall cost of production, other costs such as transportation, administration, overhead and information systems are small in comparison to the cost of raw milk. These other costs can be negotiated, smarter buying can reduce costs and improve efficiencies, and combined buying power can generate economies of scale thereby mitigating their impact. The cost of raw milk however cannot be controlled and is the same for every processor in the province. Processors able to process milk in their Alberta plant and ship it to BC have a dramatic advantage.

18. BC has seen its single biggest dairy go bankrupt even with its tremendous efficiencies. Small dairies similar in size to Blackwell Dairy have also failed despite being extremely efficient. Island Farms argues that it is tremendously efficient and has survived while others have failed. It wants to continue to survive and do well for its producers, which is why it filed this appeal. A change in the price of milk requires a change in price to the customer. If raw milk goes up by half a penny, that cost must be passed on; there is no choice. The two cents per liter advantage that Alberta now has will increase the amount of milk flowing into BC.

19. While Island Farms is supportive of producers and believes the increase to the MCL Levy is a tool to offset losses of revenue due to BSE, it maintains that it is not the right tool and suggests that the way to deal with this issue was through the pricing mechanism. Increasing the MCL Levy has forced a wedge between the BC and Alberta price leaving Island Farms with little recourse. Further, Island Farms points to the lack of MIAC support for this Levy increase as a further indication of its inappropriateness.

20. Island Farms questions the validity of putting the industry in peril in order to protect the $5/HL in gross revenue for milk producers that is affected by issues relating to BSE. George Aylard, Chairman of the Board of Island Farms and a long time dairy producer, questioned whether the loss is as high as stated by the Milk Board. In his opinion and looking at his farm, the loss is probably closer to $3/HL.

21. David Blackwell of Blackwell Dairy in Kamloops testified in support of Island Farms. Blackwell Dairy is a small local processor with markets in the Interior of

BC.  He states that the name Blackwell has meant a good product from good people.  Blackwell Dairy enjoys significant customer loyalty and does not want to become a huge processing plant.  Mr. Blackwell opposes the increase in the MCL Levy, arguing that the whole point of the WMP was to have a common price for milk in all western provinces, in particular with Alberta.

22. Mr. Blackwell observed that large processors have already moved some of their processing facilities to Alberta to take advantage of the price differential between BC and Alberta and the lower costs for land and taxes.  Now those processors have been given an additional advantage on their largest cost, raw milk.  Mr. Blackwell believes that processors in BC are very competitive, but if the price of milk is lower in Alberta, that difference is reflected in the store.  Mr. Blackwell's dairy cannot compete against that price nor can he do anything other than what he is currently doing.  Mr. Blackwell would like to see a return to the standard originally contemplated under the WMP where the price of milk is the same across western Canada.

23. The IMPO intervened in support of Island Farms in this appeal arguing that the Milk Board acted unilaterally when it imposed the increased MCL Levy.  The better course would have been to work within the WMP to find relief for all dairy producers in Western Canada.  A levy or adjustment made within the WMP is preferable as it avoids giving processors from one province a competitive advantage over those from another province.

24. IMPO argues that the financial loss to dairy farmers is a small part of their total income.  IMPO President Chris Groenendijk estimates that, prior to the discovery of BSE in Canada, he earned approximately 3-5% of total gross income from livestock (cull cattle) sales.  Although it may seem ironic that a milk producer would oppose an increase to his milk cheque, Mr. Groenendijk argues that the short-term gain offsetting a partial loss of 3-5% total gross income comes at the risk of a larger long-term loss of processing within this province.  With BC-only processors being placed at a competitive disadvantage by this levy increase, there is the potential for more Alberta milk to be sold in our markets, further eroding the market for locally produced milk and threatening local processors.

25. The Milk Board opposes the appeal.  It argues that the impact of BSE on dairy producers has been significant.  Milk Board Chair, John Jansen stated that according to numbers obtained from the Dairy Farmers of Canada ("DFC"), the loss to BC producers equates to approximately $5/HL.  When the government program is factored in, the net loss to producers is $4/HL.  Given that the MCL Levy of $1.96 is assessed only on the fluid milk portion of production (60% of all milk produced) the levy is actually closer to $1/HL of all milk produced.  Even with the increased MCL Levy and government assistance, producers in BC are still out of pocket $3/HL.

26. The Milk Board has made submissions at WMP meetings about the need to act to assist producers dealing with losses due to BSE. However, as other WMP provinces are still waiting for their governments to act, no similar levies have been imposed. The Milk Board also argues that the other provinces are in the process of putting in place their own mechanisms to offset producer losses; these measures may exceed those taken by the Milk Board and be in the range of $3.60 - $4.00/HL.

27. As for Island Farms' assertion that the increase in the MCL Levy will render it less competitive, the Milk Board argues that the evidence led at this hearing falls short of proving this assertion. The Milk Board asks how Island Farms can be less competitive, given that they pay the same price for their fluid milk as other processors in BC? All processors in BC, regardless of their physical location in the province, have a level playing field regarding fluid milk prices. Island Farms has not supplied any information about the impact of pricing on its margin. On the basis of the lack of financial information supplied by Island Farms, the Milk Board argues that it is difficult to discuss market competitiveness and thus, it rejects the position that BC's pricing of fluid milk puts BC processors at risk.

28. The Milk Board argues that it has shown leadership amongst its WMP counterparts to reflect the impact of BSE on the cost of production. The Milk Board maintains that based on its discussions with other provinces, they too, will incorporate the cost of BSE into their pricing formula in the very near future. Pricing of fluid milk is complicated and the comparisons are done on the basis of cost inputs for dairy producers. This is not done in isolation to what is happening in the rest of Canada.

29. While Island Farms may attribute their lack of competitiveness to the cost of raw milk, it has failed to show evidence of this and has provided little or no information to allow a proper evaluation of this position. Input costs, taxation, wages, utilities, fees, transportation, etc. vary from province to province. A company that operates in a province must adapt and make changes to enable it to maintain its competitive position in that marketplace. The Milk Board argues that it is incorrect for Island Farms to base its arguments on another province's economic data relative to commercial operations in that province and suggests instead that it focus on the level playing field enjoyed in this province.

30. The BCMPA and the Heritage Dairyfarm Association both intervened in support of the Milk Board's decision to implement a $1.96 increase in the MCL Levy. The BCMPA argues that the Canadian agricultural sector, and specifically the dairy industry, has been devastated by the discovery of BSE in a cow in Alberta in May 2003 and a Washington cow in December 2003. A study by the Canadian Animal Health Coalition entitled, *Economic Implications of BSE in Canada, 2003*, estimates the losses to the dairy industry due to difficulties related to the disposal

and sale of cull cows at $300 million over the six month period from December 2003 to May 2004.

31. The BCMPA have worked diligently with the DFC, various stakeholders in the beef industry and both federal and provincial governments to deal with BSE and the related cull cow dilemma. Contrary to the evidence of the Milk Board, the BCMPA states that the DFC estimated the loss to producers in the WMP at $3.66/HL (not $5/HL); with producers in Quebec and the Maritimes having an estimated loss of $4.08/HL while those from Ontario have losses of approximately $4.62/HL.[2] The BCMPA have asked the Milk Board to deal with their counterparts in the WMP to develop a formula for adjusting producer returns to give partial relief for the significant loss in revenue caused by BSE.

32. Although the BCMPA would have liked more relief, they are grateful and support the Milk Board's decision to implement the increased MCL Levy. Given the second incident of BSE in Washington State in December 2003, no one is optimistic that the United States border will soon reopen to livestock shipments. Without relief, BC's 700 dairy farmers will see an income loss of on average $30,000 per farm, translating to approximately 50-80% of "net bottom-line profits".

33. Heritage Dairyfarm Association tendered a written submission, part of which states:

> As Vancouver Island milk producers we welcomed the BCMMB recognition of the financial impact to us as a result of the BSE crisis. The BCMMB's willingness to attempt to redress the disparity in financial assistance from the various provinces in the Western Milk Pool and the innovative solution they have proposed are to be commended.
>
> We recognize Island Farms concern with a potential competitive disadvantage as a result of the BCMMB initiative, and wish to be clear that it is of the utmost importance that processing remain viable on the Island. However in recent years their have been a number of attempts to exploit Alberta pricing advantages by various processor's. These were quickly abandoned, presumably for economic reasons.
>
> A key aspect of the BCMMB proposal is the temporary nature of it. With the recent discovery of BSE in the U.S. and changes in the political climate there is reason to hope that a resolution and return to a more normal trading relationship in cattle will occur sooner rather than later.
>
> In the meantime it is very helpful for producers to have a portion of the financial burden alleviated by the BCMMB initiative.

## DECISION

34. Having given this matter careful consideration, we conclude that the implementation of the MCL Levy under appeal should be suspended for a maximum of 60 days from the date this decision is released. At the conclusion of 60 days or sooner, the parties will report in writing to this Panel advising whether

[2] These losses were calculated in August of 2003 and do not take into account the discovery of a second BSE infected cow in Washington in December 2003.

the appeal has been resolved. If so, the appeal file will be closed. If the Milk Board's decision is to affirm their current order, Island Farms may pursue its appeal. The parties will be required to attend a pre-hearing conference and new hearing dates will be set to conclude the appeal. If however, the Milk Board amends or varies its November 20, 2003 decision, persons aggrieved or dissatisfied by the new decision have a right of appeal.

35. The basis for our decision to temporarily suspend both the $1.96 increase to the MCL Levy and a final disposition of this matter on appeal relates to the uncertainty regarding whether the other members of the WMP intend to take similar action. As noted above, the Milk Board submitted that other provinces will act "in the very near future"; this suggests that its action was taken in part based on that assumption. However, nearly three months have passed since the Milk Board took action, and no evidence has emerged of similar action by the other provinces. The Appellant was clear that if the other Provinces do act, the Appellant would have no issue with the Levy, as its concern in this context relates to relative rather than absolute cost. We find that the interest in having this point addressed outweighs the temporary prejudice to producers for the 60-day suspension period.

36. We appreciate the Milk Board's submission that Island Farms has provided little to substantiate precisely how its competitive position will be affected by the $1.96 increase. For present purposes, we do not need to make a finding that the increase would necessarily bring Island Farms to its knees. At this stage in the matter, we accept that there is common sense in the position that a significant increase in the cost of the largest component of production carries more than a speculative risk of loss of market share in a market where out of province processors are aggressively seeking to obtain a greater share. Clearly, the health of the BC processing industry is closely linked with the health of the BC regulated industry as a whole. There is sufficient legitimacy in this position, <u>at this stage</u>, to warrant suspending the $1.96 MCL Levy increase for the 60-day period imposed here.

37. In making the above point, we wish to emphasise that should this matter reconvene, and should the issue be whether to permanently cancel the Levy, with or without corresponding action by other members of the WMP, the Panel would expect more from Island Farms by way of substantiation of its position. This is because the issue would then become one of carefully balancing the impacts on producers versus the impacts on processors. In that context, Island Farms would be expected to provide detailed data, and to address legitimate questions raised by the Milk Board at this hearing concerning the impacts of other costs of production on its margin, on its marketing, the reality that Island Farms also competes in Alberta, and that the cost to move milk between Alberta and BC is reported to be approximately $5/HL.

38. In recognition that Island Farms has a legitimate interest in retaining the privacy of its sensitive commercial information, the Panel has the legal power on appeal to receive sealed or private evidence, including evidence that is not provided to any

other party, in order to allow a party to advance its claim without compromising its commercial position. Island Farms will be expected to make application under this power if it wishes to advance its case at a later stage, in the event the appeal is not resolved earlier. The right to appeal carries with it the responsibility to prove the appeal.

39. For the Milk Board's part, we would also expect any reconvened appeal to provide more cogent evidence regarding the impact on producers, both in absolute terms and as a percentage of their net income, of the lost income experienced as a result of the depressed cattle market caused by BSE. We note that the Milk Board and the BCMPA gave different estimations of BC's loss both of which were attributed to the DFC. In addition, we would expect the Milk Board to provide a current assessment of the statement by the Heritage Dairymen Foundation that "…there is reason to hope that a resolution and return to a more normal trading relationship in cattle will occur sooner rather than later."

40. In addition to allowing the Milk Board to communicate with the other members of the WMP regarding their intention to increase their MCL Levy, this suspension decision will also enable discussions as to whether there might be other creative ways to offset this loss, such as factoring the issue into the pricing formula. As the WMP is designed to provide regional pricing and given that BSE is a national problem, it is not unreasonable from a policy perspective (despite the commendation rightly due the Milk Board for taking a leadership role rather than sitting on its hands in the face of this problem) to seek co-ordinated regional solution.

41. Another benefit provided by the 60-day suspension period is that it will allow the Milk Board to hold further discussions with the Appellant, producers, MIAC and other industry stakeholders in order to find an "in-house" solution to this issue. We say this because there were indications during the appeal itself that each party conveyed information to the Panel that was not necessarily evident to the other before they walked into the hearing room. From our point of view, that communication should continue outside the hearing room and every reasonable avenue of discussion should be exhausted before requiring the Provincial board to determine the outcome in an adversarial setting.

42. We wish to make it clear that, by issuing this suspension decision, we are not pre-judging the outcome of this appeal if and when it proceeds after the 60-day suspension. What we are saying is that if the Milk Board ultimately confirms its desire to have the suspension lifted, the Panel will expect full and detailed evidence and submissions, on both sides, of the advantages versus the disadvantages of any Levy increase in light of the circumstances. This would include the circumstances prevailing at the time, and also address any contingencies such as whether or how the Levy should be affected by other government policies or programs relative to the BSE problem.

**ORDER**

43. The implementation of the $1.96 increase to the MCL Levy is suspended for a period of 60 days from the date of this decision.

44. During the 60-day suspension period, the Milk Board is directed to hold further discussions with industry stakeholders regarding the issues outlined above, and is directed to initiate further discussions with its WMP counterparts to determine what if any adjustments to accommodate BSE are anticipated.

45. No later than the conclusion of the 60-day suspension period, the Milk Board is directed to report to the Provincial board, with rationale, regarding whether it wishes to have the suspension lifted. The Appellant is also directed to report to the Provincial board at that time regarding whether it wishes to proceed with this appeal.

46. If, during the 60-day suspension period, circumstances change, i.e. if the other WMP provinces act to impose a levy or adjustment of their own, the Milk Board is directed to report to the Provincial board, with rationale, regarding whether it wishes to have the suspension lifted earlier than 60 days. The Appellant is also to report to the Provincial board regarding whether it wishes its appeal to proceed.

47. If the parties' reports disclose that the appeal has not been resolved, they will be required to participate in a pre-hearing conference, and new hearing dates will be scheduled to conclude the appeal.

48. In the circumstances, there will be no order as to costs.

Dated at Victoria, British Columbia this 12th day of February, 2004.

BRITISH COLUMBIA FARM INDUSTRY REVIEW BOARD
Per

*(Original signed by):*

Christine J. Elsaesser, Vice Chair
Karen Webster, Member
Wayne Wickens, Member