September 8, 2017 File: 44200-60 QATE

DELIVERED BY EMAIL

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RE: QUOTA ASSESSMENT TOOLS EVALUATION (QATE) FOLLOW-UP QUESTIONS

This letter is in follow-up to the Egg Marketing Board (Egg Board) June 30, 2017 QATE submission and August 17, 2017 board to board meeting with the BC Farm Industry Review Board (BCFIRB). It sets out a number of questions related to the Egg Board's rationale and proposed changes to BCFIRB's 2005 Specialty Review directions.

QATE (initiated by BCFIRB on November 22, 2016) is intended to determine whether, and to what extent, industry and public interest policy outcomes are still being achieved by specific BCFIRB 2005 Specialty Review[1] directions, including where those directions may have had unintended or adverse consequences that need to be addressed as a matter of sound marketing policy in the public interest. As stated in BCFIRB's February 28, 2017 Letter of Expectations[2] to all supply management commodity boards, a sound evaluation process providing substantive information and rationale is required before BCFIRB will act on any proposed changes.

BCFIRB requests that the Egg Board provide a written response to the following questions prior to the QATE board to board meeting scheduled for October 2, 2017. This letter and the Egg Board's responses will be posted to BCFIRB's website. These responses are intended to support the discussions at the October 2, 2017 meeting as well as to generally inform BCFIRB's deliberations. Given the short timeframe, summary answers are acceptable at this time.

BCFIRB's questions currently focus on two of the Egg Board's proposed changes. Specifically:

1) Eliminate LIFO and 10/10/10 transfer assessment on quotas issued after 2005 to established producers (excluding new entrant and specialty incentive quotas).

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[1] BCFIRB 2005 Specialty Review Webpage; BCFIRB 2005 Specialty Review Directions

[2] 2017 February 28. BCFIRB. Quota Assessment Tools Evaluation-BCFIRB Expectations and Looking Forward.

**British Columbia
Farm Industry Review Board**

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2) 0% Transferability of all new entrant quota for 10 years (100% of quota retractable by the EMB if traded). After 10 years, these quotas would be transferable and subject to the rules governing transfer of quotas. For example, the proposed Reserve Responsive Assessment Scheme.

BCFIRB may have further questions for the Egg Board at the October 2 meeting or subsequently regarding the proposals to establish a Reserve Responsive Assessment and to include farm workers as persons exempt from transfer assessments.

Overall, BCFIRB asks that the Egg Board focus additional rationale for its proposed changes on areas that show how the changes will benefit of the industry as a whole and the overall public interest. The following criteria are provided as a guide to help draw out how the proposed changes benefit the industry and the public interest:

- Greater operating efficiencies for producers and other industry members throughout the entire system – enhancing value in the marketplace over the long-term;
- Promotion and/or continued overall industry growth and competitiveness;
- Responsiveness to the needs not only of producers, but also processors, consumers and other participants in the British Columbia food system;
- Contributions to the ongoing development of new and specialty table and processing markets (e.g., organic, Omega 3, etc.);
- Reduction of barriers to entry and promotion of growth and sustainability for new entrants and specialty markets;
- Economic activity and stability in all regions of British Columbia.

Follow-up Questions

Proposed Egg Board Change #1 - Eliminate LIFO and 10/10/10 Transfer Assessment on all Quotas Issued after 2005

In September 2005, BCFIRB issued directions to all supply managed commodity boards concerning programs for new entrants and specialty production and marketing in the regulated marketing system. BCFIRB directed the terms and conditions for the transfer of new entrant and specialty quotas, including the establishment of a declining transfer assessment schedule. This schedule requires an automatic retraction of 100% of quota issued by boards in the first year after issuance, should a producer transfer or sell it. Subsequently, the amount retracted declines by 10% per year until it reaches a minimum assessment of 10% in year 10. This declining transfer assessment is known in industry as “10/10/10”. A further condition of transfer established by BCFIRB at that time was that the last quota issued by the board to a producer would be the first quota authorized for transfer out. This principle is known in the industry as “Last in / First Out” or LIFO.

The declining transfer assessment 10/10/10 and LIFO was extended by BCFIRB in 2005 to apply to all quota (growth) allocated by boards in all classes, including mainstream and base quota.

The 2005 Specialty Review established several policies that reflect federal and provincial legislation and regulations. LIFO and 10/10/10 was designed to balance the transferability of quota with the following policy objectives established by BCFIRB as part of sound marketing policy:

- Quota is intended to be produced
- Producers are actively engaged and committed to the industry
- Quota is available to commodity boards to support policy objectives, including development of specialty markets and providing for new entrants in the supply management system.

The BCFIRB 2005 Specialty Review noted that if quota issued by a commodity board becomes instantly transferable, there is a real possibility of windfall gains. The report stated that it is a basic principle of the Boards that producers should be actively engaged and committed to being in the industry. If a producer simply applied to transfer (i.e., sold or flipped) their quota immediately upon receiving it from a commodity board, this would not seem to indicate engagement or commitment.

In its June 30, 2017 submission, the Egg Board states that the rapid and sustained growth in the egg market, in conjunction with the LIFO and 10/10/10 policy results in a substantial financial disincentive for producers who are interested in downsizing or exiting the industry. As a result, the amount of quota available for transfer is less than demand and this contributes to high quota values.

In essence, the submission states that LIFO and 10/10/10 are hindering quota transfers and hence raising "quota prices", thus creating barriers to entry. In addition it sets out that the current quota transfer assessment structure limits producer flexibility and that selling quota is necessary for industry to be able to invest in significant renovations and capital improvements – especially in light of the shifts to cage free and enriched cage production. The loss of transferrable quota back to the Egg Board exacerbates quota shortage and subsequently contributes to an increase in quota value, creating challenges for the industry and impacting on-farm efficiencies. The Egg Board submission provides a number of different examples of market distortions attributed to LIFO and 10/10/10. These examples are addressed further in the questions that follow.

One statement relied on by the Egg Board within its submission to illustrate why LIFO and 10/10/10 should be removed is "*Anytime an assessment, tax or penalty is applied to a transaction, any business person is going to look at whether it is beneficial long term to do so. Given the circumstances today, after multiple new allocations, if a person is going to do anything with their quota, these "assessments" will most certainly kill any potential deal"*.

Further information is requested on the following points:

1. Part of the Egg Board's justification for eliminating LIFO and 10/10/10 is on the basis of a point in time situation and various side effects – such as a group of producers wishing to exit, and a growth market due to changes in dietary guidelines and updates to the Egg Farmers of Canada allocation policies. Please address how the elimination of LIFO and 10/10/10 would benefit the industry strategically in the long run and how this measure would tie into the Egg Board's long term strategic goals and vision for the industry – including how the industry would benefit in growth, neutral and declining markets.

2. The Egg Board reports that the ability to freely transfer quota without assessment is important for producers to be able to afford to renovate their farms in the face of changing consumer demands. Please expand on:

   a. Why transferring quota (the licence to produce) is necessary to finance investments, as opposed to using operating profits and/or loans based on cash flow, as would be the case with non-supply managed businesses?

   b. How does transferring growth quota received for free from a commodity board for a monetary return - as opposed to existing quota traded or sold between producers in the marketplace - align with the principle that quota is a right to produce, that it is intended to be produced and that it is not property?

   c. How the Egg Board's rationale aligns with the two principles guiding quota management in BC. Please see Appendix A for a Milk Board document that BCFIRB finds adequately outlines BC's legal framework:

      i. The Board is not to assign monetary value to quota, even though it acquires value in the market place when traded between producers; and,
      ii. Quota remains under the exclusive control of the Egg Board at all points, meaning that a transfer of quota between two producers does not imply a change in ownership of that quota. Quota is a revocable license and is not property.

3. The prohibition against commodity boards in BC assigning monetary value to quota, per the discussion in Appendix A, raises the question as to what role, if any, the Egg Board properly has in seeking to address quota values in the marketplace. The prohibition against attaching a monetary value is inextricably bound with the notion that quota must remain the property of the board. Please expand on the role the Egg Board should play with respect to quota values given the discussion in Appendix A and how you see that role working to the benefit of the industry and the overall public interest.

4. If LIFO and 10/10/10 are removed, how does the Egg Board intend to achieve the following policy objectives set out in 2005, namely:

    a. Quota is intended to be produced
    b. Producers are actively engaged and committed to the industry
    c. Quota is available to commodity boards to support policy objectives, including development of specialty markets and providing for new entrants in the supply management system.

Proposed Egg Board Change #2 - 0% Transferability (non-transferability) of New Entrant Quota for 10 years

Under this proposal, all quota issued to a new entrant would be 100% retractable by the Egg Board, including any growth, if any portion of the quota is traded in the first 10 years. Essentially quota would become non-transferable for 10 years. While the Egg Board states that there have been no specific problems reported for LIFO 10/10/10 for new entrants, the proposed change will ensure new entrants are committed to the industry and will grow.

1. How does 0% transferability for 10 years square with the policy objective that quota should be transferable?

2. Imposing non-transferability on new entrant quota could discourage new producers who discover the industry isn't a good fit, from exiting. Is this something the Egg Board considered? Does it agree? If not, why? Are there sound marketing concerns with this approach? Is there a risk that a change to 0% transferability could potentially motivate 'poor fits' to stay for the 10 years, possibly creating a health or safety risk to animals or the industry overall? Is this something the Egg Board considered, does it agree?

3. The prevention of quota flipping/windfall gains is stated by the Egg Board as one of the key reasons behind moving to a 0% quota transfer scheme for new entrants. It is noted that this factor is not emphasized in the proposal to eliminate 10/10/10 LIFO for existing producers. What is the overall industry/public interest rationale for proposing to treat this risk so differently between new entrants and established producers?

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I would like to thank the Egg Board on behalf of BCFIRB for your assistance and efforts in answering these questions and for meeting again with BCFIRB to discuss them on October 2, 2017. In the meantime, should you have any questions or wish to discuss any of these items further, please call me at 250-387-3915.

Yours truly,

Kirsten Pedersen
Executive Director

cc: BC Farm Industry Review Board
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Appendix A

Milk Marketing Board's "Quota Policy and Governance Consultation" document published January 28, 2014 – "Summary Discussion of the Principle that Quota has no Value".

Under the *British Columbia Milk Marketing Board Regulation* (a regulation made under the *Natural Products Marketing (BC) Act*), the Milk Board has broad powers to "establish, allot, alter, suspend, or cancel a quota" and "to establish terms on which quotas may be allotted, held, transferred, altered, suspended or cancelled".

Subsection 7(2) of the *Regulation* vests the following specific powers in the Milk Board:

> 7. (2) The board is authorized
>
> (a) to establish, allot, alter, suspend or cancel a quota, <u>to which no monetary value is to be attached by the board</u>, that applies to any person, [*emphasis added*]
>
> (b) to establish terms on which quotas may be allotted, held, transferred, altered, suspended or cancelled,

These provisions must be understood in light of the nature of quota itself.

In *Sanders v. British Columbia (Milk Board)* (1991), 53 B.C.L.R. (2d) 167 (B.C.C.A.). In that case, the appellant producer took issue with the surrender assessment imposed by the Milk Board. The issue before the Court of Appeal was whether quota could be considered "property" as against the Milk Board itself. The Court of Appeal answered in the negative, stating:

> The Milk Board may prescribe the terms and conditions on which quotas may be issued, held, transferred or cancelled. The word "cancelled" is particularly significant as indicating the powers intended to be conferred. A quota, a license to produce, which may be issued on prescribed terms and conditions may be cancelled, that is annulled or abolished, also on prescribed terms and conditions. In summary the situation is "the Board giveth and the Board taketh away"; others may in the meantime buy and sell the licence which the Board issues, but they do so knowing that the Board has the right not to approve its further sale.
>
> In addition, the Court of Appeal quoted with approval from the reasons of Hinds J. in these terms:

> I therefore conclude that the appellant's quota should not be characterized as property. In essence, it was a revocable license to produce and ship fluid milk to a dairy plant. As quota has not been characterized as property, the foundation for the appellant's argument that the board cannot expropriate property without compensation has crumbled and has ceased to exist.

The governance of quota in BC is thus guided by two overarching legal principles. The first is that the Milk Board is not permitted to attach monetary value to quota, despite the fact that it acquires value in the market place when traded amongst producers. The second principle is that quota remains under the exclusive control of the Milk Board at all points, meaning that a transfer of quota between two producers does not imply a change in the 'ownership' of that quota.

In short, the expression "quota has no value" is a term of art in regulated marketing. It speaks to both the Milk Board and the producer. To the Milk Board, it states that when the Milk Board is issuing quota and making other regulatory decisions regarding quota, it may not attach value to that quota. To the producer, it says that the producer may not assert that quota as property against its regulator, the Milk Board, regardless of its treatment in other contexts.

<u>The legal principle that Quota has no Value may be summarized as follows:</u>

1. Quota is a revocable license which provides a conditional entitlement to produce milk, but with no right to renew or retain the quota allotted.
2. Quota is issued from the CDC to the Province with no value (free).
3. BCMMB under the regulations are stewards of quota for the Province.
4. BCMMB issues (allocates) quota with no monetary value (free) to produce milk.
5. Quota remains under the exclusive control of BCMMB at all points.
6. Quota is not owned by producers or the BCMMB.
7. Producers may trade (sell) quota with permission of BCMMB to produce milk and create value from cash flow of milk production from the quota.
8. Producers trading (selling) quota use the Quota Exchange "clearing price" based upon the cash flow of the quota but the quota itself still has no value since it is a revocable license and not property.

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