BCMMB Submission
QTAR (QATE) Follow-Up Questions

1. Part of the Milk Board's justification for eliminating LIFO and 10/10/10 is on the basis of a point in time situation and various side effects – a growth market and a rapidly changing industry environment. 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 Milk Board's long term strategic goals and vision for the industry - including how the industry would benefit in growth, neutral and declining markets.

   As previously referenced in section 7.4 of the Milk Board's submission, the Board identified challenges to being market responsive to the continuous production changes in the dairy industry.

   Strategically, if the LIFO and 10/10/10 policy was to remain in the province, the Board is confident that two outcomes are imminent; the first is the ability to sustain dairy farming in the province of BC.

   Dairy farmers are currently working in an environment with market volatility. As referenced in the SAFETI document submitted on September 14, 2017, the Canadian dairy industry has made a noteworthy change to its product class structure and billing policies to ensure the longevity of its domestic markets due to external pressures. This new national structure, applied on February 1, 2017 has created costs to dairy farmers that were not previously a part of the industry and that are not recognized in any cost of production factors.

   As referenced in section 10.1 of the Milk Board's submission, producers support the industry through levies to grow markets and provide promotion dollars to support the industry to secure Canadian markets. These combined costs contribute to a lower producer return resulting in lower cash flow.

   In addition to producing milk for a lower rate of return, producers are required to meet stringent but necessary social license requirements that create additional costs on the farm. For example, the national animal welfare code and pro-action initiatives which require reinvestment on the farm or a reduction in production to "right-size" and comply. Since both programs are national, it is important to note that only BC producers are at a disadvantage when reinvesting or rightsizing. Specifically, the loss of production on a farm when a kilogram of quota is sold. The example provided in section 10.1 from the Milk Board's submission emphasizes the issue;

100kg/day	CDQ on the farm
1	For sale (overcrowding while new barn is being built)
15	10/10/10 and LIFO assessment
84 kg/day	Remaining Production

The consequence of selling 1 kg/day of quota is a cashflow loss of 16 kg/day which now creates issues for the farm since lending institutions use cash flow to calculate loans to producers. However, if no action is taken, the producer faces non-compliance penalties which immediately impact operational decisions (i.e. the ability to buy/sell quota or conduct credit transfers and receive quota allocations).

Therefore, the Board surmises that if the 10/10/10 and LIFO policy continue, the likelihood of succession and renewal in the dairy industry for the province will decrease. Producers will continue to invest in farms across the prairies where there is no 10/10/10 and LIFO assessment and producers have the flexibility to make efficient and effective production decisions on their farms.

The second outcome of the 10/10/10 and LIFO policy is the provincial reduction of quota received to the province. The province of BC receives quota under a 10/90 policy through the national system. This means that 10% of the quota is allocated based on historical shares and 90% is based on the population growth of the province. This policy benefits growing provinces (i.e. western Canada) more so than the ones in more stable population centres.

For example, if the Canadian Requirements determine that Canada needs a 1% increase in quota requirements to meet the demand in the dairy industry, the west receives 1.5% (approx.) and the eastern pool receives slightly less than 1%. This is a significant advantage to BC and has encouraged major processors to invest millions of dollars into the province to have access to this milk when produced.

The dairy industry is currently experiencing unprecedented growth specific to the butterfat market. Worldwide trends show that demand in butterfat continues and this trend has contributed to the significant number of quota allocations over the last two years. Between August 1, 2015 and August 1, 2017, the Board has allocated 17% to support the growth in demand.

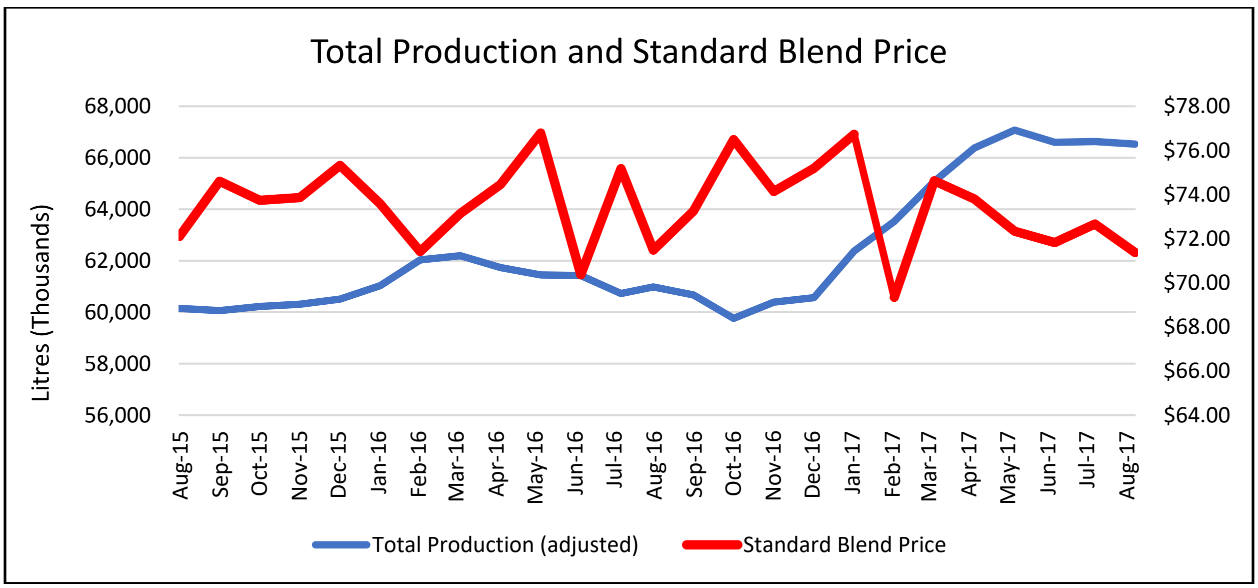
The 10/10/10 and LIFO policy is extremely punitive on production in a growth environment as producers are holding a significant portion of quota that limits their ability to right size farms if required. Remember, as a farm grows the requirements of pro-action, milk quality, food safety, animal care, livestock traceability, biosecurity and the environment also increase. At a certain point, the barns, the milk tank, the land base cannot support the growth and decisions need to be made. In a neutral or declining market, the pro-action pillars still require constant attention and investment, the only difference is the allocations will have stabilized.

If the production does not meet requirements due to farm consolidation or the migration of producers to the prairies than the province of BC could lose the 10/90 allocation policy. This will result in reduced cash receipts from the dairy industry to the province and a reduction of jobs for the BC economy. The 10/10/10 and LIFO policy impedes the strategic advancement of the dairy industry.

2. The Milk Board reports that the ability to freely transfer quota without assessment is important for producers to be able to afford to "right size" their farms, particularly in the face of increasing public expectations surrounding traceability, food safety, biosecurity, animal care, and the environment. 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?

The graph below shows the change in standard blend price and production in the dairy industry following the application of the class 7 billing in BC. Prior to February 2017, the average production volume was 60,921,000 litres and the standard blend price was $73.99. Following the policy change, the average production volume was 65,721,000 litres and the standard blend price was $72.28. Therefore, producers are producing more milk for less payment which would indicate, cashflows have depleted. This assigns more debt/kilogram of quota which limits the ability of financial institutions to provide funds for farm investments.



Although allocated quota appears to be "free" in the eyes of the public it is important to acknowledge there is a corresponding debt and tax attached to each kilogram of quota produced. In BC, the average debt value (per industry sources) is approximately 56% ($23,000/kilogram of quota) and the average tax applied to quota when sold is approximately 25% (10,250/kilogram of quota). Using the current cost of quota, the example below summarizes these figures;

$41,000	Quota
($23,000)	Debt
($10,250)	Tax (Capital Gains)
$7,750	Balance

Recognising that the amount of "windfall" gains is limited as new entrants and smaller farm could have debt levels as high as $30,000, the Milk Board is concerned that if the 1current assessment structure remains, new entrants and small farms will be further challenged with limited cashflows and opportunities for reinvestment.

b. How does transferring growth quota received for free from a commodity board – 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?
All quota is under the exclusive control of the Milk Board's whether it be traded or allocated. The quota provides accountability for the level of production needed to meet market demand. It is important to recognise that quota represents a license and an accountability structure for milk production in the province. The intent of quota is a unit of measurement that is used to bring milk to market in a fair and equitable manner across the country. The Milk Board controls the ability to purchase and sell this license and most importantly produce it. Quota has one function, to bring milk to market and producers buy and sell the opportunity to produce milk, the province retains ownership of the quota.

c. How the Milk Board's rationale aligns with the two legal 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 Milk 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.

The Boards primary concern is the production of milk and meeting market requirements. If the 10/10/10 and LIFO policy is removed, the Milk Board will continue to regulate quota and the production of milk. The intent of the policy change is to encourage the movement of quota within the industry to create supply and opportunity for the industry to grow.

The quota exchange will continue to be the primary opportunity for producers to adjust their milk production. Through the operational parameters of the exchange, the transfer value will be determined. All transfers will continue to be administered by the Board and reviewed by the staff and Board (as required). The Board will continue to determine all quota transactions through policy and will not support any activity that implies quota ownership.

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 Milk 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 Milk 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.

The Milk Board does not intend to play a role in quota values in the marketplace. The Board currently operates a quota exchange using a sealed bid process. Producers can mail or personally deliver a sealed envelope to the BCMMB offices. For email submissions, KPMG is the third-party administrator for the collection of bids and sales until the deadline date of the exchange. Following the deadline only one staff member and one manager review the results of the exchange. The Board is notified of the results at the same time as the industry. The results are held in confidence until this time.

The Milk Board will continue to rely on the operation of the quota exchange and maintain arms length involvement. A quota exchange committee made up of regional producers, Board members and staff managers periodically review the quota exchange data and provide recommendations to the Board for policy changes when required.

The Milk Board submitted recommendation "B" (price adjustment) to address the introduction of more saleable quota into the market place. This practice is not uncommon as it has been used by Dairy Farmers of Ontario when a similar situation occurred in 2015. The Board also recognised in its submission that if the target price naturally decreased due to the lengthy time between submission and decision, no further adjustment would be necessary.

The transparency and integrity of the quota exchange are fundamental to the Boards operation in the long run. The Board has invested in new programming that will allow producers to input data for the quota exchange on a secure online server creating another layer of confidentiality for the producers. Operationally the Board will continue to rely on the review of the quota exchange committee to identify potential policy changes for the Board to consider.

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

   a. Quota is intended to be produced
   The Milk Board is confident that the removal of LIFO and 10/10/10 policies will allow the movement of quota within the industry encouraging those who need to right size to sell quota and those who can expand to buy quota. With equal access to quota across the regions through the quota exchange, quota will continue to be produced and will get to those who can produce it.

   b. Producers are actively engaged and committed to the industry
   Active engagement is key to the dairy industry. By removing the 10/10/10 and LIFO, producers will make decisions related to production that will benefit the industry specifically respecting the pro-action pillars that are key to the publics interest.

   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.
   The Milk Board will continue to reconcile its quota adjustments monthly ensuring any quota required for the development of new markets, programs and new entrants are satisfied before any quota distribution or retraction takes place to the general producer base. This process does not change in a growth, neutral or declining market.

5. Whether or to what extent do any of the Milk Board's quota management policies and rules (for example, issuing continuous daily quota monthly, allocating growth pro rata and the ability to lease quota credits) play a role in the 'quota liquidity' and the ability to "right size a farm" issues reported around LIFO and 10/10/10?

   Quota management policies focus on the producer's ability to manage production on the farm. These policies are necessary for the province to meet its production requirements nationally.

   Quota Allocations

   The current policy for applying general allotments applies a percentage (as determined by the BCMMB) to the existing quota on all qualifying farms in British Columbia. The policy provides an equitable distribution of quota and a reasonable growth allocation for all farms. The policy also allows for quota to be allocated and retracted using the same method with a consistent impact on the farm.

   The policy has been applied successfully over the last 17 years due to its simplicity and ease of understanding for producers. This process is the same across the country. From a quota perspective, producers can anticipate the relative increases and decreases on the farm when allocations and retractions are announced. From a financial perspective, all freight and promotion rates are applied based on the volume of CDQ on the farm. The financial calculations are complementary to the pro-rata methodology. For example, if a 1% quota allocation is applied the producer can determine the financial impact for the cost of production.

The pro-rata distribution of quota allows the Boards to effectively mange the provinces requirements to the national system. If the provinces falls below 1.5% or exceeds 0.5% of its allocated quota it is penalised with a production loss or a severe financial penalty. As referenced in the BCMMB submission, the frequency of change in market requirements for dairy creates a limitation for the Board to use other policies of distribution without jeopardizing production.

For example, in the specialty industry, the Milk Board asks producers if they would like an increase in allocations due to growth in the market. The specialty production pool has 30 producers and changes occur twice a year. The Board cannot ask 454 producers monthly if they would like more quota and to prove they have room in their barns for the extra cows.

When the Milk Board issues more quota, the assumption is that all producers in the industry should equally share in the growth and should have the opportunity to make decisions on their farms to manage this additional quota. This could mean making plans to expand, buying new equipment (robots) or simply filling empty space. However, for those who may not be able to expand due to circumstances, these producers are limited because of the 10/10/10 and LIFO. They do not have options to right size or reinvest because of the nature of the policy.

The Board recognises that the distribution of quota is an obvious policy to change to get the quota to those who can produce it. The challenge is that the distribution would likely go to large farms with resources that can quickly buy cows, expand or rent space. Smaller farms, new entrants or producers with limited resources may be unable to accept quota from the Board at the time of distribution which could potentially eliminate these farm types in the province. The result could be a small concentration of farms (e.g. 100) with a significant amount of quota (e.g. 1000 kg/day), this scenario would not be in the publics best interest for many reasons but the most significant is that no new entrants could enter.

The following chart shows the breakdown of farm ownership and quota holdings as at July 2017;

	CDQ (KG/DAY)	**Number of IRMA's**	**Percentage IRMA**	**Volume of Quota**	**Percentage of Quota**
Small Farm	<100	190	39%	11,343	13%
Medium Farm	100-200	164	34%	23,265	27%
Large Farm	> 200	130	27%	52,914	60%

		484	**100%**	**87,522**	**100%**

The small farms consist of 39% of the IRMA's issued by the Board with 13% of the allocated quota.

The medium farms consist of 34% of the IRMA's issued by the Board with 27% of the allocated quota.

The large farms consist of 27% of the IRMA's issued by the Board with 60% of the allocated quota.

Credit Transfers

Credit Transfers provide a producer the opportunity to adjust farm production temporarily by purchasing production credits from another farm. The Milk Board administers the transfer of credits to manage production records. The financial aspect of the transfer is handled privately between producers. The current credit transfer policy was applied August 1, 2014, however various forms of credit transfer policies or swaps previous to CDQ have been applied since April 2000.

The Board allows the transfer of credits recognising that in a system where production requirements change frequently there needs to be opportunity to manage production requirements in transitory periods. This policy provides a temporary option to right size your farm up to +/-10% of your total holdings on a 12-month rolling basis. Producers are encouraged to use this policy to manage production variations (i.e. seasonality) throughout the year. Ideally the credit transfer policies are a short-term management tool that creates costs in the system. All provinces across the west have a variation of credit transfers however in BC it is the only option a producer can use to right-size a farm.

Consequently, producers invest in additional cows, feed, and barn space and try grow production with the risk of not being able to buy credits every month. In other provinces, this tool is used to manage seasonality, if a producer wants to grow permanently quota is generally available for sale for purchase. The 10/10/10 and LIFO policy has created an importance on the exchange of credits which increases costs and decreases efficiency in the system.

+5/-15 Flexibility Days

Producer flexibility in a continuous daily system provides flexibility for over and under production monthly to account for seasonality of milk production and reality that litres will not be exactly aligned to a specific production amount daily. BCs current policy is +5 days over/-15 days under to provide a total of 20 flexible production days. This policy has been applied since August 1, 2010.

This policy allows producers to manage production and it correlates to the management of quota at the national scale. Generally, producers are encouraged to operate close to 0 days of production to avoid operating at the extremes (+5/-15) to limit risk of over and under production, however producers use this policy to right size in conjunction with credit transfers.

Incentive Days

An incentive day is a temporary allocation of quota that allows a producer to ship additional production for the given month if they have shipped at least 100% of that month's daily quota. The additional production amount is determined by the Milk Board based on market demand for the main-stream market. Incentive days were introduced as a mechanism to manage production requirements when the province changed to a daily quota system on August 1, 2010.

Incentive days provide an avenue for temporary production growth during a time when the province has a need for increased milk supply. Incentive days are an opportunity for producers meeting production requirements. Due to the lower standard blend prices, increased production volumes and pro-action requirements, it is difficult for producers to make additional investments for temporary growth. If the 10/10/10 and LIFO policies were removed and producers could right-size farms or reinvest on the farm, or new entrants could access quota at an affordable price, the industry could continue to grow.

Proposed MMB Change #2 - 0% Transferability (non-transferability) of New Entrant and Specialty Incentive quotas (e.g. Cottage Industry Program Quota) for 10 years

Under this proposal, all quota issued to a new entrant or specialty incentive quotas (e.g. Cottage Industry Program), including any growth, would be 100% retractable by the Milk Board if any portion of the quota is sold in the first 10 years. Essentially quota would become non-transferable for 10 years.

The Milk Board is proposing that this would apply to all Graduated Entry Program (GEP) quota issued between 2004 and 2019 (thus it would be retroactive). After 10 years the GEP quota would be considered as 'basic' quota and subject to the market responsive assessment. 100% retraction would include any pro-rata growth issued on GEP quota.

The Milk Board submission states that this change will provide production accountability to the Milk Board which in turn supports supplying milk to market while supporting new entrants in both the mainstream and specialty markets.

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

The intent of specialty and new entrant programs is to create new farms and encourage innovation for the province. The Board is providing assistance through the allocation of quota for these programs to be successful. The program parameters should encourage applicants that can sustain new farms for a 10-year period barring any exceptional circumstances. Therefore, the quota is 100% transferable in 10 years as opposed to 10% per year under the current program. The result supports the objective that quota is fully transferable at the end of year 10. Under the current policy only 90% of the quota is transferable at the end of year 10.

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 Milk 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 Milk Board considered, does it agree?

The Milk Board has considered the risk involved with a 10-year program. However, from a public perspective, the Board wanted to create integrity and accountability for programs using Board incentive quota. Currently, a producer can enter the dairy industry under the new entrant program, farm the Board sponsored quota for 5 years and then sell the quota and retain 50% of the transferable value.

The Board recognises that 0% transferability could encourage "poor fits" to stay in the industry longer than beneficial, however "poor fits" are currently encouraged to stay in the industry under the 10/10/10 and LIFO policy for the same reason, to earn quota.

3. The prevention of quota flipping/windfall gains is stated by the Milk 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 and 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?

Generally, the Milk Board incentive programs provide a specific amount of quota for an intended purpose, i.e. to support industry renewal or innovation etc. The quota allocated will eventually be treated the same as the quota allocated and distributed in the main-stream market but since the quota is provided to fulfill parameters of a specific program, accountability to fulfill these parameters is necessary.

All general allocations would be treated the same for new entrants and main-stream producers, it would simply be the incentive quota that would need to be earned.

The Board recognizes the difference in risk but also acknowledges that new entrants receive 19.2 kg/day from the Board to start a new farm. The start up quota should fulfill program requirements before transferability can occur.

4. How will the proposed 0% transferability affect the ability of new entrants to "right size" their farms within their first decade of business?

The Milk Board currently allocates 13.7 kg/day and then allocates an additional 5.5 kg/day if the producer can match that amount in purchases bringing the farm to 24.7 kg/day in total, 19.2 kg/day is deemed incentive quota. If the producer needs to reduce quota below 19.2 kg/day a request would need to be sent to the Board explaining why and what the situation is on the farm. The Board did not think it would be a significant issue as the producer can sell the purchased quota and allocations prior to reducing below the Board incentive quota. The bigger concern in this situation would be success of the operation, new entrants and small farms should grow not decrease production.

Proposed MMB Change #3 – Lower Quota Price by approximately 15% and Freeze Quota Price for some temporary Period of Time

Under this proposal, the Milk Board would cap and freeze quota price on the Quota Exchange for one year at $36,000 CDQ. Should the target price of $36,000 kg/day be reached during the QATE review (prior to any potential policy changes, the Milk Board would freeze at target price to maintain industry stability while BCFIRB deliberates. No price adjustment would be applied if LIFO and 10/10/10 or some form of the policy remains.

Please refer to the legal opinion submitted to FIRB on September 16, 2017