BC egg MARKETING BOARD

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RE: Quota Assessment Tools Evaluation Follow-up Questions

Thank you for providing BC Egg with the opportunity to answer the follow-up questions prior to the October 2, 2017 meeting.

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

In order to answer the questions outlined for this proposed change, BC Egg will first analyze how effective LIFO and 10/10/10 are at meeting the policy objectives established by BCFIRB as part of sound marketing policy. A full SAFETI Analysis of the policy against each of the policy objectives is attached.

- Quota is intended to be produced.
  - Producer perspective – LIFO and 10/10/10 meet this objective. The prospect of losing all or a portion of their quota is an excellent incentive for producers to keep issued quota in production and not transfer it.
  - Stakeholder Perspective – LIFO and 10/10/10 do not meet this objective. When quota is assessed and held in the Board reserve, it is not being produced. In order to get this quota into production, the Board must either issue it or temporarily allot it to producers. This would only be an issue if there was a large amount of quota in the reserve, however any amount of quota not being used means that the industry is shorting the market.

- Producers are actively engaged and committed to the industry.
  - Active Engagement - LIFO and 10/10/10 do not meet this objective. In order for this objective to be met, BC Egg implemented an order that stated that producers must be actively engaged in order to receive quota issuances, both growth and new producer.

    The criteria to determine active engagement are outlined in Part V of the Orders. The Board recognized that there were a few issues with that method in regards to determining active engagement which prompted further changes to the Orders that were reviewed and approved by BCFIRB in the spring of 2017. BC Egg has not yet implemented those changes as it would cause less confusion amongst producers if those changes were implemented along with any changes that may arise from this review as it was the original intent of BC Egg to implement all changes at once. As per the BCFIRB directive issued September 25, 2017, those changes will be implemented as soon as possible.

- Committed to the Industry – LIFO and 10/10/10 are effective at ensuring that producers remain committed to the industry. The changes that BC Egg made to the Orders in the spring will help to ensure that, even without LIFO and 10/10/10, there will continue to be Orders that ensure commitment.

BC Egg remains committed to this objective and will work to ensure that any policy changes continue to meet this objective.

- 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. LIFO and 10/10/10 do not meet this objective. While the concept is sound and appears as though it would ensure there was quota available, it has not been successful in providing enough quota to support the policy objectives (New Entrants and Market Development).

  Over the last 11 years, LIFO and 10/10/10 have been successful at obtaining just under 20,000 quota units to support the policy objectives. This would support one new entrant every 2-3 years which falls short of BC Eggs commitment of starting two new entrants each year. In addition to failing to meet policy objectives, it is also hindering quota transfers as outlined in the BC Egg submission. This in turn, does nothing to reduce barriers to entry.

  BC Egg recognizes that LIFO and 10/10/10 were meant to be one mechanism of ensuring quota was available for policy objectives and that it is reasonable for BC Egg to have additional methods of ensuring quota is available for those policy objectives. Our consultation and research have provided evidence that LIFO and 10/10/10 are in fact detrimental to the industry and, as alternative policies must be relied upon either way, LIFO and 10/10/10 should no longer be supported.

It is important to understand that BC Egg recommended eliminating LIFO and 10/10/10 because the policy was not meeting the objectives as outlined by BC FIRB as part of sound marketing policy as well as their detrimental effects on quota movement.

1) *How does the elimination of LIFO and 10/10/10 benefit the industry strategically in the long run and how does this tie into BC Egg's long term strategic goals and vision for the industry?*

   BC Egg's vision, from the 2015 Strategic Plan, is to have a cohesive, sustainable and growing BC egg industry that meets the needs of consumers while being socially and environmentally responsible.

   Industry renewal depends on the ability of producers to expand their operations, pass farms down to future generations or exit the industry and provide opportunities for new entrants. These processes are integral to industry sustainability and growth. Removing LIFO and 10/10/10 would reduce restrictions on producers and provide for a more free transfer of quota, this would reduce barriers to entry and reduce the disincentives for producers wishing to exit the industry. While this seems as though it is a short term goal, related to a specific situation at a specified point in time, it is an issue that will continue in the long term.

Holding per-capita consumption rates constant, as the population continues to grow the egg industry will continue to grow as well. This will lead to periodic increases in quota and each time the industry receives growth, the disincentive to transfer will be present again and renewed for the next 10 years. In the last 20 years, there have been 9 quota increases, averaging one quota increase every two years. With each new increase, the "finish line" is extended.

The industry will benefit from the increased availability of quota in all situations; the neutral growth situation would be required to remain for greater than 8-10 years in order to positively impact quota transferability. In the 1980's and 1990's, the industry experienced declining growth. In this situation, producers had received an issuance in 1979 and their first reduction in 1980. In the event that LIFO and 10/10/10 were in effect at that time, this would have been an even greater disincentive for producers wishing to transfer quota as the LIFO and 10/10/10 assessments would compound the National reduction.

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 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?*

    Page 26 of the BC Egg submission states:

    > "In many cases, these producers will need capital to finance this transition. Being able to sell a small amount of quota on the exchange will help them to make the transition."

    The above statement was not intended to suggest that quota transfer is necessary to finance industry transition. The intention our submission was to fully explore the effects of our proposed changes to all stakeholders.

    For the seller, it is entirely plausible that the proceeds from the sale of quota would be reinvested into new capital and barn renovations. For the purchaser, there would be more liquidity in quota, which would make quota more accessible and reduce access as a barrier of entry, benefiting new producers as well.

    The consumer is unaffected because the overall provincial production remains unchanged; however, the distribution of the quota between the two parties has now changed to allow both parties to be at their desired production levels.

In addition, banks do not make loans based on cash flow only. They look at a combination of things including security value (Cost, current value and forced sale value – for land, buildings and quota); cash flow to debt service coverage; working capital; debt to equity; and management history. In some cases cash flow may be weighted more than in others, but there is still some value placed on the asset value as well, and rarely is a loan based on cash flow only.

So, if a producer were to obtain a loan without transferring quota, the banks would still care about the value of quota (recent trades) and its liquidity. The liquidity helps the bank assess a forced sale value [FSV]. FSV is the value they put in their reports outlining what the asset would be worth if they had to sell it quickly or in a down market.

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?*

While, on the surface, it appears that growth is received for free, producers have invested equipment, time, effort and levies to make that growth happen. All producers must be actively engaged and committed to the industry in order to receive their growth issuances. A producer must house the hens prior to receiving the growth issuance. The producer has invested capital and management into any quota unit they have a licence to produce prior to obtaining the ability to transfer it to another producer or new entrant.

As the producer must house the hens prior to receiving the quota issuance, that producer must also pay levies on the issuance. Levies contribute to the regulation of the industry and the marketing of the product. Levies are paid on all quota units in production. Without the producer's investment in the administration, regulation and marketing if the industry, the growth would not have occurred.

Producers are directly responsible for the growth that occurs in the industry, it is not obtained for free. The quota is produced by the producer who receives it from the Board. As with all quota, producers are well aware that quota is a licence to produce and not property. This was made very clear to producers between 1980 and 1999 when the industry experienced nine quota reductions. Once a producer obtains growth quota, it is treated as all existing quota is treated.

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;*

BC Egg has not endeavoured to assign a monetary value to quota however BC Egg does recognize that quota acquires value in the marketplace. That market acquired value must be considered, as all financial factors must be considered, when developing policy.

BC Egg did not propose any of the recommended changes using the market acquired value of quota as the responsible driver for change. Many other factors were considered such as how well the current policy is working when compared to objectives and industry efficiencies.

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.*

BC Egg recognizes that quota is a revocable licence and not property. BC Egg issues quota licences to all producers. This registers that quota to the producers according to their proportionate ownership in the farm entity that represents that licence number. If the proportionate ownership of that farm entity should change due to restructuring or sale of the entity, the proportionate registration of that quota will change accordingly and a transfer of quota, which must be approved by BC Egg, will be required.

Confusion regarding the registration of quota vs ownership of the farm entity occurs because they are linked in this manner. It is important that the two are linked to ensure active engagement and commitment to the industry as well as industry stability.

BC Egg is not attempting to imply that quota is anything other than a revocable licence in its submission; rather BC Egg is recognizing that the licence needs to be managed in a way that is predictable, fair and equitable for producers.

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.*

BC Egg is a steward for quota in the province. It is BC Egg's responsibility to manage quota in a manner that aligns with provincial and federal regulations as well as the

SAFETI Principles and Sound Marketing Policy. These have been outlined and addressed in the original submission under the Policy Objectives (page 5) as well as under each policy consideration (pages 23 and 26).

The value of quota in the marketplace was mentioned by BC Egg in the submission when discussing the implications of current and proposed policy. The value of quota in the marketplace can be a useful indicator of the effectiveness of a policy and the ability of that policy to increase the transferability of quota and reduce barriers to entry. If quota was readily transferrable, the value of quota in the marketplace should remain constant or decrease. If policies are in place that hinders the transfer of quota, the value of quota in the marketplace would increase.

BC Egg has not recommended any policy changes in the submission for the purpose of addressing quota values in the marketplace. The value of quota in the marketplace has been mentioned in the submission in terms of the effects of current and recommended policies as well as their objectives.

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*

      For all growth issuances, a producer must place the hens prior to receiving their quota; in addition, the hens must be placed within three years of notification to the producer that the quota is available. Failure to place the hens within three years of notification will result in forfeiture of the opportunity to produce with that quota.

      Over the last few years, BC Egg has updated the procedures around quota issuances to ensure that quota is produced in a timely manner.

      1) For each allocation, producers are given 30 days from the date the quota is available to them to respond to BC Egg with their expected place date.
      2) BC Egg determines how much quota will remain in the reserve from the issuance and the timeline for placement.
      3) If quota is not in production in the short term, BC Egg will implement a temporary allotment program for producers who have the capacity and the hens to put the quota into immediate production with a temporary licence. This ensures that the quota is being used.
      4) Once the intended producer has the capacity and the hens, the quota will be issued. Failure to place the hens within three years will result in forfeiture of the opportunity to be licenced for the growth.

      This process has been very effective and there have been a few situations where BC Egg has forfeited the growth opportunity for a producer.

b. *Producers are actively engaged and committed to the industry*

Part III and Part V of the current version of the Orders outline the requirements for active engagement in order to participate in the industry and receive any quota, growth or incentive. This will not change with the removal of LIFO and 10/10/10. As mentioned previously, LIFO and 10/10/10 were not effective in ensuring active engagement. LIFO and 10/10/10 does play a role in ensuring commitment however it also keeps those in the industry where Egg Production may no longer be a good fit.

In the revised Orders, there is a requirement for land ownership in Part IX which ensures active engagement and a strong financial commitment to the industry. When reviewing the requirements in Part III and Part IV of the current Orders, some of the specifications to determine active engagement are subjective while the objective ones would be covered in the requirements of the revised Orders.

c. *Quota is available to commodity boards to support policy objectives, including development and specialty markets and providing for new entrants in the supply managed system*

BC Egg has proposed the Reserve Responsive Assessment along with a 10% hold back on industry growth issued by EFC to accommodate that policy objective.

BC Egg is recommending that the reserve is maintained with a minimum of five years and a maximum of 10 years of quota to sustain the New Producer Program. At this time, our New Producer Program dictates that the BCEMB start two new producers per year so the BCEMB would maintain between 30,000 and 60,000 quota units in this reserve.

This reserve would be funded through both the 5% Transfer Assessment and a hold back on National Quota Issuances.

- If the reserve is above 30,000 quota units, then there would be no transfer assessments applied.
- If the reserve is less than 30,000 quota units, a 5% transfer assessment would apply to all non-exempt transfers.
- If the reserve is above 30,000 quota units but less than 60,000 quota units, a 10% hold back would apply to all National Quota Increases prior to distribution to producers.
- If the reserve is above 60,000 quota units, no hold back on National Quota Increases would apply.

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

BC Egg is recommending a 0% transferability policy for 10 years on the incentive quota which is the initial 3,000 quota units that a new producer receives through our new producer program. This does not apply to growth issuances received by that new producer. Growth issuances will be treated the same for all producers, regardless of how they entered the industry. Throughout the process of the consultation, it became very clear to BC Egg that wherever possible, all producers should be treated the same.

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

   In the case of the new producer programs, where new producers are able to enter the industry with quota that they did not obtain through transfer from another producer, encouragement needs to be provided to ensure that they are not tempted to "cash out." In this situation, BC Egg has determined that in the case of new producers, the initial allotment of quota must be non-transferrable for a period of time to ensure commitment to the industry. This also ensures that the quota is produced by the person who was intended to produce it. As this is only applicable to the initial incentive allotment and not growth issuances, the opposing policy objectives are balanced.

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?*

   BC Egg is aware of the potential for the 0% transferability policy to discourage new producers who are not a good fit in the industry to exit. The New Producer Program screening process, as outlined in Schedule 1 of the Orders will help to mitigate that risk.

   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?

   BC Egg has mandatory food safety, biosecurity and animal care programs with a stiff penalty policy in place. If any producer is found to be a poor fit, regardless of how they entered the industry, BC Egg will ensure that they either follow the regulations therefore becoming a good fit or their licence to produce will be revoked. This is a significantly stiffer penalty for those who have transferred quota from an existing producer than those who have received their quota from BC Egg through the New Producer Program.

   While it is a possibility that the 0% transferability for 10 years could motivate 'poor fits' to stay for the 10 years, possibly creating a health or safety risk to animals or the industry overall, the industry has policies in place to mitigate that risk.

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?*

   As mentioned above, BC Egg is treating all producers the same in terms of growth issuances, regardless of how they entered the industry. As mentioned in the opening paragraphs producers have invested equipment, time, effort and levies to make growth happen. All producers must place the hens prior to receiving growth issuances so the producer has the permanent barn space, flipping the growth quota at this time would ensure the barn was inefficient.

   As discussed throughout both this document and our formal submission, before a producer is eligible to receive a growth issuance, their active engagement is required and all producers are subject to the same treatment.

   The term "windfall gains" is not applicable to growth issuances; one of the pillars of supply management is matching supply with demand. Over the past 50 years there have been numerous increases and decreases; the producers fully bear and accept that risk.

   Conversely, incentive quota issued to new entrants under Schedule 1 of the Orders is earned differently and there is the potential for a "windfall gain" if that quota was sold shortly after its issuance. We are cognizant that this is a tightening of the policy surrounding our new entrants but feel that it will enhance the engagement of our selected applicants.

BC Egg looks forward to our October 2, 2017 meeting to discuss these answers and any further questions you may have.

Sincerely,

Katie Lowe

Katie Lowe P.Ag.
Executive Director