



# British Columbia Chicken Marketing Board Chicken Sector Pricing Supervisory Review Interim Pricing Submissions

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June 26, 2020

## *Issue*

- The BC Farm Industry Review Board (the “BC FIRB”) is attempting to determine, what, if any changes are needed to the current chicken and hatching egg pricing pending longer-term resolutions.

## *Background*

- The BCFIRB supervisory panel has met jointly with the British Columbia Broiler Hatching Egg Commission (the “Commission”) and the British Columbia Chicken Marketing Board (the “Chicken Board”) on April 30 to gain an understanding of the impact of the COVID-19 pandemic on the chicken industry in BC; the current pricing systems in place; pricing processes in progress; the issues relating to interim pricing stability, long-term planning; and long term pricing.
- The BCFIRB supervisory panel met with the British Columbia Chicken Growers Association (the “Growers”) on May 28 and the Primary Poultry Processors Association of British Columbia (the “Processors”) on June 3 and received correspondence from the British Columbia Broiler Hatching Egg Producers Association (the “Broiler Breeders”) and the British Columbia Egg Hatchery Association (the “Hatcheries”) to address the barriers to long term pricing and what changes and timelines should be considered by the supervisory panel to ensure interim pricing stability pending the resolution of the hatching egg linkage exit question and a long term live chicken price formula.
- In a June 8, 2020 letter from the BCFIRB supervisory panel requested written submissions by June 19, 2020 from the Growers, Processors, Broiler Breeders and Hatcheries on two questions:
  1. Are one or more of the pricing structures in place currently resulting in industry instability? If yes, please provide your rationale that demonstrates this instability.
  2. If you believe current pricing structure are resulting in industry instability, what interim changes do you believe are necessary to create stability? Please provide your rationale.

- The June 8, 2020 letter from BCFIRB also provided the summaries of the Growers and Processors meetings with the supervisory panel as well as the letters from the Broiler Breeders and Hatcheries regarding the key questions posed by the supervisory panel.
- The Growers and Processors filed submissions by the June 19, 2020 deadline addressing the two questions.
- The June 8, 2020 letter from BCFIRB provides the Chicken Board and the Commission with the opportunity to provide input on interim pricing and industry stability by June 26, 2020.
- The BCFIRB supervisory panel would like to resolve the specific question of interim pricing and industry stability by the start of A-164 (July 5, 2020).

### Interim Pricing Stability

- The issues raised in the stakeholder submissions include:
  - Removal of spent fowl and salvage egg revenue from the linkage COP calculation as contributing to interim pricing instability (Growers, May 28 and Processors, June 3).
  - Not allow changes to the kill age unless determined for an extended period as has historically been the case (Growers, June 19).
  - Maintain the linkage for the interim (Growers, June 19).
  - The current Ontario based pricing formula to remain functional but move from 75% to 100% recovery of feed and chick costs (Growers, June 19).
  - Moratorium on grower movement (Processors, June 3 and June 19).
  - “Changes in the Ontario live price formula that create financial relief must not flow directly to growers ... The benefits need to flow to BC processors as it is the BC Processors who have funded the ON efficiency adjustments through the increasing live price differential” (Processors, June 3 and June 19)
  - Changes imposed by the Commission on kill age and fowl revenues be rescinded (Hatcheries, May 26 and Processors, June 19).
  - BC live price formula and the linkage agreement are causing industry instability (Processors, June 19).
  - Structure of the BC live price formula results in an unpredictable and uncompetitive live price providing an avenue for stakeholders to pass on costs and margin increases onto processors without regard for the broader industry (Processor, June 19).
  - The Commission’s actions have perpetuated the mindset that every stakeholder can pass along their own costs through to the processors (Processors, June 19).
  - No further changes to the current live price formula or the factors within the formula during the Supervisory Review to bring interim price stability (Processors, June 19).
  - Consider the recent impacts of COVID-19 and the resulting increased costs to processors that are likely to become permanent (Processor, June 19).
- The issues/suggestions not previously raised related to interim or long-term pricing in the submissions relate to suggestions regarding any changes in the Ontario Live price; change to the percentage of coverage of the difference in the feed and chick cost in the

current BC pricing formula; the moratorium on grower movement; and the impact of COVID-19 on processor costs.

- The other points are consistent with the issues relating to the appeals that have been put into abeyance pending the Supervisory Review.

### **Long Term Pricing Barriers and Considerations**

- The issues raised in the stakeholder submissions include:
  - Concessions required by all parties (Growers, May 28).
  - The Board must be directly engaged (Processors, June 3 and Growers, May 28).
  - Support for a COP based pricing model, if both hatching egg producers and broiler growers moved to a COP based pricing model (Growers, May 28 and June 19).
  - Consideration of wholesale margin as a component of live price, only if processor provide independently verified data on a regular basis (Growers, June 19).
  - Serious consideration of a hard cap price differential from Ontario live price (Processors, June 3).
  - Board needs to make a decision no later than October 2020 (Growers, May 28 and June 19).
  - Need to define “fair return to growers” and “processor competitiveness” (Processors, June 3).
  - Hatchery price squeeze needs to be addressed (Processors, June 3).
  - Hatcheries need to have greater participation going forward (Processors, June 3).
  - Assurance of supply should be revisited (Processors, June 3).
  - Support continuation of the linkage (Processors, June 3).
  - Change in Chicken Board composition from 3 appointed directors to 1 appointed chair and four grower elected members similar to other boards (Growers, June 19).
  - Eliminate catching costs from the live price with processors bearing the full cost of catching as in Ontario (Growers, June 19).
  - Clarification of the transfer of ownership (FOB) to define the stage at which transfer of birds from growers to processors takes place (Growers, June 19).
- The issues raised in the submissions that had not previously been raised in relation to the live price or linkage discussions include:
  - Revisit assurance of supply.
  - Use of wholesale margin in pricing.
  - Chicken Board composition – an issue that has been raised many times in the past, but not in relation to interim or long-term pricing.
  - Exclusion of catching costs in the live price – this issue was raised as part of the discussions around the current interim live price formula. Catching costs have been a part of the BC live price formula.
  - Transfer of ownership of the regulated product and revised definition of FOB.

## Discussion

### Interim Pricing Stability

- Focus of all stakeholders on the removal of revenues from the breeder COP in the linkage and the change in kill age.
  - The processors elimination of payment of a loyalty bonus payment to growers can be viewed as an interim measure taken by processors to off-set the increase “costs” resulting from the Commission’s linkage price decisions.
  - It is interesting that Processors are suggesting a moratorium on grower movement as well as reconsideration of assurance of supply following their unilateral decision to eliminate the loyalty bonus payments.
  - Grower movement is tracked on a cycle by cycle basis and reported in the BCCMB quarterly “chicken facts”; with no indication at this point in time of an increase in requests to change processors.
- The impacts of the reduction in kill age and the removal of spent fowl and salvage egg revenues from the breeder COP in the linkage are as follows:
  - Kill age reduction from 58 to 56 weeks at 1.87 cents/chick
  - Removal of spend fowl and non-hatching egg revenue at 1.01 cents/chick.
  - The combination of these two changes total 2.88 cents/chick; based on a 2.2 kilogram live bird.
  - The 2.88 cents/chick is equivalent to an increase in cost to the chicken grower of 1.3 cents/kilogram (live weight).
- The impact of the Ontario efficiency adjustments on live price is not unique to BC, particularly when measured by live price differential over the Ontario live price.
  - Processors agreed to increased price differentials, in Alberta, Saskatchewan and Manitoba over the same period; these could be linked to the Ontario efficiency adjustments as most of these provinces do not have any defined parameters for the differential over Ontario other than catching costs.
  - Manitoba uses changes in the cost of feed and chicks as a factor in establishing live price in their province.
  - BC Processors benefit from the lower Ontario live price despite the feed and chick cost differential between BC and Ontario.
  - The inference that the current BC live price formula has compensated for the Ontario efficiency adjustments is unfounded; the differential over Ontario is based on a percentage of the difference in cost of feed and chicks which are independent of the Ontario efficiency adjustments; it is reflective of the higher cost of production facing the BC industry;
- It could be suggested that Processors having eliminated the loyalty bonus paid to growers have negated the live price increase resulting from the Commission’s changes to the Linkage Agreement and was enacted as a measure to secure interim price stability.
  - Processors across Canada have eliminated or reduced the level of bonuses paid to growers; this being not unique to BC would lead to the argument by Processors that, their elimination of the loyalty bonus does not enhance their competitive position.

- As a result of the processors eliminating the loyalty bonus payment and the increased chick cost resulting from the Commission’s linkage agreement adjustments it is the Grower segment of the chicken industry that has seen the greatest instability during the interim period.
  - The elimination of the processor loyalty bonus negatively impacts returns to Growers.
  - The payment of the loyalty bonus was not a guaranteed payment in perpetuity.
  - The Growers arguments to reinstate spent fowl and salvage egg revenue into the hatching egg COP is specious given the Growers and Processors position to not account for the loyalty bonus in the broiler COP in the linkage.
- The Processors and the Growers independently negotiated the loyalty bonus agreement following the 2010 Supervisory Review as a means to address the termination of assurance of supply.
  - The Chicken Board makes no decisions nor plays any role in the establishment or amount of the loyalty bonuses.
  - Loyalty bonuses and premiums are paid by processors in other provinces, however the fall outside of the live price formulas set by the provincial boards.
- The Commission has provided their analysis of the 2019 hatching egg allocation and egg flow to justify the reduction to the kill age in the linkage.
  - While the Commission report provides the factors that have contributed to the higher than expected egg supply resulting in the need to reduce the kill age, they have not addressed or provided any data reflecting historical variations in kill age from the long established 58 week base used in the linkage and why no adjustments to kill age were made where there were differences, longer and shorter.
  - There remains an absence of transparency for implementing a change to the kill age in the linkage; there is insufficient documented rationale provided to stakeholders to support the unilateral action taken by the Commission.
  - The ability to unilaterally amend the kill age relieves much of the responsibility for proper production planning from the Commission and passes on resulting cost of excess hatching egg production to the balance of industry stakeholders through the linkage. This has the perhaps unintended consequence of tipping the balance in one of the main tenets of the linkage being “cost recovery parity.”

### **Long Term Pricing Barriers and Considerations**

- The cost of producing and processing chicken in British Columbia is recognized to be higher than other provinces. (with the possible exception of the Atlantic) with the predominant contributing factors being:
  - Higher feed costs for growing chicken; and
  - Higher live price for chicken paid by processors.
- The live price formula set by way of a mediated agreement (September 24, 2010) between growers and processors following the 2010 BCFIRB Supervisory Review provided a fixed differential over the Ontario Minimum Farm Gate Live Price (the “Ontario Live Price”).

- The mediated agreement provided an initial differential of 4.80 cents/kg over the Ontario Live Price increasing to 4.85 cents/kg for quota periods A-113 to A-119.
- The mediated live price included catching costs of 3.3 cents/kg for single deck barns and 3.60 cents/kg for double deck barns for growers using chicks supplied by their processor’s hatchery.
- While the fixed price differential did not define what was to be included other than catching costs, it could be assumed that excluding the catching cost in the fixed price differential over the Ontario Live Price left only 1.2 cents/kg (4.8 – 3.6 cents/kg) to cover the higher feed and chick costs in BC.
- The 2017 Live Price Formula (the “2017 Formula”) provided greater transparency and rationale than the prior fixed price differential.
  - The 2017 Formula focussed on addressing the policy objective of “reasonable return to growers” by including specific reference to the feed and chick cost factors in addition to catching costs that contribute to the higher grower cost of production in BC.
  - While processors put forward information and arguments to support higher processing costs in British Columbia, only limited cost data and information was provided and no data on processor returns or margins was provided to indicate that the competitive position of processors was in jeopardy.
- In its May 2019 decision, the BCFIRB appeal panel offered the finding; “While the panel supports, in principle, a chicken pricing formula based on the Ontario price and a fixed differential, there is insufficient evidence before the panel on this appeal to establish such a formula.”
  - This finding seems inconsistent with BCFIRB appeal panel’s further point contained in the appeal summary that “It was common ground that the live price formula must be consistent, predictable and transparent”.
  - A fixed differential over Ontario, unless it is fully defined as to what the differential covers or is included in the calculation of the fixed differential, fails the transparency test.
  - It could be argued that using the Ontario Live Price reflects the COP and is responsive to changes in key components of the COP, however, the difference in key feed components and pricing, corn versus wheat, does not fully reflect the major input cost to growing chicken in BC. As such a fixed differential over the Ontario Live Price is less responsive to change than the current BC live price formula.
- The inclusion of catching costs in the live price formula inflates the BC price differential over Ontario and must be netted out when using it as a “measure” of competitiveness of BC processors.
  - Inclusion of the catching costs works to BC processors advantages in contract that are based on live price. Processors have not provided any data on the percentage of contracts that are based on live price versus wholesale price.
  - The Chicken Board has had prior discussions with Western Boards and processors on eliminating catching costs from the western provincial live prices. Processors are reluctant and have expressed reservations to agreeing to any such change.

- Ontario Live Price as the base reference point of processor competitiveness.
  - Through the 2010 Supervisory Review, the topic of premiums and bonuses were raised as part of the debate over assurance of supply.
    - It is clearly understood that the Ontario Live Price represents the “Minimum Farm Gate Live Price” that processors must provide to growers. This does not mean that it is the price that growers receive. While not contained in public documents, it is generally known that processors in Ontario pay premiums to growers that are added to the minimum posted live price.
    - The amount of premium paid by Ontario processors affects the competitive position relative to BC processors.
  - The Processors have also promoted a realignment of the BC weight price grid with the Ontario Minimum Farm Gate Live Price.
    - While Ontario has a pricing grid for different weight categories, they do not disclose the amount of production by weight category as is the practice of the Chicken Board.
    - Given the lack of transparency by the Chicken Farmers of Ontario it is not possible to ascertain as to whether or not the Ontario Minimum Farm Gate Live Price is actually reflective of the majority of production in Ontario so as to “match” Ontario and BC weight classes for establishing the BC minimum live price.
- Use of COP as the basis of the BC live price.
  - While COP has been used to provide the basis setting the chick price through the linkage formula by balancing broiler grower and hatching egg producer returns, it is subject to its own set of limitations for setting the live price or chick price.
    - For chicken growers, there is significant variability in cost of production due to size of operation and location; for hatching egg producers there is less variability.
    - Value of land as an input cost is a highly contentious variable.
    - Price solely based on cost does not instil the need for continuous improvement or efficiency.
  - The Chicken Board does use COP to set the live price for specialty birds and organic production.
    - The Chicken Board is open to review of the Commission’s proposed COP based pricing.
    - The Chicken Board will evaluate the use of COP in pricing along with other approaches in establishing a long term pricing formula.
- The Growers have been relentless in their pursuit of changes to the composition of the Chicken Board, i.e. alignment with the composition of other marketing boards; appointed chair and elected members.
  - The Grower inference that Chicken Board composition has contributed to pricing instability (June 19) is without merit, particularly the reference to “watch Ontario and rely on the Price Working Group”.

- Point of Transfer has been raised by Growers in the past. Section 9.4 of the Chicken Board General Order states: “all chicken shall be purchased and sold F.O.B. at the grower’s premise.”
  - What is not clear is the problem or issue with respect to “point of transfer”. Is it related to liability for any loss or damages or potential animal welfare issues during the catching and loading process or prior to the birds leaving the “farm gate”?

## **Chicken Board Response Points**

### **Interim Pricing Stability**

- The only pricing instability that has resulted since the Commission’s decisions regarding the Linkage Agreement to eliminate spent fowl and surplus egg removal revenue and to reduce the kill age from 58 to 56 weeks is the discontinuance of the loyal bonus paid by processors. Are these actions linked, or is the discontinuance of loyalty premiums due to additional cost pressures as a result of COVID-19 as stated by the processors (PPE, sanitation, additional labor costs etc.)?
  - Broiler growers have faced the greatest instability and are the most negatively affected segment of the chicken industry.
  - Processor decision to discontinue payment of loyalty bonuses should be viewed as an imposed unilateral interim measure to improve processor stability over pricing.
  - Hatching egg producers have benefitted from the changes, however
    - The Commission did reduce the price for spent fowl by 50%;
    - Disruptions in processing plants due to the COVID-19 pandemic also served to reduce the number of spent fowl processed and paid for.
    - The Chicken Board acknowledges costs to the Commission for destruction of hatching eggs due to reduced egg sets during period A-163 as a further impact of COVID-19.
- ***BCFIRB should not intervene with any changes to the Chicken Board’s current pricing formula at this time.***

### **Long Term Pricing Barriers and Considerations**

- The submissions of the industry stakeholders have not yielded any new issues, barriers or considerations that have not been raised in prior pricing discussions or appeals.
  - No compelling case for change has been put forward in the submissions by the Growers or Processors.
  - No quantification of harm or impact of the current situation has been provided by the Growers.
    - The financial impact to Growers from the Processors withdrawing payment of the 3 cents/kg loyalty bonus based on A-163 BC total allocation as an example, with an allocation of 37,779,540 million kg live @ 3 cents/kg equates to approximately \$1.13 million.



- Processors have presented the increased costs due to the Commission’s Linkage Agreement decisions using 2019 statistics.
  - The total numbers/value presented is not reflective of the actual “cost” of the Commission decisions to date.
  - The increased costs have only been in effect since period A-160 and will be significantly less than what has been reported in the Processors submission.
- The Chicken Board takes exception to the claims of the Growers and Processors with respect to timing of decision and need for definition of “reasonable return to growers” and “processor competitiveness”.
  - The Growers and Processors refuse to accept any responsibility for the delay in the Board decision on a long-term pricing formula.
  - The Chicken Board established a process whereby the key stakeholders, the Growers and the Processors were enabled to provide recommendations on the definition and measures of “reasonable return to growers” and “processor competitiveness” through the Pricing Working Group.
  - The Growers and Processors were invited to participate in the Pricing Working Group and were given the opportunity to provide input on the Terms of Reference.
    - The Processors claim of the “Pricing Working Group that “no one loses” is unfounded and was not contemplated or prescribed by the Chicken Board.
  - The Pricing Working Group has not delivered any recommendations to date other than the amendment to eliminating the use of the 6-cycle rolling average.
- The composition of the Chicken Board has no direct bearing on the long-term price formula.
  - Through the Pricing Working Group, the Growers were provided the opportunity to “directly” work with the Processors to make recommendations on a long-term pricing formula.
  - Having a four member elected grower board would not provide any guarantee that a long-term pricing formula would have been in place in accordance with the original timelines established by the FIRB Pricing Appeal Panel.
- The point of transfer and assurance of supply have no direct bearing on a long-term live price formula.
  - The Growers and Processors must provide greater clarity on their views of the impact that these two separate and distinct issues would have on the live price in order for the Chicken Board to consider their inclusion in pricing discussions.
- Given the complexities arising from the Commission’s decisions with respect to the Linkage Agreement and the BCFIRB Supervisory Review, the Chicken Board has defined a new path forward to establishing a long-term pricing formula that includes:
  1. Defining “reasonable return to growers” including transparent, verifiable measures.
  2. Assessing “processor competitiveness” including requesting processor input on meaningful transparent and verifiable measures.

3. Engaging stakeholders on the assessment of the current pricing formula, along with other options for consideration, such as a fixed price differential.
4. Proposing a pricing formula based on the analysis of the above for review and input from stakeholders.
5. Making a decision on a long-term pricing formula by no later than period A-167, December 20, 2020.