

BRITISH COLUMBIA FARM INDUSTRY REVIEW BOARD

IN THE MATTER OF THE *NATURAL PRODUCTS MARKETING (BC) ACT*  
AND A SUPERVISORY REVIEW OF BC CHICKEN MARKETING BOARD  
PRICING-RELATED RECOMMENDATIONS

**DECISION**

June 9, 2010

## INTRODUCTION

1. On April 6, 2009, the BC Farm Industry Review Board (BCFIRB) received a request from the Primary Poultry Processors Association of BC (the Processors) to conduct a formal supervisory review of the BC chicken industry concerning pricing, governance and bio-security issues under section 7.1 of the *Natural Products Marketing (BC) Act (NPMA)*.
2. In its report to BCFIRB titled *Model for Live Price for BC Grown Chicken and Related Recommendations*, dated September 3, 2009 (September Report), the BC Chicken Marketing Board (Chicken Board) made its recommendations with respect to the pricing of live chicken in BC.<sup>1</sup>
3. As the Chicken Board was of the view that changes to the pricing mechanism dictated changes to other programs, it made recommendations regarding the assurance of supply policy and the Market Development Program (MDP). The Chicken Board also made two recommendations with respect to the current FOB/catching policy and the Serecon linkage model between the Chicken Board and the BC Broiler Hatching Egg Commission (BHEC) that establishes the price of chicks.
4. BCFIRB agreed to review these issues under its supervisory jurisdiction with the exception of the pricing linkage which was referred to the BHEC for further discussion with the Chicken Board. BCFIRB sought and received input from industry stakeholders on the Chicken Board's recommendations. Submissions were received from the BHEC, the Pricing and Production Advisory Committee (PPAC), Processors, Chicken Growers, further processor JD Sweid Ltd. (JD Sweid) and small processors, Fraser Valley Duck and Goose Ltd. (FVDG), Farmcrest Foods Ltd. (Farmcrest), Rosstown Farms Ltd. and Island Farmhouse Poultry Ltd.<sup>2</sup> The Chicken Board was given an opportunity to respond to those submissions. After reviewing all submissions, by way of a letter dated October 6, 2009, BCFIRB directed that this matter proceed to a formal hearing.
5. The supervisory review hearing encompassed 10 days (December 14 - 18, 2009, January 8 - 11, and 21, 2010). The panel heard from representatives of the Chicken Board, the Processors, the Chicken Growers, JD Sweid, the Poultry Association, FVDG and Farmcrest. The panel also had the benefit of expert evidence from Don Ference, Dr. Al Mussell and George Leroux on behalf of the Chicken Board and Kevin Thompson on behalf of the Processors.

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<sup>1</sup> The full text of this report can presently be found on BCFIRB's website.

<sup>2</sup> Two of the Processors have further processing interests as well, Sunrise Farms (Sunwest Food Processors Ltd.) in BC and Lilydale Co-operative Ltd. on the prairies.

## **ISSUES AND SCOPE OF REVIEW**

6. The issues on this supervisory review were confirmed in the prehearing conference report of October 27, 2009 as:
  - a. Do the Chicken Board's recommendations with respect to the live price model for BC best accord with sound marketing policy?
  - b. Do the Chicken Board's recommendations regarding assurance of supply best accord with sound marketing policy?
  - c. Do the Chicken Board's recommendations regarding the market development program best accord with sound marketing policy?
  - d. Do the Chicken Board's stated intentions with respect to FOB/catching best accord with sound marketing policy?

## **DECISION**

7. By way of general introduction, we wish to make clear that we have given these issues careful and independent consideration. We have considered the Chicken Board's recommendations and the extensive written and oral submissions received as part of this review although we do not intend to refer to them all in these reasons.
8. BCFIRB has previously made supervisory or appellate decisions with respect to most of these issues and is therefore familiar with them and well aware of their significance and potential impact on the chicken industry. By using a supervisory process, these matters can be addressed in a proactive, coordinated and comprehensive manner allowing for a more efficient resolution of the issues than if left to the piecemeal, constrained approach of the appeal process. We turn now to consider the issues before us.

### **A. Live Price Model**

#### **Background**

9. Since 1995, the price of chicken has been determined through the PPAC.<sup>3</sup> This committee, made up of three chicken grower representatives and three processor representatives, negotiates the price of live chicken paid to chicken growers for each eight-week growing period and upon reaching a consensus makes its recommendation to the Chicken Board. The PPAC may ask a neutral third party to facilitate these discussions. Failing consensus, the matter proceeds to final offer arbitration with the arbitrated price going to the Chicken Board for approval.
10. In 2007, the PPAC negotiated a multi-period pricing agreement for periods A-81 to A-87 (October 2007 - November 2008). The grower representatives on PPAC opted

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<sup>3</sup> Section 3.20, British Columbia Chicken Marketing Scheme, 1961 (Chicken Scheme), B.C. Reg. 188/61.

out of the agreement after three periods as there were unresolved issues of catching cost differentials, COP linkage, feed formulation, and Chicken Board pricing/sizing categories. The subsequent pricing negotiations became increasingly polarized with no consensus on the price of live chicken, necessitating arbitrations.

11. By May 2008, the Chicken Board concluded that the PPAC process had become non-functional. In its view, the chicken industry was lost and was not acting as a “value chain” with common values, ambitions and shared rewards.<sup>4</sup> It felt that the operating environment in the industry had become increasingly acrimonious with an atmosphere of distrust and separate agendas. As a result, the Chicken Board suspended the arbitration process and obtained an agreement between growers and processors to find a better method to set live chicken price in a way that could be sustainable in the future.
12. The Chicken Board retained Ference Weicker, an agricultural consulting firm, to develop a pricing model. A three phase study was conducted: an economic analysis of the key costs in the production and processing of chicken in BC versus other jurisdictions, the development of options for a live price model and an analysis of the options to determine the preferred pricing model for live chicken production in BC. The guiding principles were to create a predictable, transparent, fact-based model which recognized the need for BC chicken processors to be competitive with processors in other parts of Canada, and the variability and differentiation of grower costs in comparison to Ontario.
13. After extensive research and consultation with industry stakeholders in BC and other jurisdictions, Mr. Ference produced his interim report: *Economic Analysis to Develop a Pricing Model for Live BC Grown Chicken*. The report contained 11 model options and concluded that no one model was sufficient to determine the BC live price for chicken on an accurate and reliable basis.<sup>5</sup> He recommended a combination of the cost model to establish an initial price and the market index model to set price boundaries (or a sleeve) to ensure that the BC price remained competitive with the prices established by key competitors, the prairies and Ontario.
14. This combined cost and market index model has the following steps:
  1. Using the cost model, determine the average BC price dictated by the model for the last 13 periods (approximately two years).
  2. Determine the BC [live] price based on using the market index model.
  3. Compare the price obtained from two different models and ensure BC live price is within 1 cent from price determined by the market index model.

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<sup>4</sup> A value chain is a consumer driven model that recognizes a product can pass through many levels, gaining value at each level, before its consumption by an end user; the model takes into account the interests of the parties that participate at each level of the chain.

<sup>5</sup> The full text of this report can presently be found on BCFIRB’s website

4. Once the BC live price is determined, keep this same price (i.e. price differential from Ontario) for the next six periods.
5. To determine the BC live price for the subsequent six periods, repeat the first four steps.
15. In circumstances where the price differential between the cost model and the market index model is more than 1 cent, the live price would be adjusted to the market index model plus one cent. Otherwise, the price dictated by the market index model would prevail.
16. The Chicken Board presented this interim report at subsequent meetings with BCFIRB, the Processors, the Directors of the Chicken Growers and the three largest chicken feed companies in BC. There were also further consultations regarding the draft live price model with PPAC in June 2009. The Processors submitted their own price model in late July 2009 which was reviewed by the Chicken Board. The end result of these consultations was the Chicken Board's September Report which recommended Mr. Ference's model.
17. At the outset of the hearing, the Chicken Board recommended Mr. Ference's combined cost and market index model as it included cost differentials on both the grower and processor sides and incorporated a market-based analysis to ensure competitiveness between BC and its closest competitors.
18. The Processors did not support this model and criticized it for:
  - a. Failing to include the perceived utility cost advantages of BC growers;
  - b. Failing to include a perceived Tariff Rate Quota (TRQ)/Market Development Program (MDP) disadvantage of BC processors;<sup>6</sup>
  - c. Including Ontario structural premiums; and,
  - d. The complexity and lack of transparency of the input data required.
19. The Processors advanced a production-based model which utilizes a weighted average of Ontario and prairie production plus a fixed differential. The model is as follows:
  - a. Determine a weighting for each province based on the total Chicken Farmers of Canada (CFC) base allocation set for Alberta, Saskatchewan, Manitoba and Ontario in each 6 period block;

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<sup>6</sup> Tariff Rate Quota is a permit that allows processors to import chicken from the United States. Given that the bulk of United States chicken production is the south eastern states, BC processors cannot access TRQ cost effectively due to the distances involved in moving imported chicken. The MDP is a domestic program that allows processors to access more white meat production in BC through an off-set of exported dark meat.

- b. Apply weighting to the live price set in each of Alberta, Saskatchewan, Manitoba and Ontario for the current period to determine a weighted average live price base for BC; and
  - c. Add a \$0.04 differential to the weighted average live price base to determine the final live price in the current period.
20. As a result of the evidence and arguments it heard during the supervisory proceedings, the Chicken Board acknowledged that its proposed model required a level of complexity which may not be sustainable and agreed that a model which is simple, transparent and capable of providing long term predictability and stability may be more appropriate. The Chicken Board accepted the potential benefits of the Processor model but saw three significant disadvantages:
- a. It does not account for changes in differential feed costs, a significant factor in the BC industry;
  - b. It is weighted too heavily in favour of Ontario over the prairies and could result in the BC live price not moving in concert with its most direct competitors; and
  - c. It imports a significant degree of arbitrariness by the somewhat random use of a \$0.04 differential.
21. At the hearing, Mr. Ference proposed altering the weighting of Ontario in the Processor model from 66% to 50% to better reflect the jurisdictions where BC chicken is actually sold. The Chicken Board also suggested a differential of \$0.0435 (rather than what it saw as the arbitrary use of \$0.04 by the Processors) as this has been the recognized benchmark differential since A-62 (November 2004) which was the product of negotiations between the parties. The Chicken Board cautions that this model only works if catching costs remain at the recent level of \$0.028 /kg. If processors maintain their current increase in catching costs, the model will need to reflect that change. The Chicken Board accepts that with these alterations, the Processor model is workable and allows for predictability and transparency.
22. The Chicken Growers support the Processor model but would like a larger differential to Ontario. Further processor, JD Sweid is not adverse to the Processor model but prefers the application of a flat \$0.0435 differential on top of the Ontario price. The Poultry Association and FVDG reiterated the importance of a pricing model that is fair and long term.

### **Analysis**

23. All parties in this supervisory review agree that a workable pricing model must be consistent, predictable, transparent, and result in a live price that gives growers a reasonable return and allows processors to be competitive in the Canadian market. The model must also allow industry stakeholders to concentrate on market issues rather than arguing over price every eight weeks.

24. There is a general consensus between the parties that the Processors' model is the most acceptable but there remain two areas of dispute:
  - the appropriate fixed differential; and
  - the weighting to be given to the Ontario price in the model.
25. There are four differential proposals before the panel: the Processors' \$0.04, the Chicken Board's \$0.0435, the Chicken Growers' "something more" and JD Sweid's flat differential of \$0.0435 over the Ontario price.
26. The panel accepts that \$0.0435 has historical significance arising as it does out of the parties' negotiations over many periods. We do not accept the JD Sweid recommendation of a static differential as it does not in and of itself account for the significant differences that exist between BC and Ontario. We were also not persuaded by the Chicken Growers that some higher number should be chosen.
27. On the issue of weighting, the panel heard from both the Processors and JD Sweid that they compete in a national marketplace which prices off of Ontario and as such the weighting for Ontario should reflect its proportion of the national allocation (~66%). The Chicken Board argues that reducing the weight given to Ontario to 50% and increasing the weight given to the prairie provinces allows for more price sensitivity, keeping the BC price in harmony with its closest competitors.
28. The panel accepts the argument that BC processors must be able to compete nationally. The fact that Ontario and Quebec, with the majority of production, set the primary and further processing wholesale pricing across the country is significant and in our view supports the Processors' recommendation to use the actual provincial allocations as the basis for the weighting. For this reason, we accept the Processors' recommendation regarding the appropriate weighting factor to use in the formula.
29. We also accept that the Chicken Board's support of the pricing formula model is predicated on catching costs returning to the recent level of \$0.028 /kg.
30. The panel directs the Chicken Board to incorporate the new pricing model into its General Orders. We note that going forward, the Chicken Board still has the legal requirement found in section 3.20(3) of the Chicken Scheme to "consult with the PPAC and consider the committee's advice before the board makes any decision relating to pricing or production". Any long term changes to the pricing model will also require the Chicken Board to consult with PPAC.
31. The panel further directs that the new pricing model be used to set the live price of chicken from the date of its implementation unless there is a finding of exceptional circumstances by the Chicken Board in accordance with section 7 of Schedule 3 of the General Orders. A decision by the Chicken Board with respect to exceptional circumstances is appealable to the BCFIRB.

## B. Assurance of Supply

### Background

32. “Assurance of supply” is a marketing policy which assigns shares of the provincial allocation of chicken under the Federal Provincial Agreement for Chicken to BC’s chicken processors. This system guarantees processors a specific amount of live chicken in each growing period based on historical market share. Although the national supply management system for chicken is considered to be “bottom up”, (meaning that each province’s allocation is determined by processor demand) in fact processors have not historically received 100% of their requested allocation and assurance of supply has been a mechanism to allow for the apportionment of the short supply between processors. In the absence of the guaranteed market share provided by the current assurance of supply system, processors would have to compete to sign up growers for fixed terms to secure the limited supply of chicken. Under such a system, there is the potential for processors to enter the BC marketplace subject to the Chicken Board’s licensing requirements. An open contracting model provides no regulatory guarantee that any processor will have a specific supply of chicken during any production period.
33. The issue of assurance of supply came before BCFIRB on appeal in 2005, in *Lilydale Co-operative Ltd. and Seven Growers v. British Columbia Chicken Marketing Board*, February 21, 2005 (*Lilydale and 7 Growers*). At that time, BCFIRB cautiously upheld the Chicken Board’s assurance of supply policy found in Parts 7 and 8 of the General Orders:
97. We do not wish to be taken as holding that there are no risks to growth and competition in adopting Part 7. But in the present circumstances of a mature BC chicken industry with its particular configuration, we see no evidence of a stifling of competition, or of moribund processing sectors as exist in Alberta and Saskatchewan (the latter has only one processor, the former has two with Lilydale enjoying 65% market share). Other than by way of some suggestions for further Chicken Board consideration to refine the policy which we make below, we are disinclined to “fix” that which has not been shown to be fundamentally “broken” in BC. This said, we recognise the value of providing appropriate opportunities for differential growth, which is why we will be issuing directions to the Chicken Board to examine how this objective might be better achieved under Part 7 in periods of increased provincial supply. ...
113. For all the reasons we have given, while there are legitimate arguments in favour of open contracting and against assurance of supply as set out in Part 7, we have concluded that in the present circumstances and configuration of the BC industry, the disadvantages of open contracting outweigh the advantages. We do not support open contracting at this time for BC...
121. In this context, we wish to recognise, as did the Chicken Board, that Parts 7 and 8 are not forever. While the best policies are those that can accommodate a substantial degree of change, it is also true that the best regulators are those that remember the reasons behind the rules and are prepared to jettison rules where those reasons no longer exist.

34. In the September Report to BCFIRB, the Chicken Board advised that if its pricing model recommendations were accepted, there would also need to be significant changes to the assurance of supply system. Apart from protecting the market share of small processors (those with less than 2% market share of domestic allocation), the Chicken Board proposed that an open sign-up process replace the assurance of supply system. Under this proposed system, growers and processors would be required to give notice of termination of the agreement prior to the next unallocated period (minimum of 13 weeks).

## Analysis

35. In 2004, as the first instance regulator of the industry, the Chicken Board enshrined the current (guaranteed market share) assurance of supply system into “Regulations”. These Regulations were challenged and subsequently confirmed by BCFIRB after a lengthy appeal hearing. The Chicken Board having once advocated for assurance of supply has reconsidered its views and now asks the BCFIRB to accept its recommendation to repeal the current system in favour of an open contracting system where growers have the freedom to deal with the processor of their choice.
36. The Chicken Board does not make this recommendation lightly. It provided the following detailed reasons for moving from the market share guarantees provided by the current assurance of supply policy to an open sign up system:
  - a. **Need to promote competition** - given the market maturity linked predominantly to national population growth and per capita consumption, it is important to ensure sufficient competition and flexibility in the uptake and utilization of BC’s share of the national allocation of chicken production. Assurance of supply system does not ensure that BC’s allocation is utilized to its highest and best use in the long term, or to the overall benefit of BC and the BC broiler sector value chain.

The major BC processors compete in the non-assured supply markets of Alberta and Saskatchewan but do not want other processors to have the same opportunities in BC. Assurance of supply strongly discourages new entrants from coming to BC. It is in the interests of BC stakeholders as a whole that competition between processors be permitted, if not encouraged.

According to the Chicken Board’s expert witnesses, Dr. Mussel, Ph.D., M.Sc., Senior Research Associate and Mr. Leroux, M.B.A, B.Sc., of the George Morris Centre<sup>7</sup>, assurance of supply does not encourage processor investments to improve efficiency as to do so would increase capacity. Given that additional capacity cannot be used without additional supply, the trend is for decreased efficiency. The competition required for a healthy industry is

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<sup>7</sup> The George Morris Centre is a Canada-wide, not-for-profit charitable organization founded in 1990. As an independent think tank, the Centre provides industry decision makers with critical information and analysis on issues affecting the Canadian agri-products sector.

discouraged. Fair competition and adaptation ought to be encouraged and the current sense of entitlement ought to be discouraged.

- b. **Need to promote good industry relationships** – Open sign up promotes closer involvement between growers and processors. While premiums may be a potential risk, there are significant benefits to adopting a process which encourages greater alignment and sharing of information between growers and processors, which in turn results in more fluidity in the industry than is possible under assurance of supply.

With assurance of supply, there is insufficient reward or penalty for good or bad behaviour on the part of growers, processors and hatcheries. The Chair of the Chicken Board testified as to his observation that since enacting an assurance of supply policy, relationships between industry stakeholders have steadily declined to the detriment of the industry as a whole. Mr. Leroux testified that there is an inverse relationship between the degree of regulation and the level of cooperation between growers and processors. His view is that the current assurance of supply system provides no incentive for processors and growers to enhance or build relationships, contrasted with an open sign-up system where open dialogue between industry stakeholders is necessary.

- c. **Risk of Plant Supply Quota (PSQ)** – With assurance of supply, there is the potential of creating PSQ, a processor “quota” of questionable economic value as has occurred in Ontario.<sup>8</sup> PSQ is a completely unnecessary level of quota that does nothing to promote national or provincial allocation objectives. If formalized in regulation, it would become a distorted expression of goodwill, capitalizing an unintended entitlement and adding infrastructure costs to the industry as a whole. To deal with PSQ, the Chicken Board would need to be more prescriptive with regulation to address the transfer of PSQ between processors. This is not an efficient or productive use of resources and is contrary to the stated objectives of BCFIRB and Chicken Board to move away from prescriptive rules in favour of principles based decision making that supports identified, desirable regulatory outcomes.
- d. **Risk of Premiums** – The Processors’ primary argument against open-sign up is the risk of “premium wars” and the resulting impact on price as has occurred in Ontario. The Chicken Board identifies factors unique to the BC industry that either minimize, or eliminate entirely, the risk of such premium wars developing:
- Significant premiums are paid in Ontario and Quebec on account of interprovincial sales but such sales are not an issue in BC as it is not feasible for BC growers to ship live product to Alberta processors on account of the travel distance required.

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<sup>8</sup> In jurisdictions with assurance of supply systems, the assured supply has been treated as an asset to sell. In Ontario, processors can buy and sell their market share as PSQ.

- BC processors operate closer to capacity than their Ontario counterparts. Thus, there is less incentive for BC processors to seek more product through increased market share at the expense of other processors or by importing product from Alberta. This suggests that there is less incentive for BC processors to pay premiums to obtain additional product.
  - Fewer processors in BC create an increased likelihood of cooperation in the distribution of product even absent assurance of supply. This is consistent with past experience in BC.
  - Saskatchewan and Alberta have open sign-up systems but have not experienced premium wars. Rather, as Mr. Rodenburg (President of Lilydale) testified, Lilydale does not pay any premiums in Saskatchewan and pays only a two cent premium in Alberta. This evidence was confirmed by other processor representatives for both Alberta and Saskatchewan.
  - Even if premiums were to arise and consolidation of processors resulted, the Chicken Board maintains that redistribution of resources to the most efficient users is a positive market development. The Processors expert, Mr. Thompson conceded that an open sign-up system could lead to consolidation among processors and that most would agree some consolidation would be good for the Ontario industry.
- e. **Market Stability** – Under an open sign-up system, a processor can enter into long term contracts with their growers and provide an alternative and more competitive means for processors to achieve the predictability they require to operate and expand their businesses absent assurance of supply.
- f. **Preservation of Assurance of Supply for Small Processors** – The recommendations maintain assurance of supply for small processors (market share under 2%) and in appropriate circumstances, the Chicken Board could direct product to such processors to allow them to maintain sufficient processing levels.
37. The Processors strongly oppose the move away from assurance of supply. They view it as the best way to distribute the provincial allocation fairly, allowing processors to focus on innovation and competition in the market place rather than on their supply of chicken. It has worked well in BC. It is essential to remaining competitive, providing processors and further processors with certainty in planning production needs and both encouraging investment and protecting the millions of dollars already invested. The changes proposed by the Chicken Board put the entire BC chicken industry at risk. Disruption in the supply chain could result in processors failing to meet customers’ needs or expectations, negatively affecting long-term business decisions relating to expansion.

38. As for the Chicken Board's argument about PSQ, the Processors deny that PSQ is an issue; no such transactions have taken place in BC and there is no process to buy or sell it. A processor's assured supply would form part of its goodwill in the event of a business sale but has no price impact on the consumer. The Processors also argue that removing assurance of supply will bring more costs into the system (in the form of premiums unrelated to value) to maintain existing production. This will result in increased cost to the consumer or, more likely, make the processors less competitive and result in jobs lost in BC.
39. The Processors deny that assurance of supply is responsible for the poor relationships between growers and processors; they do not agree there is a problem on a one-to-one basis. The Processors note that after assurance of supply came into effect, the first long term pricing agreement was negotiated. It was not assurance of supply that caused growers to break this agreement; rather they argue it was the Chicken Grower's attempt to use the cost of production formula from the Serecon model to justify a higher price for chicken.<sup>9</sup> The Processors also state that relationships in the industry deteriorated significantly after the processor member on the Chicken Board was replaced by a chicken grower and they lost their voice at the table.
40. In this supervisory review, the panel has had to weigh the advantages and disadvantages of an assurance of supply system which guarantees historical market share over an open contracting system which does not. In considering whether to prefer one policy over another, the panel has not limited itself to considering what is in the best interests of growers or processors, we have had to consider which approach best serves sound marketing policy in the present circumstances – whether one system better serves the industry as whole and is in the public interest. We have also considered how the chicken industry has evolved in the last five years and the continuing trend towards a more regional marketplace. We note that other jurisdictions have struggled with how best to ensure that processors receive the chicken they require in a short market place with mixed success. The strongly held views on both sides of this issue have caused this panel to deliberate at length.
41. However, for the reasons outlined below, we have decided to accept the Chicken Board's recommendation to move to an open contracting system.
42. First, we cannot ignore the recommendations of the Chicken Board as the first instance regulator of the chicken industry. In 2004, the Chicken Board comprised as it is now of an independent chair, two appointed members and two elected grower members, was a strong advocate for the current assurance of supply system. However, that board (constituted in the same manner with two of the same appointed members) now proposes a new system. As the industry regulator, they have seen first hand the dysfunction between processors and growers and testified as to how they have been increasingly asked to resolve disputes which more properly should be

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<sup>9</sup> The Serecon model is not a pricing formula; it is a mechanism to equalize the returns to broiler hatching egg growers and chicken growers

resolved by the industry itself. On this point, Chicken Board chair Mr. Kilmury stated:

It is my personal view that assurance of supply does not encourage value chain principles where processors and growers are like-minded and work cooperatively building long-term relationships to further the BC chicken industry. Relationships have deteriorated since assurance of supply in last 5 years and profit and loss decisions are not taking place. Many decisions large and small are coming to the board and we should not have to make these decisions. They should be made by the people who are directly affected.

43. These are not just disputes on price as this supervisory review has demonstrated:

The growers and processors are at loggerheads on pricing issues, catching costs and even the specific place at which the transfer of property in the live chicken takes place. The PPAC process has broken down – the Processors have refused to attend PPAC meetings – and the Chicken Board has had to adopt increasingly prescriptive regulation in an industry that does not seem to be able to work out its own problems. (Paragraph 13, Chicken Board Closing Submissions)

44. We reject the Processors' further argument that the Chicken Board has become focussed on grower issues alone. The Processors argue that their views are either not understood or not taken into account by the Chicken Board in its decisions. They see the Chicken Board as biased as it has a majority of chicken growers unable or unwilling to demonstrate objectivity.

45. In this case, the panel does not agree with the Processors' criticisms of how this Chicken Board has governed itself but we do see how the replacement of the appointed processor member with an appointed grower member fostered their negative perceptions. Our view is that the Chicken Board has demonstrated good governance by taking a leadership role under difficult circumstances. Furthermore, instead of adopting an adversarial position, the Chicken Board continued to listen throughout the hearing and modified its views when appropriate.

46. We also reject the Processors arguments that the Chicken Board simply wants to get out of the business of regulating. Rather, we see a Chicken Board that wants to be an effective regulator. We also do not accept the Processors' arguments that Chicken Board is overstating the problems in the industry. The very fact that this lengthy, multi-issue supervisory review was necessary speaks to the dysfunction in the BC chicken industry.

47. The Processors blamed the poor relationships within the industry in part on the Chicken Growers' attempt to use the Serecon COP model to extract higher prices in negotiations. We agree that this misconceived approach to negotiation did much to foster bad relations. As was confirmed many times during the hearing, the Serecon model was developed as part of the chicken/broiler hatching egg linkage and was never intended to be used as a COP model for growers. While perhaps a creative bargaining position, the Chicken Growers' unrealistic expectations lead to a great deal of grief at the bargaining table. (We observe that this conduct is not unlike the Processors' recent attempt to unilaterally raise catching costs.) However, we do not

accept that one misguided bargaining position is responsible for the current level of dysfunction.

48. While the move to a pricing formula may remove the contentious period to period pricing negotiations, we do not agree that a pricing formula alone will address the Chicken Board's broader concerns about poor industry relationships.
49. On this point, we rely on the Chicken Board's expert, Mr. Leroux, who testified regarding the inverse relationship between the degree of regulation and the level of cooperation between growers and processors. In his view, the current assurance of supply system does not provide an incentive for processors and growers to enhance or build relationships. He contrasted this with an open sign-up system where open dialogue between industry stakeholders is necessary.
50. The Processors' expert witness Mr. Thompson, Executive Director of the Association of Ontario Chicken Processors<sup>10</sup> and Manager, Chicken Sector of the Canadian Poultry and Egg Processors Council, also testified. We observe that he is not an independent expert but rather is an advocate for the processing sector, a factor we have taken into account in assessing his conclusions. He stated that under open sign-up, it is difficult to give customers what they want in terms of size and quality of product as growers can leave a processor at any time. In his view, open sign-up is not conducive to good relationships between growers and processors. Assurance of supply is healthier than having processors fighting over growers.
51. The panel prefers the evidence of Mr. Leroux; we do not agree that an open contracting system creates difficulties in meeting customer demands as these are the very matters to be negotiated between growers and processors.
52. In addition to its concerns around dysfunctional industry relationships, the Chicken Board also identified the need to promote competition as a reason for moving away from the guaranteed market share of the current assurance of supply system. On this point, Dr. Mussel and Mr. Leroux testified that assurance of supply leads to a less efficient processing sector through:
  - suppression of market information;
  - stifling of innovation throughout the supply chain;
  - impeding of new entrants in the marketplace; and
  - protection of poor growers.
53. The Processors' expert, Mr. Thompson, was specifically asked by the panel to speak to the benefits of the assurance of supply system. His response was that assurance of supply is the system currently in place and it exists for a reason; it is used in Ontario and Quebec and developed out of the premium war situation in those provinces, and

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<sup>10</sup> The AOCPC is a voluntary industry trade association of chicken processors in Ontario whose primary mandate is to represent the interests of processors in matters related to supply management activities in Ontario.

processors want to continue to compete within the framework of assurance of supply. Given the panel's view that assurance of supply in Ontario has not effectively addressed the problem of premiums and has promoted a locked-in system and kept the status quo of too many inefficient processors, we find Mr. Thompson's views unpersuasive.

54. The Processors also cite predictability, planning, encouragement of innovation and capital expansion as benefits of operating within an assured supply environment. However under cross-examination, the Processors conceded that lack of predictability did not prevent expansion into Alberta and Saskatchewan; nothing in those provinces discouraged innovation; and they have experienced capital expansion in these moves. The Chicken Board argues and we agree that none of the factors which the Processors identified as key benefits of the current assurance of supply system in BC prevented expansion into Alberta or Saskatchewan. In fact, had either province had the guaranteed historical market share found in BC's current assurance of supply system, such expansion would not have been possible.
55. Given our conclusion that the testimony of the Chicken Board's experts is borne out by BC processors' expansion into Alberta and Saskatchewan, we have preferred their testimony to that of Mr. Thompson. While processors are not opposed to operating in open contracting jurisdictions, they do not want to lose the competitive advantage they enjoy in BC. While this is certainly understandable from a self-interest perspective, it is difficult to see that the competitive advantage enjoyed by BC processors benefits the industry as a whole.
56. A criticism of moving to an open contracting model could be that it simply shifts the battle ground between processors and growers to contractual disputes where parties run to the Chicken Board every time there is a problem. The Chicken Board may be asked to direct product in the face of alleged breaches of contract. Growers may arbitrarily exercise their right to change processors. These are legitimate concerns. However, growers do not have endless choices among processors. There will need to be relationship building on both sides to create the necessary atmosphere of trust.
57. Further, the Chicken Board acknowledged at the hearing that going forward it intends to ensure that any of its regulatory changes are principles based and targeted at increasing efficiencies through the entire chicken production industry. We take this as meaning that the Chicken Board is not opposed to regulating but it intends to use regulation as a measured response to drive specific outcomes on areas central to its mandate. Contractual disputes may persist even with regulatory change but it will be for the Chicken Board to determine whether some types of disputes are best left to the parties to resolve privately. While there may be short term disruption as processors and growers realign relationships and the Chicken Board responds with appropriate regulation, we do not agree that long term disruption is inevitable. It is not in anyone's long term interest.

58. A major criticism of open contracting advanced by the Processors was the risk of non-value premiums inflating the live price for chicken and thereby increasing processor costs. After considering all the submissions, we find that the risk of non-value premiums is overstated. The evidence presented at the hearing demonstrated that in the past, payment of premiums has not been a significant issue in BC. While we appreciate that non-value premiums caused Ontario to move to an assurance of supply system, that has not been the reality in BC. We also note that since implementing assurance of supply, Ontario has unresolved problems with premiums. We agree with the Chicken Board that it is difficult to compare the situation in Ontario and Quebec with BC. The fact that eastern markets for live chicken are regional while production is provincial creates tensions and pressures that do not exist in BC. Given the geography involved, Ontario processors can pay premiums to Quebec growers to obtain product over their provincial allocation (despite the existence of an assurance of supply system). BC in contrast is a more geographically isolated market making it less cost effective to ship chicken into Alberta. Further, we agree with the Chicken Board that the fact that in BC there are fewer processors with plants closer to capacity appears to promote cooperation.
59. We do agree that premiums that are not associated with value and/or an incentive to meet market demands undermine the principle of supply management. Growers exist in a protected world where they are guaranteed a reasonable return for their product in a market where they control the amount of supply available. To expect to wring more out of the system in the form of premiums not tied to value creates a lack of transparency within the pricing system that is unconscionable and completely inconsistent with a value chain approach. Regulatory agencies have a responsibility to ensure that growers do not abuse the system which gives them a virtual monopoly in the marketplace.<sup>11</sup> At the same time, it is processors who control whether to pay a premium and what to pay a premium for, and there is nothing inherently wrong with paying value premiums for products driven by consumer demand.
60. The decision to accept the Chicken Board's recommendation to move to an open contracting system has not been an easy one. The panel has looked at the interests of the industry as a whole and tried to find a balance that best accords with sound marketing policy. This balance is achieved through a number of factors which we see as inter-related and which we have commented on above.
61. There are two additional points we wish to highlight. The first is that the Chicken Board must act (and be seen to act) in the interests of the industry as a whole. To this end, going forward, the appointment process for the chair and members is critical to ensuring a balanced approach. Processors, hatcheries and growers have equal responsibility to ensure that qualified candidates (without conflicts of interests) are put forward for these appointed positions.

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<sup>11</sup> There is historical precedent for the Provincial board (BCFIRB) taking action against a commodity board for failing to address payment of inappropriate premiums.

62. Given that the role of the Chicken Board as regulator is to balance a broad spectrum of interests (including growers, processors, further processors and consumers), the second point of significance is the balance of power. Where one party perceives a power disadvantage, there will be attempts to gain advantage through other means such as arbitrary changes to cost structures, less information flow, harder lines in negotiations and appeals. In our view, as a power struggle is at the core of the industry dysfunction, the balance of power has been a central theme in our deliberations.
63. We see the move to a pricing formula and the acceptance of the Processors' view on the appropriate weighting as a significant shift in the balance of power on pricing towards the Processors. If assurance of supply was maintained in light of the decision to move to a pricing formula instead of the negotiated price model used in 2005, we believe this would move the balance of power too far in favour of the Processors and exacerbate industry dysfunction. Simply put, with both price and volume fixed, it is difficult to see what incentive would remain to improve working relationships between processors and growers. In our view, a sound marketing policy is one that creates a working climate that recognizes the importance of meeting customer needs at all levels to promote a sustainable industry – from growers through to consumers.
64. Looking at the balance of power from the other end of the spectrum, if price predictability exists at the grower/processor level, there needs to be a corresponding benefit at the consumer end of the chain. Wholesale price protection does not in and of itself protect the consumer. Given that consumers have choice, the Chicken Board needs to consider how to keep chicken in a strong competitive position in comparison to other sources of protein. This issue cannot be addressed by focusing only on the concerns of growers or processors to the exclusion of consumers. In our view, one way to protect consumer price is through competition and an open marketplace. Competition drives product development and innovation.
65. The panel acknowledges that in the short term, repealing assurance of supply may cause some disruption in supply to individual processors. This will however be tempered by growers giving appropriate notice before moving to a new processor allowing the old processor some time to find replacement growers. On this point, we note that there was not much argument around the sufficiency of a 13-week notice period as the debate was centered on open contracting vs. assurance of supply as opposed to the particulars of the opening contracting model used. Given that sufficient notice can provide an alternate mechanism for assuring supply, the Chicken Board must ensure it monitors the adequacy of the 13-week notice of termination period.
66. We agree with the Chicken Board that the movement of growers between processors could work to the benefit of all parties ensuring a better fit between grower and processor needs, resulting in longer term contracts. In addition, as the allocation of chicken to BC is unchanged, chicken still needs to be processed somewhere. We

note the Processors' observation that there is no issue in their one-on-one relationships with growers. If this is indeed the case, the likelihood of significant movement of growers between processors is unlikely especially over the long term.

67. Finally, we are acutely aware of the arguments put forward by the smaller processors such as FVDG, Farmcrest, and Farm Fed<sup>12</sup> that loss of assurance of supply could be detrimental to them. The Chicken Board has built in a safeguard by maintaining assurance of supply for processors with less than 2% of the domestic allocation. We agree that without some protection small processors are vulnerable. In the absence of an evidentiary foundation we cannot say that the 2% cap will be adequate over the longer term but neither do we have a basis to direct an increase in this cap at this time. We note that the Chicken Board has acknowledged its authority to consider the special circumstances of these small processors and make whatever orders it deems appropriate. That is an essential first step. Given our concerns regarding the adequacy of the 2% cap, the Chicken Board must ensure that it monitors the effectiveness of the cap and adjusts it if circumstances warrant.
68. As an aside, we note that by agreeing to an exception to the open contracting model for small processors, we are in no way excluding them from their responsibility to work with their growers to enhance and build relationships that will support their future supply requirements.

### **C. Market Development Program**

#### **Background**

69. The MDP allows processors to balance their dark to white meat requirements by exporting the less valuable dark meat and “re-growing” the more desirable white meat.<sup>13</sup> This program has been critical in allowing BC processors to be active in the further processing market; BC has the second largest further processing industry in Canada. The MDP exists on top of the national allocation and growers and processors both have control over whether or not they participate in the program. A processor can use the MDP or not; it is a “tool in the tool box”. The program is currently over subscribed; approximately 50% of growers participate in the MDP with those growers wanting more MDP production than is available.
70. Currently, the Chicken Board is deeply involved in the administration of the MDP. The Chicken Board advertises the lease price and collects and distributes the funds to growers. If the Chicken Board's recommendations are accepted, the Processors will set the price and collect lease fees from participating growers; the funds for leasing will no longer pass through the Chicken Board and it will not advertise the lease

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<sup>12</sup> Farm Fed is a small processor and its President testified on behalf of the Processors.

<sup>13</sup> In Canada, consumer preference is for white meat. As chicken is comprised of white and dark meat, the MDP program allows for export of the dark meat and a corresponding credit to “regrow” more chicken resulting in a greater portion of white meat in the marketplace.

price. The Chicken Board argues that the people who can best deal with this transaction should do so without board interference. Processors should decide on the price and the participation rate and have the ability to reward good product and pay a differential through the MDP. The Chicken Board concedes that the effect of its recommendations is that only those growers whose processors choose to participate in the MDP will have access to the program. However, it argues that allowing processors and growers to align themselves according to their use, or lack thereof, of MDP ensures that the program is put to its highest and best use.

71. The Chicken Board states that if assurance of supply is revoked, amendments to Part 28 of the General Orders are necessary to allow those processors who utilize MDP the ability to manage it to best suit their individual business objectives:
  - a. each processor will advise the Chicken Board of the total amount of market development being requested and the names of that processor's contracted growers who wish to receive a share of the available market development allocation for the period in question;
  - b. processors must offer market development equally to all growers within the processing group who request market development;
  - c. the Chicken Board will distribute the total amount of market development available to the individual processing company on a pro-rata basis amongst that processor's currently contracted growers who request market development.
72. The Chicken Growers support the Chicken Board's recommendations but would prefer that the Chicken Board post the lease price for each processor to ensure that growers pay the same lease price. The Chicken Board is reluctant to involve itself in what it sees as a prescriptive, administrative matter, preferring to let processors use the program in the manner which best suits their business.
73. The Processors see the amendment to the MDP as "another casualty of deregulation". They argue that small regional processors who currently rely on new entrant growers will be placed at risk. New entrants do not receive enough quota to have a financially viable operation so they rely on the MDP to increase on-farm production. The Processors argue that under the new model, these new entrants "will no longer be eligible to grow export".
74. The panel rejects the Processors' arguments. First, we observe that the Processors opposition to the Chicken Board's recommendations on the MDP is more strategic in nature. To support the changes to the MDP could be seen as undermining their position on assurance of supply, since it was the recommended removal of assurance of supply that necessitated a change to the MDP. Second, the recommendations made by the Chicken Board do not automatically preclude new entrants from participating in the MDP. It will be up to a processor to decide whether to enter into a contract with a new entrant or whether to distribute that MDP quota to those within its "stable" of growers. As the Chicken Board itself points out, should Processors choose to restrict access to MDP, the Chicken Board could take action to protect small regional processors by creating incentive programs through the new entrant

grower program or unused new entrant grower allocation. Should processors refuse to contract for regional production excess to the needs of a regional processor, the Chicken Board can exercise its existing authority to direct product.

75. Given the foregoing, the panel accepts the Chicken Board's recommendations regarding the MDP. The highly variable and unique manner in which each processor uses this program supports the Chicken Board's decision to modify the MDP. Processors will be able to use the MDP in a manner that best fits within their business models to optimize their financial returns within the current regulatory framework.

#### **D. Catching Costs**

76. The Chicken Board maintains that the current definition of FOB/catching costs is no longer appropriate because of the manner in which this activity is being managed in the industry. According to the General Orders, chicken is purchased at the farm gate. However, the industry reality is that chickens are placed into cages in the grower's barn and then transferred onto processors' trucks suggesting that ownership actually transfers inside the grower's barn. The Chicken Board argues that as the Processors have raised the catching costs issue, there is a need for clarification on when ownership of chicken actually transfers.
77. The Processors argue that the Canadian standard is "FOB truck" and any change would put BC offside all other provinces. They further argue that to move the point of transfer inside the barn is just another example of growers trying to download costs with the support of the Chicken Board. They suggest that BCFIRB should direct the PPAC to draft catching standards and related pricing structures similar to those recently passed in Alberta and adopted by both growers and processors.
78. The panel makes no finding on the FOB truck issue. Given that BC processors operate in the western provinces, their recommended harmonized approach has merit. Accordingly, the panel directs the PPAC to consider the Alberta model and develop appropriate catching standards and related pricing structures. The PPAC is to submit its recommendations to the Chicken Board as soon as possible and in any event no later than December 1, 2010.

#### **E. Procedural Fairness**

79. The Processors have raised several procedural fairness concerns. Their expectation was that this supervisory review would focus on pricing alone. Instead, the Chicken Board brought forward not only a live price model, but introduced three additional proposals to radically change the regulatory environment in BC. The Processors argue that all three additional proposals (removal of assurance of supply, amendments to MDP and catching costs) were developed without industry consultation and two of the three fly in the face of past BCFIRB decisions.

80. The history here is important. In the Processors' initial request for a supervisory review, they raised three issues: pricing, governance and bio-security. After consideration of this request, BCFIRB indicated that the bio-security and governance issues would be addressed under separate processes. In September 2009, the Chicken Board made its recommendations on the four issues addressed in this hearing. While the Processors may not have expected the breadth of the recommendations as they went beyond the pricing model issue that had formed the basis of the year long consultation, the Processors did receive the report and the additional recommendations. At the pre-hearing conference in October 2009, the Processors participated in the discussions on the issues which would form part of this review and those that would not. A pre-hearing conference report confirmed these issues and was circulated to all parties. The panel does not accept that the Processors were under any misapprehension as to the scope of the issues under BCFIRB's review.
81. The Processors may have an argument that they were not directly consulted on the recommendations relating to assurance of supply, MDP and catching costs. However, the Chicken Board made its recommendations on these issues and as part of this supervisory review a submission process and a formal hearing were undertaken to address these issues, which we have considered fully and independently.
82. The Processors argue that the Chicken Board provided no justification or rationale for the removal of assurance of supply and conducted no impact assessment or consultation with the industry before this proposal was advanced. The panel finds that the overall process followed by the Chicken Board was procedurally fair. The Chicken Board as the first instance regulator of the chicken industry conducted an industry-wide consultation on the pricing model over a period of more than a year. This was entirely appropriate. When the Chicken Board determined that other recommendations would flow out of this process, it notified BCFIRB and worked to ensure that those recommendations could be addressed transparently and efficiently by industry stakeholders. While more industry consultation by the Chicken Board in the first instance was an option, it was not the only option.
83. Given that the repeal of assurance of supply has been squarely on the table since September 2009 and given that it has been the focus of the submission process and 10 days of hearing, there is no procedural unfairness to the Processors. This submission and hearing process provided a forum for all parties to voice their respective positions on all the Chicken Board's recommendations including assurance of supply. If there was any deficiency in the Chicken Board's consultation process, a conclusion we do not make, it has been cured by this fulsome and lengthy hearing process.

## **SUMMARY**

84. The general supervisory authority found in section 7.1 of the *NPMA* has been interpreted by the courts as providing BCFIRB with the authority to review any matter related to regulated marketing. This includes supervising marketing boards in a proactive fashion regarding emerging issues and conflicts within the regulated marketing industries, ranging from the specific to the systemic.
85. In this review, we have had to make choices between difficult options according to our assessment of what best accords with sound marketing policy and serves the interests of the chicken industry going forward. We agree that there are no black or white answers to these types of policy questions. We are mindful that good regulators must be open to re-evaluating decisions and revising them when circumstances so dictate. The directions and recommendations in this review set the groundwork for improved Chicken Board governance and industry relationships as well as the stability necessary for mutual growth and prosperity. We encourage the parties to avail themselves of the opportunities these changes provide.
86. As we have indicated above, all stakeholders in the chicken industry must cooperate with a view to achieving efficiencies throughout the entire system, and enhancing value in the marketplace. Change, evolution and development are a competitive necessity and should be fostered and encouraged. The system does not work when growers use supply or pricing to hold processors ransom and gain concessions, while processors arbitrarily raise catching costs to offset grower gains. This “tit for tat” approach is unhelpful, non-productive and non-sustainable.

### **Transition Period**

87. The panel recognizes that the changes contemplated by this decision cannot be brought into effect overnight. We also note that these changes will have an impact on the broiler hatching egg sector and that this will require further discussion between the Chicken Board and the BHEC. Accordingly, we direct that the current manner of setting price, assurance of supply and MDP remain in place for up to three months (until September 15, 2010) by which time the Chicken Board is directed to either have implemented any necessary changes to the General Orders or prepared and published its transitional plan for implementation of these changes.

## **Live Price Model**

88. The panel directs that the new pricing model be implemented using a weighted average of Ontario and prairie production plus a fixed differential as follows:
- a. Determine a weighting for each province based on the total Chicken Farmers of Canada (CFC) base allocation set for Alberta, Saskatchewan, Manitoba and Ontario in each 6 period block;<sup>14</sup>
  - b. Apply weighting to the live price set in each of Alberta, Saskatchewan, Manitoba and Ontario for the current period to determine a weighted average live price base for BC; and
  - c. Add a \$0.0435 differential to the weighted average live price base to determine the final live price in the current period.
89. The panel directs the Chicken Board to incorporate the new pricing model into its General Orders.
90. The panel further directs that the new pricing model be used to set the live price of chicken from the date of its implementation unless there is a finding of exceptional circumstances by the Chicken Board in accordance with section 7 of Schedule 3 of the General Orders.

## **Assurance of supply**

91. The panel directs that the current assurance of supply policy found in Parts 7 and 8 of the General Orders be repealed. In its place, the Chicken Board is to implement an open contracting system.
92. The panel also directs the Chicken Board to ensure the adequacy of the 13-week notice of termination period is monitored on an ongoing basis.
93. The panel further directs the Chicken Board to ensure the adequacy of the 2% cap below which market share is protected is also monitored on an ongoing basis.

## **Market Development Program**

94. The panel accepts the Chicken Board's recommendations regarding the proposed amendments to Part 28 of the General Orders.

## **Catching Costs**

95. The panel directs the Chicken Board to refer the issue of catching costs to the PPAC to consider in light of the Alberta model and to develop appropriate catching

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<sup>14</sup> The weighting accorded to Ontario and the prairie provinces is based on their actual base allocation figures, not an adjusted amount.

standards and pricing structures for the approval of the Chicken Board as soon as possible and in any event no later than December 1, 2010.

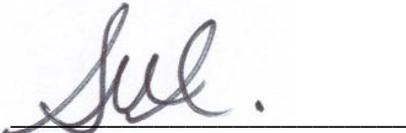
Dated at Victoria, British Columbia, this 9<sup>th</sup> day of June, 2010.

BRITISH COLUMBIA FARM INDUSTRY REVIEW BOARD

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Richard Bullock, Chair

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Sandi Ulmi, Vice-Chair

A handwritten signature in black ink, appearing to read "Honey Forbes", written over a horizontal line.

Honey Forbes, Member