British Columbia
Farm Industry Review Board

British Columbia Hog Marketing Commission

Price Equalization Program

Supervisory Review

November 14, 2007

BRITISH
COLUMBIA

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1.0 Executive Summary

Introduction

On October 3, 2006, the British Columbia Farm Industry Review Board (BCFIRB) commenced a supervisory review of the price equalization program operated by the
British Columbia Hog Marketing Commission (Hog Commission) between January 1, 2004, and December 31, 2006. This price equalization program, initiated in March 2005 but retroactive to July 2004, aimed to address differences in the hog prices offered by the two main processors of hogs in the Lower Mainland of British Columbia. Initially, the program issued equalization payments to 16 producers shipping to Britco Pork Incorporated (Britco), located in Langley, to increase their returns to a level similar to the higher returns received by 18 producers shipping to Johnston Packers Limited (Johnston), located in Chilliwack. At the outset of the program producers in both groups were paid according to term contracts between the Hog Commission and each processor. The Hog Commission acted as first receiver of funds in these contracts, collecting levies and remitting producer settlements, which for Britco producers included equalization payments. However, the movement of most Britco producers into direct contracts with their processor after the Hog Commission approved these contracts in August 2005, and the Hog Commission's subsequent exclusion of those producers with direct contracts from the equalization program, left only three producers remaining in the program after November 2005. These three producers continued to receive equalization payments from the Hog Commission through to December 31, 2006. While that date marks the end of the period formally reviewed in this supervisory report, BCFIRB has confirmed that the Hog Commission continued the equalization program into 2007, and that two producers had received equalization settlements as recently as August 2007.

This report provides background to and explains BCFIRB's supervisory review process, documents our findings and supervisory directions to the Hog Commission, and outlines the consultation process that we are undertaking with the BC hog industry regarding this report and the future activities of the Hog Commission.

BCFIRB Supervisory Review Process

The present supervisory review was first initiated as an appeal of ongoing Hog Commission decisions related to equalization payments, registered with BCFIRB by two BC hog producers in April 2006. BCFIRB coordinated preliminary steps in the appeal process. However, the appellants withdrew their appeal in September 2006, prior to the scheduled hearing. Throughout and following the appeal, the appellants requested that BCFIRB undertake a supervisory review of the issues raised.

BCFIRB determined that a supervisory review was appropriate and initiated the review in meetings with the BC hog industry in October 2006. BCFIRB then ordered an audit of the Hog Commission's price equalization program, which was contracted to KPMG LLP (KPMG) in March 2007. Between March and August 2007, BCFIRB obtained additional information on the program through communications and meetings with KPMG and the Hog Commission. BCFIRB is releasing this supervisory review report, which documents our findings and our directions to the Hog Commission, on November 14, 2007.

Issues

During the course of this review, BCFIRB identified a number of issues related to the Hog Commission's price equalization program which we believe will be of concern to the BC hog industry. The issues are as follows:

1. **The Hog Commission's decision to undertake a price equalization program**:

    a. Hog Commission jurisdiction to undertake a price equalization program:

    BCFIRB has found that the Hog Commission has the appropriate regulatory authority to undertake the price equalization program that they pursued between July 2004 and December 2006, and which they have continued to operate in 2007. The power to undertake equalization, vested in the Hog Commission by the incorporation of section 11(1)(o)(iv) of the *Natural Products Marketing (BC) Act* (the *NPMA*) into the *BC Hog Marketing Scheme* (the *Scheme*), is the only regulatory power available to the Hog Commission to remedy the adverse consequences of a significant difference in the prices producers receive for their production.

    b. Hog Commission rationale for undertaking a price equalization program:

    BCFIRB is satisfied that a significant price differential existed, whereby Johnston producers received higher net prices than Britco producers during the period of this review. Britco producers were unable to address the lower returns they received by instead contracting to Johnston, since the latter processor was operating at capacity. These producers' experience of lower returns resulted directly from their historical affiliation with Britco, and their inability to change this affiliation. In light of this situation, BCFIRB accepts the Hog Commission's decision to undertake a price equalization program to remedy the price differential.

2. **The financing, administration, and outcomes of the price equalization program that was undertaken:**

    a. Use of Trust Fund investments to make price equalization payments:

    The price equalization program undertaken by the Hog Commission was funded using investments in its Trust Fund. By the end of the period here reviewed, these significant investments had been depleted and had not been replenished. While the Hog Commission has the regulatory authority to maintain reserves such as the Trust Fund investments, and to use these reserves in accordance with the *Scheme*, BCFIRB is of the view that the Trust

Fund investments might wisely have been reserved for other industry priorities, such as responding to emergency situations, or investing in strategic planning for the BC hog industry.

Further, we note that relying on Trust Fund investments created a program that would be impossible to sustain in the long term. A price equalization program that was self-financed through dedicated levies would have been a preferable option.

b. Inclusion of hog carcass bonuses and discounts in equalization calculations:

Consistent with its decision to equalize on the net price, rather than base price received by producers, the Hog Commission included average hog carcass bonuses and discounts received by producers in its calculation of equalization payments. This could have the undesirable effect of equalizing on producer skill and acting as a disincentive for producers to meet market demands for hog quality attributes. However, in light of the particular circumstances in the sector at the outset of the program, where the bonuses or discounts available to Britco producers resulted directly from a historical affiliation with Britco that could not be changed, BCFIRB accepts the Hog Commission's decision to include average carcass bonuses and discounts in its calculation of equalization payments.

c. Alteration of the hog carcass bonus/discount range in equalization calculations:

The equalization calculations completed by the Hog Commission aimed to equalize Britco producers to a return equivalent to that which they would have received had they instead been under contract to Johnston. In the pricing template used to determine that return, the Hog Commission altered the weight range over which hog carcass bonuses and discounts would apply to allow for the fact that Britco producers, in accordance with the demands of their processor, produced larger hogs than Johnston required. BCFIRB finds this decision acceptable, insofar as the equalization payments that Britco producers receive should not penalize them for producing hogs according to the specifications of their processor.

d. Unequal producer returns:

The original objective of the price equalization program was to equalize both Britco and Johnston producers to the average returns received in the industry. However, Britco producers actually received lower returns than Johnston producers for much of the program, and would still receive lower returns were equalization to be fully paid out. Nonetheless, because the Hog Commission's intent in their calculations was to ensure equitable treatment, and because perfect price equality would have been difficult to achieve, BCFIRB accepts this result.

e. <u>Decision to allow direct contracting for Britco but not Johnston producers:</u>

In August 2005, the Hog Commission exempted Britco from the requirement of having a term contract (pricing agreement) with the Hog Commission, enabling Britco to form direct contracts with its producers. Johnston was not granted a similar exemption. Due to the recognized role of direct contracts in enabling quality-oriented production, processors and producers who were free to establish such contracts could enjoy a competitive advantage over those who were not. For this reason, BCFIRB is of the opinion that if, after considering the long term implications of direct contracts on processor prices, the Hog Commission was still persuaded to allow such arrangements, it ought to have done so for both processors.

f. <u>Price advantage received by equalization program participants relative to producers under direct contract to Britco beyond August 19, 2005:</u>

By November 2005, eight of the then 11 producers shipping to Britco had established direct contracts with that processor. These eight producers were excluded from receiving equalization payments on subsequent production based on the Hog Commission's expectation that as direct contract producers they would receive shipping bonuses from Britco sufficient to eliminate their need for further equalization payments. The three producers remaining in the equalization program continued to receive equalization payments.

The outcomes of the Britco direct contracts were not as the Hog Commission expected. Even with the shipping bonuses, Britco direct contract producers received lower returns than producers remaining in the equalization program for the majority of the period between August 19, 2005 and December 31, 2006. The Hog Commission was aware of but did not take regulatory action to address this situation. BCFIRB is of the view that by this inaction, the Hog Commission made a regulatory decision to accept the price that Britco direct contract producers were receiving as sufficient so as not to require equalization.

BCFIRB finds that once this decision was made, the Hog Commission should have either encouraged all producers remaining in the program to contract directly with Britco and terminated the equalization program, or reduced the equalization payments it was making to ongoing program participants so that these producers' returns would be equivalent to those of direct contract producers. Consistent with its determination that equalization would no longer be necessary in the case of direct contract producers, the Hog Commission could thus have avoided making payments that it had deemed unnecessary. The Hog Commission's failure to undertake one of these two courses of action means that equalization balances calculated as owing to program participants for their production beyond August 19, 2005, and perhaps a portion of the equalization payments made on these balances by the end of the review period, were greater than they otherwise would have been.

g. Uneven application of the program levy:

At the outset of the program, the Hog Commission determined that a $0.02/kg levy would be applied to all producers in order to rebuild investments in the Trust Fund that had been used to fund the program. The levy was applied to all producers on
June 3, 2005. However, due to developments during the implementation of the program, and despite their regulatory responsibility to enforce their orders, the Hog Commission soon thereafter elected to stop collecting the levy from all but those producers in the equalization program. As a result, the levy was applied unevenly to producer groups. This is difficult to justify since equalization levies must, by nature, be universal. In the current program, equalization program participants were left to fund their own equalization.

h. Equalization balances outstanding as of December 31, 2006:

Four producers who closed their businesses during the equalization program have not received the full equalization owing to them on production completed before their closure. Other producers participating in the program have received equalization payments for periods subsequent to the closure dates. BCFIRB is of the view that the Hog Commission ought to have paid the equalization balances owing to the four producers who exited the industry for completed production periods before other producers received payment for subsequent periods.

The three producers who continued to participate in the price equalization program beyond November 2005 also have significant outstanding equalization balances. However, some portion of these balances may require adjustment in light of the Hog Commission's failure to adjust its equalization payments to avoid making payments that, by continuing to exclude Britco direct contract producers from the program despite their lower returns, it had deemed as unnecessary after August 19, 2005.

3. The governance and administration of the price equalization program:

a. Lack of an industry strategy to guide the price equalization program:

The Hog Commission was called on to develop an industry strategy for the BC hog industry in the 2004 *BC Hog Industry and Marketing Commission Review*, completed by View West Marketing Incorporated for the then Ministry of Agriculture, Food, and Fisheries, BCFIRB, and the Hog Commission, and again by BCFIRB upon the appointment of an independent chair in 2005. However, this supervisory review revealed that the Hog Commission has not acted on this direction.

BCFIRB observes that an industry strategy would have been useful in guiding the Hog Commission in developing and implementing the equalization program, and could have helped resolve some of the conflicts and concerns that have arisen. Although the serious challenges facing the Canadian hog industry must be acknowledged, an industry strategy that adopted a multi-faceted, value-chain wide approach might have resulted in increasing Britco's prices. Similarly, it would have protected the Hog Commission's and producers' relationships with Johnston, which have become strained under the existing program.

b. <u>Conflict of interest situations in the governance of the price equalization program:</u>

   BCFIRB has found that two of the directors of the Hog Commission, Mr. Jerry Gelderman and Mr. Ron Boes, each received equalization settlements for some portion of the price equalization program. Both directors were also involved in preparing and approving calculations related to the equalization program.

   BCFIRB is satisfied that neither of the men had, as of the end of this review period, enjoyed improper financial benefits through the program by way of their position as directors or their involvement in program calculations and administration. Nonetheless, we are aware that the perception of conflict of interest exists and is valid with respect to the governance of the program, as both decisions related to the program, and the calculations used to determine equalization settlements, could have been impacted by the two directors given their interest as producers who were receiving equalization payments. To resolve these concerns, the Hog Commission ought to have ensured that the two directors abstained from participating in equalization program-related decisions during the production periods when they would be entitled to the benefits of the program. Furthermore, the financial functions related to equalization calculations and transactions performed by the directors would better have been performed by Hog Commission staff.

c. <u>Lack of Terms of Reference for the Hog Commission Trust Fund:</u>

   The Hog Commission did not have formal Terms of Reference for the Trust Fund they maintained, which at the commencement of the program held significant investments that were subsequently used to fund the equalization program. While the Hog Commission has the appropriate regulatory authority to maintain such funds and to use them in accordance with the Scheme, we have found that in the absence of any Terms of Reference, the investments have been distributed in a manner that does not reflect potential priorities for and risks to the sector. Having Terms of Reference for the Fund, which would specify how and when it could be used, would have helped avoid this situation.

d. <u>Lack of transparency around the equalization program:</u>

   BCFIRB cannot conclude that the Hog Commission has made sufficient effort to ensure that there is full transparency of the price equalization program to producers and other industry participants alike. The Hog Commission does not appear to have always solicited the input of producers and the primary processors prior to making program-related decisions, or to have communicated program outcomes. This appears to have fostered a level of divisiveness in the provincial hog industry, which works against the development of value-chain approaches to industry development and growth.

BCFIRB Interim Supervisory Directions

In light of the findings made in this Report, BCFIRB is providing the following interim directions to the BC Hog Commission.

BCFIRB directs the Hog Commission to freeze the price equalization program effective with the Hog Commission's receipt of this report on November 14, 2007. The Hog Commission is directed:

(1) To cease issuing weekly equalization payments to participants in the price equalization program;

(2) To cease collecting the $0.02/kg deduction used to finance the price equalization program;

(3) To calculate the amounts that pooled producers continuing in the equalization program after August 19, 2005 received over the amount that Britco direct producers received, and to make recommendation to BCFIRB as to how those monies should be repaid to the Hog Commission;

(4) To calculate, in accordance with our direction at (3), all amounts due to producers who have not received their full equalization balances, and to make recommendations to BCFIRB regarding how those balances should be paid;

(5) To make recommendations to BCFIRB regarding whether the two remaining pooled producers ought to continue to receive equalization payments of any kind, and if so, how those payments ought to be funded.

(6) To confirm to BCFIRB the dates when each group of producers were charged the $0.02/kg levy to replenish the Trust Fund, and to make recommendations to BCFIRB as to how the unequal application of this levy to the groups should be addressed.

This freeze will be in effect pending BCFIRB's further consultation with the BC hog industry and our receipt of the Hog Commission's recommendations as specified above.

BCFIRB Expectations of the Hog Commission Going Forward

In addition to applying BCFIRB's Interim Directions, BCFIRB will expect the Hog Commission to direct serious effort towards resolving the governance issues raised in this report in their future activities and operations. The Hog Commission is directed to:

(1) Develop a strategic plan that will lead the BC hog industry forward in achieving industry growth and development, as was called for in the 2004 View West report and at the appointment of the Hog Commission chair in 2005;

(2) Resolve the conflict of interest situations in the governance of the equalization program by ensuring that equalization recipients who are also Hog Commission directors are aware of their conflict of interest and conduct themselves accordingly, and by transferring responsibility for all financial calculations and transactions related to the program to Hog Commission staff;

(3) Establish Terms of Reference for the financial administration of investments accruing from levies or other deductions collected by the Hog Commission from BC hog producers;

(4) Improve transparency for both hog producers and primary processors in the province around the price equalization program and future Hog Commission initiatives;

(5) Take a proactive approach, including through dispute resolution processes, to resolving conflicts and tensions in the BC hog industry; and

(6) Undertake ongoing monitoring of its programs and activities, including future price equalization programs, amidst changing industry circumstances that may require the adaptation or termination of these activities.

BCFIRB is prepared to assist the Hog Commission in carrying out these directions.

BCFIRB Consultation with the Hog Industry

BCFIRB is releasing this report to the Hog Commission, the BC Pork Producers Association, individual hog producers, and the two Lower Mainland primary hog processors on November 14, 2007. On November 21, 2007, BCFIRB will hold a meeting with BC hog industry representatives to discuss the Report and its findings, as well as issues facing the sector and the future activities of the Hog Commission more generally.

Following the meeting and our receipt of Hog Commission recommendations in accordance with the directions above, BCFIRB will issue additional directions to the Hog Commission.

2.0 Introduction

The British Columbia Hog Marketing Commission (Hog Commission) regulates the production and marketing of hogs in the province under the *British Columbia Hog Marketing Scheme* (*Scheme*). Section 7.1 (1) of the *Natural Products Marketing (BC) Act* (*NPMA*) specifies that, in exercising its responsibilities, the Hog Commission is subject to the supervision of the British Columbia Farm Industry Review Board (BCFIRB).

In October 2006, as a result of an ongoing dispute between the Hog Commission and certain producers, BCFIRB initiated a supervisory review examining the distribution of pooled funds in the Hog Commission's Trust Fund between the dates of January 1, 2004 and
December 31, 2006. The funds were distributed as part of a price equalization program undertaken by the Hog Commission beginning on July 1, 2004. Under this program, some producers of market hogs in the BC Lower Mainland received equalization payments from the Hog Commission. The equalization payments were intended to increase the returns these producers received on their hogs to a level similar to those received by other Lower Mainland hog producers in the province.

This Report provides background to and an explanation of the supervisory review process undertaken by BCFIRB. The Report documents BCFIRB's findings during the review, and provides BCFIRB's supervisory directions to the Hog Commission in light of these findings. The Report closes by outlining the consultation process that BCFIRB will undertake with representatives of the BC hog industry regarding the report findings and the future activities and operations of the Hog Commission.

3.0 Background

3.1 The BC Hog Industry

The hog industry in British Columbia, as in other Canadian provinces, is facing significant challenges. Over the past five years, the rising value of the Canadian dollar has contributed to a significant increase in pork imports to the domestic market, as well as increased competition in global export markets. Competition with ethanol producers for corn and other grains, also used for hog feed, has increased input costs for hog producers, and producer costs pertaining to environmental management are also on the rise. Producers are also under increasing pressure to meet emerging retail and consumer demands for pork and pork products with particular quality attributes and assurances.

In British Columbia, these developments are impacting an industry that has historically faced challenges to its economic competitiveness. BC hog producers have long experienced higher costs of production than their counterparts in other Western provinces, especially given the concentration of the industry in the Fraser Valley. Hog producers in the Fraser Valley are located further from less expensive feed sources than producers in Alberta, Saskatchewan and Manitoba. The higher cost of land in the Lower Mainland has also been a factor, especially given the costs a producer may incur for manure management. BC hog producers have been slower than producers in other provinces to embrace Canadian Quality Assurance (CQA)[1] certification, despite the increasing number of processors in other parts of the country that have made CQA mandatory and the preference for CQA products shown by one of BC's two main primary processors of hogs [2]. In addition, BC farms are smaller on average than the larger production units on the prairies, meaning that most producers here do not enjoy the same economies of scale.

These economic challenges have meant that BC producers have not fared well amid the periodic low prices that the Canadian hog sector experiences. The number of farms registered with the Hog Commission has decreased from 258 farms in 1991 to 41 today[3]. While many of the remaining farms have grown significantly in size[4], this has not fully compensated for the decline in farm numbers, resulting in overall declines in provincial hog production. Canadian Pork Council figures show that the number of hogs marketed by BC has decreased from a high of 412,000 in 1989 to 327,900 in 2006.

The challenges facing the BC hog industry are not limited to the production side of the sector. BC processors are experiencing considerable cost pressure from high volume, low margin packing plants on the prairies. Due to the declines in hog production in the province described above, primary and further processing capacity has for many years exceeded hog supplies in this province. Many of the province's primary and further processors have consequently looked to relatively lower cost hogs and pork products from Alberta to fill their capacity and because of the increased profitability that these products offer. This trend extends to the retail sector, with virtually all of the national retail chains' pork supplies coming from prairie packing plants, with any growth in those markets accruing to prairie producers. The cumulative result is that hog producers in BC presently supply only 15% of British Columbia's pork requirements.

Despite the current challenges in the BC hog industry, the industry does have its own significant strengths and advantages. BC hog producers benefit from the

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[1] The CQA program was developed and is maintained by the Canadian Pork Council, the national association for Canada's hog producers. The CQA program is based on Hazard Analysis Critical Control Point (HACCP) principles, and seeks to apply these principles to each stage in the producer-to-consumer chain. HACCP is an internationally-recognized, effective system of food safety control. The CQA program also provides traceability of product throughout the producer-to-consumer chain.

[2] Presently, Britco Pork Incorporated, one of the primary processors of market hogs in BC, has an agreement with an Alberta farm to supply CQA certified hogs of a particular size and standard to Thrifty Foods, a BC food retailer. The 2004 BC Hog Industry and Marketing Commission Review (see Section 3.2.1) found that while BC hog producers were aware of and interested in this arrangement, they did not seem prepared to initiate similar arrangements with processors either individually or collectively.

[3] According to the Hog Commission, there were 41 registered hog producers in BC as of August 16, 2007. This includes both market hog and round hog producers. Thirty-six of the 41 producers are commercial producers (one of whom maintains three separate farms); the remaining five are designated "hobby farms" by the Hog Commission.

[4] In 1987, 86% of BC hog farms marketed less than 3000 hogs per year and none marketed more than 8000 hogs. In 2007, it was predicted that 72% of farms would produce more than 3000 hogs, with four above the 8000 hog mark.

province's milder climate, and they are frequently recognized for their skill in providing a high quality, lean and consistent product. One important advantage is the proximity of the industry to sizeable and ethnically diverse markets. In recent years, a number of BC producers have profited from this diversity through the production of round hogs—hogs with a smaller carcass size than market hogs, and which are primarily sold whole into local Asian markets. At the same time, some market hog producers have sidestepped some of the sector's economic pressures by growing their farm size to take maximum advantage of economies of scale. On the processing side, BC's two main primary hog processors have undertaken regular renovations and technology upgrades, enabling them to better meet emerging market demands. The provincial industry also has strong support infrastructure in terms of feed companies, good transportation systems, and ready access to export facilities.

Recent analyses have studied the British Columbia hog industry and addressed its economic viability and potential. A 1998 review of the industry by Ken McEwan at the University of Guelph's Ridgetown College emphasized the potential for value-added production geared towards specialty markets in the Lower Mainland. The 2004 *BC Hog Industry and Marketing Commission Review* by View West Marketing Inc. (View West) suggested that BC producers should use their proximity to markets—including the large ethnic market in the Lower Mainland—to their advantage. View West concluded that the high quality and consistent product produced by BC hog producers is well positioned for niche marketing, especially to local butcher and grocery stores. View West's 2004 *Report on Recommendations for the Operation of the BC Hog Marketing Commission*, which followed the original Review, concluded that "… it is incumbent on the [BC] industry to seek out smaller retailers who will work with them to develop branded markets as those firms are also looking for initiatives to build their businesses against the larger national retailers." The Canadian Pork Council has also recently acknowledged the need for producers—whether in BC or beyond—to work with the entire pork value-chain in order to effectively address current industry challenges.

Both McEwan's report and the 2003 Ministry of Agriculture Food and Fisheries Report *Investment Information on the British Columbia Hog Industry Report* emphasized the significant potential for industry development outside of the Fraser Valley, particularly in the Peace River Region and the North Okanagan. The reports noted that these areas are closer to grain production centres, have a wider availability of less expensive land, and are still reasonably close to major markets. As such, they could provide significant economic advantages for hog producers.

The conclusion drawn in each of these reports is that, with a cohesive and directed industry strategy, the BC hog industry could move beyond its current challenges to enjoy a stable, successful and prosperous future.

3.1.1 Current Industry Profile

Hog production in BC has been regulated under the *NPMA* since the establishment of the *Scheme* in 1980. Commercial hog producers in British Columbia presently produce two types of hogs: market hogs and round hogs. According to Hog Commission figures, there were 35 registered commercial hog producers in British Columbia as of August 16, 2007, and one commercial breeder. Twenty-one of the commercial producers produce market hogs only, a further six produce a combination of market hogs and round hogs, and the remaining four produce only round hogs. One additional commercial producer is producing for the Alberta market, and three are producing for the U.S. market. Production is concentrated in the Fraser Valley, with 32 of the 37 registered commercial farms located in this area.

The price equalization program that is the subject of this supervisory review applied exclusively to producers of market hogs. Presently, there are two main primary processors for market hogs in the BC lower mainland: Britco Pork Incorporated (Britco), located in Langley, and Johnston Packers Limited (Johnston), located in Chilliwack[5]. The majority of the hogs processed by Britco are imported from Alberta (80% of the kill in 2004), while Johnston processes mainly BC hogs. A third processor, Hertel Meats Limited ("Hertel"), located in Port Alberni on Vancouver Island, operated as a primary processor of both BC and Alberta market hogs during the first portion of the equalization program under review. Hertel has since ceased primary processing of market hogs; they continue to undertake further processing of pork products. Of the 27 commercial producers of market hogs in BC, 15 presently ship their hogs to Johnston for processing, and 10 ship their hogs to Britco[6]. The remaining two producers ship to smaller, regional processors in the Peace region of the province.

3.2 The BC Hog Marketing Commission

The Hog Commission was established in 1980 under the *Scheme*. The *Scheme* specifies the powers of the Hog Commission as follows:

> **6** (1) The commission is vested with the power in the Province to promote, control and regulate in any respect the marketing of the regulated product.
>
> (2) Without restricting the generality of subsection (1), the commission is vested with
>
> (a) the powers set out in section 11 (1) (e) to (j), (o) (i), (ii), (iv) and (v), (p), (q) and (v) of the Act, and
>
> (b) the powers to regulate the time and place at which a regulated product must be transported or marketed, and to determine the manner of distribution, the quantity and quality, and the grade or class of the regulated product that must be transported or marketed.

The *Scheme* defines the "regulated product" as "hogs grown in the Province for processing". The sections of the *NPMA* referred to in section 6(2)(a) are as follows:

[5] Both Britco and Johnston presently process both market hogs and round hogs.

[6] The number of producers shipping to each processor, as given in this report, is based on records BCFIRB has received from the Hog Commission. Because the industry is always in a state of flux, the number of producers at each processor changed over the period of this review, and may have changed again between the writing of this report and its presentation to the BC hog industry.

> 11 (1) Without limiting other provisions of this Act, the Lieutenant Governor in Council may vest in a marketing board or commission any or all of the following powers:
>
> (e) to exempt from a determination or order a person or class of persons engaged in the production, packing, transporting, storing or marketing of a regulated product or a class, variety or grade of it;
> (f) to require persons engaged in the production, packing, transporting, storing or marketing of a regulated product to register with and obtain licences from the marketing board or commission;
> (g) to set and collect yearly, half yearly, quarterly or monthly licence fees from persons producing, packing, transporting, storing or marketing a regulated product;
> (h) for the purposes of paragraph (g) and in respect of the persons affected by a regulation under that paragraph
> (i) to classify those persons into groups and set the licence fees payable by the members of the different groups in different amounts,
> (ii) to set and collect from those persons fees for services rendered or to be rendered by the marketing board or commission, and
> (iii) to recover the licence and other fees by proceedings in a court of competent jurisdiction;
> (i) to cancel a licence for violation of a provision of the scheme or of an order of the marketing board or commission or of the regulations;
> (j) to require full information relating to the production, packing, transporting, storing and marketing of a regulated product from all persons engaged in those activities, to require periodic returns to be made by those persons and to inspect the books and premises of those persons;
> (o) to set and collect levies or charges from designated persons engaged in the production or marketing of the whole or part of a regulated product and for that purpose to classify those persons into groups and set the levies or charges payable by the members of the different groups in different amounts, and to use those levies or charges and other money and licence fees received by the marketing board or commission
> (i) to carry out the purposes of the scheme,
> (ii) to pay the expenses of the marketing board or commission,
> (iv) to equalize or adjust returns received by producers of regulated products during the periods the marketing board or commission may determine, and
> (v) to set aside reserves for the purposes referred to in this paragraph;
> (p) to delegate its powers to the extent and in the manner the board considers necessary or advisable for the proper operation of the scheme under which the board is constituted, but a power in paragraph (f), (g) (h) or (i) must not be exercised by any person other than the federal board, a marketing board or a commission;
> (q) to make orders and rules considered by the marketing board or commission necessary or advisable to promote, control and regulate effectively the production, transportation, packing, storage or marketing of a regulated product, and to amend or revoke them;
> (v) to require a person who receives a regulated product for marketing from a producer to deduct from the money payable by the person to the producer licence fees, levies or charges payable by the producer to the marketing board or commission and to remit them to the marketing board or commission.

Unlike the marketing schemes of some of the other regulated marketing boards in BC, the *Scheme* does not incorporate section 11(1)(k) of the *NPMA*, which grants a marketing board or commission the power to set prices for the product it regulates. As such, the Hog Commission does not have pricing authority.

The *Scheme* specifies that the Hog Commission consists of a chair appointed by the Lieutenant Governor in Council (prior to January 2005 this position was filled by election from within the Hog Commission membership), and up to five members, each a registered producer, who are elected by the registered producers. Presently, the Hog Commission has three elected producer members serving as directors.

Previously, the Hog Commission has employed as many as 10 staff members. It presently employs three part-time staff members. The Hog Commission has not had a General Manager since February 9, 2005, when the contract of the then acting General Manager was terminated.

3.2.1 The 2004 BC Hog Industry and Marketing Commission Review

As noted above, in 2004, the then BC Ministry of Agriculture, Food and Fisheries, the BCFIRB, and the Hog Commission contracted View West to undertake a review of the BC hog industry and the Hog Commission. The review was intended to provide background to the Minister and the industry regarding the future needs of the Hog Commission. The report authors met with both the Hog Commission and the BC Pork Producers Association to determine the current activities of the Hog Commission. The report found that the operations of the Hog Commission entailed:

(1) Registering and licensing hog producers in the province.
(2) Conducting periodic negotiations with the primary processors to determine a formula price which producers would be paid.
(3) Collecting levies on both market hogs and round hogs. The levies were used to carry out the purposes of the scheme, pay the expenses of the Hog Commission and the BC Pork Producers Association, and set aside reserves for these purposes.
(4) Paying producers for market hogs sold in BC as well as those sold to Yosemite Meat Company ("Yosemite") in San Francisco. The Hog Commission served as first receiver of funds for market hogs, receiving payment for these hogs from the processors, and transferring payment to producers after subtracting the relevant levies. Payment for round hogs was made directly from processor to producer, with the packer withholding the levy and then remitting it to the Hog Commission.
(5) Although the Hog Commission was said to be pooling, their use of formula pricing meant that this activity amounted only to seeing that producers of market hogs sold to Yosemite, who would otherwise receive lower prices than producers shipping to BC processors, received similar returns to other hogs sold that week.
(6) Although the Hog Commission could direct hogs under the scheme, this power had been exercised infrequently, most recently in 2001. Rather, producers determined which packer they would deliver to, and arranged delivery times with that processor. This enabled processors to communicate hog quality-related market requirements to producers to ensure that these were met in the hogs provided, an important activity given that one processor was requiring a larger carcass weight than the others.
(7) The Hog Commission had not undertaken any promotion of hogs for at least four years, and possibly longer. Rather, it relied on Alberta Pork to

undertake promotion in BC, given that Alberta producers hold approximately 80% of the market in BC.

An additional function of the Hog Commission at the time that was not captured in the 2004 View West report was its involvement in certifying graders to ensure that grading standards were being correctly applied. The 2004 View West report recommended legislative changes that would support the Hog Commission in maintaining operations as they were at that time.

With the exception of its functions relative to Yosemite, which ceased in early 2004, the Hog Commission's activities have remained relatively unchanged from those specified in the 2004 View West report into and throughout the period covered by this review. In addition to registering and licensing hog producers, collecting producer levies, and negotiating prices with and receiving payment from BC processors, the Hog Commission's functions in the review period included conducting a pooling program similar to that which it had used to improve returns to Yosemite producers, but which was now directed towards producers for one of the primary processors in the Lower Mainland. It is this pooling or equalization program, described in detail in the next section of this Report, that is the subject of the present review.

The 2004 View West report relied on interviews with 38 BC hog producers as well as the main processors in the province in order to ascertain industry support for the Hog Commission and its activities. The report found that 33 of the producers contacted supported the continuance of the Hog Commission. These producers believed that "the [C]ommission [was] a necessary part of the industry that, by its existence, [kept] BC prices at a level close to Alberta price plus freight as compared to Alberta less freight. Pricing less freight harkens back to a proposal by the largest BC hog processor just prior to the time that the Hog Commission was formed in 1980." These producers felt that the potential for the local pricing situation to worsen without a Hog Commission was the major reason for maintaining the Hog Commission. By contrast, the remaining five producers interviewed did not support the continuation of the Hog Commission, and suggested that it be disbanded. For these producers, the main issue was not the levy paid to the Hog Commission[7], but rather their belief that they could do just as well on their own.

The 2004 View West report also relied on interviews with and questionnaires completed by the four main primary processors of hogs in BC[8]. The report found that while the processors generally felt that they had a good relationship with the Hog Commission and that the Hog Commission understood their needs, they appeared "to be split[,] with the majority believing that the system would work better without the

[7] The five producers who did not support the continuation of the Hog Commission indicated that they would continue to pay a levy to support the BC Pork Producers Association even if the Hog Commission were not in existence because they felt it was important to have a unified voice on issues of concern to all producers.

[8] At the time, the three largest primary processors of hogs in BC were Johnston (Chilliwack), Britco (Langley), and Hertel (Port Alberni). A fourth processor, Lawrence Meats (Dawson Creek), was processing a smaller number of hogs.

Commission and the balance suggesting that they prefer having the Commission as it relieves them of the responsibility of setting price in competition with other plants." Processors appreciated being able to work directly with producers to negotiate delivery times and to ensure that producers provided the particular quality of hogs that processor markets required. However, the majority of processors indicated that they would prefer that the Hog Commission was not first receiver of funds, suggesting that if the processor's name rather than the Hog Commission's was on producers' cheques, processors would be better recognized as the purchasers and suppliers of funds.

The findings of the 2004 View West report vis-à-vis the operations of, and industry support for, the Hog Commission provide important background and context to the current review.

3.2.2 Background on the Hog Commission's Price Equalization Program

In January 2004, the outset of the period covered by this review, all BC market hog producers shipping to either Johnston or Britco did so under term contracts (pricing agreements) that were periodically negotiated by the Hog Commission with each processor. These contracts set formula prices by specifying a base price per kilogram, establishing how animal or carcass demerits would be dealt with, and setting any bonuses and discounts that would be applied under the processors' Lean Yield Grading Programs[9] and their Carcass Bonus/Discount Programs[10]. Together, these components determined the net price that a producer would receive for their hogs. The Hog Commission acted as first receiver of funds in the administration of the pricing contracts; processors remitted payment for hogs received to the Hog Commission, which subtracted levies before issuing settlements to producers.

Between January 15, 2001 and February 10, 2003, the term contracts existing between the Hog Commission and each of the two processors were identical. On February 10, 2003, Britco negotiated a new term contract with the Hog Commission, which was subsequently replaced with a new agreement on June 14, 2004. In July 2004, Britco abandoned the latter contract, and began using a pricing formula that the Hog Commission maintains has never been fully explained to them. Johnston's January 15, 2001 contract with the Hog Commission remained in place until December 18, 2005, when a new term contract was entered into. Johnston subsequently negotiated a

[9] Lean Yield Grading Programs provide hog producers with a per kilogram bonus when they provide hogs that (i) have a hot dressed carcass weight within a specified range, and (ii) have an estimated lean meat content equal to or above a specified percentage marker. Producers receive a per kilogram discount when lean yield is below the marker. Lean Yield bonuses increase with increasing lean content up to a fixed limit. Lean Yield discounts increase with decreasing lean content.

[10] Carcass Bonus/Discount Programs provide hog producers with a per kilogram bonus when they provide hogs with carcasses within a target weight range, set by the processor in response to market demands. Producers receive a penalty for hogs with carcass weights above or below this range. While there is a single bonus rate, the penalty rate is graduated, and depends on the degree to which a given carcass is over or under the target weight.

further term contract with the Hog Commission on May 24, 2005, which remained in place until the end of the reviewed period. In the case of both processors, the Hog Commission continued to act as first receiver of funds—receiving payment from the processors, subtracting levies, and remitting settlements to the producers—until mid 2005, when developments related to the price equalization program led both to move to direct arrangements with some of their producers.

The Hog Commission has stated that it regularly tracked the hog prices received by producers shipping to each of the two processors. Beginning in July 2004, the Hog Commission observed significant differences between the hog prices received by those producers shipping to Britco and those shipping to Johnston. The Hog Commission calculated that the average price per kilogram received by Britco producers was consistently lower than the average price per kg received by Johnston producers. This price difference resulted not only from a difference in the base prices offered by the two processors, but was also due to differences in the hog carcass weight bonuses and discounts issued to producers under each processor's Carcass Bonus/Discount Program. The Hog Commission determined that Johnston shippers were receiving a higher base price and smaller carcass weight bonuses, while Britco shippers were receiving a lower base price and larger carcass weight bonuses.

The Hog Commission first considered instituting a price equalization (pooling) program in favour of Britco producers in February 2005. On March 31, 2005, the Hog Commission approved an equalization program that would issue payments to these producers, retroactive to July 2004, the first instance of a significant price difference between the processors. That proposal did not, however, proceed. Instead it was rescinded and a new pooling proposal was approved at the Hog Commission's May 27, 2005 board meeting. The new proposal specified that the equalization payments would be funded through investments that had accumulated in the Hog Commission's Trust Fund. These investments originated from levies paid by producers across the province during the period of the Hog Commission's operation. The Hog Commission has indicated that this second proposal was developed under pressure from producers who wanted faster payouts of the equalization balances than they would have received under the original proposal. The Hog Commission determined that these faster payouts could only be obtained by using the Trust Fund investments.

The second pooling proposal also specified that the investments in the Trust Fund would be replenished by imposing and deducting a $0.02/kg levy from payments due to all producers (regardless of processor) on their subsequent pork production.

The Hog Commission commenced collecting the equalization levy from all market hog producers on June 3, 2005. The first equalization payments were issued by the Hog Commission on July 15, 2005. The payments were issued to the 12 producers who were then actively producing market hogs for Britco.

In calculating the equalization owing to an individual producer, the Hog Commission first determined the price differential between the average return received by Britco producers and a proxy return calculated by the Hog Commission and regarded by them as the average return that Britco producers would receive were they producing under contract to Johnston. The average price per kilogram received by Britco producers was calculated from production and pricing information received from that processor. To arrive at the proxy return, representing the average price per kilogram that Britco producers would have received under contract to Johnston, the Hog Commission entered Britco producers' production data into a pricing template, which they had adapted from the contract that the Hog Commission had negotiated with Johnston. This pricing template mirrored the Johnston contract in every respect except that the weight range over which a producer would receive bonuses or discounts under the Carcass Bonus/Discount program was altered. The nature of the alteration, the Hog Commission's rationale for undertaking the alteration, and the potential effects are discussed in detail in Section 5.2.3. Subtracting the average return received by Britco producers in a given period from the proxy return in that period gave the Hog Commission the price differential between the two.

The price differential calculated by the Hog Commission formed the basis for its determination of the equalization owing to an individual producer. The Hog Commission calculated the equalization owing for a given period by multiplying the price differential by the producer's production data for that period. The period from July 1, 2004 to June 30, 2005, described as the retroactive period, was the first period for which the equalization owing to each producer was calculated[11]. Thereafter, the equalization owing was recalculated on a quarterly basis. The Hog Commission tracked the equalization 'balance' accruing to each producer through the periods in detailed spreadsheets.

It is important to note that the equalization payments made by the Hog Commission to a given producer did not match the equalization balance that it calculated as owing to that producer for a given period. Rather, the Hog Commission decided that equalization balances would be paid out at a fixed rate, rather than at the observed per kilogram price differential. The Hog Commission determined that using a fixed rate would allow for predictable payments over time (since producers' production levels remained fairly consistent), and selected the particular rate of $0.07/kg as one that could be sustained over the medium to longer term. To determine the weekly equalization payment that would be made to a producer, the Hog Commission multiplied this rate by the producer's production in that week. They then issued the resulting payment to the producer, along with the weekly settlement (minus the appropriate levies) from Britco.

After initiating equalization payments on July 15, 2005, the Hog Commission moved to address the equalization owing to each Britco producer for their production in the retroactive period. The Hog Commission determined that it would pay out 65% of each producer's equalization balance from this period in a lump sum payment. On August 26, 2005, this payment was issued to the 12 producers who were then actively producing hogs for Britco (and who were thus receiving weekly equalization payments at the fixed rate on their ongoing production), as well as to four additional producers

[11] The Hog Commission treated the entire retroactive period as a single period.

who had some production during the retroactive period, but who had either gone out of business during this period, or moved to producing round hogs exclusively[12]. Following this payment, the Hog Commission determined that the remaining 35% of each producer's equalization balance for the retroactive period would be issued at the same fixed rate as payments for ongoing production ($0.07/kg). This, together with the fact that the chosen rate was in some periods lower than the price differential calculated by the Hog Commission, meant that there was a time lag in equalization payments. That is, while producers were receiving equalization payments in proportion with their production in each week, the weekly settlements were actually paying off equalization balances accrued from earlier production.

As the equalization program was being prepared and implemented, two developments unfolded that impacted on its operation.

First, in the period between February and August 2005—between the initial proposal for a pooling program and the first equalization payment to producers—the Hog Commission was approached by Britco regarding that processor's desire to begin contracting directly with individual producers. Britco proposed that under these direct contracts, the Hog Commission would cease to serve as first receiver of funds. Rather, Britco would pay hog producers directly after subtracting the appropriate levies and remitting them to the Hog Commission. The Hog Commission has told BCFIRB that this idea had the support of numerous producers, who were assured by Britco that under individual contracts they would be offered a shipping bonus that would result in a higher net hog price than that which they received going through the Hog Commission.

On July 27, 2005, the Hog Commission amended its Consolidated Order to enable these direct arrangements to proceed. On August 19, 2005, six of the then 12 active Britco producers began individual contract relationships with that processor, with two additional producers following on October 14 and November 11, 2005 (one additional producer went out of business in October 2005, leaving 11 active Britco producers thereafter). As these producers commenced their direct contracting relationships, the Hog Commission continued to pay any outstanding equalization balances (i.e., equalization balances owing on production completed prior to the direct contract) at the fixed equalization payment rate of $0.07/kg, provided that the producer allowed the Hog Commission to access their continuing production data[13]. However, the Hog Commission decided that these producers would not receive equalization payments on production completed after their direct contracts were signed. The significance of this will be discussed in more detail below.

[12] Three Britco producers went out of business during the retroactive period: one in July 2004, one in August 2004, and one in February 2005. One further producer moved to producing round hogs exclusively during the retroactive period.

[13] For the Hog Commission to be able to access a producer's production data following that producer's initiation of a direct contract with Britco, the producer would have to provide the Hog Commission with the username and password they used to access the on-line reporting portion of Britco's website. Some producers provided this information immediately upon moving to direct contracts, such that there was no interruption in their equalization payments. Other producers did not provide this information right away, and so went some weeks without equalization payments, with payments resuming when the access information was provided.

The second development relates to the levy collected by the Hog Commission for the purposes of replenishing the Trust Fund investments. On June 3, 2005, the Hog Commission began subtracting this $0.02/kg levy from settlements due to all producers, regardless of processor. This levy thus applied to the ongoing production of Johnston producers. While the levy was not withheld on the first lump sum equalization payment to producers receiving equalization (i.e., the payment covering 65% of the equalization owed to each producer for the retroactive period), an amount equivalent to the levies owed in this period was later subtracted from the overall equalization balance of each producer, as calculated by the Hog Commission. Following this, the levy was applied against subsequent equalization payments to each of these producers (i.e., payments for the remaining 35% of their equalization balance for the retroactive period, and for their continuing production), such that these payments were made at a rate of $0.05/kg, rather than $0.07/kg.

The Hog Commission's decision to levy the ongoing production of Johnston producers was soon contested by that processor, which argued that the levy was effectively subsidizing its competitor, Britco. In protest, Johnston began paying all its producers directly, rather than making payments through the Hog Commission, such that the Hog Commission was not collecting levies from these producers. The Hog Commission has stated that, based on the situation with Johnston producers they stopped applying the levy to other producers excepting those in the price equalization program as of August 26, 2005[14].

In September 2005, the Hog Commission met with BCFIRB to discuss its desire to collect levies from all producers in support of the price equalization program. BCFIRB confirmed that the Hog Commission had the necessary legal authority to collect such levies. If producers were dissatisfied with a decision of the Hog Commission to apply levies, then that decision could be appealed to BCFIRB for review and a determination under Section 8 of the *NPMA*. Where no appeal was filed and producers were not paying ordered levies, then the Hog Commission could, under Section 15 of the *NPMA*, enforce its order and pursue a claim for unpaid levies in the Courts. In either case, the Hog Commission would be expected to explain and defend its decision and demonstrate that it had followed due process.

The Hog Commission determined that they did not wish to pursue levy collection through the Courts. Johnston continued to pay its producers directly until November 9, 2005, when a number of producers made a written request that the processor return to paying them through the Hog Commission. Johnston subsequently did so for the thirteen producers who signed the request, but continued to pay directly the remaining four producers whose signatures were not included. The Hog Commission agreed that it would not collect levies from the returning Johnston producers. However, it also maintains that by continuing to pay some of their producers directly, Johnston is in contravention of its orders.

[14] KPMG has noted that Hog Commission records indicate that the levy continued to be applied to producers outside of the equalization program until November 11, 2005. This disagrees with the Hog Commission's statement that the levies were ceased for all but equalization program participants as of August 26, 2005.

These arrangements continued through to the end of 2006.

Thus, the situation as of December 2006 was that of the 15 producers shipping to Johnston (Johnston producers), 11 were covered under the term contract between the Hog Commission and that processor, and were being paid through the Hog Commission, while the remaining four were being paid directly by Johnston. No levies were being received from any of these 11 producers. Of the 11 producers shipping to Britco (Britco producers), eight were under direct contracts with and were paid directly by Britco, and the remaining three producers were paid through the Hog Commission. These latter three producers were the only producers accruing equalization balances on their ongoing production, and the only producers who were making levy payments. Indeed, this had been the case since November 11, 2005, the date when the last Britco direct producer had initiated its direct contract with Britco.

4.0 History of the BCFIRB Supervisory Review

The present supervisory review originated in an appeal to BCFIRB in April 2006. BCFIRB decided to undertake the supervisory review in October 2006.

4.1 The Schutte/Binnendyk Appeal and the Origins of the Supervisory Review

On March 9, 2006, two hog producers, Mr. Jan Schutte and Mr. Bert Binnendyk, contacted BCFIRB through their legal counsel seeking supervisory intervention and an investigation into existing regulations and practices of the Hog Commission. These producers were concerned about the disbursement of funds collected from all producers through Hog Commission levies to one group of producers who were apparently receiving a lower price for their hogs from one of the primary processors. They felt this action by the Hog Commission was a subsidization of one group of producers at the expense of another. These producers requested a thorough review of the mandate, practices and policies of the Hog Commission, including:

a) The Hog Commission's role as a "marketing" Board;
b) Aspects relating to the freedom of contract between producers and processor;
c) Issues regarding certainty in the regulations, policies, and practices of the Hog Commission
d) Fairness issues relating to the use of funds gathered by the Hog Commission through levies
e) Issues relating to the impartiality of the Hog Commission and guidelines regarding conflict of interest; and
f) Any other matters that, in the course of a supervisory process, may be worthy of discussion in order to provide for a healthier, more productive, and more financially stable hog industry in BC.

BCFIRB determined that it would not be appropriate to undertake a supervisory review at that point, and the producers were advised to file an appeal if they wished to pursue the matter.

On April 11, 2006, the producers filed an Appeal of ongoing decisions of the Hog Commission related to the issue of equalization payments. The Hog Commission requested, via correspondence dated April 26, 2006, that the appeal be dismissed on the basis it was not filed within the applicable time limits, pursuant to subsection 8.1 (1) of the *NPMA,* and subsection 24(1) and 31(1)(b) of the *Administrative Tribunals Act.*

On April 27, 2006, a pre-hearing conference call was held. Following that conference, and submissions from both parties, BCFIRB decided the matter under appeal was significant to the BC hog industry and concluded that a formal appeal was indeed the most appropriate process to bring the matter to a resolution.

On June 20, 2006, a second pre-hearing conference was held. On June 23, 2006, the issues and grounds of appeal were articulated as follows:

> The issue on appeal is:
>
> Did the BC Hog Marketing Commission err in its March 31, 2005 decision to confirm its February 25, 2005 decision to establish a pooling system and commence equalization payments to producers?
>
> The grounds of appeal are:
>
> 1. The decision is contrary to sound marketing policy in that:
>   a. Pooling contributes to the continuing deterioration in the health and competitiveness of the BC hog industry generally and by forestalling better and more flexible marketing of hogs;
>   b. Pooling interferes with the freedom of producers to contract with the processor of their choice;
>   c. Pooling contributes to uncertainty in producer income (levies to be paid are unknown) and
>   d. Equalization payments from the Hog Commission general and trust accounts to individual producers are unfair and contrary to the principles of natural justice.
>
> 2. There is inconsistency and uncertainty with respect to Hog Commission policies and practices, in that:
>   a. The process was not clear and transparent; and
>   b. An apprehension of bias exists due to the composition of the Hog Commission, with producer directors making decisions which have financial impacts on their own livelihood at the expense of other producers.
>
> The Appellants are seeking the following remedy:
>
> 1. The March 31, 2005 decision be reversed and the matter be referred back to the Hog Commission with directions or alternatively, BCFIRB make another order it considers appropriate in the circumstances.

The appeal hearing was set for October 3-5, 2006, with pre-hearing steps proceeding in July 2006.

In August 2006, the appellants' counsel wrote BCFIRB again requesting that the matter be moved to a supervisory review process. On August 28, 2006, BCFIRB advised that the matter should proceed to appeal as scheduled. On September 1, 2006, the Appellants informed BCFIRB that they were formally abandoning the appeal and again requested that BCFIRB consider a supervisory review of the hog industry.

Following the abandonment of the appeal, BCFIRB again discussed the merits of conducting a supervisory review, and concluded that this was the appropriate path forward. BCFIRB arranged to conduct a series of industry meetings, first with the Appellants, and then with other interested parties, including processors, the BC Pork Producer Association, and finally the Hog Commission, using the original dates set for the Appeal (October 3-5, 2006).

Numerous issues were raised during the industry meetings conducted by BCFIRB. These included:

- The Hog Commission's estimated legal costs for an Appeal[15];
- The decline in the number of hog producers and processors in BC;
- The importation of a significant number of hogs for processing from Alberta to Britco;
- The lack of producer consultations and apparent lack of transparency of Hog Commission decisions;
- The inability of the Hog Commission to negotiate term contracts with all processors;
- The Hog Commission's decision to allow Britco to enter direct contracts with producers while not allowing Johnston to do the same;
- The failure of three "spot" producers (one on the Hog Commission's Board of Directors) to negotiate commitment with either of the two Lower Mainland primary processors;
- The "subsidization" of one group of producers;
- The depletion of the investment fund used to pay the equalization process and the decisions made during this process;
- The apparent control of the BC hog industry by the two processing firms;
- The loss of support for the Hog Commission by these processors and some producers;
- The future need or role for the Hog Commission; and
- The recent firing of the Hog Commission's General Manager and the resignation of the government appointed Chair as they related to the general discord and issues surrounding the Hog Commission.

During the meetings, BCFIRB confirmed that it would proceed with a supervisory review of the Hog Commission's price equalization (pooling) program.

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[15] These legal costs were estimated by the Hog Commission at $100,000. BCFIRB is of the opinion that this is a significant overstatement of the costs that the Hog Commission would likely have faced.

4.2 The Supervisory Review Process

BCFIRB determined that the appropriate first step in addressing the issues raised regarding the Hog Commission's distribution of pooled funds was to obtain an objective audit of the Hog Commission's price equalization-related activities. On March 1, 2007, BCFIRB issued an Order for this audit, which was to be completed by April 30, 2007. The audit was to review whether there had been any financial or procedural irregularities by the Hog Commission in the management, collection, and the distribution of funds in the price pool. Specifically, the audit was to cover the period January 1, 2004 to December 31, 2006 and would:

a) Review the Hog Commission's financial statements for 2004, 2005 & 2006;
b) Review the Hog Commission's accounts for 2004, 2005 and 2006;
c) Report on financial management of the Hog Commission's General Operating Fund and Trust Fund; and
d) Compare and report on payments received from and the distribution of pooled funds to producers who did not ship to Britco vs. payments received from and distribution of pooled funds to producers who shipped to Britco during the period covered by this audit.

KPMG LLP was contracted to conduct the audit. On April 12, 2007, the firm provided a preliminary report on its work to BCFIRB. This preliminary report was reviewed by BCFIRB and discussed with KPMG on May 14, 2007. Following this meeting, BCFIRB asked KPMG to conduct additional work. On June 5, 2007, KPMG produced a draft supplemental report, delivered in its final form to BCFIRB on June 11, 2007.

On June 12, 2007, BCFIRB sent both the preliminary and the supplemental reports to the Hog Commission with a covering letter identifying a number of questions for the Hog Commission's response no later than July 31, 2007. On July 13, 2007, BCFIRB received the Hog Commission's response, dated July 3, 2007.

On August 8, 2007, a meeting between BCFIRB, KPMG and the Hog Commission was convened to address outstanding questions concerning the equalization program and Hog Commission's decision-making respecting the program. The objective of the meeting was to provide BCFIRB with sufficient information to commence deliberations on the issues raised by this review.

Following the August 8, 2007 meeting, BCFIRB asked KPMG to undertake additional work on questions raised at that meeting. On September 18, 2007, KPMG provided a further supplemental report outlining these additional details.

At the request of BCFIRB, KPMG compiled the findings from the preliminary report and the two supplements into a single report, dated and received by BCFIRB on October 26, 2007. This final report replaces the earlier reports. BCFIRB has determined that it would not be appropriate to release the earlier reports, which do not represent KPMG's final opinions and are not necessarily based on full and accurate information. Such a release would be unfair both to KPMG and others. We have not yet reached a final decision about release of the final report, as we are reviewing legal issues related to proprietary and personal information. We will advise the industry of how we intend to address this issue once our review is complete.   We will of course summarize the key conclusions of the final report in this document.

5.0 Issues

BCFIRB's supervisory review has identified a number of issues related to the price equalization program undertaken by the Hog Commission between July 2004 and December 2006. This section of the supervisory review report discusses these issues, which fall into three broad areas:

(1) The Hog Commission's decision to undertake a price equalization program;

(2) The financing, administration and outcomes of the price equalization program that was undertaken; and

(3) The Hog Commission's governance of the price equalization program.

5.1 Hog Commission Decision to Undertake a Price Equalization Program

The Hog Commission first decided to initiate a price equalization program in March 2005. In examining the Hog Commission's decision to undertake a price equalization program, BCFIRB has considered the Hog Commission's regulatory authority to undertake the program, as well as its rationale for doing so.

5.1.1 Hog Commission Jurisdiction to Undertake a Price Equalization Program

The Hog Commission states that under the *Scheme*, it had the regulatory authority required to undertake the price equalization program that it pursued between July 1, 2004 and December 31, 2006. The *Scheme,* which incorporates by reference section 11(1)(o)(iv) of the *NPMA*, authorizes the Hog Commission to undertake an equalization program of the type pursued. That section vests in the Hog Commission the power to set and collect levies or charges from persons engaged in the production or marketing of hogs in BC in order to equalize or adjust returns received by producers during periods that the Hog Commission may determine.

BCFIRB agrees with the Hog Commission's position regarding its jurisdiction. We note that while the *Scheme* does not grant the Hog Commission the power to control price, it does expressly authorize the Hog Commission to undertake equalization. The Hog Commission's equalization power is the only regulatory power available to it to remedy the adverse consequences of a significant difference in the prices producers receive for their production. The equalization power has the effect of ensuring that any equalization in the BC hog industry is funded by hog producers, not by the primary processors, as would be the case with a price control power.

5.1.2 Hog Commission Rationale for Undertaking a Price Equalization Program

BCFIRB is satisfied that a significant price differential did exist between Britco and Johnston for most of the period between July 2004 and December 2006 (see Section 5.2.4 for KPMG's findings in this regard). We are satisfied that Johnston producers received a higher net price from their processor than did Britco producers, net price being the combination of base price and the carcass weight bonuses or discounts offered by the processor through their Lean Yield Grading and Carcass Bonus/Discount programs.

BCFIRB understands that during the period of this review, Britco producers were not able to address the lower returns they were receiving by moving to a contract with Johnston, as Johnston was operating at capacity and was not willing to contract additional producers. The returns that a producer received were thus decided by that producer's historical affiliation with one or the other processor. When these affiliations were first established, both processors were offering comparable base prices and carcass weight bonuses/discount programs.

BCFIRB has considered this situation—whereby Britco producers' experience of lower returns resulted from historical associations that they had limited ability to change—to be an important factor in our deliberations on the Hog Commission's price equalization activities.

In determining whether the Hog Commission's rationale in establishing a price equalization program was sound, BCFIRB has considered that there are two possible situations where the Hog Commission might wisely have chosen not to proceed with such a program. The first such situation is that a significant price differential was justified. BCFIRB accepts that in certain situations where product differentiation is significant, and where legitimate markets for differentiated products exist, price differentiation is justified and acceptable. A good example of this arises from a comparison of specialty products (including organic products) and mainstream products, where a price difference exists due to both the higher costs of specialty production and the higher market value attributed to specialty products.

BCFIRB recognizes that the BC hog industry may be starting to move towards more specialized and value-added production and products. We agree with the analyses profiled in the background to this report that this movement is crucial to the future development and success of the BC hog industry. However, even in light of this increasing specialization, the argument that the price differential that existed within the hog industry during the period of this review was justified would be difficult to sustain in light of the particular situation, where Britco producers' experience of lower returns results directly from their historical association with that processor, and their inability to ship elsewhere.

BCFIRB thus agrees with the Hog Commission that the existing price differential was not justified. It is a fundamental premise of regulated marketing that producer payments be stable, that similar products receive similar returns, and that producers are not subject to the adverse market impacts of a concentrated processing sector. As such, after careful consideration, it is our view that the Hog Commission cannot be faulted for proceeding with equalization, in accordance with its express regulatory power.

The second possible situation in which the Hog Commission could reasonably have decided not to undertake a price equalization program despite an existing and unjustified price differential would be where the price differential, in terms of either the degree of differential or the number of producers affected, was not sufficiently significant to justify the program. Regarding the degree of differential, the Hog Commission has told BCFIRB that it chose not to institute the price program at the first observation of a price difference between Britco and Johnston producers (in the autumn of 2003), but rather to wait until that price difference was significant (in July of 2004). BCFIRB is satisfied in respect of the Hog Commission's decision in this regard.

Regarding the number of producers affected by the low prices, BCFIRB notes that at the outset of the program, there were 12 producers actively shipping market hogs to Britco, and four additional producers who had done so for some portion of the retroactive period. BCFIRB is satisfied that this represents a significant portion of the BC market hog industry at that time. As such, we agree that the Hog Commission was justified in establishing the equalization program on this front.

These two points having been made, the Hog Commission of course had, throughout the period here reviewed, responsibility to assess the ongoing utility of a price equalization program as circumstances unfolded. This point is further addressed in Section 5.2.6 of this report.

5.2 Financing, Administration and Outcomes of the Price Equalization Program

Having determined that the initial decision to implement the program was justified, BCFIRB now turns to a consideration of the financing, administration, and outcomes of the program. We wish to emphasize at the outset that, following an exhaustive review, BCFIRB found no evidence of fraud or misconduct on the part of the Hog Commission or any of the Hog Commission's directors.

This point made, BCFIRB has identified a number of concerning issues related to the program, including:

(1) The Hog Commission's use of Trust Fund investments to make price equalization payments;

(2) The inclusion of hog carcass bonuses and discounts in the calculations of equalization payments;

(3) The alteration of the hog carcass bonus/discount range in the calculation of equalization payments;

(4) Inequalities in the returns received by producers;

(5) The decision to allow direct contracting for Britco and Britco producers, while not allowing similar arrangements for Johnston and Johnston producers;

(6) The price advantage received by equalization program participants relative to producers under direct contract to Britco beyond August 19, 2005;

(7) The uneven application of the $0.02/kg deduction meant to replenish investments in the Hog Commission Trust Fund; and

(8) The outstanding equalization balances existing as of December 31, 2006 for some producers.

5.2.1 Use of Trust Fund Investments to make Price Equalization Payments

As described in the background to this report, the Hog Commission decided that the price equalization program would be funded by cashing in investments in the Trust Fund. These investments had accrued through levies collected from producers over the period of the Hog Commission's operation. KPMG reviewed the audited financial statements released by the Hog Commission for 2004, 2005, and 2006. They summarized the cash and investment balances of the Hog Commission's Trust Fund at the three fiscal year ends as follows:

	December 31, 2004	**December 31, 2005**	**December 31, 2006**
Trust Fund Cash	$62,457	$118,322	$21,958
Trust Fund Investments	$245,438	—	—
Total	$307,895	$118,322	$21,958

The Hog Commission has confirmed that the Trust Fund investments were cashed in 2005 and used to facilitate the equalization payments for Britco producers. The Hog Commission indicated that these investments were used in response to pressure from producers who wished to receive equalization payments more quickly than they would have had the program been funded by a dedicated levy alone. The Hog Commission has also stated that while it had originally planned to replenish the Trust Fund investments through a $0.02 per kilogram of production levy that would be applied to all producers, it was not successful in implementing this plan (this is discussed in detail in Section 5.2.7 of this report). The Hog Commission's 2006 financial statements indicate that the investments had not been replenished by December 31, 2006, the end of the period of this supervisory review.

Under Section 11(1)(o)(v) of the *NPMA*, the Hog Commission has the authority to establish reserves such as the investments that it maintained in its Trust Fund. The *NPMA* provides that any reserves held by the Hog Commission must be used within the parameters of the Scheme. Other marketing boards in BC have established similar reserves.

BCFIRB has identified two concerns related to the Hog Commission's use of Trust Fund investments to fund their price equalization program. The first concern pertains to the Hog Commission's decision to use the full balance of the investments for the price equalization program, seemingly without consideration of other possible programs or activities that might wisely have been viewed as industry priorities.

The Hog Commission did not have formal Terms of Reference for its Trust Fund to clearly specify the conditions under which its investments could be used. BCFIRB believes that all marketing boards and commissions maintaining financial reserves should establish such Terms; we return to this concern in Section 5.3.3 of this report. However, the Hog Commission has verbally indicated that the investments in the Trust Fund account were intended to be used for emergency situations. BCFIRB is not convinced that the equalization program was a program of suitable urgency to justify the full disbursement of the Hog Commission's significant investments.

BCFIRB appreciates the difficult position of BC hog producers and the industry more generally due to economic pressures in recent years. Nonetheless, we observe that there are additional threats, such as flooding or other natural disasters and disease outbreaks, which have real potential to compromise the hog industry in this province, whether alone or in combination with the economic challenges the industry currently faces. These emergencies could have serious negative impacts for a wider range of producers than those experiencing a price disadvantage during the period of this review. BCFIRB is of the view that at least part of the investments in the Trust Fund would more appropriately have been reserved for assisting with such an emergency situation.

Furthermore, BCFIRB notes that during the period reviewed in this report, the Hog Commission ought to have been responding to the priorities identified in the 2004 View West Review and by BCFIRB upon the appointment of an independent chair in 2005. In this regard, the Hog Commission might wisely have used some of their investments to support a strategic planning process for the BC hog industry. BCFIRB will return to the subject of strategic planning in Section 5.3.1.

BCFIRB's second concern regarding the Hog Commission's reliance on Trust Fund investments to fund the price equalization program relates to the fact that this decision created a program that would be impossible to sustain over the long term. In light of the possibility of a lasting price difference, an equalization program funded directly through a dedicated levy would have been preferable to funding the program through Trust Fund investments.

5.2.2 Inclusion of Hog Carcass Bonuses and Discounts in Equalization Calculations

As noted above, the differing returns received by Johnston as compared to Britco producers at the outset of the equalization program resulted from differences in both the base prices and the sizes and ranges of the carcass bonuses and discounts offered by each processor. Johnston's higher overall price was comprised of a relatively higher base and smaller bonus, while Britco's lower overall price was comprised of a relative lower base but larger bonus.

The Hog Commission elected to equalize on the average net price, rather than the average base price. That is, the Hog Commission included the average carcass bonuses/discounts received by Britco producers at their home processor in their calculation of the average price per kilogram received by those producers. Similarly, the Hog Commission calculated an average carcass bonus/discount that these producers would receive at Johnston as part of the proxy return that they would receive therein. These net prices were used to establish the price differential and from this the equalization balances accruing to Britco producers.

In assessing the Hog Commission's decision to equalize on net price, rather than base price, BCFIRB has again considered that during the review period, producers were not able to freely contract with their processor of choice. Rather, processor affiliation—and thus both the base price and the carcass bonus/discount program available to a producer—was dictated by historical arrangements.

We have noted above our view that equalization was an appropriate regulatory response from the Hog Commission in this context. We have also determined that the Hog Commission's decision to equalize on net price by including average carcass bonuses/discounts in the equalization calculations is acceptable in the particular circumstances here.

In making this determination, we do however wish to note one reservation. By including carcass bonuses/discounts in equalization calculations, the Hog Commission was effectively equalizing on a hog quality attribute, the achievement of which results from individual producer effort and skill. Equalizing on weight bonuses/discounts may in some circumstances act as a disincentive for producers to meet quality-related market demands, as producers may benefit from others' efforts in these areas without applying similar efforts themselves. As a general rule, individual producers of regulated products are better served by being rewarded for their individual efforts and achievements with respect to product quality. In the long run, this will ensure that producers and regulated sectors remain responsive to quality-related market demands. BCFIRB believes that such responsiveness will be particularly important for the future of the BC hog sector, given the significant opportunities associated with quality-oriented and value-added pork products in this province, as highlighted in the background to this report.

As such, while BCFIRB has concluded that equalizing on net prices, rather than base prices was an acceptable regulatory response for the Hog Commission in the particular circumstances here, we note that the Hog Commission also has an ongoing responsibility to proactively encourage the development and servicing of emerging markets, particularly in light of the possibility that pooling could act as a disincentive in this regard.

5.2.3 Alteration of the Hog Carcass Bonus/Discount Range in Equalization Calculations

The Hog Commission calculated equalization payments by using a pricing template designed to determine the returns that equalization program participants would receive had they instead been producing under contract to Johnston. This pricing template matched the Johnston contract in all respects except for the following alterations to the weight ranges over which carcass weight discounts and bonuses were applied:

- The point below which low weight discounts were applied was increased from 60 kilograms in the Johnston contract to 70 kilograms in the Hog Commission’s pricing template.

- The weight range over which a weight bonus was applied was shifted from 79-85 kilograms before May 16, 2005 and 78-86 kilograms after May 16, 2005 in the Johnston contract to 85-95 kilograms in the Hog Commission’s pricing template.

- The point above which high weight discounts were applied was increased from 95 kilograms before June 13, 2005, and 93 kilograms after June 13, 2005 in the Johnston contract to 105 kilograms in the Hog Commission’s pricing template.

The Hog Commission has argued that these alterations were necessary because Britco required a larger hog than did Johnston during the equalization period. The Hog Commission stated that leaving the bonus/discount range unaltered would unfairly penalize Britco producers for producing the heavier hogs that their processor desired over the lighter hogs desired by Johnston.

KPMG took the position that the alteration of the carcass bonus/discount range in the pricing template resulted in an overstatement of the equalization balances calculated as owing to producers in the price equalization program by the Hog

Commission. For all producers in the program collectively, the overstatement amounted to $217,073. These balances had not been paid in full as of December 31, 2006 due to the time lag discussed in the background to this report, as well as the Hog Commission's decision to withhold a $0.02/kg levy against equalization program participants in order to rebuild Trust Fund investments. However, the full balances would eventually be paid out with the continuation of the equalization program into 2007.

The overstatement noted by KPMG results from the way that the Hog Commission calculated the price differential, and specifically its decision to equalize Britco producers to a proxy price representing what those producers would have received under contract to Johnston, rather than equalizing them to the average price actually obtained by Johnston producers (see Section 5.2.4). The Hog Commission has told BCFIRB that it made this decision because it was regarded as fairer to rely on the actual production data of the Britco producers as a group in determining the equalized price that these producers would receive, rather than on the data of an outside group of producers, in this case the Johnston producers.

BCFIRB supports the intent of the Hog Commission to ensure that the returns received by a producer through the equalization program reflect as much as possible the actual production of that producer, while still allowing for a practical calculation method. Indeed, this is the source of our reservation regarding the Hog Commission's decision to equalize on net, rather than base prices, as described in the last section of this report. While we accept that it is difficult to assess both the relative costs of production experienced by Britco versus Johnston producers, and also the relative skill that would be required to meet each processor's specifications, we accept the Hog Commission's argument that to leave the carcass bonus/discount ranges unaltered could unfairly penalize Britco producers for producing according to their processor's specifications. Hence, BCFIRB does not agree with KPMG's observation that there has been an overstatement in equalization balances resulting from the alteration of these ranges[16]. BCFIRB's concerns about balances accrued by participants in the program after August 19, 2005, and hence further payments on balances outstanding as of December 31, 2006, are discussed in detail in Sections 5.2.6 and 5.2.8 of this report.

5.2.4 Unequal Producer Returns

KPMG calculated the average returns (i.e., average net price per kg) received by participants in the equalization program before equalization payments were issued, the average returns received by the end of the review period (December 31, 2006), and the

[16] BCFIRB has also observed that the adjustments which the Hog Commission made to the upper and lower limits of the carcass weight bonus and no-discount windows in the pricing template used to calculate the proxy return (representing the price Britco producers would receive at Johnston) effectively widened these windows relative to those applied to Johnston producers under the actual Johnston contract. Although BCFIRB had some questions as to whether this widening was valid and justifiable, we have not explored this issue in light of our decision to accept the mechanisms used by the Hog Commission to calculate equalization payments.

average returns that participants would receive after all outstanding equalization balances had been settled[17]. KPMG compared these three sets of returns with:

- the average return that those producers would have received had they shipped their hogs under direct contract to Britco;
- the average return that those producers would have received had they shipped their hogs under the Hog Commission contract to Johnston;
- the average return received by Britco direct contract producers; and
- the average return received by Johnston producers.

The returns documented by KPMG give rise to six findings:

(i) Returns paid to equalization program participants as of December 31, 2006 relative to returns that these producers would receive after payment of equalization balances that remained outstanding on December 31, 2006: Equalization program participants have not been paid in full for the equalization owing on production they completed between January and December 2006, due to a time lag created by the Hog Commission's decision to pay out equalization at a fixed rate tied to continued production. As such, the returns that program participants had received by December 31, 2006 for production in that year were lower than the returns that producers will eventually have received for these periods once their outstanding equalization balances have been paid[18]. Payment of the outstanding balances would occur through continuation of the equalization program beyond the period under review (see Section 6.0).

(ii) Returns to equalization program participants relative to what the same producers would have received under the Hog Commission contract to Johnston: Once equalization balances outstanding as of December 31, 2006 have been settled, the average price per kilogram received by equalization program participants will be equivalent or higher than the average price per kilogram that the participants would have experienced under the Hog

[17] At the close of this review period, program participants had not been paid the full equalization balances owing for their production in 2006, due to the time lag in equalization payments. As such, the returns that producers had received for these periods by the end of the review period do not equal the eventual returns they will have received after all outstanding equalization balances have been settled through the continuation of the program beyond the period of this review (see Section 6.0).

[18] In actuality, the fact that producers in the price equalization program had not received their full equalization payout at the end of the review period modifies the other findings in this section. Specifically, it decreases the price advantage enjoyed by equalization program participants over Britco direct contract producers from January to
March 2006, leads to a price disadvantage as compared to these producers from April to June 2006 and from October to December 2006, and increases the price disadvantage that would exist relative to Britco direct contract producers from July to Sep 2006. Similarly, the price disadvantage of equalization program participants relative to Johnston producers that would exist for every quarter of 2006 is in each quarter increased.

Commission's term contract with Johnston in every period from July 2004 through December 2006. The relatively lower returns that equalization program participants would have received from Johnston are at least partly due to the fact that they were producing hogs that were heavier than the target weight preferred by that processor (see Section 5.2.3).

(iii) Returns to equalization program participants relative to what the same producers would have received under direct contract to Britco: Once equalization balances outstanding as of December 31, 2006 have been settled, the average price per kilogram received by equalization program participants will be higher than the average price per kilogram that the participants would have experienced under direct contract to Britco in every period from August 19, 2005 (the date on which direct contracts were first initiated), through to December 2006, excepting from July to September 2006. Equalization program participants made less in the program than they would have made under direct contract to Britco from July to September 2006, because for this period the shipping bonus offered by Britco to direct contract producers—which was increased from $3/hog to $6/hog in March 2006—compensated for the price differential between what Britco producers participating in the program received and what they would receive under contract to Johnston. Outside of this six-month period, the shipping bonuses were too small to compensate for the overall price difference.

(iv) Returns to equalization program participants relative to returns to Johnston producers: Once equalization balances outstanding as of December 31, 2006 have been settled, the average price per kilogram received by equalization program participants will be equivalent to the average price per kilogram received by Johnston producers from July 2004 to August 19, 2005, and will lower than the average price per kilogram received by Johnston producers in subsequent periods through to December 2006.

(v) Returns to equalization program participants relative to returns to Britco direct contract producers: Once equalization balances outstanding as of December 31, 2006 have been settled, the average price per kilogram received by equalization program participants will be higher than the average price per kilogram received by Britco direct contract producers in every period from August 19, 2005 through to December 2006, excepting from July to September 2006.

(vi) Returns to Britco direct contract producers relative to Johnston producers: Since these producers did not participate in the equalization program, they had received all payments owing to them by December 31, 2006. Britco direct contract producers received lower returns in every portion of the review period from August 19, 2005 to December 2006.

BCFIRB is not convinced that the Hog Commission has clearly communicated these outcomes of the price equalization program to hog producers impacted by the program.

The findings reveal that after August 19, 2005, Johnston producers enjoyed a price advantage over program participants, an advantage that would continue even after all outstanding equalization balances were paid out. This contrasts with the original intent of the program, as communicated by the Hog Commission, which was to equalize both Britco and Johnston producers to the average price obtained in the industry.

The Hog Commission has indicated that it regularly tracked the prices received by both groups of producers, and was aware of the differing returns. However, rather than adapt the program to pursue precise equality of prices, it elected to continue with the existing format, on the grounds that increasing the returns received by program participants, and hence narrowing the price gap between these producers and Johnston producers, was sufficient to address price inequalities in the industry.

BCFIRB accepts that Britco producers participating in the price equalization program and Johnston producers received different returns. In this case, we are satisfied that through their calculations of equalization balances and payments, the Hog Commission's intent was to ensure that the two producer groups would receive equitable treatment. BCFIRB agrees that perfect equality would have been difficult to attain, and that equitable treatment was a legitimate regulatory objective of the program.

BCFIRB is, however, concerned about the price disadvantage that producers entering direct contracts with Britco or after August 19, 2005 will have faced, relative to equalization program participants, once all equalization balances have been settled, in all but the three month period from July to September 2006. We will discuss this issue in more detail in Section 5.2.6.

5.2.5 Decision to Allow Direct Contracting for Britco but not Johnston Producers

On July 27, 2005, the Hog Commission modified its Consolidated Order to allow the Hog Commission to exempt processors or vendors from the requirement of having a term contract with the Hog Commission, and of issuing payment to the Hog Commission rather than directly to producers. The Hog Commission then granted such an exemption to Britco, enabling that processor to form direct contracts with producers, which that processor did beginning
August 19, 2005. At the same time, the Hog Commission decided that it would not offer a similar exemption to Johnston and Johnston producers, such that those parties would be required to continue with the term contract between Johnston and the Hog Commission, and with remitting payment to the Hog Commission as first receiver of funds.

During the industry meetings coordinated by BCFIRB in October 2006, a number of producers expressed a concern that allowing Britco producers to establish direct contracts with that processor, while not allowing Johnston producers to establish similar relationships with their processor, was unfair. BCFIRB agrees with the assessment that this creates an imbalance between one processor and its producers and the other. Direct contracts were recognized in the 2004 View West report as important to both supporting quality-oriented production (in line with industry trends), and enhancing producer recognition of the role and importance of processors within the hog industry. Producers and processors who were allowed by the Hog Commission to establish direct contracts could enjoy a competitive advantage as compared to those who were not. As such, BCFIRB is of the opinion that if, after considering the long term implications of direct contracting for processor prices, the Hog Commission was persuaded to allow such arrangements, it ought to have done so for both processors.

5.2.6 Price Advantages Received by Equalization Program Participants Relative to Producers under Direct Britco Contracts beyond August 19, 2005

The Hog Commission decided that any Britco producer electing to establish a direct contract with Britco on or after August 19, 2005 would not receive equalization payments on subsequent production. The Hog Commission based this decision on a promise from Britco that a per hog shipping bonus would be paid to all direct contract producers. The Hog Commission believed that the bonus would raise the returns received by producers under direct contract to Britco to a sufficient extent that they would no longer require equalization. Britco producers who did not initiate direct contracts, but instead continued with the existing relationship, would not receive the shipping bonus, and would thus continue to receive equalization payments.

As discussed in Section 5.2.4, once all equalization balances have been settled, producers under direct contract to Britco received lower returns than equalization program participants for all but three months (July to September 2006) of the reviewed period. That is because, outside of this three month period, the shipping bonus did not make up for the price differential between what Britco producers participating in the program received and what they would receive under contract to Johnston, as calculated by the Hog Commission. On this basis, KPMG questioned the Hog Commission's decision to exclude Britco direct contract producers from the price equalization program, which KPMG suggested could be seen as unfair.

BCFIRB accepts that the decision to initiate a direct contract with Britco, rather than to continue with the existing relationship, lay with the producer. Nonetheless, in the event that direct contracting resulted in a price disadvantage to producers who entered such arrangements, and that the Hog Commission was aware of this situation, the Hog Commission would have a regulatory responsibility to address this disadvantage.

The Hog Commission has indicated that it was aware of the prices received by Britco direct producers as the program progressed. It realized that a price differential existed between these producers and equalization program participants for most of the period here reviewed.

BCFIRB has not found evidence that this situation was communicated to the producers with direct contracts. The Hog Commission has said that it did communicate that a producer who had entered a direct contract with Britco was free to return to going through the Hog Commission, but that no one approached the Hog Commission to do so. BCFIRB does not know whether this is because the direct contract producers did not understand that they were receiving significantly lower returns on average than other producers, or whether these producers were aware of this situation, but chose not to return to the Hog Commission for other reasons.

BCFIRB is of the view that when the Hog Commission—despite its understanding that Britco direct contract producers were receiving lower returns than equalization program participants—did not provide equalization for the direct contract producers, it effectively made a regulatory decision that the price being received by the direct contract producers was still sufficient so as to make it unnecessary for them to receive equalization. In other words, the Hog Commission elected to accept a wider price differential between its two main groups of producers. We believe that following this decision, the Hog Commission was necessarily required to consider a series of related regulatory options to meet its regulatory duty to treat all producers fairly, and so avoid having two classes of Britco producers.

One option would have been to encourage the three producers remaining in the program beyond November 19, 2005 to themselves initiate direct contracts with Britco, so that all Britco producers would be on an equal footing. The Hog Commission could then cease equalization altogether. BCFIRB observes that with eight producers under direct contract to Britco and only three producers continuing in the program beyond November 2005, the circumstances were clearly different than those that had prevailed when the program was commenced. Further, there would be little incentive for equalization program participants to secure a stable and desirable pricing agreement with Britco if they were receiving extra money by continuing their existing relationship.

The Hog Commission has argued that maintaining some Britco producers outside of direct contracts was useful or necessary. It has suggested that this gave the Hog Commission a better bargaining position in its negotiations around hog prices with Britco. However, BCFIRB has not found any evidence that this was resulting in increases to Britco's price over the duration of the program. Furthermore, a direct contracting environment would not necessarily have prevented the Hog Commission from participating in price discussions in order to assist all producers.

The Hog Commission also stated that Britco was simply unwilling to accept the three producers who continued to participate in the price equalization program beyond November 2005 under direct contracts. BCFIRB has not confirmed that this was the case. However, BCFIRB is of the view that if it were the case that a few Britco producers had no option for direct contracting, the Hog Commission would still have had to consider an alternative regulatory option to avoid having two classes of Britco producers.

In this case, the Hog Commission ought to have considered whether it needed to adjust the equalization payments it was making to participants in the price equalization program, to equalize participants to the price which they would have received, were they under direct contract to Britco (i.e., rather than to the price which they would have received under contract to Johnston). This would prevent payments being made that the Hog Commission had already determined were unnecessary for the direct producers. To pay out unnecessary equalization funds is obviously not sound marketing policy.

In all of the circumstances, BCFIRB does not accept the Hog Commission's decision to continue the equalization program, unaltered in format, beyond August 19, 2005. Once the decision was made not to equalize producers under direct contract to Britco, the price received by these producers should have served as the target of the Hog Commission's equalization program. The failure to adjust the equalization program accordingly means that equalization balances calculated as owing to program participants for their production beyond this date and perhaps a portion of the equalization payments made on these balances by the end of the review period, were greater than they otherwise would have been.

5.2.7 Uneven Application of the Program Levy

The Hog Commission's second pooling proposal, approved at the May 27, 2005, meeting, specified that a $0.02 per kilogram of production levy would be applied against all producers of market hogs in the province for the duration of the equalization program. According to the minutes for this meeting, the levy was meant to rebuild investments in the Hog Commission's Trust Fund, which would be drawn upon at least in the short term to fund the equalization program.

The Hog Commission began applying the levy on all production completed by BC hog producers, regardless of processor, beginning June 3, 2005. However, only a few weeks later Johnston protested the application of the levy to its producers, and started paying those producers directly. The Hog Commission has stated that in light of this development it stopped applying levies to producers other than those in the price equalization program on August 26, 2005[19]. The Hog Commission did not return to levying Johnston producers after most indicated that they wished to continue being paid through the Hog Commission on November 9, 2005[20]. The Hog Commission elected not to pursue outstanding levies, despite BCFIRB's confirmation in meetings with them in September 2005 that it had regulatory authority to do so, and that in fact it had a regulatory duty to enforce its orders. As a result:

[19] KPMG notes that Hog Commission records suggest that this levy was actually applied through to November 11, 2005. There is a discrepancy between this and the Hog Commission's statement that the levies were ceased on August 26, 2005.

[20] According to the Hog Commission, producers shipping their hogs to Hertel also paid the $0.02/kg levy from
June 3 to August 26, 2005. KPMG notes that Hog Commission records suggest that this levy was actually applied through to November 11, 2005.

(i) Johnston producers paid the levy on production completed between June 3 and
August 26, 2005. They have not paid the levy on production completed subsequent to August 26, 2005.

(ii) While the levy was not initially applied to the first lump sum equalization payment made to each Britco producer for the retroactive period (constituting 65% of the equalization owing for production in that period), an equivalent deduction for this period was later subtracted from each producers' equalization balances. As such, the equalization payments made to Britco producers for the remainder of their production in the retroactive period, and for their production beyond this period but before they established direct contracts with Britco (where applicable), took into account the levy owed for the initial lump sum payment.

(iii) Those producers who continued to participate in the equalization program, rather than moving to direct contracts with Britco, have had the deduction applied to the remaining 35% of the equalization owing for production completed in the retroactive period, and to their production in quarters subsequent to those periods. The two producers who continued to work through the Hog Commission for some time before switching to direct contracts with Britco paid the deduction on the production they completed before the switch.

(iv) The deduction was not applied against production completed by producers who entered direct contracts with Britco subsequent to their initiation of the direct contract.

What is evident in this assessment is that the program levy has been applied unevenly against different producer groups. This is difficult to justify given the intent of the equalization program, as discussed above. Equalization levies must, by nature, be universal. It is difficult to understand how one group of producers can fund their own equalization.

5.2.8 Equalization Balances Outstanding as of December 31, 2006

KPMG identified three groups of producers with outstanding equalization balances at December 31, 2006, the end of the reviewed period.

Firstly, KPMG identified four producers who went out of business during the portion of the Hog Commission's equalization program covered in this review. KPMG calculated that these four producers had unpaid equalization balances that together totalled $5,771.00. In the case of each producer, the outstanding balance represents equalization owing on production they completed during the retroactive period and/or in periods subsequent to the retroactive period, but before they moved to a direct arrangement with Britco (where applicable), and before they went out of business.

These producers had not received the full amount of equalization owing on this production at their time of closure due to the time lag in equalization payments discussed earlier in this report. Further, they did not receive payments on their equalization balances going forward because equalization was tied to continuing production. As such, when the producers closed they ceased receiving equalization payments, even though these payments covered production that had already been completed, and even as other producers who continued to produce hogs, continued to receive equalization payments. At the end of the period reviewed in this report, these continuing producers have received their full equalization balances for periods subsequent to the closure date of the last of the four producers to go out of business, while the out-of-business producers have not received full payment for preceding periods.

The Hog Commission has noted that this issue has come to the attention of their board members, but has not been resolved.

KPMG has noted that the outstanding balances owed to the four producers could be considered unfair, as it could be argued that the out of business producers should receive their equalization for completed production periods before anyone else receives equalization for subsequent periods. BCFIRB agrees with this assessment, and is of the view that the Hog Commission ought to have paid out the outstanding equalization balances owed to these producers for the production they had already completed.

Secondly, KPMG reported that two producers had significant outstanding equalization balances because, after moving to direct contracts with Britco, they did not give the Hog Commission permission to access their production data. The Hog Commission required this information to make equalization payments because these payments were tied to continued production. The Hog Commission has indicated that in one case, conflict between the Hog Commission and the producer led to the producer choosing to discontinue any further relationship with the Hog Commission. BCFIRB believes that it is the responsibility of all parties to a working relationship to ensure the smooth functioning of that relationship. In this case both the producer and the Hog Commission are responsible for ensuring that the relationship between them remains positive. However, we cannot fault the Hog Commission for declining to make payments when a producer does not provide necessary information to its regulatory agency.

Thirdly, KPMG reported that each of the producers who continued in the equalization program beyond November 2005 has significant outstanding equalization balances. Again, this results from the time lag in equalization payments. These balances would continue being paid with continuation of the equalization program into 2007 (see Section 6.0). However, in light of our comments regarding the adjustments that the Hog Commission ought to have made to the program beyond November 2005, as discussed in Section 5.2.6, BCFIRB is not confident that these balances should be paid out as they stand. We issue specific directions to the Hog Commission on this issue in Section 7.0 of this report.

5.3 Governance of the Price Equalization Program

The last group of issues raised in BCFIRB's review of the Hog Commission's price equalization program pertain to the governance and administration of the program. BCFIRB identified four main issues in this area:

(1) The lack of an industry strategy, developed by the Hog Commission, to guide the Hog Commission in designing and implementing its price equalization program;

(2) The conflict of interest situations presented by the involvement of two directors who were also beneficiaries of the price equalization program in decisions relating to the program, and in the calculation of equalization settlements;

(3) The lack of formal Terms of Reference for the Trust Fund maintained by the Hog Commission; and

(4) The lack of transparency surrounding the equalization program.

These issues are addressed in turn, below.

5.3.1 Lack of an Industry Strategy to Guide the Price Equalization Program

As noted in the background to this report, the need for a clear and cohesive strategy for the BC hog industry has been repeatedly emphasized by industry analysts. The 2004 View West report suggested that "[i]f the [hog] industry in BC is to survive in the long-term, it needs to come up with a strategy to turn the decline around. As an industry body the Hog Marketing Commission along with the assistance of the BC Pork Producers Association and the processors should develop that strategy." BCFIRB agrees that the Hog Commission has a leadership role to play in the development of an effective industry strategy. The Hog Commission was directed by BCFIRB to develop such a strategy at the appointment of an independent chair in 2005. Unfortunately, in the course of this review, BCFIRB found no evidence that the Hog Commission has undertaken meaningful action on this direction.

BCFIRB acknowledges that BC hog producers are today faced with very challenging economic circumstances, but also that circumstances were somewhat less challenging when the Hog Commission commenced its equalization program in 2005. We observe that quite aside from any benefits that an industry strategy might have played in helping producers to face the difficult times that have since come to pass, such a strategy would certainly have been useful in guiding the Hog Commission in the development and implementation of the price equalization program. It could have also helped resolve some of the conflicts and concerns that have arisen around the program.

As part of a well-developed industry strategy, the Hog Commission's price equalization program would not have been an isolated mechanism, but would have been created and administered with a view to complementing activities or measures designed to move the industry in the preferred direction and resolve conflicts encountered along the way.

The Hog Commission has indicated that the major problem underlying the equalization program was the relatively low price offered by Britco as compared to Johnston for hogs produced in BC. That being so, one would expect, in addition to equalization, a concerted effort by the Hog Commission directed at developing a multi-faceted industry strategy that would work with the entire pork value-chain to increase this price. The decision to allow direct contracting would have been assessed in this light. Further, the Hog Commission could actively explore alternative processing markets for BC pork. However, BCFIRB found no evidence in this review that the Hog Commission was seriously pursuing these goals.

Given that the prices paid by Johnston were held by the Hog Commission to be more appropriate or desirable than those offered by Britco, an appropriate strategic plan for the BC hog industry would have been to ensure that any course of action taken by the Hog Commission would not compromise producer relationships with Johnston, or the prices that this processor paid. Yet, it appears that relations have become strained between the Hog Commission and Johnston, at least in part due to the Hog Commissions decision not to allow Johnston to establish direct contracts with producers, while allowing Britco to establish such contracts.

5.3.2 Conflict of Interest Situations in the Governance of the Price Equalization Program

In the process of conducting this supervisory review, BCFIRB has found that two of the directors of the Hog Commission, Mr. Jerry Gelderman and Mr. Ron Boes, have received price equalization settlements. We have confirmed that Mr. Gelderman participated in the price equalization program for the full duration of the program covered by this review, that is, from July 1, 2004 to December 31, 2006. Mr. Boes participated in the program between July 1, 2004 and October 7, 2005, whereupon he entered a direct contract with Britco.

BCFIRB has also found that Mr. Gelderman was extensively involved in the day-to-day running of the Hog Commission and in the administration of the equalization program. Mr. Gelderman prepared all of the figures and calculations relating to the payments distributed through the Hog Commission's equalization program. Furthermore, Mr. Boes had the responsibility of checking Mr. Gelderman's figures to ensure that they were appropriate and in order.

KPMG analysed the overall benefit of the equalization program to Mr. Gelderman relative to what he would have made had he instead received the average return paid to Britco direct producers or the average return paid to Johnston producers, respectively. KPMG's findings suggest that Mr. Gelderman had, at the end of the review period, received slightly less through the equalization program than he would have had he produced under direct contract for Britco, and considerably less than if he had produced for Johnston. However, Mr. Gelderman currently has a substantial outstanding balance in his equalization account, as discussed in Section 5.2.8, since he has not yet received his full equalization payment owing for production completed between January and December 2006. Were this outstanding balance paid out, Mr. Gelderman would, by way of his participation in the Hog Commission's price equalization program, have made somewhat more than if he had produced under direct contract for Britco, though still significantly less than if he had produced for Johnston. However, his benefits under this circumstance would not be substantially higher than the two other producers who also continued to participate in the equalization program as of December 31, 2006.

KPMG did not calculate the relative benefit that participating in the price equalization yielded for Mr. Boes, who established a direct contract with Britco as of October 17, 2005, and who has since received the full equalization balance owing to him. However, since Mr. Boes ended his participation in the program along a similar timeline to the nine other producers who also moved from the equalization program into direct contracts with Britco between August 19 and November 11, 2005, BCFIRB expects that the benefits Mr. Boes enjoyed would not be out of line with those enjoyed by the other Britco direct contract producers. As with these other producers, Mr. Boes would generally have experienced a price disadvantage as compared to Johnston producers beyond August 19, 2005.

In view of KPMG's findings, BCFIRB is satisfied that neither Mr. Gelderman nor Mr. Boes has enjoyed any improper personal benefit arising from their involvement in decisions pertaining to and calculations in support of the Hog Commission's price equalization program. Nonetheless, BCFIRB observes that the perception of a conflict of interest exists and is valid given the involvement of the two men in the governance and administration of the program.

The first conflict situation regards the participation of Mr. Gelderman and Mr. Boes as directors in decisions regarding the implementation and continuation of the equalization program during periods when they were beneficiaries of the program. BCFIRB agrees with the observation of the appellants in the Schutte/Binnendyk Appeal that this raises a reasonable apprehension that decisions around the program could be impacted by the producer interests of the two directors. To address these concerns, BCFIRB is of the view that both of these directors ought to have abstained from participating in decisions relating to the program during periods when they would be entitled to the benefits of the program.

The second conflict situation regards the involvement of Mr. Gelderman and Mr. Boes, as beneficiaries of the program, in equalization program calculations and administration. This situation raises an apprehension that, like decisions related to the program, the program calculations could be impacted by the producer interests of the two Directors. It also highlights the need to improve internal financial controls. To address these concerns, BCFIRB believes that Hog Commission staff ought to have undertaken the calculations necessary to administer the equalization program. While the Hog Commission no longer maintains a General Manager, Hog Commission staff do currently handle many aspects of the operation of the equalization program (for example, tracking weekly prices, issuing cheques to producers, etc.). As such, the Hog Commission staff appear to have the capability that would be required to undertake the equalization program calculations and administration.

5.3.3 Lack of Terms of Reference for the Hog Commission's Trust Fund

The Hog Commission did not have formal Terms of Reference for its Trust Fund, which at the outset of the price equalization program held significant investments amassed through levies collected over the period of the Hog Commission's operation. These investments were disbursed through the Hog Commission's price equalization program.

As discussed in Section 5.2.1 of this report, the Hog Commission did have the authority to maintain reserves such as the Trust Fund investments, and to use them in accordance with the *Scheme*. However, BCFIRB is of the view that Terms of Reference for the fund could have ensured that the significant investments therein would be available to be used to fund other programs and activities which the Hog Commission might wisely have considered priorities, such as maintaining a reserve for responding to emergency situations, or investing in strategic planning for the BC hog industry (see Section 5.3.1).

5.3.4 Lack of Transparency around the Equalization Program

The Schutte and Binnendyk appeal alleged that processes related to the equalization program were not clear and transparent. This concern was shared by other producers in the industry meetings, who noted a lack of producer consultations and a lack of transparency in Hog Commission decisions.

After completing this review, BCFIRB cannot conclude that the Hog Commission has made sufficient effort to ensure proper transparency of the price equalization program to producers and other industry participants. Details of this complex program, its operation, and its outcomes, were likely not fully apparent to producers and other industry participants, even as they were being impacted by the program.

Certain records related to the program and the operation of the Hog Commission, including the minutes of Hog Commission meetings where key decisions regarding the program were made, contain an insufficient level of detail. The Hog Commission does not appear to have always provided producers with adequate information or to have solicited their input prior to making program-related decisions. Decisions taken and their implications were not always clearly communicated to producers, nor were key outcomes of the equalization program. Neither did BCFIRB find evidence that the Hog Commission clearly consulted and communicated with Britco and Johnston about its equalization activities. The Hog Commission's performance in these areas is disappointing. Open communication within an industry is central to developing positive working relationships and to the quick resolution of emerging issues.

BCFIRB observed in its meetings with the BC hog industry in October 2006 that producers and processors have many questions and concerns about the program. This has contributed to industry divisiveness. That is unfortunate, particularly in light of recent reports highlighting the importance of a more closely united front for the BC hog industry if the industry is to move beyond its current challenges. The 2004 View West Recommendations paper noted that the Hog Commission "should play a stronger role in examining the interests of all components of the value-chain and methods to enhance the shared understanding of these interests as a basis to take the industry forward." Maintaining greater transparency around the Hog Commission's price equalization program could have been a central mechanism for achieving this goal.

6.0 Current Status of the Hog Commission's Price Equalization Program

During the course of BCFIRB's deliberations, BCFIRB reviewed the minutes of the Hog Commission's 2007 Board meetings. We also reviewed a registered producer list maintained by the Hog Commission, as well as a copy of the spreadsheet used by the Hog Commission to calculate the equalization payments owing to producers in the price equalization program, both current to August 16, 2007.

The minutes for the Hog Commission's January 29, 2007 board meeting note that the Hog Commission decided that it would present information on the existing price differential between producer groups to Britco direct producers, so that these producers could resolve this difference with their processor directly. BCFIRB cannot confirm that this was done. The Hog Commission also decided in this meeting that those producers participating in the price equalization program and not moving to direct contracts with Britco would cease receiving equalization Feb 12, 2007. These producers would be encouraged to go direct, although they would also be given the option of continuing to work through the Hog Commission, while not being pooled. However, the minutes for the Hog Commission's February 27, 2007 meeting note that the equalization program participants had talked to Britco, but that that processor was unwilling to accept them as direct contract producers. These producers expressed a desire to continue to be pooled. The Hog Commission then rescinded the January 29, 2007 motion to discontinue pooling. The minutes for the Hog Commission's April 25 and May 29, 2007 note that a significant price difference between the two processors continued to exist on those dates.

At the August 8, 2007 meeting between BCFIRB, the Hog Commission and KPMG, the Hog Commission told BCFIRB that since the end of period covered by this review, one of the three remaining producers participating in the price equalization program throughout the period reviewed in this report had begun shipping his hogs to Johnston, and had left the program. BCFIRB confirmed on the Hog Commission's equalization balance spreadsheet that this producer began shipping his hogs to Johnston on April 16, 2007. Between January 1 and April 16, 2007, the producer received weekly equalization payments through the price equalization program, excepting the week of January 19, 2007, when the Hog Commission records this producer as having had no production. Although the producer still has a significant equalization balance owing for production completed before moving to Johnston, the equalization balance spreadsheet showed that the producer had not received payments on this balance since changing processors.

This producer's move to Johnston left two producers in the price equalization program, one of whom is Mr. Gelderman. The August 16, 2007 version of the equalization spreadsheet provided by the Hog Commission shows that these two producers continued to receive weekly equalization payments for at least some weeks between January 1 and August 10, 2007. The second producer received payments in every week excepting February 23, 2007, when the Hog Commission records the producer as having had no production. Mr. Gelderman received payments for every week excepting those between January 19 and June 1, 2007, when the Hog Commission indicates that he was not shipping to Britco. According to the equalization spreadsheet, both producers were due to receive a further equalization payment on August 17, 2007. For both producers, payments made in the first part of 2007 would go towards reducing the equalization balance owed on production they completed in 2006.

7.0 BCFIRB Supervisory Directions

7.1.1 Interim Directions on the Hog Commission's Price Equalization Program

The fundamental finding we make in this Report is that while the Hog Commission had the appropriate regulatory authority and made an acceptable decision in embarking on the equalization program, it fell short in the design and implementation of this program in the following respects:

(1) By not making the program self-financing through a levy applicable to all producers;

(2) By enabling only one processor (Britco) to engage in direct contracting, without considering whether such a policy should extend to all processors, and in that context, considering the long term implications of direct contracting on producer prices;

(3) By continuing to make equalization payments that resulted in the returns to ongoing equalization program participants being greater than those received by Britco direct producers after it had determined that Britco direct producers did not require equalization;

(4) By not requiring all producers to pay the levies that it had established in order to rebuild the Trust Fund; and

(5) By not paying outstanding equalization balances to producers who went out of business during the price equalization program.

In addition to these shortcomings, there are a number of issues related to the Hog Commission's governance of the program.

In light of the findings made in this Report, BCFIRB provides these interim directions to the Hog Commission.

First, BCFIRB directs the Hog Commission to freeze the price equalization program effective with the Hog Commission's receipt of this report on November 14, 2007. The Hog Commission is directed:

(1) To cease issuing weekly equalization payments to participants in the price equalization program;

(2) To cease collecting the $0.02/kg deduction used to finance the price equalization program;

(3) To calculate the amounts that pooled producers continuing in the equalization program after August 19, 2005 received over the amount that Britco direct producers received, and to make recommendation to BCFIRB as to how those monies should be repaid to the Hog Commission;

(4) To calculate, in accordance with our direction at (3), all amounts due to producers who have not received their full equalization balances, and to make recommendations to BCFIRB regarding how those balances should be paid;

(5) To make recommendations to BCFIRB regarding whether the two remaining pooled producers ought to receive equalization payments of any kind, and if so, how those payments ought to be funded.

(6) To confirm to BCFIRB the dates when each group of producers were charged the $0.02/kg levy to replenish the Trust Fund, and to make recommendations to BCFIRB as to how the unequal application of this levy should be addressed.

This freeze will be in effect pending BCFIRB's further consultation with the BC hog industry, as described below, and our receipt of the Hog Commission's recommendations, specified above. BCFIRB intends to issue further directions following this consultation process.

7.1.2 BCFIRB Expectations of the Hog Commission Going Forward

In addition to applying BCFIRB's Interim Directions, BCFIRB will expect the Hog Commission to direct serious effort towards resolving the governance issues raised in this report in their future activities and operations. Going forward, the Hog Commission is directed to:

(1) Develop a strategic plan that has the purpose of assisting the BC hog industry in maintaining and enhancing industry growth and development, as was called for by the 2004 View West report. As indicated at the 2005 appointment of the independent chair, this plan is to be supported by annual operating plans that, together with the strategic plan, reflect a forward-looking, long-term industry strategy.

(2) Resolve the conflict of interest situations in the governance of the equalization program. The Hog Commission must ensure that any equalization recipients who also hold a position on the Hog Commission's board are aware of their conflict of interest and conduct themselves accordingly. The Hog Commission should also transfer responsibilities for all financial calculations and transactions related to the program to their staff.

(3) Establish Terms of Reference for the financial administration of investments accruing from levies or other deductions that the Hog Commission collects from BC hog producers. These Terms of Reference should clearly specify the purposes for which and the conditions under which these investments can be used or disbursed.

(4) Improve transparency for both hog producers and primary processors in the province around the price equalization program, the steps the Hog Commission is required to take pursuant to our directions above, and future Hog Commission initiatives. Producers and primary processors alike should be informed of Hog Commission decisions and activities, and of the outcomes of these decisions and activities.

(5) Take a proactive approach, including through dispute resolution processes, to resolving conflicts and tensions between the Hog Commission and participants, and/or between participants in the BC hog industry.

(6) Undertake ongoing monitoring of the Hog Commission's programs and activities, including future price equalization programs, amidst changing

industry circumstances that may require the adaptation or termination of these activities.

The Hog Commission must take a fair and balanced approach to implementing these directions.

BCFIRB is prepared to assist the Hog Commission in carrying out these directions. However, this does not preclude the Hog Commission from engaging the issues independently, or from pursuing other sources of support for their efforts. BCFIRB reminds the Hog Commission of the training and professional development seminars offered by the Centre for Organizational Governance in Agriculture (COGA), and supported by the BC Council of Marketing Boards and the Investment Agriculture Foundation of BC. These courses, which address various aspects of marketing board and commission governance including financial stewardship, strategic planning, decision-making, and dispute resolution, are offered two to three times per year, and have been since 2003. BCFIRB has regularly encouraged marketing board and commission participation in the seminars, on the basis that they provide attendees with the opportunity to expand their skills in areas of board governance, and enhance their effectiveness as members of their respective boards and leaders in the industry. Unfortunately, while the seminars have been very well attended by board members and staff from the province's other regulated marketing boards and commissions, as well as by BCFIRB members and staff, the Hog Commission has not had a single board or staff member attend any of the courses to date.

8.0 BCFIRB Consultation with the BC Hog Industry

BCFIRB will release this report to the Hog Commission and the BC Pork Producers Association on November 14, 2007. The report will also be sent electronically and/or delivered by courier to each producer on the producer list maintained by the Hog Commission, and to the primary processors of hogs in the province, also on November 14, 2007.

BCFIRB recognizes that this Supervisory Report may provide new information to participants in the BC hog industry, and appreciates that the release of the report may impact industry support for the price equalization program pursued by the Hog Commission, and possibly for the future activities of the Hog Commission more generally. BCFIRB's
October 2006 meetings with the BC hog industry suggested that support for the Hog Commission was already an issue for some producers and processors.

BCFIRB has called a meeting of BC hog industry representatives to discuss the Report and its findings, and to solicit industry input on these matters. The meeting will be held at
7:00 p.m. on November 21, 2007, in the Summit Room of the Ramada Plaza and Conference Centre, 36035 North Parallel Road, Abbotsford. The meeting is open for attendance to all BC hog producers, and to primary processors of hogs in the province.

It is not open to the general public. In addition to the Hog Commission and BCFIRB board members and staff, representatives of the Ministry of Agriculture and Lands will also be invited to attend.

Following the meeting and our receipt of the Hog Commission's recommendations, as specified in Section 7.0, BCFIRB will make further recommendations and issue further directions to the Hog Commission regarding the issues facing the BC hog industry.