

BRITISH COLUMBIA FARM INDUSTRY REVIEW BOARD

IN THE MATTER OF THE *NATURAL PRODUCTS MARKETING (BC) ACT*
AND A SUPERVISORY REVIEW OF THE
BRITISH COLUMBIA MILK MARKETING BOARD
ACCOMMODATION LEVY POLICY

DECISION

May 4, 2010

INTRODUCTION

1. On May 29, 2008, the BC Farm Industry Review Board (BCFIRB) initiated a supervisory review of the Accommodation Levy of the British Columbia Milk Marketing Board (Milk Board). The Milk Board is provided with authority under the *British Columbia Milk Marketing Board Regulation* to regulate the production, transportation, packing, storing and marketing of dairy products in BC. The Accommodation Levy policy which is found at Schedule 6 of the Milk Board's *Consolidated Order*, imposes a \$0.30/hectolitre (hl) charge on dairy processors for all milk or cream received and processed in BC.
2. This review stemmed from an appeal made in early 2008 by Saputo Inc. (Saputo), a Montreal-based international dairy processing company with operations in BC. Saputo's appeal sought the repeal of the Accommodation Levy and reimbursement of levies paid pursuant to that policy. BCFIRB dismissed the appeal on the basis that the 'decision' under appeal, a letter written by counsel for the Milk Board, did not in fact constitute an "order, decision or determination" of the Milk Board and therefore did not create a right of appeal. In addition, Saputo was well outside the 30 day time period set out in the *Administrative Tribunals Act* for filing an appeal of the original decision to establish the Accommodation Levy, which has existed in its current form since September 1, 2001.
3. While the appeal was dismissed, BCFIRB recognized that there were significant policy issues underlying the Accommodation Levy that could best be addressed under its general supervisory authority found in s. 7.1 of the *Natural Products Marketing (BC) Act (Act)*. Courts have interpreted this section as providing BCFIRB with the authority to review any matter related to regulated marketing and to supervise the marketing boards in a proactive fashion regarding emerging issues and conflicts within the regulated marketing industries, ranging from the specific to the systemic.
4. BCFIRB sought to resolve this matter by requesting the Milk Board, as the first instance regulator of the dairy industry, to review the Accommodation Levy and to provide a considered report on the merits of the issues raised by Saputo, including the advantages and disadvantages of adopting the course of action proposed by Saputo in its appeal. The Milk Board was encouraged to consult fully to ensure its views were informed by the input of all industry stakeholders.
5. On January 16, 2009, BCFIRB received the Milk Board's report. Neither the Milk Board's report nor further submissions received from both Saputo and the Milk Board were sufficient to allow for a resolution of the issues. Therefore, on July 16, 2009, BCFIRB advised that it would hold a supervisory hearing to examine whether the Accommodation Levy in its current form accords with sound marketing policy.

6. The supervisory hearing was held on March 8 to 11, 2010. In addition to the Milk Board and Saputo, the BC Milk Producers Association, the BC Dairy Council and Vitalus Nutrition Inc. (Vitalus) participated in the hearing.¹
7. In arriving at its decision, the panel has reviewed all submissions received during the supervisory process as well as the evidence and testimony presented at the hearing.

BACKGROUND

8. To consider whether the Accommodation Levy in its current form accords with sound marketing policy, it is useful to begin by reviewing some of its historical context.
9. Because of its perishability, any milk production system needs a mechanism to deal with milk produced in excess of processor requirements on any given day. Historically, the mechanism in BC has been characterized by a processor commitment to maintain sufficient standby plant capacity to process and store surplus milk. This standby service has come to be known as the “Plant of Last Resort” (PLR). It should be noted that in the dairy industry, there are different classes of milk depending on how the milk is used. Broadly speaking, the two classes are fluid milk, which is sold as fresh milk, and industrial milk, which is processed into other dairy products such as cheese, yogurt, butter, etc. Fluid milk receives a higher price than industrial milk.
10. The PLR service in BC was first provided in 1957 by Dairyland, the processing arm of the Fraser Valley Milk Producers Association (FVMPA). The FVMPA, a producer cooperative, had by that time already established manufacturing plants in order to generate a return for its members on the large amounts of milk not sold on the highly competitive fluid market. This excess milk was manufactured into dairy products such as butter, evaporated milk, cheese and skim milk powder.
11. In the years leading up to the establishment of the *Milk Industry Act* in 1956, there were a number of inefficiencies and inequities in the dairy industry which had an impact on consumers, distributors, processors and producers. In his influential *Report of the BC Royal Commission on Milk 1954-55*, the Honourable J.V. Clyne recognized that the FVMPA’s manufacturing plants had a stabilizing effect:

Not only has the F.V.M.P.A provided the capital to erect and equip large manufacturing plants to process and market enormous quantities of surplus which accumulate during the season of high production, but it has also borne the costs of overhead in carrying heavy inventories of the manufactured product until such time as it could be absorbed by the market. The F.V.M.P.A., by reason

¹ Vitalus is an international company with operations in BC specializing in supplying isolated food ingredients to the food processing industry.

of its manufacturing activities, has rendered possible the maintenance of the price differential, and, in the words of Dean Clement, 'it (the F.V.M.P.A.) has held an umbrella over all the producers in the area by diverting a large portion of the total production through the manufacturing facilities which it has created without controls' (p. 30).

12. In support of equalization of producer returns by means of quotas, a concept being discussed at the time of the Clyne Commission review, the FVMPA agreed to accept surplus milk from all producers in the region, including from non-members, and thus Dairyland became the first PLR in BC. Over time FVMPA merged with a number of different regional cooperatives in BC, Alberta and Saskatchewan. By 1996 the cooperative was known as Agrifoods International Cooperative Limited (Agrifoods), which operated under the trade name Dairyworld Foods (Dairyworld); it was Canada's second largest dairy cooperative.²
13. The *Milk Industry Act*, which governed the system of milk flow and equalization in the province at that time, authorized the Milk Board to direct transfers of milk between distributors of fluid milk giving rise to what is now referred to as the 'milk-on-demand' system. Because fluid milk demands a higher price and thus generates greater revenue for the producer pool, milk is directed away from the PLR as needed to meet the fluid milk demand of other plants. In the 1980's, as additional cheese processors started up operations in the lower mainland, the PLR in cooperation with the Milk Board also began directing milk for industrial purposes. In this way, the PLR is said to act as a 'balance wheel' for the milk supply in the province to maintain standby capacity to receive and process surplus milk and direct it elsewhere according to priority needs³.
14. The merging of cooperatives and plant consolidation that took place in the 1990's led the BC Milk Board, the Alberta Dairy Control Board, the Saskatchewan Milk Control Board, and the Manitoba Milk Producers to enter into a market and revenue sharing agreement known as the Western Milk Pooling (WMP) Agreement, effective March 1, 1997. The agreement included the pooling of all revenues from milk sales among producers in the four provinces.

² FVMPA merged with the Shuswap Okanagan Dairy Industries Cooperative Association to become the Fraser Valley Milk Producers Cooperative Association (FVMPCA). In 1992, FVMPCA merged with Edmonton's Northern Alberta Dairy Pool and Red Deer's Central Alberta Dairy Pool to create the western Canadian cooperative of Agrifoods.

³ BC entered the national supply management system in 1973, bringing industrial milk in BC under a federally managed quota system. Changes to the Milk Board's orders later provided the Milk Board with the power to direct "excess" milk for any use i.e. not just for fluid purposes. In 1989, the *Milk Industry Amendment Act* repealed the provisions regarding the Milk Board, and today's British Columbia Milk Marketing Board was established under the *British Columbia Milk Marketing Board Regulation* to the *Natural Products Marketing (BC) Act*.

THE ACCOMMODATION LEVY POLICY

15. There are costs associated with performing the PLR service and for many years, these costs were, at least in part, funded by two charges: a “Handling Charge” and an “Accommodation Levy”. The Handling Charge was paid to transferring dairies (i.e. the PLR) out of the producer pool at \$1.10/hl on all Class 1 (fluid milk) transfers. The Accommodation Levy, first implemented on November 1, 1986, was charged to processors at a rate of \$0.80/hl based on their industrial milk utilization⁴.
16. Over the years, the role of the PLR and the costs associated with that service were often at issue within the industry and were the subject of several reports submitted to the Milk Board. In its own November 2000 report, the Milk Board observed:

From the inception of the charges, it has never been clear for what services the Accommodation and Handling [charges] were designed to pay. Enough revenue was generated to compensate the PLR and therefore close scrutiny of the charges was not necessary. However, the charges have been irritants in the industry for many years....⁵

17. The following year saw significant changes in the BC dairy industry. In January 2001, Saputo bought the processing assets of Agrifoods, ending the producer cooperative’s long history as the PLR provider. Saputo agreed to continue operating as the PLR and to this end signed an agreement with the WMP effective August 1, 2001. Under this agreement:

Saputo agrees to have available, at one or more of its processing plants, sufficient processing capacity to ensure the exclusive processing of all Surplus Milk produced in the PLR-WMP Provinces, and Saputo agrees to process all such Surplus Milk. This holding of capacity and processing commitment is the “Plant of Last Resort Services” or the “PLR Services” for the purposes of this Agreement. (section 2.1)

The PLR agreement stipulated that Saputo was to receive an annual “standby fee” of \$5 million per dairy year for the PLR service paid jointly by the WMP members. BC’s share of this fee is approximately \$1.76 million.

18. Following Saputo’s acquisition of Agrifoods’ processing capacity, the Milk Board held consultation meetings with dairy industry stakeholders regarding matters related to milk management amidst the consolidation of dairy processing ownership in BC and throughout the Western Milk Pool (WMP) provinces. One result of these consultations was the Milk Board decision to become ‘first

⁴ Prior to November 1986, the Milk Board paid transferring dairies \$1.10/hl on all milk transfers. The accommodation levy was \$1.25/hl for the first two months, i.e. November and December 1986, before it was changed to \$0.80/hl in January 1987.

⁵ *Milk Direction in British Columbia*, BC Milk Marketing Board, November 2000.

receiver' of milk in BC. Producers now do not contract with processors directly; the Milk Board takes ownership of all milk and directs the milk to processors according to their weekly orders. This enables the Milk Board to manage the cascading 'milk-on-demand' system, whereby processors' weekly demands for milk used in Classes 1 and 2 and for cottage cheese or cream cheese are given first priority. Once these demands are met, the remaining volume of milk for use in other milk classes can be identified for delivery.

19. When the Milk Board became first receiver of milk, the \$1.10/hl Handling Charge paid out of the producer pool was dropped and the Milk Board took on the responsibilities for freight and handling logistics and directing milk to the plant requesting it. The Accommodation Levy, which had been \$0.80/hl charged to processors on industrial classes of milk, was replaced with a \$0.30/hl charge to processors on both fluid and industrial milk. The Accommodation Levy has been in effect in this, its present form since September 1, 2001.
20. The nub of Saputo's issue on this review is that under the PLR agreement it is to receive \$5 million *net* for providing the PLR service. However, by virtue of the Accommodation Levy and because Saputo accounts for most of the milk processed in BC, it is paying for the majority of the PLR service, in effect paying itself to provide a service which it argues is fundamentally for the benefit of producers⁶.

RECOMMENDATIONS OF THE MILK BOARD

21. In response to BCFIRB's May 29, 2008 letter directing the Milk Board to provide a "considered report" on the merits of the issues raised by Saputo, the Milk Board provided its views on the Accommodation Levy to BCFIRB on January 16, 2009. After reviewing the history of the policy and the submissions of the various producer and processor associations as well as Saputo, the Milk Board made no recommendations instead stating:

The Milk Board respectfully submits that it must first be recognized by the BCFIRB that primary purchasers are obligated to purchase the daily aggregate volume of "within provincial allocation" production as is necessary for the proper functioning of the national supply management system. Once this recognition is formally made real attention can be turned to whether the processors sincerely desire to move away from the "milk on demand" system that has been used for many years towards an alternative system based on direction of producers or production.

22. Saputo was critical of the Milk Board's report stating that it was not a considered report but rather was "an attempt to justify the *status quo* without ...delving into

⁶ Saputo, depending on the year, processes between 60 and 70 percent of the milk produced in BC.

the substantive issues of whether imposition of the Accommodation Levy solely on dairy processors is justified from a policy perspective”.

23. What followed was a series of responses and counter responses from the Milk Board and Saputo wherein each party took issue with the factual and legal assertions of the other. The Milk Board’s suggestion in its January 2009 letter that processors are obligated to purchase milk, tangential to this review, was eventually dropped. None of the issues raised by Saputo caused the Milk Board to reconsider its views on the Accommodation Levy. Throughout its submissions, the Milk Board maintained a clear link between the Accommodation Levy and the PLR. The Milk Board’s May 1, 2009 submission states:

...in British Columbia, the PLR maintains sufficient standby capacity to receive *all* surplus milk on behalf of *all* processors. The cost of this standby capacity is defrayed by the Accommodation Levy, which is paid by all processors based on their throughput. (italics in original)

24. Given that the supervisory panel was unable to make a decision based on the submissions received, it scheduled a supervisory hearing. The panel indicated to the parties it expected them “to specifically address whether in light of the realities of the dairy industry in 2009, it is sound marketing policy for processors to pay an Accommodation Levy to fund the PLR system or whether it is more appropriate that the Accommodation Levy be paid by producers, a combination of both, or perhaps some different system altogether.”
25. On February 10, 2010, four weeks prior to the hearing, the Milk Board advised by email from its counsel that it would be recommending a harmonized levy system implemented within the WMP as the most ‘sound’ policy for the present and for the future.
26. At the supervisory hearing, the Milk Board explained that under this proposed approach, the fluid milk price and the industrial milk price would be the same in BC as it is Alberta. The levies in BC would be the same as the ‘up charges’ in Alberta and there would be harmonization of program content. Under this approach, the Accommodation Levy would no longer exist and the BC processors’ contribution towards the costs of the PLR agreement would be paid through a higher price for milk, just as in Alberta, rather than from an Accommodation Levy. According to the Milk Board, the harmonized approach would remove \$400,000 from the pockets of producers and put it into the pockets of processors. The Milk Board argues that this harmonized approach is the best and only policy tabled in this supervisory review and it is “universally recognized” as worthy of consideration.
27. The Milk Board cautioned this panel against making “pronouncements or specific directions on what the policy should be on a go-forward basis”. There are simply

too many stakeholder interests to consider, and too many potential implications for the industry and for the relationship between producers and processors, the relationship between the WMP partners, and even the relationship between the Western and the Eastern pools and provinces, for a policy to be spelled out in detail as a result of a supervisory review.

28. Instead the Milk Board indicated its willingness to “now begin consultation” with the industry on the proposed harmonization policy with BCFIRB providing supervisory oversight, perhaps by appointing an observer to the consultations, to ensure that the industry moves quickly to implement a policy that serves the industry as a whole. While the Milk Board currently advocates the harmonized approach, it says that it is willing to consider other potential policies that might be tabled during this process. The Milk Board strongly urged the panel to let that process continue and to use its supervisory jurisdiction to guide the participants forward “as quickly as possible”.

BENEFITS OF THE PLR

29. In the past, as the dairy industry evolved and as changes were contemplated to the funding of the PLR, the Milk Board sought and received input on the role of the PLR and the costs associated with it. While the questions of ‘who should pay’ and ‘how much’ have been examined and debated in detail, the general consensus is that the PLR system is beneficial to the whole dairy industry:

- There are a number of benefits received by the dairy industry resulting from the services of a PLR. All segments of the industry participate in those benefits including producers, processors and consumers (Dunwoody and Company Report to the Board of Directors, FVMPCA, BC Dairy Industry Plant of Last Resort, December 1, 1986, page 3);
- The services provided by the PLR benefit all industry participants because of the integrated nature of the market. The industry’s portion of the costs of providing the plants should therefore be allocated to processors and producers (Dunwoody and Company Report to the Board of Directors, FVMPCA, BC Dairy Industry Plant of Last Resort, December 1, 1986, page 6);
- The BC charges are shared between the producer (the \$1.10/hl charge) and the industrial processor (\$0.80 /hl accommodation charge). There is a small indirect benefit to processors of a plant of last resort because of stabilization created in the industry. We believe that both fluid and industrial processors benefit equally. It is therefore not reasonable to charge this amount on industrial milk only. Moreover, since the majority of the benefit of a plant of last resort is to the producers (because the plant of last resort ensures that they will have a market for their product) and because of the importance of allowing our processors to be competitive, we believe that any charge for the plant of last resort should be borne entirely by the producers. Such a charge should also be independent of the ultimate use of milk production (BDO Dunwoody Handling Charge Review, 4th draft report dated June 5, 1997);
- The PLR serves the mutual interests of both producers and processors, correspondingly to ensure that there is a PLR presence, the insurance component; this cost is to be equally borne by both all producers and all processors (Undated internal discussion paper of the BCMMB).

30. While the panel agrees that the PLR system benefits both processors and producers, in our view, the distribution of these benefits significantly favours producers. While producers do not have absolute control over the volume of milk produced by their herds, they do have significant influence over the overall volume of milk produced in the province. Moreover, processors have no control over milk production. In the normal course, it is the originator of a surplus who shoulders responsibility for dealing with it. In the same way that dairy processors must deal with any surplus in processed milk or milk products that they have produced, it follows that dairy producers should be primarily responsible for fresh milk surplus to processor needs.

THE ACCOMMODATION LEVY

31. The Milk Board's position prior to the supervisory hearing was that the Accommodation Levy was used exclusively to pay for the PLR:
- E-mail of Rob Delage, Milk Board controller to Catherine Tokarz, Vice President Industry, Government Producer-Relations of Saputo dated April 13, 2007:

The accommodation levy was in place prior to the BCMMB becoming first receiver of milk on October 1, 2001. The levy was collected from industrial vendors at the rate of \$0.80 per hectolitre and remitted to Dairy World to act as the PLR.
 - Letter of the Milk Board dated August 6, 2008 to industry stakeholders as part of the consultative process as directed by BCFIRB:

The BCMMB has made use of an Accommodation Levy of sort for over twenty years (since prior to 1990) to fund the concept of a Plant of Last Resort (PLR) for the benefit of the industry.” (underlining in original)...

On the strength of the Accommodation Levy to fund the PLR, the BCMMB has been able to make use of the PLR as a “Balance Wheel” to manage the fluctuation in milk requirements by all processors. This balance wheel approach permits the direction and redirection of milk to processors as needed – Milk on Demand, (MOD).” (underlining in original)...

Formerly the Accommodation Levy was applied to Industrial Milk only at \$0.80 per HL. The change [to apply the Accommodation Levy to all milk at \$0.30 per HL] extended the cost of funding the PLR to all processors who benefit with the direction of the freshest of milk from the Milk on Demand system.
 - January 16, 2009 report from the Milk Board to BCFIRB:

Obviously, there is a cost associated with the provision of PLR services, including the cost of maintaining stand-by capacity. This is the principle cost of a “milk-on-demand” system. It is this cost which is defrayed by the Accommodation Levy.

- May 1, 2009 letter from the Milk Board to BCFIRB:

In British Columbia, the PLR maintains sufficient standby capacity to receive *all* surplus milk on behalf of *all* processors. The cost of this standby capacity is defrayed by the Accommodation Levy, which is paid by all processors based on their throughput. (italics in original)

- Undated internal discussion paper of the Milk Board:

...the funds from this charge (the Accommodation Levy) are paid to the operator of the PLR ensuring that there is sufficient milk storage in the Province...

- Annual reports for the years 1998-1999 to 2006-2007 all disclose amounts “assessed on processors for remittance to plant of last resort” described as “Accommodation fees”.

32. However, the panel also heard that the purpose of the Accommodation Levy was not always clear to the processors who were paying it. Saputo maintains that there has been a lot of confusion about the use of the Accommodation Levy and that, from 2001 to 2007, they did not understand that the levy was being used to fund in whole or in part the PLR services that Saputo provided. The BC Dairy Council agrees that processors have not been clear on what the Accommodation Levy was used to fund. When asked by the Milk Board to comment on the appropriateness of the Accommodation Levy for their report to BCFIRB, the BC Dairy Council wrote on October 31, 2008:

As stated in our letter to Mr. Gorrell dated January 24, 2008, until recently, members of the BCDC were not fully aware of the facts and circumstances surrounding the Accommodation Levy. Certainly, it was not known that this levy was being used by BC milk producers to fully fund their obligation to deal with surplus milk, which we understand BC milk producers chose to do by way of entering into the PLR Agreement with Saputo in 2001, nor was it understood that BC is the only province that collects this levy from dairy processors for this purpose.

33. The BC Milk Producers submit that they were “shocked and incredulous” when they heard that it took over seven years for Saputo to realize that it was paying \$1.6 million per year in Accommodation Levy fees without knowing what the levy was for.
34. The former chair of the Milk Board involved in the 2001 PLR Agreement negotiations indicated that he understood that the Accommodation Levy would pay the PLR fee to Saputo. It was inherent in the system as every processor was paying the levy on milk it processed. With respect to Saputo’s position that the purpose for the Accommodation Levy was unclear, he candidly observed that “I guess my accounting skills were better than theirs.”

35. The Milk Board's position at the hearing was somewhat different from their earlier submissions that linked the Accommodation Levy directly to the PLR. In the hearing, the Milk Board argued that the Accommodation Levy is used to defray the cost of the 'milk-on-demand' system, of which the PLR is an important component. As such, the Accommodation Levy is used not only to pay for the PLR, but also to pay freight and other costs such as milk testing and administration. According to Mr. Delage, the money raised by the Accommodation Levy is only one of the levies which it receives and "the money goes into the provincial pool and the pool pays a lot of costs", one of which is the approximately \$1.7 million owed to Saputo under the PLR Agreement. The Milk Board chair stated that this is sound marketing policy as in his view the definition of sound marketing policy is one where all those who benefit from a system pay for that system.
36. The Milk Board does not have a monthly accounting of how the Accommodation Levy is spent, rather it is charged to generate revenue for the producer pool, out of which the PLR cost and other costs related to the 'milk-on-demand' system are paid. The Milk Board does not use fund accounting in the technical accounting sense, where each fund is audited separately. In the words of a Milk Board member "at the Milk Board it is not specified what the levies are for. We charge levies and we pay bills."
37. Saputo argues that this change in the Milk Board's position with respect to the use of the Accommodation Levy is an attempt to show that producers are also contributing to the 'milk-on-demand' system, including the PLR. Saputo does not see any justification for the other uses the Milk Board reportedly makes of the Accommodation Levy, such as freight and administration costs. Intra-provincial freight charges are a producer obligation under the PLR agreement (s. 6.1.a) and have always been paid by producers in BC as raw milk delivery is FOB (freight on board) at the plant. Administration costs are covered by the Administration Levy.
38. In the panel's view, the Accommodation Levy is, and has traditionally been used to fund the PLR. The Milk Board has repeatedly confirmed this reality to BCFIRB and other industry stakeholders. In this hearing, the Milk Board has not challenged the conclusion that producers benefit from the existence of a PLR. Rather the Milk Board appears to say now that while the processors pay the Accommodation Levy, producers bear other costs of the 'milk-on-demand' system such as the Milk Board's administration, first receiver responsibilities and transportation.
39. It may be that the Milk Board is correct, that a comparison of the indirect costs of the 'milk-on-demand' system paid by the producers to the direct costs of the Accommodation Levy paid by processors, would demonstrate that the producers are paying their fair share. Unfortunately, this is a conceptual argument not

supported by evidence (either direct testimony or independent accounting evidence in the supervisory hearing). It became clear in the course of the review that the Milk Board has in the past sought and received accounting assistance to clarify these very types of issues. Questions around who benefits and who should pay for a levy or a system are not new; they have been asked and answered many times. When necessary, the Milk Board has adapted policies to fit new realities. It is not an answer to the serious concerns raised by Saputo – including who should properly be paying the Accommodation Levy and thereby funding the PLR – for the Milk Board to now say that it cannot report on exactly what the Accommodation Levy pays for or to state that the funds simply go into general revenue from which bills are paid. Such a response lacks regulatory accountability.

40. We pause here to comment on regulatory accountability. Marketing boards must be transparent in the funds they collect and the funds that they spend. People who are asked to pay a levy need to know what the levy is intended to fund and further that the money collected pursuant to that levy goes to fund its intended purpose. The Milk Board must be able to justify the amount of the levy assessed to the person that is being assessed. Without transparency and proper documentation, the Milk Board cannot justify existing levies, defend any proposed changes to their levies, or demonstrate that this particular levy accords with sound marketing policy.

WESTERN HARMONIZATION

41. As part of this review, the Milk Board advocates moving to a harmonized levy structure within the WMP. It maintains that the harmonized approach would shift a greater portion of financial responsibility for the PLR/‘milk-on-demand’ system to producers and achieve the greatest possible degree of parity across the WMP. Under this new system, the Accommodation Levy would disappear and the cost to processors in each class of milk would be the same in BC as in Alberta, inclusive of all levies and ‘up-charges’. Given these proposed changes, the Milk Board says the panel should not focus on the Accommodation Levy but rather it should look forward to this new system, as this will solve the problems associated with the Accommodation Levy.
42. Saputo is not opposed on principle to harmonization; however it notes that harmonization is not implementation ready. Further, harmonization is a completely distinct issue from the present supervisory process and can only be addressed after resolution of the issue on this supervisory review. The BC Dairy Council does not object to the concept of harmonization between the WMP but does not agree with the methodology as presented or the lack of industry consultation. They seek more information and more transparency regarding the costs and revenues from both sides. They are particularly interested in an analysis

of how the proposed changes would impact individual processors depending on whether they process primarily fluid or industrial milk, or both.

43. The BC Milk Producers state that under the proposed harmonized system producers will have to absorb a shortfall of \$400,000 that will be incurred by the Milk Board. They do not support any further transfer of costs to producers to operate the orderly marketing system. They also suggest that the proposed changes should be more equitably distributed between fluid and industrial processors.
44. To the extent that the Milk Board, in its description of the benefits of the harmonized approach, concedes both that there is a problem with the Accommodation Levy and that producers should be paying more, the panel agrees. While the panel can see merit to the harmonization concept, the purpose of this review was to consider the appropriateness of the Accommodation Levy. Before contemplating any regulatory change in the context of this review, it is necessary for all stakeholders to understand the current policy in order that any weaknesses can be identified and addressed. Only then can the Milk Board properly consult with industry stakeholders on a new policy in a transparent manner. Unfortunately, given the concerns that we see with the governance of the Milk Board, which we will address more fully below, we anticipate that it will be very difficult for the Milk Board to create the necessary environment of trust to move the industry toward the significant changes it is now proposing.

MILK BOARD GOVERNANCE

45. ‘Governance’ refers to the structures and processes which an organization uses to achieve its objectives. Sound marketing policy can take many forms depending on the circumstances. In all cases, however, it holds constant that in order to demonstrate that a policy is sound, a marketing board must be able to point to processes of good governance. Unfortunately, the Milk Board has not demonstrated good governance in either the implementation of the Accommodation Levy or in responding to concerns about that policy. In the absence of good governance practices, the panel cannot conclude that the Accommodation Levy in its current form accords with sound marketing policy.
46. The legal authority assigned to the Milk Board, as first instance regulator of the dairy industry in BC, imposes a corresponding responsibility to ensure that this authority is exercised in accordance with fundamental principles of good governance. BCFIRB’s expectation in commencing this supervisory review and directing the Milk Board to respond to the points raised by Saputo was that the Milk Board, at a minimum, would demonstrate cooperative leadership by considering the merits of the issues raised by a significant stakeholder and by giving the BCFIRB the benefit of its expertise. As part of this review, the panel was referred to a number of different position papers prepared for or submitted to

- the Milk Board over the years on these and other related issues. Instead of providing an analysis similar to any of these earlier position papers, the Milk Board sought only to defend its policy – a policy which it now concedes is problematic.
47. In its submissions received in advance of the hearing, the Milk Board did not provide a considered review of the Accommodation Levy which addressed the benefits of the PLR or included any analysis of who is paying for what or who *should* pay for what. The submissions were adversarial and failed to meaningfully address the issues on this review, including the advantages and disadvantages of Saputo's original proposal that the Accommodation Levy be removed. When questioned in the hearing whether they had estimated the impact to the industry of removing the Accommodation Levy, the Milk Board responded that it had not, that this was not a consideration. Furthermore, the Milk Board introduced what appeared to be unnecessary complexities in its submissions.
 48. As a result of the supervisory hearing, the panel accepts that Saputo, from 2001 to 2007, did not understand that the Accommodation Levy it paid was being used to fund in whole or in part the PLR services that it provided. Nonetheless it is surprising that it took Saputo seven years to question the purpose of this levy. We are also surprised that the BC Dairy Council did not question this levy earlier. As significant players in the industry, both have a role to play in bringing issues to the Milk Board in a timely and constructive manner. This noted, it is the Milk Board that, first and foremost, has a fundamental and ongoing responsibility to do what is required to ensure that stakeholders have a clear understanding of its policies especially where those policies involve levies. The Milk Board disagrees with the notion that Saputo was not aware of the purpose behind the Accommodation Levy but it cannot point to clear and transparent communication on its part confirming that the monies collected from the Accommodation Levy were in turn used to pay for the PLR service provided by Saputo. It is not acceptable for the Milk Board to say that perhaps their accounting skills were better than Saputo's when it is clearly the role of the Milk Board to be fair and transparent.
 49. The perception of a lack of transparency on the part of the Milk Board was exacerbated by its failure to account for how the Accommodation Levy was spent. Transparency and openness in levying are not new concepts. Producers and processors alike are entitled to know what they are being levied for and how that money is being used. Only through openness and transparency can public confidence in the regulated marketing system be maintained.
 50. The lack of transparency with respect to levies is problematic not only from a Milk Board governance perspective but also for the long-term sustainability and viability of the dairy industry. The panel heard Kempton Matte, Senior Vice President, Industry, Government, Producer Relations of Saputo say that the

domestic dairy market is shrinking and not responding competitively to market trends and that in today's marketplace, demand for milk is no longer a given. Although processors have one foot in the regulated industry, the other foot is firmly planted in the unregulated marketplace. Processors must be able to "sell" their product to consumers who have choices. They have to be responsive to buyers' concerns on price and be able to defend costs. Thus, there is a need for a high degree of transparency on the price paid by processors for their raw milk supply. Mr. Matte stated:

We're quite happy to pay the full price that this [regulated] system demands of us. But when we're in this system, we want equity, we want fairness, we want to know what it is exactly we are paying for, whom we are paying it to. [...] That's the transparency we need. That allows us to go into the marketplace and defend the system, defend the product, and defend the price to the consumer. Without that, we're working with one hand tied behind our back.

In this case, a lack of transparency hinders the system's potential to encourage growth and innovation, which is critical if it is to be successful in the long term.

51. With respect to the Milk Board's governance responsibilities related to the harmonization proposal, the Milk Board argued that it could not proceed with industry consultation on harmonization because of this supervisory review. It says the possibility that the panel might issue very specific directions on the Accommodation Levy policy made it unwise and perhaps even disruptive to engage in consultations and discussions. On this point, Mr. Matte disagrees:

...the impression we got from FIRB and any communication from FIRB was quite the contrary. It was more ... 'Hey, guys, get together and fix it' So I don't agree with [the Milk Board's argument] whatsoever. [...] In fact, I would argue that those proposals came forward only after it was clear that we were determined to come to FIRB if we didn't get clarity and some kind of satisfaction on the question we raised.

52. At the start of this supervisory review, clear expectations were communicated to the Milk Board and yet there was little attempt to meaningfully address these significant issues. Instead, the Milk Board did not fully engage in the process. Its approach was not to address the legitimate concerns of Saputo but rather to first defend the policy and then to argue that the Accommodation Levy policy had been overtaken by a new policy. This approach appeared to be an attempt by the Milk Board to deflect the discussion from its past policy by simply advocating a new policy.
53. The Milk Board now asks BCFIRB "to continue to provide supervisory oversight over the next phase of these industry consultations... to ensure that the industry can move ahead as quickly as possible with the steps that need to be taken to implement a policy that serves the interests of the industry as a whole". We take the Milk Board's desire to consult now and accept BCFIRB's supervisory role

with a grain of salt. The Milk Board has demonstrated throughout this process that it is acting primarily in the interests of producers. It is the job of the Milk Board to act not solely in the interests of producers, but in the interests of the industry as a whole. If there remains any need for clarity on this matter, the Ministry of Agriculture and Lands 2004 Regulated Marketing Economic Policy states:

The regulated marketing system operates in the interests of all British Columbians. Boards and Commissions operating under the authority of the *Natural Products Marketing (BC) Act* are responsive to the needs of British Columbia producers, as well as to processors, consumers and other participants in the British Columbia food system.

54. BCFIRB has since reinforced this expectation of accountability with all of BC's regulated marketing boards on several occasions including:
- B.C.'s regulated marketing boards and commissions ultimately have the primary responsibility for making proactive, well-reasoned, fair and balanced decisions on issues pertaining to their industry. However, stakeholders are increasingly recognizing the importance of good governance and administrative practices in the regulated marketing sectors. Strategic planning, increased transparency around board processes and decisions, and improved communication and consultation across the value chain, all present important opportunities for ensuring the future health of B.C.'s regulated marketing sectors. (BCFIRB's 2008/09-2010/11 Strategic Plan)
 - BCFIRB expects ... that boards and commissions will undertake effective consultation with and consideration of industry perspectives in their decision-making. (BCFIRB's 2008/09-2010/11 Strategic Plan)
 - Appropriate mechanisms for industry-wide consultations can take many forms but are a requisite component of good decision-making for all of our boards. (December 16, 2008 letter to regulated marketing boards and commissions)
55. All industry participants are responsible for fostering relationships characterized by trust, cooperation and respect. However, the burden of responsibility rests on the Milk Board, as a government-legislated body, to administer industry regulations and to govern the system in a manner that is fair, transparent, accountable, and responsive to the industry as a whole. Accountability, transparency and fairness are not empty platitudes; these are the hallmarks of leadership and independent decision-making.
56. We agree with George Leroux, who participated in the hearing on behalf of Vitalus, that in order to move forward "clearly, highly enlightened, well informed, progressive governance and strong management is required to help minimize perceptions of unfair treatment by individual producers and processors." When governance is poor, a host of problems can arise, leading to the decline or even

the demise of an organization⁷. In this case, the Milk Board's poor governance has contributed to a breakdown of trust and given rise to mutual suspicion between stakeholder groups. We now find ourselves at the conclusion of a lengthy and adversarial process conducted at significant cost to the industry and to the public. If there is to be any progress on these issues, there needs to be a fundamental shift in Milk Board governance.

DIRECTIONS

57. Given that we cannot conclude that the Accommodation Levy accords with sound marketing policy (as explained in paragraph 45 above), we must consider what the appropriate order is in the circumstances. Given the governance concerns identified in this review, we were inclined to repeal the Accommodation Levy immediately. However, we recognize that it is not in the interests of the dairy industry to move precipitously. Instead, we have opted to allow a brief period of transition during which time the Milk Board will account for the costs of the current 'milk-on-demand' and PLR system and how those costs have been borne by industry stakeholders. Once the current cost structure is understood, the industry will be in a better position to move forward to new policy that better accords with sound marketing policy where the true beneficiaries of the system take financial responsibility for it.
58. Accordingly, we direct that the current Accommodation Levy remain in place for a period of six months. During this time, the Milk Board is directed to complete an analysis of the costs of the current 'milk-on-demand' system and how those costs are met. To complete this analysis, the Milk Board must develop appropriate terms of reference and retain an independent accounting firm to provide, at a minimum, the following information and analysis:
- The total cost of the 'milk-on-demand system' including the PLR system;
 - The breakdown of the components of that cost;
 - An assessment of how those costs are currently met; and
 - Apportionment of costs between producers and processors.

⁷ S. Bartos, 'Public Sector Governance – Australia' as quoted in Australian Public Service Commission 'Building Better Governance', p. 2, 2007.

59. Once this preliminary accounting analysis has been completed, there will be transparent baseline data regarding the current cost of the system and how those costs are borne. The Milk Board will have an informed basis to move forward and engage the various stakeholders in a fulsome consultation process regarding how to fund the 'milk-on-demand' system including the PLR (bearing in mind our earlier finding that surplus removal should be primarily a producer responsibility).
60. Having rendered our decision in this supervisory review, the panel wants to make clear that this process is back in the hands of the Milk Board to address using principles of good governance. The Milk Board is expected to engage with the industry and report to BCFIRB on its progress as and when necessary. It should be noted that this period of transition is intended to be brief. There should be no misapprehension on the part of any party to this supervisory review that this six month period will be extended. It should also be noted that this direction in no way precludes any consultation by the Milk Board with industry stakeholders with respect to harmonization over the next six months. This supervisory process has been delayed long enough and it is within the industry's hands to find a resolution to these significant issues now. Failing any such resolution, BCFIRB is prepared to be as directive as necessary.
61. Finally, Saputo raised the issue of reimbursement for what it perceives as the past injustice of paying for the PLR. The panel is not prepared to make such an order. While we accept that the current system is flawed, the fact that this system has been in place as long as it has suggests that it has had some utility as much as there has been a lack of accountability on all sides. While the Milk Board has demonstrated a lack of transparency, Saputo and the BC Dairy Council did not challenge the Milk Board on its policies and were apparently complacent regarding the system.

Dated at Victoria, British Columbia, this 4th day of May 2010



Richard Bullock
Chair



Sandi Ulmi
Vice Chair



Honey Forbes
Member