

October 13, 2006

Howard Migie
Chair
Task Force on implementing marketing choice
for wheat and barley
c/o Agriculture and Agri-Food Canada
930 Carling Avenue
Ottawa ON K1A 0C5

Via facsimilie: (613) 759-6612.

Dear Mr. Migie:

Further to our meeting with the task force of October 11, 2006, please find attached the CWB's responses to your advance questions, plus additional clarification of some of the main topics addressed during our meeting. As we indicated to you when we met, we have also provided a document that describes the features and services of the CWB. It is our belief, that intense examination of these areas is warranted as the task force continues its work.

Yours sincerely,

original signed by:

Adrian C. Measner
President and Chief Executive Officer

ACM/da
POC1670-CEO

Attachments

Benefits and Services of the CWB

The CWB's marketing approach, including among other things single-desk selling, sourcing grain by means of a contract call system, and providing negotiating leverage for farmers results in farmers earning between approximately \$530 million and \$655 million more for their grain each year than they would in an open market. A summary table of the benefits is appended. The CWB's advocacy efforts on behalf of farmers on such issues as the premature introduction of genetically modified grain, and holding service providers accountable for their level of service to farmers is also substantial. The results of some of these efforts are quantified in the following.

- Single-desk selling gives farmers marketing clout when negotiating with customers worldwide. Many customers around the world consider the products grown by western Canadian farmers and marketed by the CWB to be of premium value. These customers' willingness to pay is reflective of the value they place on western Canadian grains. In a multiple seller environment, where a number of companies would have access to both the product grown by western Canadian farmers and the customers that place a high value on that product, the negotiating position of customers will improve considerably. Ultimately, this improved negotiating leverage would mean customers would no longer have to pay premium prices for the grain they buy. The value of the single desk marketing approach is substantial, as follows:
 - The value of single-desk selling for wheat has been estimated to be between \$146 million¹ and \$256 million² annually.
 - The value of single-desk selling for barley has been estimated to be \$59 million³ annually.
 - The value of single-desk selling for durum has been estimated to be between \$92 and \$103 million⁴ annually. The CWB recognizes that in order to achieve single-desk benefits in this magnitude for durum, there may be years like 2005-06 where farmers end up storing excess durum on-farm. In 2005-06 durum carryout was a million tonnes higher than average. The cost to farmers of carrying that million tonnes until 2006-07 would be approximately \$15 million⁵. Note that this is not an annual cost to farmers and assumes that an average carryout for durum would be approximately 1.8 million tonnes irrespective of the marketing system in place in Western Canada.

The following CWB activities and services contribute to the value of the single-desk identified above.

- Marketing discipline – by managing price, volume and timing, the CWB ensures that CWB grains do not flood the market and push values down to a level that would clear volumes quickly but not return a reasonable value to farmers – durum, malting barley and high protein wheat are good examples. The benefits of disciplined selling are sometimes hard to quantify, however they were very apparent in 2005-06 CWAD marketing. Total Canadian CWAD supplies in 2005-06 were 8.4 million tonnes versus total world durum trade of 7.3 million tonnes (IGC). If that quantity of durum was offered to the marketplace in 2005-06 values would have deteriorated to near feed values. Instead, CWB marketed record durum quantities but in a manner that maintained international values and the excess carryover will be marketed at even higher values in 2006-07.

¹ Gray benchmarking exercise – port to port results.

² *Performance Evaluation of the Canadian Wheat Board*. Kraft, D., Furtan, W.H. and Tyrchniewicz, E. 1997

³ *The CWB and Barley Marketing: Price Pooling and Single-desk Selling*. Schmitz, A., Schmitz, T. and Gray, R. 2005

⁴ CWB calculations based on similar methodology to KFT and Schmitz barley studies.

⁵ Calculation includes the 5-year average farmgate value of durum (\$189/tonne) and an 8 per cent annual time value of money.

2005-06 exports	4.23 million tonnes	
2005-06	1 CWAD 13.0	\$195.00
2005-06	CWFW/5 CWAD	\$115.00
2006-07	1 CWAD 13.0	\$208.00

The benefit of this year alone (conservatively) would be \$200-300 million dollars.

- Branding – the CWB promotes western Canadian grain as consistent and high-quality in order to attract premiums from customers and maximize the value of the single-desk
- Market development – the CWB is dedicated to expanding markets for western Canadian grain and products, both directly and through its support of partners such as the Canadian International Grains Institute and Canadian Malting Barley Technical Centre.
- As an extension of its market development efforts, the CWB offers identity preserved contracting geared towards developing new markets for new varieties of CWB grain.
- The CWB supports research and development at Universities, through the Western Grains Research Foundation and elsewhere on issues important to and affecting farmers. Support in the past has included the following:
 - \$400,000 contribution to the Canadian Wheat Board Centre for Grain Storage Research at the University of Manitoba-- a facility used to conduct research aimed at reducing the effects of harmful factors such as insect infestation, mould and excess moisture on grain stored in granaries;
 - \$400,000 contribution to Agri-Food Discovery Place at the University of Alberta— a research facility focused on developing new value-added opportunities for wheat and barley;
 - Proposed \$400,000 contribution to the University of Saskatchewan Department of Agricultural Economics to establish a Grain Policy Research Chair. Research conducted by the Chair will focus on the effect of policies on the economic sustainability of grain production on family farms, in particular the development of new technology, production and transportation systems, and governance;
 - Proposed \$1 million in capital funding to establish a training and technical centre in Beijing, China in partnership with the China Cereals Oilseeds and Foodstuffs Corporation (COFCO). The centre will support China's milling and food-processing industry. The technical centre is a natural extension of the CWB and COFCO's long-standing, positive business relationship. Operating costs of the technical centre will also be shared between the CWB and COFCO.
 - \$330,000 in funding to date plus an additional \$300,000 commitment for future funding for fusarium research at the Brandon Research Centre and at Agriculture and Agri-food Canada's Ottawa facility;
 - \$400,000 per year in graduate level and undergraduate level College and University scholarships.
- The CWB's Weather and Crop Surveillance department constantly monitors worldwide weather and crop conditions. These efforts enhance the CWB's market intelligence and its revenue-maximizing marketing strategy.

- Similarly, the CWB's Market Analysis department constantly monitors market conditions around the world, which further enhances the CWB's market intelligence and its revenue-maximizing marketing strategy.
- Policy expertise in areas important to the CWB and its marketing efforts (e.g., trade, transportation, etc.) – has been a factor in the successful defense of various U.S. trade challenges, a successful railway level of service complaint, etc.
- As the sole seller of wheat, durum and barley grown in Western Canada, the CWB has significant negotiating leverage with service providers including railway companies and grain handling companies.
 - Tendering and railway and terminal handling agreements contributed \$38.1 million to CWB pool accounts on average over the 2001-02 to 2004-05 time period⁶.
- Farmers benefit from the Government of Canada's initial payment and borrowing guarantees. The initial payment guarantee protects farmers from incurring the cost should sales revenues be insufficient to cover the payments made to farmers. The borrowing guarantee enables the CWB to borrow at interest rates comparable to its competitors.
 - The CWB generates net interest earnings on money owed to the CWB by customers on past grain sales. Net interest earnings are generated because the CWB borrows at lower rates than are paid by its debtor customers and have been on average \$66.2⁷ million over the past 5 years.
- As a corporation that does not retain profits from the sale of grain, farmers receive the full value of their grain from the CWB less the corporation's operating costs. In other words, unlike companies operating in the open market for non-board grains, the CWB does not retain any profits for shareholders. Additionally, the use of the contract call system to establish delivery access rather than price (basis) ensures all farmers equitable access to the delivery system
 - The CWB estimates that grain handling companies have charged almost 40 per cent more in basis than their actual handling costs⁸. If the same handling companies had the ability to do the same for wheat, durum and barley, farmers' costs would increase by almost \$8 per tonne or \$145 million annually (based on a 5-year average of 18 million tonnes marketed through the CWB and handling costs of \$19.34 per tonne). The CWB recognizes that rationing delivery through a contract call system rather than price can result in farmers carrying stocks for longer periods than might otherwise be the case. To calculate the magnitude of these carrying costs, it is assumed farmers store 50 per cent of their contracted tonnage 3 months longer than they otherwise would. Based on the 5-year average quantity marketed by the CWB and average farmgate returns, farmers' carrying costs are approximately \$30 million annually. This assumes 8 per cent time value of money. Taking these carrying costs into account, the net benefit of the CWB's contract call approach is approximately \$115 million annually.
- The CWB's approach to managing the supply chain ensures that farmers capture any benefits from supply chain activities. An example of this is directing terminal blending to increase the overall value of grain. Arranging combination cargoes for customers demanding multiple products from Western Canada is another example of CWB involvement in managing the supply chain.

⁶ CWB calculations

⁷ CWB annual reports

⁸ CWB calculations based on CGC posted handling and cleaning tariffs and CWB observed canola basis numbers

- Terminal blending is estimated to provide a benefit of \$7-\$10 million to western Canadian farmers each year⁹. A portion of this is the benefit that accrues to farmers as a result of the terminals blending different downgrading factors from different regions to increase the proportion of higher quality milling wheat. The additional benefit is the result of the blending of wheat with varying protein levels so as to maximize total revenue on the sale of those grains.
- The CWB ensures farmers have a unified voice in the marketplace. In this regard, the CWB advocates and pursues farmers' interests on marketing-related issues (e.g., GM wheat, transportation, etc.)
 - The CWB won a 1997 legal challenge against CPR for failing to provide farmers adequate rail service. The CWB and CPR settled on a \$15 million compensation for damages
 - On the same claim, the CWB reached a commercial settlement with CN outside the courts. The amount of compensation was never released publicly.
 - The CWB has been instrumental in preventing the premature introduction of genetically modified wheat varieties. It has been estimated that introducing GM wheat into Western Canada could result in a revenue loss to farmers in the range of \$200 - \$400 million annually¹⁰ to the Canadian Wheat Board CWRS pool accounts
- In its efforts to encourage availability of competitive services for farmers, the CWB ensures a level playing field exists for supply chain participants. This includes supporting the existence and feasibility of producer cars, shortline railways, farmer-owned inland terminals, etc.
 - Farmers have shipped 7,800 producer cars on average over the last three years. Approximately 2,600¹¹ move through producer car loading facilities whereby handling charges apply. Administration costs of \$1 to \$2 per tonne apply to the other 5,200 cars. Assuming 85 tonnes per producer car and a \$10 per tonne net savings on primary elevation (\$5.50 on the 1,500 cars moving through the WCRR facilities; \$8-10 on the 1,110 cars moving through other producer car loading facilities), total benefit to farmers equates to approximately \$6 million annually.
 - The benefits of farmer-owned terminals are not easily quantified, but are very important to the competitive environment farmers experience in different regions. It can be assumed that farmers earn larger trucking premiums and receive more favourable grades in regions where farmer-owned handling facilities exist compared to regions where farmers are captive to one or two line companies.

There are also a number of benefits that can not be quantified in the same way as those above, but have considerable value to many farmers. These include:

- Pooling as a risk management tool for those who choose. Participation in the pool accounts ensures farmers that their commodity and foreign exchange risk is being managed diligently.
- Pooling is also the means used by the CWB to fairly distribute the value of the single-desk, and ensure all farmers share in the marketing and logistical costs and benefits equitably.

⁹ CWB calculations

¹⁰ Range depends on adoption of GM wheat in the U.S. Lower estimate reflects impact to Canadian farmers if Canada adopting and the U.S. does not. Upper end of range reflects the impact to Canadian farmers if both countries adopt. *Regulatory Approval Decisions in the Presence of Market Externalities: The Case of Genetically Modified Wheat*. Furtan, W.H., Gray, R.S and J.J. Holzman. 2005

¹¹ 1,500 move through West Central Road and Rail facilities and are charged a \$6.50 per tonne handling fee. The other 1,600 move through other producer car loading facilities and are charged between \$2 and \$4 per tonne for handling.

- For those farmers who choose, flexible pricing options enable them to make their own pricing decisions and still receive equitable share of the value of the single-desk.
- Flexible payment options also allow farmers to set a price floor for their grain at 80, 90 or 100 per cent of the expected value of that grain and still participate in upward movement in the market. The options available to farmers through the CWB exceed those available in an open market, where pooling has limited to non-existent availability.
- The CWB also administers the cash advance program on behalf of the federal government.
- As an extension of the cash advance program, the CWB Pre-delivery top-up program is a top-up to the cash advance program that gives farmers access to a greater portion of the value of their wheat before delivery.
 - Farmers borrowed \$5.9 million through the CWB pre-delivery top-up program in 2005-06. The CWB charges farmers prime rate on this money. Assuming this money was borrowed at 4 percentage points lower than what these farmers are paying elsewhere for a period of 6 months, the benefit to farmers equates to \$120,000.

Appendix 1 – Summary of annual CWB benefits and services

Summary of annual CWB benefits and services	Annual net benefit
Value of CWB single desk marketing approach for wheat	\$146 - \$255 million
Value of CWB single desk marketing approach for barley	\$59 million
Value of CWB single desk marketing approach for durum	\$92 - \$103 million
Tendering and railway and terminal handling agreements	\$38.1 million
Net interest earnings	\$66.2 million
Approach to managing delivery system access	\$115 million
Terminal blending	\$7 - \$10 million
Farmer access to producer cars	\$6 million
Total	\$530 - \$655 million

In addition, the following must be considered:

- The CWB won a 1997 legal challenge against CPR for failing to provide farmers adequate rail service. The CWB and CPR settled on a \$15 million compensation for damages. On the same claim, the CWB reached a commercial settlement with CN outside the courts. The amount of compensation was never released publicly.
- The CWB has been instrumental in preventing the premature introduction of genetically modified wheat varieties. It has been estimated that introducing GM wheat into Western Canada could result in a revenue loss to farmers in the range of \$200 - \$400 million annually¹² to the Canadian Wheat Board CWRS pool accounts.

¹² Range depends on adoption of GM wheat in the U.S. Lower estimate reflects impact to Canadian farmers if Canada adopting and the U.S. does not. Upper end of range reflects the impact to Canadian farmers if both countries adopt. *Regulatory Approval Decisions in the Presence of Market Externalities: The Case of Genetically Modified Wheat*. Furtan, W.H., Gray, R.S and J.J. Holzman. 2005

**RESPONSE OF CANADIAN WHEAT BOARD TO QUESTIONS RECEIVED ON
OCTOBER 4, 2006 FROM MINISTER STRAHL'S TASK FORCE EXAMINING
IMPLEMENTATION OF MARKETING CHOICE**

and

**RESPONSES TO SUPPLEMENTAL QUESTIONS RAISED AT MEETING OF
OCTOBER 11, 2006**

October 13, 2006

The CWB is pleased to respond to the Task Force's questions.

Before doing so, however, we note that each of these questions refers exclusively to the "CWB". The questions are clearly premised on the assumption that the "CWB" would continue to exist in the absence of the single desk.

The name "CWB" carries many connotations; positive for those who support it and negative for those who do not. However, in the open market environment that the Task Force seeks to implement, the "CWB" as it exists today and, just as importantly, *as farmers understand it today*, simply would not, indeed cannot, exist.

This is not just a question of semantics. It is essential that farmers understand that in the absence of the single desk a "strong and profitable CWB" is a myth. In the absence of the single desk an entirely new entity would have to be created to assume whichever of the CWB's current functions might continue to make economic sense in an open market environment. Unquestionably, however, the CWB as farmers know it today would be gone. Preserving the name "CWB" does not preserve the essential value-proposition that it brings to western Canadian farmers. It is a mistake to think that there would be any similarity between the current CWB and whatever entity might exist after the single desk has been removed.

In the absence of a single desk there is no viable alternative for the Canadian grain industry other than that which exists in the rest of the world -- an open market controlled by the same transnational corporations that currently control the global grain trade in every country except Canada and Australia. By last count four of these companies controlled 73 percent of the world's grain trade. This was up from 62 percent five years earlier and their influence is increasing. There is no reason to believe that in the absence of the CWB's single desk these same companies would not quickly control western Canada's grain trade as well.

The single desk exists solely to benefit farmers. It allows the CWB to market wheat, durum and barley produced by some 65,000 western Canadian farmers as part of a strategic sales process. This process ensures that, just like a company holding a patent on a product, western Canadian wheat, durum and barley products do not compete with themselves in the global market. It also ensures that western Canadian farmers are not bidding against each other in the rush to sell their grain each fall. As a result farmers' grain can be pooled enabling a focus on overall, rather than transaction-specific returns. It can be sold as products rather than commodities and premiums can be extracted from the market and returned to farmers.

The open market is the only other sustainable grain marketing system in the world. By definition, its participants exist solely to benefit themselves. The open market places the identical grain in direct competition with itself through multiple sellers. In an open market western Canadian farmers would be among these sellers. They would compete with each other -- and with grain farmers around the globe -- to sell their grain to the handful of corporations that control the world's grain trade. In this environment, grain is sold as a commodity rather than as a product. Arbitrage destroys the possibility of market premiums. Grain companies trade on margins alone -- they purchase at the lowest possible price and re-sell at the price that secures their target margin and profits are returned to the owners of the companies rather than to farmers. Finally, the concept of price-pooling is unsustainable in the open grain market and therefore does not occur.

Whatever one's views on the ideology of "marketing choice", there is no similarity between the value proposition that the open market brings to farmers and the one that the single desk brings. The former brings the freedom to sell -- at will -- a drop of grain into an ocean of grain for a lower overall return. The latter is based on working collectively and results in more money in the bank and more clout in the marketplace. A few individuals may thrive in the open market but most would not.

Western Canadian farmers should be under no illusions over what is at stake. There can be no "strong and profitable CWB" in an open market. As framed by the terms of reference given to the Task Force, "marketing choice" means the choice between the single desk and the open market. There is no middle ground.

1. Would you anticipate that the CWB would contract with all or most grain companies for grain handling services in an effort to provide the widest geographic coverage and access for farmers to its services, or would the CWB contract with only a small number of grain companies in an effort to negotiate a lower price for grain handling services?

The question describes an open market environment. As noted above, the question mistakenly presupposes that the CWB would continue to exist in the open market. The CWB, as it is currently composed, would not exist in the absence of the single desk. A new entity would have to be created.

As for the contracting and other activities in which such an entity might engage, that would depend on its business model, corporate structure and capitalization.

Assuming that the new entity intends to engage in grain marketing it would only do so with a view to maximizing returns to its "owners", be they all farmers, a select group of farmers, public investors, private investors or any combination thereof. Whether and how the new entity might contract for grain handling services would, of course, depend heavily on the factors noted above.

For the sake of argument, however, logically a new entrant into the industry might attempt to contract with those grain companies that collectively or individually provide the best package of price and service. Significantly though, in the absence of owning grain handling assets of its own the new entity would have no choice but to rely on its competitors to execute its marketing program. In an open market this would place the new entity at an insurmountable competitive disadvantage.

The new entity's grain marketing activities would very quickly be drawn away from it to those companies that have both primary and terminal elevator assets, that are both vertically and horizontally integrated and that are tied to strong international marketing networks. There are already a number of mature companies in the Canadian market place that have all these attributes and they would very quickly dominate the business. Market participants without these attributes would either align with these mature companies or fail. Moreover, of these mature Canadian companies, only those that are closely aligned with the transnational companies that control the vast majority of the current global grain trade would ultimately survive. All of these companies are integrated, both vertically and horizontally, across most if not all key elements of the value chain. They source grain from around the world and in doing so their focus is quite naturally only on the most profitable way to make the sale. Subject only to transportation costs they are necessarily indifferent to whether the grain needed for the sale comes from Argentina, America or Ukraine as long as it meets the minimum quality specifications. In the absence of the single desk it is inevitable that these same companies would control the Canadian wheat, durum and barley trade as well.

2. Does the CWB foresee the need to own grain handling facilities in Canada?

This question also contemplates an open market environment and as noted above, mistakenly presupposes that the "CWB" would continue to exist in the open market.

Again for the sake of argument, however, in an open market environment, grain handling volumes would be dominated by organizations that have primary and terminal elevator assets with strong international marketing networks. For the reasons set out above, a new grain marketing entity that does not own its own grain handling facilities would not survive. A new entity would therefore have no choice but to either buy existing facilities or build new ones.

The current country elevator system already has excess handling capacity. And were it economically sensible to build a new port facility it seems clear that would already have been done. Thus purchasing existing facilities would be the only logical choice for the new entity. However, the existing owners recognize that these assets are the key to their competitive advantage and they would guard this competitive advantage jealously. Only the largest companies would survive in the long-term and they would not trade away their competitive advantage to anyone -- including any new entity that would replace the CWB -- unless they receive full value for it. Needless to say there is only merit to asset ownership if the assets can be purchased at a value that allows a competitive return. The barriers to entry in an open market environment are extremely, perhaps insurmountably, high. Certainly they are high enough that a sustainable asset purchase would be impossible for an entity as small as any that might be created out of the CWB's demise.

Nonetheless, assuming once again for the sake of argument that the new entity was successful in purchasing both primary and terminal assets, it is inevitable that the only potentially viable corporate structure would be that of a for-profit venture driven to maximize returns to its investors rather than to farmers as a whole -- in short, a grain company. Not only that but one which, in the global marketplace, would be insignificant at best. Lest this be misconstrued, let us make it clear that there is nothing wrong with the for-profit, grain company model -- it is clearly an economically successful model for many investors. Rather, we simply pose the question -- "Would western Canadian farmers be economically better off by adding another small grain company to an industry dominated by corporate giants?" If the answer to that is,

“no” as we firmly believe it be, then farmers must decide whether they are prepared to sacrifice a proven economic advantage for the philosophical right to select among fewer options.

3. What merits does the CWB see in individual farmer ownership (through shares or a cooperative structure) of the CWB versus the type of ownership put forward in Harvesting Opportunity (that seems to be less clear)?

Harvesting Opportunity was premised on retention of the single desk. The corporate structure proposed in it was carefully designed to balance the many factors that must be taken into consideration under that scenario. As described above, removal of the single desk means the end of the CWB. In the absence of the single desk a new entity would have to be created and a new analysis would have to be undertaken to determine its optimal corporate structure. Again that analysis would have to consider the intended business model, corporate aims, capitalization, etc. In an open market environment direct farmer ownership may indeed be preferred.

However, the analysis that the CWB undertook in developing the Harvesting Opportunity proposal sheds valuable light on the implications that would flow from the destruction of the single desk. It is therefore worth spending a moment to consider it in more detail.

The single desk exists not just for the benefit of those farming today but, for tomorrow’s farmers as well. By its very nature, however, because it operates on a crop year basis, the activity profile and even the identity of its participants changes dramatically from one year to the next. Its “owners” are therefore not only this year’s farmers but future years’ as well. This fact was a key driver in the development of Harvesting Opportunity and accordingly the CWB established a number of key criteria against which potential business structures were assessed. These were:

- Maximize producer benefit and control;
- Maximize protection of key business assets;
- Maximize good governance and accountability;
- Minimize taxation (income, capital and withholding taxes);
- Minimize impact on creditworthiness
- Minimize cost of capital;
- Minimize operating cost and complexity;
- Recognize the importance of sound public policy in light of the CWB’s retention of the single desk.

The range of structures reviewed included non-share capital corporations, cooperative corporations, share capital corporations, trusts and limited partnerships.

Ultimately, the CWB and its consultants determined that the CWB’s business activities should be conducted through two primary operating entities – a parent corporate agricultural organization (CWB) to conduct the core single-desk marketing business and a wholly-owned subsidiary company, coined Business Ventures Holding (BVH) to serve as a vehicle for commercial investing activities. The core business (the single desk marketing of wheat, durum and barley and such other marketing activities as might be undertaken) would be conducted

through a not-for-profit corporation, without share capital and non-taxable pursuant to section 149 (i)(e) of the Income Tax Act. It would be incorporated by a special act of Parliament. BVH would be established as a separate, for profit, taxable, share-capital corporation that would be incorporated under the *Canada Business Corporations Act*.

For current purposes, the analysis that led to the selection of a special act (not-for-profit, non-share capital) corporation model for the CWB's core business is the most relevant. Ultimately, it was felt that true control of the organization was more important than technical ownership:

- The structure ensures that the restructured CWB would be operated solely for the benefit of western Canadian grain farmers and that key ownership rights would be conferred on such farmers. The entity could continue to focus on maximizing returns to farmers for their deliveries rather than creating surpluses to reward investment capital. An inherent conflict arises in maximizing returns to the farmers participating in the single desk and in maximizing the profitability of shareholders, which include both farmers and non-farmers. Agricore United and Saskatchewan Wheat Pool are both examples of how the focus moved away from western Canadian farmers and towards shareholders. The Australian Wheat Board has also had a similar experience where farmer control has been diluted over time through the share capital model. In the share capital model farmers are inevitably forced into the position of being a supplier instead of an owner.
- The special act corporation provides full farmer control, as farmers would continue to elect the majority of the board of directors. Yet, critically, that control could not be diluted over time.
- At the same time the unique governance needs outlined in the Harvesting Opportunity proposal (e.g., farmer-elected directors, ensuring appropriate expertise among appointed directors, special governance for the capital infusion, etc.) can readily be achieved in a special act corporation whereas they would be very difficult (at best) to achieve through a traditional share capital or co-operative vehicle.
- Income and capital tax considerations could also be best managed in the non-share capital model. The CWB's consultants estimated the tax-exempt status of the Harvesting Opportunity model would save farmers approximately \$70million - \$80 million per year (based on the 2003-04 financial results). In addition, the new model would be tax neutral with respect to farmers' participating interests in the CWB. Income from grain receipts would continue to be taxed at the appropriate point, namely in the hands of farmers.
- The proposed model would have access to low cost debt and its ability to distribute surpluses to farmers and to hold tax efficient capital reserves to enable the CWB to sustain its activities, would assure a strong credit rating and access to capital.
- Farmers participating in the CWB can change significantly from year to year depending on the specific farmer's own desire/ability to produce product marketed by the CWB. It was our view that this made "control" of the CWB much more appealing and less complicated than share "ownership" – which would inherently cause a significant number of share redemptions and issues periodically/annually to adjust for farmers entering/exiting the business. In addition, there could be substantial valuation concerns at each redemption and issue, especially in a situation where taxes had been incurred (directly or indirectly by exiting

farmers) in advance of any related cash payments. Provincial security law regulations would also need to be adhered to with regard to the issuance of shares.

- Finally, the philosophy of the not-for-profit, non-share capital corporation is consistent with that of the CWB. Non-share capital corporations are often controlled by members, just as the CWB is controlled by farmers. There would be an obligation to treat members of the same class equally, just as the CWB treats farmers equally through the pooling process. The non-share capital corporation model has been used in other instances like NAV Canada where an entity moves away from government control but without full privatization.

4. What financial advantage, if any, is there to the CWB retaining the assets and liabilities related to rescheduled export credit sales vs the government of Canada taking over these assets and liabilities?

Again, the question is mistakenly premised on the continued existence of the CWB in the absence of the single desk. However, even assuming for the sake of argument that the government wanted to take over the assets, one would have to question the decision. We would assume that the government would not want to take for itself a revenue stream that now goes directly to farmers through the pool accounts.

The financial advantage to whomever holds the assets and liabilities related to rescheduled export credit sales is the net interest earnings spread between the assets and liabilities. In 2005-06 those net earnings were approximately \$32 million.

Transferring the assets (approximately \$2.7 billion at July 31, 2006) from the CWB to the Government of Canada could be a relatively straightforward matter. However, it would be inappropriate to transfer the assets without also transferring the corresponding liabilities and there are sound business reasons why that should *not* be done. Transferring the liabilities without a *significant* financial gain accruing to the transferee would merely serve to damage Canada's reputation in the international financial community.

The CWB issues both short and long term liabilities in a variety of markets including the domestic commercial paper and medium term note markets, the U.S. commercial paper market, and the Euro commercial paper and medium term note markets. The majority of the CWB's investors are resident in Canada, U.S., Japan, Europe, Latin America and China.

Given that the CWB's numerous debt instruments are widely held by investors worldwide, assigning the CWB's liabilities to another entity is complicated. None of the debt instruments have a call feature that could be exercised by the CWB. In other words, the CWB has no capacity to compel the investors to accept an assignment of the debt. Given that the instruments are effectively contracts between the CWB and the investor (understanding that the CWB rarely deals directly with the investor as all notes are placed through a variety of the CWB's dealers around the world), each investor would have to consent, in writing, to an assignment relative to each transaction before it could be affected. In the case of widely held notes, each investor's consent would be required. Obtaining such consents would be administratively cumbersome and consideration must also be given to investor concerns including, their credit limits assigned to the CWB and Canada. It is commonplace for investors to have distinct credit limits for the government of Canada and the CWB. Investors develop these limits carefully so as to suit their particular needs and they take any breaches of such limits very seriously. Assignment of such notes to the government of Canada may result in

investor's credit limits being breached. In addition, it must be recognized that there is little to no financial benefit for investors to undertake the administrative burden relative to assignment of the notes to the government.

5. Do you have views on any transition issues that you would like to pass on to the task force?

Simply stated there can be no "transition" for the CWB. In the absence of the single desk the only business option is for the company to close its doors. The single desk is the engine from which the CWB generates its entire value proposition for farmers. That proposition is significant but without it the CWB could not continue to be a valuable contributor to the economic well being of western Canadian farmers. In that regard we have attached for your reference a paper that sets out in more detail the specific value proposition that would be lost in the absence of the single desk.

The nature of the Task Force's questions suggests the creation of some sort of grain trading entity out of the remains of the CWB -- in short, a grain company. However, we trust that anyone considering such a plan will bear in mind the points we have made previously. In particular:

- The only options are a single desk or an open market. There is no such thing as a "dual" market.
- In an open market, the "CWB" -- as farmers understand it -- simply would not exist. Only entities that possess both primary and terminal elevator assets, full integration across the value chain and strong international marketing networks would be successful and sustainable in an open market environment. The necessary scale of operations would be measured in global terms and the barriers to entry at that level are astronomical. Because of this there can be no "strong", "profitable" or "viable" CWB -- the global grain market won't allow for it.
- Western Canada already has at least as much primary elevator capacity as it needs and the cost of constructing new port facilities is prohibitive.
- It is extremely difficult to see how the new entity could ever be sufficiently capitalized to step into a business with such high barriers to entry.
- If the CWB's single desk is removed, all of Canada's current share of wheat, durum and barley trade would be taken over by the same companies that control the rest of the world's trade.

Again for the sake of argument, however, if a new entity were created to play a role in the marketing of wheat and barley it would be obliged to assess the current activities in which the CWB engages with a view to determining which, if any, continue to make economic sense in the open market. That assessment would be essentially the same as that undertaken in any merger or acquisition situation. The following sets out the most likely outcome of any such analysis:

- **Sales.** Obviously critical to success in any marketing environment. However, the greatest sales team in the world is of no use without a product to sell. The likelihood is that the CWB's sales team would be hired away to work for the private trade.
- **Market Development.** A critical component of the long-term activities of the single desk, as all returns on market development expenditures come back to the single desk and therefore farmers. However, in the open market the organization making the investment

has no way to capture the returns because all of its competitors have the same ability to execute on the investment. Therefore no investment in market development is likely.

- **Market Analysis and Weather & Crop Surveillance.** A critical component of single desk marketing activities (key to market positioning, risk management and strategic pricing) made possible because all increased returns associated with expenditures come back to the single desk and therefore farmers. However, in the open market pricing is driven entirely by the margins required to achieve the target return over and above the entities fixed and variable costs on a transaction-specific basis. With little ability to view the market strategically, investment in such activities is unlikely as it would simply raise unit costs without generating any increased return.
- **Logistics and Procurement.** A key activity in maintaining control of the CWB brand and in leveraging grain companies and railways to drive rates and services. In the open market no such leverage would exist. More importantly, grain companies have the same expertise and resources. Accordingly, there would be no economic rationale for any new entity to retain the function.
- **Advocacy.** Advocating on behalf of farmers is something that only the single desk has an economic incentive to undertake as all benefits associated these activities are earned by or returned to farmers. Examples include CWB positioning on GMOs, railway level of service issues, port competition, railcar fleet ownership and trade matters. The direct benefits to farmers of these activities is in the hundreds of millions of dollars. In the open market, this activity cannot be sustained. By definition, a grain company answers only to its shareholders. Accordingly, any policy activity undertaken would be based on specific benefits to the company and not to the industry as a whole.
- **Other.** The remaining support activities such as Finance, I&T, human resources, etc., that the CWB currently must maintain may all be redundant in the open market. Such activities are common to all participants in the industry and as with any acquisition or merger the extent to which the new entity would require them would depend entirely on the business model that it pursues and the expertise that the target entity already possesses.

Suggestions have also occasionally been made that a new entity could provide some sort of brokerage services. Were that a viable business model one would expect such brokerages to be thriving yet, there are no such brokerages of any significance at all that are not already aligned with one of the transnational countries. Besides, is it realistic to think that any of these companies would actually need whatever services the new entity might be able to offer them? Certainly the CWB's extensive experience competing with them every day for the past 70 years would suggest that they do not need any help at all.

Regardless of what form a new entity might take, it is clear that the CWB itself would be in a wind-up situation.

As long as it is operating under its current legislative mandate the CWB must continue to work toward its overall objective of maximizing returns to producers on both the short- and the long-term. In this regard, the CWB is continuing to make long-term sales and long-term contracts that make sense for Western Canadian farmers. The federal government should be responsible for all of the costs associated with the inability to meet contracts or to execute on them in the post

single desk environment. Similarly, the CWB has a wide array of contracts and activities in other areas of its business that would have to be wound up. These range from service providers to all of the CWB's staff. Again, it is only fair to farmers that the federal government cover this cost. Finally, assets such as the CWB's hopper cars, the Canadian Malting Barley Technical Centre's equipment, and the future income stream from net interest earnings would have to be disposed of and the proceeds appropriately distributed to farmers.

Nor is it simply a matter of addressing those matters to which the CWB is a direct party. The CWB has a significant impact on a broad range of activities, tangible and intangible, economic and otherwise. For example, the implications for Canada's grain quality control system, the competitive balance in the ports and between the railways, the future utilization of ports such as Churchill and the likely reaction of the U.S. government to a potential influx of Canadian grain across its border are just a few of the significant policy issues that would need to be addressed.

When -- as it must -- this government calls upon western Canadian farmers to decide whether the single desk should continue, we believe that those farmers are entitled to a full and accurate understanding of the consequences of their decision. We presume that the results of this Task Force will tell farmers what this government believes that they would be getting when the single desk is removed. We trust that, in good faith, you will also tell them what the CWB believes they would be giving up if that happens.

RESPONSES TO SUPPLEMENTAL QUESTIONS RAISED AT MEETING OF OCTOBER 11, 2006

When the CWB met with the task force on the afternoon of October 11, 2006, additional questions were posed in the following subject areas:

Voluntary pooling – Can a voluntary pool operate effectively? What would be the effect of a guaranteed initial payment on a voluntary pool?

CWB response: There are two core components to the unique value proposition that the CWB can offer to producers; two things that no other industry participants could provide. These are single desk selling and price pooling. These two aspects are fundamentally related because the ability to pool prices is directly related to being able to secure supplies for sales commitments. In a rising market situation, if the spot price exceeds the expected pool return during a crop year, a voluntary pool would be unable to make sales because of limited supplies or worse be short grain against its sales commitments. The net effect is that the pool does not benefit from the rising spot price environment. Conversely, in a falling market, the voluntary pool would be flooded with grain, driving the pool value down for those who had already committed to the pool.

Providing a guaranteed initial payment to a voluntary pool might make the pool more attractive to farmers, by giving them a guaranteed floor price. However, this would ultimately depend on the level of the guarantee in relation to the market place. If the guarantee is similar to what exists today in a single desk environment, it would be essentially worthless. Regardless of the level of the guarantee, the reality is that the pool would run regular deficits as it experienced the shorts and floods that would inevitably happen. With the greater risk of deficit it would be prudent to assume that the government would use an even higher risk factor than it does today in setting the level of the guarantee. On the other hand, using a risk factor that is inappropriately low could raise trade concerns. Taking all of these factors into account it is unlikely that the government would be able to offer a meaningful initial payment guarantee.

This is a well understood phenomenon, as it is exactly what historical experience has been. The decade and a half leading up to the passage of the 1947 *Canadian Wheat Board Act* provide ample evidence of this. Furthermore, this very issue was fully debated by economists on both sides of the debate in the so-called "Charter Case".¹ In that case, after hearing from both sides, Justice Muldoon reached the same conclusion:

"The result of a non-viable Wheat Board is apparently this. Those who are skilled and/or lucky enough sometimes to "win", avoid the problems of the open market and probably would then greatly profit from it. Those who "lose", inevitably suffer the harms which the CWB was created to prevent. The ultimate result of the failure of the Wheat Board would mean a return to an open market which, Parliament has determined, is not an unalloyed benefit to Canada. Thus, on a balance of probabilities a dual market is indeed a merely transitional market. Should this be the case, everything would return to square one: an open

¹ *Archibald, et al v Canada*, Federal Court Trial Division, April 11, 1997 Muldoon J reported at (1997) 146 D.L.R. 4th 499. Plaintiffs' appeal to the Federal Court of Appeal was dismissed in a decision reported at 188 D.L.R. (4th) 538. Plaintiffs' subsequent application for leave to appeal to the Supreme Court of Canada was dismissed on March 15, 2001.

market which Parliament has recognized as causing (sometimes massive) problems.”²

Farmer loyalty/contract commitments – Assuming farmers would commit up to 50 per cent of supplies to a new entity, what would be the outlook?

CWB response: This question describes an open market environment where several sellers of Canadian wheat are offering product to buyers simultaneously. In this environment, where price premiums are lost and the price is bid down to the lowest cost alternative, a new grain marketing entity that does not own grain handling facilities would not survive. Refer to question 2 for a more fulsome explanation.

Customer relationships – The CWB has strong relationships with its customers – why wouldn't these relationships be maintained?

CWB response: In an open market environment, the ability to capture the single desk premiums that exist today would be lost. There would be several sellers of Canadian product ready to serve buyers. Buyers, operating commercial businesses, would be looking to source product at the lowest possible price. Relationships with customers would only be maintained to the extent that the new entity created is able to source, handle, transport and sell the product to the buyer at these competitively lower prices. Buyers would not be loyal to suppliers who are selling the same product at higher prices than what is available elsewhere.

It should also be noted that the sales function at the CWB is handled by a very small group of people. It is assumed that if the single desk is dismantled, these people, who hold the relationships with customers, would be aggressively pursued by other grain marketers.

Task force mandate – The mandate is to deliver a model that allows for marketing choice and a strong and viable CWB. Is there a business model that will allow the task force to achieve its objectives?

CWB response: In our view, the task force has an impossible task. Marketing choice means an open market. Without the single desk, the CWB cannot exist as farmers understand it today.

Transportation/system capacity – If access to Vancouver terminals is a problem, why couldn't the new entity look at moving grain through the U.S ports? Wouldn't the market adjust to these new realities?

CWB response: Moving grain through U.S. ports is cost prohibitive. Currently, U.S. rail freight rates are substantially higher than rail rates in Canada. For instance, rail rates to key ports in the U.S. are \$10 to \$25 per tonne more expensive than going to competitive ports in Canada. Railways in the U.S. charge shippers according to what the market will bear. Where water transport is a competitive alternative, U.S. rail rates tend to be around 3-4 cents per tonne mile. However, where water is not a competitive alternative, these rates are 6-7 cents per tonne mile.

In Canada, CN and CP Rail are required to manage their overall rate structure within the regulated “rail revenue cap” established under the *Canada Transportation Act*. This limits the

² Archibald (FCTD) at par. 178.

amount that they can charge for shipping grain products. The revenue cap provides for a rate structure that is in the 3-4 cents per tonne mile range.

If the CWB single desk is eliminated, it is the CWB's opinion that the revenue cap would eventually disappear. In this environment, Canada's major railways would have the full opportunity to charge what the market would bear. Given the fact that water is not a competitive alternative in Canada, the results based on U.S. experience are clear. American ports might be more competitive but at a substantially higher price for western Canadian farmers than they pay today.

There is no other body that has the CWB's combination of extensive and direct commercial involvement in the industry, resources to ensure sound economic analysis and singular focus on the best interests of farmers. This combination has been critical in the shaping of western Canadian grain transportation policy. It would not be possible in the absence of the single desk. The CWB was a key player in the development of the revenue cap as a replacement to the regulated rate cap. It regularly advocates on behalf of farmers in the area of transportation. As the single seller of Prairie-grown wheat and barley, it has substantial negotiating clout. The CWB has been a member of the Western Shippers' Coalition for many years, being a vocal proponent of running rights. It offers assistance to grain handlers with new railway product offerings. The CWB also successfully challenged both major railways on a level of service case and achieved a decisive decision that benefited farmers then and many years forward in the form of improved service. If the single desk is eliminated, these benefits to farmers, and to some players in the industry, would be lost as well.

Supplemental question to Question # 4 -- What about transferring the assets/liabilities to a new entity rather than to the government of Canada? When are they due?

As discussed in our response to the original question, transferring the assets could be a relatively straightforward matter. However transferring the liabilities is more complex. If the new entity is the government of Canada, which carries the same credit rating, this could be manageable. If the new entity has a different credit rating than the government of Canada, the exercise becomes even more complex and potentially not possible. Why would an investor who has a AAA rated note agree to move that note to an entity rated less than AAA? They would only do this if the compensation on the interest rate was sufficient to offset the increased risk. What is satisfactory compensation to one investor will be insufficient to another so, given the fact that the notes are widely held by investors worldwide, it would be a virtually impossible task to arrange consents to transfer all of the notes.

The terms of the CWB notes outstanding have maturities ranging from 15 years, 10-12 years and under 10 years.

The CWB also took the opportunity to ask the task force some questions and suggest areas of examination. They are:

- What deliberations have you had regarding the price and trade implications of implementing an open market? How will you be addressing these in your report?
- Do you intend to address the economic impacts associated with the task force's terms of reference? Will this be addressed in your report?
- Do you intend to address the transitional issues of employee severance, long-term customer contracts and long-term supplier contracts in your report?

- How do you intend to address some of the broader policy issues, such as:
 - Lack of railway competition
 - Variety development
 - Genetically modified products
 - Short line railways and producer cars
 - Quality control and assurance
 - Food safety
 - Market development