



Harvesting opportunity

Strengthening farmers' competitive advantage

CWB Board of Directors
Proposal to the Government of Canada



The Canadian Wheat Board
La Commission canadienne du blé

Executive summary

Each year, western Canadian farmers sell between \$4 billion and \$6 billion worth of wheat, durum, and barley to more than 60 countries worldwide through their marketing agent, the Canadian Wheat Board (CWB). These more than 68,000 farmers are uniquely positioned in the global marketplace through their single-desk marketing system, which provides them with the ability to differentiate and brand their quality Canadian products to extract superior returns from premium markets.

Through the consistency of their product, strength of their brand and effectiveness of their marketing system, Canadian farmers have established a position as a major exporter of wheat, durum, and barley, commanding an 11 per cent, 50 per cent, and 8 per cent share of the world market, respectively. The single-desk is an important factor in establishing this position, as it is the vehicle that enables farmers to effectively compete in the concentrated global market. However, this position is under significant pressure from existing and emerging exporters who continue to improve their offerings. This, coupled with volatile and often depressed commodity prices, poses a severe risk to the earning power of western Canadian farmers over the long-term. Compounding this issue is the fact that farmers are at a competitive disadvantage in the supply chain compared to the large vertically-integrated companies with which they compete, to which they sell, and from which they source inputs.

These national and multinational companies are able to leverage their dominant market position to maintain their profitability by passing along incremental costs to consumers or other participants in the supply chain. As a result, farmers are faced with an environment where input and logistical costs are increasing at a faster rate than revenues. Statistics Canada reports that since 1992 Canadian farm input prices have increased almost 32 per cent, while commodity prices have increased only 19 per cent. This prolonged trend has severely impacted the viability of farming in Western Canada to the point where Statistics Canada is projecting that total farm net income for the Prairie provinces in 2005 will be negative for the first time in history.

As the last farmer-controlled corporation in the western Canadian grain industry, the CWB is uniquely positioned to assist farmers in addressing the significant issues they face – through its focus on farmer needs, the strength of its farmer-elected board of directors and its ability to leverage the single-desk to maintain a strong Canadian brand, generate market premiums and champion farmers' interests throughout the supply chain. For farmers to successfully compete against large vertically-integrated multinationals over the long-term, their involvement in other aspects of the supply chain must be strengthened. The CWB board of directors proposes that

this can be accomplished through revisions to the *Canadian Wheat Board Act* that would allow the organization to operate in other segments of the supply chain to enhance the core marketing function and capture additional value for western Canadian farmers.

As part of this transformation, the board of directors proposes that the CWB alter its structure from a shared-governance corporation to a not-for-profit, non-share capital corporation that is entirely farmer controlled. In addition, the organization would establish a for-profit subsidiary with a mandate to add value to farmers by pursuing investments, partnerships, and joint ventures in other areas of the supply chain. This business model benefits western Canadian farmers by:

- Continuing to provide them with single-desk premiums and other benefits of the core marketing function;
- Providing them with the ability to share in profits earned upstream and downstream in the supply chain;
- Improving their access to premium grain markets via complementary investments or partnerships;
- Increasing negotiating authority with other market participants;
- Ensuring a secure demand for their products through downstream investments and relationships; and
- Reducing their overall supply chain costs.

The impending World Trade Organization (WTO) agreement also poses a significant issue for farmers, as they currently benefit significantly from the guarantees provided by the Government of Canada on the CWB's initial payment and borrowings. The initial payment guarantee provides protection to farmers in the event of catastrophic losses in the world grain markets, while the borrowing guarantee allows the CWB access to debt at competitive interest rates without capital against which to borrow. In light of the fact that the guarantees will cease to exist after an eventual WTO agreement, capitalization of approximately \$1.5 billion is being sought from the federal government to secure the long-term competitiveness and sustainability of western Canadian farmers. This contribution of capital will provide further evidence to farmers, the financial community and the general public of the government's commitment to build a successful future for Canadian agriculture.

The implementation of this proposal will strengthen western Canadian farmers competitive advantage and enable them to prosper in the global marketplace over the long-term by providing them with the ability to take advantage of opportunities to sustain and grow their businesses. As the last farmer-controlled corporation in Western Canada, the CWB is committed to taking action to address the significant issues farmers are facing to secure their future success.

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1.0 Introduction

The grains and oilseeds sector in Western Canada is under intense pressure due to increasing global competition from existing and emerging exporters, as well as significant concentration of ownership throughout the supply chain. Multinational market participants continue to increase their profitability by vertically and horizontally integrating their operations to increase their influence over the supply chain – often to the detriment of individual western Canadian farmers. Over time, Prairie farmers' profitability has been eroded dramatically. In fact, Statistics Canada is projecting that total farm net income for the Prairie provinces for 2005 will be negative for the first time in history.

The purpose of this document is to provide an overview of the CWB board of director's proposal to address these and other issues impacting western Canadian farmers. The report examines the western Canadian and global market environments in detail to determine how the CWB can be an element of the solution. It also outlines the major components of the board's proposal. This report has been updated from the previous version created in February 2005, and now includes updated information and reflects conversations that were held with senior federal bureaucrats with regard to clarifying aspects of the proposal.

2.0 The Canadian Wheat Board – farmers’ marketing partner

In 1998, following an extensive review of western grain marketing by the federal government, one of the most significant changes in the history of western Canadian agriculture occurred.¹ The *CWB Act* was amended to place farmers in control of their marketing agency and to allow for new farmer payment options to be developed. On December 31, 1998, a 15-member board of directors assumed overall governance responsibility of the CWB. Under this new model, 10 members of the board of directors are elected by western Canadian grain farmers, four are appointed by the federal government and the fifth, the President and CEO, is selected by the board and appointed by the federal government. Through this new shared-governance structure, the CWB became an organization that operates arms’ length from the federal government; it also became more directly accountable to the farmers it serves.

During this transformation, the CWB’s business lines remained consistent – the organization continued to manage the single-desk marketing of branded, high-quality western Canadian wheat, durum and barley, both domestically and internationally on behalf of Canadian farmers. These governance changes ensured that the organization’s only focus would be serving the needs of more than 68,000 western Canadian farmers², with the sole mandate of maximizing returns from the sale of their grain.

2.1 Scope of CWB operations

Western Canadian farmers sell 18 to 24 million tonnes of western Canadian wheat, durum and barley through the CWB each year to more than 60 countries worldwide.³ Annual revenue from those sales is in the range of \$4 billion to \$6 billion, with all sales revenue, less operating costs, returned directly to farmers. The organization’s headquarters are in Winnipeg and satellite offices are located in Vancouver, Ottawa, Beijing and Tokyo. The CWB also operates regional offices in Saskatoon and Airdrie, just north of Calgary. The majority of the CWB’s 460 employees are based in Winnipeg. Sixteen Farm Business Representatives cover large districts across Western Canada and are responsible for serving the business needs of farmers and maintaining contact with the individual grain-handling facilities within their districts. They meet with farmers individually and in groups to provide regular updates on CWB programs and work with farmers on issues around delivery, contracts and payments. The CWB’s annual operating costs are approximately \$60 million, which represents less than 2 per cent of annual revenues.

¹ A detailed history of these changes and the CWB can be found in Appendix 1.

² Based on the number of permit books for the 2004-05 crop year.

³ Current as of 2005.

The CWB helps coordinate the transportation of wheat, durum and barley grown on the Prairies from country elevator to port locations up to 2000 kilometres away by rail cars, but does not own or operate any elevators or railways. The CWB also provides a valuable service to farmers through the administration of producer cars, which is necessary when producers choose to load their own grain into rail cars instead of delivering it to an elevator. In 2004-05, 1,238 producer cars were administered by the CWB, which represents over 100 000 tonnes of grain.

2.2 Adding value for farmers

Western Canadian farmers are uniquely positioned in a fiercely competitive global marketplace through their single-desk marketing structure. The combination of single-desk selling, branding of western Canadian grain, flexible pricing and payment alternatives, focused market development and financial guarantees provides farmers with higher returns than they would receive in an open market. Additionally, all marketing revenues (less administration costs) are returned to farmers – not corporate shareholders. This allows the CWB to have a single focus – earning as much as possible for farmers through the marketing of their wheat, durum and barley. Each of these unique characteristics of the western Canadian marketing system is discussed in more detail below.

2.2.1 Single-desk selling – leveraging the premium western Canadian brand

The wheat, durum and barley grown by western Canadian farmers is recognized by customers worldwide as safe, consistent and of extremely high-quality. This brand value has been built over time and is maintained through a combination of Canada's world-class quality control structure, the single-desk marketing system and the CWB's superior customer service. Additional detail on western Canadian wheat, durum and barley and CWB brands can be found in Appendix 2. The single-desk is a key factor in maintaining and growing the brand, because it ensures western Canadian farmers are able to capture the full value of their product. In a market with multiple sellers of western Canadian wheat, buyers would be able to bid down the price they pay and the value farmers receive by encouraging competition among the sellers. The single-desk prevents this erosion of value. As a result, the annual value of the single-desk to farmers has been independently estimated to be between \$355 and \$405 million annually.⁴ This represents a significant contribution to the economic well-being of western Canadian farmers and to the entire western Canadian economy.

⁴ *The CWB and Barley Marketing: Price Pooling and Single-desk Selling*; January, 1997 - Schmitz, Schmitz, Gray and Storey; *Performance Evaluation of the Canadian Wheat Board*; January, 1996 - Kraft, Furtan and Tyrchniewicz; *Price Discrimination in the Context of Vertical Differentiation: An Application to Canadian Wheat Exports*; American Journal of Agricultural Economics, Volume 87, Issue 4 (2005) – Lavoie.

As identified above, Canada's quality control system is also an important factor in maintaining the value of the western Canadian brand. This system, established under the *Canada Grains Act*, determines the quality parameters for western Canadian wheat, durum and barley with considerable involvement by the CWB. Only varieties that meet performance criteria are licensed to be grown, which results in the production of grains that perform exceptionally well from agronomic and end users' perspectives (e.g., flour millers, maltsters). Furthermore, this system ensures the grain that end users receive will perform consistently from cargo-to-cargo and from year-to-year.

In addition, by working together through the CWB, farmers possess increased authority when working with other supply-chain participants. Farmers benefit through reduced rates and improved service when negotiating with grain buyers and other key service providers, including railways and grain handlers.

2.2.2 Flexible pricing and payment alternatives

Farmers receive sales revenue from the CWB in a number of ways. The traditional pooling system returns revenues, less marketing costs, through four pool accounts - wheat, durum, malting barley and feed barley. The pooling system:

- Ensures all farmers receive their share of single-desk premiums;
- Is a pricing risk management tool for those farmers that choose to use it – grain in the pool is priced throughout the year;
- Ensures individual farmers are not disadvantaged due the timing of sales of their grain; regardless of when grain is sold and the country to which it is sold, all pool participants delivering a particular product to a specific CWB pool will receive the same payment for it, after adjustment for transportation costs; and
- Spreads the costs of marketing, delivery and distribution over the entire volume of sales.

The 1998 governance modifications to the CWB provided the opportunity for the organization to better meet farmers' diverse business needs. Producer Payment Options (PPOs) have since been developed that provide farmers greater individual control over the pricing of their wheat, durum and barley, as well as how and when they get paid. These options provide farmers with the ability to manage their own pricing risks if they prefer this flexibility to manage their businesses.

The main payment options now available to farmers through the CWB (in addition to the traditional pooling system) are as follows:

- Basis Payment Contract (BPC): Farmers are able to lock in a basis for their wheat and malting barley when they consider it favourable, and subsequently lock in the futures price during the crop year. With this option, farmers have full control over the pricing of their grain.
- Fixed Price Contract (FPC): This option gives farmers a fixed price for their wheat, durum or barley. It is similar to the BPC option above, except it is a one-stage process, whereas the BPC is a two-stage process. Again, with this option, farmers have full control over the pricing of their grain.
- Early Payment Option (EPO): The EPO enables farmers to lock in a floor price for their wheat, durum, designated barley and feed barley at 80, 90 or 100 per cent of the value of the Pool Return Outlook (PRO). This option also allows farmers to participate in price gains if pool returns exceed the EPO price.
- Daily Price Contract (DPC): A new option introduced in 2005, the DPC provides farmers with a mechanism to earn a price for their wheat that reflects U.S. market spot prices on the day they choose to sell their grain.

The introduction of these options has been recognized by many farmers as very positive enhancements to their businesses. The CWB is continually seeking ways to improve these flexible options and add more value to farmers.

Producer Direct Sale (PDS)

Farmers also have the ability to sell directly to buyers through the PDS program in order to take advantage of niche and premium market opportunities. This program ensures that all western Canadian farmers retain the benefits of single-desk selling and earn their share of the single-desk premiums while enjoying additional marketing flexibility.

2.2.3 Financial guarantees

Western Canadian farmers benefit significantly from initial payment, borrowing and credit guarantees provided by the Government of Canada.

Government guaranteed initial payments provide protection to farmers in the event of a catastrophic collapse in grain markets. Initial payments are currently set by the government and are based on the CWB's best estimate of pool returns and the government's own analysis of markets. A risk factor is then deducted to account for potential price decreases. Farmers receive

initial payments on delivery to elevators followed by adjustment payments during the year and final payments following the close of the crop year.

Farmers also benefit from the government guarantee on the CWB's borrowings. Because the CWB returns all revenues less marketing costs to farmers, it does not retain any capital against which to borrow. Therefore, this guarantee provides the organization with the ability to borrow at competitive rates in order to finance its ongoing capital needs.

While most sales are made on a cash basis, credit is requested from customers periodically. Farmers benefit from the government's credit guarantees, which allow the CWB to compete in the global marketplace with large multinational companies that have access to similar (or more generous) credit programs from their respective governments.

2.3 Farmer perspectives and expectations of the CWB

The CWB is the last farmer-run corporation in the western Canadian grain industry. The transformation of the Prairie pools to shareholder-driven corporations has left farmers with no other market participant focused on their interests. In annual farmer surveys conducted on the CWB's behalf,⁵ farmers continually rate the CWB highest in terms of representing views that are very similar to their own (in 2005, 68 per cent of farmers surveyed indicated that the CWB's views on farming issues were very, or somewhat, close to their own).

As their marketing organization, farmers expect the CWB to be effective at selling grain and returning the highest prices. This fact is demonstrated by eight annual surveys, where farmers have consistently indicated that "getting the best price", "maximizing returns" and "aggressively marketing farmers' wheat internationally" are their main expectations of the CWB. Those same surveys have indicated that the majority of producers view the CWB as an efficient marketer, working on their behalf. Creating more value-added opportunities, branding western Canadian wheat as a unique, high-value product and becoming more involved in grain transportation have also consistently ranked high among farmers' expectations of the organization. The underlying theme to these statements is that farmers are seeking ways for the CWB to assist them in improving their bottom-line results. In addition, farmers have clearly articulated that they expect the CWB to defend their financial interests in the marketplace, both in dealing with customers and suppliers. Appendix 3 provides historical survey results reflecting the most urgent factors facing farmers and their perceptions of the CWB.

In addition, farmers have indicated they expect the CWB to advocate for them on issues of importance. On issues as diverse as trade, transportation and genetically-modified organisms, more than three-quarters of farmers surveyed thought the CWB should speak on their behalf (as reflected in the 2001 producer survey⁶).

Advocacy, trust, accountability, and business efficiency – farmers are expecting leadership from the CWB on grain industry issues in order to position them for growth and success. This is clearly and regularly stated by farmers through multiple avenues.⁷ In addition, they are concerned about the impending loss of the government guarantees through the current World Trade Organization (WTO) discussions and are pressing the CWB to work with government to define how the western Canadian agriculture industry will operate without the guarantees. Farmers are also calling on the CWB to explore the possibility of selling other crops, expand the basket of products and services offered to customers and undertake joint ventures or strategic alliances with other supply-chain participants, to add value to farmers' businesses.

Lastly, it is clear that farmers also expect the CWB to continue to demonstrate flexibility and complement its core pooling function with additional PPOs that enable them to meet their needs for enhanced cash flow and more hands-on risk management. In the CWB's 2005 farmer survey, 84 per cent of farmers indicated the CWB should continue to expand the PPOs – a strong signal for the growing support of initiatives of this kind.

⁵ The CWB has been conducting annual surveys since the farmer-elected board of directors assumed control of the CWB in 1998.

⁶ This information is most recently available from the survey conducted in 2001.

⁷ The CWB has held annual Combine to Customer Alumni Conferences in each of the past two years. Each conference was attended by 150 western Canadian farmers. Participants are alumni from an intensive one-week course held in Winnipeg to discuss the Prairie grain industry, where participants are invited to provide their views and guidance to the CWB board of directors. These farmers have been identified as "leading producers" and represent a wide variety of age groups, regions and viewpoints. Additionally, farmers regularly express their views on the western Canadian grain marketing system through annual farmer surveys, CWB farmer forums and conversations with directors and staff.

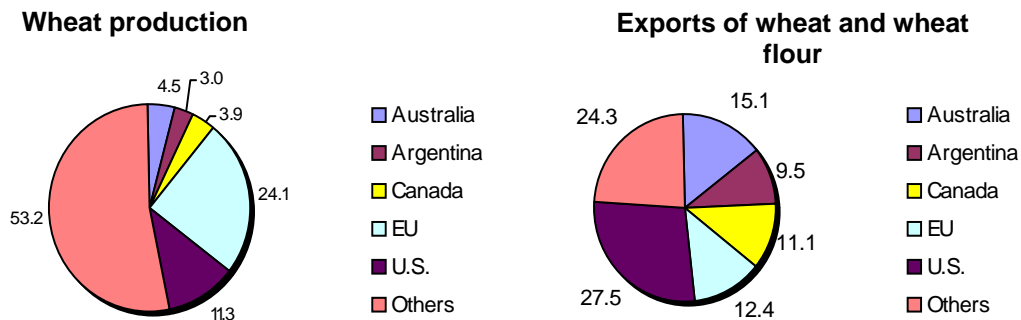
3.0 The western Canadian & global market environment

3.1 Global wheat, durum and barley market

The global market for wheat, durum and barley is highly competitive. All market participants are seeking ways to sustain and expand their share of the global market, particularly those markets that pay a premium for grain. Canada has established a strong market presence, controlling 11 per cent of the world's wheat export market, 50 per cent of the world durum market, and eight per cent of the world barley market.

Together, Canada, Argentina, Australia, the European Union (EU), and the U.S. account for approximately 75 per cent of the total wheat traded worldwide, while producing less than 50 per cent of the world supply, as outlined below. This represents a significant disparity, which has the potential to exert pressure on Canada's market share, particularly as traditionally "minor" exporting countries, such as Russia, Kazakhstan and Ukraine increase their presence as wheat exporters (see section 3.2). This disparity, coupled with the emergence of additional competitors and their competitive advantage from a cost-of-production standpoint, will continue to place downward pressure on wheat export prices.

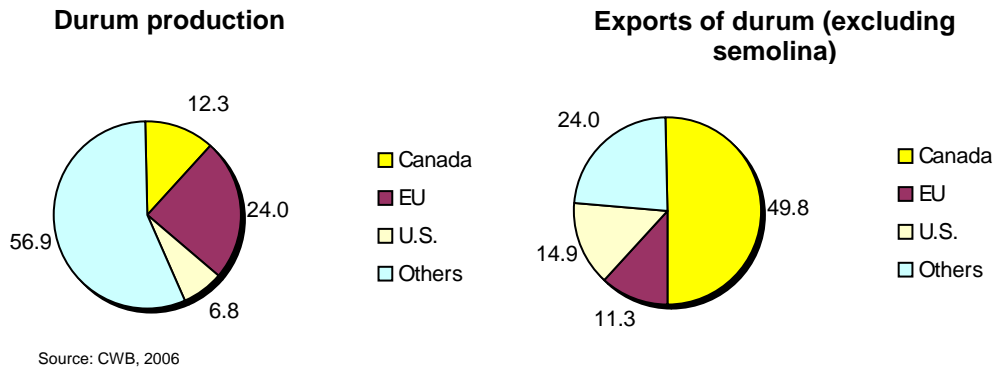
Market shares of production and exports by principal wheat exporting regions
(% of world totals over the 2001-2006 time period)



Source: CWB, 2006

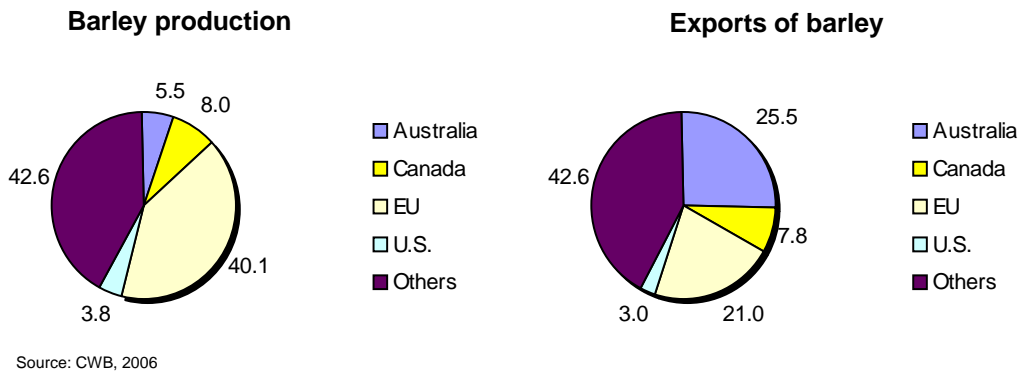
A similar condition exists in the durum market. As outlined below, the EU, Canada and the U.S. control approximately 75 per cent of the export market, led by Canada with 50 per cent market share. However, together these countries produce less than 45 per cent of the world's supply, with Canada producing only 12 per cent. This again leads to a disparity in production versus export market share, which intensifies an already competitive marketplace.

Market shares of production and exports by principal durum exporting regions
(% of world totals over 2001-2006 time period)



In the feed and malting barley export market, the main suppliers are Australia, Canada, the EU and the U.S, who together control approximately 55 per cent of exports. The EU dominates the barley market, capturing about 32 per cent of exports. The disparity between production and export is less significant in this market, as share of production is roughly equal to export market share for the major countries in aggregate.

Market shares of production and exports by principal barley exporting regions
(% of world totals over 2001-2006 time period)



3.2 Emerging exporters

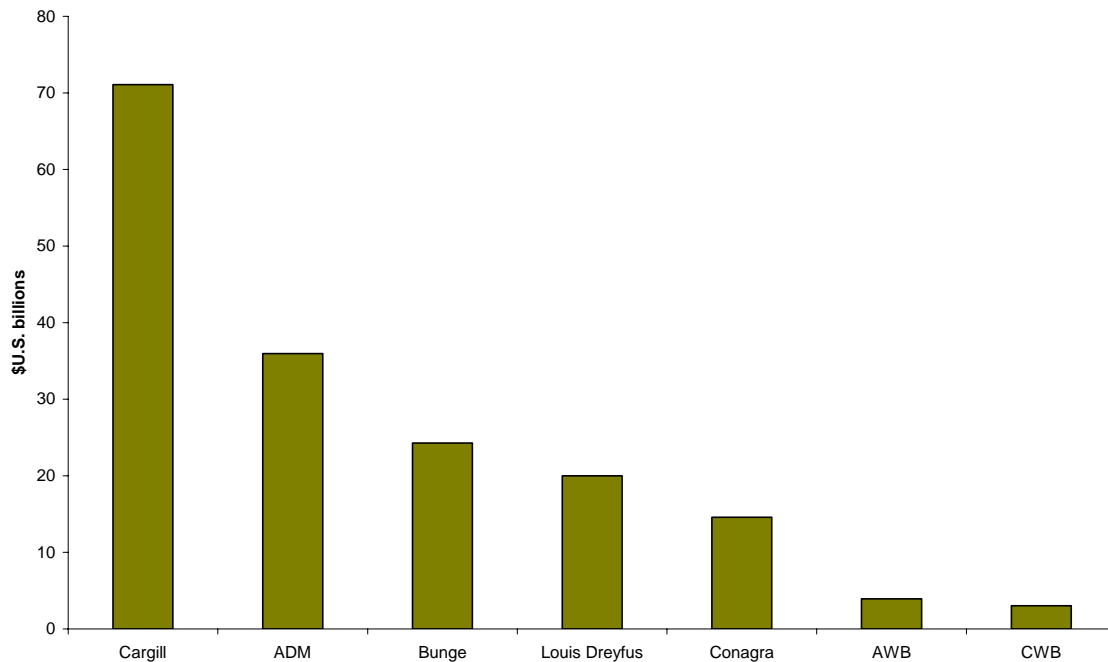
Recently, the notion that minor commodity exporters would remain “minor” in the long run has changed, particularly with respect to the countries of the Former Soviet Union (FSU) and Eastern Europe. With lower production costs compared to most wheat producing nations and a natural freight advantage to key markets in the Middle East and Africa, farmers in these countries have a considerable competitive advantage over their Canadian counterparts. These countries also have the potential to produce high-quality wheat, which would rival the quality of wheat produced by Canada, Australia and the U.S. should they dedicate sufficient resources to developing a system that would assure a consistent level of quality in the future. The development of a

reputable quality-assurance system combined with the low cost of production and freight advantage could result in exporters from these regions potentially gaining a much larger share of the global wheat market which would negatively affect the returns for farmers in Western Canada.

3.3 Participants in the global grain trade

A handful of vertically and horizontally integrated multinational agri-businesses effectively control the global grain trade. A 2003 study by the Boston Consulting Group for the Australian Wheat Board (AWB) reported that four companies – Cargill, Louis Dreyfus, Archer Daniels Midland (ADM) and Bunge – effectively control 73 per cent of the global market for grain. The 2005 gross revenue for these companies is depicted in the chart below, and a detailed description of each is included in Appendix 6.

Total Revenue of CWB's Global Competitors (2005)



Source: Publicly available company information

These companies own or have a stake in multiple segments of the food supply chain, including plant breeding, production and distribution of crop inputs, merchandising (i.e. financial and risk management services, handling/storage, transportation, and marketing), and processing (primary, secondary, and tertiary food processing; feed processing; livestock feeding; and industrial processing). They are also engaged in numerous production and consumption markets around the world, which allows them to source grain from multiple areas to smooth supply, while simultaneously securing stable demand for their products worldwide. Through their integrated

businesses, these companies are able to extract value for their shareholders from multiple segments of the supply chain, while significantly reducing the supply, demand, and other risks associated with their businesses.

AWB Ltd. is another major market participant that is highly integrated, with interests ranging from varietal research and breeding, crop inputs, storage and handling in the country and at port, ownership of rail cars, chartering and freight trading, optional origin trading, marketing of a variety of crops into domestic and offshore markets and milling operations. Their integration has been accomplished mainly through direct investments, acquisitions, and joint ventures. A detailed account of AWB's evolution and current status are provided in Appendix 4.

In addition to these companies' extensive ownership of businesses along the supply chain, they also participate in numerous strategic alliances and joint ventures, which act to significantly broaden their reach. These alliances and joint ventures are used to enhance company revenues by improving their access to grain and oilseed supplies, strengthening their contact with end-users and consumers, increasing their presence in burgeoning grain and oilseed producing regions, generating logistical cost savings and entering into non-traditional business activities without undertaking a large initial capital and resource investment.

Examples of some of these business ventures include:

- AWB's participation in a logistics joint venture with Co-operative Bulk Handling (CBH) Group to manage the grain logistics and generate cost savings in Western Australia for AWB;
- Cargill's operation of a marketing joint venture with AOASS, an association of seven farmer-owned co-operatives located in Sonora, Mexico. This arrangement gives Cargill the exclusive right to market 500 000 tonnes of durum from the 1,600 farmer-members; and
- ADM's participation in numerous joint ventures with local grain handling and storage companies, including ADM/Cenex Harvest States, ADM/Farmland, ADM/Growmark, ADM/Countrymark LLC and Farm Services Coop/ADM Grain, among others.

These companies are also aligning with customers in order to gain preferential supply access. For example, AWB Ltd. has established joint ventures with mills in Egypt (Five Star Flour Mill), and China, which require the mills to use an agreed upon amount of Australian wheat in their operations. As a result, these companies are able to lock in a stable demand for their products through companies they own or have business relationships with. This can result in the exclusion of other grain sellers who are unable to complete sales to these customers. This level of integration continues to disadvantage farmers, who are becoming increasingly captive and reliant on fewer and fewer companies.

3.4 Concentration in the domestic grain handling and transportation system (GHTS)

The grain handling and transportation system in Western Canada is also highly concentrated. In the grain handling sector, a few large companies dominate all stages (primary, terminal and transfer) of the supply chain. Four companies control both primary elevators and terminal elevators, namely, Agricore United (AU), Saskatchewan Wheat Pool (SWP), Cargill and James Richardson International (JRI). The fact that these companies own both country and port facilities means that they control both ends of the supply chain, providing them with significant market power. These four companies control over 65 per cent of primary elevator capacity across the Prairies. The two largest, AU & SWP, control almost 50 per cent of the GHTS.

Concentration is even more pronounced at the West and East Coast ports (including Thunder Bay). AU, SWP, Cargill and JRI control 100 per cent of the licensed terminal storage capacity in Vancouver. A consortium of these four owns the sole terminal in Prince Rupert. In Thunder Bay, AU, SWP, Cargill and JRI control approximately 75 per cent of terminal capacity.

Due to the high concentration of port ownership, competition tends to be minimal, particularly in Vancouver. Due to the prohibitive costs of constructing a port terminal, and barring a major shift in the customer base for Canadian grains, Vancouver terminals will continue to hold considerable market power over grain shipments through the port.⁸ To drive greater competition in the ports, the CWB has repeatedly sought to enter into agreements with terminal owners. Despite its attempts, the CWB has been unable to find a West Coast terminal willing to enter into an agreement. The only terminal agreement that the CWB has been able to secure is in Thunder Bay, with a small terminal that does not own primary elevator facilities and is not a member of the Western Grain Elevators Association (WGEA).

Key participants in the GHTS are also closely integrated with the multinational corporations that the CWB competes with worldwide (for example, ADM is a major shareholder of AU and, through a trading arm, A.C. Toepfer, is closely tied to SWP).

In terms of rail transportation, two railways, Canadian National (CN) and Canadian Pacific (CPR) effectively control 100 per cent of the movement of grain from Western Canada. Geographic circumstances, such as location of product relative to a rail line severely limit competition between the railways, while the lack of effective running rights remedies under the *Canada*

⁸ The Competition Bureau's involvement at the port of Vancouver indicates there is concern over the level of competition at port. They are requiring that AU divest itself of one of its facilities after the merger of Agricore and United Grain Growers. The Bureau is also examining the competitive environment vis-a-vis the Saskatchewan Wheat Pool/JRI joint-operating agreement.

Transportation Act significantly restricts any grain shippers' ability to shift traffic from one railway to the other.

Rationalization of CN's and CPR's rail networks has further increased the captivity of farmers to the service and rates offered by a single railway. Without effective competition between CN and CPR for grain deliveries, or without effective shipper safeguard or running rights legislation that compels CN and CPR to compete, farmers' freight costs are expected to continue to increase while service levels decline.

3.5 The domestic processing industry

The Canadian processing industry is also highly concentrated. Two companies (ADM and Robin Hood) control almost 60 per cent of the Canadian milling industry, while Canada Malt (owned by ConAgra) and Prairie Malt (owned by SWP and Cargill) control approximately 75 per cent of the Canadian malting industry.

The CWB is currently the major supplier to the Canadian processing industry, but it is not the sole supplier. Canadian mills located in Eastern Canada (which account for over 65 per cent of milling capacity) also source grain from Ontario and/or Quebec. Similarly, maltsters also source a percentage of their grain from outside Western Canada. Most significantly, however, Canadian millers and maltsters have duty free access to U.S. and Mexican wheat, durum and barley. These crops are also available from other countries under tariff rate quotas (TRQs).

3.6 Summary

Both the western Canadian and global agriculture industries are in a state of constant transition. While change itself is not unhealthy, the factors driving the change and how farmers are positioned are causes for concern. Appendix 5 describes in additional detail how the agriculture industry in Western Canada has evolved over time, and some of the factors that are driving the change. The market power imbalance between farmers and other participants in the agricultural supply chain is significant, and western Canadian farmers will continue to face difficulty in maintaining and growing their access to the global marketplace. For those who remain in farming, change is necessary in order to sustain and enhance their businesses over the long-term.

4.0 The case for change

As demonstrated in the industry overview, the grains and oilseeds sector in Western Canada is under intense pressure from multiple forces. Increasing global competition from existing and emerging exporting countries, coupled with continually depressed commodity prices, is placing severe pressure on the revenue western Canadian farmers are able to earn for their products. Exacerbating this issue is the fact that farmers' input and logistical costs continue to increase, due in large part to the significant competitive imbalance that exists between large multinational participants in the supply chain and individual farmers.

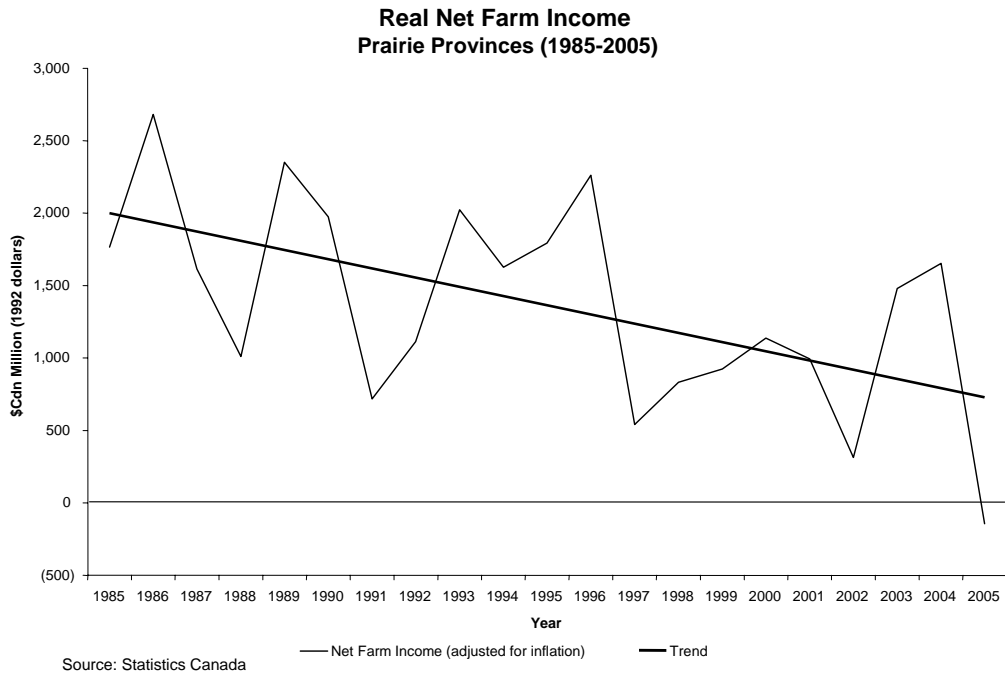
As previously outlined, the western Canadian and global grain trade is dominated by a few vertically and horizontally integrated national and international organizations. As a result, western Canadian farmers are at a significant disadvantage in the supply chain, acting as a price taker on the purchase of their inputs and the transportation and handling of their output. In contrast, larger market participants are able to pass along incremental costs incurred to other parts of the supply chain, or consumers, to maintain their profitability. In addition, vertically integrated companies in the industry are able to control multiple aspects of the supply chain, enabling them to influence pricing across the industry to their advantage, secure steady sources of supply and negotiate exclusive delivery arrangements with desirable customers. As a result, these organizations are able to command a significant amount of control over the western Canadian grain industry and are able to earn an increasingly large percentage of the profits generated, often at the expense of farmers.

For example, Statistics Canada reported that between 1997 and 2003, the price Canadian consumers paid for food increased 13.8 per cent, while the average price received by farmers increased only 2.1 per cent. This means that the price paid by consumers increased over six times more than the price received by farmers. Furthermore, while farmers' share of the food dollar from the marketplace has been declining steadily, farm input costs continue to increase. Statistics Canada reports that the Farm Input Price Index for Western Canada increased 31.7 per cent from 1992 to 2004. Additionally, since 1992 the following input cost increases for western Canadian farmers have been observed:⁹

- 58.4 per cent increase in overall crop production input prices;
- 67.9 per cent increase in fertilizer prices;
- 60.7 per cent increase in diesel-fuel prices; and
- 33.7 per cent increase in pesticide costs

⁹ Statistics Canada Farm Input Price Index

Over time, this imbalance in market power has led to declining farm profitability. Statistics Canada is projecting that total net income for the Prairie provinces in 2005 will be negative for the first time in history, as outlined below:



The pronounced downward trend in income demonstrates these issues are not short term or cyclical but rather long term and systemic in nature. Canadian farmers are clearly locked in a deep and continuing economic crisis – the CWB’s 2005 farmer survey found that 62 per cent of farmers expected to lose money in 2005 and more than 50 per cent indicated they were in imminent danger of going out of business. With crop prices and input costs where they are today, this number is likely to increase in the 2006 survey.

4.1 An element of the solution

As the last farmer-controlled corporation in the western Canadian grain industry, the CWB is uniquely positioned to assist farmers in managing the pressures they are facing and will continue to face in the future. A few of the organizational characteristics that demonstrate this are as follows:

- The company exists solely to deliver maximum returns to Canadian farmers – it passes back the full value of grain to farmers and retains no earnings for corporate shareholders;
- Farmers continually rate the CWB the highest in terms of representing views that are very similar to their own;
- The organization is a strong and effective marketing organization, with longstanding business relationships both domestically and abroad;
- The farmer-controlled board of directors and senior management team understand and act on farmer issues;
- The company has established a value-added brand for Canadian wheat, durum and barley, which is leveraged exclusively for the benefit of farmers; and
- On behalf of its more than 68 000 farmer-owners¹⁰, the CWB, as a major market participant, can act to increase farmers' competitive leverage in the supply chain to offset some of the business pressures resulting from the significant competitive imbalance.

As a farmer-driven Canadian organization, the CWB has a vested interest in ensuring the ongoing viability of its owners, western Canadian grain farmers. However, as previously demonstrated, farmers' influence across other areas of the supply chain must be strengthened if they are to compete and remain successful over the long term. With some change, the CWB, through its farmer focus, unique structure and existing core competencies will be well positioned to strengthen farmers' competitive advantage in the global marketplace.

¹⁰ Based on the number of permit books for the 2004-2005 crop year.

5.0 The CWB board of directors' proposal

Based on the issues outlined in the previous sections, the CWB board of directors has developed a detailed plan that addresses the needs of farmers, as well as the interests of other key stakeholders. The driving force behind this proposal is the strengthening of western Canadian farmers' competitive advantage to ensure their ongoing viability and prosperity in the global market. To that end, the board has developed a revised vision and mission for the CWB that reflects the organization's focus on farmers and their leadership role in the global grain market, as follows:

Vision: Canadian farmers innovatively leading the way in the global grain market.

Mission: Creating a sustainable competitive advantage for farmers and customers through our unique business structure, innovative marketing, superior service, profitable investments and effective partnerships.

During the process to develop this detailed plan, the board of directors worked with external advisers to develop a business model and governance structure designed to achieve the following broad objectives:

- Maximize farmer benefit and control;
- Maximize the value of key business assets, including the single-desk;
- Maximize good governance and accountability;
- Minimize taxation (income, capital and withholding taxes);
- Minimize impact on creditworthiness and the cost of capital; and
- Minimize operating costs and complexity.

5.1 Business model

To achieve the vision, the CWB must expand its role beyond the traditional mandate as purely a marketer of Canadian wheat, durum and barley. A revised *CWB Act* that enhances farmers' single-desk marketing system and allows the organization to operate in other segments of the supply chain to capture additional value for farmers is critical to address the disparity in market power that currently exists. In addition, due to the broadening of the organization's mandate and its necessary entry into more commercial activities, the board of directors recommends that the CWB transition to an entirely farmer-controlled organization.

To effectively manage this business model, the board of directors recommends that CWB business activities be conducted through two primary operating entities:

- 1) A parent agricultural organization (CWB), to conduct the core marketing business; and
- 2) A wholly-owned subsidiary company, coined Business Ventures Holdings (BVH), to serve as a vehicle for commercial activities, including investments, partnerships and joint venture arrangements.

This business model benefits farmers through:

- Continuing to provide farmers with single-desk premiums and other benefits of the core marketing function;
- An ability to share in profits earned upstream and downstream in the supply chain;
- Improved access to premium grain markets via complimentary investments or relationships;
- Increased negotiating authority with other market participants;
- A secure demand for their products from downstream investments and relationships; and
- Reduced supply chain costs.

5.1.1 Core business – parent holding company (CWB)

The parent company will be focussed on the single-desk marketing of western Canadian wheat, durum and barley sold for human consumption in Canada and export. Key activities necessary to perform this function include:

- Operation of the single-desk, the pools and other marketing activities;
- Producer payments, pricing options and sales operations;
- Maintenance of reserves or contingency funds relating to pricing options;
- Management and administration of new and rescheduled sales accounts receivable;
- Management of debt required to finance the parent company's operations; and
- Management and administration of capital received from the federal government (as outlined below).

In order to effectively carry on this type of business, the board of directors reviewed a broad range of business models including a for-profit corporation under the *Canada Business Corporations Act*, a cooperative corporation under the *Canada Cooperatives Act*, a non-share capital corporation under the *Canada Corporations Act*, a trust, and a limited partnership. In addition, the board examined four structure options that included separate business units under a CWB holding company and other variations of that theme.

Based on assessment criteria, including the affect on farmers, farmer control, farmer ownership, the single-desk operation, WTO consistency, taxes, governance and new business initiatives, the board of directors concluded that the core business should be conducted through a special act non-profit corporation. This corporation would exist without share capital and be non-taxable pursuant to section 149 (i)(e) of the *Income Tax Act* (to be confirmed by an advance income tax ruling) as a continuation of the existing CWB. As a result, the CWB would cease to be classified as a Shared Governance Corporation.

Some of the key findings leading to this conclusion include:

- The non-share capital corporation will provide farmer control. Farmers will control the entity through a board of directors, the majority of whom are elected farmers. In addition, this structure ensures that farmer control is not diluted through time, as can be the case under a share capital model (examples include Agricore United and Saskatchewan Wheat Pool, who began as farmer-controlled entities and are now controlled by and act in the interests of shareholders);
- The model ensures that the restructured CWB will be operated solely for the benefit of western Canadian grain farmers and that key ownership rights will be conferred on such farmers. The entity will focus on maximizing returns to farmers for their deliveries, rather than creating surpluses to reward investment capital; and
- A non-share capital model allows the core business operations of the CWB to remain non-taxable, which is critical to ensuring farmers' returns are not adversely impacted.

Overall, the non-share capital corporation model was determined to provide the highest economic value to farmers through its non-taxable status, access to low-cost debt, ability to distribute surpluses and ability to hold tax-efficient capital reserves.

A special act is required, since none of the existing statutes, (the *Canada Business Corporations Act*, the *Canada Corporations Act*, and the *Canada Cooperatives Act*) allow for achievement of the objectives outlined. A special act would ensure the organization is accountable to western Canadian farmers and is structured to provide them with maximum benefit.

Ownership

Farmers would have ownership rights in the CWB parent company as follows:

- Financial benefit from the operations of the organization. Farmers would receive the net revenue from the sale of products marketed by the CWB;
- Control of the corporation through its governance structure and in particular, farmers' right to vote for directors. These voting rights are as influential as those enjoyed by members of non-profit corporations, members of cooperatives and shareholders of a share capital corporation;
- Farmers' ownership stake in the CWB could be transferred. In practical terms, if a voting producer sold the underlying property interest, the purchaser would have access to a new permit book; and
- The CWB would be accountable to farmers. In addition to accountability through the electoral process, this proposal to government recommends that governance and accountability structures similar to those that exist in other modern corporate and securities statutes be included in the *CWB Act* (see section 5.2).

Capitalization

As previously outlined, western Canadian farmers currently benefit from the guarantees provided by the Canadian Government on the CWB's initial payment and borrowings. The initial payment guarantee provides protection to farmers in the event of catastrophic losses in the world grain markets, while the borrowing guarantee allows the CWB access to debt at competitive interest rates without capital against which to borrow. In light of the fact that these guarantees will cease to exist with an eventual WTO agreement¹¹, capitalization is being sought from the federal government to ensure the CWB can continue to borrow at reasonable rates to finance its operations, including providing cash flow to farmers throughout the year. In addition, the contribution of capital will provide further evidence to farmers, the financial community, and the public at large of the government's commitment to build a successful future for Canadian agriculture.

Together with external experts, the CWB has employed varying approaches to complete some initial assessments of the amount of capital required in the absence of the guarantees. One approach assessed the capitalization of other companies with similar credit ratings to provide a benchmark regarding the market value of the guarantees. Cash flow evaluations of the guarantees were also considered to quantify costs to the CWB as a result of the loss of the guarantees. Based on this review, the board of directors has concluded that a capital contribution of an estimated \$1.5 billion will be required. Of that amount, the board intends, at the outset, to

¹¹ It is the CWB's understanding that while the WTO Framework Agreement contemplates further disciplines on export credit (applicable to all members), export credit guarantees will not be eliminated. Thus, the federal government's export credit guarantee should continue to be available to the CWB.

dedicate \$100 million to potential equity investments that would provide benefit to farmers through Business Ventures Holdings (as outlined in section 5.1.2).

To reflect the organization's fiduciary duties regarding this capital, an appropriate governance model will be implemented (as outlined in section 5.2.2).

5.1.2 Other businesses – separate wholly-owned subsidiary (BVH)

Commercial activities would be undertaken by a separate entity, "Business Ventures Holdings" (BVH), a CWB subsidiary. This entity's primary mandate would be to explore opportunities to add value to Canadian farmers through participation in domestic and international agriculture ventures. BVH would make strategic investments in commercial businesses, enter into partnerships, or form joint ventures throughout the supply chain to achieve its mandate.

Any profits or returns earned on investments would either be reinvested in opportunities that satisfy the investment criteria outlined below, or paid back to the parent company for possible distribution to farmers.

Investment considerations

BVH would be established as a distinct, for profit, taxable corporation with share capital, incorporated under the *Canada Business Corporations Act* (CBCA) as a wholly-owned subsidiary of the CWB. Each BVH investment would be undertaken in a separate operating entity that is owned in whole, or in part, by BVH. The organization would be structured as a stand-alone corporation, with no cross-subsidization between it and the CWB.

As a *Canada Business Corporations Act* corporation, BVH could permit voluntary producer direct investment, should that prove to be financially attractive to individual producers. BVH could also, if desirable, allow third party (i.e. non-producer) investments, including capital markets participation, directly in the operating entities. It is also possible, though not required, that the capital fund of the CWB (as part of its investment portfolio and strategy) might invest from time to time in BVH to earn an appropriate return. Decisions regarding new ventures would be considered based on the following criteria:

- Any new venture must add value for western Canadian farmers by increasing sales revenues, reducing handling, transportation, other production input costs, or maintaining/enhancing demand for western Canadian wheat and barley;

- New ventures must be profitable on a stand-alone basis (i.e. independent of the core business) and within a defined time period. The defined time period will be specific to the individual investment;
- An acceptable corporate return-on-investment to meet pre-determined targets will be established;
- Adequate funding for the venture must be assured prior to its implementation;
- Financial liability in respect to the new venture must be defined and controllable;
- Any new venture must have quality management with the appropriate expertise to run the new venture. Executive-level management and staff for CWB marketing operations and BVH must be separate;
- Potential investment in a new business venture may need to be reviewed by independent consultants or hired professionals with the required expertise in the proposed activity; and
- Any project would be undertaken only after rigorous due diligence with all necessary risk mitigation strategies.

Subject to the above criteria, some of the areas of investment that may be undertaken by BVH to add value for farmers include:

- Primary grain handling and elevation;
- Grain handling and elevation at port position;
- Value-added processing, including, milling and baking facilities, malting facilities and ethanol production facilities, nutraceutical production facilities;
- Financial and risk-management services for farmers;
- The manufacture, wholesale and retail distribution of crop inputs, including seed, fertilizer and chemical; and
- The infrastructure, if required to conduct the above business activities.

5.1.3 Domestic competition

The CWB recognizes that maintaining the single-desk while pursuing domestic investments gives rise to the need for oversight mechanisms to ensure the organization does not:

- a) Operate outside of its statutory mandate;
- b) Operate in an anti-competitive manner;
- c) Abuse regulatory powers for competitive advantage; and
- d) Engage in cross-subsidization between the CWB parent company and BVH.

Oversight mechanisms exist for each and are addressed separately below:

(a) Actions beyond the statutory mandate

Administrative law remedies are available that provide well-understood and effective means to resolve disputes. The CWB directors will also have a governance responsibility to ensure that the corporation respects its mandate.

(b) Anti-competitive market conduct

Remedies exist in the *Competition Act*, including the ability of the Competition Bureau to intervene to discipline inappropriate market conduct. The Bureau has the required expertise to address disputes of this nature, and as such it is not necessary to establish a parallel bureaucracy. If needed, specific language could be added to the *Competition Act* to confirm the Bureau's jurisdiction.

(c) Abuse of regulatory powers for competitive advantage

The courts provide an appropriate existing venue to resolve such disputes. It would also be feasible to amend the *Competition Act* to empower the Competition Bureau to consider and resolve complaints against the CWB for using its regulatory powers in an anti-competitive manner. Again, the existing expertise in the Bureau, both to investigate complaints and to determine remedies, would be directly applicable.

A further possibility for oversight, both in respect to abusive market behaviour (item (b) above) and misuse of regulatory powers, would be a specifically designed directive power available to the government in such circumstances.

(d) CWB/BVH cross-subsidization

The Competition Bureau could, in the case of any BVH acquisition, impose appropriate terms, as it has done in the past in other somewhat similar circumstances. Those could include the establishment of commercially-driven firewalls. In addition, the governance framework of CWB and BVH will be structured to ensure appropriate fiduciary obligations to guard against cross-subsidies from the CWB to BVH.

5.2 Governance

In light of the broadening of the CWB's mandate and its necessary entry into more commercial activities, coupled with the elimination of the federal government's financial stake in the CWB that will come with the removal of the guarantees on the CWB's borrowings and initial payments, it is an appropriate time to formalize farmer control of the CWB. Therefore, the governance structure recommended by the board of directors is designed to build on the present governance practices of the CWB, updated to formalize farmer control and address the expanded range of commercial activities. The changes that the board is recommending also focus on enhanced accountability to farmers and on achieving good governance practices by: (i) assuring the independence of directors; (ii) assuring the board has the required skill mix; and (iii) assuring the integrity of financial practices, oversight and reporting.

5.2.1 CWB parent company – governance structure

Board size and composition

The number of board members would remain at 15 with the current mix of farmers (10), appointees (4) and the President and CEO. There should be flexibility to allow for the appointment of additional directors (i.e. in excess of 4) to meet skill set requirements necessary to meet emerging demands.

Electoral oversight

At present, board elections are conducted pursuant to the detailed terms contained in the *CWB Act*. The Regulations, among other things, prescribe electoral districts, establish eligibility criteria for voters and candidates for election, provide the mechanics for the transferable vote system which is employed and define other important electoral procedures (including items such as nominations procedures, spending limits and contribution disclosures). Given the revised governance structure and changes in business model, this framework would need to be altered as outlined below.

The *CWB Act*, like other corporate statutes, should specify the essential components of producer voting rights and the electoral process, including, for example, the eligibility criteria for voters and candidates. Thus, the fundamental rules and rights in respect to elections would be entrenched in statute. However, there would remain more detailed electoral issues which, while important, may require revision over time without the need to involve Parliament (for example, candidate spending limits for the purpose of their campaign). In addition, there should be an impartial and

readily available means to resolve complaints or disputes that might arise in the conduct of elections.

To address these issues, the board of directors is proposing that a new CWB Electoral Commission be created, with authority to make regulations in respect to the electoral process and to resolve complaints and disputes. The electoral commission would consist of two eminent persons from the producer community selected by the CWB board, two independent persons selected by the government and a fifth person, selected by the other four.

The board also recommends that the *Report Respecting the Review of the Electoral Process for Election of Directors of the Canadian Wheat Board* submitted by the CWB Election Review Panel on November 30, 2005 be implemented, subject to the items listed above and the points raised by the CWB in a letter to the Honourable Chuck Strahl, dated March 6, 2006 (included in Appendix 7).

Director qualifications and appointment

Improving board quality and effectiveness has been one of the key priority areas to which current governance reforms in Canada and around the world have been devoted. In Canada, Bill 198 has established that public corporation boards are required to develop a board profile, which defines the skill sets required for appropriate oversight. It is increasingly common for public companies to engage outside consultants to source directors to fill the gaps identified by the board, so they can ensure they possess all the relevant skills. To like effect, Crown corporations at the federal level, through their nominating committees, are required to have the assistance of executive search firms as they identify candidates to fill board positions. Therefore, in order to formalize farmer control and to address the needs and requirements set out by Bill 198, the board is recommending that:

- A clearly defined, optimal skill set required by the board of directors for farmer directors be documented and implemented; and
- The appointment of external directors be the board of director's responsibility. The board, assisted by the Governance and Management Resources Committee (GMRC), would identify key skills required to fill any board vacancy. A search firm would be utilized to source suitable candidates, with the GMRC acting as the nominating committee and compiling a short list of applicants. The board of directors would consider the short list and would identify the preferred candidate to fill the vacancy.

5.2.2 Capital - governance

The capital fund will be held on behalf of, and for the sole benefit of, current and future Canadian farmers. The management and integrity of the capital infusion will be critical to the sustainability of the recommended business model over time. An investment policy will be developed which outlines how the fund will be managed to ensure the long-term stability of the capital.

In light of the governance objectives noted above, the board of directors is recommending the following oversight structure for the capital:

- (i) The board of directors of the CWB would have functional responsibility for the oversight and management of the capital, as with other CWB business functions. However, this responsibility would be undertaken with the added rigor noted below.
- (ii) The *CWB Act* should detail the purposes of the capital and the high-level mechanics of its operation, including an identification of the fundamental decisions, which would require director approval for use of the capital.
- (iii) A special Oversight Committee should be established with the mandate to oversee the capital (and to recommend key decisions to the board as a whole) in light of the statutory objectives.
- (iv) The Oversight Committee should consist of five persons; two would be elected CWB directors designated by their peers, two would be appointed CWB directors designated by their peers, and one would be an outside party with particular skills relevant to the financial mission of the capital. The outside party would be chosen by the other members of the Committee and would serve as the committee chair. It is recommended that the Chief Executive Officer (CEO) not be a member of the Oversight Committee, but it should be made clear that the CEO has a right to attend its meetings.
- (v) The *CWB Act* should expressly obligate all directors to manage the capital to achieve its statutory objectives, with the advice of the Oversight Committee. This duty would supplement the general fiduciary duties of the directors toward the CWB.
- (vi) The capital would be accounted for separately, and would be the subject of specific disclosures and reporting in the CWB annual report and at its annual meeting.

5.2.3 Business Ventures Holdings - governance structure

At its inception, BVH would have limited assets and management structure. As such, to minimize undue complexity, BVH and the CWB parent holding company would be governed by a common board, until the organization reaches a state whereby it merits a separate governance structure.

If, as previously outlined, producers or other investors participate in various BVH ventures, a governance structure that recognizes the economic interests of the other shareholders would be implemented.

5.2.4 Additional governance features to be entrenched in the statute

To ensure that the governance objectives noted earlier are achieved, the *CWB Act* should entrench certain minimum ongoing governance and accountability structures similar to those that exist in other corporate and securities statutes. Among those that should be included are the following:

- The requirement for an Audit Committee, with defined functions and membership criteria;
- The requirement for a Governance Committee and published corporate governance guidelines;
- The requirement that appointed directors all meet independence standards to be defined by statute;
- A statutory regime, similar to what exists in other statutes dealing with governance, to manage any unavoidable (but commercially acceptable) conflicts of interest of directors and officers;
- The requirement that an annual meeting of producers be held within a defined time period from the CWB year-end. At the annual meeting, producers would receive a report in respect to the operations of the CWB, with a separate accounting in respect of its capital;
- The requirement that reports on operations be provided to producers on a regular basis during the year (for example, quarterly); and
- The certification by the Chief Executive Officer and the Chief Financial Officer of the fairness of financial statement presentation in respect of the CWB as a whole and its capital fund.

6.0 Conclusion

The implementation of this proposal will strengthen western Canadian farmers' competitive advantage in the global marketplace and help to address the significant issues they are facing. By engaging in other areas of the supply chain through a completely farmer-controlled CWB, farmers will be better positioned to take advantage of opportunities to sustain and grow their businesses. Furthermore, the activities undertaken throughout the supply chain will strengthen their ability to maximize the value of their single-desk by securing existing and new premium markets for their grain and being able to compete effectively with vertically and horizontally integrated multinational organizations.

To accomplish these goals, changes to the *CWB Act* will be required to broaden the organization's mandate and transition to complete farmer control. Formalized farmer control will ensure that the organization remains focussed on farmer needs and issues in perpetuity. The impending removal of the government's initial payment and borrowing guarantees through the WTO negotiations adds urgency to the process, as this change will result in farmers being further disadvantaged which will exacerbate an already difficult environment.

This proposal has been developed by the CWB's farmer-elected board of directors to address the long-term competitiveness and sustainability of western Canadian farmers. Action is required to address the systemic issues farmers are currently facing and will continue to face in the future. The CWB, as the last farmer-controlled corporation in western Canada, is committed to acting on behalf of farmers to secure their future success.

Appendix 1 History of the CWB

The history of the Canadian Wheat Board (CWB) is grounded in the experience of farmers prior to World War I. At the time, many farmers felt captive to the railways, the line elevator companies, and the Winnipeg Grain Exchange for the delivery, weighing, grading, and pricing of their grain. They wanted greater power and protection for themselves in the grain marketing system. They developed a strong confidence in cooperative strategies and government intervention for addressing their needs and thus established the Grain Growers' Grain Company in 1905.

During World War I, the federal government was eventually forced by wartime conditions to become directly involved in grain marketing and established a body called the "Board of Grain Supervisors" (BGS) for the 1917-18 and 1918-19 crop years. Wheat futures trading in Winnipeg was suspended in 1917 and the BGS assumed complete control over the purchase, sale and pricing of wheat for export. After the war, the federal government replaced the BGS with the first Canadian Wheat Board (CWB) to market the 1919 wheat crop.

The CWB implemented a two-payment system, by which producers were first given an initial, or part payment when they delivered their wheat to elevators, and a final payment at the end of the marketing year once the financial results of the sale of the 1919 wheat crop were known. The initial payment was, in effect, a floor price guaranteed by the federal government and any deficit was to be absorbed by the government.

The CWB of 1919-1920, like the BGS before it, was seen as an extraordinary measure by both the federal government and its political supporters in the Canadian grain trade – one that it was felt could not be justified as a permanent marketing arrangement under peacetime conditions. It was disbanded in 1920 after one year's operation. However, in this one year, the concept had gained widespread support among farmers and farm organizations throughout Western Canada. These organizations opposed the abandonment of the CWB in 1920 and began immediately to press the government to re-establish it. When the government refused to do this, farmers took action of their own and created "wheat pools" in each of the three Prairie provinces in 1923. The pools also set up their own jointly-owned Central Selling Agency for wheat. Their system of payments for wheat deliveries was similar to that established under the 1919-20 CWB.

The pools operated well for several years, but the federal government was once again forced to intervene in grain marketing after the collapse of international wheat prices in 1929 and the onset of the Great Depression. Wheat market prices fell to such low levels that the wheat pools could no longer hope to recover from the market what had been paid out in initial payments for the

harvest of 1929; the pools were facing bankruptcy. From 1930 onward, the federal government had to step in and provide the bankers of the wheat pools with a federal guarantee on their loans to the wheat pools, and had to guarantee the pools' initial payments to farmers. In this situation, the government decided to put its own representative in place as the general manager of the Central Selling Agency. In the early 1930s, the federal government still hoped that its involvement in grain marketing would be temporary and that it could return all grain marketing activities to the private sector. However, when it became clear by 1935 that government involvement was going to be needed on a longer-term than was originally envisioned, the government decided to formalize its involvement and enact the *CWB Act*, which was signed into law on July 5, 1935. As with the 1919 CWB, any losses incurred by the new CWB on its operations were to be absorbed by the federal government and any profits were to be returned to producers who delivered wheat to the CWB.

Over the years, the CWB's authority over the marketing of types of grain has varied considerably. At first, deliveries to the CWB were voluntary, and it handled only wheat. Then, during World War II, the CWB was empowered to market all Canadian grains, including oilseeds and Ontario corn. Wheat futures trading was suspended in 1943 during wartime conditions and deliveries to the CWB became compulsory.

In 1949, Parliament amended the *CWB Act* to extend the CWB's marketing responsibility to encompass oats and barley, but retained a clause that required the *Act's* renewal by Parliament every five years. In 1966, this clause was removed and the *CWB Act* became permanent legislation. In 1974, inter-provincial sales of wheat, oats and barley for use in animal feeds within Canada were removed from the sole authority of the CWB. In 1989, the marketing of oats was also removed from the authority of the Board, leaving it responsible only for the marketing of wheat and barley, both for export and for human consumption domestically.

The decade of the 1950s marked the return of the U.S. as a major exporter in the world grain market. During World War II, the U.S. had concentrated mainly on supplying its own domestic grain market. After the war, there were severe shortages of grain stocks in liberated countries around the world and the U.S. was unable to meet demand. At first, Canada filled the gap, but drought conditions reduced Canadian grain output from 1946-1950, and a surge in world demand quickly depleted stocks.

In response to customers' wishes in the early 1960s, the CWB started making more sales directly to buyers, rather than through agents. At the same time, the Board started to enter into long-term supply or purchase agreements. The first major deal was a 2-and-a-half year long-term

agreement signed with China in 1961. It called for three to five million long tons of wheat. This was followed by an even larger three-year long-term agreement with the Soviet Union in 1963.

The next three decades witnessed considerable changes to grain markets. Europe reversed its position as a net importer of wheat to a net exporter. Wheat surpluses, a result of large production subsidies to European farmers, were off-loaded onto the world market with the aid of export subsidies. The U.S. responded with export subsidies of its own through the Export Enhancement Program (EEP). While both programs affected Canadian farm income by depressing export prices, EEP also had the unintended effect of making the U.S. market attractive to Canadian wheat. U.S. government management of the EEP insulated the U.S. domestic market from lower export prices equivalent to the value of the export subsidy. Canadian farmers compared higher prices in the U.S. to prices from the CWB that reflected average, and therefore lower prices from all markets, leading some to question the value of the CWB. A few vocal farmers chose to export wheat into the U.S. without the requisite export license. The CWB also responded to higher U.S. prices by exporting wheat and durum into that market. The use of export subsidies by the EU and the U.S. was the genesis for much of the controversy surrounding the CWB, within Canada and internationally, that continues today.

Importing structures also evolved during this period. Many government import agencies were dissolved, leading some to argue that government export agencies, like the CWB, would soon follow. As it turned out, millers and maltsters were driven less by payment considerations when making decisions over imports and more by just-in-time delivery of quality product. The Canadian system, including the single-desk and the CWB's focus on quality and customer service, was well positioned to address both payment considerations and just-in-time delivery.

The latter part of the period also saw considerable evolution of Canadian agricultural policies which affected the grain sector. Many policies were abolished, including the two-price wheat system, the *Western Grain Stabilization Act*, the *Feed Freight Assistance Act* and the *Western Grain Transportation Act*. While Canadian political and budgetary considerations played a role in the demise of these farmer support policies, the advent of trade agreements, in particular the Canada-U.S. trade agreement and the conclusion of the Uruguay Round of multilateral trade negotiations (which for the first time included agriculture) were particularly relevant.

While the CWB was a government agency for most of its history, its status changed in the late 1990s. From 1935 until the end of 1998, the CWB was overseen and managed by three-to-five federally-appointed full-time Commissioners, who acted collectively as its chief executive officer. In addition, there was an Advisory Committee of Prairie grain farmers, which had the function of

bringing Prairie grain farmers' views to their marketing agency. The Advisory Committee was appointive until 1975, when it became elective. In that year, the first farmer accountability meetings were held to provide direct communication between CWB officials and Prairie farmers.

Appendix 2 Branding the CWB

Canadian wheat is a strong and stable brand. Like Coca-Cola, IBM and Microsoft, Canadian Wheat is also a valuable brand. As with any brand, there is a single champion promoting it – the CWB. Like any good brand, opportunities exist to build on its strength.

Opportunity exists for farmers to further leverage this reputation and extract even more value from it. The CWB has and continues to make substantive changes to its operations and its activities, with an eye on extracting greater value from the brand for farmers. The CWB is currently developing a concrete plan to help the CWB foster increased enthusiasm among farmers and customers, so that it can exert greater control over its own future. The plan may include a name change for the corporation.

The CWB's corporate branding strategy identifies the ideal positioning for the CWB, what the obstacles to securing that ideal positioning are and what choices are needed to overcome those obstacles. The corporate branding strategy will provide clear direction to help the CWB enhance the value it offers to farmers.

The strategy was developed through extensive research and consultation. Years of farmer research indicated that there was a disconnect, especially with younger farmers, that needed to be addressed. The single-desk selling mechanism was misunderstood, the government relationship was creating distance from farmers and perceptions of a monopoly institution were unhelpful. On the customer side, the product faced an increasingly competitive marketplace internationally.

Therefore, the corporate branding strategy was designed to:

- Build a greater affinity with farmers
 - to enhance the trust relationship that allows farmers see the organization as their own and identify with it
- Expand markets for Prairie wheat and barley
 - to build on a historically strong brand and add value to it to allow for higher returns
- Allow CWB employees to work in a dynamic positive environment
 - to develop a renewed sense of purpose

Label it Canadian

The CWB has been working with various customers, domestic and international, to incorporate the words 'Canada' and 'CWB' into their packaging and marketing activities. End use customers equate Prairie-grown wheat with high quality so more and more buyers of wheat and barley are interested in using that information as a marketing tool. .



ADM Milling (Canada), a milling and processing giant, has added a CWB visual identity on flour bags destined for Asia. The identity merges wheat stalks into a maple leaf and proudly proclaims that "Canadian Wheat is Best".

In Poland, past maker Danuta hired film star Sophia Loren as spokesperson for its Malma line of products, which the company also advertises as being made with 100 per cent Canadian amber durum.

International beer customers too, are jumping on the 'brand' wagon. Tsingtao beer, bottled by China's largest brewery and exported to more than 40 customers, accounts for 80 per cent of total Chinese beer exports. Tsingtao's marketing Web site highlights the fact that every bottle of beer contains at least 50 per cent Canadian malting barley.

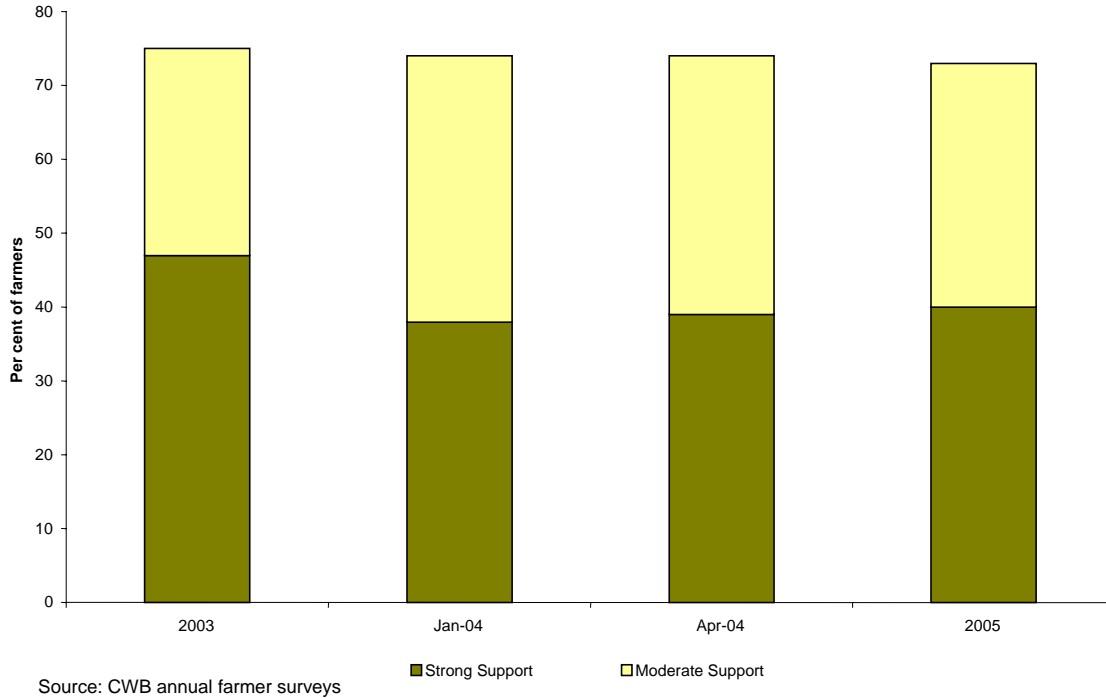
In Japan, all of the country's 1,304 Mister Donut shops placed waxed sheets advertising No. 1 Canada Western Red Spring (CWRS) wheat on customers' trays as part of a three-month promotion. The sheets say, "Number One Canada Western Red Spring, or '1 CW' for short, which is one of the highest quality varieties of hard wheat. The '1CW' used by Mister Donut consists of only the very best of this high-quality wheat. The essence of good taste starts with being particular about each grain of wheat. Each year, an average of 250 million people visit Japan's Mister Donut shops.



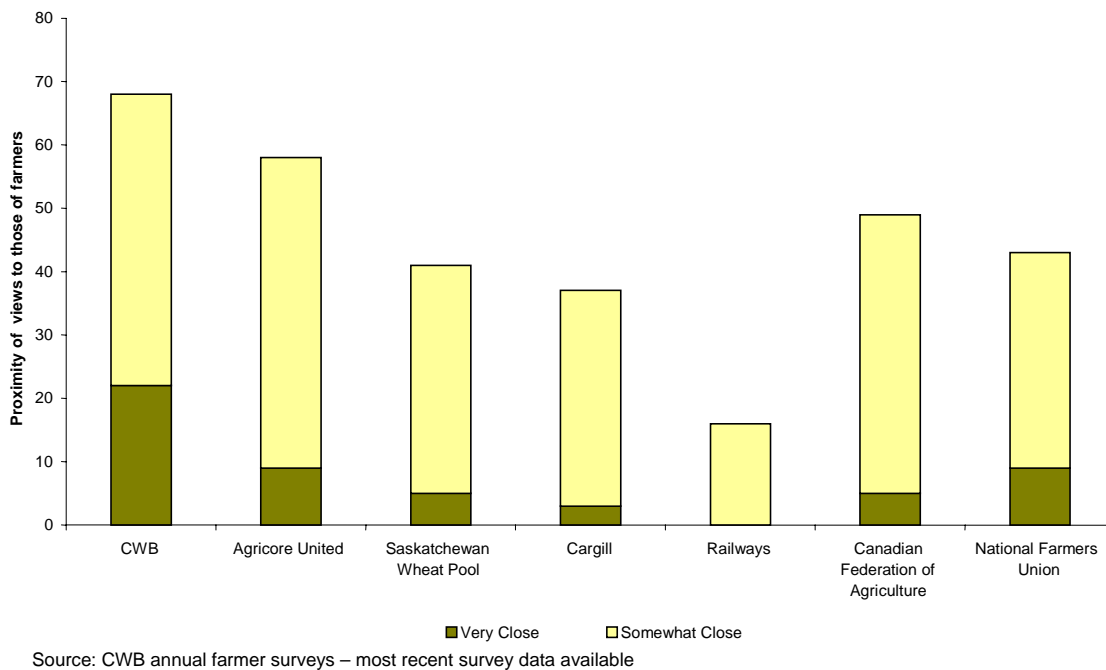
Products currently carrying the CWB visual identity only scratch the surface of what is possible in the future. Discussions are ongoing to have the CWB symbol placed on more domestic and international end-products.

Appendix 3 Farmer Perceptions of the CWB

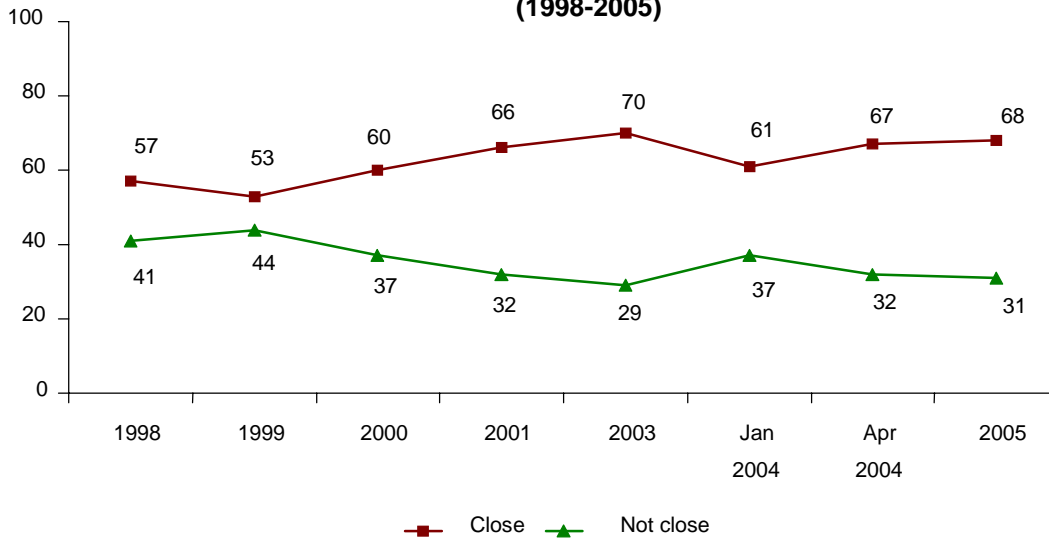
Farmer Support for the CWB



Proximity of views to farmers' views CWB compared to service providers and farm organizations

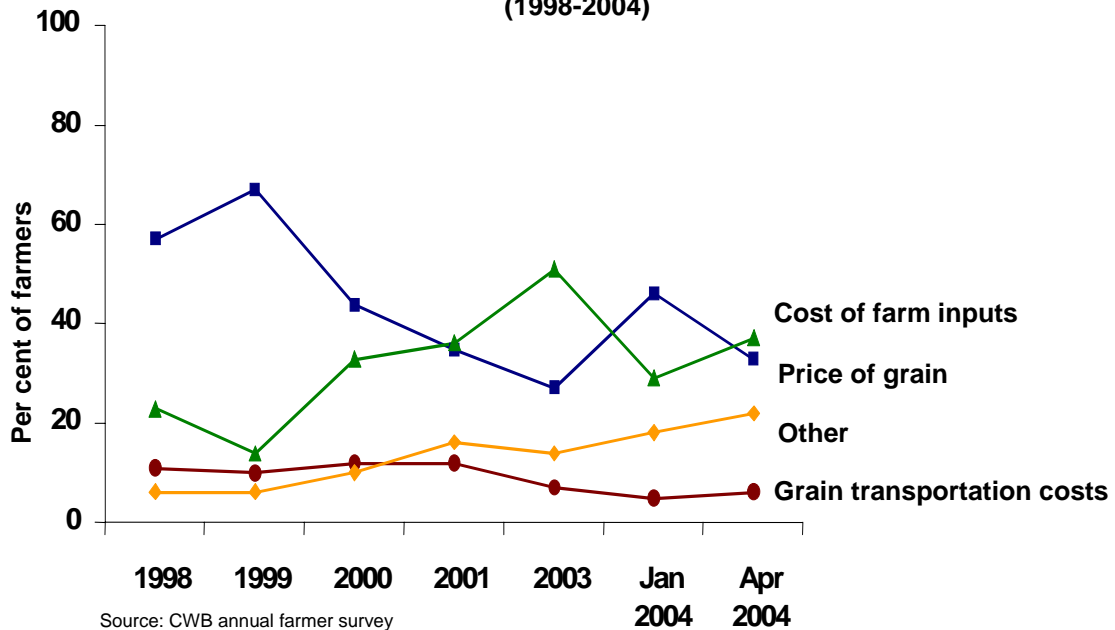


Proximity of the CWB's views to those of farmers (1998-2005)



Source: CWB annual farmer surveys

Most Important Issues for Farmers (1998-2004)



Source: CWB annual farmer survey

Appendix 4 The Australian Experience

In 1989, legislation was passed in Australia that would eventually result in the Australian Wheat Board (AWB) being restructured to become a publicly-traded company. The new AWB structure retained the single-desk for exports of wheat while giving shareholders ownership and some control of AWB Limited and its subsidiaries. Australian farmers have majority control on the board of AWB. A sufficient capital base was a critical factor for the success of this new model.

The *Wheat Marketing Act* deregulated the domestic market, allowed the AWB to trade other grains and created the Wheat Industry Fund (WIF) which brought into effect a mandatory 2 per cent levy on the price of wheat (up to a maximum of 5 per cent). The WIF was established to generate a capital base for the AWB to undertake investment activities that would benefit all grain growers, including financial support (underwriting) for domestic trading, direct investment, provision of guarantees to finance projects, insurance support and underwriting the National Pool above the government ceiling.

Changes to the *Act* in 1992 allowed AWB to invest in value-added activities and extended the government underwriting of AWB borrowing until 1999. The purpose of the WIF was broadened in 1993, in consultation with the Grains Council of Australia, to include the use of the fund to provide advance payments to growers, should the government guarantee on borrowing cease in 1999. In this context, it was agreed by the industry that the WIF could continue to build up a capital base of between A\$450-A\$500 million by 1999 (at the time the AWB was exporting about 10 million tonnes of wheat annually).

In 1998, AWB began their transition from statutory authority to a publicly-traded grain company. By this time, it had investments in overseas mills and it began investing in the seed industry. By 1999, the WIF equity had reached A\$625 million, which was then converted to B class shares. At the time of privatization, there were over 36,000 A class farmer shareholders, 400 employees and 30 offices throughout Australia and around the world. In 1999 AWB started its move into bulk grain storage in Eastern Australia. By 2001, it officially listed on the exchange at A\$3.15 per share.

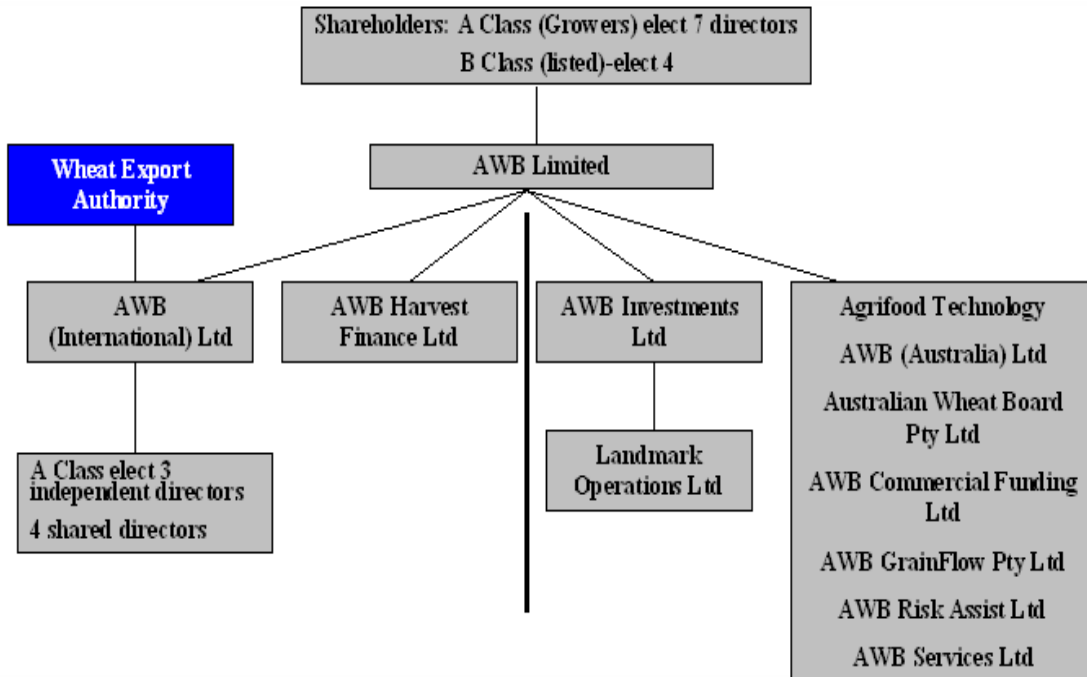
In the fall of 2003, AWB Ltd. bought Landmark for A\$714 million. Landmark is one of the largest rural service providers in Australia. Equity as of Sept 2004 exceeded A\$1 billion and their share price has traded about A\$4.68. The AWB now has about 2,700 employees, with 431 offices both in the country and around the world. This purchase expanded the AWB Ltd. reach both horizontally and vertically. It is now involved in virtually every link in the supply chain, including

developing seed varieties, milling, fertilizer sales, livestock trading, deposit accounts, insurance and operating loans.

AWB Ltd. is governed by a 12-member board. Seven board members are farmers, elected by their peers; two members are elected by B Class shareholders, two members are directors appointed by the farmer-elected directors and a managing director that is appointed by the board.

The chart below illustrates the AWB Ltd. structure. The left side of the diagram is charged with maximizing returns to growers, while the right side consists of a number of subsidiaries that are charged with the profit maximization strategies of a publicly-traded company.

AWB International (AWB (I)) is responsible for the national pool and manages the wheat single-desk. AWB (I) has its own board of directors, three of which are independently elected directors (growers); the other four directors are shared with AWB Ltd. The statutory authority for the single-desk resides with the Wheat Export Authority. AWB Ltd. provides all the resources and expertise to run AWB (I) and in return AWB (I) pays AWB Ltd. a fee out of the pool revenue.



AWB Harvest Finance provides growers delivering to the AWB National Pool with a range of financing alternatives (including underwriting). It also manages foreign currency and interest-rate exposures for AWB (I)'s pooling activities. It was recently restructured as AWB's credit rating and borrowing ability was being adversely affected by their other investments.

The Wheat Export Authority

The Wheat Export Authority (WEA) was established as an independent statutory authority on July 1, 1999 following the restructuring of the Australian Wheat Board. The WEA was set up to control the export of wheat, following the transfer of the government's wheat marketing and selling role to AWB Ltd. That is, the WEA effectively has the single-desk and manages the AWB (I). The WEA operates independently from AWB Ltd. and its subsidiaries, which include AWB (I). It is accountable to the Minister for Agriculture and has special reporting functions to the Grains Council of Australia.

The WEA has two main functions:

- to control the export of wheat from Australia; and
- to monitor AWB (I)'s performance in relation to the export of wheat and examine and report on the benefits to growers that result from that performance.

With respect to controlling the export of wheat, AWB (I) does not need to apply to WEA for an export license to export wheat. Other exporters wishing to export wheat in bulk, bags or containers are subject to WEA approval. Other exporters are also subject to AWB (I)'s approval in the case of bulk shipping.

AWB revenue

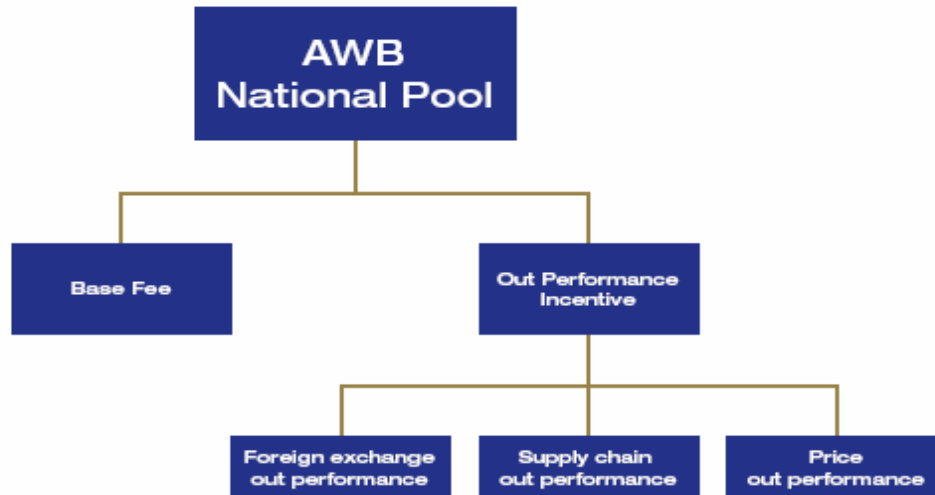
In terms of revenue, AWB Ltd. has six revenue streams: pool management services, finance and risk management, grain acquisition and trading, supply chain and other investments, grain technology and Landmark. Each of these are discussed in the following section.

Pool management services

Pool management services is the revenue generated from the fees charged to the National Pool in remuneration for the services and expertise provided by AWB Ltd.

The fees charged by AWB Ltd. for providing the services to AWB (I) were initially set by a cost-plus formula. However in the last couple of years, the fee structure has evolved to more of a fund management approach, whereby AWB Ltd. is compensated via a base fee (equal to 1.5 per cent of the Gross Pool Value) and an Out Performance Incentive (set at 20 per cent of the revenue over and above the Wheat Industry Benchmark (WIB)). The WIB consists of three sub-benchmarks established for foreign exchange, price and supply chain costs. There is a floor and

ceiling set on this revenue set at A\$46 and A\$61 million respectively. On a per tonne basis, AWB charged the National pool A\$4.58/t in 2001-02. In 2002-03, due to the drought, it cost about A\$14.69/t, with the floor being triggered due to small pool volumes.



Finance and risk management

Finance and risk management generates revenue through the provision of finance and risk management products to growers and end users. These include the Harvest Loan, Flexible Drawdown Loan (FDL), Advance Payment, Deferred Payment, the Basis Pool and Risk Assist.

Currently the most popular option amongst growers is the AWB Harvest Loan, which gives farmers the majority of the cash flow at harvest, as an interest bearing loan based on 90 per cent of the Nominated Estimated Pool Return (Nominated EPR), less estimated costs. This loan is repaid with pool distributions. The 90 per cent is underwritten by AWB (I).

The FDL works like a line of credit. The grower can draw cash when needed, and can make prepayments at their discretion. Interest is paid only on the drawn amount. Amounts owing under the FDL are fully underwritten. They have access to a total credit limit calculated at 90 per cent of the Nominated EPR, less estimated costs. This limit is reduced as pool distributions are paid. Advanced Payment gives growers the majority of their cash at harvest as a payment, not a loan. The initial payment is based on 80 per cent of the Nominated EPR, less estimated costs. Should the Nominated EPR drop below this figure, growers are not be asked to repay any money to AWB. This is very similar to the CWB initial payment system.

Deferred Payment gives growers 90 per cent of their cash flow in July (following the harvest), in the form of a payment, not a loan. In July, growers receive a payment based on 90 per cent of the applicable July EPR, less estimated costs.

AWB harvest finance also earns revenue through their Basis pool. This option allows farmers to lock in a basis and manage their own futures and foreign exchange exposure. Fees are charged for the management of this program.

Growers are charged A\$1.60/t for underwriting on the applicable options. The number of tonnes underwritten has gone from 83 per cent to 70 per cent of the National Pool tonnes delivered by growers. Of the total pool, only about 55-65 per cent is underwritten by AWB Finance – other banks underwrite as well.

Grain acquisition and trading

Grain acquisition and trading consists of the trading of grains and the management and trading of shipping capacity and customer management. This area basically performs two functions: first it buys grain on a cash basis using a variety of tools for delivery to and trade with customers and players. It also acquires grain through the cash market and delivers it to the National Pool to receive the pool distributions. In 2003-04 it traded about 3.2 million tonnes of wheat and 953 thousand tonnes of other grains domestically. It trades in multiple grains domestically and offshore.

A Geneva office was set up in 2002 to grow AWB (I)'s presence, through trading in optional origin contracts. It also provides a market intelligence function. In 2003-04, it traded about 2 million tonnes of international grains.

Supply chain and other Investments

Supply chain and other investments consists of the development of, and direct investment in, supply chain infrastructure and end-use grain businesses.

AWB Grainflow is in charge of the domestic supply chain investments. The major purpose of its investment into country and port storage was to drive cost efficiencies via competition. It has taken a competitive approach in the east and a cooperative approach in the west.

It has signed numerous freight agreements. It actually owns and leases out two, 51 car trains. AWB is leveraging its single-desk position and negotiating cheap rates to its own facilities.

Chartering takes on entire freight-risk for National Pool for a fee of A\$0.80/t. Their cost and freight business has increased from about 40 per cent in 2001 to 55-60 per cent in 2003-04.

In terms of offshore investments, the AWB has experienced mixed results. Although its stake in Five Star Flour and Feed Mills in Egypt is performing well, it is now divesting themselves of its stake in the mill in Vietnam. It also owns a stake in a flour mill in China and a stake in a trading company in Japan called AWB-Zenoh. The 14 per cent stake in Futuris (one of Landmark's rivals in the rural service industry) was purchased in 2002, but that has also been recently sold.

Grain technology

Grain technology consists of the development and Australian application of grain-related technologies.

Agri-food technology provides analytical laboratory services to the food, feed and related agriculture businesses. This group also assists the AWB National Pool marketing program and provides services to external clients.

AWB Seeds (formerly Revell Seeds) is responsible for commercialization of high-performance seed-base genetics in new varieties. AWB Seeds generates revenue through plant breeders rights (PBR) royalties, seed sales etc. According to AWB it holds about 60 per cent of available wheat variety licenses.

Innovation and research manages different research projects on behalf of AWB, and is usually involved in alliances to develop new plant traits and varieties to establish proprietary positions.

Quality assurance & hygiene provides services to the National Pool, ensuring quality-inspection services and monitoring the collection processes at sites receiving grain.

Landmark

In August 2003, AWB acquired Landmark at a cash purchase price of approximately \$714 million. The acquisition of Landmark was clearly a major milestone for AWB. Landmark is Australia's largest supplier of farm inputs and its purchase is meant to help AWB create a 'one stop shop' for

farmers. At the time of purchase, it operated from 230 company-owned locations and 200 outlets operated by franchisees, agents and affiliate members located throughout Australia. In addition to being the largest employer of agronomists in Australia, it has about 1,950 staff and services roughly 100,000 customers.

Landmark is Australia's largest supplier of farm inputs, including fertilizer and chemicals. It also has significant interests in wool and livestock marketing, rural property and real estate sales, and finance and insurance. Cotton is a significant part of Landmark's business in northern New South Wales and southern Australia. Landmark handles about 22 per cent of the nation's wool clip through its national brokering service, Fibre Direct, and through private buying activities. It has developed a range of wool risk-management products and provides up-to-date wool marketing. Landmark offers "Stocklink" – a range of livestock marketing options for buying and selling livestock – in addition to the traditional saleyard auction. Landmark handles about 20 per cent of livestock trading in Australia, supplying processors, supermarket chains, lot feeders and live export markets.

Landmark's real estate business markets large rural properties, residential real estate, and clearing sales in country areas throughout Australia. Landmark, allied with Rabobank, provides producers with a range of highly competitive financial products, including term deposits, cheque accounts, credit cards, and seasonal and term loans. Landmark is also one of the largest rural and regional insurance agents in Australia, offering a range of insurance options for the rural business person or household. Landmark acts as an agent for Wesfarmers Federation Insurance Limited (all states) and CGU Insurance Limited (all states other than Western Australian).

AWB's future direction

Over the past couple years there has been a significant shift in the AWB's focus. At present, their current vision is "to be Australia's leading agribusiness". This is a substantial change from their vision in January, 2003, which said "Grains managed by AWB will be the world grains of choice". Of note is that the word "grain" is no longer in their vision statement.

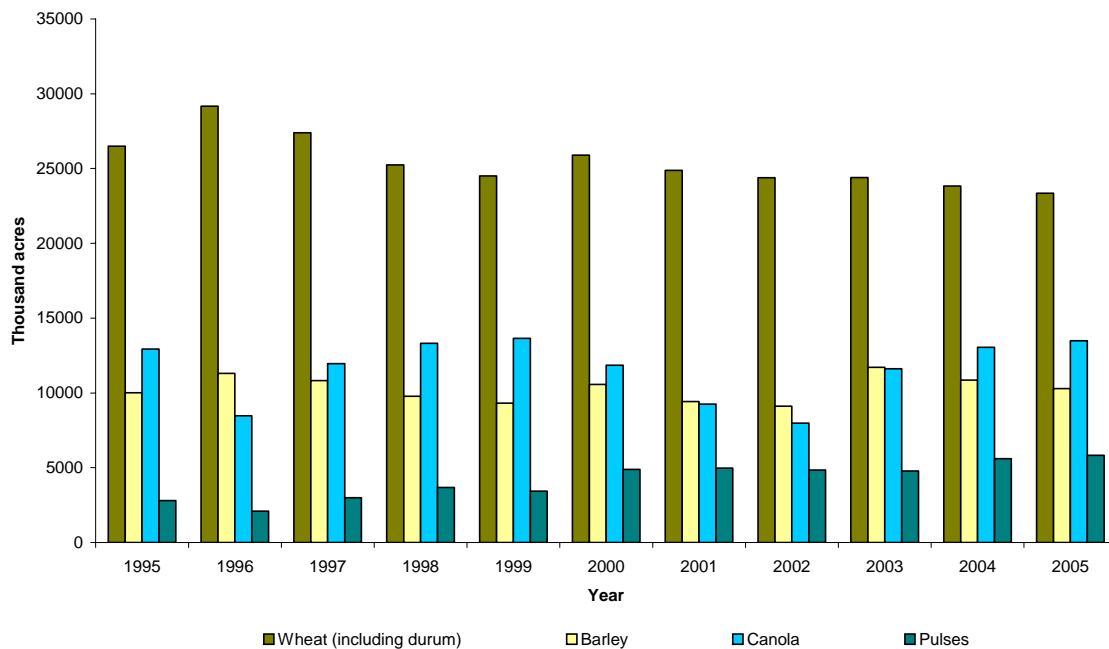
AWB is making every effort to reduce their reliance on the wheat crop. They ideally want less than 80 per cent of their profits before tax to be dependent on the wheat crop. Rural finance looks to be one of the areas where they may look to expand.

Appendix 5 Overview of western Canadian agriculture

Area in crops in Western Canada

The graph below depicts production of various crops in Western Canada over the past ten years. For the most part, the share of each commodity has remained relatively constant. Wheat acreage has declined, while production of pulses has increased. These changes can partly be attributed to the relative profitability of the various crops, but are more likely attributable to varietal development in some of the less traditional crops, which has resulted in these newer crops being suited to a wider range of farmers geographically.

**Area in crops in Western Canada
(1995-2005)**



Source: Canada Grains Council

The western Canadian agricultural industry in transition

According to Statistics Canada's Agriculture Census, the number of farms on the Prairies has decreased 19 per cent since 1981, to 125,321 farms in 2001. The downward trend in the five-year period from 1996-2001 was even more pronounced, with an 11 per cent decrease in the number of Prairie farms over that time period. Technological advancements that allow farmers to cover more acres in less time, declining profitability for some farmers and the aging farm population (retiring farmers not being replaced by younger farmers) are the primary drivers behind these trends.

The number of farmers who rely on grain production decreased significantly over the 1981-2001 time period as well. In 1981, 63 per cent or approximately 97,000 Prairie farms were considered grain farms¹². In 2001, less than 50 per cent, or approximately 62,000 Prairie farms were considered grain farms. This illustrates the trend in agriculture over this time period where grain production profitability was declining, relative to the alternative (e.g., livestock), resulting in a greater reliance on these alternatives.

The average farm size on the Prairies has increased 18 per cent since 1986, to 1,083 acres in 2001. Saskatchewan has the largest average farm size at 1,283 acres, with Alberta and Manitoba at 970 and 891 acres respectively. These figures represent all farms on the Prairies. It is important to note that many grain farms in Western Canada are several thousand acres in size.

In 2001, 45 per cent of farm operators worked off-farm. Young farmers are even more dependent on off-farm income, with sixty-four per cent working off-farm. Those with greater farm receipts were much less inclined to work off-farm.

The number of farmers under the age of 35 has decreased by more than 47 per cent since 1991, with 18,950 young farmers either entering the next age category or leaving the farm. Only 12 per cent of farm operators are under 35, compared to 40 per cent in the overall Canadian workforce. At 49 years old, farm operators are on average five years older than the average self-employed Canadian. In the entire Canadian work-force, the average individual is 38 years old.

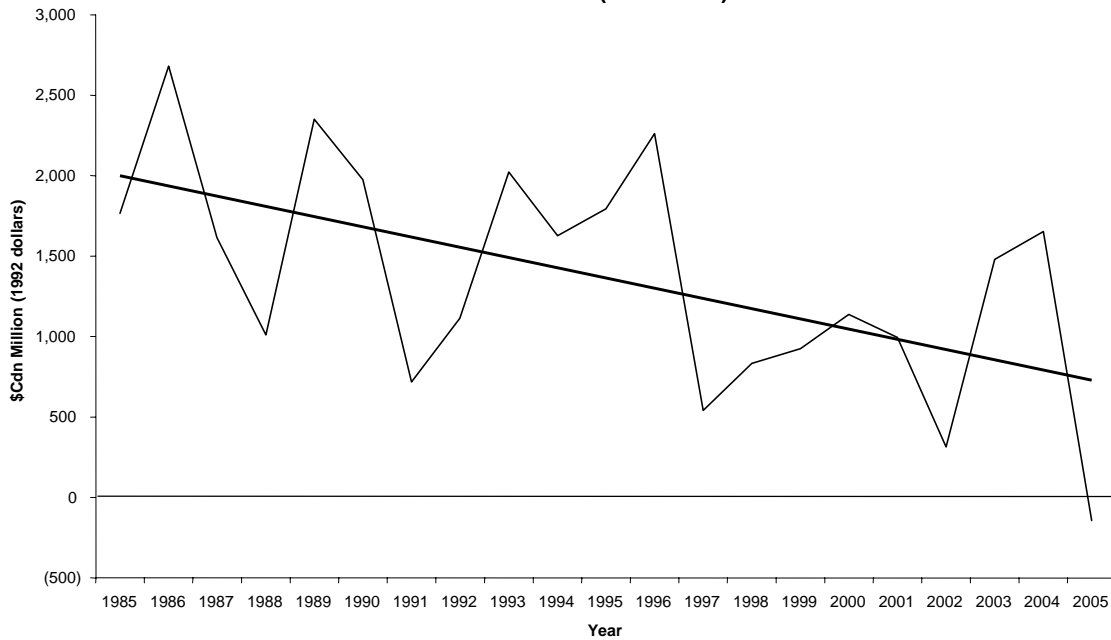
Factors driving transition

The graph below illustrates the primary reason farmers are leaving farming. The graph shows real net farm income for Prairie farmers over the past two decades. Although there is considerable variability year over year, net income is on a significant downward trend. In fact, in 2005, net income is expected to be negative for the first time in history¹³. This means that farmers' cost of production is expected to exceed the revenue they received from the market and any government payments they received. Some of the factors affecting farmers' profitability are described below. These and other factors are dealt with in more detail in the body of the proposal.

¹² Calculated based on number of "wheat", "other grain and oilseed" and "other field crops" farms identified in the Agriculture Census. Statistics Canada considers a wheat farm to be any farm that has greater than half of its annual receipts generated by producing wheat.

¹³ Numbers are based on Statistics Canada projections. Final numbers are expected in late May 2006.

Real Net Farm Income Prairie Provinces (1985-2005)



Source: Statistics Canada

Cost of production

The table below compares the cost of producing grain and moving it from an inland location to a free on board (FOB) position at port in various wheat export countries. Taking into account both variable and fixed costs, the cost of producing wheat in Canada is low, relative to the U.S. and United Kingdom but is considerably higher than in Australia. Canada is at a significant disadvantage to other countries because the cost of moving wheat from an inland to FOB position is much higher, largely due to the distance of wheat production to port. Taking everything into account, Canadian farmers incur relatively high costs to produce wheat and to move it to export position – reducing Canadian farmers’ competitiveness in the international marketplace.

	Wheat - cost of production (Regional average - US\$ per tonne)							
	Canada	U.S.	UK	France	Argentina	Australia	Russia	Ukraine
Cost of Production:								
Variable costs	73.60	71.12	109.28	86.60	84.59	48.10	50.50	47.00
Fixed costs	45.27	123.81	54.88	44.82	42.60	47.20	N/A	N/A
Total costs	118.85	194.93	164.14	131.42	127.19	95.30	N/A	N/A
Inland to FOB costs:	42.14	41.49	10.90	17.15	20.00	26.41	25.00	25.00
Total Cost (Production and Inland to FOB Cost)	160.99	236.42	175.04	148.57	147.19	121.71	75.50	72.00

Source: Canadian Wheat Board calculations

Inconsistency in government support for wheat producers

The Organization for Economic Co-operation and Development (OECD) publishes producer support estimates (PSEs) for several commodities for various OECD member countries.¹⁴ The PSE was developed to illustrate the level of support across different commodities and nations and has become a widely cited estimate of support to agriculture producers. The OECD defines the PSE as “an indicator of the annual monetary value of gross transfers from consumers and taxpayers to support agricultural producers, measured at farm gate level, arising from policy measures, regardless of their nature, objective or impacts on farm production or income.” Therefore, the PSE not only includes direct transfers from the government to farmers, such as crop insurance or income support programs, but also implicit transfers directly from consumers to farmers, through mechanisms such as supply management in Canada. Note that the PSE is a measure of total support and does not account for how trade-distorting agricultural policies employed in any given country may be.

The OECD publishes PSE data for a select number of commodities, including wheat, but not barley. The following shows wheat support in Canada, the U.S., the EU and Australia in recent years, on a per unit basis.

	Wheat PSE per unit (Cdn \$/tonne) ¹			
	2000	2001	2002	2003 ^p
Canada	22	31	46	29
United States	132	119	116	58
European Union	129	144	125	164
Australia	8	6	9	4

p/ - projected

1/ Obtained from Agriculture and Agri-Food Canada

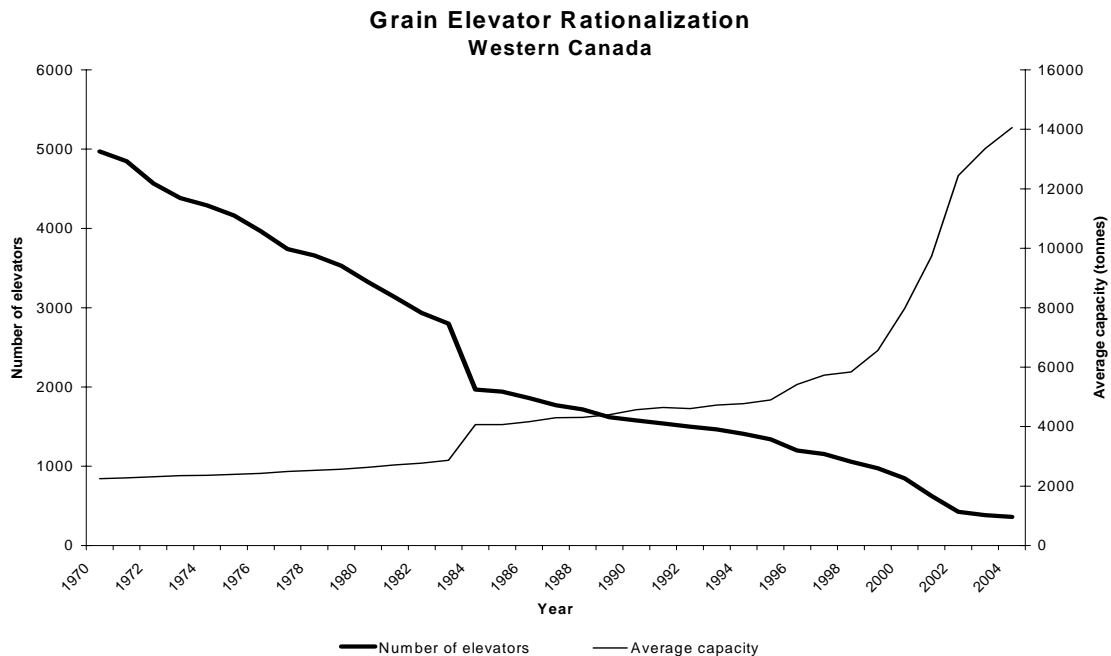
Wheat support in the U.S. and the EU on a per unit of production basis is typically much higher than in Canada and Australia. While the sharp reduction in U.S. wheat support per unit in 2003 appears to be positive for the U.S., it must be recognized that U.S. spending on wheat support is much more closely tied to prices than Canadian farm programs. Therefore, in years where prices are lower, the U.S. wheat PSE will likely be higher. While this does not result in large transfers to producers in times of relatively high prices, it does result in significant support when commodity prices are low. This method of support insulates producers from the effects of low prices and makes them less responsive to market prices during that time. As a result, U.S. farmers are

¹⁴ Among other data, the OECD publishes PSE information in one of two bi-annual publications: *Agricultural Policies in OECD Countries: Monitoring and Evaluation* and *Agricultural Policies in OECD Countries: At a Glance*, which are published in alternating years.

slower to respond to market signals and will overproduce in times of low prices, further depressing prices for producers in other countries and extending periods of low prices. In addition, the devaluation of the U.S. dollar contributed to the decline in 2003 U.S. wheat support expressed in Canadian dollars.

Consolidation and rationalization in grain handling

Rationalization of the western Canadian grain handling industry over the past thirty years has resulted in many elevator closures. As of August 1, 2005, there were 352 elevators operating in Western Canada, with an average capacity of approximately 14,000 tonnes. This compares with almost 5,000 elevators in 1970 with an average capacity of approximately 2250 tonnes. As small elevators are replaced by more widely dispersed, large, high-throughput facilities, the hauling distance for many farmers has increased. According to a survey conducted by the CWB in April 2004, only 45 per cent of farmers are able to haul their grain fewer than 25 miles to reach their preferred elevator, compared to 86 per cent in 1999. Rationalization has the potential to increase the efficiency of the system by achieving economies of scale in grain handling. This would presumably result in lower system costs and lower costs for farmers. However, according to the Canadian Grain Commission's posted tariff rates for elevators, handling tariffs (adjusted for inflation) have remained relatively constant over the past 20 years, with marginal increases in the past 10 years – contrary to what would be the case if efficiency gains were being passed back to farmers.



Source: Canadian Grain Commission – Grain Elevators in Canada

Farmers have also had to adjust to consolidation in the grain-handling industry. The most significant consolidation event in grain-handling began with the merger of two of the three Prairie pools: Manitoba Pool and Alberta Wheat Pool in November 1998 which formed Agricore Co-operative Ltd. At the time of the merger, Manitoba Pool was operating 119 elevators and Alberta Wheat Pool was operating 160 elevators on the Prairies. Of greater significance was the second stage of this consolidation event, which saw the newly formed Agricore Cooperative Ltd merge with United Grain Growers in November 2001 to form Agricore United. At the time of this merger, Agricore was operating 207 elevators and UGG was operating 87 elevators on the Prairies. In a span of three years, three companies that once competed for farmers' grain with a large share of the grain-handling capacity on the Prairies became one single entity. The Agricore United merger also resulted in the newly formed company having an interest in 62 per cent of the terminal capacity at Vancouver. As a result, a Competition Tribunal ordered Agricore United to divest of one of their port facilities. However, divestiture will still leave AU with an interest in 41 to 51 per cent of the Vancouver terminal capacity, depending on which terminal is divested.

The combination of elevator rationalization and grain company consolidation is reducing farmers' delivery options, which will likely result in higher costs for services and/or less-favourable prices for their grain over time. Grain company consolidation is also resulting in less Canadian ownership and control of the grain-handling industry. U.S. and multinational companies have recently increased their presence on the Prairies by establishing elevator networks and by entering into arrangements with farmer-owned elevators. Archer Daniels Midland (ADM) emerged onto the scene by taking a large ownership stake in United Grain Growers (UGG) and now owns a sizeable portion of the shares of Agricore United following the merger of UGG and Agricore in 2001.

Saskatchewan Wheat Pool (SWP) recently eliminated its multiple class share structure to create a single class of shares with equal voting rights among all shareholders. Previously, farmers controlled SWP, as they were the only individuals that could hold class A voting shares. All shares are now traded on the Toronto Stock Exchange, which has eliminated farmer control of SWP and has placed control in the hands of shareholders.

According to Dominion Bond Rating Service, the level of competition in the grain industry in Western Canada is too high to sustain the current number of firms. Four large firms (SWP, AU, Pioneer, Cargill) may not be sustainable in the long term. The loss of any one of these large players, especially if it were one of the two companies with any remnants of farmer control (SWP and AU), could have significant effects on the costs farmers pay in this system and the services they receive.

Appendix 6 CWB competitors in the global marketplace

Cargill (headquartered in Minneapolis, Minnesota)

Cargill is a global, diversified company with operations that include grain, cotton, sugar and petroleum origination; transport and trading; financial trading; food processing; futures brokering; feed and fertilizer production and steelmaking. Cargill has grown its business through direct investment and acquisitions. Cargill is the second-largest maltster in the world and the third-largest miller in the United States. It operates in over 60 countries around the world and has a presence in most grain and oilseed producing regions of the world. Cargill operates five business segments: agriculture services, origination and processing, food ingredients and applications, risk management and financial, and industrial. Cargill had annual gross revenues of \$71 billion in 2005.

Louis Dreyfus (headquartered in Paris, France)

Louis Dreyfus is a global, well-diversified company engaged in processing, trading and merchandising a range of agricultural commodities, including wheat, oilseeds, cocoa, coffee, cotton, meat, rice, sugar and ethyl alcohol, as well as orange juice production; petroleum product refining and marketing; shipping; property development; forestry management and particleboard manufacturing and the design and building of telecommunication infrastructures. Louis Dreyfus is ranked as one of the world's largest merchandisers of grains and oilseeds every year, and has a presence in most grain and oilseed producing regions in the world. Louis Dreyfus operates in over 53 countries, with major offices in Buenos Aires, London, Paris, São Paulo, Connecticut, and Tennessee. Its aggregate-average annual gross sales in recent years have exceeded \$20 billion.

ConAgra Foods (headquartered in Omaha, Nebraska)

ConAgra Foods (CF) is a leading packaged-food company serving a wide variety of food customers. It has grown primarily through acquisitions and internal brand development. In recent years, it has pursued an aggressive acquisition and divestiture strategy to shift its focus toward its core branded and value-added food products. It is now the second-largest packaged food company in the U.S. – behind Kraft Foods.¹⁵ CF operates out of plants located primarily in North America and distributes its products to over 32 countries around the world. Its operations are

¹⁵ In 2003, CF divested a controlling interest in its fresh beef and pork slaughter businesses and fully divested its canned seafood operations, North-American crop-inputs business, certain cheese operations and announced the sale of its chicken operations. It also divested its barge-related assets in 2002. These divestitures were part of its restructuring program to position the company in higher-margin consumer-focussed businesses along the supply chain, thus improving the company's future financial results.

broken into two segments: packaged foods and food ingredients. Its business activities generated net sales of \$14.6 billion for the fiscal year ending in May 2005.

ADM (headquartered in Decatur, Illinois)

ADM is a globally-integrated grain company with major interests in procuring, transporting, storing, processing and merchandising agricultural commodities and products. In the past five years, ADM has experienced significant growth, investing in the construction of new plants, expansion of existing plants and the acquisition of new plants and transportation equipment. It is one of the world's largest processors of oilseeds, corn, wheat and cocoa, as well as the world's largest ethanol producer. ADM operates in Canada, U.S., Mexico, Central and South America, Europe, Asia/Pacific Rim and Africa, and is expanding into Eastern Europe. Its operations are broken into five segments: oilseeds processing, corn processing, wheat processing, agricultural services and other (cocoa, bio-products and corn-flour ventures). ADM had gross revenues of over \$35.9 billion for the fiscal year ended June 30, 2005.

Bunge (headquartered in White Plains, New York)

Bunge Limited is an integrated, global agribusiness and food company operating in most segments of the farm-to-consumer food chain, which ranges from raw materials, such as grains and fertilizers, to retail food products, such as flour and margarine. The company has experienced significant growth through acquisitions, investment, and expansion. It is the world's leading oilseed processing company, the largest producer and supplier of fertilizers to farmers in South America, and the world's leading seller of bottled vegetable oils to consumers. It has primary operations in North America, Brazil, Argentina and Europe (and has expansion plans for Eastern Europe), as well as worldwide distribution capabilities. Bunge operates in over 30 countries around the world. It operates three business segments: agribusiness, fertilizer and food products. Bunge had annual net sales of \$24.3 billion in 2005.

Appendix 7 CWB Election Review Panel Report response

March 6, 2006

The Honourable Chuck Strahl, P.C., M.P.
Minister responsible for the Canadian Wheat Board
Agriculture and Agri-Food Canada
Sir John Carling Building
930 Carling Avenue
Ottawa, ON K1A 0C5

Dear Minister Strahl:

Re: CWB Election Review Panel Report

The CWB has had an opportunity to review the *Report Respecting the Review of the Electoral Process for Election of Directors of the Canadian Wheat Board* and wishes to provide its response.

It is clear upon reviewing the report that the panel has made a very positive contribution to the evolution of the CWB director election process. The report addresses the most challenging aspects of the election in a thoughtful and balanced manner and proposes solutions that are both practical and likely to be acceptable to the farm community.

The CWB supports the panel's recommendations, with the exception of Point 2 of Recommendation #13 (Change method of appointing directors). While Point 1 of this recommendation is sound, Point 2 prescribes that only three of the five appointed directors be eligible to vote. Since a director cannot be expected to assume the responsibility and liability associated with being a board member without the power to vote on decisions, we recommend that Point 2 be rejected. With regard to Point 1, we intend to develop a process for making recommendations to government on potential appointees.

We also wish to express a concern with Recommendation #11 (The Election Code of Conduct should be revised). Although we respect the intent of the panel to achieve fairness and impartiality in the election process, the CWB must be able to carry on its business activities during the election period. We would not support any restrictions regarding the election code of conduct that interfere with the CWB's regular business or interrupt regular cash flow to farmers.

We would also like to advise that, while we respect the panel's judgement on Recommendation #12 (The timing of the CWB director election should be changed), we would prefer a compressed timetable in the late fall as opposed to the winter period. The reason for this preference is that winter is farm meeting season and directors must meet their accountability obligations at this time.

There are two recommendations in the report on which we require further clarification. The first is with regard to Recommendation #1 (Change the eligibility to vote criteria) and whether crop share landlords who deliver the 40-tonne minimum would be eligible to vote. The other relates to Recommendation #6 (Maintain Third Party spending limits) and how candidates would control third party spending that would count against the candidates' spending limits.

In order to see some of the very positive changes recommended by the panel brought into effect as quickly as possible, we encourage you to accept the panel's report, noting our concerns relating to Recommendations #13, #11 and #12. The next director election commences in

September 2006, and it would be beneficial if, at a minimum, the changes that are regulatory in nature could be enacted by June 2006 at the latest. We recognize that some of the changes would require amendments to the legislation, which may require more time. These include changes to voter eligibility, the method of appointing directors, the timing of the election (as it affects directors' terms of office), and possibly the establishment of an Independent Election Commissioner.

I should note that the CWB has also identified a number of minor technical improvements that could be made to the election regulations. We would be pleased to discuss these changes with your representatives at the appropriate time.

In considering your decision on how to proceed with the election review, it will be important to bear in mind that the panel was comprised of respected, independent farm leaders representing each of the prairie provinces. The panel led a credible review process that afforded both farmers and farm groups the opportunity to provide input. (The CWB itself did not submit recommendations to the panel, but did assist initially to identify the key issues that needed to be addressed in the review.) The work of the panel has the potential to result in very positive changes to the CWB election process.

I would be pleased to meet with you at your earliest opportunity to discuss this matter.

Sincerely,

Ken Ritter
Chair, Board of Directors

KR/dlh
2902q

c: Mr. Paul J. Martin, Director General, Marketing Policy Directorate