

Specialty Production and Marketing in the Regulated Marketing Sector  
British Columbia Milk Marketing Board  
Response to R. Bullock Information Request of April 18, 2005

May 20, 2005

1. The British Columbia milk market is considered a mature market with growth attributable to population increases and new products. The fluid market is served by seven major processors versus eleven just five years ago. Plant closures and consolidation have reduced the number of processors but strengthened the competitiveness of the remaining players. The majority of the industrial market is served primarily by five processors although there are a number of smaller regional processors. In total the Board has issued thirty-three processing licences.

Fluid milk sales in BC account for approximately 56% of in-quota production with the balance processed as cheddar cheese, mozzarella cheese, cottage cheese, sour cream, yogurt, butter and other products/uses. Because BC is a partner in the Western Milk Pool and shares revenue, the income to producers per hectolitre of milk is adjusted according to the participation formula.

Milk production is shown in the attached chart of provincial quota allocation. Most but not all milk is processed in BC the exceptions being the Peace River and Kootenays where transportation costs favour processing in Alberta.

2. Growth allocation may be found in the Annual Reports; however, a clear distinction must be made to understand fluid quota, MSQ, TPQ and WMP Sharing. Attached to this report is an accounting of MSQ allocated for industrial use by the Canadian Dairy Commission from 1973 to current. Also included are the annual amounts of TPQ from 1998 to current. Prior to 1998, quota was split into Fluid and MSQ for which comparative data is irrelevant. However, as shown in the chart for MSQ the amount allocated to the province in 1973 was 5,220,000 kg compared to the allocation in 2005 of 10,540,387 kg. The increase is attributable to domestic consumption and population growth in BC and is directly impacted by the relatively new 10/90 Agreement which directs that 90% of the national quota growth allocation is to be based on population growth in the province. The chart also shows the relative growth in milk production for fluid and industrial use combined, with the equivalent of 20,842,458 kg in 1998 versus 23,319,435 in 2005. Most of the increase is attributable to MSQ.
3. There is only one quota in the BC milk industry and that is Total Production Quota (TPQ). This is made up of Federal Market Sharing Quota (MSQ) and Provincial Fluid Quota. TPQ is allocated to producers of Specialty Product to fulfill the needs of the market as determined by processors and communicated to the Board. It is expected that the SMPAC will be the vehicle used by processors to communicate their needs to the Board. The Board will then allocate TPQ to producers who wish to produce a Specialty

Product. The allocation will be as described in the March 31, 2005 Response. At this time the only milk that is deemed to fall into the category of Specialty Product is Certified Organic Milk. The Board allocates quota to producers based on the amount of transferable TPQ allotted to the producer. Producers of Specialty Product will share on an equal basis with mainstream producers for the allotment of TPQ. Processors as the marketers of milk and dairy products are the logical avenue for bringing new Specialty Product recommendations to the Board via the SMPAC. Acting on the advice of the SMPAC, the Board will determine how to address the requirements for bringing new milk to market. A new Specialty Product will be expected to have the same farm to table criteria as Certified Organic Milk as well as a price premium.

The allotment of quota for the production of a Specialty Product will be allotted in accordance with the FIRB directive of May 20, 2004 governing the allocation of quota to new producers as described herein. New producers who have been on a Wait List for some time are allotted non-transferable quota according to the following directive:

The overriding principle of the GEP is to support the growth and viability of the milk industry by promoting the ongoing entry of new farmers who wish to be actively engaged in producing milk to meet the demand of British Columbia consumers for a broad range of milk and milk products. The FIRB is satisfied that there is industry support for the continuation of a GEP and that the revisions proposed by the Milk Board will enhance the viability of the program. Therefore, the FIRB directs that the Milk Board make the necessary amendments to Schedule 1 of the Consolidated Order to provide for the following:

- Non-transferable Total Production Quota (TPQ) will be allotted and held by a GEP entrant while they are actively engaged in milk production, after which time, it will be returned to the Milk Board. On the death or incapacity of a GEP producer or at the discretion of the Milk Board, non-transferable TPQ allotted to the producer may be transferred to Exempt Persons (as defined in the Milk Board Consolidated Order), provided the Exempt Person meets the eligibility requirements established for the GEP.
- The initial allotment of non-transferable TPQ will be 5,000 kilograms.
- A GEP producer who acquires transferable TPQ within five years of commencing production will be allotted a matching amount of non-transferable TPQ by the Milk Board (1 kilogram non-transferable TPQ for every 1 kilogram transferable TPQ acquired by the GEP producer) to a maximum of 2,000 kilograms non-transferable TPQ.
- GEP producers will receive a share of general allotments resulting from increases to the provincial allocation, based on the volume of transferable TPQ held by the GEP producer. Non-transferable TPQ issued to a GEP producer will not be reduced as the result of reductions in the general allotment.
- Until such time as a person has been invited by the Milk Board to enter the GEP, neither the person nor their spouse may have any financial interest in any quota or permit allotted for the production of a supply managed commodity, directly or indirectly, through any organization or entity.

- A minimum of three persons on the GEP wait list will be invited by the Milk Board to enter the industry each year. The Board may invite additional new entrants as required to meet the demand for specialty and niche products.
- The Milk Board may give preference to persons on the GEP wait list to enter the milk industry to produce specialty milk products.

The Milk Board will continue to collect an assessment on TPQ transferred between producers for allotment under the GEP. The Milk Board may, in its discretion, maintain exemptions on the type of quota transfer which is subject to assessment.

4. Under current Federal and Provincial legislation governing quota and market sharing policies there is only one quota. This one quota in BC is made up of a Federal allocation of MSQ and a Provincial allocation of fluid quota. Any attempt to disconnect the two will cause the Federal allotment to be adjusted accordingly. Furthermore, the Federal MSQ is allotted for national sales of dairy products and with open provincial borders Specialty Product must be covered by this quota allocation at the risk of putting the province into an over-quota situation with the associated financial penalties. The Board has therefore allocated TPQ to Specialty Production and recognizes that mainstream allocations are reduced proportionately. Although there is only one quota for all milk production and one pooling mechanism, the Board proposes to pool the Organic Milk Premium for the benefit of all Certified Organic Milk producers
5. The Board only licences producers who ship milk. The Board arranges milk pickup, delivers the milk to a Pool Vendor, collects the Class of use payment, conducts the Equalization Pool and pays producers. The Board has a practical minimum amount of milk that a producer can ship based on quota of 1,500 kg of TPQ or approximately 5 cows. The infrastructure to ship milk at small volume is not conducive to economic viability. At this low volume it is unlikely that a producer will be able to fulfill the Ministry requirements for safe handling of milk. It is not in the power of the Board to police safety of milk issues and health concerns; however, the Board is able to assist the Ministry by not licencing small producers. It bears noting that the small producers referred to here are not allowed to sell, offer for sale, deliver or distribute un-pasteurized milk, also known as raw milk.
6. The Board discussed the application of a Transfer Assessment of 1% on all Quota Exchange transactions but as described in the March 31, 2005 Response, is not recommending that it be implemented. For interest sake, this assessment, had it been applied over the past five years would have provided an additional 26,167 kg, for allotment. However, it bears noting that although the Board only collected 85,800 kg in the period 1999-2005, 24 producers have been invited to commence production with a total allotment of 172,000 kg. The shortfall is currently being funded from the provincial allotment. (See Chart of Quota Exchange Transactions)

The Consolidated Order defines the transactions on which the current 5% assessment applies and which transactions are Exempt Transactions.

### **Surrender of Total Production Quota on Transfer**

23. (1) Subject to subsection (5), where Total Production Quota is Transferred, the Transferor shall surrender to the Board an amount of Total Production Quota equivalent to 5% of the amount of Total Production Quota being Transferred.

(2) When a Person who has not commenced Deliveries of Qualifying Milk Transfers Total Production Quota registered in that Person's name, such Person shall surrender to the Board an amount of Total Production Quota equivalent to 20% of the amount of Total Production Quota being Transferred.

(3) Where the interest of a Producer in a partnership is increased, decreased or transferred, a proportionate Transfer of the Total Production Quota deemed to have been allotted to such Producer is deemed to occur.

(4) Where the direct or indirect interest of an individual in a corporate Producer is increased, decreased or transferred, a proportionate Transfer of the Total Production Quota deemed to have been allotted to such individual is deemed to occur.

(5) A surrender of Total Production Quota is not required where:

- (a) Total Production Quota is Transferred through the Quota Exchange;
- (b) Total Production Quota is Transferred to an Exempt Person;
- (c) the Transfer of Total Production Quota constitutes a Total Production Quota Swap;
- (d) a deemed Transfer of Total Production Quota is to partners or shareholders who are Exempt Persons;
- (e) two or more licensed Producers enter into an agreement of partnership and the partnership interest of each such licensed Producer is proportionate to the Total Production Quota registered in that licensed Producer's name;
- (f) the amount of Total Production Quota deemed to have been allotted to a Producer having an interest in a partnership remains registered in that Producer's name upon dissolution of the partnership;
- (g) Total Production Quota is Transferred by a Person to that Person's brother or sister in circumstances where (and only for so long as) the entirety of the Total Production Quota so Transferred is held for production by the Transferee at the same dairy farm as was operated by the Transferor immediately prior to such Transfer.

**"Exempt Person"** means:

- (a) a Producer's spouse, child, child and the child's spouse, grandchild, grandchild and the grandchild's spouse; or
- (b) where no Person named in sub-paragraph (a) exists, the Producer's nephew, niece, nephew and the nephew's spouse, niece and the niece's spouse; or
- (c) where no Person named in sub-paragraphs (a) or (b) intends to operate a dairy farm, such other Person, as the Board may determine;

7. The Board has received and reviewed processor projections for Specialty Product in establishing an entry level program for new and existing producers. The primary source of milk to fulfill the current near-term needs of existing processors will be filled by existing producers with an increased allocation of non-transferable quota designated for a specific market. Additional requirements will be filled according to the incentive described in the March 31, 2005 Response.

The enclosed chart shows the projected volume of Certified Organic Milk for the near term.

8. The Cottage Industry Program (CIP) was created in response to producer requests for a wholly independent producer/processor manufacturing operation without access to the provincial pool. In responding to this request the Board created a program to temporarily allocate quota to the producer/processor during the start-up years with the expectation that the producer would purchase quota as the business expanded. In addition to a separate class of licence, the Board allocated 10,000 kg of quota which is reduced at the rate of 20% per year.

In the March 31, 2005 Response, the Board proposed including Cottage Industry Program producers of Specialty Product in the Board's initiatives. Specifically, existing Cottage Industry Program producer/processors will be granted 10,000 kg of permanent, non-transferable quota to continue their manufacturing operation on the conclusion of their participation in the Cottage Industry Program.

Some CIP producer/processors have been approved for the manufacture of innovative products not otherwise produced in Canada for which milk is allotted by the Board. Under the terms of the CIP a producer/processor has no access to the provincial pool of milk so the DDPIP requirement of milk is temporarily allotted to the CIP producer on the same basis as a non-CIP producer. The temporary allotment of milk under the DDPIP is made in accordance with an Undertaking & Declaration (U&D) made by the producer which spells out the process for the return of the quota to the Board over a period of time.

In the instant case, CIP/DDPIP participants will be allotted permanent, non-transferable quota of 10,000 kg plus a temporary allotment of the quota equivalent of the milk used in the forty-ninth month to the sixtieth month of the DDPIP to the maximum specified in the U&D. The temporary allotment is returned to the Board on the terms specified in the U&D. The rationale for the return of DDPIP quota to the Board in all cases is in keeping with past practice in which all quota allotted to the province is shared among producers. It is evident that the existing participants would prefer to have the permanent use of quota allotted DDPIP without restriction including in some cases the right to sell the quota. It has never been the interest of the Board to confer windfall gains on any producer intending on selling quota (temporarily or otherwise) allotted to the producer. It should be clear that quota allotted under the DDPIP is to provide a supply of milk to the successful processor applicant. Quota temporarily allotted under the program would normally be allotted to all producers. It is only in the case of CIP that one specific producer obtains

the temporary allotment. The claw-back provisions are in keeping with common practice throughout the province.

Olympic Dairy has been approved for participation in the DDPIP for the production of Five Culture Un-homogenized Yogurt. Consequently, BC will receive an allotment of quota equivalent to the amount of milk utilized in the final year of a five year program. The approved application is not organic milk dependent meaning that Olympic could use mainstream milk to produce this product. The fact that Olympic chose to use organic milk only affects where the Board allocates the production. In the instant case, one producer was certified and able to produce the organic milk that Olympic requested in their original application to the Canadian Dairy Commission. Subsequent application has resulted in an increase in the amount of milk permitted for the DDPIP product. The Board is addressing this additional requirement by bringing more organic milk into production.

9. The Board commends initiative and especially the activities of on farm producer/processor participants in the Cottage Industry Program. Consequently the Board has developed the CIP to assist producers who wish to process their own milk into an industrial product with a temporary allotment of 10,000 kg of quota. The Board has determined that only Certified Organic Milk qualifies as a Specialty Product and has provided information on quota administration in the March 31, 2005 Response. Relative to non-organic milk CIP producers, the Board has not restricted participation in the program and continues to support participants.
10. The Graduated Entry Program is a means of assisting new producers starting in the industry. Under the terms of the Program a new producer is allotted 5,000 kg of Total Production Quota as well as matching quota to a maximum of 2,000 kg. for quota purchased within five years of starting. Participants on the GEP are taken from a Wait List of applicants who have registered their intention with the Board. At time of last printing there were 77 names on the Wait List. The Wait List is refreshed each year net of non-renewals and new additions. The refreshed Wait List is to be published in June 2005. Since time of last printing we have invited the first three names to commence production in August 2005 and have received two applications. The terms of the program are published in the Consolidated Order, Schedule 1 and incorporate FIRB Directives issued on May 20, 2004.