



B. C. Milk Marketing Board

March 6, 2006

Via e-mail: firb@gov.bc.ca

Farm Industry Review Board
PO Box 9129 Stn Prov Govt
Victoria, BC V8W 9B5

Attention: R. Bullock

Dear Richard

Re: Specialty Product and New Entrant Program

As we are now in the final stages of the Specialty Product (SP) and New Entrant Program (NEP) review, we wish to thank you for inviting further comment on the BC Milk Marketing Board (Board) draft changes to the Consolidated Order (CO). We further acknowledge the productive meeting with processors last week and are pleased to see that some progress is being made in understanding the options. Following the meetings with processors we were invited to provide further comment which we are pleased to do here.

Provisions for the Expansion of Specialty Product – Contracting Versus Pooling

As first receiver of all milk in BC, the Board manages farm pickup, transportation and delivery of milk to processors on demand. Concurrently, the Board allocates milk supply according to established criteria based on processor demand and historical allocation. On the producer side the Board processes a payment structure that ensures all producers are paid for their milk according to an Equalization Pool process that has been in existence for a number of years.

In the current instance, processors are asking for a supply of Specialty Product milk which until now has been supplied under Board authorized supply programs. Further expansion of the market and milk supply now calls for the introduction of new producers who have the desire to become providers of Specialty Product milk. The Board expects the demand for SP to more than double within ten years thus creating opportunities for new and existing producers in BC.

During the FIRB review of SP and NEP, it has been proposed that processors should have the exclusive ability to select those producers with whom they wish to contract for Specialty Product. Notwithstanding, that there are numerous producers who have indicated a willingness to convert their dairy to SP (organic milk). In the FIRB directives to the Board it was made clear that the Board is to make use of expanded assessments on quota transfers to start new producers on the Graduated Entry Program, some of whom may become SP producers. Granting exclusive authority for contracting SP milk supply to processors clearly limits the new SP GEP producer unless a processor is willing to contract for the SP milk. Under FIRB directives the Board is expected to start new SP producers, but in the absence of a contract with a processor the new SP

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producer will have no market for his milk. It is not feasible for a SP producer to ship milk to the mainstream pool without the organic premium which is only available on the sale of SP milk. Under this scenario the Board does not see how it can act on FIRB directives to start new SP producers.

Some processors have built up their SP volume over a number of years, assisted by Board programs. These programs have now reached maturity meaning that additional milk supply needs to come from the current quota managed system. Although the Board has quota granting programs, the need for processor contracts could make the programs useless.

Assuming that processors are permitted to control milk supply through contracts, the Board does not see how other new and perhaps smaller processors could secure SP milk. It is quite possible that even existing processors will be competing with each other as they attempt to secure contracts with desirable producers, i.e. those producers in closer proximity to their plant, with the right amount of quota available, with more attractive farms, etc. This then leads to the obvious question. How does a producer enter the SP milk business if no processor will grant a contract? How does the Board bring more SP milk to market if contracting is the exclusive right of processors? How does Equalization of producer returns occur if there is no equality in milk production?

The Board proposed the pooling concept for SP milk in a manner not unlike the provincial pool for mainstream milk. In the pooling concept all producers share equally and are paid the same for their milk components regardless of use or geographic location. The Board is of the opinion that granting contracting rights to processors is the first step in segregating milk into fluid and industrial with the risk of un-equalized returns. In the Board proposal of May 2005, SP milk not required by the market is shipped to the PLR and enters the mainstream market. It is clearly apparent that processors want this mainstream safety valve in the case of over supply but are not willing to share the SP market with the mainstream producer.

The Board is aware of a need to bring more SP milk into production but under the contracting scenario is unable to make a commitment to producers. Likewise some processors are asking for more SP milk but are not able or unwilling to make contracts with producers as individuals. It goes without saying that producers offered a contract will also expect a long term assurance that their milk will be used and the premium will be paid. Producers will not make the kind of investment required for SP unless there is a long term assurance of continuity. What processor is able to make this kind of commitment? Although the Board has received requests for SP milk, new processors have no intention of entering into legally binding contracts that could be financially draining. In all cases we see the Board as First Receiver of milk and abrogating the Board's authority over milk will not bring growth and stability to the SP market. On the contrary, it will bring frustration to producers and processors who cannot tolerate long term contracts and who have no recourse for a milk supply. It has been proposed that a processor with additional surplus milk could supply other processors who have short term needs. This sounds a lot like the mandate of the BC Milk Marketing Board, the First Receiver of milk in BC.

The only possible solution to bring assured SP milk supply is for pooling arrangements with producers who have entered the industry under Board invitation. Processors will still need to

identify their SP milk requirements over the short and long term as the first step in the Board inviting new producers to enter the SP market or converted mainstream producers. It will be up to the SMPAC, working with the Board to bring new producers into the SP market to fill demand. Surplus SP milk will still go to the PLR but under authority of the Board. Remember it is the mainstream producers that will be marketing surplus SP milk for the benefit of only SP producers. The milk of all SP producers will attract the SP Premium regardless of class of use. All SP producers will benefit from equalized returns regardless of use including the Equalization Pool for components as well as the organic milk premium payable by processors.

Under the pooling scenario, the Board will bring new producers into SP production. Processors will order milk and receive their pro-rata share. Surplus milk will be removed by the mainstream market and all SP producers will share in the premium pool. Milk delivered to the PLR will not attract a premium unless a sharing arrangement is proposed by the SMPAC. It is not inconceivable that processors could be held to account on some portion of additional milk as they proceed to build their business. This additional milk is the insurance they require to take advantage of market opportunities. Therefore it is logical that they share somewhat in a premium payment on this potentially surplus milk.

One argument we have heard is the additional cost of transportation for SP milk. Given that only SP processors benefit then it is only logical that SP processors should bear the additional cost of transportation. Under the current transportation rate policy, all producers subsidize the high cost shippers. It is therefore not logical that we should expect mainstream producers to pay a transportation premium on SP milk. Furthermore, we have not built transportation surcharges into the organic premium. It is the position of the Board that the processors have the means to recover this cost at retail and therefore they should continue to pay the transportation surcharge.

Graduated Entry Program (GEP) – Transferable versus Non-Transferable Quota

In 2003, the FIRB directed the Board to grant permanent, non-transferable quota to GEP producers. This direction came as a result of abuse in the leasing of restricted quota before the conclusion of fifteen years at which time the quota could be transferred. The abuse was evident in that the quota often transferred upon the fifteenth year anniversary. In 2000 the GEP was changed to make the quota subject to claw-back which turned the quota into an assistance program for new producers as opposed to a financial windfall at fifteen years. Unfortunately, the claw-back provision became unworkable as the price of quota escalated. Under the current program, a producer is given 5,000 kg of permanent, non-transferable quota and receives matching quota for purchases up to 2,000 kg. A full allotment then becomes 9,000 kg which is enough for approximately thirty cows.

A new producer entering the industry via the GEP has been on a Wait List for many years during which time they are expected to accumulate assets to start a dairy operation. Upon invitation to start, the Board provides this quota as assistance without guarantee of success. It is up to the producer to manage the dairy operation for the long term benefit. The Board recognizes that building a successful dairy is a long term, often family commitment and therefore has made the quota a permanent allotment to the producer. In the event the producer decides to exit the industry, the Board uses the quota to start another producer. It is not now nor was it ever the

intention of the Board to create windfall profits from GEP quota allocations. On the contrary, the Board supports new GEP producers with assessments on mainstream producers who recognize the long term benefit of new entrants. There is no benefit to giving quota to persons whose only intention is to cash-out when the time is right. This door was closed in 2000 when the quota was made non-transferable and remains non-transferable in the draft CO.

The Board recognizes the FIRB desire for similarity among the supply managed commodities in the matter of new entrant programs. Although not proposing any change to the current Graduated Entry Program, the Board is prepared to discuss transferability upon completion of ten dairy years' participation in the GEP with a 10% assessment to fund other new entrants. Clearly this is not the Board's first position and is only mentioned here as an alternative.

General Allotments

The Board has thoroughly reviewed the concept of assessment referred to as the 10/10 retraction principle as applicable to the general allotment of quota. This further assessment is being proposed to fund a new entrant program already established as the GEP. The Board has committed to starting a minimum of three new entrants each year irrespective of the general allotment of quota. It is therefore the Board considered opinion that the assessment on general allotments should parallel mainstream quota. It is the position of the Board that a separate and exclusive application known as the 10/10 retraction will only serve to confuse producers and compound the work of the Board in administering the GEP. Again, the Board has committed to starting three new entrants each year with the quota funded through the proposed assessment proposal or via negative general allotments as the case may be.

In summary, we feel confident in our ability to use the draft Consolidated Order to expand the Specialty Product supply with new and existing producers and to bring new producers into the industry. Although there may still be some uncertainty in how all this will happen, the opportunity should be allowed to proceed under the control of the Board. The Milk Marketing Board has, in one form or another, managed milk in BC since 1955 and it is a testament to the strength of our industry how well this has worked.

We thank you for your consideration as we work on improving our industry and will welcome further opportunity to answer any questions. In the meantime we are fully prepared to proceed with the formation of the SMPAC so we can work on satisfying market requirements for Specialty Product.

Yours sincerely

(Original signed)

Blaine Gorrell
Chairman