CWB comments on the Regulation Amending the Canadian Wheat Board Regulations and on the Regulatory Impact Analysis Statement

The CWB submits the following comments on the proposed *Regulations Amending the Canadian Wheat Board Regulations* that were published in the Canada Gazette on April 21, 2007 (the "Proposed Regulatory Amendments").

Description

The CWB is the largest wheat and barley marketing organization in the world. As one of Canada's largest exporters, the CWB sells grain to customers in more than 70 countries, returning all sales revenue, less marketing costs, to its farmer constituents. In accordance with the *Canadian Wheat Board Act* (the "*Act*"), the CWB single desk (sometimes inaccurately described as a monopoly) is the means through which western Canadian farmers market wheat (including durum wheat) and barley around the world and for human consumption within Canada.

As set out at Section 5 of the Act, the CWB's statutory mandate is to "market in an orderly manner, in interprovincial and export trade, grain grown in Canada". Under Parts III and IV of the *Act* and the regulations enacted thereunder, the CWB has been granted the exclusive legal authority to sell wheat, durum wheat and barley produced in the "designated area" (basically, the grain-growing region of the Prairies and the Peace River District of B.C.) that is intended for export from Canada or for human consumption within Canada. Loosely speaking, Part III of the *Act* enables pooling and certain other pricing mechanisms while Part IV creates the single desk.

The notion of farmer control is critical to understanding the current CWB and its position with respect to the Proposed Regulatory Amendments. In 1998, following an extensive review of western grain marketing by the federal government, the *Act* was amended to create a new corporate governance structure. As part of this change, on December 31, 1998, the CWB's board of directors (the "board") was granted overall responsibility to direct and manage the business and affairs of the CWB by Parliament. Since that time, 10 of the 15 members of the board have been elected by western Canadian producers, with each elected member of the board representing one of 10 districts within the designated area. Four of the remaining directors are appointed by the federal government while the fifth, the president and chief executive officer, is appointed by the federal government in consultation with and with the approval of the board.

Since the amendments to the *Act* in 1998, the CWB is now directly accountable to the farmers it serves. While the farmer-elected directors join the board as representatives of the farmers in the district that elected them, like any member of any corporate board in Canada they owe their duty to the corporation rather than any specific group of shareholders or stakeholders. The appointed directors also owe their duty to the corporation. All directors, whether elected or appointed, have the same powers, duties and functions.

Central to the issues surrounding the Proposed Regulatory Amendments – and central to the ultimate issue of farmer-control – was the addition (also in 1998) of section 47.1. That section imposes an obligation on the Minister responsible for the Canadian Wheat Board to consult with the board and to conduct a binding producer referendum prior to taking steps to extend the application of Parts III and/or IV of the *Act* or to exclude the application of Part IV. Section 47.1 reads as follows:

Minister's Obligation
47.1 The Minister shall not cause to be introduced in Parliament a bill that would exclude any kind, type, class or grade of wheat or barley, or wheat or barley produced in any area in Canada, from the provisions of Part IV, either in whole or in part, or generally, or for any period, or that would extend the application of Part III or Part IV or both Parts III and IV to any other grain, unless

(a) the Minister has consulted with the board about the exclusion or extension; and

(b) the producers of the grain have voted in favour of the exclusion or extension, the voting process having been determined by the Minister.

It is the CWB's position, given parliamentary and government commentary related to this provision and consistent with the overall intent of the 1998 amendments, that section 47.1 was intended to ensure that farmers, not government, would be in control of any future change to the CWB's mandate. Read in their proper context along with the remaining provisions of section 47, the proposed replacement provision for section 47 and the revisions to the *Act* as a whole, it appears that Parliament's intent was that section 47.1 is the gate through which any change in the CWB's mandate must pass before it can take effect. In addition to a properly conducted farmer vote in accordance with the requirements of section 47.1, many observers believe the opportunity for a full Parliamentary debate is a precursor to any change in the CWB's mandate.

It appears the 1998 amendments were clearly intended to prevent the alteration of that mandate by the government of the day acting on its own. The experience of just such an attempt by then Minister Charlie Mayer in 1993 to create the "Continental Barley Market" was undoubtedly in the minds of both the legislative drafters and of Parliament when the 1998 amendments were prepared and enacted. That government's unsuccessful attempt to deregulate the barley market by regulation as opposed to legislative change cost the industry millions of dollars. In short, it seems clear that barley can only be excluded from Part IV of the *Act* by legislation; the simple making of a regulation does not suffice.

Alternatives
There is no apparent alternative to the passage of a bill to amend the *Act*. Such a bill may only be introduced into Parliament if the conditions of section 47.1 have been met, namely: (a) consultation with the board and (b) a valid and binding farmer referendum approving the change.

It is the CWB's position that neither of the conditions has been met:

- While there have been meetings and exchanges of correspondence with the Minister, these have not been "consultations" with the board regarding the exclusion of barley from the application of Part IV within the meaning of section 47.1.

- The Minister has stated that this vote was not conducted pursuant to section 47.1 and that it was not binding. Moreover, the vote may have been, in any event, inconsistent with the *Act* and with accepted principles of Canadian law and academic commentary regarding plebiscites and referenda. Most notably, the use of the three-part question posed rather than a simple "yes" or "no" question may have been inconsistent with the principle that the result of the vote, if it is to be taken as an expression of democratic will,

must be free of ambiguity both in terms of the question asked and in terms of the support it achieves.

The Regulatory Impact Analysis Statement ("RIAS") also states that proceeding by way of regulatory rather than legislative amendment is the best way to avoid "an unnecessarily long period of market uncertainty" and to provide "clarity to the industry and to promote market certainty". The Minister has previously stated his desire to avoid a repeat of the Continental Barley Market. The CWB believes that there are many other ways to avoid the uncertainty that now plagues the malting barley sector:

- Allow the evolution of the CWB's barley marketing to continue. The 1998 amendments placed the decision-making powers in the hands of the people most affected (farmers) and with direct, unfettered access to board information (directors). Since that time the board has been moving steadily in a measured and thoughtful way towards greater producer flexibility and control over marketing decisions through the Producer Payment Options. It will continue to do so while maintaining the strengths and advantages of single desk marketing – as long as it is allowed to do so without political interference.

- Seek and obtain a court ruling on this matter prior to acting. This approach has been proposed to the Minister by the CWB as a means of curtailing some of the above-mentioned uncertainty. A significant part of the uncertainty to which the RIAS refers is a direct result of the experience that the industry had of the difficulties created by the regulatory implementation and subsequent unwinding of the Continental Barley Market in 1993.

- Provide legal analysis. In anticipation of the above, provide the industry with a detailed legal analysis supporting the government's position that these changes can be implemented by regulation rather than the intended statutory amendment.

- Defer implementation. Both the CWB and the malting industry have recommended a delay in the implementation of the government's "marketing choice" policy until the 2008-09 crop year. This would give the government time to obtain legal clarity and allow farmers and the industry time to prepare for any resulting change.

Benefits and Costs

The RIAS states that "(t)he CWB may not receive sufficient barley deliveries from producers who decide to continue to market their barley through the CWB after August 1, 2007, to enable it to honour sales commitments which have already been signed." However, the RIAS does not address the other significant costs associated with the issue.

For example, the RIAS does not address the fact that pre-August 1, 2007 sales are also in jeopardy. The uncertainty created by the government's actions is also a factor in creating origination problems for the current 2006-07 crop year. The erosion of the 2006-07 Pool Return Outlook (PRO) began on March 28. Difficulties in attracting immediate farmer deliveries are mostly to blame for the $8 drop in the CWB's PRO for malting barley that was announced in late April.

Until the law is changed, the CWB must continue to operate as a single-desk seller. As per normal commercial practice in the malt barley market, the CWB has forward-sold significant volumes of 2007 malting barley, primarily to domestic maltsters. Those maltsters have made

those purchases on the basis of corresponding forward sales of finished malt to their customers. Had the CWB declined to take advantage of attractive 2007-08 sales opportunities and the government's actions do not ultimately withstand a court challenge, then the CWB would not have fulfilled its obligation to market in an orderly manner and maximize returns to farmers. The domestic value-added industry would also have been harmed, since it would have lost export malt business to competitors, most likely from the European Union. The export malt business is a successful value-added grains sector located primarily in Western Canada.

Valuable sales opportunities have been and continue to be lost as buyers are waiting for some sign of certainty that either the single desk will remain or there will be an opportunity to source their product from multiple sellers. The announcement has meant that some customers will hold off purchasing until after August 1, when they may be able to purchase from competing sellers.

In addition, the CWB has decided to suspend publication of a PRO for 2007-08 because it is impossible to predict a pool price for barley without knowing how much barley will be delivered to the CWB. Similarly, the CWB has decided to cancel all barley-related producer pricing options for 2007-08 as they too are dependent on the PRO and there are no other markets on which to price malting barley. These pricing options are among the very options that the farmer-controlled board has put in place to respond to producer demands for flexibility within the single-desk model.

The CWB's legal liability as it relates to broken contracts is by no means distinct from farmers' liability. While individual farmers may benefit from abandoning prior commitments and making sales at higher prices, farmers collectively will pay for these individual gains. The CWB's financial interests are farmers' interests. Farmers pay all of the bills at the CWB and if and when the CWB is named in legal actions because contracts go unfulfilled, farmers themselves will pay.

Legal costs are not the only costs at stake. Farmers are at risk of having their reputation as reliable suppliers of barley severely tarnished and, ultimately, losing customers both domestically and world-wide. The grain market is characterized by intense competition and if Prairie farmers do not deliver on the commitments that have been made in good faith to buyers, those buyers will go elsewhere. The potential losses to the CWB and through it, to farmers are significant and the federal government must realize that farmers cannot and should not be asked to shoulder them.

The RIAS also makes no reference to the loss of the premiums that farmers have obtained through single-desk marketing of their barley. These premiums have been estimated by independent research at close to $60 million annually, but they would be lost in the open-market environment that the Proposed Regulatory Amendment will create.

It is noteworthy that the government has presented no detailed economic analysis of the impacts of the Proposed Regulatory Amendments or of the benefits of an open market; an unusual omission for such a significant policy initiative.

Finally, the Proposed Regulatory Amendments are premised on the concept that a dual market can exist and that a "strong and viable" CWB – to use the Minister's terminology – can continue to add value for Prairie farmers in the absence of the single desk. In direct contrast, the board has concluded that, in the absence of the single desk, the CWB cannot provide farmers who choose to continue to market barley through the CWB with a materially higher net benefit (e.g., farm gate return) relative to competing buyers; and many in the farming community share that

view. The concept is also contradicted by the ruling in the Federal Court of Justice Frank Muldoon in 1997 on a challenge that was brought forward by the Western Barley Growers' Association, the Alberta government and a group of farmers opposed to the single desk. At the time, Justice Muldoon concluded the following:

> "168. In simple terms, the effect of the Wheat Board's monopoly, in particular, by operation of its "three pillars", is to eliminate the "harm" which it was enacted to avoid. It follows that the next question to ask, by way of an alternative, is whether a so-called "dual market" might also reasonably avoid this harm. Through the evidence of Dr. Murray Fulton, the defendant has surely proved on a balance of probabilities that the Wheat Board would not be viable in a dual market. The three advantages of pooling are the pooling of risk, removing the timing of sales as a factor in the market price (price stabilization) and relieving the farmer of marketing responsibilities in order to concentrate on production decisions, (Dr. Carter's rebuttal affidavit, exhibit 23, p. 16). Those advantages would be lost (transcript: vol. XXVII, p. 2706). In Dr. Fulton's words, "a dual market would mean the end of the Canadian Wheat Board as we now know it" (transcript: vol. XXVI, p. 2668). Of all of the agronomical experts proffered by both sides, Dr. Fulton was the most credible, if not sole, authority on co-operatives and pooling.
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> The reason why the CWB could not survive in a dual market as a voluntary pool can be put no more eloquently than Dr. Fulton's words at p. i of his report "Dual Marketing and the Decision Facing Western Canadian Farmers for Wheat and Barley Marketing" (exhibit 72). He wrote:
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> > 'The reason why a completely voluntary pool cannot operate alongside a cash market is a direct function of pooling. Pooling is a system whereby high and low prices -- prices received at different times of the crop year and in different markets -- are averaged in some weighted fashion to give the pooled price. The consequence of the averaging process is that when market prices are rising, the pool price will generally lag behind. The lower price of the pool will result in farmers delivering to the cash market. In contrast, when prices are falling, the pool price will generally be above the cash price. This will provide an incentive for producers to deliver to the pool. The consequence of this behaviour is that the voluntary pool experiences either relatively small volumes being pooled or substantial losses in the pool if guaranteed initial prices are present.'"

Justice Muldoon's findings continue to reflect the current reality.

Consultation

The CWB takes issue with the characterization of the consultations set out in the RIAS. It leaves the impression that a broad-based consultative process has taken place. Rather, the process consisted of seeking the confirmatory views of long-time opponents of the CWB, to the exclusion of all groups who hold contrary opinions. Similarly, the task force that was established as a direct result of the July 27, 2006 meeting in Saskatoon did not have the mandate to consider the merits or impacts of the removal of the single desk. Rather, as indicated in the RIAS, the task force was established simply to recommend <u>how</u> the government's policy intentions could be implemented. It is noteworthy that the resulting report made no suggestion that the "dual market" or "marketing choice" model that the government has chosen is viable. On the contrary, it concluded that there are only two options when it comes to a marketing structure for western Canadian grains – the single-desk model or the open market.

Conclusion
Aside from the legal concerns related to the government's regulation-making authority under the *Canadian Wheat Board Act*, the Proposed Regulatory Amendments have been put forward without an adequate foundation, plan or policy to support their premise that this move towards an open market environment will in fact benefit the farmers of Western Canada. Accordingly, the CWB requests that the government:

- Defer the implementation of the Proposed Regulatory Amendments until at least August 1, 2008.

- Provide the industry with a detailed legal analysis supporting its position that the change can be made by regulation.

- Proceed immediately to obtain a court ruling as to the validity of the Proposed Regulatory Amendments.

- Meet with the CWB board of directors at the earliest possible opportunity to review means by which further commercial harm to farmers and the industry can be avoided or at least mitigated.

- Meet with the CWB and with the industry to establish the appropriate compensation for the losses that have been and will be caused by the government's actions.

We trust that our comments will be seriously considered as you attempt to develop policy for the marketing of Prairie-grown barley for both the feed and human consumption markets.

Respectfully submitted,
May 18, 2007