Submission by the National Farmers Union
to the
Manitoba Agricultural Services Corporation

on the
issue of potential farmers' liability
as a result of changes to the
Canadian Grain Commission
and the
Canada Grain Act

March 4, 2009
Portage la Prairie, Manitoba

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Introduction

The National Farmers Union welcomes this opportunity to present our views on the impact that legislative and regulatory changes to the Canada Grain Act and the Canadian Grain Commission will have on Manitoba – and by extension the Manitoba Agricultural Services Corporation.

In December, 2007, Bill C-39, An Act to Amend the Canada Grain Act, was introduced into the House of Commons. That piece of legislation died on the order paper in the fall of 2008 due to a federal election. However, similar legislation is expected to be put forward by the federal government in the near future. This impending legislation, combined with the regulatory changes which have occurred over the past year, pose a profound risk to Manitoba grain producers, and by extension, to the Manitoba Agricultural Services Corporation.

The legislation contemplated by the federal government will effectively restructure the Canadian Grain Commission so that its primary mandate is no longer to operate in farmers' interests, but instead is to function as a facilitator for large grain companies.

It is important to remember that Canada's farmers have not advocated any weakening of the CGC regulatory role, nor have they called for cuts to the CGC's mandate or its resources. The calls for changes to the CGA and the CGC are coming from corporate interests.

Licensing and bonding of grain companies

When the Canada Grain Act was proclaimed in 1912, a primary objective was to ensure that farmers' interests were protected when grain companies went bankrupt. Over the course of several decades, a requirement for licensing and bonding of grain companies was refined and implemented.

The NFU believes the licensing principles currently contained in the CGC's legislated mandate are the best means of achieving production protection and grain quality and quantity assurance. These principles include:

1. Producer protection, including reduction of farmers' financial risk;
2. Effectiveness and accountability;
3. Fairness and equity through consistent application of requirements for all companies involved in the grain trade;
4. Cost efficiency;
5. Transparency in the form of clear definitions of licensing criteria and requirements;
6. Enforcement and Compliance. The Canada Grain Act and Canada Grain Regulations are only effective if all players involved in the industry comply with the law. Voluntary compliance has clearly not worked in the past. The integrity of Canada's grain quality system, and the rights of farmers, depend on effective enforcement.

The CGC was set up by the federal government as a watchdog agency to ensure Canadian grain quality is not compromised, that farmers are treated fairly by the grain trade, and that the rules are applied equally to all grain companies. For many decades, the CGC fulfilled its obligations and deservedly earned the respect of farmers and other interests in the grain industry. Over the past decade, however, a number of unlicensed grain companies and brokers have taken advantage of lax enforcement measures.

This lack of enforcement has put farmers at risk because they usually assume that if a grain company is in business, it must be licensed. Farmers also assume they have financial protection in the event the company they are dealing with goes out of business, as well as having full access to CGC official inspection certificates for grain grades and tolerance levels.

The reality is, of course, much different. Unlicensed grain companies do not post security, so farmers are left unprotected. Farmers also do not have access to statutory rights under the *Canada Grain Act* guaranteeing fair grading of their grain. Unfortunately, the onus at the present time is completely on farmers, a situation which harkens back to the "bad old days" of the early 20th century, when grain companies exercised excessive control over the system at the expense of farmers.

Despite warnings issued periodically by the CGC about the pitfalls of selling to unlicensed brokers and companies, the situation has not improved. In fact, it is apparent

that many farmers do not take the warnings seriously because they interpret “lack of enforcement” on the part of the CGC as “implicit endorsement”.

Primary, process and terminal elevators, as well as grain brokers, are well aware of the requirements of the *Canada Grain Act*, and are also well aware of the Canada Grain Regulations, with which they must comply. The grain companies’ lobbying efforts have been especially vigorous in recent years as they press for changes to the regulations regarding their own licensing and bonding requirements.

The NFU urged the CGC to immediately step up enforcement of licensing requirements, adding that any potential loopholes which put farmers at financial risk should also be closed immediately. The NFU concluded that licensing and bonding by the CGC is the most reliable and cost-effective way of ensuring farmers’ financial interests are protected in the event a grain company cannot cover its payment obligations.

Despite a legal obligation requiring grain companies to be licensed and bonded, the Canadian Grain Commission for many years was not fully enforcing this requirement. Complaints from farmers and farm organizations finally resulted in the following declaration by the CGC in May, 2005:

“Simply stated, effective August 1, 2006, grain companies dealing in or handling western grain will either be licensed by the CGC, or lawfully exempted from licensing, or subject to criminal prosecution.”

At the time, the National Farmers Union strongly endorsed the initiative, noting that Western Canadian farmers have been calling on the CGC to enforce the provisions of the *Canada Grain Act* for a number of years. The fact that many companies have chosen to ignore both the letter and the spirit of the law does not mean the law should be adjusted to suit these companies. It simply means the companies know they can get away with these violations, and take for themselves an unfair advantage over both farmers and their competitors in the marketplace.

The Clearinghouse model

Meanwhile, in 2006, a review of the CGC was conducted by the consulting firm Compas. This review recommended scrapping the licensing and bonding requirement, citing the excuse that the requirement had not been fully enforced. However, it is clear from the Compas report itself, that the pressure to eliminate licensing and bonding came from the grain companies themselves: “A number of grain companies have urged Compas to recommend optionality for security on the grounds that the mandatory requirement for security imposes an unnecessary cost during a period when global markets are unusually price-sensitive. The carrying cost for committing this collateral increases their cost of doing business, placing at risk price-driven sales. Furthermore, mandatory security introduces a cost that impedes new entrants, thereby constraining competition. In recent years, the Western Barley Growers Association and other groups have called for implementation of clearing house systems as economical substitutes for assuring payment. Modeled on futures exchanges, clearinghouse systems would require pre-

approval of participants, margins to assure performance, and administration by such experienced bodies as the Winnipeg Commodity Exchange, Toronto Stock Exchange, or the Montreal Bourse."[1]

The NFU objected strongly to this recommendation, as well as to a number of other recommendations contained in the Compas Review. Despite the fact that no such working model existed for primary agriculture, the Compas Review recommended implementation of the "clearinghouse" model proposed by the Western Barley Growers Association. The federal government, in its response to the Parliamentary Agriculture Committee report, left the door open for implementation of a "clearinghouse" to replace the existing licensing and bonding requirements.[2]

Both the federal government and commodity organizations like the Western Barley Growers Association and the Western Canadian Wheat Growers Association suggested that "producer groups" would quickly step in and take advantage of their newfound regulatory freedom to implement voluntary programs to protect farmers' interests. However, past experience with voluntary programs of this nature has not been positive. It is interesting to note that in the mid-1990s, the elimination of a voluntary CGC program aimed at providing financial protection to producers of specialty crops was abandoned because not enough farmers were willing to participate in the program to make it actuarially sound.[3]

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[1] Compas Review of the Canada Grain Act and the Canadian Grain Commission, August 15, 2006, page 68.

[2] April 16, 2007, Government response to the fifth report of the Standing Committee on Agriculture and Agri-Food; Review of the Canada Grain Act and the Canadian Grain Commission by Compass (sic) Inc., http://www2.parl.gc.ca/HousePublications/Publication.aspx?DocId=2831317&Language=E&Mode=1&Parl=39&Ses=1 "While recognizing the importance of contractual security in the grain sector, the Government believes that, like other agricultural sectors, the grain industry can develop cost-effective and appropriate mechanisms for producer payment security."

[3] 1. Legislative Summary of Bill C-39: An Act to amend the Canada Grain Act, chapter 22 of the Statutes of Canada, 1998 and Chapter 25 of the Statutes of Canada, 2004, April 8, 2008: http://www.parl.gc.ca/common/Bills_ls.asp?lang=E&ls=C39&source=library_prb&Parl=39&Ses=2#licences **Licences and Abandonment of Special Crops Programs (subclause 64(1), clauses 65 to 69 and 71)** On 4 December 1997, Bill C-26: An Act to amend the Canada Grain Act and the Agriculture and Agri-Food Administrative Monetary Penalties Act and to repeal the Grain Futures Act, was introduced in the House of Commons; it received Royal Assent on 18 June 1998. That bill amended the Canada Grain Act to permit the separation of licensing and security provisions for special crops dealers. It had been argued to that point that the inability to separate these two activities was the primary impediment to the development of an insurance plan for the special crops industry of Western Canada. By requiring such a separation in law and by putting the administration of a voluntary insurance plan under the CGC, the legislation aimed to relieve special crops dealers of the need to post costly security against the possibility of their defaulting on payments to special crops producers. Furthermore, by repealing the Grain Futures Act, Parliament wanted to facilitate non-grain futures trading on the Winnipeg Commodity Exchange. (8) Subclause 64(1) and clauses 65 to 69 and 71 of Bill C-39 to repeal certain provisions of the *Act to amend the Canada Grain Act and the Agriculture and Agri-Food Administrative Monetary Penalties Act and to repeal the Grain Futures Act* that were designed to create a new class of licences for special crops dealers. The elimination of those provisions reflects the fact that special crops programs were abandoned, and, consequently, those sections were never in force.

The Compas report claimed the relaxation of licensing and bonding requirements would allow an increasing number of smaller grain companies, dealers and brokers to compete for farmers' business. The inference in the report is that farmers should be able to negotiate higher prices and therefore enjoy higher returns from the increased competition.

However, the removal of the CGC licensing and bonding requirements and the introduction of a voluntary "clearinghouse" model are much more likely to actually decrease the level of competition in the long run. Farmers, once they understand the risks involved under the new regime, will be much more inclined to sell their grain to a large, established corporation that has a proven record of financial stability and longevity, rather than take a chance on potential bankruptcy of a small, new company. The large corporations will understandably rely to their advantage on a marketing message aimed at reassuring farmers that their transactions are safe, and that farmers will be paid at the end of the day.

The risks inherent in eliminating licensing requirements for grain companies are evident from the wild market fluctuations which occurred in 2008. The CGC acknowledges that many licensees were adversely affected when grain prices rose dramatically and the level of security posted with the CGC fell short of what was needed to cover liabilities. A letter to NFU President Stewart Wells from CGC Chief Commissioner Elwin Hermanson, dated June 26, 2008, outlined the CGC's risk assessment of its licensing security program, "triggered because of the increased transaction risk to producers stemming from high and volatile grain prices." The CGC noted that the liabilities of many licensees were exceeding the security posted by the companies. Companies have had to either increase their security or reduce their liabilities by paying farmers more quickly for deliveries. However, Mr. Hermanson also noted that farmers themselves were being encouraged to "mitigate their risk" by: "undertaking their own due diligence regarding licensees, limiting the value of unpaid deliveries, requiring eligible documents that confirm delivery or payment, and depositing their payments as soon as possible."

The elimination of licensing requirements for grain companies will have serious repercussions for western Canadian farmers, and by extension, the MASC. For example, if a farmer suffers a severe financial loss due to an unlicensed grain company declaring bankruptcy, what policies – if any – would MASC implement to insure farmers are protected against such an occurrence ?

Loss of Mandatory Inward Inspection

The CGC is moving steadily toward eliminating inward inspection and weighing of grain, which will have far-reaching negative implications for the farmers of Manitoba and indeed, all of western Canada.

Inward inspection ensures that:

- The identity of the grain is established before co-mingling;

- The identity of the grain is preserved so that the sample will be available to resolve disputes or facilitate the appeal process;
- Substantive and valuable statistical information is available to: a) establish the basis for warehouse receipts; b) identify current stock positions; c) facilitate future audit processes; and d) predict cargo quality prior to shipment;
- Grain is collected to allow for future reviews of grain grades and specifications;
- The final grade assigned by the CGC can be checked against the grade initially assigned by the elevator manager to ensure consistency in accuracy, and to reduce the incidence of penalties imposed by the Canadian Wheat Board (CWB) for "missed grades;
- The presence of illegal or ineligible varieties is detected before these varieties enter the system;
- CGC-approved automatic sampling systems are monitored; and
- Railway freight rates are based on CGC-monitored weights.

These benefits are of primary importance to farmers, who understand the importance of a strong CGC which operates on their behalf. Mandatory, immediate, and on-site inward inspection by CGC inspectors provides substantial benefits to the system. It allows inspectors to "catch" contaminated, off-condition or incorrectly-represented carloads while they are being emptied, weighed, and elevated, and before they are mixed with large quantities of other grain. Even if contaminated or off-spec grain is binned, current inward inspection procedures allow problems to be spotted and isolated almost immediately. If a shipment of grain is contaminated due to the loss of inward inspection, it is highly likely that farmers will end up paying the financial penalty.

In 1995, the *Canada Grain Regulations* were amended to eliminate the requirement for official inspection and weighing of grain transported to the US from licensed primary and transfer elevators. These amendments resulted from intense lobbying by the Western Grain Elevator Association. However, the regulations still stipulated that official inspection and weighing was necessary at port facilities.

Since 1997, when the Grain Commission proposed curtailing inward inspection at ports (again, in response to pressure from the Western Grain Elevator Association), the NFU has been the most active farm organization in Canada in studying and evaluating CGC programs and operations and in making recommendations to improve and strengthen the CGC. More recently, on January 15, 2009, the CGC released a background paper entitled "Consultation on US Export Policy – Questions and Answers. In this document, the Canadian Grain Commission states that it "seeks a coherent and consistent policy applicable to all exports of Canadian grain to the United States." <u>However, it is clear that the stated goal of "consistency" is merely a smokescreen designed to hide the real objective. If "consistency" was truly the goal, both options would be examined equally. However, the option of strengthening official inspection and weighing to once again include primary and transfer elevators is not even considered.</u>

In the background paper, the CGC states: "stakeholders have expressed concern to the CGC that inconsistent requirements represent a competitive disadvantage for one

conveyance type in relation to another." However, it is well established that costs associated with grain shipments, including transportation, tariffs and handling charges, are all eventually passed back to the producer. There is little evidence to suggest that farmers whose grain is shipped by rail from inland elevators to the United States receive any higher returns than those whose grain is shipped from port terminals. Therefore, the argument that a "competitive disadvantage" afflicts port terminal operators such as those along the St. Lawrence Seaway, is without serious merit.

The CGC provides statistics that show 90% of total grain shipments from all of Canada to the US are conveyed by truck or rail, and that only 10% of the shipments are by lake or ocean-going vessel.[4] The rationale for the proposed change appears to be that because most of the grain is already not subject to CGC official inspection and weighing, the impact on the overall system would be negligible. However, the effect of removing official CGC inspection and weighing at the terminal elevators would be far more significant than those numbers would indicate. The CGC issues official certificates indicating grade and dockage of grain subject to official inspection. These official certificates provide legal protection to the farmer by virtue of their signifying official grade and weight of grain shipped. They also provide a guarantee to the final customer regarding grade and quality of the grain they are buying from Canada.

In cases where the CGC was not involved in weighing or inspecting the grain shipped, the farmer therefore does not have the legal protection of the CGC certificate of official inspection. Farmers who mistakenly assume the CGC's role and responsibility have not changed, will only discover after the fact that they are left unprotected.

This situation will be aggravated by another recent move by the CGC to further reduce farmers' access to on-site inspection services. In a letter to NFU President Stewart Wells, dated February 17, 2009, CGC Chief Commissioner Elwin Hermanson indicates the CGC has made a decision to "transition away from on-site inspection services on the Prairies, effective August 1, 2009." As a result of the decision, CGC service centres in Brandon, Moose Jaw and Melville – which all offered on-site inspections - will be closed. The services currently offered at those centres will be relocated to Saskatoon, Calgary, Weyburn, and Winnipeg. As stated in Hermanson's letter: "The transition away from on-site inspection services means that the CGC will no longer provide official grading and weighing on grain shipments from the Prairies to terminal facilities, nor for export shipments to the United States or domestic mills." The on-site inspection service centres were originally established to allow farmers to take a representative sample of their grain to a centre in their area and have it evaluated as to grade, protein content, dockage and other factors. If the sample was representative, farmers would then have a clear understanding of what they were delivering instead of relying strictly on the assessment given to them by the elevator. In the event of a discrepancy, the farmer could ask for the grain to be delivered "subject to inspectors' grade and dockage." Unfortunately, few farmers took advantage of the services offered by the centres because they were unaware how the system worked. This fact, combined with the CGC's long-range strategy of

[4] CGC Chief Commissioner Elwin Hermanson, statement made during a conference call with grain industry stakeholders, January 22, 2009.

underfunding and downsizing inspection services, is now being used to justify the decision to make inspection services more difficult to access.

The loss of access to inspection services, and the resulting loss of legal protection afforded farmers by the CGC inspection certificates, are issues that must be addressed by the MASC. Many farmers will be unaware of the correct procedures needed to retain official samples of their grain deliveries, and may be held liable for unintentional contamination of grain shipments.

Loss of Kernel Visual Distinguishability (KVD)

The potential for unintentional mixing of grain varieties is further aggravated by the removal of the Kernel Visual Distinguishability (KVD) system and the subsequent introduction of a system that relies on variety declaration affidavits.

The loss of the KVD system occurred on August 1, 2008. This move by the federal government carries severe ramifications for producers. Many of these ramifications will only become evident in the coming months and years as Canada's grain quality control measures are eroded and undermined.

The loss of the KVD system means that producers will likely be held liable for unknowingly misrepresenting a variety that may eventually contaminate a shipment. The only protection farmers may have under this scenario is to ensure they retain a sample obtained on their farm by a licensed inspector.

Farmers may also be at risk financially if they buy a variety that is misrepresented by a seller, and consequently suffer lower yield and/or quality.

The pressure for removing KVD is coming from those interests who stand to benefit from the introduction of lower-quality, higher-yielding varieties, and those who will benefit as a result of contractual control of certain varieties. There is presently no reliable method, other than KVD, for quick and accurate identification of grain varieties. While research needs to be done on **complementing** the KVD system with additional methods of identification, is it in the public interest to spend millions of taxpayer dollars to **replace** a system that has proven its reliability and consistency for more than a century?

Identity-preserved systems are not infallible, and in fact are likely to seriously impair Canada's ability to maintain quality standards. In the absence of any proven alternative system capable of guaranteeing Canada's grain quality standards, the NFU believes the KVD system for variety identification must be immediately reinstated.

In an environment which places the onus of responsibility on farmers to ensure the varieties they deliver to the elevator are what they declare them to be, what insurance programs will the MASC be prepared to introduce to provide protection to farmers against unintentional contamination? Similarly, what protections would farmers have in

the event they suffer yield shortfalls as a result of purchasing misrepresented seed varieties?

Environmental degradation and implications for crop insurance

The NFU is concerned that the removal of established shelterbelts and tree cover is exposing Manitoba soils to wind erosion. While farmers clearly tend to bear the direct costs of this loss of valuable topsoil in the near term, the long-term costs are more difficult to measure. In fact, the total cost of soil erosion is not borne only by the affected landowner. In the case where municipal drainage infrastructure is affected, all ratepayers of the municipality ultimately share the costs of restoring municipal drainage infrastructure that is damaged by drifting soil.

The NFU suggests that MASC work with the White Mud Conservation District to initiate a record of shelterbelt establishment, as well as a record of shelterbelt and tree removal in the conservation district. By keeping an ongoing record of when and where shelterbelts are established, and also when and where shelterbelts and tree stands are removed, MASC will be better able to determine if there is any correlation between these actions by landowners and any subsequent crop damage claims. In the event that a direct correlation is determined, then it would seem practical to adjust crop insurance premiums. Such adjustment would reflect the individual policy holders' efforts to limit the risk of soil erosion as evidenced by their decision to remove or retain shelterbelts and tree cover.

Conclusion

While the NFU continues to educate Members of Parliament about the need to reinstate the KVD system and the need to ensure the CGC recognizes its primary responsibility of protecting farmers' interests, the federal government and the CGC commissioners appear intent on re-regulating the grain sector to accommodate the commercial interests of large grain corporations.

These policies will undoubtedly mean increased liability for farmers. But in the final analysis, whatever problems that farmers encounter as a result of losses due to these changes to the CGC and CGA will eventually filter back to the MASC and become problems for Manitoba taxpayers.

The accelerating introduction of this new regulatory regime means that farmers will face situations that are not necessarily covered under normal crop insurance circumstances. For example, if a farmer takes out crop insurance under MASC and then applies for assistance, only to discover that his grain is not a registered variety, what happens then? What are the implications for MASC?

In another example, if a farmer suffers a severe financial loss due to an unlicensed grain company declaring bankruptcy, what policies – if any - would MASC implement to insure farmers affected by such an occurrence?

These and other questions need to be taken into account if MASC is to ensure its interests, and the interests of Manitoba farmers, are protected.

And finally, we encourage MASC to work with the White Mud Conservation District to establish a record of shelterbelt planting and removal in an effort to track any possible correlations between the effects of soil erosion and crop damage claims.

All of which is respectfully submitted
By the National Farmers Union – Manitoba region