

**BEFORE THE UNITED STATES DEPARTMENT  
OF AGRICULTURE  
AGRICULTURAL MARKETING SERVICE**

**In the Matter of** :  
**Milk In The Western** : **Docket Nos.:**  
**Marketing Area** : **AO-380-A18;**  
: **DA-01-08**  
:

**Statement Regarding Proposals  
3 & 4 & 6 & 7**

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# **Statement of Dairy Farmers of America**

Proposals 3, 4, 6 and 7 deal with our concern that performance standards in the Western Order are too liberal. The current standards allow far more milk to be associated with the market than can be considered a necessary reserve and this results in such a reduction in the blend price that milk production in the geographic area of the Order where Class I sales are the greatest is declining. Producers respond to blend prices and it behooves the Secretary to administer the Orders in such a way that blend prices accomplish the purpose of the Order.

As local production declines, the costs to serve the market increase and ultimately consumer costs will increase as well. Proposal 6 deals with the pooling standards directly by reducing the amount of milk that can be pooled by a handler on the Order. Proposals 3, 4 and 7 support the desired action called for by Proposal 6.

## **Statutory purpose for a Federal Order**

Section 8c(18) of the Agriculture Marketing Agreement Act, 7 U.S.C. § 608c(18), states in relation to Federal Order milk prices that prices to farmers are to be set at a level which will "insure a sufficient quantity of pure and wholesome milk". The statute is not directed towards supplies of cheese or butter or other dairy products; but to milk.

The Order 30 Tentative Decision amplified this point as it described what Orders are intended to do:

Pooling standards of milk orders, including Order 30, are intended to ensure that an adequate supply of milk is supplied to meet the Class I needs of the market and to provide the criteria for identifying those who are reasonably associated with the market for sharing in the Class I proceeds. Pooling standards of the order are represented in the Pool plant, Producer, and the Producer milk definitions of the order. Taken as a whole, these definitions set forth the criteria for pooling. . . . This is the only basis viable for determining those eligible to share in the pool. It is primarily the additional revenue from the Class I use of milk that adds additional revenue, and it is reasonable to expect that only those producers who consistently supply the markets fluid needs should be the ones to share in the distribution of pool proceeds.

Any benefits that accrue to producers from an Order stem from the role Orders play in accomplishing the primary objective of an Order – obtaining an adequate supply of milk for the “added value fluid use.”

Various other key principles of federal order operation are subsidiary to the principal purpose of serving the fluid market. The principle that Orders establish minimum prices, while certainly valid, must be evaluated in light of the primary objective – obtaining an adequate supply of milk for fluid use. The principles of equity that establish market wide pooling, are also equally valid and necessary but must be evaluated in light of the primary objective – obtaining an adequate supply of milk for fluid use. There is no basis in the statute for any possible claim that all Grade A milk has the right to share in the returns of the Order. When evaluated in light of the primary objective of serving the fluid market, milk that is excess to the market needs or situated so that it would rarely if ever serve the market has no valid basis to share in the blend proceeds.

Orders provide tests to measure if the milk of a producer meets the primary objective. Those tests, termed performance requirements, generally require association at the supply plant level (section 7 in most Order provisions) or association at the producer level (section 13 in most Order provisions) with a distributing plant as the measure of whether the milk of a producer meets the primary objective. The orders do not provide a free pass for any reason including geographic location.

At the supply plant level a milk supply must be transferred or diverted from the supply plant to the distributing plant in some minimum quantity. The provisions usually allow for some variation in quantity depending on the month of the year. So this section of the Order could be changed to vary the volume of milk allowed to share in the blend return in Order 135. However there are no supply plants on the market so any changes in that provision would have no effect at present. Examining the Market Administrator’s Exhibit \_\_\_ reveals that there are no plants qualified as supply plants on the Order thus far in calendar year 2002 or for all of 2001.

At the producer milk level there are two provisions that generally define performance. The “touch base rules” determine how many days of production the milk of a producer **must be delivered to a pool** plant during the designated period of time in order to share in the blend returns. The diversion limitations define how much milk of each producer (or group of producers) **may be delivered to nonpool plants** and still be allowed to share in the blend price.

DFA Exhibit \_\_\_\_\_ Table 1 **Summary of Diversion Provisions Under Federal Milk Marketing Orders** shows that these producer milk provisions vary from Order to Order reflecting different market conditions in each Order. In general the higher the Class I use the more touch base days are required and the lesser volume of

milk is allowed to be diverted from pool plants to nonpool plants in order to share in the blend returns.

In Order 135 there are large volumes of milk associated with the Order that are not near the population centers. In recognition of this, the Order requires only a one time forever "touch base" (so long as the producer does not deliver to another Order). For Order 135 we support this standard. Requiring a more frequent "touch" could be costly and inefficient.

The Market Administrator's Statistical Summary for December shows that there were 828 producers pooled on the Order and that the average daily delivery per producer was 17,978 pounds. In a 30-day month, using a 50,000 pound farm pickup load would require an average of 10 loads per day of "touch base" milk. (828 farms X 17,978 lbs per farm = 14.9 million pounds; 14.9 million pounds / 50,000 pounds per load = 298 loads; 298 loads / 30 days = 10 loads per day)

Given the weekly variation in fluid use demand, one could construct a scenario that this demand is utilized mostly over three days per week, with four weeks per month the delivery per day of "touch base milk" inflates to 25 loads per day. Perhaps in some months this might be accomplished within a demand driven scenario. But in many months it could not and would result in inefficiency in the market where some milk supplies would be transported away from pool distributing plants in order to accommodate milk that needed to be hauled in just to touch base.

Noticeably, no proponent requested a change in this provision during the notice period. So most of the other Order handlers must also feel as we do that this provision is correct and adequate for the market.

The remaining area to effect a change is in the diversion limitation language. This language defines the volume of milk that can be delivered to nonpool plants and still share in the blend returns from the market wide pool.

Clearly, not all milk can be delivered to distributing plants every day because the market will not demand it. This means that more milk must be associated with a market than the minimum delivery volume in order to have enough for the days that the market will demand it.

Consumer demand is generally filled over four days of the week. The reserve needed to fill that demand constitutes the remaining three days of milk production. So the most simplistic measure of a necessary reserve would imply a diversion limit of 43%. (A delivery of 100 pounds over 4 days - 25 pounds per day - would allow the remaining three days of production, 75 pounds to be pooled. Total poolings would be 100 + 75 pounds for 175 pounds.)

## Evidence for a Reduction in Diversion Limits

We believe that the current diversion limits in Order 135 are far too permissive. We endorse the statements made by the Utah Commissioner of Agriculture and the representative of Senator Hatch concerning the impacts of the present regulations. We suggest that a review of the marketing conditions in the marketing area of the order demonstrates that the present order diversion limitations are not appropriate.

Exhibit \_\_\_\_\_ Table 2 **Population Data for Idaho and Utah Counties** detail that for the states that comprise the largest portion of Federal Order 135 the bulk of the population is in Utah (69%) versus Idaho (31%). The population is further concentrated in just six Utah counties that account for 69% of Utah's Order 135 population and these top six Utah counties account for 59% of all of Orders 135 population. The population data indicate that consumption of Class I products must be "tilted" towards the Utah geography.

Exhibit \_\_\_\_\_ Table 3 **Comparison of Estimated Nonpool Plant Capacities by Type of Plant and Location Federal Order 135 Utah and Idaho** shows the distribution of manufacturing plants and their capacity in Utah and Idaho. The capacity estimates are made by DFA. They show that Idaho has an estimated 500 million pounds of manufacturing plant capacity or five times that of Utah. The Market Administrator's exhibit prepared for Mr. Vetne, titled **Pounds of Milk Reported as In- Area Sales by Handlers in the Western Order Marketing Area (FO 135) May and November 2000 and 2001** details In Area sales by Utah and Idaho handlers. This data indicates that the ratio of distributing plant milk is just the opposite – weighted towards Utah by a 3:1 ratio.

Exhibit \_\_\_\_\_ Table 4 **Trends in Production Factors in Idaho and Utah** detail several items about Idaho and Utah milk production conditions. Table A recaps annual milk production from the NASS **Milk Production Report**. Data for the past ten years shows a steady and dramatic increase in Idaho milk production. Increasing from an annual production volume of 3.1 billion pounds in 1992 to nearly 7.8 billion in 2001. The one-year increase in Idaho production of 7.8 % ranked as the second largest year over year change among all states for the 2000 – 2001 period (Alaska was first) and tops among the major dairy states. Production in Utah has also increased over 1992 levels but at rate only 1/7 of the Idaho expansion. Production of 1.3 billion pounds increased 21.6 percent to 1.6 billion in 2001. The year to year change was a decrease of 3.1%.

Table B taken from the NASS **Dairy Products Report** shows Total Cheese production by state for the same 1992 – 2001 period. There is no data for the years 1993 and 1994 because NASS only recorded two reporting plants thus preventing them from reporting individual state data. Cheese production in Idaho has grown by 171.5% over this period while declining 26.6% in Utah. Based on 2001 data Idaho is the fifth

ranked state for cheese production in the US. Table C details that a significant portion of the milk supply in Idaho is used in cheese production. During the 1992 – 2001 period in only one year did the percentage of milk used in cheese production fall below 75%. During this period there were both expansions in cheese plant capacity and construction and expansion of capacity for condensing. Likely the expansion of other than cheese manufacturing capacity accounts for most if not all of the reduction in the percentage of milk supply used in cheese making.

During this same period the percentage of the milk supply used in cheese making in Utah declined steadily. The percentage hovered above 60 percent in the early part of the ten year period, averaged in the 50% level in the middle, dropped to the 40% range during the end of the 1990's and fell below 40% in calendar year 2001. Over the entire ten year period milk used in cheese production in Idaho has grown 9.8% while declining 39.6% in Utah.

Looking again to Exhibit \_\_\_\_\_ Table 3. **Comparison of Estimated Nonpool Plant Capacities by Type of Plant and Location Federal Order 135 Utah and Idaho**, we would add that the cheese plant capacities of the Glanbia and the Jerome plants would rank them among the largest milk plants of any type in the country. The other two plants, Kraft at Rupert and the Sorrento – Lactalis plant at Canyon are owned by two of the largest cheese manufacturing and marketing companies in the US.

Table D, with data drawn from the Market Administrator published statistical summaries, shows production pooled on Order 135 by state of origin. For calendar year 2000 Idaho production represented 53% of the pounds pooled on the Order; growing to 60% in 2001. Utah production represented 36% in 2000 and declined to 24% in 2001.

By analyzing the production and use statistics it is easy to see that Idaho production represents a large share of the pounds pooled on the Western Order. Its' share is growing. Equally clear however the reason for its growth and the market for which it is intended is the manufacturing market. No rationale can be credibly advanced that this milk supply is being developed for the fluid market or to serve as a reserve supply. The data simply do not support such a contention.

To further support this contention one needs only to look at the procurement offerings from the major manufacturing plants in the area. They all base their procurement and payment practice on a cheese yield formula. They are open, clear and up front about this practice.

Exhibit \_\_\_\_\_ Attachment 8 **Comparison of Procurement Schemes Western Order Cheese Plants** details the milk payment schemes offered by Avonmore West (Glanbia Foods) and Davigo Foods (Jerome Cheese) to producers.

Clearly in both cases the prices paid to producers are derived mainly from cheese yield formulas.

Returning to Exhibit \_\_\_\_\_ Table 4 **Trends in Production Factors in Idaho and Utah** section E outlines the effects on the prices paid to producers of the large volume of milk pooled on the Order in excess of any reasonable measure of a reserve supply. Table E **Annual All Milk Price Idaho and Utah 1999 – 2001** details the All Milk price as published by NASS. The All Milk Price is a measure of prices paid to dairy farmers for milk sales to all uses. It is not a 3.5% butterfat adjusted price.

In the early nineties the prices between the two states maintained a fairly close relationship. However, in 1998 the higher utilization and tighter pooling provisions of the Great Basin Order combined with a tighter milk supply boosted the Utah All Milk Price. By CY 2001, however, the larger than called for reserve on the market allowed by the pooling provisions that more closely resembled the former Southwest Idaho – Eastern Washington Federal Order depressed the All Milk Price in the newly formed Western Order. The All Milk price fell 18% in Idaho, down \$2.38 to \$10.62. However prices fell even further in Utah, the section of the Order where the Class I use is the highest, by 24%, down \$3.28 to \$11.20. The 24% drop was even more than the national average decline for the year of 22%.

The ultimate measure of the effect of the decline in price would be the numbers of dairy farms in business. The best measure of this trend is the annual survey done by Dr. Ken Olsen for the American Farm Bureau. This survey is published in Hoards Dairyman annually, is quoted by FAPRI in their Congressional Policy studies and is used by the industry media regularly.

This survey collects information about the number of dairy permits in each state. The survey results for the period 1992 to 2001 are shown in Exhibit \_\_\_\_\_ Table 3 F. **Farm Numbers Utah and Idaho 1992 – 2001**. The number of Utah farms declined by 68 between 2001 and 2000. The 13.9% year to year drop is the largest decline since the 1992 – 1993 period. While the absolute decline parallels the Idaho drop for 2000 – 2001 the base from which the Idaho change is measured is twice as large making the percent of Utah farms going out of business nearly double.

An additional reason to support a reduction in the diversion limit is that the overly loose provisions aid milk in coming off and onto the pool at will and many times not being available to the market in the fall months when most needed. Exhibit \_\_\_\_\_ Table 5 **Comparison of Poolings Western Order Calendar Year 2000 and 2001** was constructed from Order data. It is designed to provide a relative measure of the level of Class III milk pooled relative to Class I utilization.

All the pounds were converted to an average daily basis and then indexed. For the Class I / III comparison the September – November periods on 2000 and 2001

were used. For the Class III computation October of 2001 was omitted due to price relationships that caused handlers to "depool" Class III volumes

Chart 1 **Comparison of Indexed Averaged Daily Class I and Class III Pounds, Federal Order 135, Calendar Years 2000 and 2001** demonstrates the relationships between Class III and Class I poolings. The chart shows that milk supplies contract and are not available to the Class I market in the fall months when it is needed most; but poolings expand in the spring months when it is needed the least. Put another way milk supplies chose another market in the fall and do not share those returns but chose to pool the milk when it is no longer demanded elsewhere in the spring months and then share in the blend returns. Returning to Exhibit \_\_\_\_\_ Attachment 8 **Comparison of Procurement Schemes Western Order Cheese Plants** it is clear that "bouncing on and off" of the Order when ever it is advantageous to "ride the pool" is a deliberate and planned for part of Davigco's business practice.

This process does not reward adequately those producers who choose to supply the Class I market year round. It tends to raise their costs of obtaining additional milk in the fall months when spot supplemental supplies are needed and lowers their return in the spring months when the milk that left the market in the short season returns. This is not orderly marketing.

The year round producers tend to carry the reserve costs for a supply that they cannot access when it is needed. Our proposal would not prevent handlers from choosing to market in this manner but would reduce the effect of it on other producers who supply the Class I market year round.

Exhibit \_\_\_\_\_ Table 6 **Comparison of Provisions** is a comparison of the producer milk pooling provisions for the current Western Order and the two primary predecessor Orders. The Great Basin Order regulated what is now the Utah portion of the current Western Order and the Southwestern Idaho – Eastern Washington Order what is now the Idaho portion of the Order. Table 6 shows that the provisions chosen in Reform tilt towards the more liberal limits of the old Southwestern Idaho Order. This helps to explain why the prices experienced by Utah producers have eroded, why Class I use has declined significantly, why poolings in excess of reasonable reserves are being accommodated and how significant quantities on reserve supply can come on an off of the pool easily.

The Reform Decision noted that the initial diversion percentage was set at 80% but was changed to a higher level. This activity makes clear that some type of decision-making analysis was performed in order to change the standard. We would hope that the additional detail and scrutiny which is available through the formal this hearing process will lead to a change in that decision.



We request that as the Secretary revisits that decision, consideration be given to the following facts:

1) The data show that the population (consumption) and the processing center (location of distributing plants) of the market is located in Utah.

2) The data show that production, farm count and prices are declining in Utah.

3) The data show that the Utah production is the closest and best situated to supply the market providing milk supplies to consumers at the most reasonable prices.

4) The data show that the Idaho milk supply has grown, not for the purpose of being a reserve supply for the Western Order, but rather for the purpose of manufacturing cheese. Furthermore, the Idaho milk supply is being used in cheese manufacture in a greater and increasing percent.

5) The data show that the reserve milk supply decreases in its ability to supply the market at just the time it is most critically needed and returns to the market at just the time it is needed least. This action penalizes the year round supplier of the Class I market. Furthermore this practice is a planned deliberate business event.

6) The adoption of the proposed 70% diversion standard would still supply the market with an over abundance of reserve supply as evidenced in Exhibit \_\_\_\_\_ Table 7. This table begins with the market wide data showing poolings over the past two calendar years. Assuming that most handlers require suppliers to deliver enough milk to meet the Class I and II needs of their plant, all calculations are based the sum of the two volumes. This is a reasonable yet charitable assumption.

If the 43% diversion standard developed earlier was applied **market wide** in January 2001 the market would need total poolings of only 203.6 million pounds in order to serve as a reserve supply for the monthly demand for Class I and II use of 116.1 million pounds. Application of this standard would cause upwards of 200 million pounds of milk to leave the pool. (depicted in columns f, g, and h)

Application of a 70% diversion standard using the same logic as above would, on a **market wide** basis, provide for far more reserves than could ever be required and still accommodate a significant volume of milk that has been traditionally pooled on the market. (depicted by columns f, i and j)

Finally the application of the 90% standard (depicted by columns f, k and l) shows the over generosity of this standard from a market wide basis.

The current permissive diversion standard damages the returns to producers in the area of the market that supplies the Class I market most of the time and it should be changed.

The specific language required to implement our proposal on diversion limitations is:

**Proposal 6**

**§1135.13 Producer milk.**

\* \* \* \* \*

(d) \* \* \*

(2) Of the quantity of producer milk received during the month (including diversions) the handler diverts to nonpool plants not more than 70 percent;

\* \* \* \* \*

1) Our intent is to have no change in the operation of this provision from current practice other than to reduce the limit from 90% to 70%.

**Corollary proposals**

In order to effectuate the changes we are proposing and to make sure that the intent is not mitigated there are three additional proposals that we have offered. Two of them deal with net shipment provisions and the remaining one with the cooperative supply plant provision.

Proposals 3 and 7 call for all performance measures to be made on the basis of a "net" calculation. That is, the diversion limit needs to be measured against real deliveries to the Class I market. As the limits are reduced in order to give recognition to adequate performance the pressure to ship milk into the qualifying plant and back out to the supply plant or handler increases. This allows the handler seeking qualification to pool more milk and to pool milk without giving any up at all. In a way, "double dipping"!

No doubt there are some additional costs to accomplish this goal but if the PPD is high enough the action will take place. Proposal 3 deals with the supply plant:

**Proposal 3**

**§1135.7 Pool plant.**

\* \* \* \* \*

(c) \* \* \*

(5) Shipments used in determining qualifying percentages shall be milk transferred or diverted to and physically received by distributing pool plants, less any transfers of bulk fluid milk products from such distributing pool plants.

\* \* \* \* \*

**Note:**

1) We would intend for the measurement to take place on a monthly basis.

2) We would expect the measurement to take place only between two handlers. If supply plant A ships 10 loads into distributing plant B and distributing plant B ships 9 loads back to supply plant A during the month only a single load is available for computing qualification. The calculation is to take place at the handler level so that a multi plant handler cannot "play games" with shipments.

3) We do not expect the Market Administrator to sort out shipments that involve more than two handlers. In the example above if distribution plant B ships a load out to supply plant C no "net calculation" would occur.

Proposal 7 makes the same type of calculation only at the producer milk level instead of the supply plant level. All of the qualifiers reviewed in items 1 – above would also be in effect here. Additionally we would make the wording changes noted by the strike thru and bold text.

**Proposal No. 7**

**§ 1135.7 Pool plant.**

\* \* \* \* \*

(d) \* \* \*

(3) Receipts Deliveries used in determining qualifying percentages shall be milk transferred to, diverted to, or ~~delivered~~ from farms of producers pursuant to § 1000.9(c) **delivered to**, and physically received by plants described in § 1135.7(a) or (b), less any transfers or diversions of bulk fluid milk products from such pool distributing plants.

\* \* \* \* \*

Finally, we would support Proposal 4 by saying that while there are no cooperative supply plants on the market currently (see MA Exhibit \_\_\_\_\_) the institution of our proposals may create the desire for one. If so, we offer Proposal 4, which would increase the cooperative pool plant provision delivery performance standard from 35% to 50%.

## **Proposal No. 4**

### **§ 1135.7 Pool plant.**

\* \* \* \* \*

(d) A milk manufacturing plant located within the marketing area that is operated by a cooperative association if, during the month or the immediately preceding 12-month period ending with the current month, 50 percent or more of such cooperative's member producer milk (and any producer milk of nonmembers and members of another cooperative association which may be marketed by the cooperative association) is physically received in the form of bulk fluid milk products (excluding concentrated milk transferred to a distributing plant for an agreed-upon use other than Class I) at plants specified in paragraph (a) or (b) of this section either directly from farms or by transfer from supply plants operated by the cooperative association and from plants of the cooperative association for which pool plant status has been requested under this paragraph, subject to the following conditions:

\* \* \* \* \*

#### **Note:**

- 1) As the diversion limits decrease, we would anticipate that a handler may wish to establish a cooperative supply plant under section 1135.7(d). To do so we propose that the standard be raised from 35% to 50% to make sure that an adequate performance level is met.
- 2) No plants qualify under this standard presently so no current plant would be affected.
- 3) Finally with regard to our proposal 2 and 9 we note that a geographic distinction is made in this provision and was a part of this provision prior to Order Reform as a performance measure.