

EXHIBIT NO. 19

Metropolitan

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

**In the Matter of** :  
**Milk In The Central Order** : **Docket Nos.:**  
**Marketing Area** : **AO-313-A48 et al;**  
 : **DA-04-06**  
 :

**Statement Regarding Proposals 1-3**

**Elvin Hollon**

**On behalf of  
Dairy Farmers of America, Inc.  
Prairie Farms Dairy, Inc.**

**December 6, 2004  
Kansas City, Missouri**

## **Statement of Proponents**

**Dairy Farmers of America, Inc. and Prairie Farms Dairy, Inc. are the proponents of proposals 1 – 2 and a modification to proposal 3.**

**Dairy Farmers of America (DFA) is a member owned Capper Volstead cooperative of 13,500 farms that produce milk in 49 states. DFA pools milk on 10 of the 11 Federal Milk Marketing Orders including the Central Federal Order.**

**Prairie Farms Dairy, Inc. (PF) is a member owned Capper Volstead cooperative of 800 farms that produce milk in 6 states. PF pools milk on 3 of the 11 Federal Milk Marketing Orders including the Central Federal Order.**

**The proponents are supporters of Federal Milk Marketing Orders and we believe that without them dairy farmers' economic livelihood would be much worse. Federal Orders are economically proven marketing tools for dairy farmers. The central issues of this hearing are providing for orderly marketing, economically justifying the appropriate performance qualifications for sharing in the market wide pool proceeds of an Order and recognizing that the cost of serving Class I markets should be borne by all producers who share in the Order's revenues. Failure to address these issues will be detrimental to all the members of our cooperatives both in their day-to-day dairy farm enterprises and the milk processing investments that they have made.**

### **Summary of Proposals for This Hearing**

**These amendments are being requested by producers due to the present day dynamics surrounding the pooling of milk in Federal Milk Marketing Orders.**

**The supporters of Proposals 1 and 2 recognize the disorderly market conditions that now exist due in large part to what we see as loopholes in the Federal Order regulations. Milk can exit the pool at any time there are negative consequences to pooling and immediately return to the pool when it is extremely advantageous to do so. Milk that is so distant from the Order 32 Class I market that it would never regularly ship to fluid use, could, after meeting the initial one day touch base requirement, shares in the fluid earnings of the pool in an opportunistic manner.**

**Proposal 1 deals with performance standards for both local and distant milk. Its goal is to more fairly define the milk that should share in the pool's Class I returns.**

**Proposal 2 deals with the issue of de-pooling. Its goal is to minimize the practice of depooling by requiring milk that chooses to "opt out" of the pool to face greater economic consequences for that behavior. Both DFA and Prairie Farms depool milk when advantageous and feasible. However, we think this practice is detrimental to the Order system and to dairy farmers and wish it stopped or curbed.**

**Our modification to proposal 3 offered by Foremost Farms USA and others, would establish a "transportation pool" funded by blend price revenues to offset a portion of the cost to transport milk produced in the marketing area to the market.**

**We will present two witnesses, Mr. Lee and Mr. Hollon to deal with the specifics of our proposal and the technical workings of the language we propose. We will also present several dairy farmers who will address how the practical aspects of the current inadequate performance standards affect their ability to produce milk for the Class I market in Order 32.**

Because of the way our proposals work we will testify first to Proposal 2, then to proposal 1. We will also address a modification to Proposal 3 and speak to the emergency nature of the hearing.

### **Class I Value and Performance Standards**

We provided proposals and supporting evidence at the 2001 Central Order hearing on pooling and performance standards. (AO-313-A44) We are here today because we feel some of the same issues need to be revisited and other marketing problems addressed.

DFA Exhibit \_\_\_ Table 1- Pounds of Milk Used in Class I Products, by Federal Milk Order Marketing Area, 2003 demonstrates that the Central Order is the third largest Federal Order market in terms of Class I use with 4.724 billion pounds of Class I sales in 2003. It is the value of these Class I sales that provides revenue to producers over the market clearing prices from lower valued milk uses. MA Exhibit \_\_\_ DFA Request #10 details just how much of the Central Order's pool values are derived from the value of Class I milk. For example for the month of January 2000 there remains \$6.66 million dollars in value to be shared in the pool after all of the producer milk is priced at component value. Class I sales generate these extra dollars. Clearly the value contributed by Class I is not static. In the period covered by the table the Class I contribution ranged from a high of \$16.5 million in November 2001 to a low of \$1.5 million in March 2004.

The question of who shares in these values is the key question at this hearing.

Should performance standards allow milk to opt in an out of the pool on a month to month basis depending on the relative blend price return and share

**in the market returns on the same basis as the milk that supplies the Class I market's regular every-day demand? We think they should not.**

**Should the third largest Class I sales volume market have a more diligent performance standard than what is commonly termed "once and done"? We think it should.**

**Should performance standards be so lenient to allow pooling of milk, which if delivered to meet the market's every-day Class I demand, would lose large amounts of money? We think they should not.**

**Should all producers who share in the market's return have some obligation to help offset some of the cost of supplying the market's every-day Class I needs? We think they should.**

**These questions form the focus of our proposals.**

**The decision from the 2001 Order 32 (Central Order) hearing directly addresses the relevant questions before us at this hearing and provides direction for both our proposals and the testimony and evidence we provide to support them. We want to highlight a few selected paragraphs from that decision:**

**"The pooling standards of all milk marketing orders, including the Central order, 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 as a condition for receiving the order's blend price. The pooling standards of the Central order are represented in the *Pool Plant, Producer*, and the *Producer milk* provisions of the order. Taken as a whole, these provisions are intended to ensure that an adequate supply of milk is supplied to meet the Class I needs of the market. In addition, it provides the criteria for identifying those whose milk is reasonably associated with the market by meeting the Class I needs and thereby sharing in the marketwide distribution of proceeds arising**

primarily from Class I sales. Pooling standards of the Central order are based on performance, specifying standards that, if met, qualify a producer, the milk of a producer, or a plant to share in the benefits arising from the classified pricing of milk.

Pooling standards that are performance-based provide the only viable method for determining those eligible to share in the marketwide pool. That is because it is the additional revenue from the Class I use of milk that adds additional income and it is reasonable to expect that only those producers who consistently bear the cost of supplying the market's fluid needs should be the ones to share in the distribution of pool proceeds.

...

Pooling standards are needed to identify the milk of those producers who are providing service in meeting the Class I needs of the market. If a pooling provision does not reasonably accomplish this end, the proceeds that accrue to the marketwide pool from fluid milk sales are not properly shared with the appropriate producers. The result is the unwarranted lowering of returns of those producers who actually incur the costs of servicing and supplying the fluid needs of the market.

...

The tentative decision and this final decision find that the milk of some producers is benefiting from the blend price of the Central order while not demonstrating actual and consistent service in satisfying the Class I needs of the Central milk marketing area.

...

The reform Final Decision, as it related to the Central marketing area, did not intend or envision that the pooling standards and pooling features adopted would result in the sharing of Class I revenues with those persons, or the milk of those persons, who would not be demonstrating a measure of service in providing the Class I needs of the Central marketing area.

...

As previously indicated, pooling milk on the Central order without demonstrating actual performance in servicing the Class I needs of the market area is neither appropriate nor intended." 68 Federal Register 51644 – 51646 (August 27, 2003)

## **Proposal 2 - Depooling**

**Proposal 2 deals with the issue of depooling. While there is no official Order term "depooling", the industry generally understands it to mean the process of removing pounds of milk (by class) from the pool whenever the blend return is less than the corresponding Class value to the pooling handler and then re-associating the same milk in a later month with the pool when the return is above the class value. The pooling handler retains the higher-class value, having billed his customer for it, but does not share the higher value in the Order pool and has more dollars (generated by the Order) available to pay to his milk supply than a handler that cannot depool. (By definition Class I milk must be pooled and the value shared thru the pool's blend price.) This is a rational economic practice - but the consequences in a regulated environment are disorderly. Competing milk supplies do not have equal returns generated by the Order available to pay for milk.**

**Depooling is allowed by the order for Classes II and III and IV. In every order except the Northeast Federal Order this economic comparison can be made monthly with no consequence in a later month for a decision made this month.**

**The term and its occurrence is not a new or even recent Federal Order phenomenon. But as milk prices become more volatile the high dollar value associated with depooling becomes more critical and is both a recent phenomenon and a critical reason why changes must be made to the Order system.**

**I personally performed depooling decision calculations for Order 30 for my employer in the 1980's and 1990's but remember very few price differences of the over \$2.00 per hundredweight range. In an exhibit prepared for the**

most recent Order 30 hearing, instances of negative PPD's for Order 68 were presented and for the period 1993/1999 (84 months) there were 16 negative months with PPD's listed. Six of them were in excess of 50 cents. Furthermore I cannot recall more than a few times that depooling decisions extended into what was then the Indiana, Michigan, Central or Southern Illinois orders. Certainly it was the mid to late 1990's before that type of decision-making was "regular" outside of the Upper Midwest Orders.

Among the basic purposes of the Federal Order structure are to assure an adequate supply of milk for the fluid market, equitably share the pool proceeds in an economically justifiable manner, and promote orderly marketing. Orderly marketing would encompass principles that attract milk to the highest value use when needed and clear the market when not needed. Marketwide pooling allows qualified producers to share in the market returns on a fair and equitable basis and establish requirements that provide the necessary incentives to efficiently supply the market. Working in conjunction with classified pricing, these principles and requirements assure an adequate supply for the fluid market.

A review of MA Exhibits, published Order data, and DFA exhibits for Order 32 show that depooling opportunities have been present 43 times since the implementation of Federal Order Reform. In CY 2000 there were 8 opportunities (0 - II, 0 - III and 8 - IV); in 2001 there were 10 opportunities (5 - II, 0 - III and 5 - IV); in 2002 there were 4 opportunities (3 - II, 0 - III and 1 - IV); in 2003 there were 10 opportunities (6 - II, 4 - III and 0 - IV); and thus far in 2004 there have been 11 opportunities (9 - II, 2 - III and 0 - IV).

Depooling is a problem because it results in different returns from the Order for milk sales. Milk is only depooled when the result means more money for



**the handler who depools. Since by definition Class I milk cannot depool, then the Class I sale is always disadvantaged when milk is depooled. The handler with Class I sales must draw from margins in order to pay a competitive pay price because his regulated return is less than the depooling handler. If he cannot or does not, he will lose his milk supply to a handler who does depool. Thus, handlers in common procurement areas face widely different returns from the regulated pricing scheme. This is the ultimate in irony – that the source of additional value to the pool, Class I milk, is unable to be competitive with other class sales due to depooling. If one of the purposes of the Order is to provide milk for Class I sales then depooling thwarts that purpose and must be considered disorderly.**

**The magnitude of the difference in returns is large. Looking to DFA Exhibit \_\_\_\_ Table 2-E Utilization and Statistical Uniform Blend Price Federal Order 1032 CY 2004 for April a handler that was unable to depool was \$4.02 per hundredweight behind in ability to pay versus a handler that was able to depool. For the supplier that delivered a tanker load of milk per day to a fluid bottler that difference amounted to \$62,310 for the month; for 10 loads per day \$623,100 per month. Differences of this magnitude would be insurmountable for nearly any milk procurer. In May, that difference was \$2.18 per hundredweight. While much less, still very significant. Expressed another way in February 2004 1.2 billion pounds of milk was pooled on the Central Order including 628.8 million pounds of Class III milk. In March there was only 0.712 billion pounds in the pool and 141.6 million pounds of Class III. In April and May both volumes dropped even more but completely returned in June to nearly the same February levels. Much of the milk that shared in the Class I dollars generated by the Order in February opted out in March and April and returned easily in June to share again. Looking again to MA Exhibit \_\_\_\_ DFA Request #10 those who chose to depool, left the pool**

when there was only \$1.5 million dollars of revenue to share and returned to the pool in June when there was \$11.7 million to share. Thus those who could not depool were not able to "collect more" when "more" was available to make up for the shortfall in March and April because more pounds opted to share in the total pool and blended down the per unit return. This situation must be remedied.

If handlers face different returns from the blend pool, then ultimately producers in common procurement areas will face differing returns – a second sign of disorderly marketing. Furthermore, while not a purpose of Orders, depooling makes risk management tools normally available to dairy farmers virtually useless since the magnitude of risk they must now account for is far too wide for any speculator to be willing to take on or the price for such activity so great as to render the hedge useless.

**MA Exhibit \_\_\_ DFA Request 4B Producer Price Differential (PPD) Computation with the Effect of Incremental Increases of Depooled Producer Milk Utilized in Class III July 2003 to May 2004 depicts the financial impact on the PPD from various levels of depooling Class III milk. As noted in the footnote, each PPD computation does not include the producer settlement fund reserve amount. Adding four and a fraction of a cent to each number would result in the published PPD for the month in the column labeled weighted average PPD.**

Using the data in the table we can determine that in April 2004 the published PPD of -\$3.974 would have been 87 cents more if the pool had contained 25% more Class III milk. If all of the depooled Class III milk would have been included the pool would have been \$2.15 greater and of equal importance all handlers in the marketing area would have had the same level

of return from the pool. In December 2003, a month of a sizable positive PPD of \$1.08, if 100% of the Class III milk would have chosen to depool, the PPD would have been 2.03 or 95 cents more. Clearly the order system was designed to share the December 2003 - 95 cents of value. That is the principle of marketwide pooling and the concept is designed to prevent producers from taking on ruinous competition in order to capture the class I market such that no one is profitable and all are out of business. But it should seem equally clear that the system should not abet the in and out behavior that we now have.

It is our testimony that differing returns in the ability to pay of up to \$4.02 are disruptive, disorderly and greatly affect our ability to procure and maintain a milk supply for our Class I customers.

### **Proposal to Limit Depooling**

The proposal we offer is to limit the pounds a handler can pool each month to a volume lesser than or equal to 125% of what was pooled in the prior month. This proposal is too drastic for some, as I am sure we will hear, and not nearly strong enough for others in the marketing area.

In the development of Proposal 2, the proponents reviewed the Order's pooling requirements. Among possible changes reviewed and discarded were changing the touch base to an every month requirement; eliminating split plants so that a plant was either a pool plant or a nonpool plant at any given location; instituting a producer for other markets provision; and developing a type of committed supply program. All of these would have meant some change, and in some cases great change, at great cost for Order 32 handlers.

**Proposal 2 would limit how much milk a handler could add to the pool or repool each month. Milk pooled would be limited to 125% of the previous month's pooled volume with a few exceptions. It will not eliminate depooling. It does mean there are potential consequences to massive depooling. If you depool under the current regulations there are no long-term consequences. In fact there are virtually no negative impacts for those who depool. The level of this limitation was chosen after receiving information similar to that found in MA Exhibit \_\_\_ DFA Request 8. The two large percentage changes shown in Table 8 are the 148.32% in November of 2003 and the 189.38% in July 2004 - in both cases these percentages follow months of massive depooling and represent the type of situation our proposal is designed to correct. The 126.98% in February 2000 represent a response to Order Reform where pooling decisions were being made to take advantage of new Order provisions and the February calendar was not long enough to make all the delivery requirements necessary to comply with handlers' new intentions. More milk than normal was then associated for the first time with the in March pool. The 125% limitation in our proposal should accommodate the normal market situation in the Central Order and allow for a reasonable amount of added volume in any given month.**

**MA Exhibit \_\_\_ DFA Request 5 Estimated Volume of Maximum Milk Allowed to be Depooled at 125% Depooling Limit with a Three Month Time Lag demonstrate that depooling is not eliminated by our proposal. Under "perfect conditions" a handler could depool up to 35% of his milk supply over a three-month period and still get it all back on the pool in month 4. While not eliminating depooling, this is a modest, and in our minds reasonable, position to take to control the problem.**

**Restricting the pooling of milk based on prior performance is not new to Federal Orders. The Northeast Order has had a "producer for other markets" provision for many years. Under this provision, milk of a producer cannot be immediately repooled if it has been depooled and is, in fact, excluded from the pool for an extended period of time. Proposal 2 would not impose such a burden on an individual producer but limits pooling based on an aggregate total of the handler's previous month's pooled pounds.**

**Years ago, other Orders primarily in the South and/or Southeast either had a producer for other markets provision or base plans to accomplish similar goals. In these markets, the intent of such provisions was to limit the sharing of the marketwide pool during the spring months to those who pooled during the fall.**

**An additional benefit to our proposed limitation on pooling is that it would reduce or eliminate the possible need for an increase in the Market Administrator's administrative assessment fee. In Federal Order 30 the Market Administrator has budget has been so impacted by depooling that he felt necessary to ask for an increase in the upper limit for the fee level in order to assure that the Order can properly function and do so with a reasonable budget. While this is not a current issue in the Central Order it may well become one and our proposal should keep that from occurring. The pool volumes would be more stable. It is our view that there would be more milk pooled and less need for a fee increase. At the very least, with stability in the pool volumes, it would be easier for the Market Administrator to make staffing and other operational decisions which benefit the Order.**

**Some have asked why not seek a "non" Order solution to this problem. However, those solutions are not always workable or consistent. There is not any way to recover the negative PPDs from the Federal Order. A handler that**

**must pool is always at a disadvantage when there is a negative PPD. And when there is a positive PPD, the handler who depooled during the negative PPD immediately returns to share in the pool.**

**There has been a recent effort to recover the negative PPDs through increased fluid market service charges. While admirable and welcomed by those who supply the fluid market, this effort is not sustainable over the long term. The increased price may have contributed to the larger than normal decline in fluid milk sales this summer. Also, the fluid plants in Order 30 where the added price has been implemented were placed at a competitive disadvantage with fluid plants in the Central and Mideast Orders and other areas where there has not been an increase.**

**The fluid plant cannot always recover this increased cost from the marketplace. Many of the longer term packaged milk supply arrangements with national and regional accounts have a price adjuster for changes in the Federal Order cost of milk. There may not be any provision, however, for changes in over order prices. The fluid plant ends up "eating" this increase and the books show red ink.**

**Central Milk Producers Cooperative and Upper Midwest Milk Marketing Agency (CMPC and UMMA) are pricing agencies composed of some of the cooperatives that supply milk for Class I use in the Upper Midwest. CMPC and UMMA put the increased service charge (negative PPD surcharge) in place for those plants that obtain milk from the CMPC and/or UMMA membership. Not all suppliers in Order 30 were members of CMPC or UMMA. This adds to the difficulty of maintaining a negative PPD surcharge premium. This method is not a long-term workable solution.**

**There are other proposals that have been offered here and will be testified to later in the week. We discussed many of those proposals and feel that several of them may well work in principle but are not the best solution for the Central Order.**

**The language that we offer is as follows:**

**(f) The quantity of milk reported by a handler pursuant to § 1032.30(a)(1) and/or § 1032.30(c)(1) for the current month may not exceed 125 percent of the producer milk receipts pooled by the handler during the prior month. Milk diverted to nonpool plants reported in excess of this limit shall be removed from the pool. Milk received at pool plants in excess of the 125% limit, other than pool distributing plants, shall be classified pursuant to § 1000.44(a)(3)(v). The handler must designate, by producer pick-up, which milk is to be removed from the pool. If the handler fails to provide this information the provisions of 1032.13(d)(5) shall apply. The following provisions apply:**

**(1) Milk shipped to and physically received at pool distributing plants shall not be subject to the 125 percent limitation;**

**(2) Producer milk qualified pursuant to § \_\_\_\_\_.13 of any other Federal Order in the previous month shall not be included in the computation of the 125 percent limitation; provided that the producers comprising the milk supply have been continuously pooled on any Federal Order for the entirety of the most recent three consecutive months.**

**(3) The market administrator may waive the 125 percent limitation:**

**(i) For a new handler on the order, subject to the provisions of § 1032.13(f)(3), or**

**(ii) For an existing handler with significantly changed milk supply conditions due to unusual circumstances;**

**(4) A bloc of milk may be considered ineligible for pooling if the market administrator determines that handlers altered the reporting of such milk for the purpose of evading the provisions of this paragraph.**

**Section (f) sets out that the total volume of milk that can be pooled this month is no more than 125% of what was pooled in the prior month. Any milk in excess of this volume will be removed from the pool. It is the handler's responsibility to designate which milk is not to be pooled if the limit is breached. Section (f)(1) directs that milk shipped directly to a distributing plant is exempt from the limit. In the extreme case of 100% depooling a handler can always pool his deliveries directly to a distributing plant next month and also begin to earn pooling ability for subsequent months. Section (f)(2) allows milk that has been pooled on another order to be exempted from the 125% limit so long as the milk has been continuously pooled for at least three months on some Order. This does not penalize a Central Order handler from being a supplemental supplier to another Order plant and also prevents a multi regional supplier from selectively depooling and moving producers around between Orders to maximize depooling gains. Section (f)(3) allows the Market Administrator some discretion in administering the proposal to account for a new handler, drastic but explainable reasons for changes in a pooling volume, and the ability to investigate and deny pooling for instances where some type of fraud or mal-intent is going on.**

## **Proposal 1 - Performance Standards**

**Proposal 1 deals with the recognition that the performance standards for the Central Order need further review. Current provisions - while improved from the standards set in Order reform, are still too lax and allow far more milk to be associated with the market than what might be considered a normal**



reserve. The excess reserve depresses the blend price for producers that serve the every day needs of the market. It is increasingly difficult to attract milk to the Central Order with the existing blend price or to keep milk from being attracted away to other Orders. Furthermore, we are concerned that a pooling situation may develop with milk supplies from the Mountain states, similar to the "double dipping" concerns from California milk that was evident only a few months ago where large volumes of milk may get attached to the Central Order from distances so far away that it can rarely if ever serve the market. This situation has already occurred in the Upper Midwest Order and we want to insure that performance standards are adequate in the Central Order to correctly identify which milk should share in the market returns.

### **Distant milk - concerns**

We note that today little distant milk is associated with Order 32. However, the same thing could have been said about California milk in CY 2000 – there was none on the pool. But from 2001 – 2003 a large quantity was pooled in the Central Order Milk from California. The volume first pooled on Order 30 because it was the easiest and most lucrative Order to attach to. After that option was no longer an alternative, much of the milk moved to the Central Order and then to the Western Order. This situation is illustrated with data taken from MA Exhibit \_\_\_\_ (Western Market Administrator), MA Exhibit \_\_\_\_\_ (Central Market Administrator) and MA Exhibit \_\_\_\_ (Central Market Administrator). The data was assembled in Table form in DFA Exhibit \_\_\_\_ Table 4 - Compilation of Pounds of Milk Pooled on Orders 30, 32 and 135 From All Sources and California and graphically in DFA Exhibit \_\_\_\_ Table 4 - Chart 1 – Comparison of Total Milk Pooled and Milk Pooled from California, Federal Orders 30 - 32 - 135 January 2000

– **December 2003.** It is clear to see that California milk moved between the Orders as provisions allowed. The parties that pooled the California milk were acting in their own self-interest and made rational economic decisions within the framework of the rules allowed. However we, much of the rest of the industry, and eventually the Secretary felt this type of pooling was disorderly and adopted regulations to limit California milk from pooling in Orders 30, 32 and 135.

We have seen a similar situation arise with milk from Idaho and other portions of the former Western Order become pooled on Order 30. (See MA Exhibit \_\_\_ DFA Request 1 from the Upper Midwest Market Administrator) Data presented in these tables was offered in the recent Order 30 performance provision hearing and detailed how milk from Jerome County Idaho had become the single largest milk supply county on the Order - at over 1200 miles away from the Minneapolis market. Milk from this area would be a long distance from Central Order markets. MA Exhibit \_\_\_ DFA Request #2 details mileages from several Southern Idaho cities to bottling plant locations in the Central Order. As seen from the table the distance ranges from 548 miles (Preston ID to Denver) to 1,434 (Boise ID to Sioux Falls SD). These distances make it difficult to be a regular supplier to the market. There are some questions about dependability of supply and certainly the cost of transport would be excessive. In addition, Order provisions are such currently that only a miniscule amount of the milk would ever have to perform. Testimony presented at the Order 30 Hearing indicated that less than 1% of the milk pooled ever delivered to the market. We will present some additional testimony relative to cost and return later in our statement. We know from our own marketing information and from testimony presented in the Order 30 hearing that a significant quantity of the Southern Idaho milk supply that is attached to Order 30 is Class IV. The

Central Order has little Class IV utilization currently so any additional supply would not be a traditional part of the market. MA Exhibit \_\_\_\_ Central Federal Milk Order table's 11- 13 show Class IV percentage use to be in the high single digits since Federal Order Reform consolidated several markets into the Central Order. Pounds of Class IV utilization have been between 1.1 and 1.45 billion pounds annually since 2001. MA Exhibit \_\_\_\_ DFA Request #3 shows that for some of the predecessor Orders there was a smaller but consistent amount of Class III - A utilization pooled in the Central Order geography.

In the Order 30 Hearing, the Class IV volume paper pooled on Order 30 was estimated to be near 100,000,000 pounds per month. MA Exhibit \_\_\_\_ DFA Request 4A computes an estimated impact that additional pounds of Class IV milk pooled on the Central Order would have, if added in increments of 25 million pounds for the months of November 2003 – January 2004. These months were full-pool periods with prices in normal alignment. From this exhibit we can see that in November at the full 100 million pound rate the negative impact to the pool would have been 25 cents per hundredweight on all milk. This would also have resulted in a negative PPD of 5 cents – even in a month with normal price alignment. The dollar impact of the November pooling would have been \$2.898 million. In December the effect would have been 16 cents on the PPD and \$1.984 million; and 8 cents in January 2004 and \$1.020 million. Producers that supply the every day needs of the market should not have to have their revenues reduced by this amount for milk that rarely if ever serves the market.

DFA Exhibit \_\_\_\_ Table 3 - Comparison of Fluid Use Pounds and Reserve Supply Pounds Federal Order 1032, January 2000 –

**October 2004** and the accompanying chart DFA Exhibit \_\_\_\_ Chart 2 compares reserve supplies in indexed form from January 2000 – October 2004 using January 2000 as a base. The table clearly shows that reserve supplies have been reduced likely as a result of the first “performance provisions” hearing. But clearly there is a significant amount of reserve still attached to the Order, as levels of 125% still seem high. Some may claim that this level of reserve supply is needed or should be a part of the Order for various historical reasons. But that argument must surely be weakened when as shown by the data that the reserve readily leaves the market, and is not available to supply the market any time the PPD relationship is not economically attractive. We have had supplemental suppliers refuse to make deliveries when faced with the “opportunity” to receive a negative PPD. The rationale that a large supply should have access to the pool must be measured against its ongoing availability to actually serve the market.

One of the measures of orderly marketing is some semblance of price alignment within and between Federal Order markets. The entire price surface is theoretically established to facilitate milk movements to supply markets. Class I differentials and class prices are designed to maintain a milk supply, provide incentives to transport milk and clear markets. Differentials are established with assumptions about pooling and milk use. The differential surface established in Federal Order Reform is not performing for Order 32. The anticipated Class I use of 50.1% has never been achieved. Either price is not high enough or more milk is blending down the returns than was anticipated when the differentials were established. While we have opinions about the first option, the remedies for that option are much more limited and not available to us here. So we are focusing our efforts here on the second remedy of reducing the milk that can be pooled and may be pooled in the future.

**DFA Exhibit \_\_\_\_ Tables 5A – E thru 7A – E - Comparison of Relative Returns Between Markets** makes computations about the relative returns after freight costs between Federal Order 32 and reserve supply points in the Upper Midwest and competitive demand destinations in the Appalachian (Order 5) and Southeast (Order 7) Federal Orders. The relative return (blend less haul) from Order 5 has out paid the Order 32 return every month except two since January 2000. While the annual average has narrowed this year the 10 month average of for a southern Illinois producer has been 61 cents per hundredweight better from Order 5 and for a southeast Missouri producer 92 cents better from Order 5. Producers in this area will not supply the St Louis market when differences of this magnitude are available.

A similar comparison has been made for a southern Oklahoma producer showing the returns from Federal Order 7 at Little Rock and Ft Smith. While the Order 32 return is 4 cents / cwt better when compared to Little Rock; it will not procure the milk away from a Ft Smith sale as the haul is much less and the return 62 cents above the Order 32 level.

When the comparison shifts to Order 30 and the ability of the Order 32 blend price to attract a supplemental supply from Lancaster, Wisconsin to St Louis or Melrose Minnesota to Des Moines Iowa the comparison worsens. In both cases, the Order 32 return is inadequate and has actually worsened since the 2001 performance hearing. The Order 32 return for the Lancaster – St Louis comparison is a -\$1.22 per hundredweight and - \$1.41 for the Melrose – Des Moines delivery for ten months of 2005. It has been negative for every year for both markets since 2000. While Orders are designed to establish

**minimum prices only, the premium level it would take her to procure a reserve supply in this case is unrealistic.**

**These data clearly show that the blend level will neither attract a reserve supply nor maintain a local supply from competition from Orders to the southeast.**

**MA Exhibit \_\_\_\_ Central Federal Milk Order No. 32 and MA Exhibit \_\_\_\_ Dean Foods Company details the sources of milk supply to the Order for each year since 2000 and deliveries to pool distributing plants. We note that the milk supply has been historically associated with the market and has delivered to distributing plants has originated from plants with at least one county in the marketing area and from New Mexico. No milk is shown to be a part of the Central Order supply on a regular basis from the Mountain states.**

**We would contend that Order provisions should bear some relationship to real world economic decisions. One measure of the reasonableness of a performance standard is if the standard did not exist would the economic reality of the transaction prevent it from ever taking place. The minimum pricing environment objective of Orders is such that Orders establish minimum prices that should still require some level of negotiation in the marketplace. The "flip side" of this concept is that the Order pricing provision (performance standard) should not enable a transaction to take place that is so absurd that it would never occur outside of the regulation. The debate and resulting decisions on "open or paper pooling" clearly established the principle that pooling without regard to performance was wrong. The part that was wrong was that a benefit was obtained that was not nor could not be earned absent regulation – the economic cost would be too great and the party seeking the gain would abandon the effort.**

**We have attempted to measure the relationship between performance standard and return in order to demonstrate that current standards are too lax and to defend both our proposed change in touch base, diversion limit and diversion point. Our measure again compares the relative return over various pooling standards and PPD level driven by both a Class III (the traditional) and Class IV standard. (blend less Class IV price) These comparisons are located in DFA Exhibit \_\_\_ Table 8A – I and 9 I titled Comparison of Delivery Charge versus Producer Price Differential.**

**We have compared the return from a delivery originating in Southern Idaho to Denver – the closest point for the milk supply that may seek a new pooling location if prevented from pooling on Order 30. The distance for this comparison is 686 miles. We have reduced the haul by the proposed transportation benefit offered by Proposal 3. We have used a haul rate of \$2.00 per loaded mile which after the application of the transportation credit yields a \$2.19 per hundredweight cost. We made four comparisons for the assumption based on a Class III PPD and four comparisons for a Class IV PPD. All examples are for the 58 months since Federal Order Reform and are based on a single 1,000,000-pound per month delivery. No consideration is given for the effect of “pooling deals”. All the return is expected to accrue to the shipping handler. Also, all “depooling” decisions are made based on the PPD. In some cases the freight consideration may make the decision to depool, even if the PPD is positive.**

**Comparison A constructs a scenario where milk is pooled every month. In each scenario the milk would lose a lot of money if it had to perform every day. No rational economic business would ever make this business arrangement. However after the “once and done” current Order 32 touch**

base requirement is met no other deliveries are required (so long as association is maintained with the market) and the return becomes profitable over the entire period earning an average of 34.8 cents per hundredweight per month. For the period even with negative returns for CY2003/4, \$201,881 is earned by pooling on Order 32 – a great return for delivering a single load to the market.

Comparison B constructs a scenario where our proposed delivery / diversion requirement of 25%/20% delivery in the shipping months / surplus months is in effect. Under this scenario the handler must still pool every month – no depooling option is considered. Also, this option would have our proposal to only allow diversions to non pool plants in the marketing area. Under this scenario the 58 month average return is 6.5 cents or \$37,770 in total. Still a positive return, but one in which some level of premium / negotiation would be likely before the transaction would take place.

Comparison C depicts a “once and done” depool at will scenario that is the most lucrative. Under this scheme the return is 65.2 cents per cwt average for the period and earns \$312,981 for the milk pooled. The review of an economist would not be needed to make this business decision.

Comparison D depicts a delivery / diversion requirement of 25%/20% delivery in the shipping months / surplus months performance standard, but the ability to depool at will. This effort earns a 37.1 cent return and \$178,307 for the period. Note that all of these comparisons are at million pound increments. The Idaho / Order 30 pooled milk in a full pool month averaged slightly over 260 million pounds – some of which is Class IV which would make this comparison worse.



**Comparison E - H shifts to a Class IV PPD holding all other variables the same as in scenario's A – D. This would be the economic pooling decision as viewed by a maker of Class IV products. As we have noted there is about 100,000,000 pounds of Class IV milk pooled on Order 30 from Idaho. That milk has been a significant negative draw against the Order 30 blend price and warrants our consideration in this analysis to study its potential effect on the Order 32 blend price. In Comparison E the "once and done" touch base – pool every month situation resulted in a 37.1 cent per hundredweight gain or \$215,781 for the period.**

**Comparison F details the higher performance standard but not allowing for depooling and results in a 8.9 cent per hundredweight gain or 51,670 for the period.**

**Comparison G shows "once and done" and depool at will and the most lucrative return of the scenarios of \$1.102 per hundredweight and \$396,581.**

**Lastly, scenario H shows the higher performance standard coupled with the ability to depool at will. This strategy yields a return of 81.7 cents per hundredweight or \$294,048.**

**Table 8I is a summary of all comparisons using the existing performance standards and the ones we have proposed.**

**Table 9I makes all of the same comparisons but at the existing delivery standards in the Central Order. Those are 20% / 15% delivery in the shipping / surplus months. In all cases the current standards are even more lucrative than those we propose and would have to be viewed as a reason to correct the existing performance standard.**

**When the current performance standards are reviewed, it becomes clear that they allow and perhaps encourage business decisions to be made that would never take place in the real world. This leads to and supports the conclusion that the performance standard is faulty and needs correction.**

**We concluded that milk outside the marketing area and the adjoining defined area needed to perform, in order to derive the benefits of the marketwide pool. There may be a better alternative to achieve this goal for the unique marketing circumstances of the Central Order than our Proposals but we have not discovered them. Under our Proposal diversions to plants located outside the prescribed geographic area would not be allowed to pool. Our proposal requires that all poolable deliveries must be to either an Order 32 pool plant or a plant located within the prescribed area. Also our delivery standard, if to achieve the goal of a more reasonable performance standard, must be coupled with a minimal increase in touch base standards and a limitation to depooling. Retention of the existing "until" language, 1032.13(d)(1), also is an integral part of the performance standard.**

**The approach that Proposal 2 takes is supported by the logic used in the last Order 32 performance standards decision. That decision established the principle that in area milk could not be used to qualify out of area milk. ((1032.7(c)(2) ) The out of area milk needs to perform on its own merit in order to earn the reward of sharing in the pool returns.**

**Federal Orders have had a long tradition of differentiating between in area and out of area milk. Former Order 68 had provisions for reserve supply plants. Initially these plants had no regular shipping requirement except for**

**the initial load of milk that established association with the market. There was however, one major criterion these reserve supply plants had to meet – they had to be located in the marketing area. The same criteria applied for supply plant systems in former Order 30. A supply plant had to be located in the marketing area to be part of a supply plant system. Supply plants outside the marketing area were obligated to perform on their own behalf.**

**Further support for the approach that out of area milk should perform on its own is found in the requirements for the formation of pool plant systems in current Order 30 and 32. A supply plant must be located in the marketing area. Supply plants outside the marketing area cannot be part of a supply plant system. This method for supply plants to meet the Order’s performance requirements was developed to allow milk to move to fluid use in the most economical fashion but still provide for reasonable and economically justified performance criteria. By excluding plants from outside the marketing area there was assurance that the included supply plants had ties to the market – even if an individual plant did not ship for fluid use. From the Reform Decision:**

**“The only requirement affecting an individual plant within the unit is that the plant must be physically located within the marketing area. This restriction is necessary to prevent distant plants from receiving the benefits of participating in the marketwide pool without actually having an association with the market.”**  
**64 Federal Register 16154 (April 2, 1999).**

**The plant-based approach in Proposal 2 is appropriate since supply plants or supply plant systems inside the Order area are treated no differently than**

supply plants located far from the Order's core. Both are responsible to perform at similar rates.

Since the time of the 2001 Hearing, the market situation has changed dramatically. The Western Order, which encompassed much of Idaho, has been terminated. Class IV prices have swung from much higher than Class III to being significantly lower. This changed relationship is primarily due to a change in purchase price of nonfat dry milk powder by the CCC under the milk support price program. This action was far outside the Federal Order realm though it has a major effect on Federal Order Class prices and pools.

The adoption of Proposal 2 will ensure that any milk, no matter how near or far from the marketing area, can and will serve the needs of the fluid market if it is going to enjoy the rewards of the marketwide pool.

We draw the following conclusions from our data:

- 1) The Central Order still has more reserves than can be reasonably justified and those reserves are not always available to the market when needed.
- 2) There is a real concern that milk that cannot reasonably ever serve the every day needs of the market may seek to attach to the Order 32 pool if foreclosed from Order 30;
- 3) Current performance standards would allow this milk to share in the pool returns even though it would never serve the market without the lax standards because doing so would be hugely unprofitable.
- 4) The Order 32 blend price is not meeting the objectives of attracting a reserve supply or preventing its supply from moving to other markets and its ability to do either has worsened;
- 5) The current performance standards will allow and even encourage milk from areas too distant to ever serve the market on a regular basis to

become attached to the Order pool. The "once and done" standard combined with the ability to easily depool any volume can be very detrimental to the Order 32 blend price.

- 6) Comparison of the various alternatives for pooling show that Class IV milk can have an even more detrimental effect on the blend price to performing Order 32 producers;
- 7) An economic model of evaluating the performance standards for the Central Order demonstrate that a higher level standard is needed to determine who should share in the market returns.
- 8) In order to protect the blend price from milk supplies that do not exhibit adequate performance, Order provisions that correct depooling abuses and enhance performance standards are needed.

## **Proposal Language to Enhance Performance Standards**

All Federal Orders have performance standards. The reasons for their existence is uniform while the exact standards themselves are varied. In order to best fit the marketing conditions we see in the Central Order we offer the following language:

**Regular case = existing language**

**Bold case = proposed language**

**~~Strikethrough = deleted language~~**

### **§ 1032.7 Pool Plant.**

...

(c) A supply plant from which the quantity of bulk fluid milk products shipped to (and physically unloaded into) plants described in paragraph (c)(1) of this section is not less than ~~20~~ **25** percent during the months of August through February and ~~15~~ **20** percent in all other months of the Grade A milk received from dairy farmers (except

dairy farmers described in § 1032.12(b)) and from handlers described in § 1000.9(c), including milk diverted by pursuant to § 1032.13, subject to the following conditions:

...

The result of this language change is to increase the delivery standards for supply plants by five percent to 25% during the months of August through February and by five percent to 20% for all remaining months. We felt no changes were needed in the months for which the percentages would apply. In light of our data showing that market reserves are still excessive and blend prices too low to attract a reserve supply or retain a supply from other markets we think this modest change is warranted. We had requested higher levels than granted in the last performance hearing and can appreciate the position of the Secretary to make changes gradually; so now is the time to make the next change. Other proposals that have been made for this hearing also endorse improvements in the performance standards of the Order. No proposals have been offered to weaken them. We think the Secretary should consider the fact that much of the Order supports the direction that our proposal is taking.

### **§ 1032.13 Producer milk.**

(d) Diverted by the operator of a pool plant or a cooperative association described in § 1000.9(c) to a nonpool plant located in the States of Colorado, Illinois, Iowa, Kansas, Minnesota, Missouri, Nebraska, New Mexico, Oklahoma, South Dakota and Wisconsin subject to the following conditions:

We note that the language as proposed in this testimony is different from that of the notice. There was an error in the sentence structure of our initial request to the Secretary that we overlooked. The phrase "to a nonpool plant" should be in the position it is here rather than following the words

**“Wisconsin” and before the word “subject”. The error was on our part and not that of the Department.**

**Our intent here is to allow any plant or cooperative handler to divert milk only to non pool plants in the prescribed area, As always any delivery may be made to an Order 32 pool plant. A plant outside the prescribed area can become a supply plant by meeting the supply plant requirements. The states listed in our prescribed area all have either a county or counties located in the marketing area or have been a regular portion of the market’s supply as noted in the MA statistics since 2000.**

**The conditions that the diversions are subject to have been modified as listed below.**

**(1) Milk of a dairy farmer shall not be eligible for diversion until ~~at least one day’s production~~ milk of such dairy farmer has been physically received as producer milk at a pool plant and the dairy farmer has continuously retained producer status since that time. If a dairy farmer loses producer status under the order in this part (except as a result of a temporary loss of Grade A approval), the dairy farmer’s milk shall not be eligible for diversion until milk of the dairy farmer has been physically received as producer milk at a pool plant;**

**The “once and done” touch base provision has been eliminated. However the “until” language has been retained which will continue the practice that milk that has lost its association with the market must first re-associate with the market before obtaining diversion privileges. We view this as an additional safeguard for the blend price pool and do not wish to change it.**

**(2) The equivalent of at least one day’s milk production is caused by the handler to be physically received at a pool plant in each of the months of August through November and January through February.**

The "once and done" standard has been replaced with a single day's touch base in each of the months of August through November and January and February. These months correspond to the times when Class I demand is the highest and hardest to fill. Having a requirement for a touch base delivery should help make milk available for Class I use. The month of December was excluded because of the Christmas / New Years holiday period which while it has a high demand for part of the month is non-the-less difficult to comply with any touch base standard because demand changes radically at the end of the month.

3) The equivalent of at least one days' milk production is caused by the handler to be physically received at a pool plant in each of the months of March through July and December if the requirement of paragraph (d)(2) of this section (§1032.13) in each of the prior months of August through November and January through February are not met, except in the case of a dairy farmer who marketed no Grade A milk during each of the prior months of August through November or January through February.

This section describes the necessary touch base requirements for the "non shipping" months if the requirements are not met in the shipping months.

~~(2)~~ (4) Of the quantity of producer milk received during the month (including diversions, but excluding the quantity of producer milk received from a handler described in § 1000.9(c)) the handler diverts to nonpool plants not more than ~~80~~ 75 percent during the months of August through February, and not more than ~~85~~ 80 percent during the months of March through July, provided that not less than ~~20~~ 25 percent of such receipts in the months of August through February and ~~15~~ 20 percent of the remaining months' receipts are delivered to plants described in § 1032.7(a) and (b);

This language provides the shipping / diversion requirements for a 9(c) handler. These requirements are the same as those for a supply plant in both percentage requirements and months of application.



## **Marketwide Services**

Proposal 3 is a proposal for marketwide services. Congress instituted these types of provisions in the Order system in order to help pay the costs of supplying milk to the market. In some sense it follows the economic concept of a public good in that all benefit (for Class I sales) but it is difficult to recoup the cost associated with the good (servicing the Class I demand) from any individual in the entire market. Said another way, there are benefits derived from the market by all but some do not pay the full cost associated with those benefits.

Marketwide services have been tailored directly to a specific service such as in market transportation, surplus milk disposal and supplemental milk procurement. However the original language clearly does not limit the concept to just these types of services as the enabling legislation provides for," ...( C) services of marketwide benefit, including but not limited to—".

Federal Order 30 provides for an assembly credit paid to all suppliers of Class I milk. The initial decision implementing assembly credits spelled out the assembly credit as the compensation for the assembling and reloading Class I milk. Federal Order Reform extended this payment; but neither it nor the original decision provided an exact definition of "assembly". It would be difficult to limit the definition of assembly to only those services associated with reloading Class I milk- when the credit was initiated or today.

Assembly must then encompass more services. Charles Ling in the RCBS publication *Cost of Marketwide Services in the Northeast Economic* lists the following activities as services for assembling and procuring milk for Class I use:

## **Services for the producers:**

- 1) field services – assist with production problems**
- 2) assist with inspection problems**
- 3) sell milking supplies and equipment**
- 4) information on price and availability of hay, herd replacements, etc.**
- 5) provide marketing and outlook information**
- 6) provide insurance programs—life, health, disaster**
- 7) provide retirement programs**
- 8) guarantee daily market for milk**
- 9) negotiate haul rates**
- 10) collect and insure payment from buyers**
- 11) check weights and tests**

## **Services for the market:**

- 1) direct farm to market milk movement**
- 2) pay haulers**
- 3) allow for farm shrinkage of milk**
- 4) maintain quality control and related lab services**
- 5) deliver preconditioned or standardized milk**
- 6) sell milk f.o.b receiving point**
- 7) split loads among processors**
- 8) maintain spot and hold tank storage**
- 9) participate in Federal Order hearings**
- 10) negotiate Class I prices and service charges**

**We have already shown that the Central Order blend price is not able to neither attract a supplemental milk supply from other Orders or keep its milk supply from seeking a home in other markets. DFA Exhibit \_\_\_\_ Chart 9-1 Annual Milk Production shows that milk production is declining in the states composing the Central Order. The five-year decline for the 10 states measures is 1.9%. The decline ranges from down 0.8% in Iowa to double-digit declines in North Dakota / Minnesota and Missouri. The states that show increases are on the western side of the Order and to some extent serve as a reserve supply for the Order and that role may increase in the future. We see an increasing need to transport milk from southwest and west to east and north in the Order. MWS payments tailored to transportation will help offset the cost associated with these movements. Both of these facts should be part of the rationale for instituting an assembly credit. What greater service can there be than to have a supply to sell!**

**Our data indicates that the Order 32 blend is insufficient to hold its milk supply away from Order 5 (Southern Illinois farm to Madisonville KY bottler) by \$0.61 per cwt thru 10 months of 2004; from Order 5 (Southern Missouri farm to Madisonville KY bottler) by \$0.92 per cwt; from and Order 7 (Southern OK to a Fort Smith AR bottler) by \$0.62 per cwt. We have also shown that a St Louis bottler is \$1.22 per cwt short of being able to attract a reserve supply from Order 30 / Southwest Wisconsin; and a Des Moines area bottler is \$1.41 short of being able to attract a reserve milk supply from a central Minnesota milk supply. These costs far exceed the requested 10 cents assembly credit requested. Certainly having a Class I milk supply to sell is of marketwide benefit. We also note that the cost of such a credit is approximately 3 cents on the entire pool volume. (MA Exhibit \_\_\_\_ DFA Request 11 – 12) We support the proponents of Proposal 3 in their efforts to secure an assembly credit.**

**We also support their proposal for a transportation credit on tanker shipments again noting that this MWS payment assists in providing milk to the class I market. We concur with their proposal and language. We would offer that their proposed rate is reasonable. In the recent hearing held to provide for cost recovery associated with hurricanes in the southeast the cost recovery was limited to actual costs or \$2.25 per mile – that rate being considered a high end rate. Dividing \$2.25 by 500 hundredweights (50,000 pound OTR tanker volume) yields \$0.0045 per mile so the \$0.003 requested (2/3 of the cost) is both reasonable and in line with the concept of Order minimums. The same calculation at \$2.00 per mile yields a \$0.004 / 75% recovery ratio; and at \$2.10 - \$0.0042 / 71%.**

**Holding the rate per mile constant and dropping the tank size smaller – as might better reflect a farm pickup tank size yields an even more conservative reimbursement ratio.**

**Thus, we also support the proponents of Proposal 3 in their efforts to secure a supply plant transportation credit. We also note that the cost to the blend pool ranges from \$0.006 - \$0.01 per cwt. (MA Exhibit \_\_\_ DFA Request 11 – 12)**

**However, we view Proposal 3 as incomplete. Only a small percent of the Class I market is served via milk from supply plants. MA Exhibit \_\_\_ DFA #7 Pounds of Milk Transported from Supply Plants in to Pool Distributing Plants in Increments of 100 Miles in 2003 indicate that in 2003 213.7 million pounds were delivered in that format. In 2003 there was 4.7 billion pounds of Class I milk so only 4.5% of the Class I supply reached the market in this manner. The remainder came directly off the farm**

**(or thru a reload) – and in a more efficient manner. We cannot support a credit for one portion of the supply and ignore the balance within the same market. Especially when that ‘ignored’ balance is delivered in a more efficient mode of transportation.**

**Our proposed modification would add a payment for direct-shipped milk that delivers to a pool distributing plant for Class I use. We would allow the payment for milk that is reloaded also. But at the same rate as milk that is not reloaded. This should recognize the service but provide the market with a ‘carrot’ to move to the most efficient manner of delivery – farm direct.**

**Our proposal would use the same rate of payment \$0.003 per mile as we think that is both responsible and reasonable and pushes the market towards efficiency. We would limit our proposed payment to deliveries of 500 miles; and net the pounds paid to any distributing plant against any diversion or transfers made on the same day as protections from abuses of the credit. Additionally we would direct the MA to make the measure of miles be the shortest distance possible by comparing the shortest road miles from the distributing plant to the nearest farm on the route. The handler requesting the credit must provide data to the Market Administrator justifying all calculations. Our proposal would exempt the first 25 miles from payment. That distance is what we have determined reasonably represents the distance that producers serving the market thru supply plants pay for in haul. It seems reasonable to us to treat all producer in the same manner in this regard.**

**The justification for our choice of factors is as follows:**

**MA Exhibit \_\_\_\_ DFA Request #9 presents summations of producer haul charges by county and sums up to the state level for the Central Order. This**

**data is taken from actual payroll tapes and was collected by the Market Administrator. Data collection and publication of this information is a routine practice in most MA offices. There is a single recap of "every county" data for January 2004 and a monthly average for each state for all months from January 2002 to August 2004. A review of the data shows that from month to month the change in rate is small. We chose to use December 2003 rates because we also have December 2003 pounds in the record and needed both for our calculation. For example the December 2003 average haul rate for Iowa was 18.4 cents.**

**In the process of determining the mechanics of our proposal we concluded that a direct ship transportation credit should not pay for 100% of the cost nor reimburse for 100% of the miles. We concluded that a fair target would be to exempt from the credit the mileage that a producer paid to a supply plant in the northern sector of the market. This way all producers would have the same responsibility. Furthermore the supply plant credit is designed to offset the cost from the plant to the bottler so its proponents envisioned the producer paying the haul to the plant. Page 91 of MA Exhibit \_\_\_ **Central Federal Milk Order No. 32 Pools Supply Plants** is a map showing the location of supply plants in the market. The DFA plant in Fort Morgan does not function as a reload and transship point; nor does the Prairie Farms plant in Carbondale IL. However the remainder of the Order 32 supply plants do assemble and ship milk to the market. For this reason we chose the states where those supply plants are located to attempt to measure the miles that local producers pay hauling for. Those states would be Iowa, Minnesota, North & South Dakota and Wisconsin. Note the South Dakota data is combined with the North Dakota information but is overwhelmingly influenced by the South Dakota volumes.**

**DFA Exhibit \_\_\_\_ Table 10- Analysis of Local Haul Mileages** makes computations for mileages. (The methodology was explained when the exhibit was introduced.) We regularly negotiate for haul rates, buy haul routes, sell haul routes and maintain extensive costs for doing so. Our analysis of a farm haul yields a rate per loaded mile of \$3.03. This figure covers mileage costs (both stop and go, pickup and transport), labor and time on the route, maintaining the equipment and a facility which sometimes functions as a pump over, the equipment itself and a fuel adjustor. As expected these costs are not static. We deal with a large number of truck – tank combinations. The range is 20,000 pounds on the low end to 53,000 on the upper end. In some cases the route goes directly from the haulers location to al farms and then to a customer. In other cases routes are picked up and pumped over. Higher volume tanks lower the rate while lower volume tanks increase it. We are comfortable with \$3.03 as a typical rate and 45,000 pounds as a typical tank size. The calculation using these constants and the weighted average hauling paid in the Central Order in the area where there are supply plants yields a 23-mile distance that the producer rate pays for. We have chosen 25 miles for our proposal. Thus any rate calculation for credit would not pay for the first 25 miles of haul.

Given our proposal, and the constants used to determine the exempted miles, we then attempted to determine an estimated impact on the Order blend pool. MA Exhibit \_\_\_\_ DFA \_\_\_\_ **Producer Milk Received at Central Order Distributing Plants** was designed to show the milk received in 4 quadrants of the market in order to preserve confidentiality. The accompanying tables show the pounds by county that made up that supply. DFA Exhibit \_\_\_\_ **Table 10-B Recap of Transportation Proposal** details by example what we did with the data. We assigned pounds to each bottling plant in each quadrant. In the case where the bottler was a DFA or Prairie

**Farms customer we used our own information. If not we developed an estimate from our own market intelligence sources. In each case we balanced the total to the Market Administrator data. We compared deliveries to Class I use for January and concluded that 83% of all deliveries on average were used in Class I. We tested this calculation with data for DFA sales and found it to be reasonable.**

**With pounds by bottler and supply by county we attempted to assign the pounds to each plant from the closest source. In some cases we had to split large counties between plants as those counties were the reserve supplies for the milkshed. We assigned all milk to the county seat and computed mileages from an internet based calculator. We inserted all the appropriate county location differentials for each bottler location and each county supply source. We then computed the credit amount using the language in our proposal. The mechanics of the computation were as follows:**

- 1) miles between supply and demand less 25;**
- 2) cap the miles at 500;**
- 3) if more than 0 miles multiply by \$0.003;**
- 4) reduce this product by any positive difference in Federal Order location adjustment;**
- 5) if positive multiply by the pounds;**
- 6) multiply this product by 83% to arrive at a credit payment for Class I;**
- 7) Sum the pounds, miles and dollars for each quadrant.**

**DFA Exhibit \_\_\_\_ Table 10 C - Recap of Transportation Proposal sums for the market all of the data from each Quadrant for January 2004. For the deliveries made \$573,414 dollars would be spent in a farm direct**



transportation credit as we have proposed. The effect on the entire pool for January would be an estimated \$0.045 per hundredweight.

MA Exhibit \_\_\_ DFA #11, 12, 14 & 15 each explain some portion of the Marketwide Service Payments credit calculations. We agree with the explanations and resulting cost estimates. It appears that the two proposals made by Foremost Farms and the modification as proposed by DFA / PF would cost the pool (reduce the blend by) approximately 8.1 cent per hundredweight on all milk. This would in turn provide a payment to the Class I shipper of approximately 25 cents per hundredweight. In both cases modest.

### **Proposal Language for a Direct Ship Transportation Credit**

**Insert as appropriate in the newly formed section 1032.55 proposed by Foremost Farms:**

(1) Transportation credits paid pursuant to paragraph (a)(1) and (2) of this section shall be subject to final verification by the market administrator pursuant to § 1000.77. and

(2) In the event that a qualified cooperative association is the responsible party for whose account such milk is received and written documentation of this fact is provided to the market administrator pursuant to § 1032.30(c)(3) prior to the date payment is due, the transportation credits for such milk computed pursuant to this section shall be made to such cooperative association rather than to the operator of the pool plant at which the milk was received.

We would envision that each handler would compute and apply for credit as appropriate at pool time. Each handler would have to maintain a file of locations and distances and perform the various computations. While

**cumbersome to establish the task can easily be accomplished with computer aid. The Market Administrator would accept and make payments and then audit as necessary.**

**(a) Transportation credits shall apply to the following milk:**

**(1) Bulk milk received directly from the farms of dairy farmers at pool distributing plants subject to the following conditions:**

**(i) The quantity of such milk that shall be eligible for the transportation credit shall be determined by multiplying the total pounds of milk physically received from producers meeting the conditions of this paragraph by the Class I utilization of all producer milk of the pool plant operator receiving the milk after the computations described in § 1000.44;**

**(ii) The transportation credit shall be limited to the first 500 miles of delivery.**

**(b) Transportation credits shall be computed as follows:**

**(1) The market administrator shall subtract from the pounds of milk described in paragraphs (a)(1) of this section the pounds of bulk milk transferred or diverted from the pool plant receiving the milk if milk was transferred or diverted to a nonpool plant on the same calendar day that the milk was received. For this purpose, the transferred or diverted milk shall be subtracted from the most distant load of milk received, and then in sequence with the next most distant load until all of the transfers have been offset;**

**This section defines that the credit will apply to milk shipped directly from farms, limited to Class I use only and for no more than 500 miles. Additionally any transfers or diversions away from the distributing plant on the same day as the credit is applied for will be netted against the computation.**

**(2) With respect to the pounds of milk described in paragraph (a)(1) of this section that remain after the computations described in paragraph (b)(1) of this section, the market administrator shall:**

- (i) Determine an origination point for each load of milk by locating the nearest city to the closest producer's farm from which milk was picked up for delivery to the receiving pool plant;
- (ii) Determine the shortest hard-surface highway distance between the receiving pool plant and the origination point;
- (iii) Subtract 25 miles from the mileage so determined;
- (iv) Multiply the remaining miles so computed by 0.3 cent (\$0.003);
- (v) Subtract the Class I differential specified in § 1000.52 applicable for the county in which the origination point is located from the Class I differential applicable at the receiving pool plant's location;
- (vi) Subtract any positive difference computed in paragraph (d)(3)(v) of this section from the amount computed in paragraph (d)(3)(iv) of this section; and
- (vii) Multiply the remainder computed in paragraph (d)(3)(vi), if positive, by the hundredweight of milk described in paragraph (b)(2) of this section. If the remainder computed in paragraph (d)(3)(vi) is negative no transportation credit shall be computed.

## **Summary of Proponent's Views**

**Our concerns at this hearing deal with the current and difficult issue of depooling; the need for changes in the Order's performance standards and the impact those changes may have on both "distant" milk and local milk and our desire to have a modest portion of the cost of serving the market borne by all producers who share in the blend pool.**

**Depooling is an equity issue and greatly impairs the ability to attract and maintain a milk supply for Class I use! The increased level of price volatility has made the issue much worse. We expect depooling to be a problem in December and January so the need to correct the issue as best we can is very timely. Our proposal to limit future poolings by 125% of the current months pooling is modest and will have a positive effect on the Central Order pool. Furthermore, it is a key component in our**

**effort to establish reasonable performance rules in the Order for milk so distant from the market that it can never reasonably serve the market.**

**While “distant milk” is not a current issue in the Central Order we have demonstrated that it could very possibly become a costly issue for producers. Our proposed changes in performance standards would greatly reduce the potential for negative blend impact from milk that did not perform, would help the Order have a more reasonable reserve supply and provide changes that will help attract milk to markets when needed.**

**Finally, our proposal for marketwide services will help to share in the cost of maintaining and attracting a Class I milk supply. Our proposals are backed by data that show them to be targeted, effective, modest and workable.**

### **Need for emergency provisions**

**There is a need for this hearing to proceed on an emergency basis.**

- 1) The issues with depooling will be a problem in the market with December milk. Volatile dairy markets seem to know no season and we may have negative PPDs in January also. Opponents in the Order 30 hearing argued that there was no need for emergency provision treatment because the concern was past – they are wrong already. A correction is needed as soon as possible.**
- 2) Our concerns with performance standards also have a very short-term horizon for need. The record showed that California milk moved very easily thru the Order system shifting from one market to the next as regulation changed. The producers in Order 32 have no desire to experience the blend damage that producers in Order 30 have and emergency action will greatly help that desire.**

**Thank you for listening to our views. We also greatly appreciate the efforts of the Central Order staff in preparing data for this hearing. They already have the well-deserved reputation of being proactive and user friendly and that reputation was only magnified in their effort to produce data and information for industry use here this week.**