

BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE

In the Matter of

: DOCKET NO. AO-166-A68; DA-01-04

**MILK IN THE MIDEAST
MARKETING AREA**

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**COMMENTS BY CONTINENTAL DAIRY PRODUCTS IN SUPPORT OF THE
INTERIM RULE TO THE MIDEAST ORDER, 7 CFR Part 1033**

These comments are submitted on behalf of Continental Dairy Products, Inc., in support of the Tentative Decision on Proposed Amendments to the Mideast Marketing Area as found at 67 Fed. Reg. 39871 (June 11, 2002) ("Tentative Decision") and the "Interim Rule". 67 Fed. Reg. 48743 (July 26, 2002). The modifications made to Order 33 were necessary and should be made a Final Rule. In addition to the statements made herein, Continental incorporates its post-hearing comments and also supports the position of Dairy Farmers of America in its comments to the Tentative Decision.

I. Introduction and summary of position.

Continental Dairy Products, Inc. is a qualified milk marketing cooperative with members located in the Order 33 marketing area – Ohio, Indiana, and Michigan. The prices these members receive depend upon the producer price differential or blend price announced by the market administrator for Order 33. This price is, in large part, a function of the amount of milk pooled on the order and the amount of the Class I sales. Prior to the Interim Rule, milk with no economic or

historic association with the order was pooled and substantially reduced the blend. The Interim Rule corrects this.

Continental strongly supports the Secretary's Tentative Decision and requests that it be made a Final Rule. Modifications to plant, producer, and milk definitions of 7 C.F.R. Part 1033 were necessary to insure that any milk qualified to receive payments from the producer settlement fund had to show a reasonable association with the order and the ability to service its Class I market as needed. The Prior Order permitted virtually unlimited pooling of distant milk and permitted large quantities of milk that had no historical or practical association with the marketing area to share in the producer blend prices.

The changes incorporated in the Tentative Decision with which Continental agrees are as follows:

1. Eliminating the automatic pool plant status for the months of March through August and replacing it with a rolling twelve month average.
2. Eliminating the ability to qualify a supply plant by shipments to an other order pool plant.
3. Eliminating the "split plant" provisions.
4. Establishing a "net shipments" provision.
5. Eliminating the ability to use a pool plant's diversions to qualify an out-of-the-marketing-area supply plant.
6. Modifying producer definitions (7 C.F.R. §1033.9) to seasonably increase the number of days' production that must go to a plant to qualify.
7. Establishing year round diversion limits.

The proposed changes are interrelated. Retaining only part of the changes will not solve the disorderly marketing conditions exhibited in the Prior Order. The most important changes are those to 7 C.F.R. §1033.7(c)(2). Though Continental supports the entire Tentative Decision, these comments will focus primarily on the use of farm to in-order plant deliveries to qualify an out-of-the-marketing-area supply plant and its producers. Changes to 7 C.F.R. §1033.7(c)(2) as explained in the Tentative Decision and now effective through the Interim Final rule do just that.

II. Explanation of the problem.

The plant and producer definitions in the predecessor orders (Orders 33, 36, 40 and 49) to the Mideast Order did not result in the kind of abuse producers have experienced since the January 2000 start of the new Mideast Order. Although the Mideast Order incorporated the definitions from the predecessor orders, the negative implications of those regulations were largely negated by “zone back” pricing of plants outside of the marketing order. These pricing provisions priced milk at distant plants in terms of its relative value to the respective order. In 2000, absolute plant pricing replaced this relative order pricing. 7 C.F.R. §1000.50. The price of milk at a distant plant is not necessarily reduced and clearly does not reflect the value to the order. Since the plant pricing is not addressable at this time, it is necessary to look at the producer and plant definitions.

Table 9, Exhibit 13 in the hearing record illustrates the impact of the pool riding that has taken place. Those were current as of the hearing date – October 2001. Since the institution of the “free months” of March through August 2002, the open season on the Mideast Pool returned with a vengeance. Where Class I utilization approached 50% in early 2000, the Class I utilization for July 2002 was less than 30% for the first time in the history of the order and its predecessor. The PPD has been almost halved.

The reasons this has occurred are well stated by the Secretary in the Tentative Decision – distant milk is being pooled on Order 33. Chart 1 to Exhibit 13 graphically illustrates the growth in the volume of milk being pooled on the order.

The lax requirements for pooling prior to the Tentative Decision did not require a physical or economic connection with the marketing area. Milk from Wisconsin, Minnesota, the Dakotas, Montana and even California was permitted to attach to the order which encouraged the paper pooling of milk. This enormous amount of milk attached to Order 33 only because of lax to non-existent pooling limitations for supply plants located outside of the marketing area. *Under the Prior Order, none of the distant milk that receives Order 33 blend prices need ever come to a distributing plant that services the market.* The amount of milk which a supply plant could pool had nothing to do with the market's needs. Availability to the market place had little bearing on whether milk could be pooled.

This excessive pooling of milk that cannot serve the needs of the Mideast Market is the result of the archaic supply plant qualifications (7 C.F.R. §1033.07(c)) ("Qualifying Percentages"), limited periods for qualification (7 C.F.R. §1033.07(c)(4)) ("Qualification Period"), minuscule delivery requirements for individual producers (7 C.F.R. §1033.13(d)(2)) ("Touch Base"), the ability to qualify the plant by deliveries to distributing plants in other orders (7 C.F.R. §1033.07(c)(1)(iv)) ("Split Plant"), and the ability to use local, close-in milk, to qualify the distant supply plant. (7 C.F.R. §1033.07(c)(2)) ("Direct Delivery"). *The Secretary corrected these provisions in the Tentative Decision and it should stand.*

The problem of "paper pooling" is illustrated with a hypothetical Cheese Coop in California that wishes to pool the milk of its producers on Order 33. Assume the Cheese Coop in California

receives about 115 million pounds per month. In order for Cheese Coop to receive money from the Order 33 producer settlement fund, it must “qualify” the cheese plant as a “supply plant” under the Order. In return, the plant will receive from the producer settlement fund the difference between the blend price under Order 33 and the Class III price for milk, a lower price. Every dollar that the plant receives will reduce the funds available in the producer settlement fund for those producers who actually service the order. Under the Prior Order, Cheese Coop only needed to send 30% of its milk to a Mideast bottling plant during the months of September through February to qualify the plant. Ordinarily, the cost of hauling that much milk East would negate the gain from pooling on Order 33 and discourage such activity. Loopholes in the Prior Order reduced those costs substantially.

Practically, much less was required. Cheese Coop needed to ship only a very small amount of milk from its farmers in California to the Mideast to qualify the plant. All that was required was a contract with a milk bottler in the Mideast who already had its own supply of milk. Only 30% of the milk the bottler receives has to actually go into the bottle. A bottler that receives 10 loads a day or 15 million pounds of milk per month for bottling can divert an additional 35 million pounds of milk per month.

On paper, the Cheese Coop and Bottler treat the milk in California as a diversion from the bottler’s supply. Only 30% of Cheese Coop’s supply has to go to a bottler. The 35 million can qualify 116 million pounds from Cheese Coop.

The rules permit up to 90 percent of the qualifying shipments of a supply plant to be direct from the farm to the plant. Thus, of the 35 million in deliveries, only 3.5 million has to be delivered to the bottler to qualify the 115 million pounds attached to its supply plant. The cost of that hauling

is spread over 115 million pounds of milk that benefit from the higher blend. Thus even a \$10 haul per hundredweight, is only 30.4 cents on all of the milk.

If the Cheese Plant qualifies September through February, there are no shipments required for the next six months of March through August. On an annual basis, the average monthly production that actually has to come to the Mideast is now only an average of 1.75 million per month. The \$10 hauling blends out to about 15.25 cents on all of the milk benefitting from the additional pooling.

Under the Prior Order, half of these direct shipments could go to *any* federal order plant, *any plant*, including ones in Arizona or Colorado! The cost is for hauling hundreds of miles instead of thousands. This makes the cost of hauling less than a dime per hundredweight. In return for those pennies per hundredweight, the Cheese Coop receives a PPD of a dollar or more from the Mideast pool for 115 million pounds – a ten times recovery.

Additionally, each producer has to qualify to receive the money. With a supply plant qualified under the Mideast Order, a producer could be entitled to receive Mideast pool money by shipping only one day's production each of September through November to a pool plant under the order. The pool plant is, of course, the supply plant in California.

The result of this qualification scheme is in a year only mere 21 million pounds of milk actually had to come to a FMMO market, not necessarily the Mideast Order, to attach 1.38 billion pounds.

The potential for abuse under the Prior Order did not end there. Since in the months of March through August the Cheese Coop does not have to ship any milk to the Mideast at all, it can qualify all the additional producers, and their milk, it wants by accepting just one days' milk for

each additional producer during the six months at its cheese plant. There was no limit to the amount of milk that could be qualified on the Mideast Order during those months. None of it, not one pound, had to leave California.

The above is an example of how the scheme would work. No one did it exactly like that but enough were close to it so that hundreds of millions of pounds from California, Wisconsin, Minnesota, South Dakota and even Montana showed up as being pooled on the Mideast Order.

The obvious question is how did this happen? The answer is quite simple. Under the predecessor orders, there was built in a counter to the relative ease in qualifying milk that “zoned back” the blend prices paid producers based on the relative location of the supply plant to the order. Thus a plant in California, 3000 miles away, would be paid the Mideast blend price less about \$10.80 and, as a result, the move would not be profitable. In fact, even milk in Wisconsin or Illinois would not profit from pooling on Order 33. The order reform went from a relative price surface to an absolute price surface. Thus Tulare County, California is priced at 1.60 and Columbus, Ohio is 2.00. The “zone back” is only 40 cents, not 10.80 and in Wisconsin is almost zero. The result is the Ohio blend is only slightly reduced even if it is delivered to a distant plant.

In response to the hearing testimony, the Secretary found as follows:

The record of this proceeding strongly supports concluding that the various features of the Mideast order’s supply plant pooling standards are either inadequate or unnecessary. Because the order currently contains inadequate pooling standards for supply plants, much more milk is able to be pooled on the order than can be considered properly associated with the Mideast market. This milk does not demonstrate a reasonable level of performance necessary to conclude that it provides

a regular and reliable service in satisfying the Class I milk demands of the Mideast marketing area. Therefore such milk should not be pooled on the order.

67 Fed. Reg. at 39877-39878.

III. The Issue before the Secretary.

The Secretary necessarily must determine how to structure the Mideast Order so as to permit the orderly movement of milk without attracting milk that has no economic or historic association with the Order.

IV. Comments in support of the Tentative Decision.

A. Any Final Decision should be stayed pending current litigation.

The Interim Rule is now subject to a lawsuit in Wisconsin. *Alto Dairy v. Veneman*, E.D. Wisconsin, Case No. 02-CV-750 . Because the legality of the amended order is being addressed there, Continental suggests that the Secretary not announce any change to the Tentative Decision until that litigation has run its course.

B. The diversions from a pool plant should not be used to qualify an out of order supply plant.

The Tentative Decision modified 7 C.F.R. §1033.7(c)(2) and reads:

The operator of a supply plant located within the marketing area may include deliveries to pool distributing plants directly from farms of producers pursuant to §1033.13(c) as up to 90 percent of the supply plant's qualifying shipments. Handlers may not use shipments pursuant to §1033.13(c) to qualify plants located outside the marketing area.

[Emphasis added to show the added provisions].

1. The Final Rule does not impose a trade barrier in violation of 7 U.S.C.A. §608c(5)(G).

It is expected that opponents to the provision will argue that it is a trade barrier in violation of 7 U.S.C. §608c(5)(G). It is no such thing. The Final Rule does not keep milk from flowing into Order 1033. None of the milk riding the pool could or would flow into the market. As indicated by the example above and illustrated by the statistics in the hearing exhibits, *none of the milk that was being attached to the order from outside the order could economically come to the market, none was intended to come to the market, and none would ever come to the market.* Distance and economics are a barrier to the movement of milk into the Mideast Order that the market does not need. Prior to the Tentative Decision, milk that could never have participated in the market, were permitted, nonetheless, to participate in the fruits of the market. The Tentative Decision, ended that practice. The Decision did not bar milk coming in, only money going outside of the market.

2. The Interim Rule does not create non-uniform pricing among producers.

Continental expects opponents to the Interim Rule to claim that the rule creates non-uniform pricing among producers in violation of 7 U.S.C. §608c(5)(B). The Interim Rule defines what is “pool” milk and “non-pool” milk. Under the Interim Rule milk that had no historic or economic association with the Order will now be “non-pool” milk. As non-pool milk it is not entitled to participate in the pool and thus it is not entitled to a uniform price equal to the pooled milk.

C. The record amply supports the decision.

The Secretary was fully within her authority to propose the changes to 7 U.S.C. §1033.7(c)(2). Exhibit 13, Table 11 showed that in some months as much as 80% of the milk being pooled on the order from “non-historic sources” was riding on diversions from in area plants. All

of the other provisions under the order that were being modified (changes in touching base, increasing shipping requirements, eliminating free months) could not fully reduce the problem as long as a distant supply plant could rely upon close in milk to qualify. See, Hollon at 160.

As a result, Carl Rasch of MMPA proposed a change as follows:

We are also proposing to modify proposal
to by inserting the following language at the conclusion
of Section 7(c)(2) to read as follows: provided, however,
that if the supply plant is located outside of the
marketing area, any such qualifying shipments must be from
farms located in the county of that supply plant, or a
contiguous county or from any county further away. And
this relates to the testimony that Mr. Hollon presented
earlier in the Exhibit 12 dealing with the ability to meet
90 percent of your performance requirements with
diversions directly from farms.

Rasch, Hr. Tr. 266.

The purpose of supply plants was explained during cross examination. *Id.* at 283 *et seq.* He further testified that the use of close-in milk to qualify a distant supply plant was "disorderly marketing". *Id.* at 284.

As the Secretary correctly noted in the Tentative Decision, the 90 percent direct shipment provision "was not intended to be used as a mechanism to pool milk on the order that was not providing a reasonable measure of service in supplying the Class I needs of the Mideast marketing

area.” She also correctly noted that plants far from the marketing order that use near-in milk for qualification “do not provide milk to the marketing area that can be shown to be a service in meeting the Class I needs of the Mideast marketing areas.” *Id.*

D. The provision was procedurally correct.

On September 28, 2001, the Secretary issued a notice of hearing on proposed amendments to the Order 33 regulations. The notice of hearing stated as follows:

A public hearing is being held to consider proposals that would amend certain pooling and related provisions of the Mideast order. Proposals include increasing the minimum route disposition requirements for distributing plants; *amending the automatic pool plant qualification provision; decreasing the amount of producer milk that can be diverted to nonpool plants for varying months of the year; and increasing the minimum amount of milk that a producer needs to deliver to pool plants in order to qualify as a producer and to be eligible to be pooled on the order.*

Additionally, other proposals which call for *eliminating a provision that currently permits a pool plant to have both a pool and a nonpool portion; establishing a “net shipment” provision for milk received at pool plants for determining pooling eligibility*; and establishing the criteria for requiring a waiting period for a supply plant to regain pool status if it fails to meet the pooling requirements, will also be considered. A proposal that would change the rate of partial payments to producers will also be heard.

66 Fed. Reg. 49571 (Sept. 28, 2001) [Emphasis added]. A number of proposed changes were presented. Nine proposals were identified, of which 4 specifically addressed 7 C.F.R. §1033.7.

The notice also stated, "The purpose of the hearing is to receive evidence with respect to the economic and marketing conditions which relate to the proposed amendments, hereinafter set forth, and any appropriate modifications thereof, to the tentative marketing agreement and to the order." *Id.* [Emphasis added].

As a result everyone who read the notice knew that the pooling requirements of plants, including supply plants, were subject to modification as a result of the hearing. As the courts have said, "Notice of proposed rule making under 5 U.S.C. § 553(b) 'must be sufficient to fairly apprise interested parties of the issue involved ..., but it need not specify every precise proposal which [the agency] may ultimately adopt as a rule.'" *Walmsley v. Block*, 719 F.2d 1414, 1481 (8th Cir. 1983) quoting *Trans-Pacific Freight Conference of Japan/Korea v. Federal Maritime Comm.*, 650 F.2d 1235, 1248 (D.C.Cir.1980).

Based on the evidence at the hearing it was apparent that in order to end the abuse of the pooling provisions, the use of nearby milk already going to bottling plants in the order as the qualifying shipments for distant orders also had to end.

The Secretary correctly summarized the testimony in the following manner.

Four proposals seeking to modify the pooling standards for pool plants fo the Mideast order were considered in this proceeding. The record evidence makes clear that the proponents of thse four proposals, described and discussed further below, are of the opinion that the current pooling provisions of the order are not accurately identifying those producers and the milk of those producers consistently serving the fluid needs of the marketing area.

V. Conclusion

The hearing record amply supports the Interim Rule and the Secretary should make it a Final Rule.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that an accurate photostatic copy of the foregoing was served upon the following this 12th day of August 2002, by facsimile, email and ordinary United States Mail service, postage prepaid.

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