

SENT BY EMAIL

March 16, 2009

Dana H. Coale
Deputy Administrator
USDA, AMS-Dairy Programs
1400 Independence Ave., SW
Washington, DC 20250-0225

**Re: Request for Denial of Proposals to Eliminate Producer-Handler Exemption;
Alternative Proposals and Request for Pre-Hearing Information Session**

Dear Ms. Coale:

This letter of opposition and alternative proposals is submitted on behalf of the American Independent Dairy Alliance. AIDA is an ad hoc coalition of producer-handlers and exempt handlers. While the members of AIDA are diverse in location, customer base, product lines, and business philosophies, we all share a singular common purpose. We oppose the efforts of the National Milk Producers Federation (“NMPF”) and International Dairy Foods Association (“IDFA”) to eliminate the producer-handler designation.

America is in the worst economic crisis since the Great Depression. We have each built our dairy businesses through extremely hard work, innovation and a willingness to assume full responsibility for the risks inherent in being a producer and a handler, namely producing enough milk solely on our own farms to ensure that we can meet supply agreements with our own customers. We have not and do not rely upon the cushion of the regulated pool. We are not “robbing” the pool of milk check blend value, nor does our business model provide us an unfair price advantage for milk vis-à-vis the dominant market handlers. We also provide good jobs throughout the United States, many in rural areas that this proposal puts at risk. We provide a small degree of competition in the marketplace – most often in categories where value is added to milk on the farm to respond to differentiated consumer demand.

As a total category, USDA statistics demonstrate that producer-handlers:

- provide 1.5% of the fluid milk in the regulated market.¹
- have actual raw milk costs equal to their cost of production, which do not track the FMMO blend prices, but rather often exceed the announced Class I prices.
- have an aggregate impact on the pool price paid to farmers of less than one cent per hundredweight, based on the limited available public data.

Like NMPF and IDFA and their members, we are aware of the substantial economic challenges facing the dairy industry. Feed and fuel prices are at historically high levels –and the FMMO

¹ <http://www.ams.usda.gov/AMSv1.0/getfile?dDocName=STELPRDC5075741>.

statistical uniform price to producers is extremely low. We are not the cause of these disruptions, and scarce government and private resources should not be wasted pursuing a fast-track formal rulemaking proceeding premised on illusory allegations. There are significant problems and inequities in the FMMO system. The appropriate response, emphasized by President Obama and his administration, is for government to take a hard look at which programs are working and which ones are not.

In this case, the correct response is to cease the process of holding multiple, duplicative hearings on single focus issues and to revisit national policy. The key issue raised by these proposals is the fundamental question of what constitutes “disorderly marketing” conditions. If the activity of producer-handlers is considered to meet this test based on the statistics cited above, it simply cannot be argued that the FMMO program is working. No system that restricts competition is economically viable. Instead, what is needed is a comprehensive government policy that clearly defines what constitutes “disorderly marketing” and that is transparent, workable, and consistent for all activity in the regulated system. Rather than the misguided proposals of NMPF and IDFA, the members of AIDA propose the alternative actions listed below.

Who We Are:

The members of our Alliance are Kreider Dairy, Manheim, PA; Snowville Creamery, Pomeroy, Ohio; Heartland Dairy, Newark, MO; Braum Dairy, Oklahoma City, OK; GH Dairy-El Paso, El Paso, TX; Aurora Organic Dairy, Boulder, CO; and Longmont Dairy, Longmont, CO.

- Kreider Dairy has been operating its dairy farm and facility in Lancaster County, Pennsylvania since 1935. It employs 225 people at its facility, which also includes a working egg-laying operation.
- Snowville Creamery is located in Pomeroy, Ohio. It is an exempt plant under terms of the Mideast Order. But its long-term business plan is premised on its future operation as a producer-handler. Snowville Creamery bottles milk only from pasture-grazed cows and sells its milk through retailers in Southern and Central Ohio. Its milk is the largest selling brand at several of the stores it supplies.
- Heartland Dairy is owned and operated by Sharpe Holdings, LLC of Newark, Kansas. Heartland Dairy bottles the milk from its dairy farms and supplies a unique product—fresh, glass-bottled milk—to grocery stores in Illinois, Iowa, Kansas, and Missouri. It employs 150 people at its farm and creamery.
- Braum Dairy operates retail stores throughout Oklahoma, Texas, Missouri, Kansas, and Arkansas. Its milk production is utilized to produce bottled milk sold in Braum’s Fresh Market Stores and Braum’s Ice Cream and Bakery Stores. Braum Dairy has been operating its dairy farm and stores since 1968 and employs 328 people in its dairy operation and thousands of others in its stores.
- GH Dairy-El Paso is owned and operated by Hein Hettinga and his son Gerben Hettinga. GH Dairy supplies milk to the El Paso School District and to retailers in the El Paso area.

GH Dairy-El Paso employs 30 people at its plant and dozens more in its farm operations. Hein Hettinga is also the operator of Sarah Farms, a regulated plant in Yuma, Arizona that is organized under a producer-handler model.

- Aurora Organic Dairy's mission is making high-quality organic milk and butter more affordable and available for American families. With 345 employees, the company is a leading producer of private-label (store-brand) certified organic milk and butter. The company has its headquarters in Boulder, Colorado, five organic dairy farms in Colorado and Texas, and an organic dairy processing plant near Platteville, Colorado.
- Longmont Dairy Farm was founded by Jim Boyd and Reese Boatman in 1965. Jim's son, David Boyd and David's wife Susan, have operated the company since 1988. Longmont Dairy Farm sells its milk primarily through home delivery to approximately 19,000 customers. Longmont Dairy Farm employs 75 people.

Our opposition to the producer-handler proposals is based on two broad principles. First, the arguments from NMPF and IDFA are based on speculation about what might happen in the future; in fact they admit that there is no disorderly marketing in several milk marketing areas and fail to allege the type of specific information that could reasonably be rebutted by the targeted producer-handlers in any fast-track hearing. They are the same kind of allegations presented in a 2004 hearing regarding a proposal to amend the producer-handler definitions for the Appalachian and Southeast marketing areas to limit monthly Class I route disposition to 3,000,000 pounds. Although a formal hearing and briefing was completed, the Department never reached a decision on this matter, presumably because of a lack of evidence and factual support to change the regulations prospectively.² The same result is warranted here; the proposals should not be adopted.

Second, the NMPF/IDFA proposals do not present sufficient threshold evidence of "disorderly marketing" in the context of the current FMMO system to justify initiating this proceeding. There are multiple forces in the market that influence the uniform statistical price of milk – not the least of which is the ability of cheese plants to move in and out of orders when the price of milk for cheese exceeds the price for fluid milk. The current economic situation and sound public policy require that these be addressed collectively, and in a manner that affords a uniform, transparent and broad-based discussion. The course pursued by the hearing proponents places dozens of independent businesses at risk through onerous financial costs and disruption of their chosen lawful business model. In light of the genuine challenges facing the industry and the Congressional directive to review the regulatory program, it is a poor choice to tackle this non-issue while larger structural issues remain unaddressed, which if properly addressed could render any discussion about producer-handlers moot.

² On March 13, 2009, the Department issued a notice terminating these proceedings without addressing the merits of the producer-handler proposals. 74 Fed. Reg. 10842. The articulated basis for terminating the proceeding was the requests from NMPF and IDFA to eliminate producer-handlers. Aside from indicating that the Department had, in fact, determined to hold a hearing before comments and alternate proposals were submitted, the termination of a proceeding fully argued and briefed demonstrates a lack of evidence to justify any changes, at least with respect to those two marketing areas.

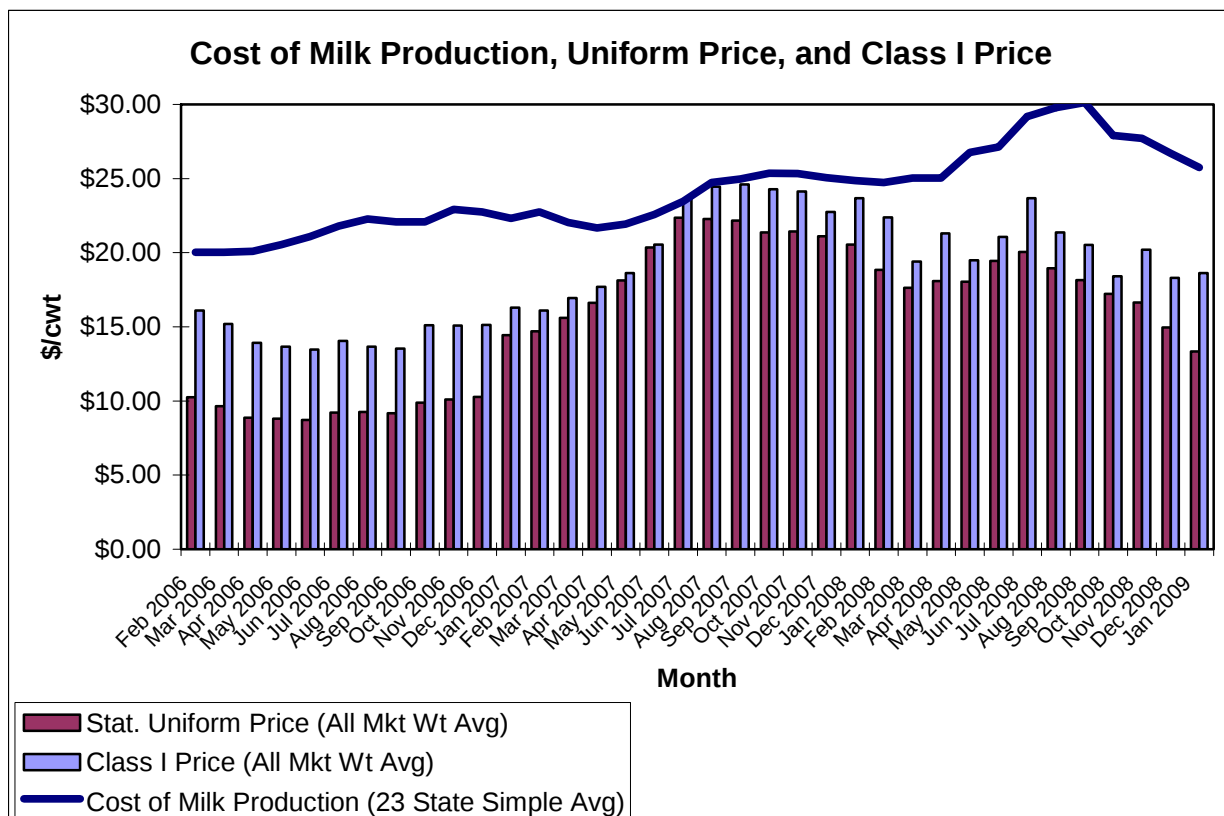
The purpose of the AMAA is to ensure orderly marketing of agricultural commodities. But despite 70 years of administering milk marketing orders, the Department has yet to articulate any standard or objective criteria by which to identify disorderly marketing conditions. Absent a lucid definition of disorderly marketing against which target companies such as those in this group can mount a rational defense, there can be neither reasonable notice nor a fair opportunity to defend against and rebut assertions and allegations in a proceeding such as this.

This letter first outlines our opposition to the proposals, then discusses briefly the reasons why a full review of federal milk marketing order policies should be undertaken before the Department elects to hold a hearing on what empirical evidence will show is a non-issue. Finally, we offer several alternative proposals that the Department should consider if, notwithstanding the strong factual and pragmatic reasons for denying these proposals, a formal hearing is noticed.

Arguments in Opposition to the Producer-Handler Proposals

NMPF alleges that producer-handlers possess and “exploit their artificial raw milk price advantage” over other handlers because, it is claimed, the uniform price for milk in the order is the price that a producer-handler incurs to obtain its raw milk. NMPF asserts without basis in fact that, “As the market price for producer milk on the market, this [the uniform price] is the appropriate transfer price for analysis of the regulatory impact on the producer-handler’s plant.” NMPF alleges that this hypothetical price advantage is 72 cents to \$1.74 per hundredweight.

No producer-handler acquires its raw milk supply at the uniform price. The cost to acquire own-farm produced milk in an integrated operation is the actual cost of production. Obviously, this cost varies by operation and over time. But using the national cost of production estimates from USDA-ERS, those costs of production have exceeded both the uniform price and the Class I price on a consistent basis since early 2006. The actual data shows that producer-handlers have no advantage in the cost of acquiring milk.



Sources: USDA ERS Data Sets, Monthly Milk Costs of Production; USDA AMS Dairy Programs, Individual Milk Order Prices.

NMPF also relies upon the specter of runaway competition that has yet to materialize to justify its proposals. Of course, these alleged “problems” are based on the false premise that producer-handlers possess a price advantage. Even so, the language used by NMPF establishes that there is no current basis for these proposals to even be noticed for a hearing, let alone adopted:

“More importantly, such a producer handler **could** proliferate across a market . . .” p. 1

“**The potential exists** under current regulation for such producer-handlers to be recruited and organized. . .” p. 1

“... recognition of the **increasing potential** of such handlers . . .” p. 2.

“Producer-handlers’ special treatment **threatens** orderly marketing.” p. 5.

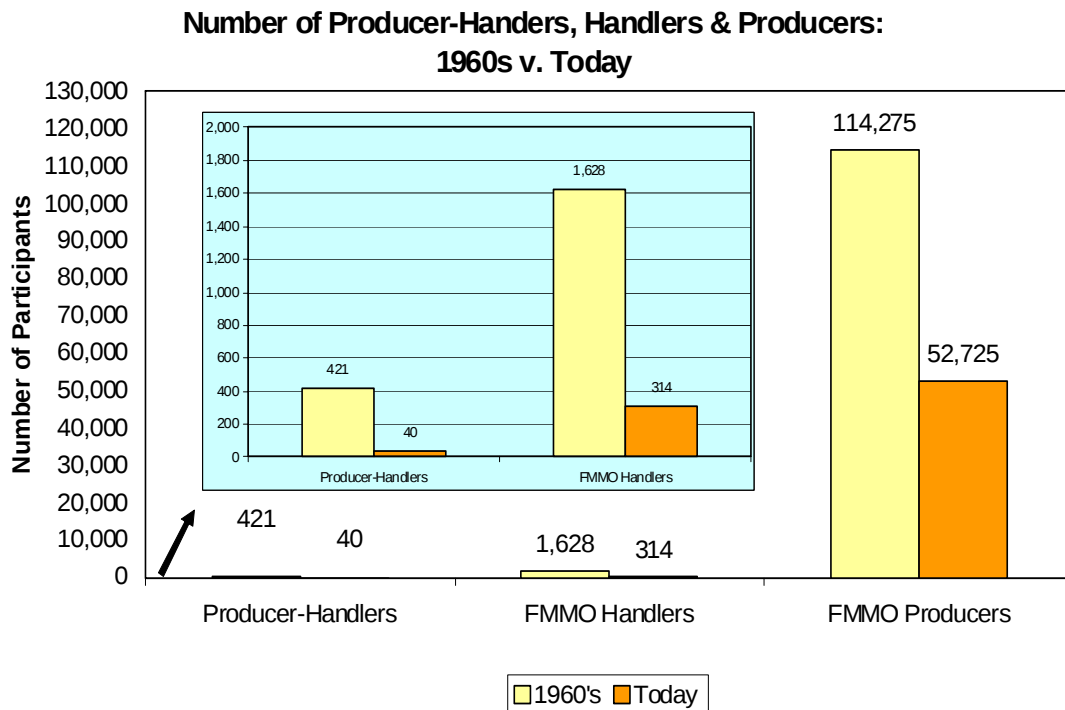
“Although several federal order markets are **not now substantially disrupted** by the operations of large producer-handlers . . .” p.6

Despite the passage of over three years since the USDA decision on producer-handlers in the Pacific Northwest and Arizona-Las Vegas orders, from which the proponents derive the alleged USDA policy in favor of eliminating producer-handlers, the proponents do not include any actual data from any of the eight other marketing areas documenting an actual example of market disorder or quantification of market disruption.

Lacking quantifiable data to support their request, NMPF states that even after over 70 years of producer-handlers being in the marketplace, their mere existence is now disruptive since “its customers have a choice of alternative supplies of milk.” This cannot possibly constitute a serious definition of disorderly marketing. Choice is, by definition, the hallmark of a healthy marketplace. Certainly, such market choices existed in the past with no market disruption. Today, consumers have multiple alternate choices for generic commodity milk – including the niche milk markets served by many of us, but also for calcium enriched fruit juices, flavored waters, etc.

The structural changes in the dairy industry cited by NMPF are not confined to producer-handlers. NMPF asserts that because producer-handlers are larger in 2009 than they were in the 1930’s, elimination of their regulatory status is warranted. But the dairy industry as a whole has experienced the same type of market consolidation and participant growth over the past seven decades. The fact that the size of producer-handlers today was once unimaginable seven decades ago provides no basis for a charge that this creates disorderly marketing conditions today. Who in 1930 could fathom a cooperative with over 25,000 dairy farm members; that the nation’s entire dairy needs would be supplied by 60,000 dairy farms; that single dairies would effectively milk thousands of cows; or that consolidation in the industry would have become so nearly complete as it is now? As with the other arguments raised by the proponents, there is no actual data that analyzes the growth in size of producer-handlers in comparison with the growth of producers, distributing plants, or marketing orders in general.

For example, the statement by NMPF that “In 1947, . . . four different federal milk orders each pooled less than 3,000,000 pounds of producer milk per month,” actually illustrates a point contrary to that which NMPF wishes to establish—that the growth in size of producer-handlers and decline in their numbers is consistent with the consolidation occurring in other parts of the dairy industry. This is not evidence of current or impending disorder; this is merely verification that the relative role of producer-handlers in the marketplace is consistent. In fact, the ratio of producer-handlers to FMMO handlers has diminished from approximately 1:4 to 1:7 since the 1960s.



Sources: USDA AMS Dairy Programs, Information on Producer-Handlers Operating in Federal Milk Order Marketing Areas, Selected Time Periods³; USDA AMS Dairy Programs, Measures of Growth in Federal Milk Order Markets, Years, 1947-2006.⁴

In addition to the lack of data to support changing the producer-handler provisions, there are other conditions that truly create a lack of orderly marketing. These include FMMO pricing formulas, Class I prices, and depooling.

In the Central Order in June 2008, nearly 200,000,000 pounds of Class III milk was removed from the pool, which reduced the blend price by \$0.57 per hundredweight that month as calculated on a simple average basis utilizing April 2008 utilization ratios. The continued ability of Class III milk to leave and re-enter the pool has a significant monetary effect on the blend price that is far greater than any alleged impact from producer-handlers.

With regard to pricing formulas, much of the industry has indicated support for the re-examination of a competitive price system to replace the current end-product price system. As part of such an examination, it would be prudent to review the relative values of milk used in manufacturing and milk used for Class I purposes.

³ <http://www.ams.usda.gov/AMSv1.0/getfile?dDocName=STELPRDC5075741>.

⁴ <http://www.ams.usda.gov/AMSv1.0/getfile?dDocName=STELPRDC5064354>. (Table 2).

The specific amount of the Class I differentials for each location and their interrelationships, “the Class I price surface,” is also continually debated. The current pricing system presumes that milk utilized for bottling has an inherently higher value than does milk utilized for use in manufactured milk products. During federal order reform, the Class I differentials adopted by the Department premised those differentials on several factors, two of which are frequently cited as the driving force for differential pricing: (1) Class I values needed to account for upgrading production facilities to Grade A status, and (2) the pricing surface needed to account for the location value of milk in order to attract that milk to the bottling plant. The Department has adopted temporary adjustments to the Class I pricing surface. But does it continue to make sense to maintain Class I differentials that reflect the cost to operate a Grade A facility? Rather than maintaining a Class I price surface subject to periodic revisions and adjustments based on changes in the overall economy, could a farm-point pricing system provide for a less-complicated Class I pricing surface and more economic movement of milk?

Before any changes to the producer-handler regulations are revisited, the Department should review the larger structural problems in the FMMO program. If subjected to regulation, the Department will assess producer-handler plants a compensatory payment to the producer settlement fund equivalent to the difference between the Class I price and the uniform price. This will have the effect of forcing producer-handlers to pay substantial payments on a monthly basis to the pool without any countervailing benefit. As a result, the proposal is merely an effort to impose a significant additional tax and business burden on any competitor who chooses not to participate in a cooperative.

The American Independent Dairy Coalition Supports Raising the Exempt Plant Limitation But the Proposed Monthly Limit of 450,000 Pounds is Anticompetitive

While our coalition opposes elimination of limitation of the producer-handler exemption, we support the expansion of those plants that qualify as exempt plants. The NMPF proposal explains that, “Given growth in farm size and growing economies of size in milk processing, it is reasonable to increase the size exemption to 450,000 pounds per month, and we propose to do so.”

We agree that the current exempt-plant size is archaic. Peer reviewed dairy literature, however, demonstrates that a fluid milk plant restricted to this size is destined to be an economic failure.⁵ A well-prepared recent study found that even a facility processing 644,000 pounds of milk per month would have a substantially negative net present value (NPV) or profitability:

“Fluid milk plants have closed due to inefficient economies of scale, and because the product – beverage milk – is essentially an indistinguishable commodity. It is very difficult for a processor to position a fluid brand to strategic advantage. The exceptions seem to prove the rule.”

⁵ “A Cost and Returns Evaluation of Alternative Dairy Products to Determine Capital Investment and Operational Feasibility of a Small-Scale Dairy Processing Facility” J. Dairy Sci., Vol, 90, No. 5, 2007 p. 2506-2516.

“The 5-farm (644,000 pounds per month) fluid plant would need a 6% increase in present value of reserves, which translates to a \$0.24 increase in the price received per gallon of milk sold.”

“It is unlikely that the fluid processing plants would be able to overcome the baseline revenue shortfalls or the high level of expenses to reach a break-even point.”

The request to increase the exempt plant limitation to 450,000 per month is an add-on proposal. NMPF and IDFA are attempting to completely eliminate the producer-handler exemption as an option for independent businesses in the dairy industry. The actual reason for the exempt plant proposal is to avoid the political backlash from a proposal that would otherwise injure, damage, or destroy dozens of small family businesses. The reported revised proposal from NMPF to now cap producer-handlers at 3,000,000 pounds per month, rather than abolish them, is yet another attempt to limit the number of businesses that it seeks to destroy. In any event, the proponents’ goal appears to be limiting the number of processors that can effectively compete with existing industry players.

The proposed monthly limitation of 450,000 pounds is clearly anticompetitive.

Permissible Courses of Action for the Department To Follow with Regard to the Producer-Handler Proposals

1. Deny the Requests for a Formal Hearing: The Department has the discretion to deny the NMPF/IDFA proposals outright. Given the dearth of substantive support for the proposals, this is the most sound and defensible course of action. But if there is a reason to further examine the issues alleged in the proposals, the Department has multiple options in lieu of issuing an immediate hearing notice.
2. Initiate an Informal Notice and Comment Rulemaking Under Section 553 of the Administrative Procedure Act as Authorized Under the 2008 Farm Bill:

USDA should respond to these proposals by initiating an Advance Notice of Proposed Rulemaking (“ANPR”) that describes the proposals and the need to develop a clear neutral standard of the conditions that constitute disorderly marketing in the FMMO system.

The 2008 Farm Bill gives USDA for the first time the legal authority to use the APA Section 553 informal rulemaking process as an alternative to the cumbersome and relatively inaccessible formal rulemaking hearing proceedings. The ANPR tool permits the Department to commence the necessary national dialogue in order to properly address what is occurring in the milk industry. This will allow all affected interests – the thriving 80 year businesses built into their local communities, producers, the consumers who seek value-added fluid milk products, new entrepreneurial enterprises, innovators, and existing cooperatives and handlers – to participate in an open and transparent dialogue. Then AMPR process provides USDA the leadership role in clarifying the current system while the larger debate now underway on system-wide modification proceeds. It also provides a framework

for national policy discussion unconstrained by the truncated formal rulemaking deadlines added to the 2008 Farm Bill for petitions to amend individual marketing orders.⁶

The key issue for such a national policy rulemaking is the definition of “disorderly marketing” for all activities in the FMMO system. There is currently no objective USDA regulatory definition of the term “disorderly marketing conditions” against which any of the NMPF/IDFA allegations could be measured or against which a defense could be mounted. If the hallmark of disorderly marketing is to be the size of the impact on a producer’s milk check, then all of the factors impacting that check must be treated in an equal manner. If the hallmark of disorderly marketing is to be any impact on handler prices, then there must be an objective definition that accounts for the variable factors across all competitive forms of organizations. While the NMPF/IDFA proposals offer unneeded radical changes to the system that will have a disparate effect on producer-handlers and an impact that may drive members of this coalition out of business, the Department has not addressed the widening gap between the controlling collective in the dairy industry and everyone else. Certainly, some handlers reported record profits for 2008 due to the low price of milk. That has not been the case for producer-handlers.

The proponents of a change in national policy may well have the burden of proof, but everyone has the right to know the parameters of the government’s standard of “disorderly marketing” prior to the initiation of any formal hearing process. In fact, NMPF admits that there is no evidence of disorderly marketing in at least several of the FMMOs today⁷ and fails to identify any specific order in which such disorderly marketing purportedly caused by the mere existence of producer-handlers is even alleged to exist.

3. Request Additional Information from the Proponents and Investigate the Merits of Alternative Proposals: Under the revised rules of practice issued by the Department, which implemented provisions of the 2008 Farm Bill, the proposed action plan is nonbinding on the Department. While at first blush, the NMPF/IDFA proposals might appear sufficient to request additional proposals, further review identifies serious factual shortcomings in their premises and bases for amending the orders. Before a hearing is noticed and the affected interests of the industry commit the hundreds of thousands of dollars to participate in a hearing based on speculation and incorrect assumptions, it is within the Department’s discretion to demand additional **factual** (rather than anecdotal or hypothetical) justification for proceeding to a hearing. Only after that information is submitted and evaluated by the Department can a decision be made on the actual need for a formal hearing.

The revision of the action plan is fully within the letter and spirit of the 2008 Farm Bill and the implementing regulations. The Farm Bill requires the Department to set forth an action with “expected timeframes” not binding timeframes.⁸ If the Department determines that additional information from the requestors is appropriate, it can revise the action plan to demand that the factual support be produced.

⁶ 7 U.S.C. § 608c(17).

⁷ NMPF Hearing Request, p. 6.

⁸ 7 U.S.C. § 608c(17)(C)(i)(I).

4. Hold a Pre-Hearing Information Session: The alternate proposals submitted by our coalition, in some instances, raise possible solutions that are either novel or could be better understood and appreciated in the context of discussions with the Department in advance of a formal rulemaking. The Rules of Practice explicitly permit the Department to hold pre-hearing sessions. We request that such a session be held if the NMPF/IDFA proposals are not denied. This session, conducted outside of the scope of *ex parte* communication restrictions, would benefit all involved. The standards applicable to the Department's decision-making process could be reviewed and any questions from the marketing specialists related to the proposals could be ascertained and addressed in anticipation of any hearing ultimately noticed.

Alternative and Additional Proposals

The proposals advanced and offered in this submission are premised on a simple truth. The FMMO system is at a crossroads. Despite the best of intentions and diligent efforts, FMMO reform has not been a complete success. In recognition of this issue, in the 2008 Farm Bill Congress commissioned a panel to review the FMMO system, which was to address the effectiveness of the system, simplification of the system, and examination for the need for continued regulation.

Examples of ongoing, difficult problems in the dairy industry abound. The use of end-product pricing to determine the value of milk used in manufacturing has resulted in multiple contentious hearings. Those hearings resulted in decisions that left none of the interested parties entirely satisfied with the outcome or the process used to reach the outcome. In the last hearing addressing the Class III and Class IV pricing formulas, a proposal to replace end-product pricing with a competitive price system received broad interest, if not broad support, from producers and processors. The concept is still one that is viable and necessitates further exploration. Other handlers have indicated their belief that adoption of individual handler pools, rather than marketwide pooling, is superior because it ensures proper association of producers to the Class I price and also ensures an adequate supply of milk to Class I handlers. Examination of the pricing and pooling system, as advocated by the broader industry could obviate any need to modify the producer-handler regulations. An editorial in *Hoard's Dairyman* of March 10, 2009 noted that, "There's growing consensus that we must make changes in federal milk marketing order provisions."⁹ The article pointed directly to the methods for determining prices and the number of classifications of milk.

Yet, if adopted in whole or in part, the NMPF/IDFA proposals will cause severe economic damage to producer-handlers across the country. The NMPF/IDFA proposals do not simply reshuffle funds. Unlike many FMMO hearings, the economic impact of a decision will not be measured in pennies per hundredweight, but in thousands, even tens or hundreds of thousands of dollars per month, per operation. Instead, the impact on affected producer-handlers will be far more significant. In exchange for fractions of a cent to the pool, producer-handlers will lose significant dollars and potentially the businesses that they have worked to build for years. Many will not survive. Others will be forced to layoff employees, sell assets, reconfigure operations, or reduce their customer bases.

⁹ Hoard's Dairyman, "Federal Order Reform Will Become Even More Vital," 170, March 10, 2009.

With that frame of reference, the American Independent Dairy Alliance offers our alternative proposals for consideration.¹⁰

1. Exempt Own-Farm Production with Down Allocation: Rather than exempting own-farm produced milk from the pricing and pooling requirements only for those handlers that qualify as producer-handlers under the federal milk marketing orders, the Department has the authority to exempt the volumes of milk acquired from farms under the ownership and control of that handler. Under this proposal, the designation of an operation as a producer-handler would be eliminated and handlers would file reports indicating the volumes of milk acquired from their own controlled farms. The handlers' report would identify milk received from the handler's own farm, but not include that volume of production in the computation of the handler's obligation to the producer settlement fund. There would be no volume limitation of the amount of own-farm production that a handler could utilize and receive credit. The market administrator would be charged with determining that the handler claiming own-farm production share ownership and control over the production and processing facilities in order to qualify for the exemption, just as with the current producer-handler regulations.

Proposed regulatory language is appended to this submission.

2. Exempt All Milk Sold By Producer-Handlers at Retail: Producer-handlers who dispose of their own-farm production in handler-controlled retail channels (either through home-delivery or through handler controlled retail outlets) would retain an exemption for such disposals regardless of their level of sales. A perfectly integrated farm-to-plant-to-customer venture operates autonomously. These operations, bearing the entire risk of their production, processing, and retailing should be exempted on such volumes.

Proposed regulatory language is appended to this submission.

3. Individual Handler Pool: Producer-handlers operate as *de facto* individual handler pools. All of the producers supplying a producer-handler plant (the producer-handler's own farm) receive the same price for the milk supplied to the producer-handler plant. NMPF and IDFA complain in their hearing proposals that this creates alleged inequities. Adoption of individual handler pools for all handlers in all federal orders would address any purported inequities and would deal with several of the recurring problems with the FMMO system.

While the FMMO system does not prohibit the use of individual handler pools, there are currently none in operation. Notwithstanding, individual handler pools are not new. In fact, this system was utilized even before adoption of the AMAA and implementation of the current FMMO system and up until the completion of FMMO reform. During FMMO

¹⁰ Our proposals are explained throughout this letter, including their intended purposes, the industry practices related to them, the anticipated impacts on the industry and consumers, the effects on small businesses (specifically producer-handlers), the effects on prices and costs, and the need for a pre-hearing information session. To the extent appropriate, we can provide elaboration at the pre-hearing information session scheduled for March 20, 2009. See 7 C.F.R. § 900.22.

reform, a paper issued by the Cornell Program on Dairy Markets and Policy summarized the alternatives that USDA might consider in reforming the federal orders. Among those proposals was the use of individual handler pools. The Cornell paper identified the following benefits and disadvantages to individual handler pools:

In contrast to market-wide pooling, the individual handler pool does provide substantial incentive to sell class I milk to handlers. Individual handler pools mean that producers selling to the same plant get the same blend price, but each plant has its own blend price, calculated according to its own milk utilization. Consequently, producers have a much stronger incentive to sell milk to the plants paying the higher prices. The drawback of this approach is that it moves away from the objective of equal treatment of producers. That is, it may be a good way to achieve one objective of orderly marketing, but is counter-productive to another which is producer price equity. Nevertheless, it has two distinct advantages. One, it channels all class I revenues to those plants and producers who are actually serving the class I market. There is a substantial incentive for all milk in the supply area to be readily available to meet class I requirements. There is little or no need for qualification requirements or call provisions. Second, there is little incentive for the supply area to expand beyond that which is sufficient to meet class I needs of the market. Milk producers and buyers who are not selling milk for class I use do not participate in the class I revenues.¹¹

Other regulated entities, including Dean Foods¹² and Lamers Dairy¹³ have advocated for individual handler pools. Yet the Department has not addressed the issue since FMMO reform, when it adopted marketwide pooling for all federal orders.

No hearing has been held on the issue despite the fact that if individual handler pools had been in operation since order reform, the bulk of federal order hearings addressing pool qualification, opportunistic de-pooling, and producer handlers would have been obviated. If, as the Cornell paper opined, the primary disadvantage to individual handler pools is that producers in geographic proximity to each other would receive differing prices for their milk production, then we should examine (1) whether the federally guaranteed minimum prices are sufficient for producers who would receive the lower value classified prices; (2) whether the current system actually ensures comparable returns to producer in a given geographic area; and (3) whether in a regulatory system that ensures a fair minimum price to all producers equality in producer returns is a preferred or feasible alternative.

The government should not jeopardize the investment-backed expectations of businesses that are providing employment, innovation, and consumer choice. And there is no need to subject

¹¹ Alternative Order Provisions To Facilitate that Orderly Movement of Milk to Fluid Market, Dr. Robert Cropp, Cornell Program on Dairy Markets and Policy, February 1997, available online at <http://www.cpdmp.cornell.edu/CPDMP/Pages/Publications/Pubs/O9.pdf>.

¹² Hearing on Central Order Pooling Provisions, Testimony of Evan Kinser, p. 642-43: available online at: <http://www.ams.usda.gov/AMSv1.0/getfile?dDocName=STELPRDC5059302>.

¹³ Hearing on Central Order Pooling Provisions, Post-Hearing Brief of Lamers Dairy, p. 10, available online at: <http://www.ams.usda.gov/AMSv1.0/getfile?dDocName=STELDEV3025206>.

producer-handlers to that risk because individual handler pools address any concerns about alleged handler inequity. Individual-handler pooling would permit each processing plant to operate on the same basis as producer-handler plants have for over 70 years. The adoption of individual handler pools would have the added benefits identified by the Cornell study—ease of association of producers with plants and a strong incentive to supply the fluid market. There would be no need for further hearings regarding pool qualification, and no longer would an entire marketing area be subjected to the economic damage caused by opportunistic depooling. In short, many of the recurring problems with the marketing orders would be addressed and resolved.

Proposed regulatory language is appended to this submission. The proposed language, while sufficient to convey the intent and scope of this proposal, would need to be modified slightly for orders pricing all milk on a skim-butterfat basis. Order provisions related to pool qualification would also need to be modified or eliminated, as appropriate.

In conclusion, the NMPF/IDFA proposals should be denied. Alternatively, the Department should utilize informal rulemaking to consider the proposals, including the issuance of an advance notice of proposed rulemaking to establish a transparent and uniform definition of “disorderly marketing.”

In the event that the Department determines to proceed to a hearing, the scope of the hearing should be sufficiently broad to include an examination of pricing and pooling issues that would affect the need for a producer-handler designation, the need for multiple classifications of milk, and the method for determining classified prices. We request that our alternative proposals be included in the hearing notice along with any other proposals addressing the issue submitted by other interested parties.

Very truly yours,
American Independent Dairy Alliance

Ron Kreider
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AMERICAN INDEPENDENT DAIRY ALLIANCE
PROPOSED REGULATORY LANGUAGE REGARDING
EXEMPTION OF OWN FARM PRODUCTION

Replace the existing Sec. _____.10 in each marketing order with a new Sec. _____.10 as follows:

Sec. _____.10 Exemption for Own Farm Production of Handlers

Any operator of a pool plant or partially regulated distributing plant:

- (a) from which there is route disposition in the marketing area during the month; and
- (b) that receives fluid milk from the own farm production of a farm under the ownership and control of the operator; and
- (c) who provides proof satisfactory to the market administrator that the care and management of the dairy animals and other resources necessary to produce the volume of milk processed under (b) of this section and the processing and packaging operations are the operator's own enterprise and at its own risk;
- (d) shall have such the volumes of own-farm production treated as exempt volumes for the purposes of calculating any obligation of the handler under Sec. _____.71 and 72 of the order. For handlers also purchasing producer milk for use at its plant, the market administrator shall down-allocate the volumes of own-farm produced milk to the plant's lowest value use before calculating the plant's value of milk and any obligations to the producer settlement fund.

AMERICAN INDEPENDENT DAIRY ALLIANCE

**PROPOSED REGULATORY LANGUAGE REGARDING
EXEMPTION FOR RETAIL SALES BY PRODUCER-HANDLERS**

Add a new paragraph to the producer-handler definitions for each marketing order

(g) Any producer-handler with route disposition through retail channels, either by sales direct to consumers, through home delivery, or to distribution outlets owned or controlled by the producer-handler, shall have such retail sales volumes treated as exempt volumes for the purposes of calculating any obligation of the producer-handler under Sec. _____.71 and 72 of the order. The producer-handler shall provide proof satisfactory to the market administrator that the retail dispositions are made by the producer-handler direct to consumers, through home delivery, or to distribution outlets owned or controlled by the producer-handler.

AMERICAN INDEPENDENT DAIRY ALLIANCE
PROPOSED REGULATORY LANGUAGE REGARDING
INDIVIDUAL HANDLER POOLS

Sec. 1001.61 Computation of producer price differentials.

For each month, the market administrator shall compute ~~a~~ producer price differential~~s~~ per hundredweight for each handler required to file a report prescribed by § 1001.30 and for the order in aggregate. ~~The report of any handler who has not made payments required pursuant to Sec. 1001.71 for the preceding month shall not be included in the computation of the producer price differential, and such handler's report shall not be included in the computation for succeeding months until the handler has made full payment of outstanding monthly obligations.~~

(a) Subject to the conditions in this paragraph, the market administrator shall compute the producer price differential for the order in aggregate in the following manner:

(1a) Combine into one total the values computed pursuant to Sec. 1001.60 for all handlers required to file reports prescribed in Sec. 1001.30;

(2b) Subtract the total of the values obtained by multiplying each handler's total pounds of protein, other solids, and butterfat contained in the milk for which an obligation was computed pursuant to Sec. 1001.60 by the protein price, other solids price, and the butterfat price, respectively;

(3e) Add an amount equal to the minus location adjustments and subtract an amount equal to the plus location adjustments computed pursuant to Sec. 1001.75;

(4d) Add an amount equal to not less than one-half of the unobligated balance in the producer-settlement fund;

(5e) Divide the resulting amount by the sum of the following for all handlers included in these computations:

(A1) The total hundredweight of producer milk; and

(B2) The total hundredweight for which a value is computed pursuant to Sec. 1001.60(h); and

(6f) Subtract not less than 4 cents nor more than 5 cents from the price computed pursuant to paragraph (e) of this section. The result, rounded to the nearest cent, shall be known as the orders' producer price differential for the month and shall be calculated for purposes of statistical comparison.

(b) For each handler required to file a report prescribed by Sec. 1001.30, the market administrator shall calculate the handler's producer price differential in the following manner:

(1) Subtract the total of the values obtained by multiplying the handler's total pounds of protein, other solids, and butterfat contained in the milk for which an obligation was computed pursuant to Sec. 1001.60 by the protein price, other solids price, and the butterfat price, respectively;

(2) Add or subtract an amount equal to the location adjustments computed pursuant to Sec. 1001.75;

(3) Divide the resulting amount by the handler's total hundredweight of producer milk; and

(6) Subtract not less than 4 cents nor more than 5 cents from the price computed pursuant to paragraph (b)(3) of this section. The result, rounded to the nearest cent, shall be known as the handler's producer price differential for the month and shall be

utilized for determining the pay prices for producers and cooperative associations shipping to that handler.

Sec. 1001.62 Announcement of producer prices.

On or before the 14th day after the end of the month, the Market Administrator shall announce the following prices and information:

- (a) The producer price differential s for the order in aggregate and for each handler; |
- (b) The protein price;
- (c) The nonfat solids price;
- (d) The other solids price;
- (e) The butterfat price;
- (f) The average butterfat, protein, nonfat solids, and other solids content of producer milk; and
- (g) The statistical uniform price for milk containing 3.5 percent butterfat computed by combining the Class III price and the producer price differential.
- (h) If the 14th falls on a Saturday, Sunday, or national holiday, the Market Administrator may have up to two additional business days to announce the producer price differential s and the statistical uniform price. |

Sec. 1001.70 Producer Settlement Fund

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Sec. 1001.71 Payments to the Producer Settlement Fund

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Sec. 1001.72 Payments from the Producer Settlement Fund

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Sec. 1001.73 Payments to producers and to cooperative associations.

(a) Each handler that is not paying a cooperative association for producer milk shall pay each producer as follows:

(1) Partial payment. For each producer who has not discontinued shipments as of the 23rd day of the month, payment shall be made so that it is received by the producer on or before the 26th day of the month (except as provided in Sec. 1000.90) for milk received during the first 15 days of the month at not less than the lowest announced class price for the preceding month, less proper deductions authorized in writing by the producer.

(2) Final payment. For milk received during the month, payment shall be made during the following month so it is received by each producer no later than the day after the required date of payment by the Market Administrator, pursuant to Sec. 1001.72, in an amount computed as follows:

(i) Multiply the hundredweight of producer milk received by the handler's producer price differential for the month as adjusted pursuant to Sec. 1001.75;

(ii) Multiply the pounds of butterfat received by the butterfat price for the month;

(iii) Multiply the pounds of protein received by the protein price for the month;

(iv) Multiply the pounds of other solids received by the other solids price for the month; and

(v) Add the amounts computed in paragraphs (a)(2)(i) through (iv) of this section, and from that sum:

(A) Subtract the partial payment made pursuant to paragraph (a)(1) of this section;

(B) Subtract the deduction for marketing services pursuant to Sec. 1000.86;

(C) Add or subtract for errors made in previous payments to the producer; and

(D) Subtract proper deductions authorized in writing by the producer.

(b) One day before partial and final payments are due pursuant to paragraph (a) of this section, each handler shall pay a cooperative association for milk received as follows:

(1) Partial payment to a cooperative association for bulk milk received directly from producers' farms. For bulk milk (including the milk of producers who are not members of such association and who the market administrator determines have authorized the cooperative association to collect payment for their milk) received during the first 15 days of the month from a cooperative association in any capacity, except as the operator of a pool plant, the payment shall be equal to the hundredweight of milk received multiplied by the lowest announced class price for the preceding month.

(2) Partial payment to a cooperative association for milk transferred from its pool plant. For bulk milk/skimmed milk products received during the first 15 days of the month from a cooperative association in its capacity as the operator of a pool plant, the partial payment shall be at the pool plant operator's estimated use value of the milk using the most recent class prices available at the receiving plant's location.

(3) Final payment to a cooperative association for milk transferred from its pool plant. Following the classification of bulk fluid milk products and bulk fluid cream products received during the month from a cooperative association in its capacity as the operator of a pool plant, the final payment for such receipts shall be determined as follows:

- (i) Multiply the hundredweight of Class I skim milk by the Class I skim milk price for the month at the receiving plant;
- (ii) Multiply the pounds of Class I butterfat by the Class I butterfat price for the month at the receiving plant;
- (iii) Multiply the pounds of nonfat solids in Class II skim milk by the Class II nonfat solids price;
- (iv) Multiply the pounds of butterfat in Class II times the Class II butterfat price;
- (v) Multiply the pounds of nonfat solids in Class IV milk by the nonfat solids price for the month;
- (vi) Multiply the pounds of butterfat in Class III and Class IV milk by the butterfat price for the month;
- (vii) Multiply the pounds of protein in Class III milk by the protein price for the month;
- (viii) Multiply the pounds of other solids in Class III milk by the other solids price for the month; and
- (ix) Add together the amounts computed in paragraphs (b)(3)(i) through (viii) of this section and from that sum deduct any payment made pursuant to paragraph (b)(2) of this section.

(4) Final payment to a cooperative association for bulk milk received directly from producers' farms. For bulk milk received from a cooperative association during the month, including the milk of producers who are not members of such association and who the market administrator determines have authorized the cooperative association to collect payment for their milk, the final payment for such milk shall be an amount equal to the sum of the individual payments otherwise payable for such milk pursuant to paragraph (a)(2) of this section.

~~—(c) If a handler has not received full payment from the market administrator pursuant to Sec. 1001.72 by the payment date specified in paragraph (a) or (b) of this section, the handler may reduce payments pursuant to paragraphs (a) and (b) of this section, but by not more than the amount of the underpayment. The payments shall be completed on the next scheduled payment date after receipt of the balance due from the market administrator.~~

(d) If a handler claims that a required payment to a producer cannot be made because the producer is deceased or cannot be located, or because the cooperative association or its lawful successor or assignee is no longer in existence, the payment shall be made in trust to the market administrator to the producer settlement fund, and in the event that the handler subsequently locates and pays the producer or a lawful claimant, or in the event that the handler no longer exists and a lawful claim is later established, the market administrator shall make the required payment ~~from the producer settlement fund~~ to the handler or to the lawful claimant as the case may be.

(e) In making payments to producers pursuant to this section, each handler shall furnish each producer (except for a producer whose milk was received from a cooperative association handler described in Sec. 1000.9(a) or 9(c)), a supporting statement in such form that it may be retained by the recipient which shall show:

- (1) The name, address, Grade A identifier assigned by a duly constituted regulatory agency, and the payroll number of the producer;
- (2) The month and dates that milk was received from the producer, including the daily and total pounds of milk received;

- (3) The total pounds of butterfat, protein, and other solids contained in the producer's milk;
- (4) The minimum rate or rates at which payment to the producer is required pursuant to the order in this part;
- (5) The rate used in making payment if the rate is other than the applicable minimum rate;
- (6) The amount, or rate per hundredweight, or rate per pound of component, and the nature of each deduction claimed by the handler; and
- (7) The net amount of payment to the producer or cooperative association.