

TESTIMONY OF PERRY M. HEDIN, EXECUTIVE DIRECTOR, CHERRY INDUSTRY
ADMINISTRATIVE BOARD

SUPPORT FOR THE PROPOSAL TO AMEND THE TART CHERRY MARKETING ORDER (7 CFR
930 ET SEQ) TO PERMIT "BOTTOM LINE" GROWER IN-ORCHARD DIVERSIONS

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INTRODUCTION

The Cherry Industry Administrative Board (CIAB) is a Federal marketing order for tart cherries produced in various states across the country. It applies to the production of tart cherries in the states of Michigan, New York, Oregon, Pennsylvania, Utah, Washington and Wisconsin. It is authorized by 7 CFR §930 et seq.

The order was created in 1996 at the request of the industry and implemented by order of the United States Department of Agriculture (USDA). The first year of operation of the order was crop year 1997, and it has operated every season thereafter through to and including crop year 2010.

The ultimate purpose of the CIAB, like all other marketing orders, is to improve grower returns. It accomplishes this end by seeking to improve the environment for the production, processing and sale of tart cherries in both the domestic and international marketplaces. The principal mechanisms utilized under the marketing order to reach the desired outcomes are (1) control of the supply of cherries moving to the "free" market and (2) the funding of market promotion activities.

Regulated entities under the marketing order are the processors of tart cherries, a.k.a. "handlers". Growers are not directly regulated under the marketing order, but they can and do participate in the compliance aspects of the order by undertaking in-orchard diversion activity

The marketing order has gone through a number of amendments to make it fit better with the needs of the industry. The present amendment is intended to do the same. The current amendment seeks to change the way in which account is made for grower in-orchard diversion activities and the manner in which grower diversion certificates are used within the industry. To accomplish this change, it is necessary to amend and alter what is considered to be the "handle" (§930.10) of tart cherries under the order and to define how the diverted cherries are incorporated into the Optimum Supply Formula (OSF) which is described in §930.50.

STATEMENT OF THE ISSUE

The grower in-orchard diversion process has not worked as well as or as effectively as it should in dealing with surplus production. The current marketing order effectively discourages in-orchard diversions especially in those years when the restriction percentage is large and/or increases from the preliminary calculation. This aspect of the order needs to be

restructured to better serve the needs of the tart cherry industry. The way to accomplish this is to redefine what is included in the term "handle" means which, in turn, will impact the operation of the Optimum Supply Formula (OSF) and permit "bottom line" in-orchard diversions, i.e. in-orchard diversion credits that handlers can use pound-for-pound against restriction obligations.

BACKGROUND REGARDING GROWER DIVERSION ACTIVITIES AND CERTIFICATES

Under the order, growers have the right and the opportunity to undertake in-orchard diversion of cherries. (§930.58) These diversions are done during harvest in accordance with procedures delineated under the order, and they are overseen by the CIAB. If these in-orchard diversions are done properly, the CIAB issues "grower diversion certificates" to the growers that represent the pounds of cherries that were left in the orchard.

HANDLE - §930.10

Growers themselves do not use their certificates. Rather, grower diversion certificates are used by the handlers as one their compliance alternatives. However, in the current construct of the order, handlers must include the pounds of cherries represented by the certificates as part of their "handle" as though these cherries had been delivered and processed.

Under the order as currently crafted, grower diversion certificates are treated as though they were harvested cherries delivered for processing.

"Handle means the process to brine, can, concentrate, freeze, dehydrate, pit, press or purée cherries commercially into a processed product, or divert cherries pursuant to §930.59 or obtain grower diversion certificates issued pursuant §930.58 or otherwise placed cherries into the current of commerce within the production area or from the area to points outside thereof: ..." (§930.10 Handle, emphasis added)

The fact that grower diversions are considered part of a handler's "handle" creates confusion and difficulty for both growers and handlers. Grower diversion certificates contribute to "supply" in the restricted districts for purposes of the Optimum Supply Formula. Consequently, grower in-orchard diversions effectively increase the supply of restricted cherries in any given year even though none of these cherries were delivered for processing.

OPTIMUM SUPPLY FORMULA - §930.50

The OSF is the mechanism by which supplies of tart cherries and the demand for them are brought into proper relationship with each other. When the supply tart cherries available for the market place exceed the average demand for them in the "free" market, the crop is restricted regarding what may move to the "free" market. A "restriction percentage" is

calculated pursuant to the formula, and each handler's handle of "restricted cherries" is subject to that percentage.

The interaction of §§930.10 and 930.50 establish that grower in-orchard diversions will be subject to and then discounted by the restriction percentage calculated for the year. Therefore, when the handler utilizes the grower diversion certificates it received from growers, the certificates will have a reduced worth¹ as a compliance tool.

An example of this impact will undoubtedly be beneficial.

Table 1 - Impact and Compliance Worth of Grower Diversions - Baseline Calculation

Handle:		Restriction by Source:	
Cherries for processing:	9,000	Cherries for processing:	2,250
Grower Diversion Certificates	<u>1,000</u>	Grower Diversion Certificates	<u>250</u>
ST, handle:	10,000		2,500
Restriction:	25%		
Inventories:		Net Grower Certificates	
Free inventory	7,500	For Other restriction	
Restricted Inventory	2,500	Grower Diversions Delivered	1,000
		Grower Diversions Used	<u>(250)</u>
		Net Grower Diversion Certs.	<u>750</u>
Assumption:	25%	Restriction percent	

In this example the handler takes in 1,000 pounds of in-orchard diversions, but it must use 250 pounds of the certificates against the restriction it bears from these diverted cherries. The handler has only 750 pounds of in-orchard certificates to use against other restriction obligations. Thus, in the current OSF formulation the grower diversion process yields a compliance tool that is discounted by the degree of restriction for the year. This fact alone discourages grower diversions.

The discounting of the grower diversion certificates is certainly a problem. The issue is compounded by the fact that the restriction percentage will, by definition, change during the crop year. In June the preliminary percentages are calculated using the industry's best estimate of cherry production. In September the percentage are adjusted to reflect actual production, both delivered and diverted, for the season.

The estimate of production and the actual production will never be the same. Therefore and by definition, the restriction percentage will change during the course of the season. It could go either up or down depending upon the nature of the harvest. If the actual production exceeds the estimate, the restriction percentage will increase. If the actual production is less than the estimate, the restriction percentage will decline. Either way, the changing restriction

¹ The term "worth" is used in this testimony to represent the value of certificates as a compliance tool. It is not intended to imply dollar value of grower diversion certificates. When speaking of the dollar value of certificates, I will use the term "value".

percentage will impact the worth of in-orchard diversion certificates to the handler between the time they are undertaken by growers and the time they are incorporated into a handler's compliance plan.

Assuming, for discussion purposes, that the restriction percentage increases between June and September, there will be a decline in the "worth" of the in-orchard diversion certificates. In the example set out in the table below we have assumed that the restriction percentage increased from twenty-five percent (25%) in June to fifty percent (50%) in September. As can be seen, the volume of diversion certificates available to offset other handler diversion requirements decreased accordingly. The "Net Grower Certificates" declined by 250 pounds or one-third (1/3) of their original compliance worth to the handler. It is this decrease in worth of diversion certificates that presents such a difficulty for both growers and handlers in undertaking and utilizing in-orchard diversion activities and grower diversion certificates in compliance with crop restrictions mandated by the order.

Table 2- Impact and Compliance Worth of Grower Diversions With Increased Crop Size

Handle:		Restriction by Source:	
Cherries for processing:	9,000	Cherries for processing:	4,500
Grower Diversion Certificates	<u>1,000</u>	Grower Diversion Certificates	<u>500</u>
ST, handle:	10,000		5,000
Restriction:	50%		
		Net Grower Certificates:	
Inventories:		Other restriction	
Free inventory	5,000	Grower Diversions Delivered	1,000
Restricted Inventory	5,000	Grower Diversions Used	<u>(500)</u>
		Net Grower Diversion Certs.	<u>500</u>
Assumption:	50%	Restriction percent due to larger than estimated production	

In the example, the compliance worth of the grower diversion certificates is reduced in value solely because the restriction percentage increased.

This fluctuation of the restriction percentage and its impact upon grower diversion certificates creates considerable uncertainty within the industry, and nobody likes uncertainty. Neither handlers nor growers know what will be the worth of grower diversion certificates. Growers who harvest early in the season in accordance with what they believe to be adequate diversion may find themselves needing to supply more certificates for the fruit that they delivered. Handlers who have acquired and paid for certificates under the original set of parameters may find that their compliance plans are severely disrupted. All of this flows from the fact that grower diversions are part of the "handle", are part of supply in the OSF and contribute to restriction determinations.

In some years the restriction percentage becomes so large that it provides a very strong disincentive to undertake in-orchard diversion activities altogether. It becomes a matter of diminishing return to accept in-orchard diversion credits as a compliance tool. In such cases,

handlers are often more inclined to receive fruit, process it and either hold it in inventory reserves or otherwise divert it through another option available to handlers. While this alternative may not make economic sense from the growers' perspective, it may make sense from a handler's compliance perspective. Regardless of the perspective, this outcome suggests that the marketing order does not operate as effectively as it should, and this is especially so when restrictions become large.

HISTORICAL PERSPECTIVES OF IN-ORCHARD DIVERSION ACTIVITIES

Gower in-orchard diversion activity varies quite a bit by year. There are various factors that contribute to making decisions about whether or not to divert cherries in the orchard in any given year. The size of the crop is a very significant factor in this decision, but other factors, including carry-over, inventory reserves, the size the previous year's crop, handlers' plans for complying with restrictions and/or handlers' prospects for sales of products in the upcoming year also are factors in growers' decisions about whether or not to divert cherries in the orchard.

The following table sets forth the in-orchard diversion activities by crop year.

Table 3 - In-orchard diversions Sorted by Crop Year

(Millions of Pounds)

Year	In-orchard ##	Rest. ##	% of Rest. ##	Restriction %		
				Prelim %	Final %	
1997	2.27	239	0.95%	34%	45%	
1998	42.58	305	13.96%	34%	40%	
1999		239		0%	0%	No Restriction
2000	5.20	231	2.25%	48%	50%	
2001	60.90	336	18.13%	36%	41%	
2002		60		0%	0%	No Restriction
2003	0.03	210	0.01%	23%	25%	
2004	0.17	202	0.08%	30%	28%	
2005	1.39	264	1%	36%	48%	
2006	16.28	251	6.49%	40%	45%	
2007	6.00	236	2.54%	52%	43%	
2008	0.09	203	0.04%	10%	27%	
2009	37.75	338	11.17%	49%	68%	
2010	3.52	120	2.93%	40%	58%	Small Crop

Sorting the data by the size of restricted crop, the data is as follows:

Table 4 - In-orchard diversions Sorted by Restricted Pounds

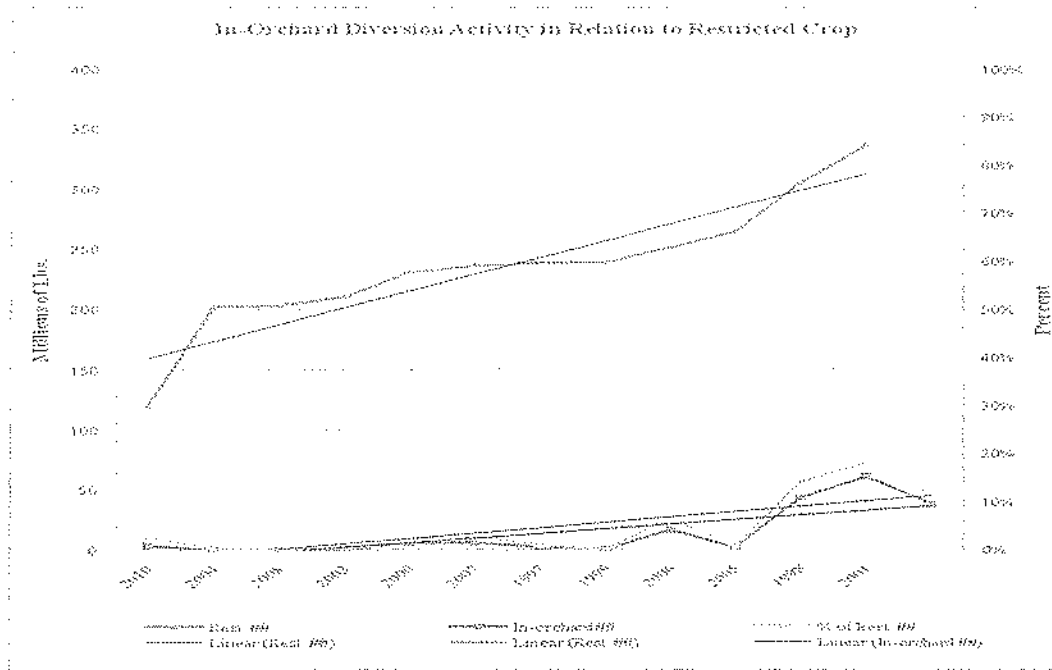
Year	In-orchard ###	Rest. ##	% of Rest. ##	Restriction %		No Restriction Small Crop
				Prelim %	Final %	
2002		60		0%	0%	
2010	3.52	120	2.93%	40%	58%	
2004	0.17	202	0.08%	30%	28%	
2008	0.09	203	0.04%	10%	27%	
2003	0.03	210	0.01%	23%	25%	
2000	5.20	231	2.25%	48%	50%	
2007	6.00	236	2.54%	52%	43%	
1997	2.27	239	0.95%	34%	45%	
1999	0.00	239	0%	0%	0%	No Restriction
2006	16.28	251	6.49%	40%	45%	
2005	1.39	264	0.53%	36%	48%	
1998	42.58	305	13.96%	34%	40%	
2001	60.90	336	18.13%	36%	41%	
2009	37.75	338	11.17%	49%	68%	

Average
4.55%

2002 is not included in the average or
on the graph derived from the data.

Viewing the information from the table as a graph, it can be seen and stated that the general trend for in-orchard diversions is for there to be a greater volume of in-orchard diversion activity as the crop size increases. In those years when there is a smaller crop, there is less diversion; in those years when there is a larger crop, there is greater diversion. Often time both handlers processing capacity and the poorer quality of cherries associated with larger crops drives the in-orchard diversion decisions. A regression analysis performed on the information indicates that there is, in fact, a demonstrable correlation between the two. The R squared value for this relationship is 0.622 and the T-Stat is a positive 4.26. (See Exhibit A)

Graph I – In-orchard Diversion Activity



It must be noted, however, that there are instances when the in-orchard diversion activity in any given year that does not comport with the general trend. This suggests that grower diversion decisions are not premised upon crop size alone, but, rather incorporate other factors, as well.

The in-orchard diversion activity must also be viewed in light of the alternative compliance options available to handlers. It is handlers who are regulated under the order, and it is they who must comply with restriction obligations. Each handler will craft a compliance plan that is appropriate for its business model, and it will utilize the most appropriate tools for its situation.

The default position in dealing with restriction for any given year is placing the restricted product into inventory reserves which could be either primary or secondary reserves. In lieu of maintaining inventory reserves, handlers may earn post-harvest diversion credits for their finished goods moved (1) into export markets, (2) into expansion markets, (3) as new products, (4) as charitable contributions or (5) as destroyed products. In addition to the post harvest options, handlers can use grower in-orchard diversion credits to meet the restrictions.

From the following table it can be seen that post-harvest diversion options have been of considerable worth to handlers. In the early years of the order export markets were a major outlet for restricted cherries. The importance of this category has lessened in the more recent years, but it still occupies an important position in the industry. It will also be noted that

secondary market activities, noted as "Mkt Expan" in the table, have become very significant as a compliance option for handlers. Utilization of in-orchard diversions has fluctuated considerably during the years of operation of the marketing order.

Table 5 - Compliance Activities Sorted by Crop Year

(Millions of Pounds)

Year	In-orchard ##	Post-harvest Diversions		Restriction %	
		Exports	Mkt Expan	Prelim %	Final %
1997	2.27	49	0	34%	45%
1998	42.58	36	0	34%	40%
1999	0.00	37	0	0%	0%
2000	5.20	36	4	48%	50%
2001	60.90	27	4	36%	41%
2002	0.00	0	5	0%	0%
2003	0.03	10	2	23%	25%
2004	0.17	8	2	30%	28%
2005	1.39	13	16	36%	48%
2006	16.28	10	29	40%	45%
2007	6.00	17.6	38.8	52%	43%
2008	0.09	11.2	30.9	10%	27%
2009	37.75	20.1	34.4	49%	68%
2010	3.52			40%	58%

The interest of handlers in the alternative compliance options is certainly understandable. Selling products generates revenue for the handlers; buying in-orchard diversion credits is a cost. Post-harvest diversion activities support and develop markets; having fruit diverted in the orchard precludes those cherries from being marketed. Processing cherries rather than having them diverted in the orchard reduces unit operating costs for the handler. As noted above, in-orchard diversion credits present a risk to handlers; post-harvest diversion credits present no risk since they are fixed, known and will not change in worth as a compliance tool. All of these elements serve to lessen the attractiveness of in-orchard diversion credits to handlers.

There is potential risk associated with receiving, processing and storing cherries and relying upon the alternative compliance tools to deal with restriction. The cherries will remain in inventory reserves until handlers' compliance plans are fulfilled. If handlers engage in post-harvest diversion activities without much delay, then the decision to receive and process cherries will be a good one both for handlers and for growers. On the other hand, if the handlers are unable to earn post-harvest diversion credits in a timely manner, then the cherries harvested, processed and stored in inventory become a burden to the handlers, to the growers and to the industry. Unfortunately, too often such cherries become reserve inventory rather than revenue-generating sales which serves to reduce returns to growers.

HOW THE PROPOSED AMENDMENT WILL OPERATE

As mentioned above, the gist of the amendment is the redefining of the term "handle" so that it does not include grower diverted cherries. With this change, the Optimum Supply Formula (OSF) operates just as it has traditionally, but it does so with a smaller production base than it previously used. Those cherries diverted in the orchards are not subject to restriction as they were before, and handlers may use the certificates generated by this activity pound-for-pound against their restriction obligations in the same manner as they currently do with their post harvest diversion credits. In other words, grower diversion certificates will not be discounted as they currently are. (Please see Tables 1 and 2.) This change eliminates the disincentive for orchard diversions currently present in the marketing order, and it will result in a more tenable outcome for growers and handlers.

The process of how the change works is somewhat technical and will be discussed at length using an example to demonstrate the change. The example is titled "Bottom Line In-Orchard Diversion Credits, Their Impact upon the OSF and Restriction Compliance", is attached to this testimony as Exhibit B, and is incorporated herein by this reference.

The assumptions for this review are:

1. A crop projected in June to be: 300,000,000 pounds;
2. An actual crop of: 300,000,000 pounds;²
3. In-orchard diversions of: 30,000,000 pounds;
4. A free carry in of: 50,000,000 pounds; and
5. A demand of: 170,000,000 pounds

The example has three columns of information. The first is the OSF as it would be calculated in June ("Preliminary"). The second column is the OSF as it would be calculated in September ("Final") under the current marketing order. The third column in the example represents the OSF as it would be calculated in September with the amendment to the order ("Final, Amended").

Before going through the steps of the various formulations, it must be clarified what the in-orchard diversion figure represents and how it plays into the various equations.

In column 1, the OSF operates with the estimate of production generated in June. Any and all cherries that are available to the industry for harvest and processing are included in the estimate. It must be understood, however, that in June it is not known if or how many cherries will be processed; in June it is not known if or how many cherries will be diverted by growers. All that is known at this time is that there is an

² In reality the June estimate and the final production numbers will never coincide with each other. However, for purposes of the discussion of the OSF with the amendment of the order, we will assume these are the same. This will avoid confusion the discussion and analysis.

estimated crop of cherries in the orchards. The preliminary restriction percentages are calculated using this estimate of the crop.

In column 2, the OSF operates with known figures both for the processed tonnage and for the grower diverted cherries. In the example, this latter figure is 30,000,000 pounds.³ This volume of cherries is included as part of the restricted handle as required by §930.10 as currently written. The final restriction percentages are calculated using these diverted cherries as part of the restricted supply.

In column 3 which lays out the OSF as it would operate after the amendment is completed, the restricted supply includes only those cherries that were delivered for processing and processed by handlers. (This is because in-orchard diversions are not part of "handle" for the processors under the proposed §930.10.) The final restriction percentages are calculated using the tonnage actually processed as the restricted supply. As a result of this change in treatment of orchard diverted cherries, the divisor in the OSF calculation for restriction is smaller than it would be under the order as presently crafted.

Restricted Supply

Restricted supply under the amended OSF is the volume of cherries received for processing by handlers. Looking to the elements in the OSF equation, those cherries that were diverted in the orchard, 30,000,000 million pounds, will not be included in the "supply" component by which the restriction is calculated. This is because they are not made available to move into the markets for cherries.

Surplus Cherries

The amount of the excess supply of cherries for the OSF is the volume of cherries available to the industry in excess of the three (3) year average demand for them in the "free" market.

The diverted cherries are included when calculating the excess of cherries produced over the average demand. This is because:

- the diverted cherries were, in fact, produced by growers,
- they were included in the estimate of production done in June,
- if not diverted, they would have been delivered for processing and would have generated available supply for the marketplace.

Thus, in both the current and amended formulations of the OSF, the average demand is compared to the total of produced cherries and the surplus/excess is calculated. In both cases of the example, the surplus is 180,000,000 pounds of cherries.

³ Please note that the 30,000,000 pounds of cherries were part of the estimate of production made in June.

Table 6 - Supply Under the OSF

	OSF (Final)	OSF (Final, Amended)
Processed production		
Restricted	295	265
Unrestricted	<u>5</u>	<u>5</u>
	300	270
Carry-in	50	50
Diverted Cherries		<u>30</u>
	350	350
Average Sales	<u>170</u>	<u>170</u>
Surplus	<u>180</u>	<u>180</u>

In both the current and the amended versions of the OSF, the same amount of cherries is considered “excess” and subject to restriction.

Restriction Calculation

The heart of the OSF is the calculation of the restriction percentage. It is the comparison of the “excess” cherries to the supply of cherries. Although the excess of cherries is the same under the current and the amended OSF formulations, the outcome differs as the degree of restriction.

The calculations for the two formulations are:

Table 7 - Surplus and Percentages

	OSF (Final)	OSF (Final, Amended)
Surplus	180	180
Restricted	<u>295</u>	<u>265</u>
Percentages		
Restricted	61%	68%
Free	39%	32%

The restriction percent in the two formulations is different because of mathematics. While the surplus, i.e. the volume of cherries in excess of demand, remains constant, the divisor in the two calculations changes. Since the divisor in the calculation in the amended OSF is reduced by the amount of cherries diverted in the orchards, there is a mathematical increase in the calculated restriction percentage.

At first blush this outcome appears an incongruous result for an amendment to the order. Why should a change to the OSF be contemplated or proposed when the outcome of it is to increase restriction? It is premature to render this conclusion since this portion of the

analysis is only one-half (½) of the equation. As will be seen in discussing compliance with restriction under the revised OSF, the benefit accruing to handlers with this change exceeds the increase to the restriction percentage.

Market Growth Factor (MGF)

The MGF is a provision in the OSF and a mandate from the USDA that cannot be altered or eliminated. It requires that the cherry industry supply one hundred and ten percent (110%) of the average demand for the “free” market place.

Implementation of this provision is done by releasing to handlers their proportionate interest in ten percent of the average demand, 17,000,000 pounds in the example. The same practice will be followed in the amended OSF as is applied under the current formulation. In both situations, the gross percentages will be reduced by the MGF to yield the net restricted and free percentages.⁴

Table 8 - Market Growth Releases

	OSF (Final)	OSF (Final, Amended)
Surplus	180	180
MGF	(17)	(17)
Net Restricted	<u>163</u>	<u>163</u>
Percentages		
Restricted	55%	62%
Free	45%	38%

Free tonnage and Carry-out

The two formulations of the order will ultimately provide the same free tonnage to the industry and the same carry-out at the end of the year. The process by which this occurs differs in the amended OSF from the current OSF. The difference lies in the fact that the amended OSF requires a larger total release to attain a MGF of 110% of the average “free” market sales.

⁴ While the USDA does not acknowledge “net” percentages, the net figures are quite important to the industry and are widely recognized by handlers and growers as the true restriction figures with which they must deal. The industry will continue to hold this position notwithstanding the USDA’s reticence to do so.

This is how the processes compare:

Table 9 - "Free" tonnage & Carry-out

	OSF (Final)	OSF (Final, Amended)	
Free Tonnage & Carryout			
Free Tonnage			
Carry-over	50	50	
Unrestricted	5	5	
Restricted, "free" portion	115	85	-30
MGF	17	17	
Adjustment to attain 110% of sales	0	30	30
Total supply	187	187	
Sales, Free	<u>170</u>	<u>170</u>	
Carry-out	17	17	

In the amended OSF, the free portion from the restriction production is 30,000,000 million pounds less than that posted in the current OSF formulation. Therefore, for the order to properly supply the markets at one hundred and ten percent (110%) of the average "free" demand, there must be an adjustment, posted here as "adjustment to attain 110% of sales", to the "free" product. When this adjustment is made, the OSF in the amended order will provide the appropriate pounds of cherries to the free market.

Compliance with Restriction

Compliance with the restriction process is imperative in a system where the flow to market of product is being regulated. Handlers must comport with the restriction in the ways delineated in the order. Compliance with the restriction process will be maintained with the amended OSF.

A comparative example of the compliance methods under the amended OSF shows that the amendment will not alter the compliance process. This comparison shows:

Table 10 - Compliance with Restrictions

	OSF (Preliminary)	OSF (Final)	OSF (Final, Amended)
Compliance			
Restricted	180	180	180
Activities			
In-orchard	0	30	30
At-plant	0	0	0
Exports	15	15	15
Market expansion	35	35	35
MGF	17	17	17
Inventory reserves	<u>113</u>	<u>83</u>	<u>83</u>
Total:	<u>180</u>	<u>180</u>	<u>180</u>

Lower Inventory Reserves and Cost Savings

A consequence of the grower diversion process is its impact on handlers' compliance activities, particularly inventory reserves. When growers undertake diversion activities as a result of the amendment, handlers will use these credits in their compliance portfolio as "bottom line" credits.

Assuming that handlers engage in the other diversion options in the same fashion as they would have under the current OSF, the effect will be reflected in reduced inventory reserves. In the above example, the impact is seen most dramatically when comparing either of the compliance programs to the preliminary program. Handlers will maintain less inventory reserves when and if they utilize more of the grower diversion credits as part of their plans. Less inventory reserves and less total supply of cherries should lead to higher prices paid to growers for their fruit.

There are significant savings that will accompany the increased use of in-orchard diversion credits. These include, but certainly are not limited to:

- Grower:
 - Lower harvesting costs \$0.060 per pound
 - Transportation \$0.005 per pound
 - Surcharges - promotion \$0.005 per pound CMI⁵
\$0.005 per pound CIAB
\$0.075 per pound
- Handler
 - variable processing costs for cherries left in the orchard this varies with each handler
 - storage costs for cherries not processed \$0.010 per pound per month⁶

Both the grower savings and the processor savings should lead to increased grower returns for their diverted cherries.

Utilization of Grower In-orchard Diversions In the Amended Order

It is difficult to predict whether or not there will, in fact, be increased utilization of grower in-orchard diversion credits in response to the amendment of the order. One can only make educated guesses about the likely responses.

Grower and Handler Discussion Regarding Diverting Fruit. As has been the case for all of the years of the operation of the marketing order, the decision to deliver cherries for processing or to divert them in the orchard is dependent upon the dialogue between the

⁵ Growers are charged the CMI promotional expenses. It is assumed that the cost of the CIAB promotional expenses is passed on to grower either explicitly or implicitly.

⁶ Storage costs for frozen products can range between \$0.005 and \$0.01 per month or \$0.06 and \$0.12 per pound per year. Goods in dry storage can be stored at less cost. There will be some savings for these, as well.

grower and the handler to which the grower delivers cherries. If the handler encourages the grower to deliver his or her cherries and is willing to pay accordingly, it is likely the grower will, in fact, deliver the cherries. On the other hand, if the grower feels that the expected return for his delivered cherries is likely to be inadequate, he may divert cherries in the orchard. This process will continue under the amended OSF. However, since the amendment to the OSF increases the compliance worth and, consequently, the dollar value of in-orchard diversion certificates, the decisions made by growers may well be quite different.

Looking to the history of orchard diversion activity, it is apparent that the volume of in-orchard diversions increases with crop size, in general.

Large crops - When the crops are very large, over 300,000,000 pounds, there undoubtedly will be significant in-orchard diversion activity. When there is this large volume of cherries to process, the supply far exceeds the demand, the industry faces capacity constraints in processing the fruit, grower opportunities to deliver cherries are often limited and the quality of the cherries suffers. In these situations handlers and growers both conclude that orchard diversions are warranted.

The same logic will continue to pertain for large crops when the proposed amendment is implemented. In fact, grower in-orchard diversions will probably increase above the historical level in years with large crops under the amendment since restriction will be higher, handlers will need more compliance activities to meet their obligations and, most importantly, all parties will know that the in-orchard diversion credits will be pound-for-pound credits against restriction obligations.

Furthermore, growers will be more inclined to divert cherries knowing that there will be a stronger demand for their certificates and knowing that the price paid to them for their delivered cherries will be significantly reduced due to crop size. (See Exhibit C attached)

Medium Crops - When the tart cherry crop is more moderate, from 225,000,000 to 300,000,000 pounds, in-orchard diversions are generally more moderate. The industry does not face the same capacity constraints; growers do not face delivery quotas and the quality of the cherries is generally better since the trees are not overstressed; deliveries of cherries can proceed in a timely fashion as the fruit ripens. In these instances the degree of diversion has ranged from 2.25% to 6.49% of the restricted crop.

While much of the same logic will apply in medium sized crop years under the amended OSF as have applied under the current OSF, it is likely that we will see proportionately more diversion. The incentives to divert in the orchard will probably be greater under the amended OSF. The interplay of grower prices and diversion activities will be much more dynamic in these sized crops. Growers might elect to divert in these situations where they might otherwise have delivered under the existing OSF. Handlers will continue to need compliance alternatives with the need for these increasing as the crop size increases. Anticipated prices for delivered cherries will play an important component in the decision to deliver or divert.

Small Crops - In small crop years there tend to be very little in-orchard diversion. Handlers want to protect their markets so they encourage delivery of cherries for processing. The price

for delivered cherries is much higher in short crop years than in medium or large crop years. The interplay of prices for delivered cherries and diversion certificates will continue to favor the delivery of cherries in short years.

GROWER PRICES AND IN-ORCHARD DIVERSION ACTIVITY

Grower prices tend to have an inverse relation to supplies. (See "U.S. Processed Tart Cherry Prices - Prices Received by Growers" attached as Exhibit C.) When there are large crops grown, delivered and processed, grower returns are lessened. By contrast, in shorter years the returns to growers tend to be increased. Given this relationship, it may be more prudent for growers to leave cherries in the orchard than to deliver them for processing.

Under the present construct of the marketing order and the OSF, the impact on pricing of grower diversion activities has not been very pronounced. Under the proposed amendment of the order this influence will increase. Should the growers engage in increased in-orchard diversions, they could influence the supply of available cherries and, thereby, increase the returns they receive. This is a principal goal of marketing orders and should be encouraged.

GROWER RETURNS UNDER THE MARKETING ORDER AND AMENDMENT

While grower returns under the marketing order are not a direct issue for this amendment, this topic is always of great interest to the industry and to the USDA in assessing the benefits of the marketing order. Reviewing information reported by NASS, USDA in its Non-Citrus Fruit and Nut publications⁷, it can be demonstrated that the marketing order has, in fact, accomplished the stated purpose of increasing grower returns.

In discussing grower return, there is a tendency to speak only in terms of grower price per pound for their cherries. Grower pricing has been stabilized under the marketing order, and the degree of the inverse relationship between crop size and grower price has, in fact, been lessened. The downward trend in pricing experienced from 1982 through 1995 has been stopped, reversed and stabilized. (See Exhibit C, attached.) These aspects are very important and valuable outcomes from the operation of the marketing order.

While price per pound is important, it may be more demonstrative to look at the farm gate value as a measure success of the marketing order. Farm gate value calculates the industry's total return by multiplying the reported grower price by the pounds produced. Using this

⁷ See the exhibits attached to this testimony and to the materials entered into the record by the Economic Analysis and Program Planning Branch, F&V, AMS, USDA

calculation, the following results are seen:

Table 11 - Farm Gate Values

CIAB vs. EARLIER YEARS		Change	
	Total \$\$	\$\$	Percent
Average during CIAB	\$ 57,214	\$ 10,516	22.5%
Average 1982 to 1996	\$ 46,699		
PERIODS of TIME (5 Yr. blocks when possible)			
	Total \$\$	\$\$	Percent
1982 - 1986	\$ 55,454		
1987 - 1991	\$ 45,249	\$ (10,204)	-18.4%
1992 - 1996	\$ 39,393	\$ (5,857)	-12.9%
1997 - 2001	\$ 50,848	\$ 11,455	29.1%
2002 - 2006	\$ 59,084	\$ 8,236	16.2%
2007 - 2010	\$ 62,836	\$ 3,752	6.3%

The farm gate value for the tart cherry industry has climbed steadily under the umbrella of the marketing order. During this period the significant decline in farm gate value seen from 1982 through 1996 was arrested and reversed. Farm gate value has increased steadily during the years of the marketing order. (See "Farm Gate Value By Year and for Other Periods" attached as Exhibit D.)

The proposed amendment for "bottom line credits" will improve the grower return even more. It will further restrain the tendency for grower prices to trend inversely to the crop size; it will alter the supply/demand relationship of tart cherries in the market place; it will lead to stronger farm gate values for the growers.

CONCLUSION

The amendment of the marketing order to allow for "bottom line" grower in-orchard diversion credits will improve the functioning of the marketing order, will enhance the likelihood of in-orchard diversions in those years when it is most appropriate to do so, will place growers on a more equal footing to handlers in dealing with restrictions on the crop and will improve returns to growers. It will not adversely affect the tart cherry industry in any known or demonstrable manner. It is supported by the vast majority of the tart cherry industry. The proposal should, therefore, be implemented as requested by the industry.

EXHIBITS TO TESTIMONY

- A. Review of In-orchard Diversion Activities
- B. Bottom Line In-Orchard Diversion Credits, Their Impact upon the OSF and Restriction Compliance
- C. Total US Production, USDA Grower Price
- D. Farm Gate Value by Year and for Other Periods

In-orchard Diversion Activity Reviewed by Crop Size and Crop Year

In-orchard Diversions and Restricted Handle

Sorted by Restricted Pounds
(Reported in Millions of Pounds)

Year	In-orchard #	Rest. #	% of Rest. #	Restriction %	
				Prelim. %	Final %
2002		60		0%	0% No Restriction
2010	3.52	120	2.93%	40%	58% Small Crop
2004	0.17	202	0.08%	30%	28%
2008	0.09	203	0.04%	10%	27%
2003	0.03	210	0.01%	23%	25%
2000	5.20	231	2.25%	48%	50%
2007	6.00	236	2.54%	52%	43%
1997	2.27	239	0.95%	34%	45%
1999	0.00	259	0%	0%	0% No Restriction
2006	16.28	251	6.49%	40%	45%
2005	1.39	264	0.53%	36%	48%
1998	42.58	305	13.96%	34%	40%
2001	60.90	336	18.13%	36%	41%
2009	37.75	338	11.17%	49%	68%

2002 not included in average or on chart

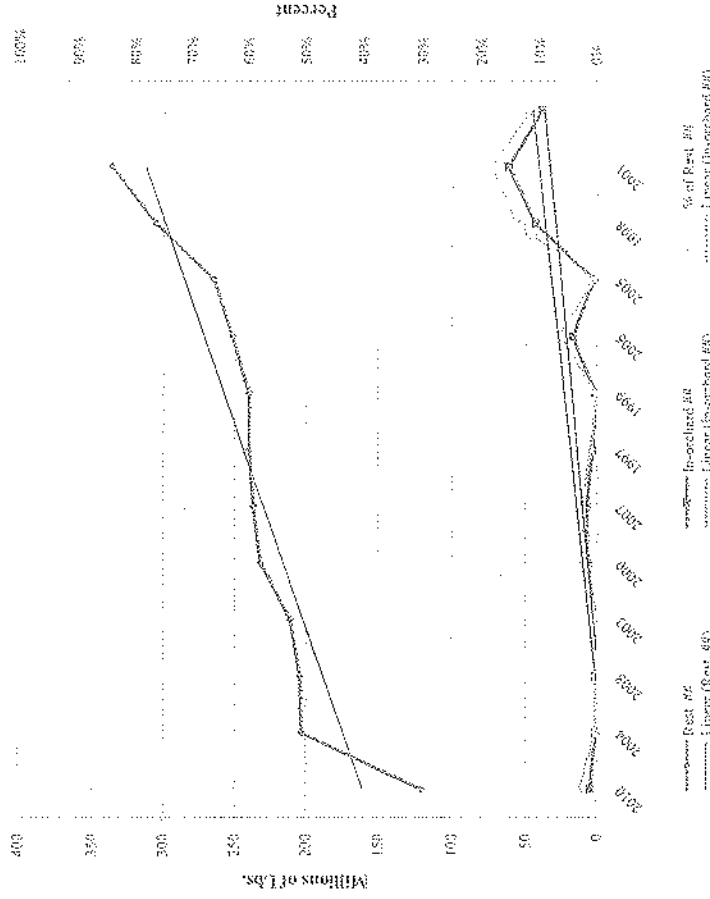
Average
4.55%

Sorted by Crop Year

(Reported in Millions of Pounds)

Year	In-orchard #	Rest. #	% of Rest. #	Restriction %	
				Prelim. %	Final %
1997	2.27	239	0.95%	34%	45%
1998	42.58	305	13.96%	34%	40%
1999		239		0%	0% No Restriction
2000	5.20	231	2.25%	48%	50%
2001	60.90	336	18.13%	36%	41%
2002		60		0%	0% No Restriction
2003	0.03	210	0.01%	23%	25%
2004	0.17	202	0.08%	30%	28%
2005	1.39	264	0%	36%	48%
2006	16.28	251	6.49%	40%	45%
2007	6.00	236	2.54%	52%	43%
2008	0.09	203	0.04%	10%	27%
2009	37.75	338	11.17%	49%	68%
2010	3.52	120	2.93%	40%	58% Small Crop

In-Orchard Diversion Activity in Relation to Restricted Crop



Analysis of Pounds Diversed in the Orchard Compared to Restricted Pounds

SUMMARY OUTPUT

<i>Regression Statistics</i>	
Multiple R	0.788849295
R Square	0.62228321
Adjusted R Square	0.58794532
Standard Error	12.98045663
Observations	13

ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	1	3053.465945	3053.465945	18.12234852	0.001349705
Residual	11	1853.409086	168.491735		
Total	12	4906.875031			

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>Lower 95.0%</i>	<i>Upper 95.0%</i>
Intercept	-52.49232349	15.92646526	-3.295917998	0.007129447	-87.54623715	-17.43840983	-87.54623715	-17.43840983
X Variable 1	0.27050416	0.063542853	4.257035179	0.001349705	0.130647284	0.410361037	0.130647284	0.410361037

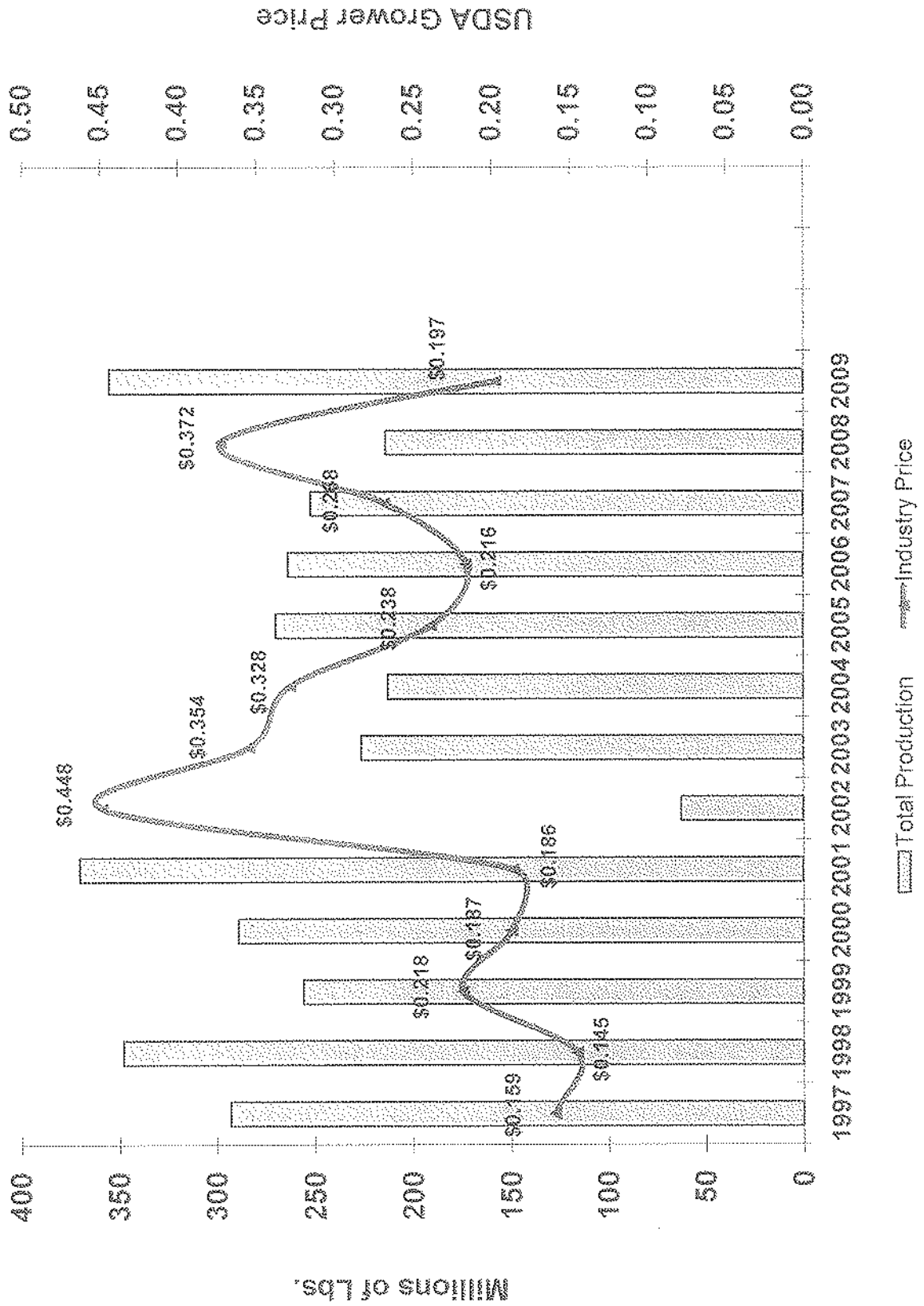
RESIDUAL OUTPUT

<i>Observation</i>	<i>Predicted Y</i>	<i>Residuals</i>
1	-20.03182423	23.55182423
2	2.149516928	-1.979516928
3	2.420021088	-2.330021088
4	4.313550211	-4.283550211
5	9.994137581	-4.794137581
6	11.34665838	-5.346658384
7	12.15817087	-9.888170865
8	12.15817087	-12.15817087
9	15.40422079	0.875779209
10	18.92077488	-17.53077488
11	30.01144546	12.56855454
12	38.59707443	22.50292557
13	38.93808275	-1.188082752

"Bottom Line" In-Orchard Diversion Credits
 Their Impact upon the OSF and Restriction Compliance
 Assuming Greater Grower Diversions in Response to Revision Proposal

	OSF (Preliminary)		OSF (Final)		OSF (Final, Amended)	
Supply						
Processed Production						
Restricted	295		265		265	
In-orchard as is (considered "handle")	0		30		N/A	
ST, Restricted:	295		295		265	
Unrestricted	5		5		5	
Carry-in	300		300		270	
ST, Processed Production:	50		50		50	
Orchard Diversions per amendment (not considered "handle")	N/A		N/A		30	
	350		350		350	
Demand						
Sales	170		170		170	
Surplus	180		180		180	
Gross Restricted & Free						
Restricted pounds (Surplus / Restricted)	61%	## 180	61%	## 180	68%	## 180
Free tonnage from:						
Restricted districts	39%	115	39%	115	32%	85
Unrestricted districts		5		5		5
ST, Free:		120		120		90
Market Growth	17		17		17	
Adjusted Surplus	163		163		163	
Net Restricted & Free						
Restricted	55%	## 163	55%	## 163	62%	## 163
Free	45%	## 132	45%	## 102	30%	## 102
Compliance						
Restricted	180		180		180	
Activities						
In-orchard			30		30	
At-plant	0		0		0	
Exports	15		15		15	
Market expansion	35		35		35	
MGF	17		17		17	
Inv. Res. (current year)	113		83		83	
Total, compliance	180		180		180	
Impact upon Reserves by Type						
Primary	50		50		50	
Secondary						
BOY	85		95		85	
Added	113		83		83	
Subtotal:	198		168		168	
Total reserves:	248		218		218	
Free tonnage & carry-out						
Free tonnage						
Carry-over	50		50		50	
Unrestricted	5		5		5	
Restricted, "free" portion	115		115		85	
MGF	17		17		17	
Adjustment to attain 110% of sales	0		0		30	
Total supply	187		187		187	
Sales, free	170		170		170	
Carry-out	17		17		17	

Total US Production, USDA Grower Price

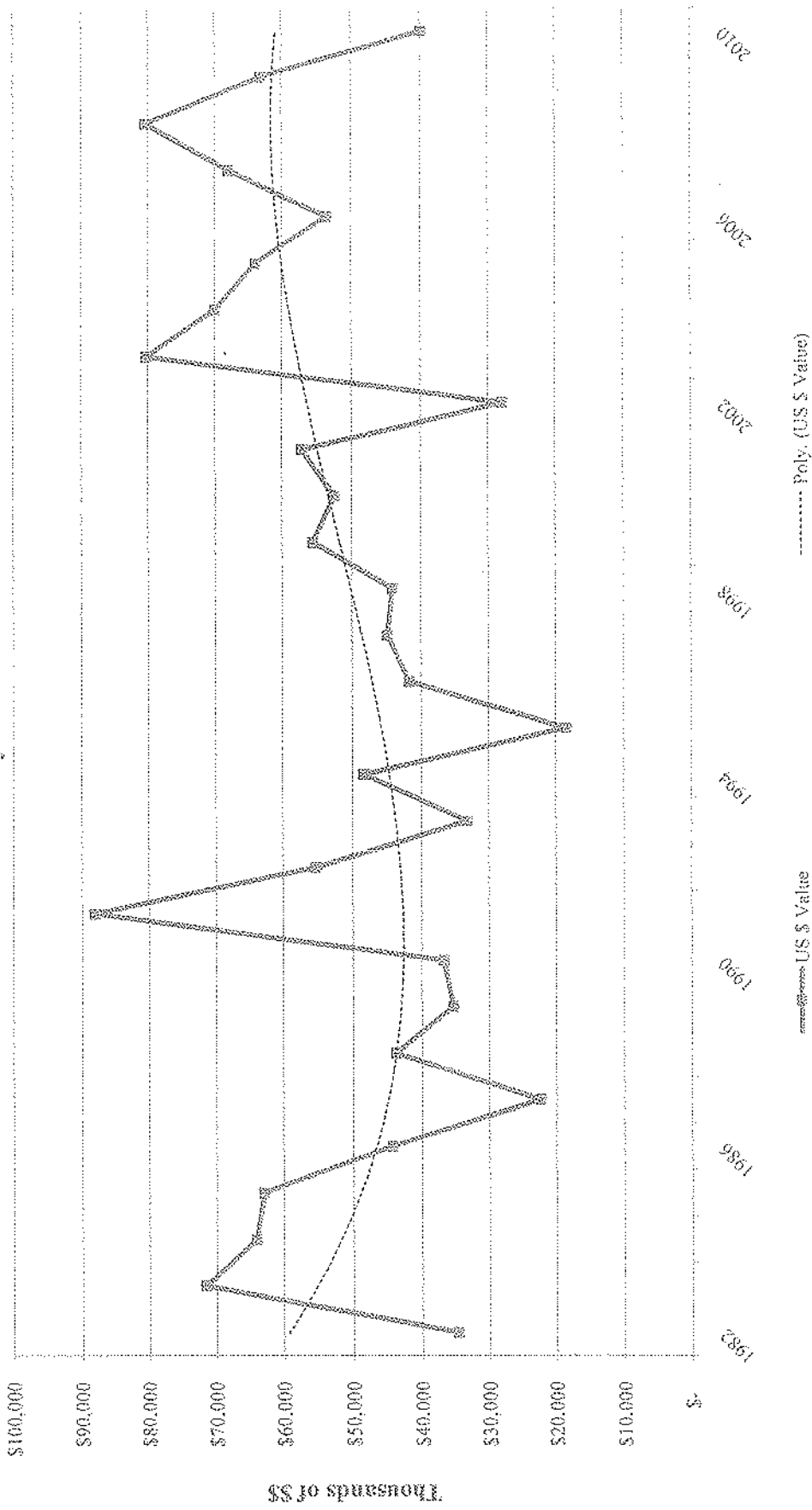


Farm Gate Value By Year and for Other Periods
By Year, 5 Yr. Avg., Moving 5 Yr. Avg. & CIAB Years

Year	US \$ Value	5 year Avg.	CIAB vs.	
			Non-CIAB	Moving 5Yr Avg
1982	\$ 34,645			
1983	\$ 71,506			
1984	\$ 64,004			
1985	\$ 62,848			\$ 58,251
1986	\$ 44,266	\$ 55,454		\$ 60,656
1987	\$ 22,357			\$ 48,369
1988	\$ 43,775			\$ 43,312
1989	\$ 35,348			\$ 36,437
1990	\$ 36,685			\$ 34,541
1991	\$ 88,082	\$ 45,249		\$ 50,973
1992	\$ 55,230			\$ 53,836
1993	\$ 33,145			\$ 53,286
1994	\$ 48,386			\$ 56,211
1995	\$ 18,456			\$ 38,804
1996	\$ 41,747	\$ 39,393	\$ 46,699	\$ 35,434
CIAB ↑ 1997	\$ 44,911			\$ 38,375
1998	\$ 44,186			\$ 37,325
1999	\$ 55,505			\$ 46,587
2000	\$ 52,488			\$ 49,273
2001	\$ 57,150	\$ 50,848		\$ 52,332
2002	\$ 27,879			\$ 48,256
2003	\$ 80,210			\$ 54,432
2004	\$ 69,941			\$ 58,795
2005	\$ 63,936			\$ 60,492
2006	\$ 53,454	\$ 59,084		\$ 66,885
2007	\$ 67,923			\$ 63,814
2008	\$ 80,344			\$ 66,414
2009	\$ 63,231			\$ 66,238
↓ 2010	\$ 39,844	\$ 62,836	\$ 57,214	\$ 62,836

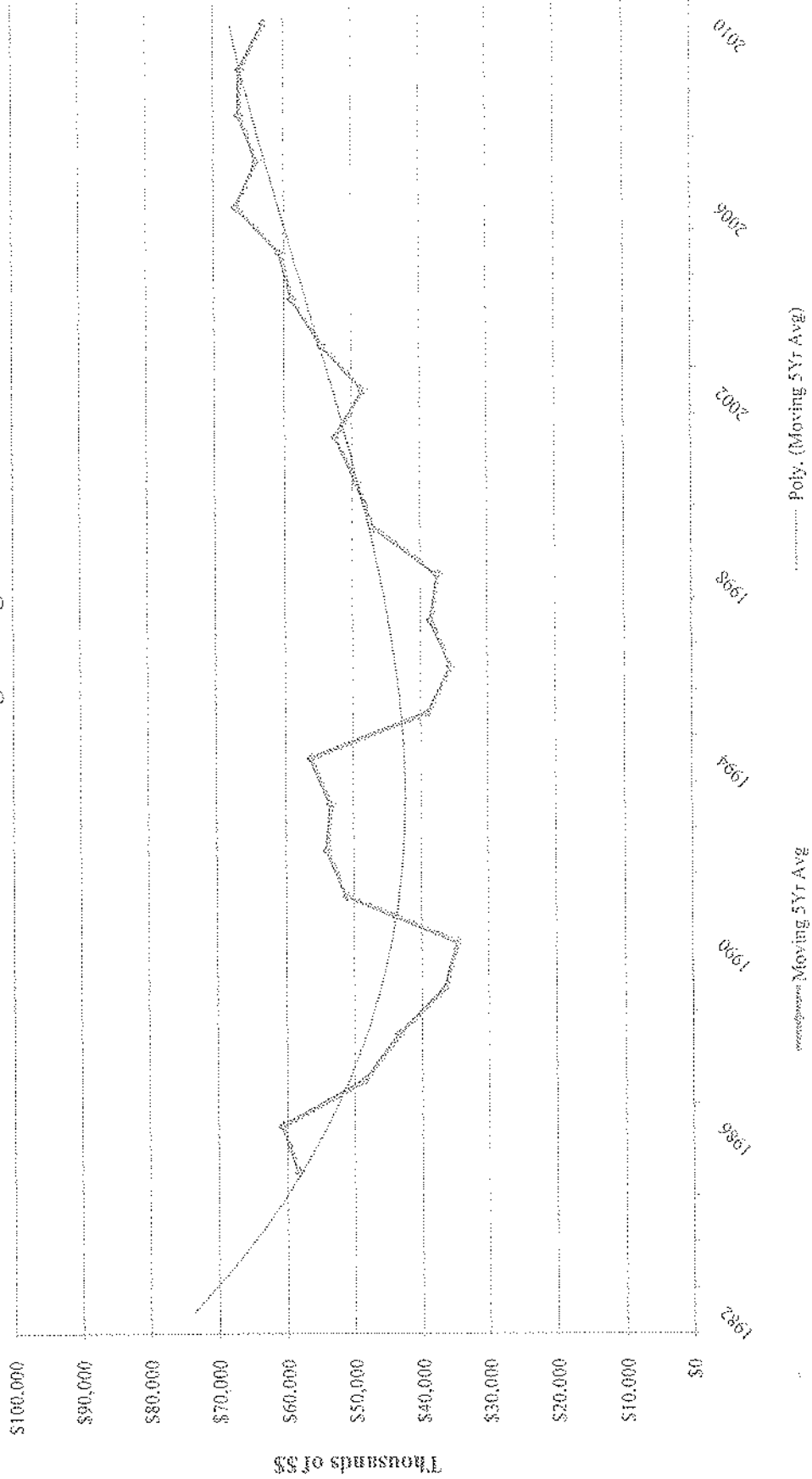
Source: NASS, USDA -- Non-Citrus Fruit and Nuts

Farm Gate Value By Year



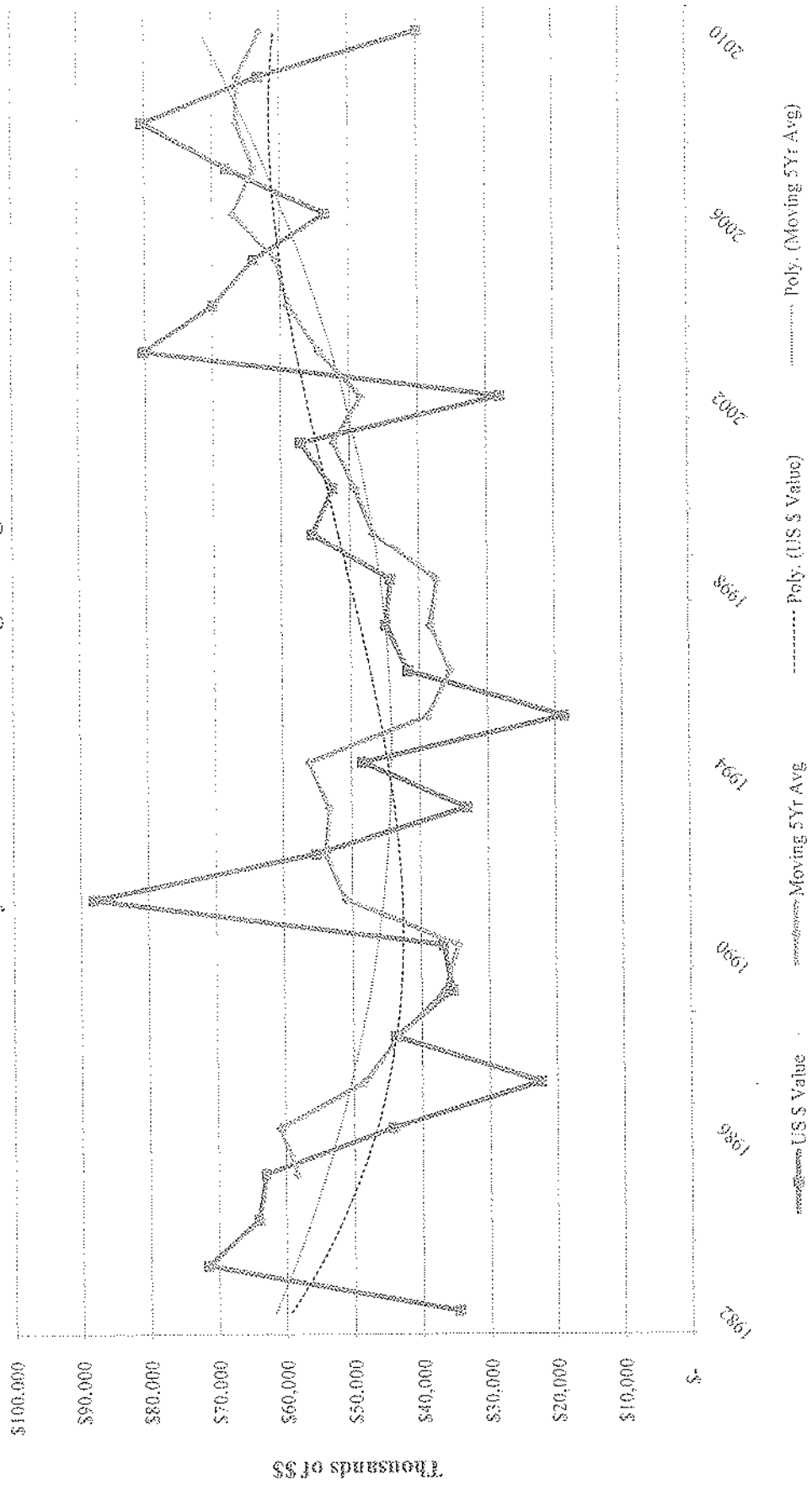
Source: NASS, USDA -- NonCitrus Fruits and Nuts

Farm Gate Value
5 Yr Moving Average



Source: NASS, USDA -- NonCitrus Fruits and Nuts

**Farm Gate Value
By Year and 5 Yr Moving Average**



Source: NASS, USDA -- Non-Citrus Fruits and Nuts