Prepared Testimony of
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Re: Proposal No. 3, "Netting for Supply Plants"

Federal Milk Market Order Hearing
Docket Nos. AO-368-A30; AO-380-A18; DA-01-08
April 16, 2002

My name is Daniel S. McBride. I am testifying regarding Proposal No. 3, on behalf of Northwest Dairy Association, which is usually referred to as "NDA". In earlier testimony I have introduced myself, as well as NDA and WestFarm Foods.

NDA Opposes Proposal No. 3. This proposal amends the pool supply plant provision in Section 7 of the Western Order (Section 135.7(c)). A pool supply plant is typically a manufacturing plant, which might become a pool plant by transferring or diverting sufficient quantities of milk to distributing plants. For example, the WestFarm Foods drying plant at Caldwell might someday qualify as a pool supply plant, serving the Boise pool plants.

The qualifications for a supply plant *[set forth in Section 7(c)]* specify that the quantity of milk transferred to regular distributing plants *[defined under Section 7(a)]* and/or to specialty distributing plants making products that are ultra-pasteurized or aseptically processed *[defined under Section 7(b)]* must be at least 35% of the milk "associated with" the supply plant (by which is meant: milk that was received, or that could have been received but was instead diverted directly to a distributing plant).

Proposal No. 3 would amend the pool supply plant provision to require that any quantity of milk transferred to a distributing plant and back out, would be reduced from the quantity of milk used in determining the plant's qualification as a "pool supply plant". To illustrate this, if the Caldwell plant were to be qualified as a supply plant, and if milk were to move to the WestFarm Foods distributing plant at Boise, then any transfers out of Boise to another plant or back to Caldwell could not be counted in the 35% qualification amount.

This proposed change is a concern to NDA, because at some point it may very well be appropriate to designate the Caldwell plant (or the WestFarm Foods plant at Jerome) as a pool supply plant to the Class I market.

Clearly, the impact of this proposal would be to reduce the amount of milk that presently can be pooled under this provision. Consistent with the position taken with respect to other proposals in this hearing, we simply think that is the wrong direction for this Western Federal order.

Today, the Western order area has so much milk relative to the amount of Class I sales, that each distributing plant has become important as a base of diversions in order to keep milk pooled. The goal of this proposal is, effectively, to reduce the amount of milk that can be pooled on the order. For reasons explained in connection with later proposals, that would not be wise policy because it would simply lead to disorderly marketing conditions.

NDA submits that under Federal order philosophy, the fundamental objective of the pooling provisions of an order is to provide the incentive to supply the fluid milk needs of the market, while also accommodating efficiently the reserve supplies of milk that are available to serve or balance those fluid needs. For that reason, the delivery percentages for pool supply plants and other types of reserve supply plants are set to ensure that they will perform when needed and supply the fluid market. Shipping requirements for such plants must be based on the supply/demand relationship in the marketing area, and should be adjusted if necessary to ensure that the needs of pool distributing plants are met. Indeed, the need to adjust to market needs is recognized by the current order language, which allows the Market Administrator to reconsider and adjust this percentage.

I will be very surprised if evidence is offered at this hearing to show that <u>any</u> plant that <u>might</u> someday qualify as a pool supply plant -- or other type of reserve plant -- is failing to make pooled milk available to the Class I market after being requested by a plant to do so. I can testify that our organization has <u>never</u> been advised that a distributing plant's needs are not being met, much less asked to supply any distributing plant that was short. We would willingly supply such a plant if asked, and I'm sure others would as well. But we have never once been asked to do so. I sincerely doubt there will be evidence – or could be evidence -- that <u>any</u> distributing plant in this Western order market has been unable to obtain a sufficient quantity of milk if its needs have been announced with sufficient time to respond.

Without such evidence, this proposal should be rejected. We are not aware of any effort to use the existing language in the order which permits the Market Administrator to make changes administratively in the delivery percentage requirements. That language was put into the order precisely to deal with such a hypothetical failure to deliver to the Class I market. There is no need to change this order to deal in advance with a problem that does not now exist, and for which the order already provides an effective solution.

Given these traditional purposes of a pool supply plant, one must wonder why there are no pool supply plants designated in the Western order. We submit that the 35% delivery requirement is too high to be utilized under current conditions in this market. The absurdity of the 35% requirement can be seen by reference to our Caldwell, Idaho plant mentioned above. If it were to be a pool supply plant, it would be required to ship or divert approximately 700,000 of the 2,000,000 or so pounds that it receives each day. There simply is no unmet need of that magnitude anywhere in the Western order market today.

Indeed, if one thinks about it, if the goal is to make more milk available to the distributing plants, the solution should be to make it more attractive to become a supply plant, rather than more difficult. It simply makes no sense to require that a cheese plant deliver 35% of its milk to others. It is simply too expensive for the operator of a capital intensive facility like a cheese plant to not utilize it at 80% to 90% efficiency. But if the percentage were lower – say 10% or 20% -- then more cheese plants may be willing to trade off the advantages of pooling for the obligation to deliver milk to distributing plants when needed. Lower delivery percentages would seem to be the better solution. We note that the pool supply plant provision of the Upper Midwest order is only 10%, in a market with similar class utilization.

The historical purpose of the delivery percentages in Federal order pool supply plant provisions has not been, and should not be, to limit or reduce the amount of milk that can be pooled, if the milk associated with that supply plant is, in fact, available to the Class I market and willing to serve it. If the purpose of this proposal is instead to limit the quantity of milk that can be pooled, it should be rejected. When shipping requirements are too restrictive, it simply causes handlers to move milk inefficiently, uneconomically, and unnecessarily or to find some other way to achieve pooling (including ways that can create disorderly markets). Of more concern to us is the practice of "selling pooling rights" as a way to achieve pooling. I will discuss that practice in more detail in a few moments, after finishing my comments regarding Proposal No. 3.

The last point I would like to make for the record about Proposal No. 3 is that none of the other Federal orders has such a "netting" provision, and there is nothing different about market conditions here to justify such a provision. Throughout the Federal order system, pool supply plants and other reserve plants benefit the market because they are able to balance milk supplies required by the fluid market and to pool milk in an orderly fashion so that disorderly marketing conditions do not occur. The obligation of such plants to serve the needs of the pool distributing plants can be regulated through the percentage delivery requirements, without a "netting" rule.

To summarize NDA's position on Proposal No. 3, if milk that is associated with pool supply plants is not serving the Class I market when needed, then the percentage requirements should be tightened administratively by the Market Administrator. However, we are not aware that such a situation has existed in the Western order. Given that, the proposal seems designed to increase sales of pooling rights, rather than attract more milk to pool distributing plants.

While NDA strongly opposes this provision, we would like to note one technical problem with it. Should the Department determine to make a change, any transfers to another pool plant should not be subtracted out. That is because the plant of first receipt did receive the milk, and it ultimately is handled by a pool distributing plant – just a different distributing plant. For example, if a distributing plant that also makes ice cream should sell a load of skim milk to a bottling plant that needs skim milk, there is no reason to reduce that transfer from the first plant's qualifying amounts, because the deliveries have still occurred (indirectly rather than directly). Indeed, it is entirely consistent with the concept of a pool supply plant that its milk supply more than one distributing plant.

General Concern About "Sale of Pooling Rights". At this point, I would like to add some general testimony about a subject that will come up in connection with many of the proposals at this hearing, including Proposal No. 3. These proposals seem more likely to increase the value of pooling rights, than to increase the availability of milk needed by distributing plants.

USDA should avoid creating "quotas" or other artificial values without specific authority from Congress to do so. It is useful to recall that some twenty years ago, the statutory authority for Federal Order Class I base plans was removed from the enabling Act, in part because there was no longer political support for a "quota system" by which shipping rights (in that case, the rights of producers to returns from the Class I market) had been created by USDA, granted to producers, and then bought and sold by their owners. Such a system exists today, under the California state milk order system.

I fear that the Dairy Division's institutional memory may not recall those days, nor the controversies that surrounded the sale of Class I Base in the old Puget Sound Federal order. At the time, I worked for the Federal Order office which administered the Puget Sound and other Northwest orders. I strongly suspect that if we could ask the late Herb Forrest, who ran the Dairy Division in those days, he would agree with our analogy to the old Class I base plan and he would also be dismayed at the sale of pooling rights that has arisen since the so-called "Reform" of Federal orders.

I do not believe that the Department, nor the Secretary at the time, intended to create conditions for the sale of pooling rights. But I am concerned by the failure of the Department to have addressed that abuse during the recent Order 30 hearing process. Today, milk from Idaho which can not be pooled in this Western order continues to be pooled on Order 30, for a fee, and the recent Order 30 decision will not impact that practice.

Perhaps that issue was not addressed in Order 30 because one of the two fundamental causes of the now widespread practice of "distant pooling for a fee" must be addressed in a national order hearing. I refer to the concept of a unified national price surface, which was introduced during the "reform" process, and which replaced the earlier concept that distant milk would be priced relative to its ability to serve the population centers in a specific order's marketing area. We are not today criticizing the concept of a national Class I pricing surface, but we strongly believe that it makes no sense for the prices of milk at out-of-order manufacturing plant locations to be set with respect to that same price surface.

The relevance of all this to this hearing – and a key point we want to make to the Department during these proceedings – is that the other aspect of Federal orders that leads to the practice of selling pooling rights is restrictive pooling requirements which make it difficult or impossible for a dairy farmer to become pooled on his local order.

In this hearing, Northwest Dairy Association is asking the Secretary to recognize that one reason Idaho milk is pooled other orders – as was testified to at other hearings, but which I can confirm in this proceeding – is that the pooling requirements of the Western order are already too tight to permit the region's milk to be pooled here. Given that, it makes no sense to tighten the Western order pooling requirements even further.

To summarize this discussion regarding the sale of pooling rights, I will bring it back to Proposal No. 3 by saying that, as near as we can see, the only practical effect of this Proposal and the companion proposals that tighten pooling requirements would be to make pooling rights more valuable, and to make the sale of pooling rights more lucrative. What Proposal No. 3 and the other proposals will not do is make more milk available to distributing plants.

I would be happy to answer any questions.

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