

**TESTIMONY OF DUANE BRANDSMA****In The Matter of: Arizona, Las Vegas and Pacific Northwest Milk Marketing Areas****Docket No. AO-368-832; AO-271-837; DA-03-404**

My name is Duane Brandsma, and I am an owner and plant manager of Edaleen Dairy, located in Lynden, Washington. Our plant is located just south of the Canadian border and east of Bellingham, Washington. We are entirely a family owned and operated business. The business was founded by my father and mother, Ed and Aileen Brandsma, who remain owners. My wife and I, my sister and her husband, Rob Heerspink, and my other sister and her husband, Mitch Moorlag, are also owners. We are opposed to all of the proposed amendments submitted at this hearing.

As I began to develop my testimony after hearing eight (8) days worth of testimony in Phoenix and Seattle, I was not sure whether I should stand up here and tell the Secretary that we are an efficient plant delivering product at a reasonable price to the consuming public or should I try to explain to the Secretary that we have inefficiencies and therefore we deserve some kind of regulatory break to deal with those inefficiencies. Frankly, the last is an absurd position. I do not believe, and after hearing the testimony of Ron Knutson, I am convinced that producer-handlers are no more or less efficient than other handlers.

The simple point of a producer-handler is that he is not purchasing milk from anyone. He is handling his own milk produced on his own farm and is taking the full risk of both being the owner of the farm and the owner of the plant. This risk cannot be overstated. If you are only a producer and one milk plant can no longer process your milk, you can deliver that milk to another handler, and

you have no economic responsibility for the future success or viability of that milk plant. If it fails, it fails, and you have a lost customer but no more. Similarly, if you are operating a milk plant and the producer cannot supply milk, you are not out anything. You are able to acquire that milk from some other source, and you have no legal or economic obligation to take care of that producer or continue to provide at a market or otherwise deal with its production.

Let me give you some examples. If I am operating my plant as a producer-handler, which we are, and some health or environmental issue arises that makes milk from our farms unavailable, I may be able to purchase milk from other sources at a price. Nonetheless, I have a continuing obligation to keep the plant operating and profitable but also available to the farm that we own. Moreover, I have a double cost. I have the cost of the milk that I purchased from the outside supplier, but I still have the cost of producing the milk that we had rejected from our own farm.

Another example explains this. If I am operating a farm as a producer-handler, and I lose a sale at the plant, I still have the milk production coming from the farm which I have to pay for even though I do not have a market for that product. A regulated handler does not have that risk but can change its production as it wishes based upon its sales. David Beene testified exactly what can happen when those stars align. When it does happen, the producer-handler faces the loss of its plant. We were almost in the same situation when Starbucks terminated our contract, but Starbucks gave us enough time to replace that sale with numerous other sales, and we worked hard to find new customers.

The reason that there is risk to both the farm and the plant is because a producer-handler is a single economic entity. A producer-handler does not "lose money" at the plant or at the farm. At the end of the day, the entire business either loses or makes money. Cost accounting does not change

that reality.

When the proponents talk about creating some assessment that we would have to pay into a pool, it is a cost that is going to be borne by the whole enterprise. So, when the Secretary would require us to make payments into the producer pool based upon our own production that we are marketing, it will be an imposition on the producer as much as it will be on the handler.

Other discussions at this hearing have dealt with cost accounting and the fact that producer-handlers get the difference between Class I and the blend price. This argument has only come from those who do not operate producer-handlers and have no understanding of what a producer-handler is or how it operates.

For a producer-handler, the blend price is a meaningless number. That figure has no bearing whatsoever in terms of the cost of operating our farm or the price at which we sell our milk. The only relevance in this hearing is that we would pay into the pool the difference between Class I and the blend price which would necessarily be a reduced price because we do not sell our milk on the basis of a blend price. In fact, our efforts are to sell milk at the highest price the market will bear, and we do not intentionally sell milk at less than Class price. If it happens, it happens. But, the Class I price is not a basis for pricing our milk. Instead, it is to our advantage that the market price be as high as possible.

It is also our advantage to have the market price exceed our cost. That is what business is all about. In the last several years, plants who are regulated have only had to pay the Class I price for their milk. In some cases that price has been lower than the cost of production. When that happens, the producer-handler is placed at a distinct disadvantage, but that situation has not been mentioned by the proponents.

What really matters to Edaleen Dairy, and all of the other producer-handlers, is that the revenue we earn from the sale of our milk exceeds the cost to produce the finished product. We try to make an overall profit on the operation. If our costs of producing milk and bottling the milk (or the cost of disposition outside of Class I) is less than the amount of money earned through the sale of such product(s), then we are a profitable enterprise. The blend price is irrelevant to this standard financial equation for any enterprise:

$$(\text{Sales} - \text{Costs of Goods Sold} = \text{Gross Profit}).$$

To illustrate the fallacy of the relevancy of the blend price to a producer-handler, a comparison of costs of milk production to the blend price shows how different they are. Where classified pricing clearly defines the cost of raw product to a pool distributing plant, the producer-handler's cost of raw milk encompasses its cost of production including feed costs, land costs, livestock costs, and other farm related expenses and investments.

The idea that the producer handler can make a profit by receiving the blend price for its milk is false. Regular reports are prepared by the California Department of Food and Agriculture documenting the cost to produce a single hundredweight of milk in California. Likewise, the Economic Research Service of USDA compiles similar information for other areas of the country. I would ask that the Secretary take official notice of the ERS data, which can be found on the Internet at <http://www.ers.usda.gov/Data/ CostsAndReturns/testpick.htm#milkproduction>. This ERS data for California and Idaho, the two states closest to Orders 124 and 131, has been incorporated into the tables accompanying this statement.

The first two tables accompanying this statement summarize this cost of production information. It compares, for various months when cost data was available, the cost of production,

as reported by the previously identified sources against the FMMO blend price for Orders 124 and 131. The final column in each table shows that, not infrequently, the cost of producing milk exceeds the blend price received by producers. In Idaho, which is the closest state to Order 124 for which data was available, ERS reports that the cost of production exceeded the blend price by over \$4.50 per hundredweight for the first eleven months of 2003. In markets such as these, producer-handlers have been stressed to sell at competitive prices, which did not meet their production costs. If producer-handlers were required to pay additional funds into the pool, these expenditures would be nothing but pure losses—assessments that would drive them out of business.

Some accounting firms that specialize in dairy accounting produce periodic composite statements for their universe of clients which including the cost of production on a per hundredweight basis. These composite statements are consistent with the data and conclusions on the attached tables. The fact that the cost of production has exceeded the blend price in recent years is well known in the industry. I would seriously doubt that any of the cooperative proponents would testify that their members have been consistently profitable receiving blend prices.

In fact, the cost of production squeeze has been so great in recent years that we feel that handlers paying minimum prices have had a cost advantage over producer-handlers.

Unmentioned so far in this hearing is the ability of cooperatives to use their ability to reblend and pay producers less than the blend price to subsidize their bottling operations such that those plants are paying less than the minimum prices.

The proponents have offered testimony to “prove” the alleged negative impact that producer-handlers are having on these marketing areas. Their arguments have been that: (1) the quantity of the Class I market “controlled” by producer-handlers is growing “unabated” and (2) producer-

handlers have exerted such fierce pricing pressure on the marketplace that others cannot compete.

Attached to my testimony is a chart which was prepared by Charlie Flannigan of Mallorie's Dairy using the information found in Exhibit 5. This shows the trend lines of both the Class I usage in the market by pool plants and the Class I usage by producer-handlers. Based upon the change in that relationship in the last two years I estimate that producer-handler milk will equal processor milk in the year 1950. Yes, I said 1950 because the percentages are going down and not going up.

If this is the kind of "unbridled growth" that the Secretary wishes to use to make determinations, then I hate to think what type of "growth" it would take to show otherwise. We would have to show a declining market share of 10 percent or 20 percent to show that we cease to be a "menace."

There is some repeated assertion that there are named and unnamed producers of such a size that they could become producer-handlers and take over significant Class I sales. This potential has existed in the Arizona market for many years, and the current situation is no different. It would be premature to enact regulations dealing with marketing conditions that do not currently exist. If and when a large producer would decide to enter the market as a producer-handler, the marketing conditions may be such and that producer-handler's operation designed so that orderly marketing is not only maintained, but enhanced. Speculating now puts the Secretary in the position of potentially creating inefficiencies in the system based on ignorance of future results. Mr. Ritchey testified in Phoenix and there was speculation that he was examining the possibility of becoming a producer-handler. However, I have been informed that he has since sold his herd and is no longer dairying.

There is other testimony about Vitamilk and how the producer-handlers allegedly did Vitamilk in. There is absolutely nothing to that claim whatsoever. I have attached to my testimony

two news releases that discuss the downfall of Vitamilk. One article is from the November 23, 1998 edition of *The Puget Sound Business Journal*; the second article is from the August 16, 2003 edition of *The Seattle Times*. As was known in the industry and recognized in each of these documents, Vitamilk lost a sale to QFC when QFC merged with the Kroger Company through Fred Meyer, which is owned by the Kroger Company. Since the Kroger Company has a captive plant, Vitamilk's sales were lost to the Kroger Company. Similarly, Vitamilk lost sales to Carr Stores in Alaska when Carr Stores were purchased by Safeway. Safeway also operates a captive plant. The end of Vitamilk had nothing to do with the price of the milk or producer-handlers. In an extremely short period of time, Vitamilk found itself with 50 percent less sales. Before the loss of these sales, Vitamilk sold 20 million gallons of milk a year. Afterward, it sold only 10 million gallons per year.

Vitamilk needed to find customers remaining in the market to pick up those sales. Well, all that would be left in that market would be sales that are not sold or controlled by Safeway and the Kroger Company and not otherwise being supplied by the other dairies in the industry, including Dean Foods, Wilcox Dairy, West Farms and others.

During that period after the loss of the QFC account, Edaleen Dairy picked up a new account that had been supplied by Vitamilk. The total sales to that account amounted to one (1) load of milk per week. A load of milk per week represents 50,000 pounds of milk. In a month that is 200,000 pounds. As a percentage of Vitamilk's fourteen million pound per month operation (before the loss of QFC and Carr's), that represents less than 2 percent of their total sales. None of us own our customers. Account switching of this nature and of this size (or larger), are regular occurrences in the dairy industry. The loss of a single, small account by Vitamilk amounted to a fraction of the loss occasioned by QFC and Carr's. Given the real facts on the demise of Vitamilk, perhaps the scope of

this hearing should be changed to eliminate captive plants, instead of to eliminate producer-handlers.

Another issue was raised dealing with school pricing and the facts that schools have contracts with flat pricing as opposed to index pricing. Under flat pricing, a distributor or a plant will give a bid to a school that will be fixed for the rest of the school year. Under an index plan, the schools will purchase the milk and the price will be adjusted in accordance with formulas and that use the Class I price in the market place. Flat pricing is not a creation of producer-handlers. Until a few years ago it was almost the absolute rule in terms of how milk was sold to schools, regardless of supplier. In the late 1990s, and early this decade, when there was great volatility and high prices in milk, some handlers tried to get schools to purchase milk on an indexed formula. Some schools agreed to consider that. But when schools requested bids on milk, they would specify whether they wanted a flat price or an index price. As in any forward contracting there are risks for both buyer and seller. For us, an index price does not shift the risk or protect us from any risk because our cost, as I mentioned before, is not the Class price or the blend price but it is our cost of production, which may or may not move in the same direction and to the same degree as a classified pricing. At the same time, the use of a flat price exposes us to risk that if our cost of production goes up, we will be exposed to an unprofitable sale, as has happened from time to time in our pricing. But when it comes to bidding on that contract, we are in no better or worse position than any other handler in the market, be it a fully priced and regulated handler or a regulated producer-handler in the market.

Also, there has been some attempt to estimate the price at which producer-handlers sell their milk based upon the store price for a gallon of milk. My experience has been that there is little correlation between the price for which Edaleen sells its milk and the price on the store shelf.



Another issue that has come up is whether there is a “good number” for a cap that can be used. The problem with any cap or limitation, and a 3 million pound cap is totally unacceptable, is that it imposes a hard limitation on any future growth of a producer-handler. First, let me explain what the impact of the cap would be. A plant is at 10 million pounds of milk and is a producer-handler, and the cap is set at 11 million pounds. To go over that 11 million is substantial. Once at 11,000,001 pounds, all of the milk is now subject to the difference between the Class I at the plant and the blend price. At an average of about \$1.20 cwt, that one pound could be very, very expensive--to the tune of hundreds of thousands of dollars.

The proposed limitation of three million pounds means that if a producer-handler has three million and one pounds of production he becomes fully priced under the order. Assume a difference between the blend price and Class I of \$1.20. At three million or less pounds per month, the producer-handler has no obligation to the pool. Once he reached one pound more, he is obligated at \$1.20 on all of his milk. That total is \$36,000.01. On a per hundredweight basis, this pound represents \$3,600,001.00 per hundredweight! All of this assessment will be borne by milk owned and produced by the producer-handler. If the Secretary were to adopt a higher cap, the rate would only go up on this marginal pound of milk.

The penalty associated with this assessment means that producers will take substantial steps to avoid reaching that level, including keeping their sales substantially below three million pounds, to avoid an accidental occurrence. I would estimate that the target would be about ten percent less. This is because the scheduling of delivery of orders and actual receipt at months end would be the most likely cause of a producer-handler being trapped. One day is approximately three percent of monthly production and three days represents a weekend with a holiday.

The current regulations limiting the ability of producer-handlers to purchase milk from other producers to 150,000 pounds of milk per month have the same effect. For example, assume that a producer-handler has monthly Class I sales of 5 million pounds of milk and for a given month, purchases three loads of milk, as is allowed. For simplicity, we assume that the cost of those three loads of milk is \$15.00 per hundredweight. If one of those trailers is overloaded by one hundredweight, that producer is not in compliance with the qualification requirements and will be assessed a pool obligation on the entirety of its own farm production. Again, at the rate of \$1.20 per hundredweight, that extra pound, in addition to the payment required to the producer would result in an assessment of \$60,000 on all of the producer-handler's milk. This is \$6,000,000.00 per hundredweight on that marginal pound of milk. Another way of saying this is that the effective cost of the 1501 hundredweight of purchased milk would be \$54.97 per hundredweight.

The money collected from these assessments would be paid into the producer settlement fund, and the producer-handler would receive absolutely no benefit from the assessments. Even if the AMAA permits the Secretary to require settlement fund contributions on milk that is never purchased from a "producer," the new regulations would take millions of dollars per year from producer-handler operations, redistribute this money to other producers, and return absolutely no benefit to the producer handler operations.

Edaleen's milk price to our customers cannot be increased to make up the substantial cost we would have to incur if the amendments were adopted. Our pool payments just cannot be recouped. The assessment will be a direct reduction from our bottom line. My father, mother, sisters, brothers-in-law, wife and I have invested the time, capital, and effort to develop our business on the longstanding policy and regulations of the department. We also bear the risk of having to maintain

our own supply of milk, largely independent of outside sources. Edaleen Dairy would be destroyed if these unreasonable and unnecessary changes were made to the Order.

Another problem with caps is that what may be reasonable today may not be reasonable tomorrow. The size of customers that we are dealing with is rapidly changing and for any dairy to be in business in the future they will have to handle larger and larger units or go out of business. Again, assuming that the cap is at 10 million pounds and a handler is at 8 million pounds he would now be in a position to have to turn down a sale of 2 ½ million pounds because it would take him over the cap. But the producer-handler will never know if tomorrow he would get a call from an existing customer canceling an order that would put him in a position to accept that new large customer.

Edaleen Dairy is very much a small business. It is a small business because we have less than 500 employees in the plant. The exhibit by the Market Administrator that categorizes producer-handlers as larger enterprises does not acknowledge the fact that producers are on both sides. We may be a large producer, but we are not a large producer-handler.

This fear of producer-handlers is really unfounded. All that is really being done is that some players in the market want to have a bigger share of the market, and they are trying to define some basis to put others out of business. On the part of West Farms, the benefit to them would be double. One, they would get the higher Class I sales, they think, because they think they could pick up some of our customers. Second, they know that under current situations we would have to join West Farms as a producer if we continue to operate the farm which would mean we would have to pay for to cover the losses at their plants and otherwise participate in their economic unit. Until now, we have chosen not to do so.

There has also been talk about a large producer-handler being created in West Oregon.

Although, we always are unhappy with the possibility of a new competitor coming into the market place, and we worry about whose sales it will take, we see no reason to fear a producer-handler any more than we would any other entrant. That is because we understand producer-handlers and we understand their economics and do not believe that they have any advantage that any other plant would not be able to use. If we are going to fear producer-handlers, why don't we fear the Krogers and Safeways that are integrated? Why don't we fear the Dean Foods that have national sales they can use profit from one plant to reduce the sales price at another to gain market share? Why aren't we worried about West Farms that blends individual producers 5 and 10 cents on all of their milk regardless of Class to offset losses at their bottling plant?

Another often repeated phrase in this hearing has been that "producer-handlers do not play by the same rules." This is untrue. Every single producer and every single handler has the right to become a producer-handler at any time. Their choice not to do so is one that they have made to their best economic advantage. Based on the decline in the number of producer-handlers over the years, it is obvious that few have taken the steps to be one, and even fewer have succeeded.

Finally, I want to talk about selling milk to Alaska. We sell milk to Alaska in 50,000 pound tankers. We pasteurize it and sell it Matanuska Maid Dairy. If we bottled it in cartons and sent it up there, we could still be a producer-handler, but if we sell raw milk, we lose. The only basis for this is to take away a sale from us, but since Alaska is not in a marketing area, the Secretary should not exercise any authority for pricing that milk.

In conclusion, Edaleen Dairy has operated for decades in the Pacific Northwest without causing disorderly marketing conditions. We make good and wholesome products which are sold at fair prices. The proposed amendments should not be adopted.